

Weekly Commentary

13 May 2019



Hundertwasser Toilets, Kawakawa

One and done

As expected the RBNZ cut the Official Cash Rate to a record low of 1.5% last week. That followed an extended period during which growth and inflation fell short of expectations. While the RBNZ remains open to the possibility of a follow up rate cut this year, we don't think one will be required. However, it is a close call and much will depend on how the economy tracks over the next few months. The key consequence of the lower OCR will be lower mortgage rates and a stronger housing market in the coming year.

The Reserve Bank's rationale for cutting the OCR by 25 basis points last week was very much in line with what we had expected. Inflation is currently a little below the 2% mid-point of the target range. The RBNZ was previously relying on a pickup in the domestic economy to ensure that inflation returns to target. But that simply has not happened. GDP growth has surprised the RBNZ to the downside for some time now, and recent indicators point to a loss of momentum in early 2019. The RBNZ has also been concerned about the strength of the global economy. Expectations of global growth have been pared back in recent months, and the RBNZ is wary that they could be revised down further.

Against that backdrop, the RBNZ concluded that a rate cut was necessary to boost demand and generate a sustained rise in inflation. We agree with that assessment – before last week's reduction in the cash rate, there was a greater risk of inflation undershooting 2% than there was of it spiralling above 2%.

The macroeconomic forecasts contained in the Monetary Policy Statement were eerily similar to our own – with one caveat. The RBNZ is expecting the housing market to get a small boost from the recent drop in mortgage rates and the OCR cut. We think the boost will be large. Our view is that

house price inflation will accelerate to 7% per annum by mid-2020, and the housing market upturn will last longer than the RBNZ is forecasting. This view is not just based on falling mortgage rates – the fact that the threat of a capital gains tax has vanished is another reason to expect a housing market upturn. And, while we continue to take it with several grains of salt, recent net migration data has also suggested that population growth won't slow as we previously envisioned.

Previously, we were forecasting an OCR cut in 2020 due to our expectation that the housing market would be weakening at that time. With the housing market now looking more likely to accelerate this year and next, we have cancelled that forecast of a 2020 OCR cut.

What about the prospect of an OCR cut to 1.25% during 2019? The RBNZ sounded 50/50 on the prospect, meaning that a follow up cut would require some form of downside surprise. But we do not expect that to happen. The RBNZ is already braced for very weak domestic economic data in the near term – it seems unlikely that they will get a downside surprise on that. Beyond the near term, we expect domestic economic data, particularly relating to the housing market, to pick up noticeably. That should scotch any talk of a follow up cut later in 2019.

One and done

We'll get an update on recent housing market developments when REINZ data for April are released this week. It's likely to show the housing market remains particularly weak in Auckland. House sales nationwide were depressed in March and while the recent fall in fixed term mortgage rates will be trickling through the market, it's probably too early to see a significant impact yet. Fast forward a few months and momentum in the housing market is set to be significantly stronger, given the sheer magnitude of the mortgage rate reduction seen recently.

International developments will also be important for the RBNZ. The global economy has slowed, but the RBNZ expects it to stabilise thanks to the large reduction in global interest rates that has occurred recently. We concur. Equity markets also seem to agree, judging by the sharp rise in global share prices recently. But with US-China trade tensions once again hitting the headlines in recent days and little clarity about how Brexit will yet play out, there's clearly still plenty of potential for bouts of heightened nervousness in financial markets in the coming months.

To date, these bouts of pessimism on global growth have had little impact on New Zealand's key commodity export prices. Dairy prices again edged a touch higher in this week's GlobalDairyTrade auction. The persistence of the run up in dairy prices this year has led us to upgrade our milk price forecast for both this season and next. We now expect a \$6.50 farm gate milk price for the 2018/19 season and are forecasting \$7.20 milk price for 2019/20 season (previously \$6.40 and \$7.00 respectively).

Putting it all together, while we acknowledge the risk of an OCR cut later this year, our view is that a strengthening local and global economy will mean 1.5% is as low as the OCR goes.

