

Weekly Commentary

1 July 2019



Stone Store, Kerikeri

Blunt talk

As expected, the Reserve Bank kept the Official Cash Rate on hold at 1.5% at its June meeting. However, the RBNZ also provided a very clear signal that the cash rate is likely to be cut again in the future. We expect this will occur in August.

The RBNZ now releases a summary of the Monetary Policy Committee's deliberations at the time of each Official Cash Rate announcement. The language in its latest summary was unusually blunt. The RBNZ noted *"that more support from monetary policy was likely to be necessary."* They also noted that the MPC *"discussed the merits"* of an immediate cut, but decided against such a move, instead noting again that a lower OCR may be needed over time.

This sort of clarity is quite a change for the RBNZ, who in recent times have tended to be more opaque about telegraphing future policy changes (though to be fair, this is only the second policy announcement since the RBNZ shifted to a policy committee for setting the Official Cash Rate). These latest comments from the RBNZ leave us comfortable with our call that the cash rate will be cut to a new record low of 1.25% at the August policy decision.

The key factor that is increasingly worrying the RBNZ is the state of the global economy. Concerns about international trade disputes and slowing global growth were highlighted back in May when the RBNZ last cut the cash rate. Since that time, trade tensions have continued to simmer away, global manufacturing has slowed, and most importantly, there has been a further dovish tilt from other central banks. The RBNZ thinks those factors are now directly

affecting the New Zealand economy via trade, finance and confidence channels.

On the domestic front, the RBNZ's assessment of conditions was more mixed, with both positive and negative developments highlighted. That chimes very well with our own reading of the tea leaves. We've been highlighting for some time that the New Zealand economy has lost some steam over the past year, with much of that softness centred on the business sector. That picture was echoed in last week's ANZBO survey of business opinion, which showed that business confidence and trading conditions remain weak. Businesses continue to highlight strong competitive pressures and rising costs, as well as concerns about the regulatory backdrop. Those factors are all weighing on plans for investment spending and hiring.

But it's definitely not all doom-and-gloom out there. In fact, as our latest *Regional Roundup*¹ highlights, conditions across the New Zealand economy have been varied. It's true that there has been softness in Auckland and Canterbury, where factors such as subdued house price growth and the winddown of reconstruction spending have been drags on broader activity. But at the same time, many regions with an agricultural backbone have been booming, as has government-heavy Wellington.

¹ Available here: https://westpaciq.westpac.com.au/wibiqaauthoring/_uploads/file/New_Zealand/2019/June_2019/Regional_Roundup_June_2019.pdf

Blunt talk

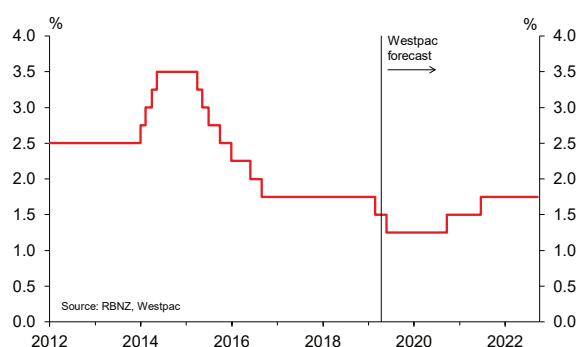
The other big factor that is shaping the domestic economic environment is fiscal policy. The Government used last month's Budget to announce an increase in its already ambitious spending plans. The RBNZ acknowledged that increased government spending was a positive for the outlook, although they discussed the possibility that spending will be delayed. Again, that accords with our own assessment that the interaction with fiscal policy is an important, and often overlooked, element of the monetary policy debate in New Zealand.

So putting all this together, where does this leave us in terms of the outlook for monetary policy? The RBNZ is still confronting a subdued inflation environment: ex-fuel inflation has lingered below 2% for nearly 8 years now, and many businesses are struggling to increase their prices even as operating costs have continued to rise. To offset this softness in inflation and limit any fallout from a cooling in the global economy, the RBNZ needs to see a lift in domestic demand. As a result, we expect that they will cut the cash rate to 1.25% in August.

