
Cardboard Cathedral, Christchurch

Weekly Commentary.

Sluggish.

Upcoming GDP figures are expected to show that economic growth in New Zealand remains sluggish, but didn't continue slowing in the second quarter of this year. However, with the global backdrop looking increasingly rocky and business conditions weak, the risks for growth over the remainder of 2019 are to the downside. Against this backdrop, the RBNZ is likely to cut the cash rate again later this year in order to boost demand.

Soggy but steady growth...

We expect that the upcoming GDP report (out on 19 September) will show that the New Zealand economy expanded by 0.6% in the June quarter, matching the pace of growth seen in the previous two quarters. That wouldn't be a great result, but it would at least suggest that there hasn't been a further deceleration so far this year.

Underlying our expectations for a moderate rise in overall activity are some mixed conditions across the economy. On the upside, we've seen some better conditions in a number of service sectors after softness earlier in the year. We also expect a boost from the agricultural sector, led by a 4% rise in dairy production. Balanced against those developments, construction, mining and food manufacturing all eased back over the quarter.

...as headwinds continue to build

While GDP growth appears to have held up in the June quarter, stepping back and taking a longer term look at economic activity, it's clear that the wind has come out of New Zealand's sails. Annual GDP growth appears to have slowed from rates of 3 to 4% in recent years down to just 2.5% now. And looking to the back half of the year, the risks for growth are to the downside.

Recent months have already seen softness in some of our key export sectors. Dairy and log prices have fallen. There are also reports of sluggish demand in the tourism sector.

We're also seeing increasing signs that the business sector is weakening. Confidence in the business sector has fallen sharply in recent months. Businesses are also reporting sluggish demand (new orders fell to a 10-year low in the latest manufacturing PMI), as well as rising costs. That combination of conditions has seen plans for hiring and investment scaled back.

A key contributor to this increasingly soggy picture for the New Zealand economy is the continued deterioration in the global backdrop. Economic activity in many of our major trading partner countries has been slowing as the US-China trade war drags on, while events such as Brexit have added to the downside risk for global growth.

These developments have spurred policy makers into action. The past week saw the ECB cutting the deposit rate and re-starting asset purchases. Chinese authorities have also announced an easing in credit conditions to support lending. Over the next few months we expect to see many others coming to the party, including the Bank of England and RBA. Most importantly, the Fed is expected to cut three more times this year, and twice in 2020. That would take the funds rate below 1%.

The RBNZ won't want to be left out of the party. After cuts in May and August, we expect that they will cut the cash rate by another 25 bps in November. Combined, those reductions signal a powerful shot in the arm for the New Zealand economy . Mortgage rates have already fallen to record lows over 2019. We expect that over time this will boost the housing market and spending more generally.

There is some question about how quickly reductions in borrowing rates will boost demand. We've been expecting to see a gradual increase in house sales over the back half of 2019, with a firming in prices becoming more evident in early 2020. However, the August update on the housing market from REINZ actually provided a surprising mix of developments. Sales were down 3.4% over the month. But over the same period, prices rocketed higher, rising 1.2% in Auckland and 1.4% in the rest of the country. Those are some of the largest monthly price increases that we've seen in several years.

Digging into the details of the August housing market report, we think it's best to take recent developments with a grain of salt. August's low level of sales probably understates the strength of demand. In part, that's because not all sales are immediately reported to REINZ and late-reported sales are added after the data is initially released. On top of that, new listings were very low over August, which would have held back the increase in sales.

At the same time, while we do think that prices will trend higher over time, the size and extent of the recent increases was surprising, and probably too soon to be related to August's 50 bps cut in the cash rate. We wouldn't expect this sort of pace to be sustained in the near term unless sales also increase.

On balance, we remain comfortable with our forecast for a gradual firming in the housing market through the remainder of 2019 and into 2020, and will be watching up coming data to confirm this. In the meantime, we're still likely to see softness in the broader New Zealand economy through the back half of 2019, especially in our export and business sectors.