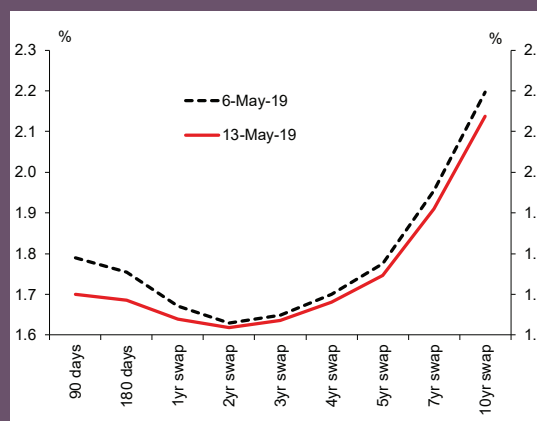
Fixed vs Floating for mortgages

Fixed mortgage rates fell sharply in anticipation of the Reserve Bank's OCR cut, with some further downward adjustments last week. Another OCR cut this year is possible if the economic outlook deteriorates, but this is not our central view.

We expect floating and one-year fixed mortgage rates to stabilise over the next year, then to gradually rise again in subsequent years. Based on that expectation, we regard three-year rates at the best on offer at present. One- and two-year rates are also fairly good value, with neither particularly preferred to the other.

Four- and five-year fixed rates have fallen sharply, and are becoming better value. These rates are only slightly higher than where we expect shorter-term rates to go over the relevant timeframe, but they 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.

NZ interest rates



The week ahead

NZ Apr REINZ house price index

Last -0.3%

- For some time house prices have been falling slowly in Auckland and rising rapidly in most other locales. More recently house sales have fallen sharply, suggesting further price weakness ahead.
- We expect the April round of housing market data to remain weak overall.
- Later this year we expect the market to pick up, because the threat of capital gains tax is gone and mortgage rates have fallen very sharply.

REINZ house prices and sales

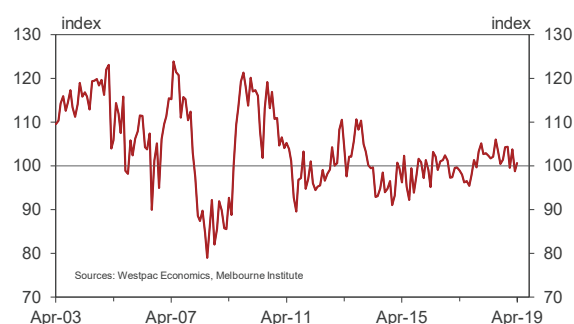


Aus May Westpac-MI Consumer Sentiment

May 15 Last: 100.7

- The Westpac Melbourne Institute Index rose 1.9% to 100.7 in April from 98.8 in March. The survey was conducted over the week of the Federal Budget and the responses show a clear boost to sentiment among those surveyed post-Budget.
- The May survey was in the field from May 6-11. It may show some let-down from the Budget boost. There may also be some disappointment around the RBA decision to leave rates on hold at its May meeting. Other factors that may impact include: a solid rise in the ASX, a further increases in petrol prices, and continued declines in house prices.

Consumer Sentiment Index



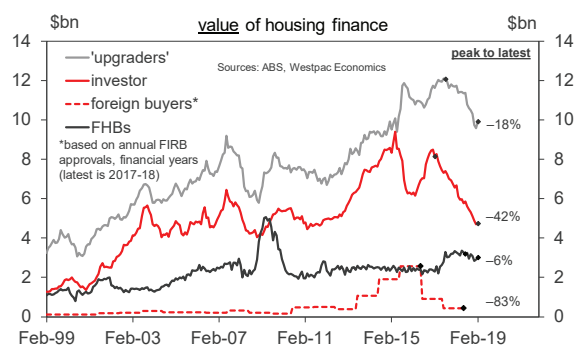
Aus Mar housing finance (no.)

May 13, Last: 0.8%, WBC f/c: -1.0%

Mkt f/c: -0.5%, Range: -2.0% to 2.0%

- The downturn of the broader housing sector accelerated in the second half of 2018. Total new lending for housing contracted by a sharp 14.3% in the six months to December 2018, including a -15.5% for investors and a -13.8% for owner-occupiers.
- Move forward to early 2019 and the pace of decline has begun to moderate. For March, the number of loans to owner-occupiers is expected to decline by 1.0%, as suggested by industry data, reversing a 0.8% rise in February. The value of loans to investors is expected to fall by 2.5% in March, more than offsetting a modest 0.9% rise last month.

