

Weekly Commentary

11 March 2019



Larnach Castle, Dunedin

A narrowing gap

Economic activity in the central and southern parts of the North Island and the most southern regions of the South Island remains strong, although momentum is starting to flag in some places. Meanwhile, activity in northern parts has been weaker, but signs of an improvement have become increasingly more evident. A further narrowing of the activity gap is likely as population growth and house price inflation in overheating regions begins to cool.

For some time now, New Zealand has been an economy of two halves. The central and southern parts of the North Island and the most southern regions in the South Island have been running hot, propelled by the success of exports, notably those relating to agriculture and tourism, population-induced building booms and healthy house price gains.

However, activity elsewhere has been less impressive. Flat to falling house prices in Auckland have weighed heavily on activity in the upper North Island with contagion effects resulting in a spill-over into neighbouring regions. Meanwhile, Canterbury, struggling to come to grips with life post-quake rebuild, has remained in the doldrums.

This still remains the case today, although the gap between strongly performing regions and the rest of the pack has begun to close.

That's not to say that traditional outperformers such as Gisborne/Hawke's Bay, Otago, and Southland, are not performing well. Thanks to some eye-popping house price gains and export successes, they still are, but momentum has been lost.

At the same time, erstwhile laggards like Northland, Waikato, and Nelson/Marlborough/West Coast, have all picked up pace, bolstered by a combination of supportive agricultural conditions, rising house prices, and improving labour markets. Auckland too has shown signs of picking up, with a sharp lift in regional confidence, retail spending

and house sales volumes. Mid-table performer, Taranaki/Whanganui-Manawatu also seems to have gained a second wind, in part because of strong house price growth, but also raised crude oil prices.

At the national level, the economy lost some impetus in late 2018, but we expect it to regain momentum in 2019. The main reason for this is a large increase in government transfers and spending, which should be felt across the whole country. Added to this the impact of weaker fuel prices and the outlook for most regions is quite positive.

The three main population centres are likely to stand out from this trend, albeit for different reasons. Wellington is expected to benefit from spending by the Government on the public sector, so the outlook there is particularly strong. In Auckland there has been a very large rise in consents for new dwellings, signalling a lift in construction activity that should boost the local economy over 2019. On the other side of the ledger, activity in Canterbury will remain hampered by a further cooling in reconstruction work.

There are a number of rural regions of New Zealand currently doing very well, and we expect that to continue in 2019. Some are already losing momentum and that may continue this year. Others, such as the Bay of Plenty, have built quite a head of steam and are expected to roll through 2019 in fine form. Many of these rural regions are overheating, and we expect they will cool in time.

A narrowing gap continued

Their success has been driven by a combination of factors. The performance of export orientated industries has been key. So too above trend population growth, raised construction activity and rapidly growing house prices.

Some of these factors are likely to further support rural activity over the course of 2019. Others not so much.

A key driver of rural fortunes is likely to be the ongoing success of export orientated industries, such as tourism and agriculture. Despite slowing growth, we expect a record number of tourists from abroad to support spending in tourism dependent regions such as Otago, Southland, and the Bay of Plenty. Even Auckland, which is our largest tourist destination, should benefit.

So too agriculture, although the picture here is a little more complicated. In general, supply and demand fundamentals suggest a pretty positive outlook for most commodities in 2019. How positive, will depend on prevailing weather

conditions. As mentioned in our recent Fortnightly Agri Update¹, concerns about the impact of recent dry weather are likely to have been a key factor leading to a downgraded forecast for milk production as well as a lift in milk prices. We expect that prices will unwind somewhat when the weather begins to normalise, but still maintain a slightly higher milk price forecast \$6.40 for this season.

Other factors, such as population growth, construction activity and rising house prices are not likely to be quite as supportive. Population growth is already slowing in many rural regions, and as it continues to cool the construction booms currently under way will wane. Meanwhile, double-digit house price inflation is currently stimulating strong consumer spending in many regions, but this will not last. When house price inflation slows or goes into reverse as we expect, consumer spending in many regions will slow from the current helter-skelter rates of growth.

