

# Weekly Commentary

10 June 2019



Stone Store, Kerikeri

## Standing tall

Nervousness about the state of the global economy is growing and overseas central banks are moving towards further easing, prompting markets to price in at least one more OCR cut by the Reserve Bank of New Zealand. There is certainly a strong risk of a cut, but we think the OCR is more likely to remain unchanged this year. The domestic economy is holding up well, and export conditions have remained quite favourable.

We now expect that the US Federal Reserve will cut interest rates twice this year. Political unpredictability has become a significant risk factor in the US, weighing on investment decisions and general confidence. We believe that it is now so embedded in US business behaviour that even resolutions of the current trade controversies are unlikely to convince businesses that the coast is clear. Lower interest rates are certainly not a cure for this, but they would help to underpin consumer spending and the housing market, which have remained robust to date.

We also expect the Reserve Bank of Australia to cut rates twice more this year, following the cut earlier this month. Australia's economic growth has slowed as falling house prices have weighed on consumer spending and construction, and inflation has been persistently below target. The RBA has decided that more stimulus is needed to drive unemployment lower and spark a lift in wage and price inflation.

Turning to New Zealand, the economy certainly lost some momentum in the second half of last year, and recent indicators have pointed to a subdued start to this year as well. But the near-term outlook has been no worse than what the RBNZ had already factored into its forecasts when it cut the OCR to 1.5% last month. Indeed, last week's data struck an even more positive note.

Building work rose sharply in the March quarter, with a 4.3% gain in residential construction and a 9% jump in non-

residential construction. This was much stronger than we expected, though some of the surprise may prove to be a matter of timing. The recent track record of building consents makes it clear that there is a substantial amount of building work in the pipeline for this year.

We have provisionally revised up our March quarter GDP forecast to 0.6% (previously 0.5%). There is upside risk to this number; we'll finalise our forecast later this week after the wholesale trade and manufacturing surveys are released.

While the recent ramp-up in building activity is welcome, our view remains that the peak in the nationwide construction cycle is approaching. In part, that's due to the continuing wind-down of post-quake rebuild work in Canterbury. In many other parts of the country, we still expect strong levels of construction activity, but beyond 2020 we don't expect to see the sort of large increases we saw in previous years, and in some regions there could be modest declines. After strong growth in recent years, homebuilding activity is now more commensurate with population growth. In addition, net migration is past its peak and we expect that it will continue to ease back over the coming years.

On the export front, the March quarter terms of trade was a little stronger than we expected, rising by 1%. Export prices fell, led by dairy products, but this was more than offset by a drop in oil import prices. Dairy prices at auction have risen strongly since the start of this year, but the usual lag between

# Standing tall

price-setting and shipment means that this won't show up in the trade figures until the June and September quarters.

The terms of trade reached an all-time high in 2017, before dropping back by about 5% last year. We expect it to improve gradually over 2019 – not necessarily testing its previous highs, but remaining at very favourable levels relative to history. Dairy prices at auction have started to ease back, but other primary exports such as forestry and horticulture are going from strength to strength.

In our forecasts we've already allowed for some pullback in world dairy prices, as concerns about reduced milk supply from the southern hemisphere ease. Even so, we expect a solid farmgate milk price of \$6.40/kg for the season just ended, and a lift to \$7.20/kg for the next season, which would be the highest payout in six years.

We also note that last week the Treasury reported a major surprise in the latest fiscal accounts. Tax revenue was previously running about \$500m below the Treasury's

forecasts in the nine months to March. But the April figures now put it more than \$2bn ahead of forecast – a forecast that itself was revised up in the Budget last month.

It is not obvious, however, what this says about the wider economy. The reasons for the surprise are unclear, but one likely suspect is that the IRD switched over to its new IT system in April. Tax revenue is reported on an accrual basis; that is, it is recorded when the tax is incurred, rather than when it is paid. The IRD's new system recognises the tax take on a more smoothed basis throughout the year, which means that some tax revenue may have been pulled forward from May and June.

While it's possible that the April figures overstate the case, it's also possible that the figures up to March understated the run of play. If so, that would paint a less worrying picture about the extent of the recent slowdown in the economy. It would also make the Government's fiscal projections more achievable than we thought at the time of the Budget.