Fixed vs Floating for mortgages.

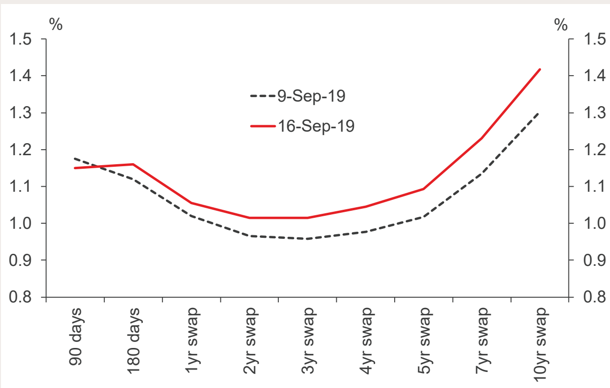
Mortgage rates are falling, and with the Reserve Bank expected to cut the OCR once more, we think they will keep falling. This means there is no hurry to fix.

Among the fixed rates on offer, we think the best value at present is the one-year rate. It is lower than the floating or six-month rates, yet it may still allow borrowers to roll onto lower rates at the end of the fixed term. Fixing for a longer term may mean that borrowers miss out on re-fixing at the lowest rates, at least according to our forecasts.

That said, fixing for longer terms does offer security against future interest rate increases, and therefore may be preferred by those with low risk tolerance.

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



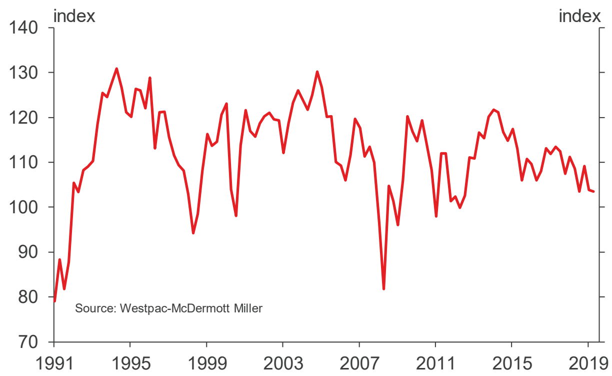
The week ahead.

NZ Q3 Westpac McDermott Miller Consumer Confidence

Sep 17, Last: 103.5

- Consumer confidence nudged down again in June, leaving it at below average levels. Households have noted ongoing concerns about their personal financial situation and the trajectory of the economy over the next few years. Nervousness about the economic outlook has been widespread across the country.
- Since the time of the last survey, we've seen an unexpected 50 bp cut from the RBNZ. We've also seen a wave of negative headlines about the state of the global economy and signs that this is affecting domestic economic conditions.

Westpac-McDermott Miller consumer confidence

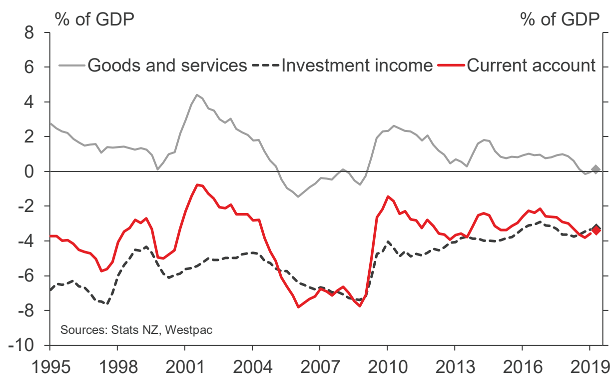


NZ Q2 current account % of GDP

Sep 18, Last: –3.6%, Westpac f/c: –3.4%, Mkt f/c: –3.3%

- We expect the annual current account deficit to narrow in June due to an improved trade performance. Goods exports rose in the June quarter as higher prices outweighed a pullback in volumes. Services exports also improved a little.
- We expect a widening in the investment income deficit, following an unusually small deficit in the March quarter. However, this would not alter the annual balance.
- Annual revisions will affect the recent history of the current account, and consequently the current level. Already-published revisions for services trade will narrow the current account deficit by as much as 0.3% of GDP, but investment income revisions can be even larger than this.

