Weekly Commentary

18 March 2019

Larnach Castle, Dunedin

Slow GDP growth expected

This week we should get confirmation of the slowdown in growth in the second half of 2018 with the release of December quarter GDP data. Our view is that this slowdown will prove temporary, with momentum set to improve in 2019, supported by high government spending, a strong pipeline of construction work, and a lift in labour incomes. On balance, data released last week tended to support that view.

We expect this week's report will show that GDP grew just 0.3% in the December quarter, after an equally modest gain in September. Our forecast is at the lower end of market expectations, and is significantly below the 0.8% GDP growth the RBNZ forecast in its February Monetary Policy Statement. If we're right that would see annual GDP growth fall to 2.7%, down from 3.1% in 2017 and 3.9% in 2016.

Some of the softness in growth in the December quarter is genuine. Importantly, the December Quarterly Employment Survey indicated less activity was taking place in the business and personal services sectors. But this weakness was also exacerbated by some temporary disruptions in the energy sector. Output from the Pohokura gas field was again interrupted this quarter (which will have a flow-on effect on methanol production). Meanwhile low hydro lake levels will directly weigh on electricity production with flow-on effects of a subsequent lift in electricity prices to reduce demand from manufacturers.

Brighter spots in this week's GDP data are likely to include a strong lift in retail spending (after a subdued September quarter), a pickup in residential and commercial construction activity and increased spending on government services.

The big question is whether the late-2018 loss of momentum will continue into 2019. We think not. We expect GDP growth to recover.

A core component of this view is that consumer spending will strengthen in 2019 as petrol prices remain relatively flat and households benefit from rising wages and range of new assistance measures from the Government. Last week's retail card spending was supportive of the view. Data showed a healthy 0.9% lift in card core spending in the month (which excludes spending on fuel and autos), bringing the annual growth to 5.1%. After some unusual volatility in this measure in recent months (largely related to durable spending) February data signaled a return to the pace of growth in retail spending that was prevailing before the sharp lift in oil prices put a brake on other retail spending late last year.

Other data we've seen in recent weeks which support a brighter outlook for 2019 include a more positive outlook for export earnings thanks to rising dairy prices and a jump in the number of residential building consents issued.

In contrast, there was mixed support for our view from last week's housing data. February REINZ data did show nationwide house price inflation accelerating over the New Year, as we expected. Nationwide house prices rose around 0.7% in February and were up 1.3% over the summer as a whole (December through to February). This was a step up from the pace of house price inflation in the spring months. However, it looks increasingly like this 'summer fling' will prove brief.

Slow GDP growth expected continued

The number of house sales provides one of the best short-term leads on house prices, and took another big step down in February. Seasonally adjusted house sales fell 5.8% in the month. REINZ data understates the number of house sales in its initial release, but even if the true fall in house sales was closer to 4%, it comes on top of several months where house sales have been trending lower. The drop in turnover has been particularly stark in Northland, Auckland and Waikato, suggesting that the north of the country in particular is about to experience further house price weakness. In Auckland, the drop in sales has not been matched by a drop in listings, meaning a surplus of unsold homes on the market. Realestate.co.nz reports there are currently 9,400 unsold homes on the market in Auckland, up 50% on three years ago. What's more, homes are taking longer to sell. Nationwide the average time to sell has risen to 40 days, up from 37.5 a year ago.

Putting it all together, and it looks like house price inflation will fall a bit short of the 3% we had been expecting in 2019. Given how closely house prices and consumer spending are entwined, there's a risk of a small knock on effect for consumer spending, although clearly house prices are not the only factor at play when it comes to determining how far households decide to open their wallets.

One reason we expect stronger momentum in the economy in 2019 to prove temporary is the outlook for slowing population growth in the coming years. But getting a clear idea of how net migration flows (which are the key swing factor determining changes in the pace of population growth) are evolving has been challenging to say the least.

The February data confirmed that net migration numbers have become something of a lottery under Stats NZ's new methodology. This week's data suggested monthly net migration has shot up from under 5,000 to above 6,000 in the past two months, largely due to arrivals of French and German migrants. We find this very hard to believe. More likely, Stats NZ's new methodology is introducing volatility to the series.