Interest rate markets are pricing in a high probability that the OCR will drop below 1.25% some time in 2020. However, we doubt that will happen. If the RBNZ does cut the OCR in August, then our key call on the economy will get even stronger. Mortgage rates have already fallen to very low levels. Combined with the cancellation of the

Government's proposed capital gains tax, we expect that will give the housing market a powerful shot in the arm, with nationwide house price inflation to reaccelerate to 7% next year. Another cut in August could push mortgage rates lower still, resulting in an even larger boost for the housing market, and by extension consumer spending. Combined with the aforementioned increases in fiscal spending, we expect that the resulting lift in demand will be enough to stay the RBNZ's hand. In fact, if the economy improves as we expect, the RBNZ is likely to look at gradual hikes in the cash rate in the early 2020s.

Official Cash Rate forecast



Fixed vs Floating for mortgages

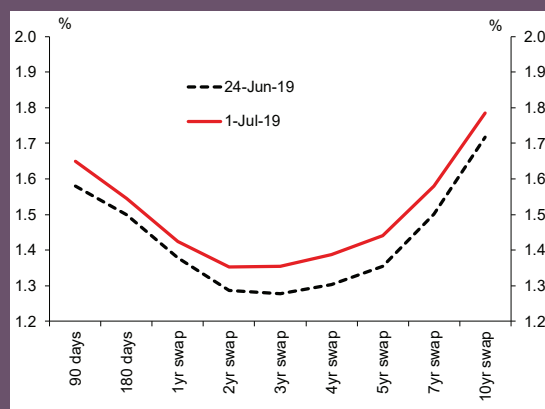
We are now expecting the Reserve Bank to lower the OCR in August. If that is correct, both floating and fixed mortgage rates may fall over the coming month or two. However, we expect the OCR to rise again in the early 2020s, pushing mortgage rates up at that time.

Based on our OCR forecasts, three-year fixed mortgage rates seem the best value on offer today. However, opportunities to fix at an even lower rate might emerge over the coming month or two. Today's one- and two-year rates are also fairly good value, with neither strongly preferred to the other.

Four- and five-year fixed rates are higher than where we expect shorter-term rates to go over the relevant timeframe, but longer-term fixed rates do offer insurance against the risk of future interest rate increases.

Floating mortgage rates are normally expensive for borrowers, but they may be the preferred option for those who require flexibility in their repayments.

NZ interest rates



The week ahead

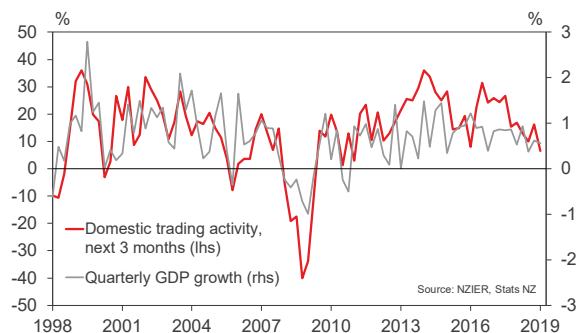
NZ Q2 Survey of Business Opinion

Jul 2, General business situation, Last: -27

Domestic trading activity, Last: +7

- Firms' confidence in the general environment and in their own performance deteriorated further in the March quarter. Monthly business confidence surveys suggest that there has been no subsequent improvement, despite the Government cancelling its plans for a capital gains tax.
- Weak business confidence appears to stem from rising costs (some of which no doubt relate to government policy) combined with an inability to pass on these costs, resulting in a squeeze on profit margins. Consequently, firms have scaled back their hiring and investment plans.
- The quarterly NZIER survey is a useful early indicator for GDP. A weaker print in June would suggest downside risk to our current forecast of 0.6% growth for the quarter.