Annual current account balance

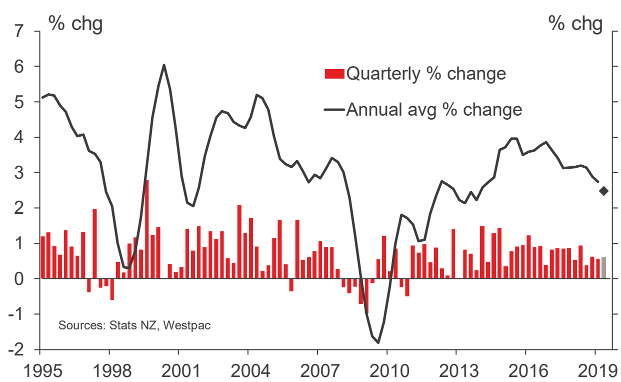


NZ Q2 GDP

Sep 19, Last: 0.6%, Westpac f/c: 0.6%, Mkt f/c: 0.4%

- We expect a 0.6% rise in the production measure of GDP for the March quarter, the same pace as in the previous two quarters. Growth is clearly down from its 2016–17 peaks, but our estimates don't suggest that there was a further deterioration in the first half of this year.
- Service sector activity looks to have picked up after a particularly soft patch in the March quarter. In contrast, we expect construction, mining and manufacturing to pull back after sharp gains in March.
- Our forecast is slightly higher than the Reserve Bank's 0.5% estimate and is at the upper end of the range of market forecasts. A result in line with our forecast is unlikely to shift the dial on expectations of further OCR cuts, as growth and inflation are expected to remain subdued over the rest of this year.

Production-based GDP



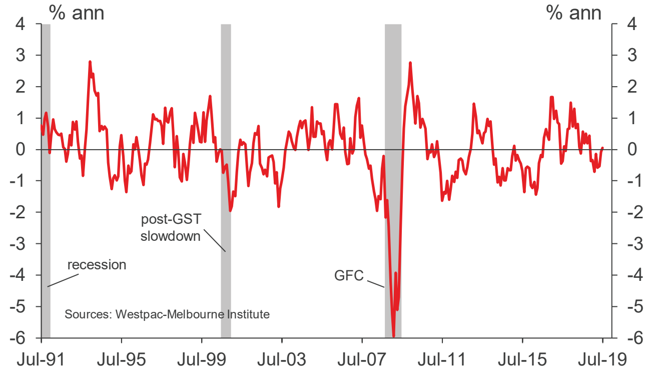
The week ahead.

Aus Aug Westpac–MI Leading Index

Sep 18, Last: +0.05%

- The Leading Index growth rate nudged slightly above trend in July, the +0.05% reading the first positive since November last year and a sign of improved momentum heading into late 2019 and early 2020.
- That signal looks likely to be very short-lived. The August read will include several significant negatives in the component updates with sharp falls for dwelling approvals (–9.7%) commodity prices (–4.2% in AUD terms) and the ASX200 (–3.1%) and a sharp narrowing in the yield spread (–23bps) as global markets were roiled by increasing concerns about a trade policy related shock to the world economy. While there are some slight positives across other components, the combined effect is very likely to drag the leading index growth rate back into below trend territory.