For now, our view remains that annual net migration flows will continue to ease. At face value recent migration data challenges our assessment of the pace of this slowdown. But with such wild swings in the data being reported, we're reluctant to go very far down this path until we have a clearer understanding of just what's going on.

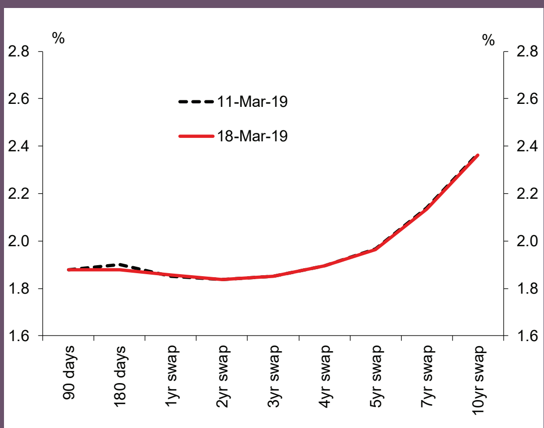
Fixed vs Floating for mortgages

We expect retail fixed mortgage rates to remain relatively steady in the near term. Wholesale rates are steady, and the Reserve Bank has no plans to change the OCR.

One-year fixed rates are currently the lowest on offer, and appear to offer good value to borrowers. However, longer-term rates offer security against the possibility of mortgage rates rising more rapidly than expected in the future.

Floating mortgage rates usually work out to be more expensive for borrowers than fixed rates. However, floating may still be the preferred option for those who require flexibility in their repayments.

NZ interest rates



The week ahead

NZ Q1 Westpac McDermott Miller Consumer Confidence

Mar 19, Last: 109.1

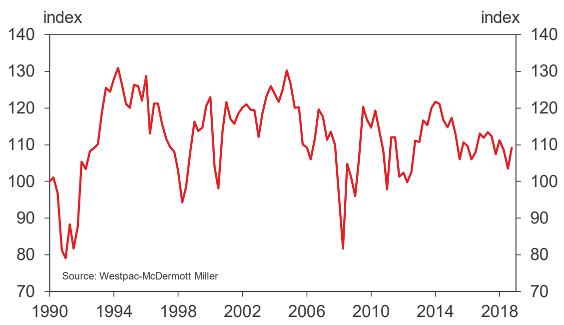
- Consumer confidence picked up in December, shaking off its mid-year slump. That was supported by the fall in fuel prices in late 2018, along with signs the housing market was firming in some parts of the country. December's gains in confidence were widespread across regions, age brackets and income groups.
- Since the time of the last survey, we've seen downward pressure on interest rates and an easing in mortgage lending restrictions. There's also been an increased focus on tax policy, including the possible introduction of a capital gains tax, following the release of the Tax Working Group's final report in February.

NZ Q4 current account % of GDP

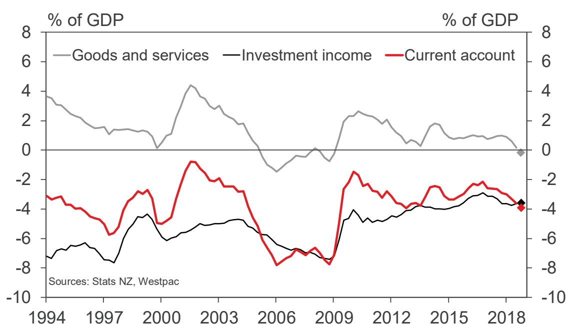
Mar 20, Last: -3.6%, WBC f/c: -3.9%, Mkt f/c: -3.9%

- We expect the annual deficit to widen further from 3.6% to 3.9% of GDP. This would match the deficit in the December 2012 quarter, which in turn was the largest since the GFC.
- The widening in the deficit has been driven by the goods trade balance. The terms of trade fell over 2018 as dairy export prices fell and oil import prices rose (though both of those have turned around in the early part of this year). In addition, import volumes have remained surprisingly high relative to domestic demand.
- In contrast, there has been little change in the investment income deficit, with profits of overseas-owned firms and interest costs on overseas debt broadly flat over the last year.

