

Weekly Commentary

17 June 2019



Stone Store, Kerikeri

How are we tracking?

The New Zealand economy has lost some steam with softness in both the household and business sectors. However, we expect to see economic growth starting to firm again through the back half of this year, supported by low interest rates and fiscal spending.

Some of the wind came out of the economy's sails in late 2018, and it looks like the pace of economic growth has remained subdued through the first half of this year. We're expecting this week's GDP report will show that the economy expanded by 0.6% in the March quarter following a similarly modest gain in December. That would see economic growth in the year to March slipping to 2.6% - its slowest annual pace since 2014.

Much of the recent softness in economic activity has been centred on the business sector. Although there's been a pick-up in food manufacturing, other manufacturing activity has been shrinking for three quarters now. We're also seen sluggish conditions in a number of service industries.

Moving into the June quarter, things aren't looking much better. The latest BusinessNZ PMI fell to 50.2 in May - its lowest levels since 2012 - with businesses reporting weakness in both production and orders.

There's also been softness in the household sector in recent months, with core (ex-fuel) retail spending essentially flat through April and May. In part, that's because high petrol prices have syphoned funds out of households' wallets, constraining spending in other areas. On top of that, weakness in the housing market has been dampening spending appetites in some regions, with spending on durable items broadly flat since November.

But while overall economic conditions are looking soft, there are still some bright spots. One of those is export earnings,

with strong prices for a number of our key agricultural exports including meat and horticulture products.

The other area of strength has been construction. Building activity rose by 6.2% in the first quarter of this year, with strong increases in both residential and non-residential work. Those increases have been widespread with particularly large gains in Auckland.

Putting all of this together leaves the economic landscape looking a bit soggy. However, as we head into the back half of the year, we expect to see economic growth starting to re-accelerate. Some of that will come on the back of continued increases in construction activity, with a large amount of residential and non-residential work consented over the past year. More generally, economic growth will also be boosted by low interest rates and increases in Government spending. Combined, those factors signal a broad-based boost to demand and employment.

One area where we expect to see a very noticeable turn around over the coming year is the housing market. That's coming on the back of two big changes in the economic environment. First is the Government's decision back in April to not proceed with its long touted plan to introduce a capital gains tax on investment properties. This was a flagship policy for the Government and, while it didn't get beyond the planning phase, its spectre had a significant dampening impact on investor demand. Now that the policy has been

How are we tracking?

shelved, we expect a rapid improvement in market sentiment and a “relief rally” in prices.

The second big change which we expect to boost the housing market is the very sharp drop in mortgage rates since May. Wholesale fixed interest rates have plunged following the Reserve Bank’s recent change of tack towards lowering the OCR. The consequence has been a near 40 basis point drop in the average two-year fixed mortgage rate. Two year fixed rates are now sixty basis points lower than a year ago. Five year rates have fallen even more sharply, and are now 120 basis points lower than a year ago. These declines have made housing more affordable for owner occupiers. They will also make the yields on investment housing look more attractive to investors, especially compared to bank deposits.

Together, we think those two changes portend a pickup in the housing market over the year ahead. We’re forecasting nationwide house price inflation will rise from around 2% currently, to around 7% in 2020. And with New Zealanders holding a large proportion of their wealth in housing assets, this also signals a more general boost to household demand.

But while we are expecting a pickup in the nationwide housing market, we continue to expect some big regional differences.

As we discuss in our recent Bulletin,¹ we expect Auckland will continue to under-perform relative to other regions, with a number of policies continuing to dampen investor demand in the region (including restrictions on foreign buyers).

We expect the boost to demand from the above policy changes will become evident through the back of this year, with a recovery in house sales likely to precede a lift in price growth. However, at least for now, the housing market remains soft. The May update from REINZ showed that sales remains low, especially in Auckland. Price growth also remains muted, with annual house price inflation running at 1.8% - a far cry from the rates of around 16% per annum that we saw in 2016.

One notable development in recent months has been the varied housing market trends across the country. Until recently, weakness was concentrated in Auckland and Canterbury, while prices in other regions had been powering ahead. However, we’re now seeing signs that housing markets are cooling in other regions, with house price inflation slowing in Waikato, the Bay of Plenty, Gisborne/Hawke’s Bay and Otago. We’ll be watching to see if this continues over the next few months.