Westpac-MI Leading Index

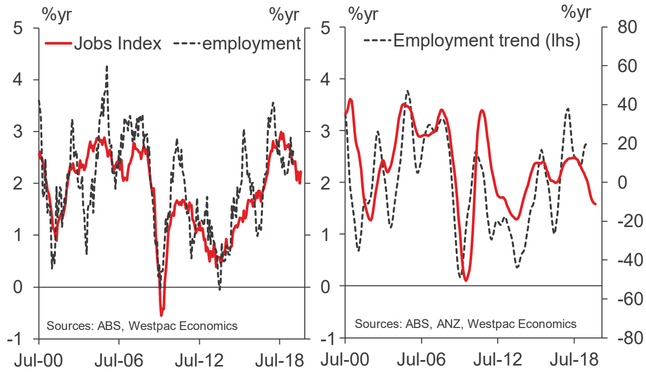


Aus Aug Labour Force Survey – employment '000

Sep 19, Last: 41k, WBC f/c: 7k
Mkt f/c: 15k, Range: -14k to 32k

- The July Labour Force Survey reported a 41.1k gain in employment. As we head into the second half of the year, employment remains quite robust with a three month average gain of 28k in July, unchanged from June and only slightly down from 35k in May.
- In the year to July, employment has grown 333k or 2.6%. The pace of employment growth has eased back from 2.9%yr in May but it is still stronger than the 2.2%yr at the end of 2018, while the six month annualised pace was flat at 2.4%yr. Our Jobs Index suggests employment should be growing around 2.4%yr currently before slowing to 2.1%yr through Q4.
- Our forecast for a 7k gain in employment in August will see the annual pace of growth dip to 2.3%yr, the slowest pace since February, more in line with what our Jobs Index is suggesting.

Leading indicators of employment

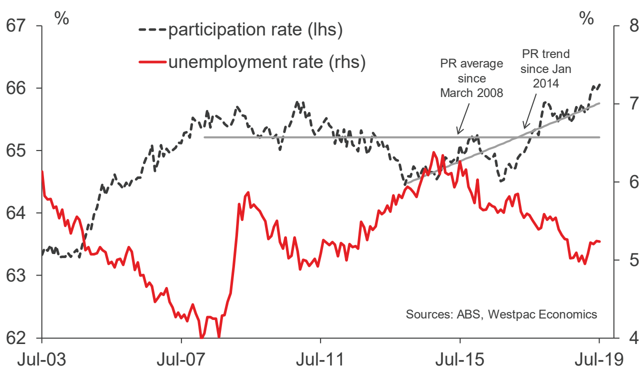


Aus Aug Labour Force Survey – unemployment %

Sep 19, Last: 5.2%, WBC f/c: 5.3%
Mkt f/c: 5.2%, Range: 5.1% to 5.3%

- In July, unemployment was flat at 5.2% (5.23% at two decimal places - it was 5.24% in June) with participation rising to a new record high of 66.1% (66.06% at two decimal places from 65.96% in June) the labour force grew a very solid 41.9k. We had expected that a soft employment print would have been associated with a moderation in participation so we are not surprised that a robust employment gain is matched by a lift in participation.
- The July update was further confirmation of a robust upward trend in participation, but there was a shift on which state is in the driving seat. NSW hit a record high of participation of 66.2% in May and has since eased back a bit as has Victoria, which leaves Qld supporting the more recent gains in participation.
- With participation forecast to hold flat at 66.1% a 7k gain in employment will see unemployment lift to 5.3%.

Unemployment and participation rates



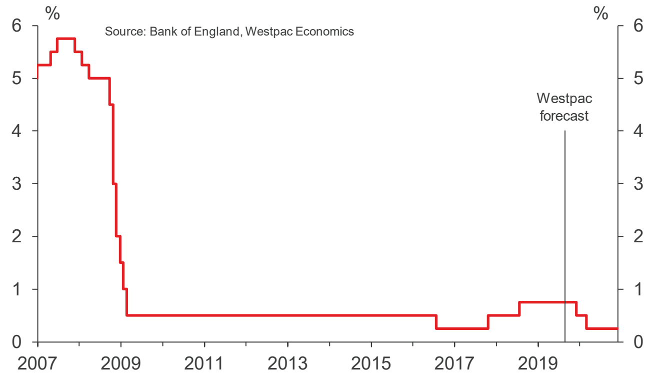
The week ahead.