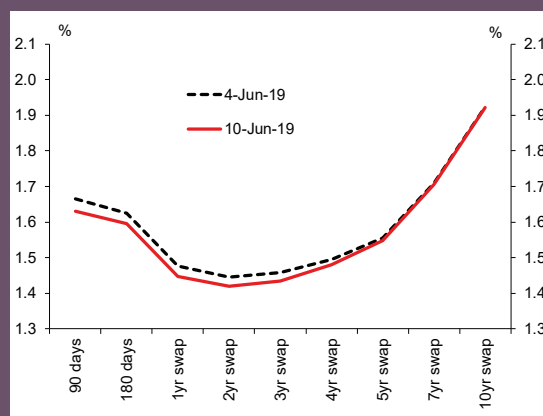
## Fixed vs Floating for mortgages

We expect floating and one-year fixed mortgage rates to be fairly stable at current levels over the year ahead, then to gradually rise in subsequent years.

Based on that expectation, we regard today's three-year rates at the best value on offer. One- and two-year rates are also fairly good value, with neither particularly preferred to the other. Four- and five-year fixed rates are a little higher than where we expect shorter-term rates to go over the relevant timeframe, but they do offer the borrower certainty. Floating mortgage rates are expensive for borrowers, but they may be the preferred option for those who require flexibility in their repayments.

The big uncertainty is what the Reserve Bank does with the OCR. Our views are based on the Reserve Bank keeping the OCR at 1.5% for the foreseeable future. If they instead cut the OCR, floating and one-year fixed rates could fall.

NZ interest rates



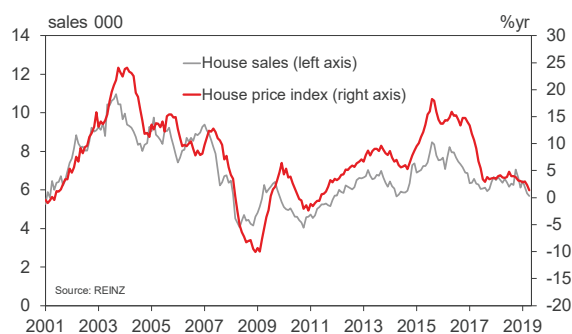
# The week ahead

## NZ May REINZ house price index

June 10-14 (Date TBD), Last: -1.0%

- The housing market slowdown intensified in recent months. Market turnover dropped sharply in Auckland, and nationwide price data was very weak in April.
- We expect a technical bounce with stronger data in May. April may have been affected by the unusual three-day week that included Easter Monday and ANZAC day.
- We do expect an improvement in the housing market due to the cancellation of the capital gains tax and the recent sharp decline in mortgage rates. However, it is probably too early to see this in the data just yet. When the turnaround does become apparent, it will show first in rising house sales.

## REINZ house prices and sales

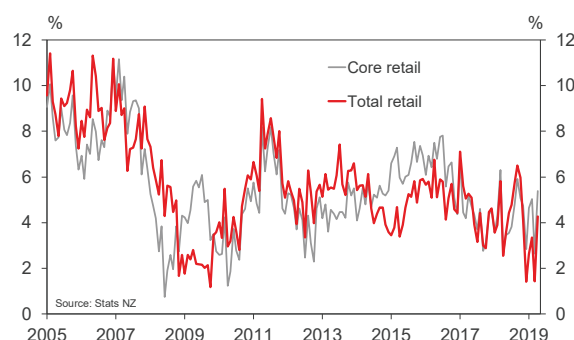


## NZ May retail card spending

June 12, Last: +0.6%, WBC f/c: +0.5%

- Retail spending rose by 0.6% in April. Spending was dampened by increases in fuel prices that siphoned money out of households' wallets and constrained spending in other areas. The result may also have been affected by the close timing of the Easter and ANZAC Day holidays.
- We're expecting a moderate 0.5% rise in retail spending in May, underpinned by a 0.4% gain in core (ex-fuel) categories. Ongoing strength in fuel prices is limiting spending growth in other areas. Continued softness in the housing market has also been a drag.