¹ Available here: <https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Fortnightly-Files-2019/NZ-Fortnightly-Agri-Update-6-March-2019.pdf>

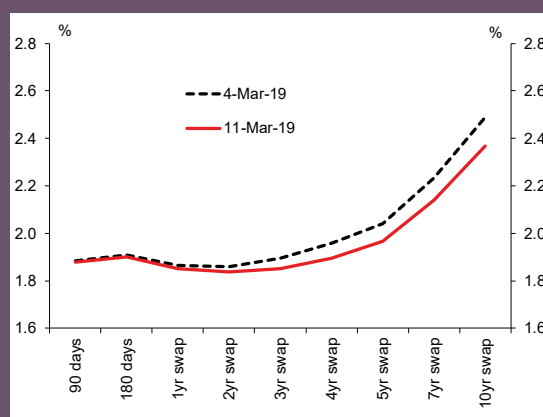
Fixed vs Floating for mortgages

The rise in wholesale interest rates following the Reserve Bank's February Monetary Policy Statement has reduced the downward pressure on retail mortgage rates. With cash rate hikes still a distant prospect, we expect retail fixed mortgage rates to remain relatively steady in the near term.

One-year fixed rates are currently the lowest on offer, and appear to offer good value to borrowers. 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



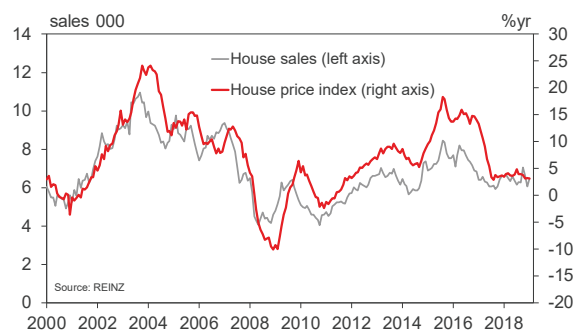
The week ahead

NZ Feb REINZ house sales and prices

Mar 11-15 (tbc), Sales last: +6.7%, Prices last: 3.1%/yr

- Nationwide house sales picked up in January after an unusually weak December. The foreign buyer ban, which took effect in October, probably accounts for some of the recent volatility in monthly sales. Annual house price inflation has slowed, albeit marginally, in that time.
- We expect a modest upturn in the housing market in the early part of this year. The RBNZ's restrictions on high-LVR lending were eased in January, while mortgage rates have been pushing down from their already low levels.
- Regional differences in price growth are likely to persist, with many areas outside of Auckland and Canterbury likely to see continued strong house price growth. Foreign buyers play little role in many regional centres, and the combination of lower mortgage rates and lending restrictions will give demand a further shot in the arm.

REINZ house prices and sales



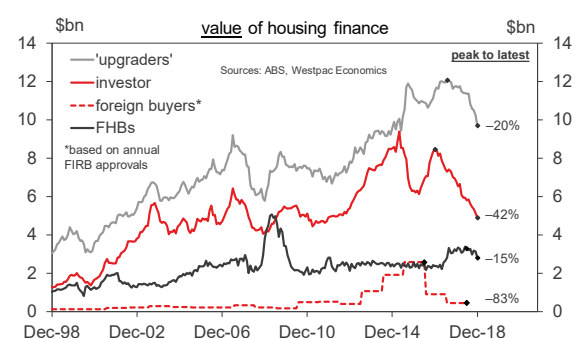
Aus Jan housing finance (no.)

Mar 12, Last: -6.1%, WBC f/c: -2.5%

Mkt f/c: -2.0%, Range: -3.0% to 2.1%

- Housing finance approvals posted a very weak finish to 2018 with sizeable declines across all components. The headline number of owner occupier loans fell 6.1%, down a hefty 8.2% ex-refi, and -14.4% for the year. Notably, what was initially an investor-led cycle is now seeing clear weakness in owner occupier activity – both the value and number of loans.
- The slide is expected to carry into January with industry data covering the major banks pointing to a further 2.5% decline. The value of investor loans is expected to see a similar fall. As always, the low activity over the holiday season means January reads are less reliable than usual.

Housing finance approvals by segment

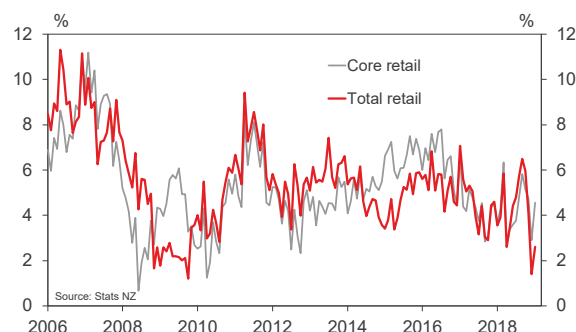


NZ Feb retail card spending

March 11, Last: 1.8%, WBC : +0.3%, Mkt: + 0.3%

- Retail spending rose by 1.8% in January. That large rise was centred on durables spending and followed an unusually large drop in spending through the Christmas shopping that may have been related to processing delays. Looking at spending more generally, household's spending was up in most categories in January. That was likely supported by the fall in petrol prices that put money back in to households' wallets. Over the past year as a whole, core (ex-fuel spending) was up 5.3%.
- Following December and January's sharp swings, we expect to see spending returning to trend in February. We're forecasting a 0.3% gain in retail spending over the month, underpinned by a 0.4% lift in core (ex-fuel) categories.