UK Bank of England Bank Rate Decision

Sep 19, Last: 0.75%, Westpac f/c: 0.75%, Mkt: 0.75%

- At its August meeting, the BOE left the bank rate on hold. While the BOE trimmed its GDP projections in the quarterly inflation report, it maintained its gradual and limited (as well as Brexit dependent) tightening bias.
- Since then, Brexit remains no less resolved. The October 31 deadline date is almost certainly going to be extended in the short-term, but a no-deal exit is still a real possibility come the next deadline date. Key to the Brexit outcome is a likely general election, which still has not been called and Parliament is suspended to October 14.
- We expect that the Bank Rate will again be left on hold at the BOE's upcoming meeting. However, against a still soft economic backdrop and persisting Brexit uncertainty, the BOE can only wait so long. We expect the BOE to deliver a 25bp bank rate cut in Q4 2019 and to follow that up with another 25bp move in Q1 2020.

Bank of England Bank Rate

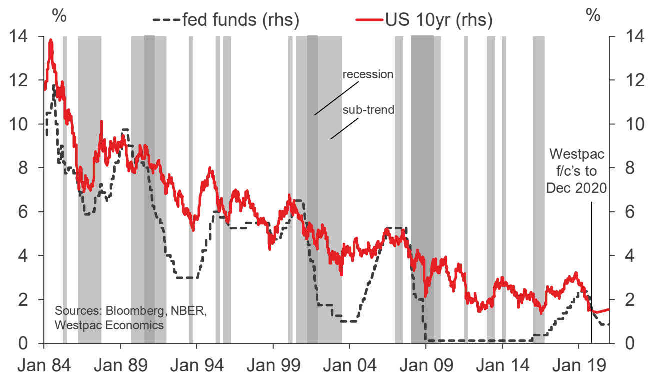


US Sep FOMC meeting

Sep 17–18, fed funds rate, Last: 2.125%, Westpac f/c: 1.875%

- Last month, we took a decidedly more negative view of the US economy, increasing the number of US rate cuts we expect to see in 2019 from two to four. This month we have gone one step further, adding two more cuts to the profile in 2020.
- The rationale behind both adjustments is the same: the effect of President Trump's tariffs on the US economy is quickly spreading from business investment to the broader economy, most notably household consumption.
- As a result, we look for GDP growth to fall from above trend in 2018 to below trend in 2020 and beyond, and see risks heavily skewed to the downside.
- Important at this meeting will not only be the decision to cut, but also how the Committee view the risks. This will be on display in the press conference and the Committee's forecasts.

US easing cycles and recessions

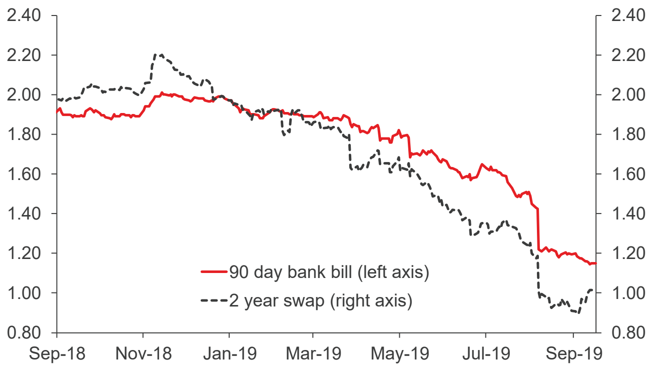


New Zealand forecasts.

