

Weekly Commentary

1 April 2019



Hundertwasser Toilets, Kawakawa

A new era

It was a pivotal week for the Reserve Bank of New Zealand, which delivered a surprising shift in its monetary policy stance. Our current forecast is for the Official Cash rate to remain on hold over the next few years, but the risks of a rate cut at upcoming reviews, including the next *Monetary Policy Statement* in May, are very much live. From here on those decisions will be made by a formal committee, with external and internal members.

Last week's OCR review broke decisively from the RBNZ's previous statements, which had noted that the next move could be either up or down. The RBNZ now believes that the balance of risks to the economic outlook "has shifted to the downside," and that "the more likely direction of the next OCR move is down."

This change in stance surprised us, because the economic situation hasn't changed a lot since the previous OCR review in February. Recent GDP data showed that the domestic economy has kept ticking over, with solid growth in consumer spending and construction. Global growth has softened, but not significantly, and the consequences for the New Zealand economy have not been obvious – in fact, our export commodity prices have been strengthening recently.

What has changed a lot since February, however, is market sentiment on interest rates. In the midst of some mixed economic data, overseas central banks have either shifted to more dovish monetary policy outlooks, or are expected to do so. The RBNZ was apparently concerned that if it didn't join the flock, there could be an undesirable rise in the New Zealand dollar, which would suppress inflation and ultimately force the RBNZ to change its stance anyway.

The other surprising aspect of the RBNZ's statement was the emphasis placed on softer domestic spending and weak business sentiment. We have long thought that the

RBNZ was too optimistic on economic growth, and hence too bullish on the extent of a pickup in domestically-generated inflation. While the December quarter GDP result wasn't significantly below the RBNZ's forecast (0.6% vs 0.8%), it may have been the last straw that triggered a change in sentiment. Recent personnel changes with the RBNZ might have also been a factor in the sudden change of view.

The thinking in financial markets has now turned to whether the RBNZ will actually cut the OCR, and if so, when. We're taking the RBNZ's statement at face value: the risks have shifted to the downside. The RBNZ is leaving open the option of cutting the OCR if required, rather than signalling that a cut is imminent.

That said, it does mean that every upcoming OCR review, including the next *Monetary Policy Statement* in May, is 'live'. Much will depend on the flow of data from both here and overseas in the coming weeks.

On the global front at least, we don't expect sentiment to turn around again in a hurry. We think that the market has become too downbeat on the US economy, which is running at close to full employment and is now seeing a notable pickup in wage pressures. But the US Federal Reserve itself has taken rate hikes off the table for now, and it will need to see an accumulation of evidence before it changes its mind again. Meanwhile, we do expect the Reserve Bank of

A new era

Australia to move toward rate cuts this year, albeit under very different conditions to what the RBNZ is facing.

In terms of the domestic economy, the RBNZ has highlighted weak business sentiment and the risk that this flows through into domestic demand. Last week we saw a further drop in the ANZ business confidence survey for March, reversing most of the modest recovery that occurred at the end of last year. Hiring and investment intentions and profit expectations were all lower.

We'll also be taking a close look at Tuesday's Quarterly Survey of Business Opinion. This tends to be the single best early indicator of quarterly GDP growth, and it also provides useful insights on the capacity constraints and cost pressures that businesses are facing. The Tax Working Group's recent recommendation to introduce a capital gains tax could weigh on sentiment this time. But beneath the headline, the QSBO will give a valuable read on whether the economy is picking up enough for the RBNZ to avoid cutting.

Actual domestic demand may be stronger these confidence surveys suggest. Electronic card spending has continued to grow at a solid pace, government spending is increasing as planned, and imports of capital equipment have picked up in the early part of this year. Dwelling consents have

continued to rise to multi-decade highs, indicating a strong pipeline of building work over the next year or so. Our view remains that growth will pick up in 2019 after a softer patch in the second half of 2018.

The other major monetary policy announcement last week was the membership of the RBNZ's new decision-making committee, which comes into effect from next week. The committee consists of four internal members, including the Governor and senior management, and three external members. The external members that were announced last week are all experienced economists, with respective backgrounds in agriculture, macroeconomics and the labour movement.

These appointments should dampen any concerns that the external committee members will be cowed by the RBNZ internals due to a lack of experience. They will all be quite capable of critiquing the RBNZ's analysis and holding their own in a debate about economics. As for how they might shift the balance of the RBNZ's decisions, the answer is less clear. In particular, they may have differing views on how to balance the RBNZ's new dual mandate, which focuses on supporting maximum sustainable employment as well as price stability.

