

# Weekly Commentary

15 July 2019



Stone Store, Kerikeri

## Help is on the way

Last week's data releases added to the evidence that the economy lost some momentum through the middle part of this year. But we also had the earliest signs that the recent stimulus to the housing market is having its expected impact. We see little that would dissuade the Reserve Bank from cutting the OCR to 1.25% at its next review in August, but we think the case for further cuts will dwindle as the year goes on.

Looking first at recent developments, the data flow last week continued to highlight the softness in both the household and business sectors. The manufacturing PMI ticked up slightly to 51.3 in June, but it remains close to the 'stall speed' level of 50. While not usually a high-profile release, it's one of the better contemporaneous indicators of GDP, and it suggests that growth decelerated further in the last few months. As noted last week, we've revised down our June quarter GDP forecast to just 0.4% growth, which would see the annual pace drop to 2%.

Electronic card spending was also subdued in June. Spending was close to flat for the month, and was up just 0.5% in the last quarter. With prices up a little over the quarter, that suggests an even softer result in terms of real spending growth.

It's likely that at least part of the slowdown in household spending over the last year or so relates to the cooling in the housing market. Wealth effects have typically been an important driver of spending in New Zealand, where housing makes up the majority of household wealth.

There is now a substantial amount of stimulus in the pipeline that should boost the housing market and, by extension, support consumer spending. The Reserve Bank's shift to easing monetary policy has brought mortgage rates down sharply in recent months. In addition, the

Government removed the spectre of a capital gains tax in April, giving a lift to market sentiment.

Last week brought the first evidence that these developments are having the impact that we expected. House sales rose by about 7% in seasonally adjusted terms in June; since sales tend to be undercounted on the first release, that suggests a gain of closer to 10%. The number of sales is still down on a year ago, but is now clearly off its lows.

Meanwhile, house prices remained fairly subdued, with another small decline in Auckland and continued modest gains in the rest of the country. That's about all we'd expect at this point: house sales tend to be the first to respond to developments, with prices following with about a three-month lag. We expect a pickup in house price inflation to be more evident by year-end.

The next major data release is the June quarter CPI on Tuesday. We expect a modest 0.6% rise in prices for the quarter, which would see the annual inflation rate lift slightly from 1.5% to 1.7%. However, the various measures of 'core' inflation are likely to be broadly unchanged.

The CPI is largely free of seasonal influences in the June quarter, so at face value a 0.6% increase would be a relatively strong result. However, about half of that reflects short-term movements in fuel prices. Petrol prices had

# Help is on the way

already risen sharply by the end of March, and were about 6% higher on average over the June quarter. Price pressures elsewhere are expected to remain modest.

Food prices rose by 0.6%, which is about average for a June quarter. There was a strong lift in prices for dining out and takeaways, no doubt reflecting the large increase in the minimum wage in April. However, vegetable prices were unusually low for this time of year.

Housing remains a positive contributor to overall inflation. We expect a further rise in prices for newly-built homes and real estate fees. However, the rate of increase in both measures has slowed lately, in line with the cooling in house sale prices.

In contrast, rents are set to make a larger than usual contribution. From this quarter Stats NZ will use a new method of calculating rents, which better captures the evolution of the stock of rental homes. The new measure has tended to rise at a faster rate than the old one, and if that pattern continues it would lift the overall inflation rate by up to 0.1% per year – not a game-changer, but every little bit matters in the current low-inflation environment.

Inflation pressures are expected to remain subdued in the import-heavy categories such as household goods and electronics. Import prices for consumer goods have risen over the last year, partly reflecting the lower New Zealand dollar. However, firms report that they are finding it difficult to pass on cost increases.

Our forecast of inflation for the June quarter (and indeed for the rest of the year) is much in line with what the Reserve Bank expected in its May Monetary Policy Statement. Inflation remains close to, but persistently below, the 2% midpoint of the RBNZ's target range.

With risks to the global economy mounting, the RBNZ has already indicated that a further OCR cut is likely at its August review. We think it would take a substantial upside surprise, with annual inflation reaching 2% or more, to make the RBNZ hesitate.

The RBNZ will no doubt leave its options open as to further OCR cuts beyond the August review. And the flow of economic data, both locally and overseas, is likely to stay subdued in the near term. But we think that by the end of the year, it will be more evident that there is enough stimulus in place to support growth through 2020.