Westpac-McDermott Miller consumer confidence



Annual current account balance



NZ Q4 GDP

Mar 21, Last: 0.3%, WBC f/c: 0.3%, Mkt f/c: 0.6%

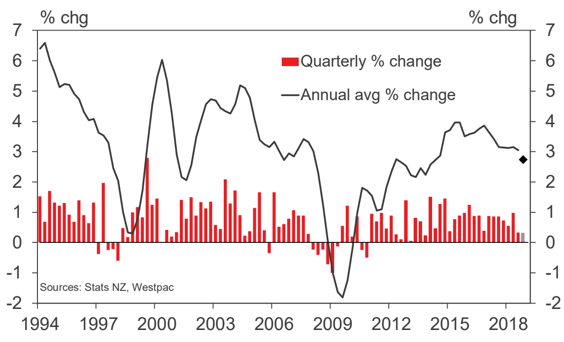
- We expect just a 0.3% rise in GDP for the December quarter, following an equally soft gain in the September quarter. Our forecast is at the bottom of the range of market forecasts, and substantially below the RBNZ's forecast of 0.8%.
- There does seem to have been some genuine loss of momentum in the second half of last year. However, in the December quarter this was exacerbated by some temporary disruptions to gas and electricity supplies.
- Consumer spending and construction are likely to be the highlights for the quarter, in contrast with the housing-led slowdown in these components in Australia.

Aus Q1 AusChamber-Westpac business survey

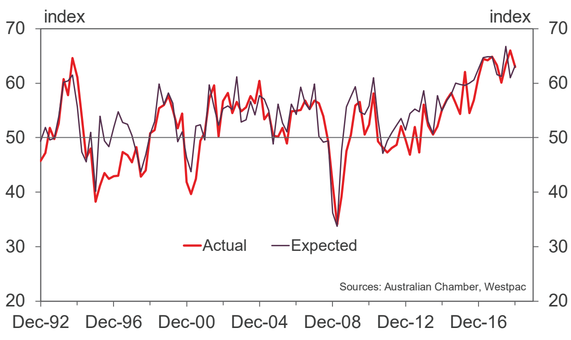
Mar 19, Last: 63.1

- The Australian Chamber-Westpac survey of the manufacturing sector provides a timely update on conditions in the sector and insights into economy-wide trends. The Actual Composite tracks a range of demand related measures including investment and employment. The Q1 survey was conducted from February to March.
- In Q4, the Actual Composite declined to 63.1 from 66.5 in September. The Composite is supported by new orders, output employment and order backlog.
- Manufacturing is benefitting from a rise in public infrastructure and a relatively low AUD. However, home building activity is now in a downturn and there are likely to be spill-over effects from the drought in NSW and Queensland.

Production-based GDP



Westpac-AusChamber Composite indexes



The week ahead

Aus Feb Westpac–MI Leading Index

Mar 20, Last: –0.43%

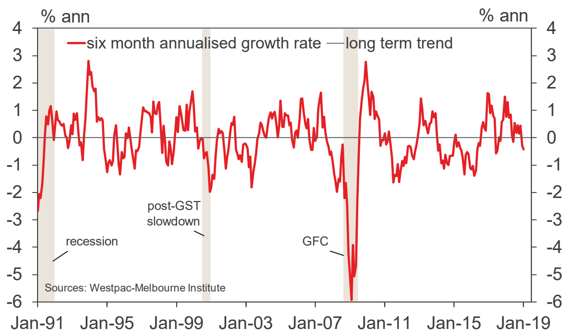
- The six month annualised growth rate in the Westpac–Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, fell to –0.43% in January. Despite some choppiness, the major trend is consistent with growth slowing to a below trend pace.
- The Feb read will include a mixed bag of component updates. Positives include strong gains for the sharemarket (ASX200 up 5.2% vs 3.9% last month) and commodity prices (up 4.6% in AUD terms vs 3.9% last month); and a small recovery in dwelling approvals. The main negatives are around sentiment, with the Westpac-MI Consumer Expectations Index down -6.1% and the Westpac-MI Unemployment Expectations Index deteriorating 8.9%. The balance is likely to see another soft read.