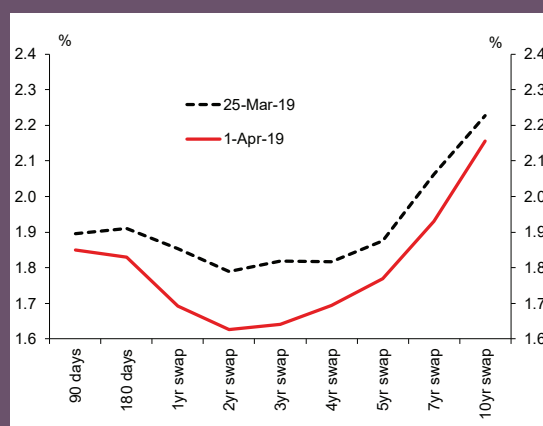
Fixed vs Floating for mortgages

Wholesale fixed interest rates dived last week. Those keen to fix would probably be better off waiting until fixed mortgage rates have followed suit.

Two-year fixed rates are currently the lowest on offer, and appear to offer good value to borrowers. However, longer-term rates are also falling. Depending on where they settle, they may eventually prove better value, offering borrowers the opportunity to lock in low interest rates for a longer period.

Floating mortgage rates are 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

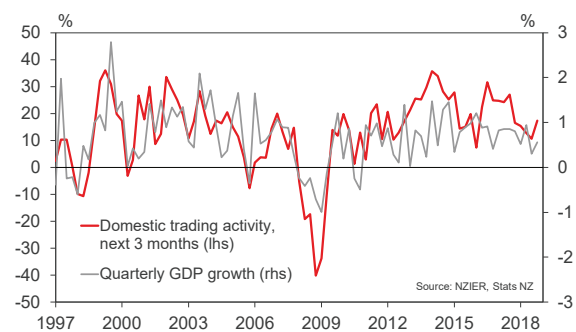
NZ Q1 Survey of Business Opinion

Apr 2, General business situation, Last: -18

Domestic trading activity, Last: +17

- General business confidence and firms' expectations for their own activity both picked up in the final months of 2018. Nevertheless, the key gauges of business activity in the NZIER's quarterly survey of business opinion remained at low levels in December.
- Since the December quarter survey, monthly gauges of business confidence have softened again, and we expect this will be reflected in the March quarter result. GDP growth slowed through the back half of 2018. We've also heard increased concern from some businesses about the potential introduction of a capital gains tax.
- The survey is closely watched as an indicator of inflation. Firms have been noting pressure on margins, with rising costs (especially for wages) but limited ability to pass this on due to competitive pressures.

QSBO domestic trading activity and GDP



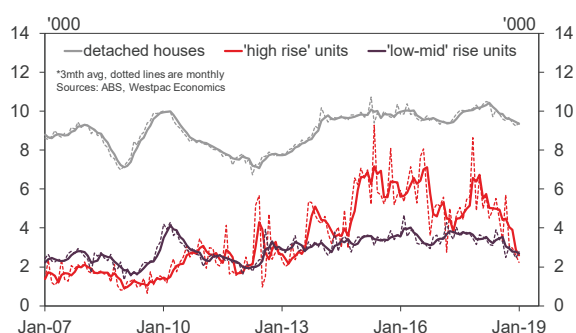
Aus Feb dwelling approvals

Apr 2, Last: 2.5%, WBC f/c: -1.0%

Mkt f/c: -1.8%, Range: -5.0% to 3.0%

- Dwelling approvals posted a 2.5% lift in Jan, paring back some of the dramatic weakening seen in late 2018 – approvals slid over 25% through the last three months of 2018.
- High rise approvals are now back to multi-year lows, Jan the weakest read since March 2013. Current levels are now around those that prevailed prior to the boom, hence some stabilisation looks likely from here. Meanwhile construction-related finance approvals are also suggesting the weakening in non-high rise approvals is starting to moderate, although this is more likely to show through in coming months. On balance, Feb is expected to see some residual weakness with a 1% decline in total approvals.