¹ Available here: <https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Monthly-Files-2019/NZ-Home-Truths-June-2019.pdf>

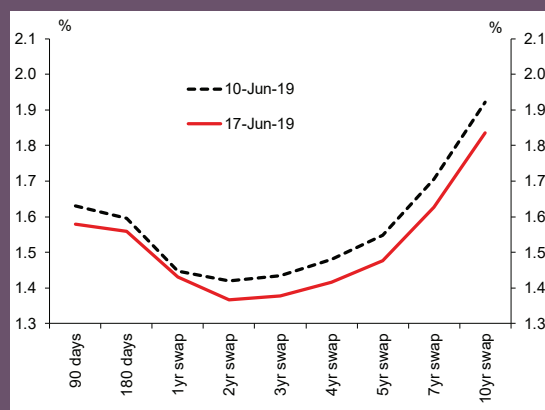
Fixed vs Floating for mortgages

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



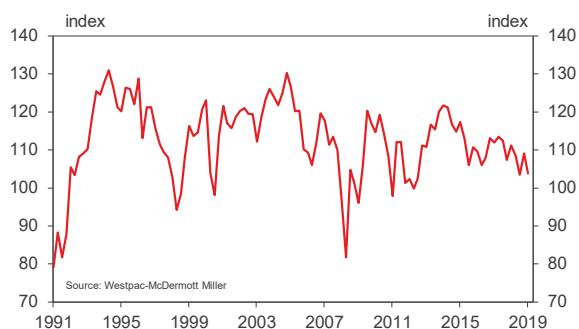
The week ahead

NZ Q2 Westpac McDermott Miller Consumer Confidence

Jun 18, Last: 103.8

- Consumer confidence fell to a below average level in the March quarter. Confidence was down across all income brackets, age groups and regions. Households noted increased concerns about their personal financial situation and the trajectory of the economy over the next few years.
- Since the time of the last survey, we've seen falls in mortgage rates. We've also seen the cancellation of the proposed capital gains tax and the announcement of increased fiscal spending as part of the Government's Well Being Budget.

NZ Westpac-McDermott Miller consumer confidence

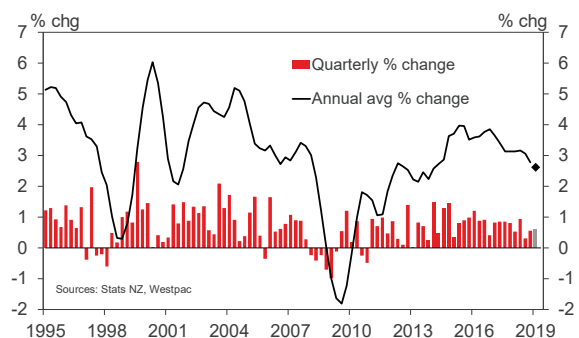


NZ Q1 GDP

Jun 20, Last: 0.6%, Westpac f/c: 0.6%, Mkt f/c: 0.6%

- We expect a 0.6% rise in the production measure of GDP for the March quarter, matching the average pace seen over the last year.
- A burst of construction activity enlivened what was otherwise shaping up to be a subdued quarter. Primary sector activity was mixed, and service sector growth has slowed noticeably in recent quarters.
- The RBNZ was already braced for a soft 0.4% result when it cut the OCR last month. A stronger outturn in line with our forecast would not take further rate cuts off the table, but would be enough to leave the RBNZ in watch and wait mode for now.

NZ production-based GDP

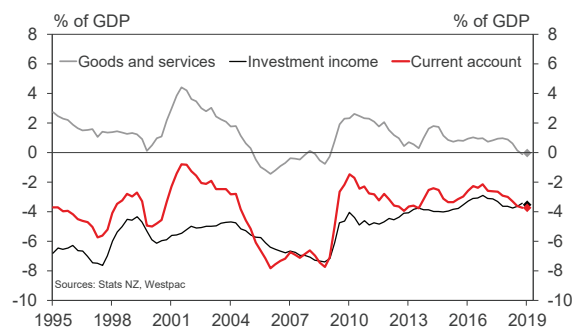


NZ Q1 current account % of GDP

Jun 19, Last: -3.7%, Westpac f/c: -3.7%, Mkt f/c: -3.5%

- We expect the annual current account deficit to hold steady at 3.7% of GDP. This would leave the deficit at its widest since September 2013.
- The goods trade deficit improved marginally in the March quarter, with a strong lift in export volumes helping to offset lower dairy export prices and higher oil import prices.
- In contrast, we expect the balance on services to soften, reflecting the drop in tourist numbers. We also expect a widening in the investment income deficit, due to higher profits for overseas-owned firms.