## Card transactions, annual % change

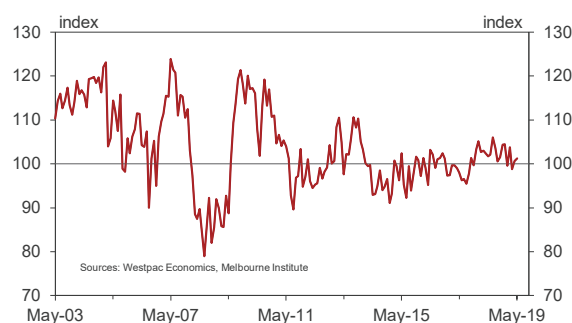


## Aus Jun Westpac-MI Consumer Sentiment

Jun 12 Last: 101.3

- The Westpac Melbourne Institute Index rose 0.6% to 101.3 in May, a modest gain overall likely reflecting a mix of firming expectations for an RBA interest rate cut and some 'cooling off' from April's Budget-related boost.
- The June survey will capture reactions to both the surprise Federal election result and the RBA's June rate cut. On rate cuts, history shows mixed responses but with the first move in a cycle typically positive (an average boost of 4-6pts). How events affect housing-related sentiment will be of particular interest given the election result has removed risks around potential changes in tax policy. Other factors that may also impact include a firmer tone from housing markets but a disappointing March quarter GDP result. Financial markets have been mixed the ASX up 3.3% over the last two months but the S&P500 down 1.3%.

## Consumer Sentiment Index



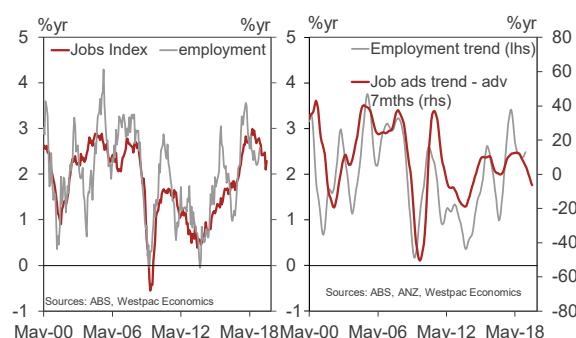
## Aus Apr employment change '000

June 13, Last: 28.4k, WBC f/c: 5k

Mkt f/c: 16k, Range: 1k to 50k

- The April Labour Force Survey reported a 28.4k gain in employment. The trend in employment remains robust with a three month average gain of 22.4k in April compared to 24.9k in March and 22.0k in February.
- In the year to April employment lifted 323k or 2.6%yr, an acceleration from the 305k/2.4%yr in March and 274k and 2.2%yr at the end of 2019. Most of the gains in employment were full-time (248.1k/2.9%yr). Part-time employment lifted 74.8k/1.9%yr.
- Business surveys and job ads point to employment growth slowing to 2.2%yr. Our 5k forecast will see an annual rate of 2.5%yr. Notably, more recent business surveys post the Federal Election show a clear lift.

## Leading indicators of employment



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# The week ahead

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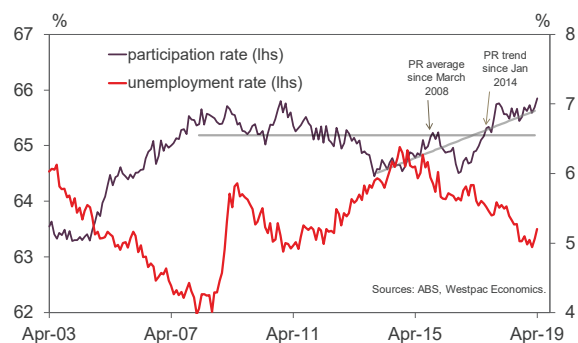
## Aus Apr unemployment rate, %

June 13, Last: 5.2%, WBC f/c: 5.2%

Mkt f/c: 5.1%, Range: 4.9% to 5.3%

- The big surprise in the April survey was the jump in the unemployment rate from 5.1% (was 5.05% revised to 5.07%) to 5.2% (5.20%). This was due to a bump in the participation rate to a new record high of 65.85%.
- So despite robust employment, unemployment has been rising due to a surge in participation. Underemployment (those employed willing and able to work more hours) rose 0.3ppts to 8.5%. Underemployment did not improve as much as unemployment did through 2018 and now it is trending higher with underemployment averaging 8.3% through the last six months.
- Holding the participation rate flat at 65.8%, a 5k gain in employment is enough to hold unemployment at 5.2%.