Dwelling approvals: houses, low-mid & high rise

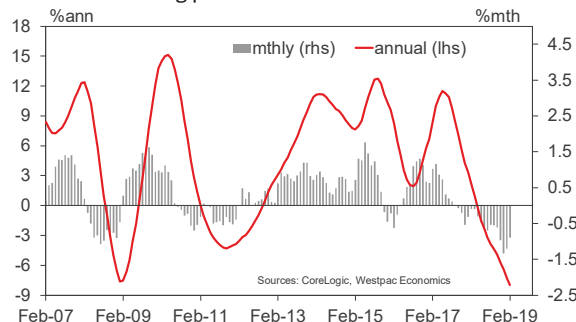


Aus Mar CoreLogic home value index

Apr 1, Last: -0.9%, WBC f/c: -0.7%

- The Australian housing market's very weak finish to 2018 has carried into early 2019, albeit with some tentative signs that the pace of price declines may be easing. The CoreLogic home value index recorded a 0.9% fall in February following average falls of 1.2% over the previous three months.
- The daily index points to a 0.7% fall for the March month, which would be the mildest decline since October. The cumulative decline since late 2017 will be close to 10%.

Australian dwelling prices



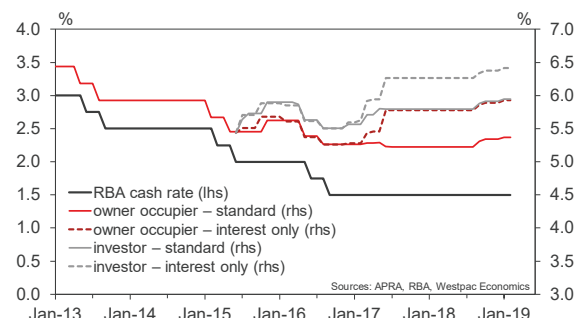
Aus RBA policy decision

Apr 2, Last: 1.50%, WBC f/c: 1.50%

Mkt f/c: 1.50%, Range: 1.25% to 1.50%

- The Reserve Bank Board meets this week on April 2. Unusually, this meeting will be on the same day as the announcement of the Federal Budget at 7:30 pm on that evening. As such, we would expect that the Governor's Statement will be fairly low key with little change from the sentiment we saw in the March meeting.
- Westpac is anticipating that following the May meeting, the RBA will move to a clear easing bias, which will be justified by downward revisions in the growth forecasts. However, it is unlikely that there will be any hints of this action in the April Governor's Statement.

RBA cash rate and mortgage interest rates



The week ahead

Aus 2019 Federal Budget, AUDbn

Apr 2, Last: -5.2(e), WBC f/c: +4.1

Mkt f/c: +4.6, Range: +4.0 to +8.5

- Federal Budget 2019 will reveal an improved starting position for the budget relative to that in the December Mid-Year Economic & Fiscal Outlook (MYEFO).
- Spending is running below forecasts in 2018/19, in part due to stronger than anticipated jobs growth to date.
- For 2019/20, the size of the nominal economy is likely to be \$10bn larger than anticipated in MYEFO because of upside surprises on commodity prices. This boosts revenue, by around \$3bn, plus spending is likely to be running around \$2bn below forecast – a combined improvement of \$5bn.
- The upside surprise to the budget is likely, in our view, to be returned to the people in tax cuts and increased spending. Hence the profile for the budget balance is as in MYEFO.

Underlying cash balance, \$bn

	'18/19	'19/20	'20/21	'21/22	4yrs
MYEFO	-5.2	+4.1	+12.5	+19.0	+30.4
% GDP	-0.3	0.2	0.6	0.9	
Improved starting position	3.0	5.0	2.0	2.0	12.0
Net new spending	3.0	5.0	2.0	2.0	12.0
Net improvement	0.0	0.0	0.0	0.0	0.0
Budget position *	-5.2	+4.1	+12.5	+19.0	+30.4
% GDP	-0.3	0.2	0.6	0.9	
Net debt					
MYEFO	352	343	330	313	
% GDP	18.2	17.1	15.8	14.3	
Budget position *	352	343	330	313	
% GDP	18.2	17.1	15.8	14.3	

* Westpac's expectation of Government forecasts to appear in 2019 Budget

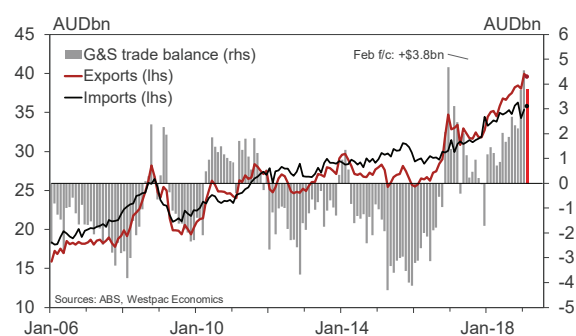
Aus Feb trade balance, AUDbn

Apr 3, Last: 4.5, WBC f/c: 3.8

Mkt f/c: 3.7, Range: 2.4 to 5.0

- The trade account was in surplus for the past 13 months. In January, the surplus soared to \$4.5bn (the 2nd largest on record), with exports +5.0% and imports +3.3%.
- For February, we expect a pull-back to a still sizeable surplus of \$3.8bn. Imports are forecast to rise by a further 1.1%, +\$0.38bn, with the potential for fuel to lift following a softer month. Exports slip by a forecast 0.9%, -\$0.36bn, with sizeable falls in gold and coal outweighing a surge in iron ore.