## Fixed vs Floating for mortgages

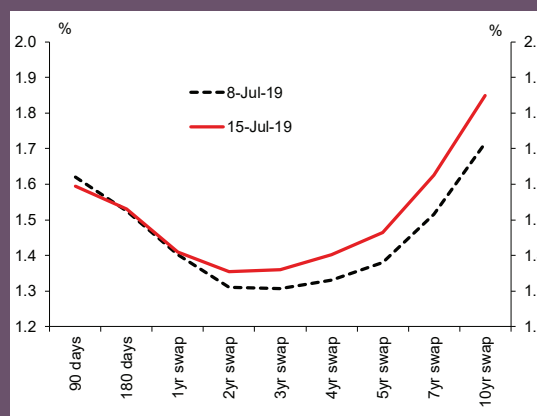
We expect the Reserve Bank will lower the OCR in August. If that is correct, both floating and fixed mortgage rates may fall over the coming month or two. However, we expect the OCR to rise again in the early 2020s, pushing mortgage rates up at that time.

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



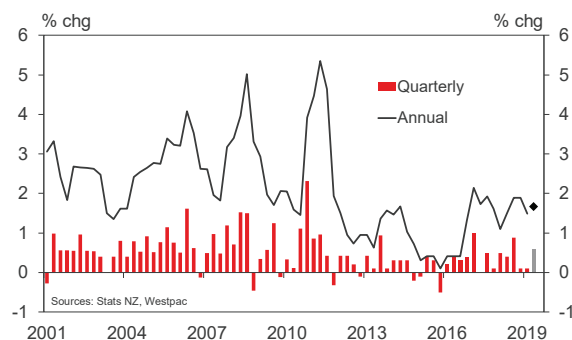
# The week ahead

## NZ Q2 CPI

Jul 16, Last: 0.1%, WBC f/c: 0.6%, Mkt f/c: 0.6%

- We expect a 0.6% rise in the Consumers Price Index for the June quarter, around half of which is due to volatile fuel prices. Price pressures elsewhere are likely to have stayed subdued.
- Our forecast would see annual inflation lift from 1.5% to 1.7%. Inflation has picked up from its lows in recent years, but continues to linger in the lower half of the Reserve Bank's target range.
- Our forecast for the June quarter is in line with the RBNZ, both for the total and in the details. It would take a substantial upside surprise to dissuade the RBNZ from cutting the OCR further at its next review in August.

## NZ CPI inflation



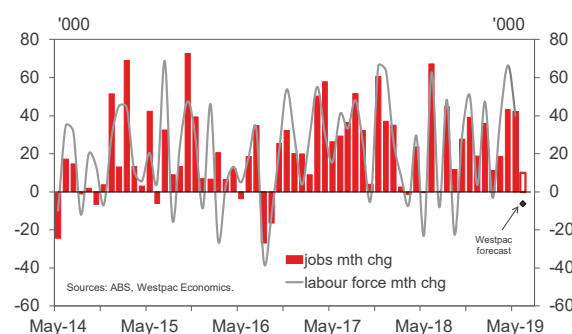
## Aus Jun Labour Force Survey - employment '000

Jul 18, Last: 42.3k, WBC f/c: 10k

Mkt f/c: 9k, Range: -10k to 24k

- In May, employment gains exceeded expectations lifting 42.3k versus the market median of 16k and Westpac's 5k. Momentum remains solid with the number employed 2.9% higher than a year ago.
- The incoming rotation group in May had a higher employment to population ratio than the group it replaced suggesting a sample rotation effect. In addition, the surge in participation took it to a new record high which was a bit surprising - particularly the surge in male participation.
- The above comments suggest downside risk to Westpac's +10k forecast due to the possibility of a lower employment to population sample rolling into the survey. The annual pace of employment growth is forecast to ease to 2.4%/yr.

## Volatility in both employment & labour force

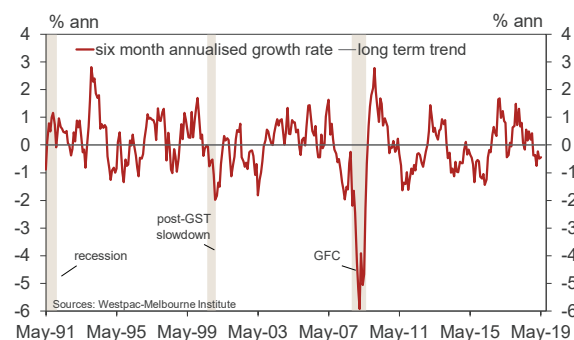


## Aus Jun Westpac-MI Leading Index

Jul 17, Last: -0.47%

- The Leading Index growth rate rose slightly to -0.45% in May from -0.49% in April. The signal has been consistently negative over the last six months, pointing to growth remaining below trend throughout 2019. Worsening global conditions have been a key driver this year.
- The June update is likely to show another below trend read. Component updates will include another positive read on the ASX200, up 3.5% vs 1.1% last month; but weakness across most other components with notable falls in the Westpac-MI Consumer Expectations Index, down -9% vs -0.2% last month; and the Westpac-MI Unemployment Expectations Index, down -10.1% vs -7.8% last month.