NZ annual current account balance

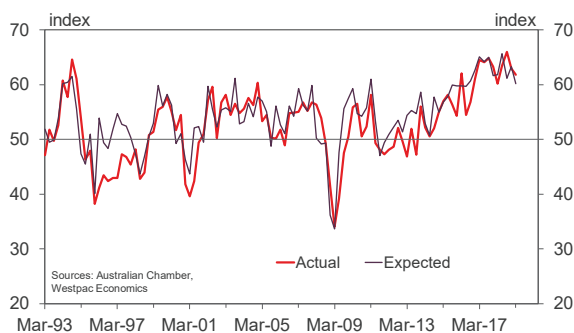


Aus Q2 AusChamber-Westpac business survey

Jun 18, Last: 61.8

- The Q2 Australian Chamber-Westpac survey of manufacturing was conducted after the May 18 Federal election, from May 20 to June 6.
- In Q1, the Actual Composite declined to 61.7 from 62.9 in December, extending the loss of momentum evident from around mid-2018. The Composite is supported by rising new orders, albeit at a slower pace, output, and order backlog.
- Confidence softened early in 2019, ahead of the election.
- Cross currents are impacting the sector. Negatives are around the housing downturn and spill-over effects from severe drought in NSW and Qld. Positives are the boost from the lower dollar and from the upswing in public infrastructure investment.

Aus Westpac-AusChamber Composite indexes



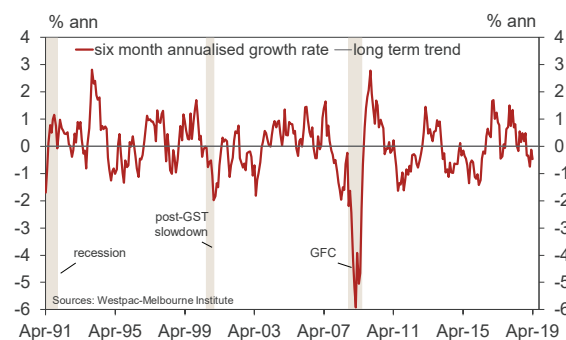
The week ahead

Aus May Westpac-MI Leading Index

Jun 19, Last: -0.47%

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, declined from -0.13% in March to -0.47% in April. The monthly move was mainly due to an unwinding spike in dwelling approvals, which fell 15% after a 19% jump the previous month. The underlying picture has been consistently negative over the last five months, a clear signal that economic growth through the three quarters of 2019 is likely to be below trend.
- The May update should show a similar story. Component updates will include slight positives around the ASX200 (up 1.1%) and commodity prices, up 2.5% (in AUD terms) but negatives across all other components.

Aus Westpac-MI Leading Index

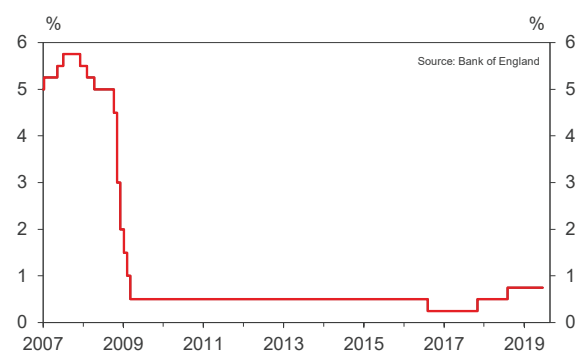


UK Bank of England Bank rate

June 20, Last: 0.75%, WBC f/c: 0.75%, Mkt f/c: 0.75%

- The Bank of England left the bank rate on hold in May, but maintained its very modest (and Brexit dependent) tightening bias.
- We expect that the Bank Rate will again be left on hold at the June meeting. However, there is some risk that the BOE's rhetoric in the accompanying statement will become more hawkish. The recent weakness in the GBP will boost near term inflation. There have also been hawkish comments from several MPC members despite Brexit related headwinds and related softness in real activity.
- We remain circumspect about the strength of inflation pressures and expect an extended period of subdued GDP growth. As a result, we expect the BOE to remain on hold for the foreseeable future.