Australia's trade balance



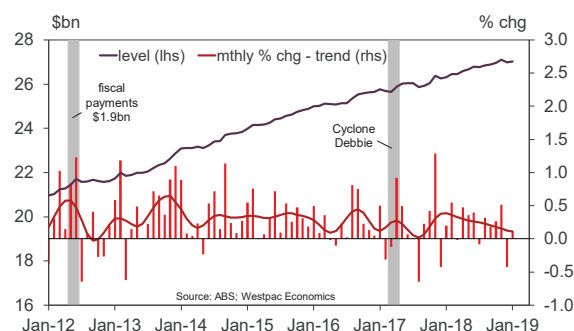
Aus Feb retail trade

Apr 3, Last: 0.1%, WBC f/c: -0.1%

Mkt f/c: 0.3%, Range: -0.1% to 0.6%

- Australian retailers continue to see very difficult conditions. Sales rose just 0.1% in Jan, a disappointing result following the 0.4% fall in Dec, annual growth slowing to 2.7%yr.
- Consumer sentiment had a shaky start to 2019, dipping into net pessimistic territory for the first time since 2017. Private sector business surveys point to a further significant weakening in conditions for retailers in Feb. We expect Feb to see a 0.1% decline, taking annual sales growth to 2%.

Monthly retail sales



US Mar employment report

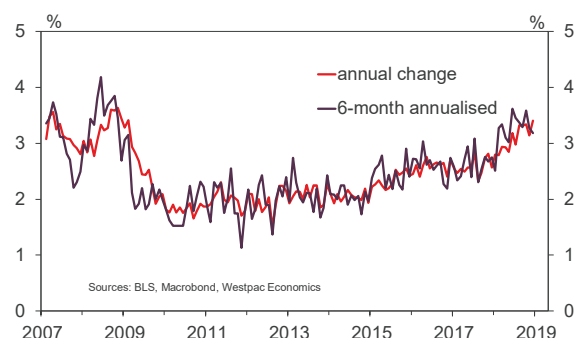
Apr 5, nonfarm payrolls, last 20k, WBC 185k

Apr 5, unemployment rate, last 3.8%, WBC 3.8%

Apr 5, hourly earnings, last 3.4%yr, WBC 3.4%yr

- The Feb 2019 nonfarm payrolls result came as a significant shock to the market, coming in at just 20k. Still, for the year-to-date, the average monthly gain is robust at 166k. Come Mar, we are looking for a 185k gain. There is however a material risk of significant positive revisions to Feb, and hence of a softer Mar.
- While the unemployment rate will most likely be unchanged at 3.8% in Mar, the trend remains downward.
- At 3.4%yr, wages growth is well up on its lows, but still not indicative of a 'hot' labour market. This modest uptrend should persist through 2019, to near 4.0%yr.