QSBO domestic trading activity and GDP

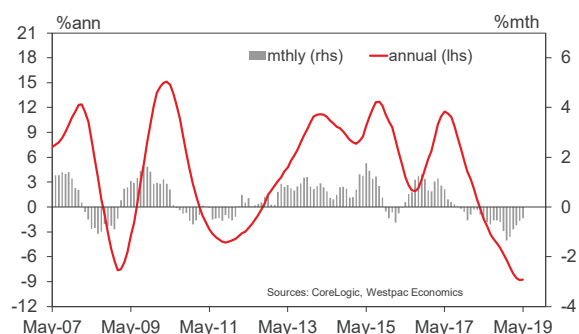


Aus Jun CoreLogic home value index

Jul 1, Last: -0.4%, WBC f/c: -0.2%

- The price correction that began in Australia's housing market in late 2017 and accelerated notably through the second half of 2018 has moderated in 2019.
- That patterns looks to have continued into June with a good chance that prices have stabilised in the key Sydney and Melbourne markets. The daily index points to a 0.2% decline nationally in June but slight gains in Sydney and Melbourne. This is consistent with the improved tone from auction markets since late May, with clearance rates and pre-auction withdrawals both back to more normal levels. Interest rate cuts and the Federal election result have provided clear support, the latter removing risks around tax policy changes that were clearly weighing on investor activity.

Australian dwelling prices

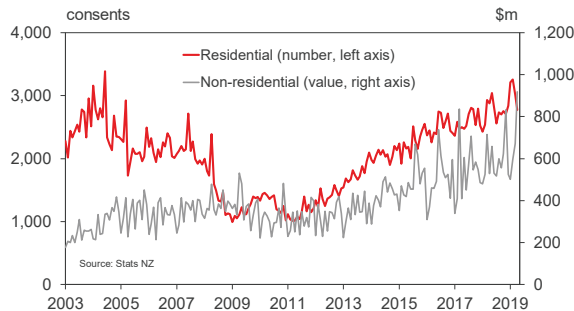


NZ May dwelling consents

Jul 2, Last: -7.9%, WBC f/c: +2%

- Residential dwelling consent issuance fell by 8% in April, following a 7% fall in March. Those declines followed strong issuance in previous months and still left consent issuance up 7% over the past year. Strength in consent issuance has been widespread, with particular strength in Auckland.
- We expect a 2% increase in consent numbers in May. That would leave annual consent issuance around multi-decade highs.
- But while consent issuance remains very high and is expected to remain so for some time, it does appear to be flattening off. This likely portends a peak in the construction cycle over the year ahead.

NZ building consents



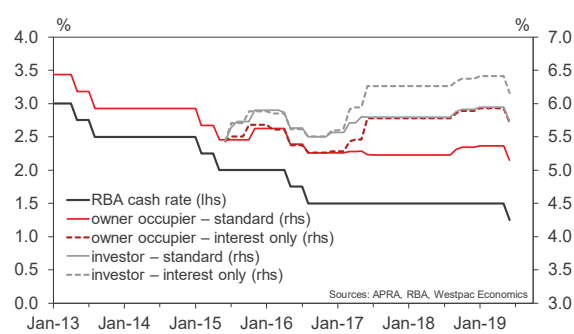
Aus Jul RBA policy decision

Jul 2, Last: 1.25%, WBC f/c: 1.00%

Mkt f/c: 1.00%, Range: 1.00% to 1.25%

- The RBA is expected to follow its 25bp cut in June with a further 25bp cut in July.
- Commentary since the June decision has been unusually direct, the Governor noting that it "is not unrealistic to expect a further reduction in the cash rate." Importantly the case for easing stems mainly from a reassessment of labour market dynamics - specifically that the unemployment rate will need to be closer to 4.5% than 5% to generate a lift in wages growth. As such, a follow-on move looks likely in July, particularly given how far the unemployment rate is above 4.5%. In addition, the near term growth risks are tilted to the downside.