Bank of England Bank Rate

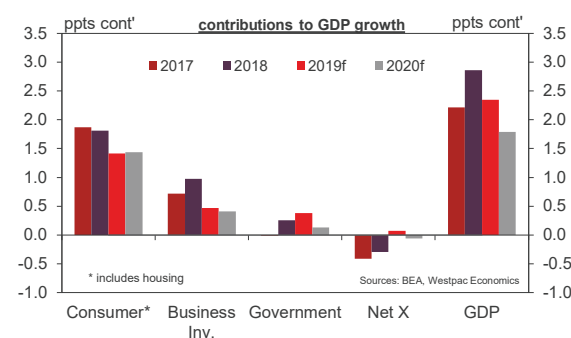


US June FOMC meeting

Jun 18-19, last 2.375%, WBC 2.375%

- Market participants clearly believe there is a need for the FOMC to respond to global uncertainty, and to do so quickly. Between now and November 2020, four cuts are priced in, with the first to come (on the market's expectation) in July.
- To occur, a material shift in FOMC communication has to be seen at the June meeting. Not only does the median Fed Funds rate expectation for 2020 and beyond have to shift from a hike to cuts, but the Committee's growth and inflation forecasts will have to be marked down materially.
- While mindful of the risks, we believe the Committee will limit the scale of the revisions to its forecasts. We do anticipate rate cuts, but only two rather than the market's four, and not until September (then December).

US GDP components

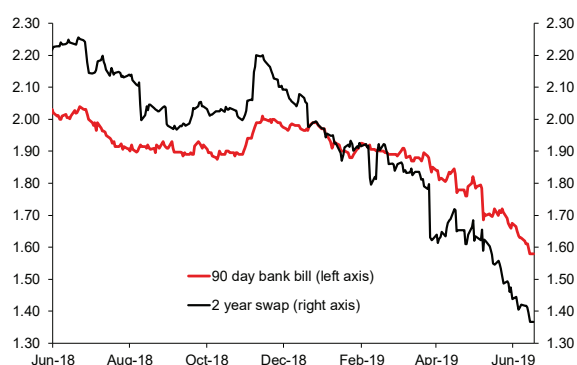


New Zealand forecasts

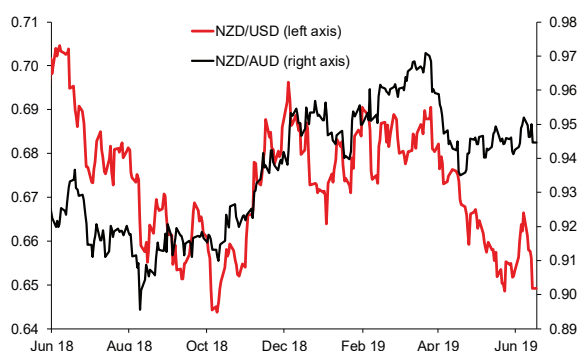
Economic Forecasts	Quarterly				Annual			
	2018	2019						
% change	Dec (a)	Mar	Jun	Sep	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.6	0.6	0.7	2.8	2.5	3.1	2.4
Employment	0.0	-0.2	0.8	0.3	2.3	1.3	2.0	1.8
Unemployment Rate % s.a.	4.3	4.2	4.3	4.3	4.3	4.2	3.9	3.7
CPI	0.1	0.1	0.6	0.6	1.9	1.7	1.9	2.1
Current 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 17 June 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.50%	1.50%
30 Days	1.64%	1.66%	1.69%
60 Days	1.60%	1.66%	1.70%
90 Days	1.58%	1.67%	1.72%
2 Year Swap	1.37%	1.45%	1.55%
5 Year Swap	1.48%	1.56%	1.67%

NZ foreign currency mid-rates as at 17 June 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6492	0.6603	0.6534
NZD/EUR	0.5793	0.5865	0.5855
NZD/GBP	0.5154	0.5210	0.5128
NZD/JPY	70.44	71.25	72.02
NZD/AUD	0.9447	0.9459	0.9438
TWI	71.83	72.62	72.33

