



Len Lye Centre, New Plymouth

# Weekly Economic Commentary.

## Line call.

Last week the Reserve Bank surprised markets (again) by keeping the Official Cash Rate on hold at its November policy meeting. Ahead of the announcement, markets had priced in a roughly 80% chance of a cut, and following the announcement, swap rates rose by 20 bps. That's a large increase which, if sustained, could see fixed mortgage rates creeping higher over the coming weeks. However, that may have been too large a response for the RBNZ's liking. Following the decision, several RBNZ speakers, including Governor Orr have emphasised that another cut is still a possibility.

While financial markets were stunned by the RBNZ's decision, we were not surprised. On October 31 we predicted no change in the OCR, even though financial markets were pricing almost a 100% chance of a cut and all other economists were forecasting a cut. We pointed out that the Reserve Bank had never signalled a November cut, and the run of data since then had been neutral overall. While GDP growth was shaping up weaker than the RBNZ expected, this was offset by a lower exchange rate, an upside surprise on inflation, and a general calming in global financial market sentiment. However, we also noted that inflation expectations were important to the RBNZ, and crucial information on that front would print the day before the *MPS*. That inflation expectations data

turned out weak, so we switched our call back to a cut while recognising that this was still a very close call.

On the day, however, the RBNZ decided that they weren't over the line at this stage. The large amount of monetary stimulus they have introduced over the past year, along with signs of a nascent recovery in economic activity, meant that they felt like they had time to watch how the economy was tracking. The RBNZ is still open to another cut if required, and their updated cash rate forecasts still settle at 0.9% (again, pointing to a roughly 50/50 chance of another cut). But the RBNZ is watching the data to decide if this is needed, and they will need to be surprised on the downside to prompt a cut.



We do think that the balance of developments will be weaker than the RBNZ expects, so we are calling a February cut. However, it is a close call and we will update our forecast as new information comes to light.

Both we and the RBNZ expect September quarter GDP to be weak, but forward looking data to suggest a significant upturn in GDP growth ahead. If that is the way things turn out, it won't influence the odds of a February cut either way.

The RBNZ are also likely to be surprised to the upside by the strength of the housing market. In fact, just this week the REINZ told us that we've had a third consecutive month of very strong house sales and house prices. Our forecast of 7% house price inflation is well in train to come good, potentially earlier than we thought. In contrast, the RBNZ thinks the current strength in the housing market will be short lived.

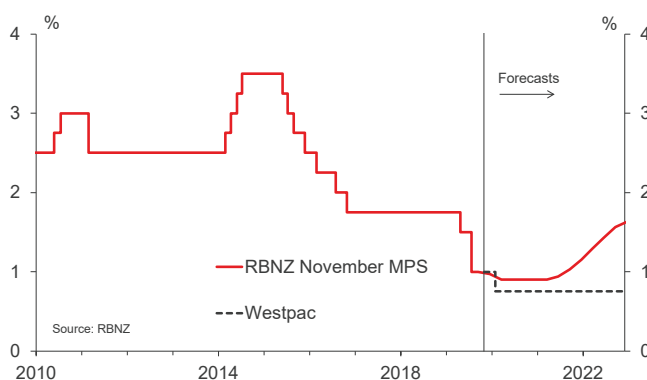
But there are also some important areas where we think the RBNZ will be surprised on the downside. The first is the global economy. While nervousness about trade wars and Brexit has eased in recent weeks and financial markets sentiment is currently on the up, we doubt that this will be sustained. The coming year is likely to see renewed nervousness on the global outlook (especially in relation to trade disputes), as well as weaker activity in the worlds two largest economies – the US and China. And we definitely cannot rule out the chance of an unexpected Presidential tweetstorm that dents financial market sentiment.

It's also important to remember that the RBNZ will be announcing the details of its revised bank capital requirements in December. The RBNZ will require banks to increase their capital levels significantly over the next few years. This will affect the cost and availability of credit, with a gradual tightening on both fronts. Those changes will also affect the make-up of the New Zealand economy, with businesses and agricultural producers in particular likely to find it tougher to access credit.

