Economic Bulletin.

8 November 2019

Nail biter – Preview of the RBNZ's MPS, Wed 13 November, 2:00pm.

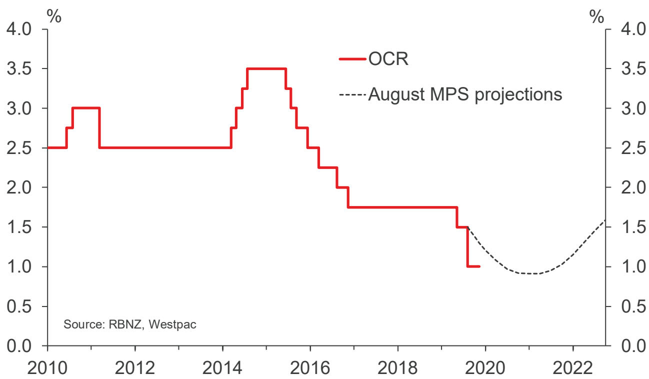
- We expect the RBNZ to keep the OCR unchanged at the November MPS.
- The statement may be very similar to the RBA's recent missive: the outlook has not changed recently, risks are still to the downside, there is scope for future easing if required.
- Recent developments have been mixed from an RBNZ perspective.
- We expect the RBNZ's OCR forecast to be unchanged from August, troughing at 0.9%.
- If the RBNZ does cut next week, we expect no signal of follow-up cuts.
- Inflation expectations data is released on November 12, and could be very influential. We will revisit our forecast at that time.
- While we expect no change next week, we do believe that sufficient evidence to justify another cut will accumulate by February next year.

Dominick Stephens, Chief Economist
+64 9 336 5671

Next week we expect the Reserve Bank of New Zealand to keep the OCR on hold and deliver a statement similar to its September OCR Review. That basically said that the outlook for monetary policy has not changed recently, although the risks are still tilted to the downside. The interest rate reductions delivered so far were starting to work their way through. And consequently interest rates were on pause for now, but there is scope to ease monetary further should that prove necessary. This would also be very similar to the Reserve Bank of Australia statement delivered this week.

The RBNZ gave no forward guidance in its August *Monetary Policy Statement*, and the OCR forecast bottomed out at 0.9%, implying only a 50/50 chance of another OCR cut at some point over the following year. At the September OCR review, the RBNZ stated that "new information since the August *Monetary Policy Statement* did not warrant a significant change to the monetary policy outlook".

RBNZ OCR forecast



Despite the lack of any RBNZ cutting signal, until recently we thought that a rash of downside data surprises would prompt the RBNZ to change its view and cut in November. That is not the way the cookie has crumbled. Instead, there have been a mix of upside and downside domestic developments recently[1]:

- The RBNZ will have to downgrade its forecast for 2019 annual GDP growth from 2.4% to around 2.0%, based on survey data showing firms are still having a tough time. If that was the only development affecting the outlook for monetary policy, it would certainly justify a cut. But there have been a number of offsetting developments.
- Although activity was weak in mid-2019, recent high frequency data suggests the economy is now firming, including electronic card transactions, building consents, car sales, tax receipts, and job ads.
- The housing market has clearly turned around, with a 2.6% lift in house prices over the past two months and secondary data suggesting price increases will continue.
- Third quarter inflation was stronger than the RBNZ expected. That was partly due to airfares and local body rates, but beneath that there was general lift in non-tradables inflation.
- The exchange rate is around 4% lower than it was in August.
- Export commodity prices, including dairy, forestry and meat products, have risen a little.
- Unemployment has remained lower than the RBNZ expected.

In addition, global financial market sentiment has improved, and US and Australian central banks are suggesting that they have cut rates far enough for now.

Putting all of this together, our analysis suggests that the RBNZ's OCR forecast will be unchanged relative to August, bottoming out at 0.9%. Consequently, we expect that the RBNZ can stick to its previous course and keep the OCR on hold, while acknowledging that the risks are skewed towards lower rates.

Our view is that evidence favouring a cut will have accumulated sufficiently by February, which is when we think the OCR will reach its low of 0.75%. That is based on our view that global economic sentiment is going to deteriorate once again.

Risks and uncertainties.

With most other economists picking a cut and markets pricing roughly a 70% chance, we have to admit that next week is a nail biter. If we are wrong and the RBNZ does cut the OCR, we would expect the Monetary Policy Statement to focus on justifying the decision. We certainly would not expect a signal of more cuts to come.

One possibility is that the RBNZ will take a dimmer view of recent developments and issue an OCR forecast of 0.7% or 0.8%, thereby justifying a cut. Another possibility is that the RBNZ will publish a 0.9% OCR forecast as we expect, but will deliver an "insurance cut" justified by the balance of regrets. (The RBNZ has explained that it is possible for Monetary Policy Committee decisions on the day to deviate from the OCR forecast published in the Monetary Policy Statement.)

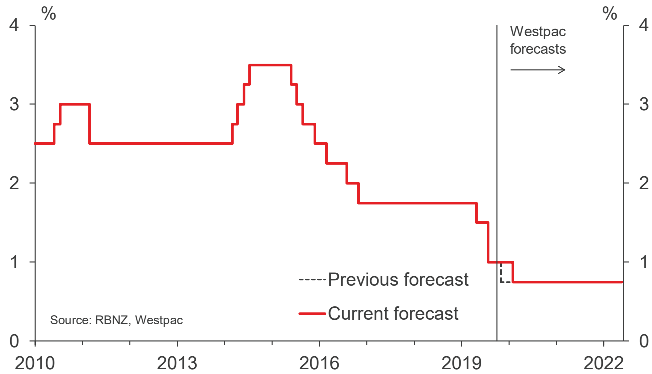
In either of these scenarios, the RBNZ would not be signalling follow-up cuts. For the RBNZ to plausibly do that, it would have to go with an OCR forecast of 0.6% or lower. That strikes us as unlikely given the mix of data that has been seen recently.