## Westpac-MI Leading Index



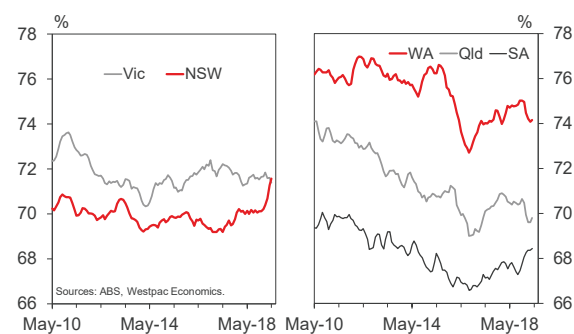
## Aus Jun Labour Force Survey - unemployment %

Jul 18, Last: 5.2%, WBC f/c: 5.1%

Mkt f/c: 5.2%, Range: 5.1% to 5.2%

- Despite the outsized gain in employment, unemployment disappointed in May, holding steady at 5.2%, vs. the market median of 5.1% and Westpac's 5.2%. Unemployment drifted higher through 2019, up from 5.0% at the start of the year.
- In June, we expect a 0.1 ppt drop in the participation rate to 65.9% to see the unemployment rate ease to 5.1%. While we noted downside risks to employment above, there are also downside risks to the participation rate, as May's gain was largely due to a lift in male participation in NSW. The participation rate in NSW (66.2%) is the highest on record, and for males (72.2%), it is the highest since Nov 1997.
- For June there is a risk we see a negative on employment, and perversely, a decline in the unemployment rate.

## Male participation rate by state



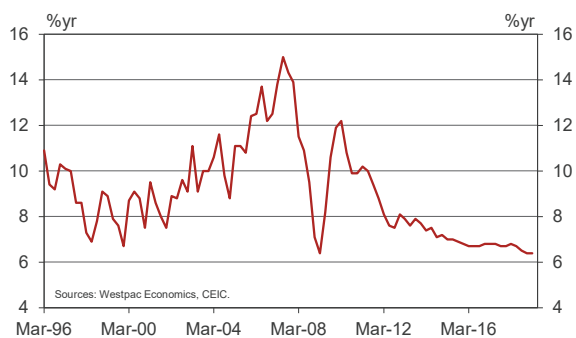
# The week ahead

## China Q2 GDP

Jul 15, Last: 6.4%, WBC f/c: 6.2%

- 2019 is proving a particularly challenging year for China. Not only has momentum in manufacturing been curtailed by US tariffs, but also the lingering impact of 2017 and 2018's investment reforms. While SOE investment has begun to strengthen, that by private business has not.
- As per the NBS PMI, the service sector has also been affected by the above, restraining household incomes and, potentially ahead, their spending.
- In Q2, we look for annual growth to slow to 6.2% as the quarterly pulse sits around 6.0% annualised. The boost to growth from exports being pulled forward to beat US tariff rises is essentially over. So in Q2 and H2 2019, momentum is set to depend on consumer spending and the nascent pick up in investment. For 2019 overall, we see growth of 6.1%.

## China real GDP slowly decelerating

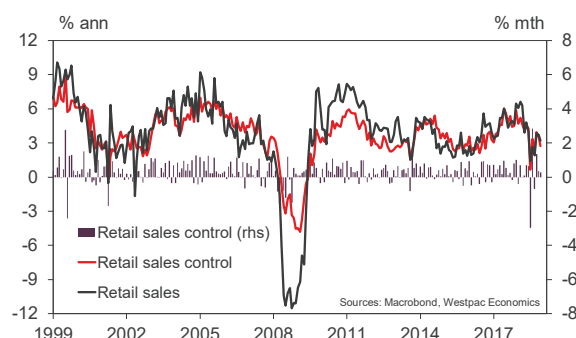


## US Jun advance retail sales

Jul 16, Last: 0.5%, WBC f/c: 0.3%

- Retail sales have averaged growth of 1.0% per month for the past three, from Mar to May. This follows a particularly weak period between Nov 2018 and Feb 2019, partly attributable to the weather.
- Come Jun, we look for a more modest 0.3% gain for the headline series and a slightly stronger 0.4% rise for the control group.
- In terms of the outlook, employment remains a strong support for spending, and wages growth is still robust despite the recent deceleration. The low level of term interest rates should also provide additional support for durables purchases into year end.
- Uncertainties apparent in the global economy and over the US outlook however mean that spending growth is likely to remain moderate versus history.