## Unemployment and participation rates

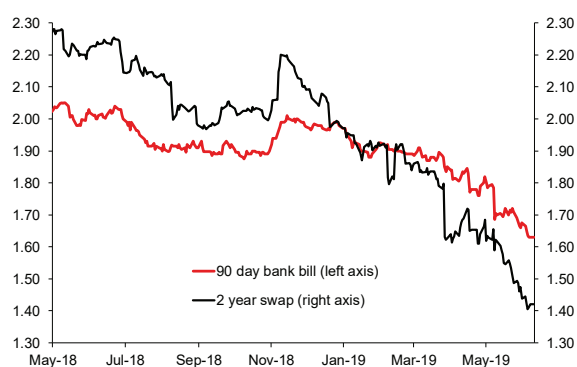


# New Zealand forecasts

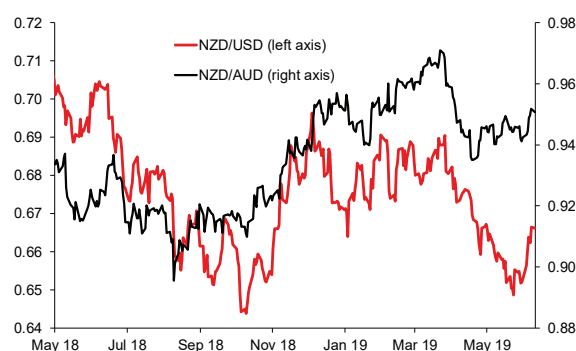
| Economic Forecasts               | Quarterly |      |      |      | Annual |       |       |       |
|----------------------------------|-----------|------|------|------|--------|-------|-------|-------|
|                                  | 2018      | 2019 |      |      |        |       |       |       |
| % change                         | Dec (a)   | Mar  | Jun  | Sep  | 2018   | 2019f | 2020f | 2021f |
| GDP (Production)                 | 0.6       | 0.6  | 0.6  | 0.7  | 2.8    | 2.5   | 3.1   | 2.4   |
| Employment                       | 0.0       | -0.2 | 0.8  | 0.3  | 2.3    | 1.3   | 2.0   | 1.8   |
| Unemployment Rate % s.a.         | 4.3       | 4.2  | 4.3  | 4.3  | 4.3    | 4.2   | 3.9   | 3.7   |
| CPI                              | 0.1       | 0.1  | 0.6  | 0.6  | 1.9    | 1.7   | 1.9   | 2.1   |
| Current Account Balance % of GDP | -3.7      | -3.8 | -3.7 | -3.8 | -3.7   | -3.9  | -3.6  | -3.9  |

| Financial Forecasts | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 |
|---------------------|--------|--------|--------|--------|--------|--------|
| Cash                | 1.50   | 1.50   | 1.50   | 1.50   | 1.50   | 1.50   |
| 90 Day bill         | 1.65   | 1.65   | 1.65   | 1.65   | 1.65   | 1.65   |
| 2 Year Swap         | 1.50   | 1.55   | 1.60   | 1.65   | 1.70   | 1.75   |
| 5 Year Swap         | 1.60   | 1.65   | 1.70   | 1.75   | 1.80   | 1.90   |
| 10 Year Bond        | 1.65   | 1.65   | 1.70   | 1.75   | 1.85   | 1.95   |
| NZD/USD             | 0.65   | 0.64   | 0.66   | 0.66   | 0.66   | 0.66   |
| NZD/AUD             | 0.94   | 0.94   | 0.97   | 0.99   | 0.99   | 0.99   |
| NZD/JPY             | 70.5   | 68.5   | 69.6   | 70.4   | 71.1   | 71.9   |
| NZD/EUR             | 0.58   | 0.57   | 0.58   | 0.58   | 0.58   | 0.59   |
| NZD/GBP             | 0.51   | 0.50   | 0.51   | 0.51   | 0.51   | 0.51   |
| TWI                 | 71.6   | 70.8   | 72.5   | 73.0   | 72.2   | 72.1   |

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 10 June 2019

| Interest Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| Cash           | 1.50%   | 1.50%         | 1.50%         |
| 30 Days        | 1.66%   | 1.70%         | 1.66%         |
| 60 Days        | 1.64%   | 1.70%         | 1.68%         |
| 90 Days        | 1.63%   | 1.71%         | 1.70%         |
| 2 Year Swap    | 1.42%   | 1.49%         | 1.62%         |
| 5 Year Swap    | 1.55%   | 1.60%         | 1.75%         |

NZ foreign currency mid-rates as at 10 June 2019

| Exchange Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| NZD/USD        | 0.6662  | 0.6555        | 0.6589        |
| NZD/EUR        | 0.5887  | 0.5849        | 0.5866        |
| NZD/GBP        | 0.5234  | 0.5142        | 0.5068        |
| NZD/JPY        | 72.34   | 71.66         | 72.30         |
| NZD/AUD        | 0.9507  | 0.9452        | 0.9421        |
| TWI            | 73.23   | 72.36         | 72.35         |