Next week's inflation expectations data.

The big remaining uncertainty is next week's inflation expectations report, released on Tuesday. In the August MPS, the Reserve Bank revealed that the drop in two-year ahead inflation expectations from 2.01% to 1.86% was a big part of the decision to cut the OCR 50 basis points. The next instalment of the survey will be critical.

The RBNZ knows the result already, whereas we learn about it only the day before the *MPS* is released. We are expecting expectations to rebound a bit. If that is correct, then an on hold OCR decision will look more likely. If, however, expectations remain low or fall further, then we would seriously consider switching our call to a cut.

Westpac Official Cash Rate forecast



1 More detail on the thinking behind our recent change of call to on hold in November can be found here.

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

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer.

Things you should know

Westpac Institutional Bank is a division of Westpac Banking Corporation ABN 33 007 457 141 ('Westpac').

Disclaimer

This material contains general commentary, and market colour. The material does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Country disclosures

Australia: Westpac holds an Australian Financial Services Licence (No. 233714). This material is provided to you solely for your own use and in your capacity as a wholesale client of Westpac.

New Zealand: In New Zealand, Westpac Institutional Bank refers to the brand under which products and services are provided by either Westpac or Westpac New Zealand Limited ("WNZL"). Any product or service made available by WNZL does not represent an offer from Westpac or any of its subsidiaries (other than WNZL). Neither Westpac nor its other subsidiaries guarantee or otherwise support the performance of WNZL in respect of any such product. The current disclosure statements for the New Zealand branch of Westpac and WNZL can be obtained at the internet address www.westpac.co.nz. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: This material has been prepared and issued for distribution in Singapore to institutional investors, accredited investors and expert investors (as defined in the applicable Singapore laws and regulations) only. Recipients in Singapore of this material should contact Westpac Singapore Branch in respect of any matters arising from, or in connection with, this material. Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activities. This material is intended only to "professional investors" as defined in the Securities and Futures Ordinance and any rules made under that Ordinance. Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking and Insurance Regulatory Commission (CBIRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

UK: The contents of this communication, which have been prepared by and are the sole responsibility of Westpac Banking Corporation London and Westpac Europe Limited. Westpac (a) has its principal place of business in the United Kingdom at Camomile Court, 23 Camomile Street, London EC3A 7LL, and is registered at Cardiff in the UK (as Branch No. BR00106), and (b) authorised and regulated by the Australian Prudential Regulation Authority in Australia. Westpac is authorised in the United Kingdom by the Prudential Regulation Authority. Westpac is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority.

This communication is being made only to and is directed at (a) persons who have professional experience in matters relating to investments who fall within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "Order") or (b) high net worth entities, and other persons to whom it may otherwise lawfully be communicated, falling within Article 49(2)(a) to (d) of the Order (all such persons together being referred to as "relevant persons"). Any person who is not a relevant person should not act or rely on this communication or any of its contents. The investments to which this communication relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this communication or any of its contents. In the same way, the information contained in this communication is intended for "eligible counterparties" and "professional clients" as defined by the rules of the Financial Conduct Authority and is not intended for "retail clients". With this in mind, Westpac expressly prohibits you from passing on the information in this communication to any third party. In particular this communication and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction. This communication is made in compliance with the Market Abuse Regulation (Regulation(EU) 596/2014).

Investment Recommendations Disclosure

The material may contain investment recommendations, including information recommending an investment strategy. Reasonable steps have been taken to ensure that the material is presented in a clear, accurate and objective manner. Investment Recommendations for Financial Instruments covered by MAR are made in compliance with Article 20 MAR. Westpac does not apply MAR Investment Recommendation requirements to Spot Foreign Exchange which is out of scope for MAR.

Unless otherwise indicated, there are no planned updates to this Investment Recommendation at the time of publication. Westpac has no obligation to update, modify or amend this Investment Recommendation or to notify the recipients of this Investment Recommendation should any information, including opinion, forecast or estimate set out in this Investment Recommendation change or subsequently become inaccurate.

Westpac will from time to time dispose of and acquire financial instruments of companies covered in this Investment Recommendation as principal and act as a market maker or liquidity provider in such financial instruments.

Westpac does not have any proprietary positions in equity shares of issuers that are the subject of an investment recommendation.

Westpac may have provided investment banking services to the issuer in the course of the past 12 months.

Westpac does not permit any issuer to see or comment on any investment recommendation prior to its completion and distribution.

Individuals who produce investment recommendations are not permitted to undertake any transactions in any financial instruments or derivatives in relation to the issuers covered by the investment recommendations they produce.

Westpac has implemented policies and procedures, which are designed to ensure conflicts of interests are managed consistently and appropriately, and to treat clients fairly.

The following arrangements have been adopted for the avoidance and prevention of conflicts in interests associated with the provision of investment recommendations.

(i) Chinese Wall/Cell arrangements;

(ii) physical separation of various Business/Support Units;

(iii) and well defined wall/cell crossing procedures;

(iv) a "need to know" policy;

(v) documented and well defined procedures for dealing with conflicts of interest;

(vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

U.S: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission ("CFTC") as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC ('WCM'), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 ('the Exchange Act') and member of the Financial Industry Regulatory Authority ('FINRA'). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. All disclaimers set out with respect to Westpac apply equally to WCM. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.