RBA cash rate and mortgage interest rates



The week ahead

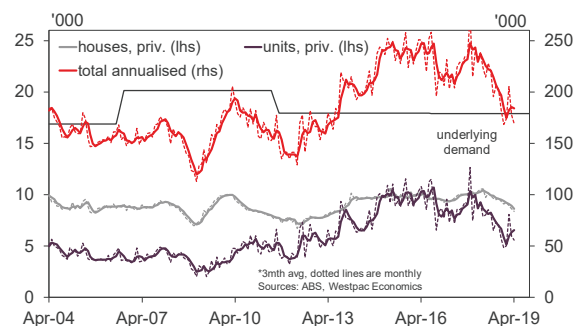
Aus May dwelling approvals

Jul 3, Last: -4.7%, WBC f/c: -2.5%

Mkt f/c: 0.0%, Range: -5.0% to 4.3%

- Dwelling approvals were weaker than expected in April, a 4.7% drop following a very choppy profile through Jan-March that mainly related to lumpy high rise approvals. Non high rise approvals were a notable soft spot in April. The timing of public holidays this year may have exacerbated the decline.
- For the May update, high rise approvals look to have some downside, the April level still well above the average over the last few months (excluding the Feb spike). However, non high rise approvals are significantly undershooting the signal from construction-related finance approvals which have shown a moderating pace of decline since the start of the year. On balance, we expect total approvals to be down 2.5% in the month but with the detail likely to be mixed.

Dwelling approvals



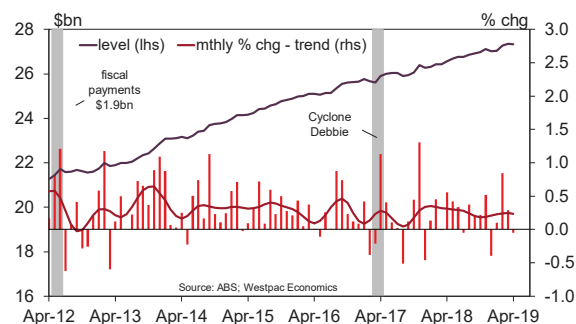
Aus May retail trade

Jul 4, Last: -0.1%, WBC f/c: +0.1%

Mkt f/c: 0.2%, Range: 0.1% to 0.8%

- Retail sales dipped slightly in April, down 0.05%mtm and coming off a fairly ordinary run over the previous four months (average gains of just 0.2%). Annual sales growth moderated to 2.8%yr, the slowest pace since mid 2018. The timing of public holidays may have been a factor in April, although the ABS tries to adjust for these shifting seasonal effects.
- Conditions look to have again been soft in May. Consumer sentiment remained stuck around neutral but with the detail showing clear pressure on family finances and elevated risk aversion. Wealth effect drags are likely to still be operating. We expect May to show a slight 0.1% gain, mainly due to holiday effects but with risks to the downside.

Aus monthly retail sales



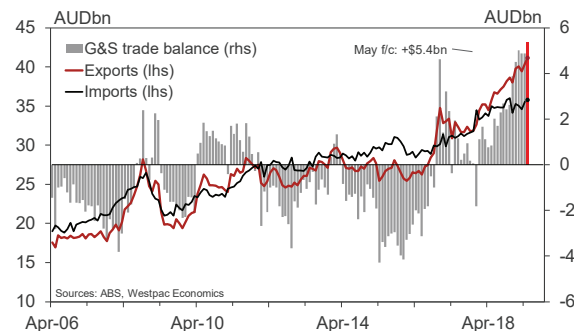
Aus May trade balance, AUDbn

Jul 3, Last: 4.9, WBC f/c: 5.4

Mkt f/c: 5.3, Range: 4.9 to 6.3

- Australia's trade surplus widened early in 2019, climbing to record highs, with export earnings boosted by higher commodity prices. This dynamic looks set to continue.
- Export earnings are forecast to rise by 1.8% in May, +\$0.7bn. Iron ore could jump by \$1.0bn in the month as the spot price climbed to US\$98/t and as volumes normalised after the impact of TC Veronica in March. Coal is the key negative in May, dented by weaker sales.
- Imports are expected to rise by around 0.6%, \$0.2bn, largely on higher prices.