## Retail sales have rebounded in Q2

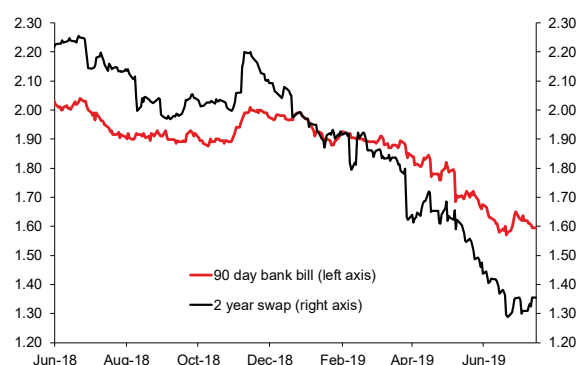


# New Zealand forecasts

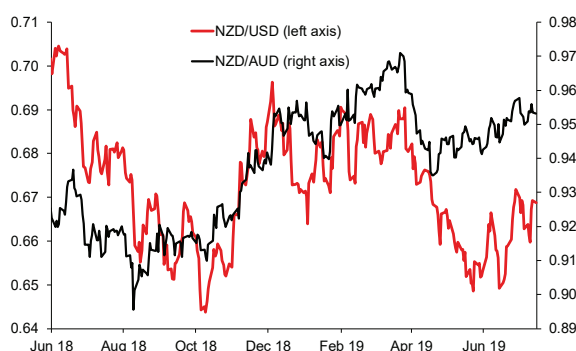
Economic Forecasts	Quarterly				Annual			
	2019							
% change	Mar (a)	Jun	Sep	Dec	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.4	0.6	0.8	2.9	2.3	3.0	2.4
Employment	-0.2	0.8	0.3	0.3	2.3	1.3	2.0	1.8
Unemployment Rate % s.a.	4.2	4.3	4.3	4.2	4.3	4.2	3.9	3.7
CPI	0.1	0.6	0.7	0.3	1.9	1.7	1.9	2.1
Current 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	0.65	0.65	0.65	0.66	0.66	0.66
NZD/AUD	0.96	0.96	0.98	0.99	0.99	0.99
NZD/JPY	68.9	68.3	69.6	71.0	72.4	73.0
NZD/EUR	0.57	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.52	0.52	0.52	0.52	0.51	0.51
TWI	71.8	71.6	72.0	72.5	72.4	72.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 15 July 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.50%	1.50%
30 Days	1.62%	1.67%	1.64%
60 Days	1.60%	1.65%	1.60%
90 Days	1.60%	1.65%	1.58%
2 Year Swap	1.36%	1.35%	1.37%
5 Year Swap	1.47%	1.44%	1.48%

NZ foreign currency mid-rates as at 15 July 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6688	0.6726	0.6492
NZD/EUR	0.5934	0.5920	0.5793
NZD/GBP	0.5323	0.5296	0.5154
NZD/JPY	72.21	72.81	70.44
NZD/AUD	0.9532	0.9566	0.9447
TWI	73.30	73.44	71.83

# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 15</b>					
<b>NZ</b>	Jun BusinessNZ PSI	53.6	-	-	Businesses reporting soft trading conditions through mid 2019.
	May net migration	4870	-	-	Annual migration down from 2016 peak, still at elevated levels.
<b>Chn</b>	Jun fixed asset investment ytd %yr	5.6%	5.6%	-	SOE investment has improved...
	Jun industrial production ytd %yr	6.0%	5.9%	-	... but private sector holding back.
	Jun retail sales ytd %yr	8.1%	8.2%	-	Workers have been hit by tariffs. Will spending be hit?
	Q2 GDP %yr	6.4%	6.2%	6.2%	GDP growth to continue slowing through year.
<b>UK</b>	Jul Rightmove house prices	0.3%	-	-	Price growth still muted in the face of economic uncertainty.
<b>US</b>	Jul Fed Empire state index	-8.6	2.0	-	Manufacturing in a soft spot.
	Fedspeak	-	-	-	Williams at LIBOR briefing.
<b>Tue 16</b>					
<b>NZ</b>	Q2 CPI	0.1%	0.6%	0.6%	Boost from fuel prices. Core measures steady a little below 2%.
<b>Aus</b>	RBA minutes	-	-	-	Colour around decision to cut rates back-to-back.
<b>Eur</b>	May trade balance €bn	15.3	-	-	Surplus lower but remains sizeable.
	Jul ZEW survey of expectations	-20.2	-	-	Dropped sharply last month on renewed trade tensions.
<b>UK</b>	May ILO unemployment rate	3.8%	3.8%	-	The labour market remains tight.
<b>US</b>	Jun import price index	-0.3%	-0.5%	-	Dollar keeping import costs in check.
	Jun retail sales	0.5%	0.2%	0.3%	Q2 has seen a robust bounce in spending.
	Jun industrial production	0.4%	0.1%	-	Manufacturers are coming under pressure.
	Jul NAHB housing market index	64	64	-	Low rates and strong job market supportive.
	May business inventories	0.5%	0.4%	-	Remain a support for growth.
	May total net TIC flows	-7.8	-	-	Long-term bond flows.
	Fed Chair Powell speaks	-	-	-	On "Aspects of Monetary Policy in the Post-Crisis Era".
	Fedspeak	-	-	-	Bostic and Bowman at Fed Listens; Evans in Chicago.
<b>Wed 17</b>					
<b>NZ</b>	GlobalDairyTrade auction	-0.4%	-	-	Limited overseas supply growth expected, NZ production to rise.
<b>Aus</b>	Jun Westpac-MI Leading Index	-0.1%	-	-	Signal consistently negative over the last six months.
<b>Eur</b>	Jun core CPI %yr	1.1%	1.1%	-	Very likely to confirm flash read of 1.1%yr.
<b>UK</b>	Jun CPI	0.3%	0.0%	-	Annual core inflation continues to linger a little below 2%.
<b>US</b>	Jun housing starts	-0.9%	-0.7%	-	Housing investment looks to have stabilised...
	Jun building permits	0.7%	0.1%	-	... modest gains are expected into 2020.
	Federal Reserve's Beige book	-	-	-	Conditions across the 12 districts.
<b>Thu 18</b>					
<b>Aus</b>	Jun employment	42.3k	9k	10k	We expect a modest rise in employment with a...
	Jun unemployment rate	5.2%	5.2%	5.1%	... pull back in participation to see UE edge down.
	Q2 NAB business survey	-1	-	-	June mthly survey, confidence (+2) & conditions (+3) below avg.
<b>UK</b>	Jun retail sales	-0.5%	-0.3%	-	Spending growth has been slowing.
<b>US</b>	Initial jobless claims	209K	-	-	Remain very low.
	Jul Philly Fed index	0.3	5.0	-	Manufacturers are coming under pressure.
	Jun leading index	0.0%	0.1%	-	Continues to point to growth about trend.
	Fedspeak	-	-	-	Bostic in armchair chat; Williams on monetary policy.
<b>Fri 19</b>					
<b>UK</b>	Jun public sector borrowing £bn	4.5	3.3	-	Borrowing requirements have remained moderate.
<b>US</b>	Jul Uni. of Michigan sentiment	98.2	98.4	-	Remains above average.
	Fedspeak	-	-	-	Bullard on fintech; Rosengren on central bank independence.

# 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	2.4
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	-0.3	-1.2
<b>United States</b>						
Real GDP %yr	2.9	1.6	2.2	2.9	2.4	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
<b>Japan</b>						
Real GDP %yr	1.2	0.6	1.9	0.8	0.7	0.4
<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	4.0	4.0
<b>World</b>						
Real GDP %yr	3.4	3.4	3.8	3.6	3.3	3.4

Forecasts finalised 5 July 2019

Interest Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
<b>Australia</b>							
Cash	1.00	1.00	0.75	0.75	0.75	0.75	0.75
90 Day BBSW	1.13	1.10	1.00	1.00	1.00	1.00	1.00
10 Year Bond	1.44	1.30	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	2.13	2.00	2.05	2.10	2.20	2.25	2.30
ECB Deposit Rate	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50

Exchange Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.6998	0.68	0.68	0.66	0.66	0.67	0.67
USD/JPY	108.36	106	105	107	108	109	110
EUR/USD	1.1272	1.14	1.14	1.13	1.13	1.12	1.12
GBP/USD	1.2543	1.26	1.25	1.26	1.27	1.29	1.30
AUD/NZD	1.0469	1.05	1.04	1.02	1.01	1.01	1.01

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