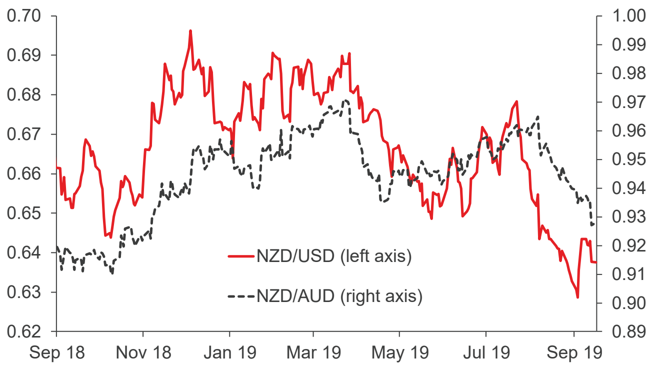
Economic forecasts	Quarterly				Annual			
	2019							
% change	Mar (a)	Jun	Sep	Dec	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.6	0.4	0.5	2.9	2.2	2.4	2.8
Employment	-0.1	0.8	0.1	0.4	2.3	1.2	1.8	2.0
Unemployment Rate % s.a.	4.2	3.9	4.2	4.3	4.3	4.3	4.3	3.8
CPI	0.1	0.6	0.6	0.3	1.9	1.6	1.7	1.8
Current Account Balance % of GDP	-3.6	-3.4	-3.4	-3.2	-3.8	-3.2	-2.9	-2.6

Financial forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Cash	0.75	0.75	0.75	0.75	0.75	0.75
90 Day bill	0.90	0.90	0.90	0.90	0.90	0.90
2 Year Swap	0.80	0.80	0.80	0.85	0.90	0.95
5 Year Swap	0.95	1.00	1.10	1.15	1.20	1.25
10 Year Bond	1.00	1.05	1.20	1.25	1.30	1.40
NZD/USD	0.63	0.62	0.62	0.63	0.63	0.64
NZD/AUD	0.94	0.94	0.94	0.94	0.94	0.94
NZD/JPY	66.2	64.5	64.5	66.8	68.0	70.4
NZD/EUR	0.59	0.59	0.58	0.59	0.58	0.58
NZD/GBP	0.54	0.53	0.52	0.52	0.51	0.50
TWI	71.4	70.6	70.1	70.6	70.1	70.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 16 September 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.20%	1.18%	1.15%
60 Days	1.16%	1.18%	1.18%
90 Days	1.15%	1.20%	1.22%
2 Year Swap	1.02%	0.91%	0.93%
5 Year Swap	1.09%	0.93%	0.93%

NZ foreign currency mid-rates as at 16 September 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6375	0.6298	0.6433
NZD/EUR	0.5751	0.5730	0.5801
NZD/GBP	0.5103	0.5183	0.5294
NZD/JPY	68.65	66.76	68.46
NZD/AUD	0.9280	0.9376	0.9473
TWI	70.80	70.62	71.71