Australia's trade balance



US Jun employment report

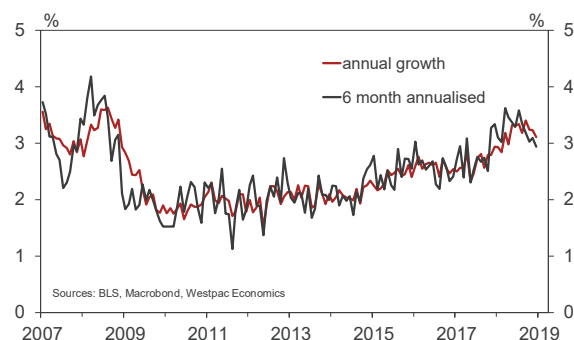
Jul 5, nonfarm payrolls Last: 75k, WBC f/c: 180k

Jul 5, unemployment rate Last: 3.6%, WBC f/c: 3.6%

Jul 5, average hourly earnings Last: 3.1%yr, WBC f/c: 3.2%yr

- The May employment report came as a significant surprise to the market, with nonfarm payrolls employment growth not only weak in the month (75k), but the prior level also revised down by 75k. As a result, the 2019 average monthly gain is now 164k, well below 2018's 223k.
- The above pace is still ahead of the level of job creation necessary to keep the unemployment rate unchanged month to month. Still, it points to a more modest and (arguably) fragile outlook for employment.
- For wages, the above implies that annual growth is likely to settle in the mid-3.0% range rather than run higher to 4.0%yr, as we had anticipated coming into 2019.

US earnings growth

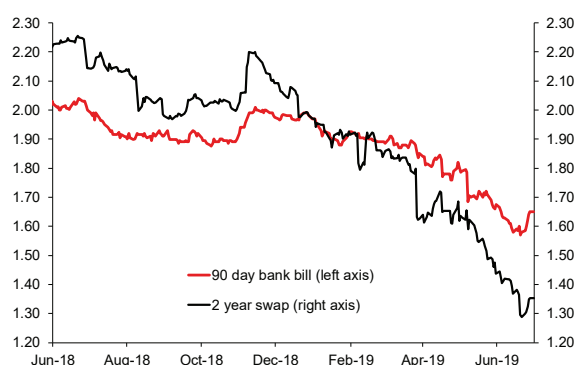


New Zealand forecasts

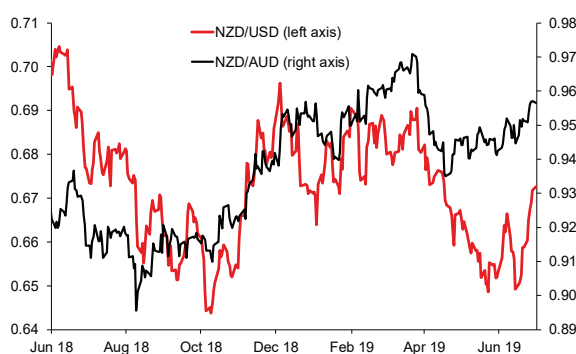
Economic Forecasts	Quarterly				Annual			
	2019							
% change	Mar (a)	Jun	Sep	Dec	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.6	0.7	0.8	2.9	2.5	3.1	2.4
Employment	-0.2	0.8	0.3	0.3	2.3	1.3	2.0	1.8
Unemployment Rate % s.a.	4.2	4.3	4.3	4.2	4.3	4.2	3.9	3.7
CPI	0.1	0.7	0.8	0.3	1.9	1.9	1.9	2.1
Current Account Balance % of GDP	-3.6	-3.4	-3.4	-3.4	-3.8	-3.4	-3.4	-3.6