Housing finance approvals by segment



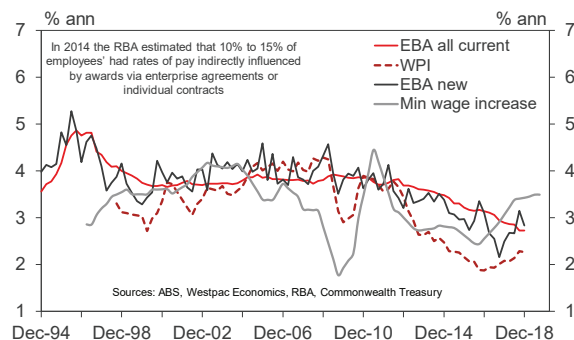
Aus Mar Quarter Wage Price Index

May 15, Last: 0.5%, WBC f/c: 0.6%

Mkt f/c: 0.6%, Range: 0.5% to 0.8%

- The labour market has clearly tightened through 2018. Unemployment has fallen tightening the labour gap. Firms are reporting it harder to find labour and the underemployment rate has been trending down. And yet the lift in wage inflation remains very modest.
- Total hourly wages ex bonuses increased 0.5% in Q4, a touch under market and Westpac expectations for 0.6%, holding the annual rate at 2.3%/yr. Both public and private sector WPI lifted 0.6%qtr (note they are seasonally adjusted separately to the total index).
- Wages in new enterprise bargaining agreements have picked up a bit and the boost to the minimum wage has been sustained. However, broader wage gains look to remain quite contained and our 0.6%qtr for Q1 will see the annual pace hold at 2.3%/yr.

As WPI stabilises, new EBAs bounce



The week ahead

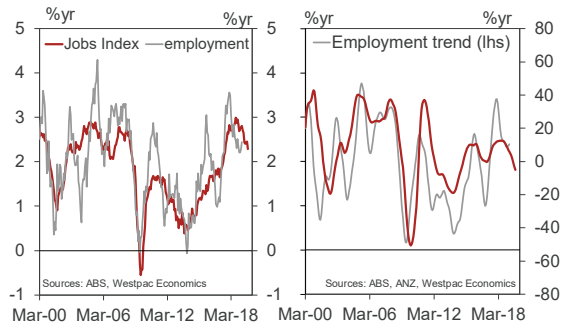
Aus Apr Labour Force Survey - employment '000

May 16, Last: 25.7k, WBC f/c: 10k

Mkt f/c: 15k, Range: 1k to 29k

- Total employment rose 25.7k in March, stronger than the market median estimate of 15k. The three month average is now 23.7k, from 21.8k in February, indicative of a robust trend in the labour market so far in 2019. In the year to March employment has lifted 305k or 2.4%.
- In the year employment has grown 129.7k in NSW compared to a slightly smaller 122.7k gain in Victoria. With the recent tick-up in unemployment in both NSW and Victoria, the ABS now reports a 0.6ppt fall in unemployment in the year for both states, but NSW is at a national low of 4.3% and Victoria is 4.6%.
- As the business surveys have started to deteriorate, our Jobs Index has turned down and is now suggesting that employment growth should slow to around 2%/yr in Q3. Westpac's forecast of +10k results in a 2.5%/yr annual pace.

Leading indicators of employment



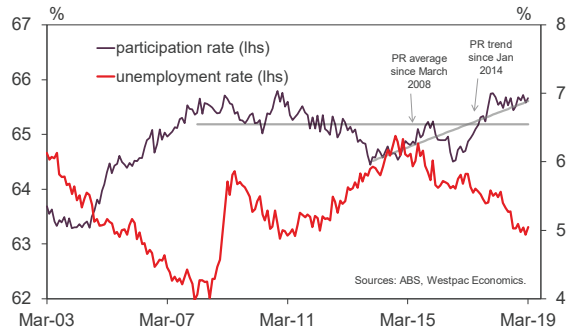
Aus Apr Labour Force Survey - unemployment %

May 16, Last: 5.0%, WBC f/c: 5.1%

Mkt f/c: 5.0%, Range: 4.9% to 5.1%

- In March, the participation rate lifted from 65.58% to 65.66% driving a 42.7k gain in the labour force. The labour force has grown at a 2.0% pace in the year to March compared to the 2.4%/yr gain in employment hence the drift down in employment through the last year.
- As total employment rose by a smaller 25.7k in March, the unemployment rate drifted higher, from 4.9% to 5.0%.
- With our forecast for +10k rise in employment, if we hold the participation rate flat at 65.7% then we get a 17.8k rise in the labour force lifting the unemployment rate to 5.1% from 5.0%.