Card transactions, annual % change

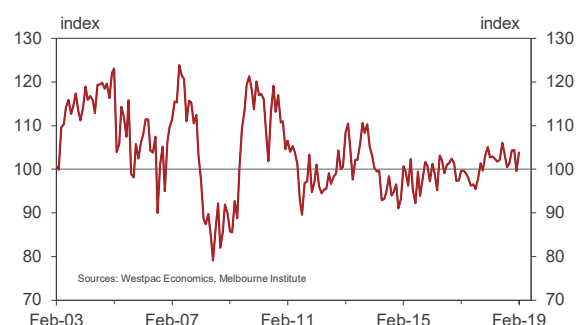


Aus Mar Westpac-MI Consumer Sentiment

Mar 13 Last: 103.8

- The Westpac Melbourne Institute Index rose 4.3% to 103.8 in Feb, recovering from a dip into slightly pessimistic territory in Jan (a reading of 99.6). The RBA's shift to a more neutral stance on the outlook for interest rates in early Feb appeared to give a modest boost to confidence after a shaky start to the year.
- This month's survey was in the field from March 4-9. The main development over the last month has been another run of weak economic data culminating in the soft December quarter national accounts showing annual GDP growth slowed to 2.3%, with press coverage emphasising the weakness of the second half of 2018. Financial markets have remained quite buoyant, the ASX up a further 3% since the last survey, but housing market conditions remained soft.

Consumer Sentiment Index



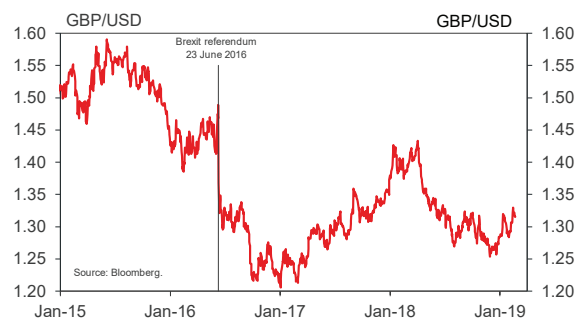
The week ahead

UK Meaningful Brexit votes

March 12 to 14

- On 12 March, the House of Commons will vote on PM May's proposed exit agreement for a second time, and it's likely to be defeated again.
- The PM has stated that should her agreement be voted down at its second reading, she would table motions on two pivotal issues on the following days. First, MPs would be asked to vote on whether they support leaving the EU without a withdrawal agreement (i.e. a 'no-deal' Brexit). We expect this motion will be defeated.
- Second, assuming MPs reject a 'no-deal' Brexit, they will be asked on whether to seek a short extension to the negotiation period with the EU. We expect that this motion will be approved. EU agreement would still be required, but this would pave the way for Brexit to be delayed beyond the current 29 March deadline.

Pound sterling



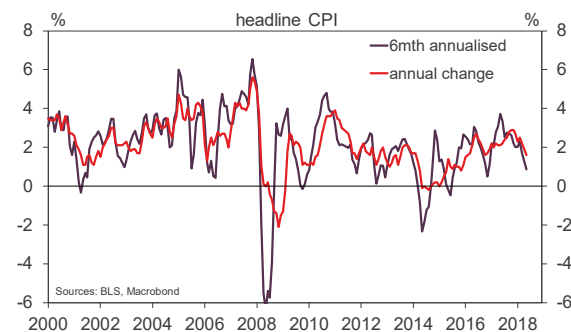
US Jan retail sales and Feb CPI

Mar 11, retail sales, Last: -1.2%, WBC f/c: 0.2%

Mar 12, CPI, Last: 0.0%, WBC f/c: 0.1%

- December US retail sales were a significant disappointment to the market, registering a 1.2% decline. Notably, this was not the result of price volatility, with the control group (which excludes volatile items) down 1.7%.
- Based on anecdotes of sales into year-end, a positive revision seems a high probability, but presumably, the decline won't be wiped away entirely. If, as we and the market expect, the January retail number is broadly flat, then it will set GDP up for a weak Q1, limiting 2019 growth to nearer 2.0%yr than the 3.1%yr pace of 2018.
- For the CPI, energy price volatility remains key. For core prices, inflation looks very sticky around the 2.0%yr medium-term target of the FOMC. This is good for policy makers, with a reactionary stance able to be maintained with little risk.