This change in New Zealand's financial architecture has been in the works for some time, but the RBNZ's monetary policy arm has been waiting for the details to be finalised before this is incorporated into their forecasts. As this change will be implemented over a number of years, it's more likely to delay future OCR hikes, rather than prompting a near term cut. Nevertheless, this is a further downside consideration for the RBNZ as the February rate decision comes into view.

Putting that all together, February is looking like another close call. However, we think that the RBNZ will cut the cash rate again. We expect that 0.75% will be the low point for the OCR in this cycle. But with lingering softness in imported inflation and concerns about inflation expectations, the RBNZ will be in no rush to hike. After February, we expect the OCR to remain on hold for several years.

### RBNZ and Westpac Official Cash Rate forecasts



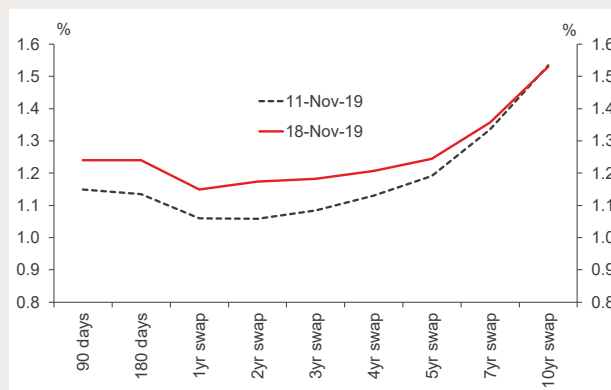
## Fixed vs Floating for mortgages.

Now is a good time to take a fixed mortgage. Fixed mortgage rates have tumbled over the past six months, but they will not go lower any time soon because the Reserve Bank has paused its series of OCR reductions.

Among the fixed rates on offer, we think the best value is in the one- and two-year rates. Longer-term rates are high relative to where we think future short-term rates will go. 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



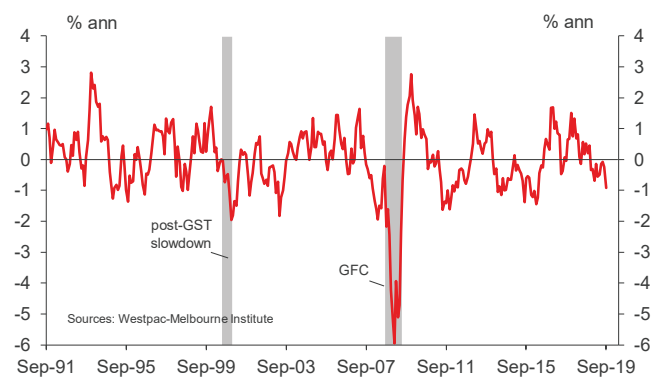
# The week ahead.

## Aus Oct Westpac-MI Leading Index

**Nov 20, Last: -0.92%**

- The Leading Index growth rate fell more materially below trend in September, to -0.92% from -0.24% in August. The signal indicates growth is likely to remain below trend through the first half of 2020.
- The October update looks likely to see another weak read. It will include softer component updates for the ASX200; the Westpac-MI Unemployment Expectations Index and total hours worked. It will also see more weak reads on US industrial production and commodity prices (-2% in AUD terms vs -3.7% last month). These will be partially offset by firmer reads for the Westpac-MI Consumer Expectations Index, dwelling approvals and a widening yield spread.