Aus Feb Labour Force Survey - employment '000

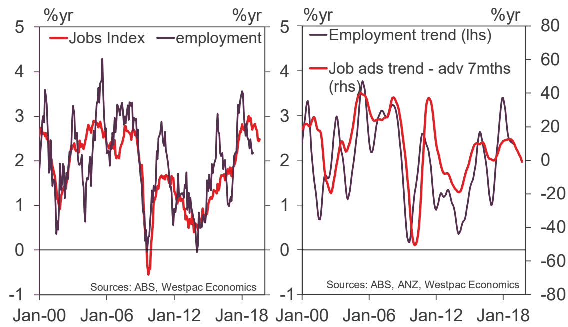
Mar 21, Last: 31.9k, WBC f/c: –5k
Mkt f/c: 15k, Range: -5k to 30k

- Total employment lifted a solid 39.1k in January, well clear of the market median of 15k. While it is just one month into the year, employment has gained 271k in the year to January (2.2%yr) with a very solid 2.9%yr six month annualised pace. There is, however, an important caveat – January is the peak holiday month in Australia as Christmas, New Year and school summer vacation all come together. Little business happens in Australia at this time.
- The leading indicators are softening but they are not pointing to a collapse in employment (at this stage). We believe that employment growth is set to stall through the first half of 2019 but our –5k forecast for February is more about monthly volatility than the start of a new trend.

Westpac-MI Leading Index



Leading indicators of employment



Aus Feb Labour Force Survey - unemployment %

Mar 21, Last: 5.0%, WBC f/c: 5.1%
Mkt f/c: 5.0%, Range: 4.9% to 5.1%

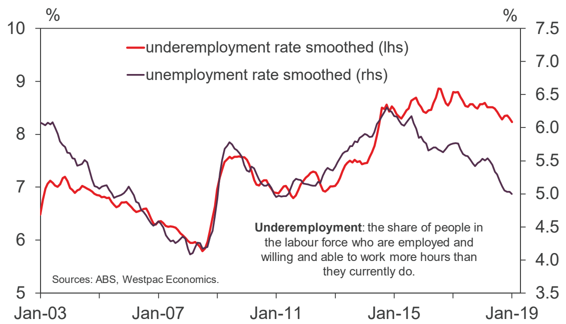
- Despite the strong gain in employment, the unemployment rate was flat in January at 5.0% (market median was for 5.0%) as a 0.1ppt lift in the participation rate to 65.7% (65.72% at two decimal places) boosted the gain in the labour force by 45.7k.
- It is also worth noting that 2018 produced a –0.2ppt decline in the underemployment rate from Q1 to Q4. In January there was a further improvement in underemployment to 8.2% (from 8.3%) the lowest print in underemployment since March 2015. Again, we would caution that this is a January print so would not project that this improvement can be sustained but nevertheless, it is another indicator of just how robust the labour market was through 2018.
- Holding the participation rate flat at 65.7%, our forecast for a –5k fall in employment will see the unemployment rate tick up to 5.1%.

UK Bank of England Bank Rate

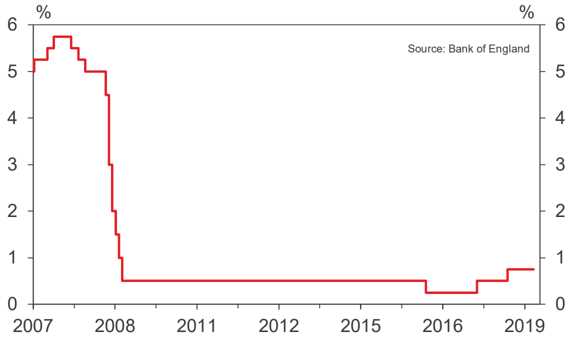
Mar 21, Last: 0.75%, WBC f/c: 0.75%, Mkt f/c: 0.75%

- In February, the BOE left the Bank rate unchanged and maintained its very mild tightening bias. However, the assumed tightening was contingent on economic conditions following the UK's exit from the EU, and the BOE noted that Brexit related uncertainty had intensified.
- Since the BOE's last update, economic activity has remained middling. Importantly, there's been no real progress on Brexit negotiations. Parliament intends to seek an extension to the negotiation period, but for businesses this means the continuation of the economic uncertainty that has been a significant drag on investment plans. Against this backdrop, there's no chance of a change in the Bank Rate this month, and the BOE will emphasise the conditionality of its forecasts.