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 17					
NZ	May BusinessNZ PSI	51.8	-	-	Businesses continue to note a range of headwinds.
UK	Jun Rightmove house prices	0.9%	-	-	While still soft, the housing market has stabilised recently.
US	Jun Fed Empire state index	17.8	12.0	-	Manufacturing coming under greater pressure.
	Jun NAHB housing market index	66	67	-	Housing market supported by job gains and low rates.
	Apr total net TIC flows	-8.1	-	-	Treasuries remain in demand despite decline in rates.
Tue 18					
NZ	Q2 WBC MM Consumer Confidence	103.8	-	-	The March survey recorded a widespread drop in confidence.
Aus	Q2 AusChamber-Westpac survey	61.8	-	-	Manufacturing conditions, a loss of momentum from mid-2018.
	RBA minutes	-	-	-	Colour re June rate cut decision & prospect for further cuts.
	RBA Kearns speaks	-	-	-	Head of Financial Stability in Canberra, 9:15 am.
Chn	May new home prices	0.6%	-	-	Strong momentum in tier 2 and 3.
Eur	May core CPI %yr	0.8%	-	-	Fell back sharply post Easter boost.
	Jun ZEW survey of expectations	-1.6	-	-	Has stabilised but heightened trade disputes likely to weigh.
US	May housing starts	5.7%	0.4%	-	Stabilisation evident in residential construction...
	May building permits	0.2%	0.8%	-	... though future growth likely to be modest.
Wed 19					
NZ	GlobalDairyTrade auction	-3.4%	-	-	Recent softness related to fats prices.
	Q1 current account % of GDP	-3.7%	-3.5%	-3.7%	Stronger dairy exports but weaker tourism.
Aus	May Westpac-MI Leading Index	-0.47%	-	-	A negative read, pointing to sub-trend growth in coming qtrs.
UK	May CPI	0.6%	-	-	Core well contained, just below 2%.
US	FOMC policy decision, midpoint	2.375%	2.375%	2.375%	Forecasts and tone of press conference key.
Thu 20					
NZ	Q1 GDP	0.6%	0.6%	0.6%	Construction surge enlivened an otherwise subdued quarter.
Aus	RBA Governor Lowe speaks	-	-	-	"The labour market & spare capacity", Adelaide, 11:15 AEST
	RBA Bulletin	-	-	-	RBA research articles.
Eur	Jun consumer confidence advance	-6.5	-	-	Has been stabilising. Robust labour market a support.
	EU Summit	-	-	-	Key decisions to be made on EU Commission leadership.
	ECB bulletin	-	-	-	ECB research articles.
UK	May retail sales	-0.2%	-	-	Retailers have been reporting softness in demand.
	BoE policy decision	0.75%	0.75%	0.75%	Risk that the BOE's rhetoric becomes more hawkish.
	BOE Gov Carney speaking	-	-	-	Annual Mansion speech, text to be released.
US	Jun Philly Fed index	16.6	10.0	-	Manufacturing coming under greater pressure.
	Initial jobless claims	-	-	-	Still very low.
	May leading index	0.2%	0.1%	-	Pointing to growth around trend.
	Fedspeak	-	-	-	Fed Listens Event with Brainard and Mester.
	Fedspeak	-	-	-	Daly holds podcast on 'community economics'.
Fri 21					
Eur	Jun Markit manuf. PMI flash	47.7	-	-	Weakness has persisted...
	Jun Markit services PMI flash	52.9	-	-	... while services has so far been resilient.
UK	May public sector borrowing £bn	-7.1	-	-	Borrowing has been lower than expected.
US	Jun Markit manuf. PMI flash	50.5	-	-	Manufacturing is clearly coming under greater pressure...
	Jun Markit services PMI flash	50.9	-	-	... services a little more resilient given domestic demand.
	May existing home sales	-0.4%	1.4%	-	Supply remains a material headwind for existing sales.

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	2.4
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	-0.2	-1.1
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.3	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
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 11 June 2019

Interest Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Australia							
Cash	1.25	1.00	0.75	0.75	0.75	0.75	0.75
90 Day BBSW	1.30	1.25	1.00	1.00	1.00	1.00	1.00
10 Year Bond	1.38	1.40	1.40	1.45	1.60	1.70	1.75
International							
Fed Funds	2.375	2.125	1.875	1.875	1.875	1.875	1.875
US 10 Year Bond	2.09	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	1.50	1.50	1.50	1.50	1.50	1.50	1.50
USD/JPY	1.58	1.65	1.65	1.65	1.65	1.65	1.65
EUR/USD	1.38	1.55	1.60	1.65	1.70	1.75	1.80
GBP/USD	1.66	1.65	1.70	1.75	1.85	1.95	2.00
AUD/NZD	-43	-45	-35	-35	-35	-30	-30

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