Unemployment and participation rates

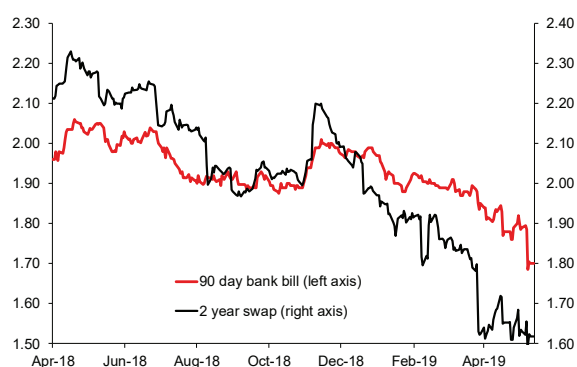


New Zealand forecasts

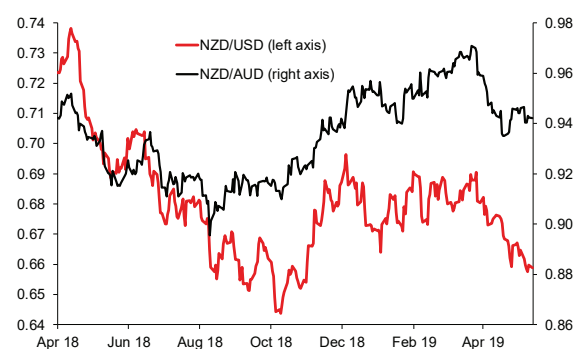
Economic Forecasts	Quarterly				Annual			
	2018	2019						
% change	Dec (a)	Mar	Jun	Sep	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.5	0.8	0.8	2.8	2.5	2.8	2.0
Employment	0.0	-0.2	0.8	0.3	2.3	1.3	1.7	1.2
Unemployment Rate % s.a.	4.3	4.2	4.3	4.3	4.3	4.2	4.0	4.0
CPI	0.1	0.1	0.6	0.6	1.9	1.6	2.1	2.1
Current Account Balance % of GDP	-3.7	-3.4	-3.1	-3.0	-3.7	-2.9	-2.7	-2.7

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	1.70	1.65	1.65	1.65	1.65	1.65
2 Year Swap	1.55	1.60	1.65	1.70	1.75	1.75
5 Year Swap	1.70	1.75	1.80	1.85	1.90	1.95
10 Year Bond	1.80	1.85	1.90	1.90	1.95	2.00
NZD/USD	0.65	0.64	0.65	0.66	0.66	0.67
NZD/AUD	0.93	0.94	0.96	0.96	0.96	0.96
NZD/JPY	72.8	72.3	73.5	73.9	73.3	73.7
NZD/EUR	0.59	0.58	0.59	0.59	0.59	0.59
NZD/GBP	0.50	0.48	0.49	0.50	0.50	0.50
TWI	71.4	71.0	71.9	72.3	71.9	72.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 13 May 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.75%	1.75%
30 Days	1.66%	1.86%	1.87%
60 Days	1.68%	1.82%	1.84%
90 Days	1.70%	1.79%	1.83%
2 Year Swap	1.62%	1.64%	1.69%
5 Year Swap	1.75%	1.78%	1.84%

NZ foreign currency mid-rates as at 13 May 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6589	0.6655	0.6764
NZD/EUR	0.5866	0.5964	0.5986
NZD/GBP	0.5068	0.5151	0.5170
NZD/JPY	72.30	74.27	75.73
NZD/AUD	0.9421	0.9456	0.9426
TWI	72.35	72.89	73.42