Unemployment & underemployment



Bank of England Bank Rate



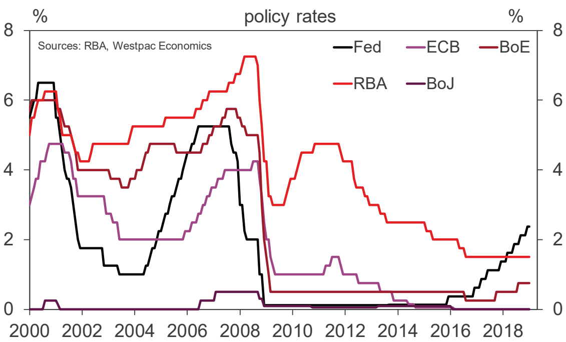
The week ahead

US Mar FOMC meeting

Mar 19–20, Last: 2.375%, WBC f/c: 2.375%

- The FOMC's March meeting will not only provide an updated qualitative assessment of the outlook, but also the first set of revised quantitative economic forecasts since the Committee's collective dovish turn at the start of this year. With data since decidedly mixed in tone, growth and inflation forecasts are under pressure. That said, the scale of downward revisions is unlikely to be significant. Growth at or above trend in 2019 is still the most appropriate core expectation to hold for the US.
- The market's primary focus will be the FOMC's Committee estimates of the fed funds rate over the forecast period (i.e. 'The dot plot'). A downward revision has to be expected. But, given the strength of the labour market, some probability of a hike will remain. We continue to forecast one more hike in December 2019.

Rate differential to aid USD

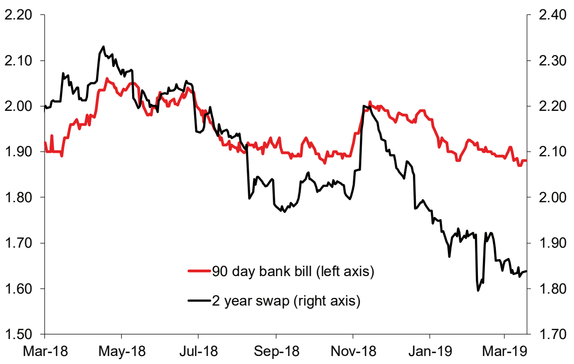


New Zealand forecasts

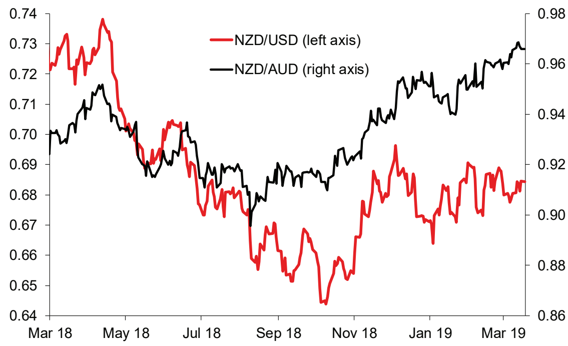
Economic Forecasts	Quarterly				Annual			
	2018		2019					
% change	Sep (a)	Dec	Mar	Jun	2017	2018f	2019f	2020f
GDP (Production)	0.3	0.3	0.8	0.8	3.1	2.7	2.7	2.8
Employment	1.1	0.1	0.2	0.3	3.7	2.3	1.1	1.7
Unemployment Rate % s.a.	4.0	4.3	4.4	4.3	4.5	4.3	4.2	4.0
CPI	0.9	0.1	0.2	0.5	1.6	1.9	1.8	2.1
Current Account Balance % of GDP	-3.6	-3.9	-3.6	-3.5	-2.9	-3.9	-3.2	-3.0