Headline and core inflation now near target

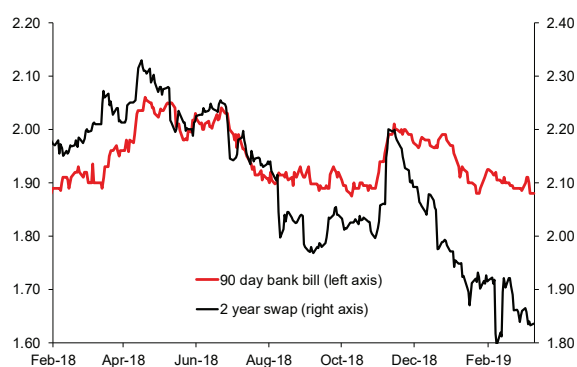


New Zealand forecasts

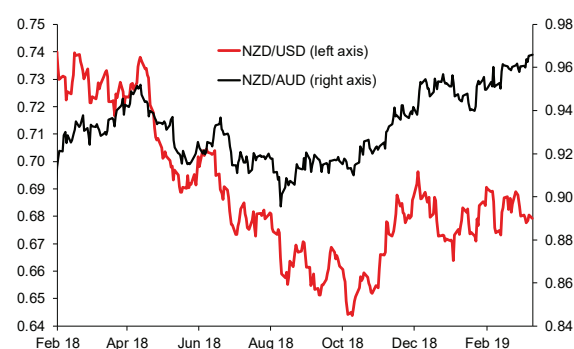
Economic Forecasts	Quarterly				Annual			
	2018		2019					
% change	Sep (a)	Dec	Mar	Jun	2017	2018f	2019f	2020f
GDP (Production)	0.3	0.3	0.8	0.8	3.1	2.7	2.6	2.8
Employment	1.1	0.1	0.2	0.3	3.7	2.3	1.1	1.7
Unemployment Rate % s.a.	4.0	4.3	4.4	4.3	4.5	4.3	4.2	4.0
CPI	0.9	0.1	0.2	0.5	1.6	1.9	1.8	2.1
Current Account Balance % of GDP	-3.6	-3.7	-3.3	-3.1	-2.9	-3.7	-3.0	-2.8

Financial Forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-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	1.90	1.90	1.90	1.95	2.00	2.05
5 Year Swap	2.10	2.10	2.15	2.20	2.25	2.30
10 Year Bond	2.20	2.20	2.25	2.30	2.30	2.35
NZD/USD	0.68	0.67	0.65	0.65	0.65	0.65
NZD/AUD	0.96	0.96	0.96	0.96	0.94	0.94
NZD/JPY	74.8	74.4	73.5	72.8	72.2	71.5
NZD/EUR	0.60	0.60	0.59	0.59	0.59	0.57
NZD/GBP	0.54	0.52	0.50	0.49	0.49	0.49
TWI	74.5	74.1	72.4	72.1	71.2	70.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 11 March 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.87%	1.85%	1.85%
60 Days	1.87%	1.87%	1.88%
90 Days	1.88%	1.89%	1.91%
2 Year Swap	1.84%	1.86%	1.80%
5 Year Swap	1.97%	2.04%	1.95%

NZ foreign currency mid-rates as at 11 March 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6792	0.6844	0.6741
NZD/EUR	0.6045	0.6034	0.5952
NZD/GBP	0.5240	0.5238	0.5208
NZD/JPY	75.41	75.76	74.03
NZD/AUD	0.9659	0.9595	0.9508
TWI	74.18	74.26	73.41