## Westpac-MI Leading Index

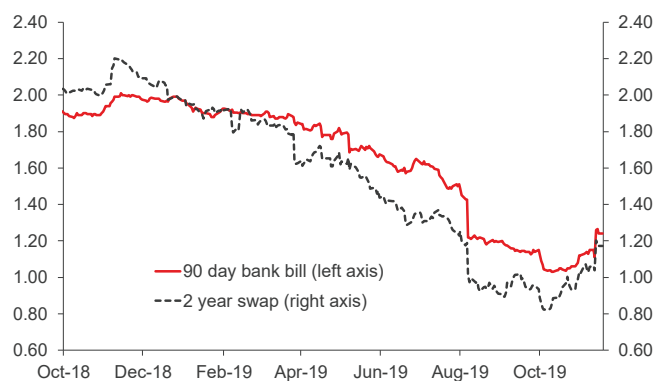


# New Zealand forecasts.

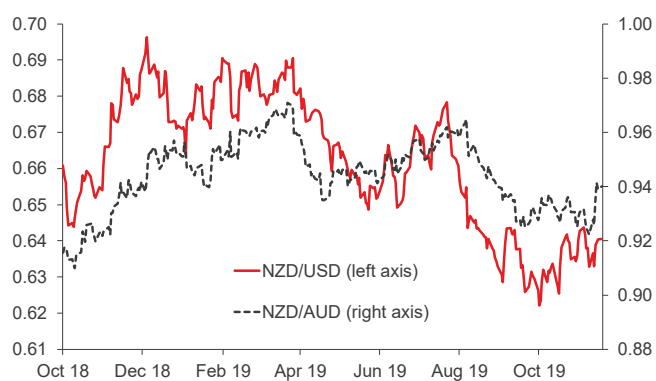
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019f	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	0.5	0.3	0.5	0.6	2.8	2.2	2.3	2.8
Employment	0.6	0.2	0.4	0.3	1.9	1.2	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.4	4.3	4.3	4.2	3.9
CPI	0.6	0.7	0.3	0.5	1.9	1.7	1.7	1.8
Current Account Balance % of GDP	-3.4	-3.4	-3.2	-3.2	-3.9	-3.2	-3.0	-2.8

Financial forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Cash	1.00	0.75	0.75	0.75	0.75	0.75
90 Day bill	1.10	0.90	0.90	0.90	0.90	0.90
2 Year Swap	1.10	1.00	1.00	1.00	1.00	1.00
5 Year Swap	1.20	1.10	1.15	1.20	1.25	1.30
10 Year Bond	1.35	1.20	1.20	1.20	1.25	1.35
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	68.0	66.3	65.7	66.2	66.2	67.8
NZD/EUR	0.58	0.57	0.56	0.57	0.56	0.57
NZD/GBP	0.49	0.47	0.47	0.48	0.48	0.49
TWI	70.5	69.5	69.2	69.6	69.3	69.9

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 18 November 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.23%	1.13%	1.14%
60 Days	1.24%	1.13%	1.10%
90 Days	1.24%	1.12%	1.05%
2 Year Swap	1.17%	1.02%	0.94%
5 Year Swap	1.24%	1.09%	1.02%

NZ foreign currency mid-rates as at 18 November 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6406	0.6427	0.6379
NZD/EUR	0.5795	0.5760	0.5723
NZD/GBP	0.4962	0.4974	0.4938
NZD/JPY	69.71	69.59	69.22
NZD/AUD	0.9401	0.9295	0.9317
TWI	70.96	71.02	70.71

## Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 18</b>					
NZ	Oct BusinessNZ PSI	54.4	-	-	Business conditions have remained weak in late 2019.
UK	Nov Rightmove house prices	0.6%	-	-	Stabilised around flat annual growth.
US	Nov NAHB housing market index	71	71	-	Low rates and a strong labour market supporting housing.
	Fedspeak	-	-	-	Mester at University of Maryland.
<b>Tue 19</b>					
Aus	RBA Assistant Gov. Kent speaks	-	-	-	At the Australian Securitisation Forum, 9:05am.
	RBA minutes	-	-	-	Tone in focus.
	Treasurer Frydenberg speech	-	-	-	CEDA Annual dinner address.
US	Sep total net TIC flows \$bn	70.5	-	-	Long-term bond flows.
	Oct housing starts	-9.4%	4.9%	-	New construction continues to mark time overall...
	Oct building permits	-2.4%	-0.7%	-	... though a modest uptrend is likely to assert in time.
	Fedspeak	-	-	-	Williams at SIFMA conference.
<b>Wed 20</b>					
NZ	GlobalDairyTrade auction	3.7%	-	-	Futures prices point to a moderate lift in prices.
Aus	Oct Westpac-MI Leading Index	-0.92%	-	-	Suggests continued below trend growth.
US	FOMC minutes	-	-	-	Discussion of risks to be the focus.
<b>Thu 21</b>					
Eur	Nov consumer confidence	-7.6	-7.4	-	Still above average on tighter labour market.
	ECB minutes	-	-	-	How high is the barrier to further easing?
UK	Oct public sector borrowing £bn	8.7	8.6	-	Deficit proving to be higher than last year.
US	Nov Philly Fed index	5.6	6.5	-	Regional surveys remain volatile.
	Initial jobless claims	225k	-	-	Lifted last week, but remain historically low.
	Oct leading index	-0.1%	-0.1%	-	Points to growth around trend.
	Oct existing home sales	-2.2%	2.1%	-	Supply remains the primary issue for existing homes.
	Fedspeak	-	-	-	Mester at fin. stability conference, Kashkari in Bloomington.
Int	OECD Economic Outlook	-	-	-	Likely to follow IMF in downgrading growth.
<b>Fri 22</b>					
Eur	Nov Markit manuf. PMI flash	45.9	46.4	-	Contraction is led by Germany...
	Nov Markit services PMI flash	52.2	52.5	-	... services expansion moderated but still well above water.
	ECB President Lagarde speaks	-	-	-	In Frankfurt alongside Bundesbank President Weidmann.
US	Nov Markit manuf. PMI flash	51.3	51.5	-	Signs of stabilisation are being seen in manufacturing.
	Nov Markit services PMI flash	51.0	51.2	-	Services however will remain at risk.
	Nov Uni. of Michigan sentiment	95.7	95.7	-	Sentiment still positive. Consumers a little wary of outlook.
	Nov Kansas City Fed index	-3	-2	-	Regional surveys remain volatile.

## International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
<b>Australia</b>						
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	1.9
Unemployment %	5.7	5.5	5.0	5.3	5.6	5.3
Current Account % GDP	-3.1	-2.6	-2.1	0.6	-0.5	-1.8
<b>United States</b>						
Real GDP %yr	1.6	2.4	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	3.8	3.6	3.6	3.8
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
<b>Japan</b>						
Real GDP %yr	0.6	1.9	0.8	0.8	0.2	0.4
<b>Euro zone</b>						
Real GDP %yr	1.9	2.5	1.9	1.2	1.0	1.2
<b>United Kingdom</b>						
Real GDP %yr	1.8	1.8	1.4	1.3	0.8	1.1
<b>China</b>						
Real GDP %yr	6.7	6.8	6.6	6.1	5.8	5.8
<b>East Asia ex China</b>						
Real GDP %yr	4.0	4.5	4.3	3.6	3.7	3.9
<b>World</b>						
Real GDP %yr	3.4	3.8	3.6	3.0	3.0	3.2

Forecasts finalised 8 November 2019

Interest rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Jun-21	Dec-21
<b>Australia</b>								
Cash	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50
90 Day BBSW	0.89	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	1.16	1.10	0.90	0.90	1.00	1.10	1.30	1.50
<b>International</b>								
Fed Funds	1.625	1.625	1.375	1.125	0.875	0.875	0.875	0.875
US 10 Year Bond	1.84	1.70	1.50	1.45	1.40	1.50	1.60	1.80
ECB Deposit Rate	-0.50	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60

Exchange rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Jun-21	Dec-21
AUD/USD	0.6795	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	108.63	108	107	106	105	105	107	109
EUR/USD	1.1029	1.09	1.09	1.10	1.11	1.12	1.14	1.15
GBP/USD	1.2884	1.30	1.33	1.32	1.32	1.31	1.31	1.32
USD/CNY	7.0066	7.10	7.10	7.05	6.95	6.90	6.75	6.60
AUD/NZD	1.0631	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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