Earnings growth to continue picking up in 2019

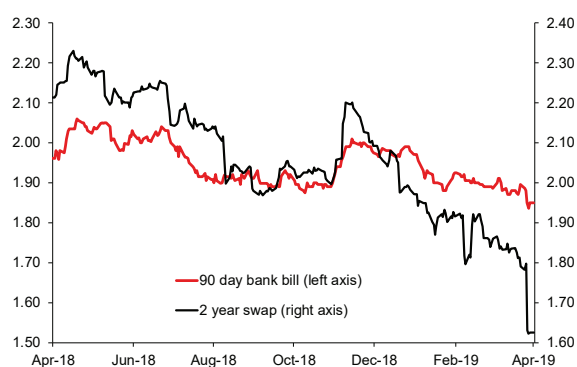


New Zealand forecasts

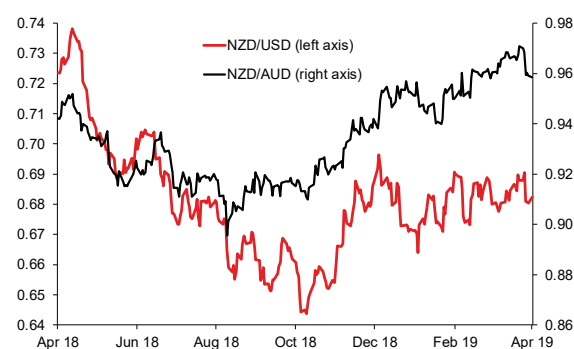
Economic Forecasts	Quarterly				Annual			
	2018	2019						
% change	Dec (a)	Mar	Jun	Sep	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.7	0.8	0.8	2.8	2.7	2.8	2.0
Employment	0.1	0.2	0.3	0.4	2.3	1.2	1.6	1.3
Unemployment Rate % s.a.	4.3	4.4	4.3	4.2	4.3	4.2	4.0	4.0
CPI	0.1	0.2	0.5	0.7	1.9	1.7	2.1	2.1
Current Account Balance % of GDP	-3.7	-3.4	-3.2	-3.1	-3.7	-2.9	-2.8	-2.8

Financial Forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
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	1.90
2 Year Swap	1.70	1.80	1.90	2.00	2.05	2.10
5 Year Swap	1.90	2.00	2.10	2.20	2.25	2.30
10 Year Bond	1.90	2.00	2.10	2.15	2.25	2.35
NZD/USD	0.67	0.67	0.67	0.66	0.66	0.66
NZD/AUD	0.96	0.98	0.98	0.96	0.96	0.94
NZD/JPY	75.7	76.2	75.4	74.1	72.6	71.3
NZD/EUR	0.60	0.61	0.61	0.60	0.59	0.58
NZD/GBP	0.51	0.50	0.49	0.49	0.48	0.48
TWI	73.7	74.2	73.8	72.5	71.7	71.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 1 April 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.86%	1.86%	1.85%
60 Days	1.86%	1.87%	1.88%
90 Days	1.85%	1.88%	1.89%
2 Year Swap	1.63%	1.84%	1.86%
5 Year Swap	1.77%	1.97%	2.04%

NZ foreign currency mid-rates as at 1 April 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6823	0.6844	0.6809
NZD/EUR	0.6073	0.6044	0.5980
NZD/GBP	0.5233	0.5147	0.5136
NZD/JPY	75.70	76.30	76.14
NZD/AUD	0.9584	0.9659	0.9598
TWI	74.17	74.41	73.99