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 13					
NZ	Apr REINZ house sales	-6.8%	-	-	Due this week. Another weak read expected...
	Apr REINZ house prices, %yr	2.3%	-	-	...including low sales levels.
	Apr food price index	0.5%	-	0.2%	Large minimum wage hike in April will boost some prices.
Aus	Mar housing finance (number)	0.8%	-0.5%	-1.0%	Trending lower.
	RBA Dep. Gov. Debelle speaks	-	-	-	A panel on the end of LIBOR, Sydney 5.00 pm
US	Fedspeak	-	-	-	Clarida and Rosengren at Fed Listens event.
Tue 14					
NZ	Mar net migration	6570	-	-	Measurement changes have seen large swings in recent months.
Aus	Apr NAB business survey	7	-	-	Conditions have eased, employment index a key focus.
Eur	Mar industrial production	-0.2%	-0.4%	-	Manufacturing weak, partly offset by robust construction.
	May ZEW survey of expectations	3.1	5.0	-	Stabilised, now edging higher.
UK	Mar ILO unemployment rate	3.9%	-	3.9%	Unemployment to remain low despite headwinds for growth.
US	Apr NFIB small business optimism	101.8	102.0	-	Still very positive.
	Apr import price index	0.6%	0.7%	-	Upstream inflation pressures benign.
	Fedspeak	-	-	-	Williams at SNB/IMF event in Zurich. George in Minnesota.
Wed 15					
Aus	May WBC-MI Consumer Sentiment	100.7	-	-	Around a balanced level, but choppy in 2019.
	Q1 Wage Price Index	0.5%	0.6%	0.6%	Minimum wages & EBAs should drive a modest wage gain.
Chn	Apr fixed asset investment ytd %yr	6.3%	6.4%	-	Investment growth is clearly recovering and broadening.
	Apr industrial production ytd %yr	6.5%	6.5%	-	Manufacturers remain under pressure.
	Apr retail sales ytd %yr	8.3%	8.4%	-	Consumer outlook depends on investment's income return.
Eur	Q1 GDP 2nd estimate	0.2%	0.4%	-	Flash showed 0.4% recovery in Q1 but risks ahead remain.
US	Apr retail sales	1.6%	0.2%	0.4%	A softer month likely after Mar rebound.
	May Fed Empire state index	10.1	8.0	-	Manufacturing growth looks to have softened recently...
	Apr industrial production	-0.1%	0.1%	-	... and industrial production remains weaker than surveys.
	May NAHB housing market index	63	64	-	Home builders remain positive on outlook.
	Mar business inventories	0.3%	0.0%	-	A big positive for growth in Q1. What will Q2 bring?
	Mar total net TIC flows	-21.6	-	-	Long-term capital inflows to Treasury securities.
	Fedspeak	-	-	-	Quarles to Senate Banking Panel. Barkin in NY.
Thu 16					
Aus	May MI inflation expectations	3.9%	-	-	Even rising petrol prices have not lifted expectations.
	Apr Labour Force employment	25.7k	15k	10k	Business surveys have turned suggesting employment is to ...
	Apr Labour Force unemployment	5.0%	5.0%	5.1%	... leading to softer employment & rising unemployment.
	RBA Asst. Gov. Bullock speaks	-	-	-	At the ASIC Annual Forum 2019, Sydney 12:45 pm.
Eur	Mar trade balance €bn	19.5	-	-	Surplus stabilising at a lower level than recent years.
US	Apr housing starts	-0.3%	7.1%	-	Residential construction expected to firm through 2019....
	Apr building permits	-0.2%	1.9%	-	... with the labor market and rates supporting end demand.
	May Philly Fed index	8.5	11.0	-	Manufacturing growth looks to have softened recently.
	Initial jobless claims	228k	-	-	Very low and set to remain that way.
	Fedspeak	-	-	-	Kashkari on the economy and policy.
Fri 17					
NZ	Apr manufacturing PMI	51.9	-	-	Momentum has softened recently.
	Q1 PPI	0.8%	-	-	Balanced between higher dairy prices and lower oil prices.
Eur	Apr core CPI %yr final	0.8%	1.2%	-	Easter effect played some part in flash est lift to 1.2%.
US	Apr leading index	0.4%	0.2%	-	Above-trend growth continuing.
	May Uni. of Michigan sentiment	97.2	97.9	-	Buoyant, thanks to labour market and wealth.
	Fedspeak	-	-	-	Williams with community leaders. Clarida at Fed Listens.
Sat 18					
Aus	Federal Election	-	-	-	Results to be found out in the evening.

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	1.8	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
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	1.2	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 10 May 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	1.65	1.60	1.55	1.40	1.40	1.40	1.40	1.40
10 Year Bond	1.72	1.80	1.80	1.80	1.80	1.80	1.85	1.90
International								
Fed Funds	2.375	2.375	2.375	2.375	2.375	2.375	2.375	2.375
US 10 Year Bond	2.44	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	-0.40	-0.30	-0.20	-0.10

Exchange Rate Forecasts	Latest	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.6986	0.70	0.68	0.68	0.69	0.69	0.70	0.70
USD/JPY	109.68	112	113	113	112	111	110	110
EUR/USD	1.1225	1.11	1.10	1.10	1.11	1.12	1.14	1.15
GBP/USD	1.3002	1.31	1.32	1.33	1.33	1.33	1.34	1.34
AUD/NZD	1.0605	1.08	1.06	1.05	1.05	1.05	1.04	1.04

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