# Data calendar

|               |                                    | Last  | Market median | Westpac forecast | Risk/Comment   |
|---------------|------------------------------------|-------|---------------|------------------|--|
| <b>Mon 10</b> |                                    |       |               |                  |  |
| <b>NZ</b>     | May REINZ house sales              | -2.6% | -             | -                | Due this week. Housing market to remain weak in near term...       |
|               | May REINZ house prices, %yr        | 1.3%  | -             | -                | ...but a pick up is expected in the back half of the year.         |
| <b>Aus</b>    | Queen's Birthday                   | -     | -             | -                | Public holiday – national except mining states, WA & Qld.          |
| <b>Chn</b>    | May trade balance USDbn            | 13.8  | 23.3          | -                | Tariffs are starting to cause trade diversion.                     |
| <b>UK</b>     | Apr GDP                            | -0.1% | -0.1%         | -                | Growth remains weak, despite the temporary boost...                |
|               | Apr industrial production          | 0.7%  | -0.7%         | -                | ...from pre-Brexit stockbuilding..                                 |
|               | Apr trade balance £m               | -5408 | -             | -                | ... as uncertainty continues to dampen demand.                     |
| <b>US</b>     | Apr JOLTS job openings             | 7488  | 7496          | -                | Hires; fires; quits and job openings.                              |
| <b>Tue 11</b> |                                    |       |               |                  |  |
| <b>Aus</b>    | May NAB business survey            | 3     | -             | -                | Post Federal election, conditions & confidence could bounce.       |
| <b>Chn</b>    | May foreign direct investment %yr  | 6.3%  | -             | -                | Has held a steady pace in recent months.                           |
| <b>Eur</b>    | Jun Sentix investor confidence     | 5.3   | -             | -                | Stabilised of late. Heightened trade disputes to take effect?      |
| <b>UK</b>     | Apr ILO unemployment rate          | 3.8%  | 3.8%          | -                | The labour market remains tight.                                   |
| <b>US</b>     | May NFIB small business optimism   | 103.5 | 102.8         | -                | Small businesses positive on outlook.                              |
|               | May PPI                            | 0.2%  | 0.1%          | -                | Upstream price pressures very limited.                             |
| <b>Wed 12</b> |                                    |       |               |                  |  |
| <b>NZ</b>     | Apr net migration                  | 5020  | -             | -                | Picked up in recent months. Data volatility still obscuring trend. |
|               | May card spending                  | 0.4%  | -             | 0.5%             | High petrol prices continuing to crimp spending in other areas.    |
| <b>Aus</b>    | Jun WBC-MI Consumer Sentiment      | 101.3 | -             | -                | Post Federal election and rate cut update                          |
|               | RBA Asst. Gov. Kent speaks         | -     | -             | -                | Remarks at Australian Renminbi Forum, Melbourne 9:25 am.           |
|               | RBA Asst. Gov. Ellis speaks        | -     | -             | -                | "Watching the Invisibles", Melbourne, 7:00 pm.                     |
| <b>Chn</b>    | May CPI %yr                        | 2.5%  | 2.7%          | -                | Inflation pressures contained, both for consumers...               |
|               | May PPI %yr                        | 0.9%  | 0.6%          | -                | ... and upstream despite tariffs.                                  |
| <b>Eur</b>    | ECB President Draghi speaks        | -     | -             | -                | At "Resilience to Global Headwinds?" conference, Frankfurt.        |
| <b>US</b>     | May CPI                            | 0.3%  | 0.1%          | 0.1%             | Core inflation at target, in month and over year.                  |
|               | May monthly budget statement       | 160.3 | -             | -                | Deficit continues to grow despite labour market strength.          |
| <b>Thu 13</b> |                                    |       |               |                  |  |
| <b>Aus</b>    | Jun MI inflation expectations %yr  | 3.3%  | -             | -                | The trend holding 3.8%yr to 3.9%yr since Oct 2018.                 |
|               | May employment change '000         | 28.4  | 16.0          | 5.0              | The leading indicators suggest employment should slow to...        |
|               | May unemployment rate              | 5.2%  | 5.1%          | 5.2%             | ... a 2%yr pace but business surveys bounced post election.        |
| <b>Eur</b>    | Apr industrial production          | -0.3% | -0.2%         | -                | Construction partly offsetting weak manufacturing.                 |
| <b>US</b>     | May import price index             | 0.2%  | -0.4%         | -                | USD gains offsetting tariff impact.                                |
|               | Initial jobless claims             | 218k  | -             | -                | Remain very low.   |
| <b>Fri 14</b> |                                    |       |               |                  |  |
| <b>NZ</b>     | May manufacturing PMI              | 53.0  | -             | -                | Surveys of business activity remain at subdued levels.             |
|               | May food price index               | -0.1% | -             | 0.3%             | Impact of minimum wage hike gradually filtering through.           |
| <b>Chn</b>    | May fixed asset investment ytd %yr | 6.1%  | 6.1%          | 6.1%             | Only seeing a gradual acceleration.                                |
|               | May industrial production ytd %yr  | 6.2%  | 6.2%          | -                | Manufacturing under pressure.                                      |
|               | May retail sales ytd %yr           | 8.0%  | 8.0%          | -                | PMIs point to softer job growth and risks for consumption.         |
| <b>US</b>     | May retail sales                   | -0.2% | 0.6%          | 0.7%             | Labour market and sentiment remain strong positives.               |
|               | May industrial production          | -0.5% | 0.2%          | -                | US dollar and tariffs a headwind for production.                   |
|               | Jun Uni. of Michigan sentiment     | 100.0 | 97.0          | -                | To remain at an elevated level.                                    |
|               | Apr business inventories           | 0.0%  | 0.4%          | -                | A big positive in Q1, support for g'th has continued into Q2.      |