Financial Forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Cash	1.25	1.25	1.25	1.25	1.25	1.50
90 Day bill	1.40	1.40	1.40	1.40	1.55	1.65
2 Year Swap	1.25	1.30	1.40	1.50	1.60	1.70
5 Year Swap	1.40	1.50	1.60	1.70	1.80	1.90
10 Year Bond	1.55	1.60	1.65	1.75	1.85	1.90
NZD/USD	0.64	0.65	0.65	0.66	0.66	0.66
NZD/AUD	0.94	0.96	0.98	0.99	0.99	0.99
NZD/JPY	68.5	68.9	69.6	71.0	71.9	73.0
NZD/EUR	0.57	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.50	0.51	0.51	0.51	0.51	0.51
TWI	70.8	71.7	72.1	72.1	72.1	72.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 1 July 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.50%	1.50%
30 Days	1.67%	1.64%	1.66%
60 Days	1.65%	1.60%	1.66%
90 Days	1.65%	1.58%	1.67%
2 Year Swap	1.35%	1.37%	1.45%
5 Year Swap	1.44%	1.48%	1.56%

NZ foreign currency mid-rates as at 1 July 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6726	0.6492	0.6603
NZD/EUR	0.5920	0.5793	0.5865
NZD/GBP	0.5296	0.5154	0.5210
NZD/JPY	72.81	70.44	71.25
NZD/AUD	0.9566	0.9447	0.9459
TWI	73.44	71.83	72.62

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 01					
NZ	RBNZ deputy Governor Bascand	-	-	-	Speech: "Macroprudential policy: past, present and future."
Aus	Jun CoreLogic home value index	-0.4%	-	-0.2%	Price declines slowing.
	Jun AiG PMI	52.7	-	-	Manuf'g mixed. Off 2018 highs, housing downturn & drought.
	Jun MI inflation gauge %yr	1.7%	-	-	Running ahead of the CPI but will it correct in Q2?
Chn	Jun Caixin manufacturing PMI	50.2	50.0	-	Released after the NBS measure
	PBOC Governor Yi speaks	-	-	-	In Helsinki at conference on monetary policy and the EMU.
Eur	Jun Markit manufacturing PMI	47.8	47.8	-	Remains in a soft spot.
	May M3 money supply %yr	4.7%	-	-	Credit growth has continued at a solid pace.
	May unemployment rate	7.6%	-	-	Trending down, jobs growth 1.2%/yr, well ahead of population.
UK	May net mortgage lending £bn	4.3	-	-	Housing market weakness has restrained lending growth.
	Jun Markit manufacturing PMI	49.4	49.2	-	Drags from soft global conditions and domestic headwinds.
US	Jun Markit manufacturing PMI	50.1	-	-	US manufacturers now seeing relief post Mexico tariffs...
	Jun ISM manufacturing	52.1	51.2	-	... and as US dollar depreciates, though the risks are clear.
	May construction spending	0.0%	0.0%	-	Private sector spending soft and at risk.
	Fedspeak	-	-	-	Clarida on policy (4:15 pm AEST).
Tue 02					
NZ	Q2 Survey of Business Opinion	-27	-	-	Businesses continue to highlight a range of headwinds.
	May building permits	-7.9%	-	2.0%	Moderate gain expected, activity levels to remain high.
Aus	RBA policy decision	1.25%	1.00%	1.00%	Governor's comments suggest they are likely to cut.
	RBA Governor Lowe	-	-	-	Speaking, RBA Board Dinner, Darwin, 7:30pm AEST.
US	Fedspeak	-	-	-	Williams on global outlook in Zurich. Mester in London.
Wed 03					
NZ	GlobalDairyTrade auction	-3.8%	-	-	Prices have fallen in the past three auctions.
	Jun ANZ commodity prices	0.0%	-	-	Overall prices still firm, despite recent softness in dairy.
Aus	May dwelling approvals	-4.7%	0.0%	-2.5%	Downside stemming from high rise approvals.
	May trade balance, \$bn	4.9	5.3	5.4	Could see a fresh record high. Exports led higher by iron ore.
	Jun AiG PSI	52.5	-	-	In May, up 6pts, on new orders. A dead cat bounce?
Chn	Jun Caixin China PMI services	52.7	-	-	Released after NBS measure.
Eur	Jun Markit services PMI final	53.4	53.4	-	Holding up despite persistent manufacturing weakness...
UK	Jun Markit services PMI	51	-	-	Earlier resilience in the services sector has been dissipating.
US	Jun ADP employment change	27k	140k	-	ADP highly volatile of late.
	May trade balance US\$bn	-50.8	-52.0	-	Tariff effects have now largely run their course.
	Initial jobless claims	227k	-	-	Very low.
	Jun Markit services PMI	50.7	-	-	Domestic demand supporting sector...
	Jun ISM non-manufacturing	56.9	56.0	-	... particularly the consumer.
	May factory orders	-0.8%	-0.1%	-	Core durable orders were robust in May.
Thu 04					
Aus	May retail sales	-0.1%	0.2%	0.1%	Conditions look to have again been soft in May.
Eur	May retail sales %yr	1.5%	-	-	Jobs growth supporting consumer but uncertainty weighs.
	ECB speak	-	-	-	Chief Economist Lane speaks in Frankfurt.
US	Independence Day	-	-	-	Public holiday, markets are closed.
Fri 05					
Aus	Jun AiG PCI	40.4	-	-	Construction, sub-50 past 9 months, led lower by housing.
UK	Jun Halifax house prices	0.5%	-	-	Prices have stabilised despite ongoing political uncertainty.
US	Jun non-farm payrolls	75k	158k	180k	To bounce back, though multi-month trend skewed down.
	Jun unemployment rate	3.6%	3.6%	3.6%	Unemployment rate likely unchanged at multi-decade low.
	Jun average hourly earnings %yr	3.1%	3.2%	3.2%	Hourly earnings have weakened of late. Should stabilise.