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 01					
Aus	Mar CoreLogic home value index	-0.9%	-	-0.7%	Daily measures suggests pace of decline moderating slightly.
	Mar NAB business survey	4	-	-	Conditions at +4, weakened sharply since 2018H1 (avg +18).
	Mar AiG PMI	54.0	-	-	Manfg index rebounded, after weak end to 2018.
Chn	Mar Caixin manufacturing PMI	49.9	50.0	-	External demand wanes.
Eur	Mar Markit manufacturing PMI final	47.6	-	-	Suggests manufacturing fell 0.5% in Q1 (25% of econ).
	Feb unemployment rate	7.8%	-	-	Has continued to trend down, but jobs momentum easing.
UK	Mar Markit manufacturing PMI	52.0	51.2	-	Softer global growth, domestic uncertainty weighing on activity.
US	Feb retail sales	0.2%	0.3%	-	Weak in Dec/ Jan. Coming months critical signal of '19 g'th.
	Mar Markit manufacturing PMI final	52.5	-	-	US PMIs remain well ahead of...
	Mar ISM manufacturing	54.2	54.3	-	... global peers.
	Feb construction spending	1.3%	-0.1%	-	Construction looks set to soften in 2019 amid uncertainty.
	Jan business inventories	0.6%	0.4%	-	Highly volatile given tariff pull-forward of trade.
Tue 02					
NZ	Q1 Survey of Business Opinion	-18	-	-	Monthly surveys suggest a renewed slump in confidence in Q1.
Aus	Feb dwelling approvals	2.5%	-1.8%	-1.0%	Another dip but may should start to stabilise from here.
	RBA policy decision	1.50%	1.50%	1.50%	Overshadowed by Federal Budget?
	Federal Budget 2019, AUDbn	-5.2	+4.6	+4.1	Improved starting position - fund tax cuts & spending.
Eur	Feb PPI %yr	3.0%	3.1%	-	Lack of inflation pressure.
US	Feb durable goods orders prelim.	0.3%	-1.2%	-	Underlying trend for equipment investment subdued.
Wed 03					
NZ	Mar ANZ commodity prices	2.8%	-	-	Further strong gains in dairy export prices.
	GlobalDairyTrade auction	1.9%	-	-	NZ milk production flat in Feb, this may weigh on prices.
Aus	Feb retail sales	0.1%	0.3%	-0.1%	Conditions look to have deteriorated again in early 2019.
	Feb trade balance, \$bn	4.5	3.7	3.8	Exports slip 0.9%, gold & coal down, iron ore up.
	Mar AiG PSI	44.5	-	-	Services index plunged 7.8pts in Jan, failed to bounce in Feb.
Chn	Mar Caixin services PMI	51.1	52.5	-	Services in better health.
Eur	Mar Markit services PMI final	52.7	-	-	Suggests services rose 0.3% in Q1 (75% of economy).
UK	Mar Markit services PMI	51.3	51.0	-	Conditions cooling amid political and global headwinds.
US	Mar ADP employment change	183k	180k	-	Typically unhelpful as lead for payrolls.
	Mar Markit services PMI final	54.8	-	-	The US' services sector remains in...
	Mar ISM non-manufacturing	59.7	-	-	... strong form.
	Fedspeak	-	-	-	Bostic speaks at the American Banker Association Summit.
Thu 04					
Eur	Feb retail sales %yr	2.2%	1.5%	-	Jumped in Jan after weak Dec - seasonality issues.
	Mar ECB minutes	-	-	-	Discussion on TLTRO in focus.
US	Initial jobless claims	211k	-	-	Very low.
	Fedspeak	-	-	-	Kashkari speaks in North Dakota, Mester at Ohio Bankers Day.
Fri 05					
Aus	Mar AiG PCI	43.8	-	-	Construction index slumped, sub 50 for past 6 months.
UK	Mar Halifax house prices	5.9%	-	-	Brexit uncertainty a significant drag, esp. in London.
US	Mar non-farm payrolls	20k	175k	185k	February was a shock, but came after strong Jan.
	Mar unemployment rate	3.8%	3.8%	-	2019 likely to see robust gains and modest fall in U/E.
	Mar average hourly earnings %mth	0.4%	0.2%	-	Annual growth now up to 3.4%/yr. Trending higher.
	Feb consumer credit	17.0	17.5	-	Auto and student loans remain the driving force.
	Fedspeak	-	-	-	Bostic discusses disruption and opportunity.

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018	2019f	2020f
Australia						
Real GDP % yr	2.5	2.8	2.4	2.8	1.8	2.2
CPI inflation % annual	1.7	1.5	1.9	1.8	1.7	1.7
Unemployment %	5.8	5.7	5.5	5.0	5.5	5.7
Current Account % GDP	-4.7	-3.1	-2.6	-2.1	-0.9	-2.2
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.4	2.1
Consumer Prices %yr	0.1	1.4	2.1	2.4	1.8	1.9
Unemployment Rate %	5.3	4.9	4.4	3.9	3.5	3.5
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	1.4	1.0	1.7	1.1	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.9	2.4	1.8	1.2	1.4
United Kingdom						
Real GDP %yr	2.3	1.8	1.7	1.3	1.2	1.4
China						
Real GDP %yr	6.9	6.7	6.9	6.6	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	4.0	4.5	4.4	4.2	4.3
World						
Real GDP %yr	3.5	3.3	3.7	3.7	3.5	3.5

Forecasts finalised 13 March 2019

Interest Rate Forecasts	Latest	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Australia								
Cash	1.50	1.50	1.25	1.00	1.00	1.00	1.00	1.00
90 Day BBSW	1.77	1.90	1.65	1.40	1.40	1.40	1.40	1.40
10 Year Bond	1.78	1.85	1.75	1.80	1.80	1.80	1.85	1.90
International								
Fed Funds	2.375	2.375	2.375	2.625	2.625	2.625	2.625	2.625
US 10 Year Bond	2.40	2.60	2.65	2.70	2.65	2.60	2.55	2.55
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	-0.10	0.00

Exchange Rate Forecasts	Latest	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.7089	0.70	0.68	0.68	0.69	0.69	0.70	0.70
USD/JPY	110.79	113	114	113	112	110	108	106
EUR/USD	1.1229	1.11	1.10	1.10	1.11	1.12	1.14	1.17
GBP/USD	1.3066	1.31	1.33	1.36	1.36	1.37	1.37	1.38
AUD/NZD	1.0447	1.04	1.02	1.02	1.04	1.05	1.06	1.06

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