# International forecasts

| Economic Forecasts (Calendar Years) | 2015 | 2016 | 2017 | 2018 | 2019f | 2020f |
|-------------------------------------|------|------|------|------|-------|-------|
| <b>Australia</b>                    |      |      |      |      |       |       |
| 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  | 1.8   | 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 | -0.7  | -2.0  |
| <b>United States</b>                |      |      |      |      |       |       |
| 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  |
| <b>Japan</b>                        |      |      |      |      |       |       |
| Real GDP %yr                        | 1.2  | 0.6  | 1.9  | 0.8  | 0.7   | 0.6   |
| <b>Euro zone</b>                    |      |      |      |      |       |       |
| Real GDP %yr                        | 2.1  | 2.0  | 2.4  | 1.8  | 1.2   | 1.4   |
| <b>United Kingdom</b>               |      |      |      |      |       |       |
| Real GDP %yr                        | 2.3  | 1.8  | 1.8  | 1.4  | 1.4   | 1.4   |
| <b>China</b>                        |      |      |      |      |       |       |
| Real GDP %yr                        | 6.9  | 6.7  | 6.8  | 6.6  | 6.1   | 6.0   |
| <b>East Asia ex China</b>           |      |      |      |      |       |       |
| Real GDP %yr                        | 3.8  | 4.0  | 4.6  | 4.3  | 4.1   | 4.1   |
| <b>World</b>                        |      |      |      |      |       |       |
| Real GDP %yr                        | 3.4  | 3.4  | 3.8  | 3.6  | 3.3   | 3.5   |

Forecasts finalised 10 May 2019

| Interest Rate Forecasts | Latest | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|
| <b>Australia</b>        |        |        |        |        |        |        |        |
| Cash                    | 1.25   | 1.00   | 0.75   | 0.75   | 0.75   | 0.75   | 0.75   |
| 90 Day BBSW             | 1.37   | 1.25   | 1.00   | 1.00   | 1.00   | 1.00   | 1.00   |
| 10 Year Bond            | 1.48   | 1.40   | 1.40   | 1.45   | 1.60   | 1.70   | 1.75   |
| <b>International</b>    |        |        |        |        |        |        |        |
| Fed Funds               | 2.375  | 2.125  | 1.875  | 1.875  | 1.875  | 1.875  | 1.875  |
| US 10 Year Bond         | 2.12   | 2.10   | 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                 | 0.6973 | 0.68   | 0.68   | 0.66   | 0.66   | 0.67   | 0.67   |
| USD/JPY                 | 108.48 | 107    | 106    | 107    | 108    | 109    | 110    |
| EUR/USD                 | 1.1267 | 1.13   | 1.14   | 1.13   | 1.13   | 1.12   | 1.12   |
| GBP/USD                 | 1.2695 | 1.27   | 1.28   | 1.28   | 1.29   | 1.29   | 1.30   |
| AUD/NZD                 | 1.0540 | 1.06   | 1.03   | 1.01   | 1.01   | 1.02   | 1.02   |

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