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	2.4
CPI inflation % annual	1.7	1.5	1.9	1.8	1.8	1.6
Unemployment %	5.8	5.7	5.5	5.0	5.4	5.6
Current Account % GDP	-4.7	-3.1	-2.6	-2.1	-0.2	-1.1
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.3	1.8
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	1.2	0.6	1.9	0.8	0.7	0.6
Euro zone						
Real GDP %yr	2.1	2.0	2.4	1.8	1.2	1.4
United Kingdom						
Real GDP %yr	2.3	1.8	1.8	1.4	1.4	1.4
China						
Real GDP %yr	6.9	6.7	6.8	6.6	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	4.0	4.6	4.3	4.1	4.1
World						
Real GDP %yr	3.4	3.4	3.8	3.6	3.3	3.5

Forecasts finalised 11 June 2019

Interest Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Australia							
Cash	1.25	1.00	0.75	0.75	0.75	0.75	0.75
90 Day BBSW	1.20	1.15	1.00	1.00	1.00	1.00	1.00
10 Year Bond	1.32	1.30	1.40	1.45	1.60	1.70	1.75
International							
Fed Funds	2.375	2.125	1.875	1.875	1.875	1.875	1.875
US 10 Year Bond	2.01	2.00	2.05	2.10	2.20	2.25	2.30
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30

Exchange Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.7010	0.68	0.68	0.66	0.66	0.67	0.67
USD/JPY	107.66	107	106	107	108	109	110
EUR/USD	1.1365	1.13	1.14	1.13	1.13	1.12	1.12
GBP/USD	1.2669	1.27	1.28	1.28	1.29	1.29	1.30
AUD/NZD	1.0462	1.06	1.04	1.02	1.01	1.01	1.01

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