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 11					
NZ	Feb REINZ house prices %yr	3.1%	-	-	Due this week. An easing in lending restrictions and...
	Feb REINZ house sales	6.7%	-	-	...low mortgage rates to provide a boost.
	Feb retail card spending	1.8%	0.3%	0.3%	A return to trend after sharp swings in December and January.
Chn	Feb foreign direct investment %yr	4.8%	-	-	China to slowly open up to foreign capital.
US	Dec business inventories	-0.1%	-	-	Added materially to growth into year end.
	Jan retail sales	-1.2%	0.0%	0.2%	Dec weakness shocked market. Expected to be transitory.
Tue 12					
Aus	Feb NAB business survey	7	-	-	Business conditions, a considerable loss of momentum.
	Jan housing finance	-6.1%	-2.0%	-2.5%	A very weak finish to 2018.
	RBA Deputy Governor Guy Debelle	-	-	-	"Climate change and the economy", Sydney, 6pm.
UK	Jan GDP	-0.4%	0.2%	-	A modest bounce after last month's weakness...
	Jan industrial production	-0.5%	-0.1%	-	...however, business conditions remains weak...
	Jan trade balance, £bn	-3.2	-3.4	-	...with a softening in external conditions...
	Jan construction output	-2.8%	-	-	...and Brexit uncertainty weighing on investment.
	UK Parliament	-	-	-	2nd meaningful vote to fail, Brexit date may be pushed back.
US	Feb NFIB small business optimism	101.2	-	-	Small business remain optimistic.
	Feb CPI	0.0%	0.2%	0.1%	Energy a negative for headline inflation currently.
Wed 13					
NZ	Feb food prices	1.0%	-	-0.3%	Annual food price inflation running at around 1%.
Aus	Mar Westpac-MI Consumer sentim.	103.8	-	-	Recovered in Feb.
Eur	Jan industrial production	-0.9%	0.5%	-	Sharp contraction over Nov and Dec.
US	Feb PPI	-0.1%	0.2%	-	Upstream price pressures modest.
	Jan durable goods orders (prelim.)	-0.8%	-	-	Investment trend subdued, with downside risks.
Thu 14					
Chn	Feb fixed asset investment ytd %yr	5.9%	6.0%	-	Investment will slowly gain traction.
	Feb industrial production	6.2%	5.5%	-	Manufacturing to remain under pressure.
	Feb retail sales ytd %yr	9.0%	8.1%	-	Spending growth has lost some momentum.
UK	Feb RICS house price balance	-22%	-24%	-	Housing market conditions remain weak.
US	Feb import price index	-0.5%	0.3%	-	Higher dollar keeping a lid on import prices.
	Initial jobless claims	223k	-	-	Very low.
	Jan new home sales	3.7%	1.0%	-	Lower rates to help sales in new year.
Fri 15					
NZ	Feb BusinessNZ manuf. PMI	53.1	-	-	Sentiment in the business sector remains muted.
	Jan net migration	5080	-	-	Monthly figures very volatile, annual expected to trend down.
Eur	Feb core CPI final	1.0%	1.0%	-	Above 2% wages growth not passed through to inflation.
	ECB Rehn speak	-	-	-	Press conference on monetary policy.
US	Mar Fed Empire state index	8.8	10.0	-	Volatile, but still pointing to robust growth ahead.
	Feb industrial production	-0.6%	0.6%	-	US manufacturers seemingly best placed around globe.
	Jan JOLTS job openings	7335	-	-	Hires; fires; quits and job openings.
	Mar Uni. of Michigan sentiment	93.8	95.8	-	Sentiment bounced back after shutdown jolt.
	Jan total net TIC flows	-33.1	-	-	Demand for US Treasuries remains strong.

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	2019f	2020f
Australia						
Real GDP % yr	2.5	2.8	2.4	2.7	2.2	2.2
CPI inflation % annual	1.7	1.5	1.9	1.8	1.8	1.9
Unemployment %	5.8	5.7	5.5	5.0	5.5	5.7
Current Account % GDP	-4.7	-3.1	-2.6	-2.4	-2.0	-2.8
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.5	2.1
Consumer Prices %yr	0.1	1.4	2.1	2.3	1.8	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	1.0	1.7	1.1	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.9	2.4	1.8	1.4	1.5
United Kingdom						
Real GDP %yr	2.3	1.8	1.7	1.3	1.4	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 22 February 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	1.86	1.95	1.70	1.40	1.40	1.40	1.40	1.40
10 Year Bond	2.03	1.95	1.85	1.90	1.90	1.90	1.95	1.95
International								
Fed Funds	2.375	2.375	2.375	2.625	2.625	2.625	2.625	2.625
US 10 Year Bond	2.64	2.70	2.75	2.80	2.75	2.70	2.65	2.60
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	0.7012	0.70	0.68	0.68	0.69	0.69	0.70	0.70
USD/JPY	111.27	113	114	113	112	110	108	106
EUR/USD	1.1199	1.10	1.10	1.10	1.11	1.12	1.14	1.17
AUD/NZD	1.0369	1.04	1.05	1.05	1.06	1.06	1.06	1.06

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
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