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 16					
NZ	Aug BusinessNZ PSI	54.7	–	–	Businesses conditions have cooled over 2019.
Chn	Aug fixed asset investment ytd %yr	5.7%	5.7%	–	Continues to be held back by uncertainty and credit.
	Aug industrial production ytd %yr	5.8%	5.8%	–	Global weakness to persist.
	Aug retail sales ytd %yr	8.3%	8.3%	–	Labour market under pressure, limiting upside.
Eur	ECB speak	–	–	–	Chief Economist Lane speaks in London.
UK	Sep Rightmove house prices	–1.0%	–	–	Brexit uncertainty remains a drag, esp. in London.
US	Sep Fed Empire state index	4.8	4.0	–	Manufacturing soft globally.
Tue 17					
NZ	Q3 Westpac MM consumer conf	103.5	–	–	Household sentiment weakened through H1 2019.
Aus	RBA minutes	–	–	–	To leave room for an October cut?
Eur	Sep ZEW survey of expectations	–43.6	–	–	Very soft as manufacturing contracts.
	ECB speak	–	–	–	Chief Economist Lane speaks in Luxembourg.
US	Aug industrial production	–0.2%	0.2%	–	US manufacturers affected by tariffs and US dollar.
	Sep NAHB housing market index	66	66	–	Rates and labour market supportive.
	Jul total net TIC flows $bn	1.7	–	–	Long-term demand for Treasury securities.
Wed 18					
NZ	Q2 current account % of GDP	–3.6%	–3.3%	–3.4%	Higher export prices boosted the trade balance.
Aus	Aug Westpac–MI Leading Index	+0.05%	–	–	Nudged slightly above trend, first positive since November.
Eur	Aug core CPI %yr final	0.9%	0.9%	–	Core inflation stuck around 1%.
UK	Aug CPI %yr	2.1%	1.8%	–	Slowing back below target.
US	Aug housing starts	–4.0%	5.0%	–	Housing investment looks to be stabilising...
	Aug building permits	6.9%	-0.5%	–	... upside seems limited.
	FOMC policy decision, midpoint	2.125%	1.875%	1.875%	Second of four cuts seen to end-2019.
Thu 19					
NZ	Q2 GDP	0.6%	0.4%	0.6%	Continued moderate growth expected.
Aus	Aug employment	41.1k	15k	7k	Employment growth firmed through 2019 even as the ...
	Aug unemployment rate	5.2%	5.2%	5.3%	... leading indicators softened & unemployment lifted.
UK	Aug retail sales	0.2%	–0.2%	–	Firmness in the labour market has supported spending.
	BoE policy decision	0.75%	0.75%	0.75%	Outlook muddled by Brexit. BOE can only wait so long.
US	Sep Phily Fed index	16.8	10.8	–	Manufacturers under pressure.
	Initial jobless claims	204k	–	–	Very low.
	Aug leading index	0.5%	0.1%	–	Pointing to growth near trend.
	Aug existing home sales	2.5%	-0.6%	–	Supply the major issue.
Fri 20					
Eur	Sep consumer confidence	–7.1	–7.2	–	Has not softened to the same extent as business sentiment.
US	Fedspeak	–	–	–	Rosengren in New York.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.4	2.7	1.8	2.4	2.7
CPI inflation % annual	1.5	1.9	1.8	1.7	1.9	2.1
Unemployment %	5.7	5.5	5.0	5.4	5.6	5.3
Current Account % GDP	-3.1	-2.6	-2.1	0.8	-0.5	-2.0
United States						
Real GDP %yr	1.6	2.2	2.9	2.3	1.6	1.5
Consumer Prices %yr	1.4	2.1	2.4	1.8	1.9	1.9
Unemployment Rate %	4.9	4.4	3.9	3.6	3.6	3.8
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	0.6	1.9	0.8	0.7	0.3	0.4
Euro zone						
Real GDP %yr	2.0	2.4	1.8	1.2	1.1	1.2
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.0	0.7	1.3
China						
Real GDP %yr	6.7	6.8	6.6	6.1	5.8	5.8
East Asia ex China						
Real GDP %yr	4.0	4.6	4.3	3.7	3.9	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.2	3.3	3.3
Forecasts finalised 11 September 2019						

Interest rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Jun-21	Dec-21
Australia								
Cash	1.00	0.75	0.50	0.50	0.50	0.50	0.50	0.50
90 Day BBSW	1.03	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	1.18	0.95	1.00	1.15	1.20	1.25	1.40	1.50
International								
Fed Funds	2.125	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.79	1.45	1.40	1.45	1.50	1.55	1.70	1.80
ECB Deposit Rate	-0.50	-0.60	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70

Exchange rate forecasts	Latest	Dec–19	Mar–20	Jun–20	Sep–20	Dec–20	Jun–21	Dec–21
AUD/USD	0.6874	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	108.13	105	104	104	106	108	111	112
EUR/USD	1.1069	1.07	1.05	1.06	1.07	1.09	1.11	1.14
GBP/USD	1.2351	1.17	1.18	1.20	1.22	1.24	1.31	1.35
AUD/NZD	1.0729	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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