Financial Forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.90	1.90	1.90
2 Year Swap	1.90	1.90	1.90	1.95	2.00	2.05
5 Year Swap	2.10	2.10	2.15	2.20	2.25	2.30
10 Year Bond	2.20	2.20	2.25	2.30	2.30	2.35
NZD/USD	0.68	0.67	0.65	0.65	0.65	0.65
NZD/AUD	0.96	0.96	0.96	0.96	0.94	0.94
NZD/JPY	74.8	74.4	73.5	72.8	72.2	71.5
NZD/EUR	0.60	0.60	0.59	0.59	0.59	0.57
NZD/GBP	0.54	0.52	0.50	0.49	0.49	0.49
TWI	74.5	74.1	72.4	72.1	71.2	70.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 18 March 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.86%	1.85%	1.85%
60 Days	1.87%	1.88%	1.88%
90 Days	1.88%	1.89%	1.90%
2 Year Swap	1.84%	1.86%	1.90%
5 Year Swap	1.97%	2.04%	2.08%

NZ foreign currency mid-rates as at 18 March 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6844	0.6809	0.6860
NZD/EUR	0.6044	0.5980	0.6074
NZD/GBP	0.5147	0.5136	0.5308
NZD/JPY	76.30	76.14	75.77
NZD/AUD	0.9659	0.9598	0.9610
TWI	74.41	73.99	74.64

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Feb BusinessNZ PSI	56.3	–	–	Has picked up. Business gauges generally remain modest.
Eur	Jan trade balance €bn	15.6	–	–	Surplus has trended down. Back to 2014 levels.
UK	Mar Rightmove house prices	0.7%	–	–	Lingering Brexit uncertainty a significant drag.
US	Mar NAHB housing market index	62	63	–	Lower interest rates to aid sentiment.
Tue 19					
NZ	Q1 Westpac–MM Consumer Conf.	109.1	–	–	Q4 saw confidence rising back to average levels.
Aus	Q1 AusChamber–Westpac survey	63.1	–	–	Survey on manufacturing conditions.
	RBA Assist Gov Financial Markets	–	–	–	Chris Kent, "Bonds and Benchmarks", Sydney 9am
	RBA minutes	–	–	–	Further colour on the Board's view.
Eur	Mar ZEW survey of expectations	–16.6	–	–	Still soft. Brexit "no–deal" rejection to have impact?
UK	Jan ILO unemployment rate	4.0%	–	–	Job growth resilent despite concerns around the outlook.
US	Jan factory orders	0.1%	0.0%	–	Underlying trend for investment subdued.
Wed 20					
NZ	GlobalDairyTrade auction	3.3%	–	–	Fonterra forecasting less milk, but dry conditions easing.
	Q4 current account % of GDP	–3.6%	–3.9%	–3.9%	Declining terms of trade, high import volumes over last year.
Aus	Feb Westpac–MI Leading Index	–0.43%	–	–	Consistent with growth below trend.
UK	Feb CPI	–0.8%	–	–	Core well contained just below 2%.
	Meaningful vote	–	–	–	3rd attempt at May's Brexit deal ahead of EU Summit.
US	FOMC policy decision, midpoint	2.375%	2.375%	2.375%	On hold for foreseeable future. Revised forecasts due.
Thu 21					
NZ	Q4 GDP	0.3%	0.6%	0.3%	A genuine slowdown, exacerbated by energy sector disruptions.
Aus	Feb employment, '000 chg	39.1	15	–5	Leading indicators are softer but still hold a robust level...
	Feb unemployment rate	5.0%	5.0%	5.1%	... so our forecast is more about volatility than a new trend.
Eur	Mar consumer confidence prelim.	–7.4	–7.4	–	Edged up in Feb after sharp decline through end 2018.
	ECB bulletin	–	–	–	Will be of interest given significant projection changes.
	EU Summit	–	–	–	Brexit extension date to be in focus.
UK	Feb public sector borrowing £bn	–15.8	–	–	Has been lower than expected, supported by firm tax take.
	Feb retail sales	1.0%	–	–	Spending has been supported by firmness in the labour market.
	BoE policy decision	0.75%	0.75%	0.75%	Brexit will keep the BoE on hold, mild tightening bias to remain.
US	Mar Phily Fed index	–4.1	4.0	–	Industry surveys have been volatile.
	Initial jobless claims	229k	–	–	Very low.
	Feb leading index	0.0%	0.1%	–	In line with trend growth.
Fri 22					
Eur	Mar Markit manufacturing PMI flash	49.3	49.5	–	... across the major hubs...
	Mar Markit services PMI flash	52.8	52.5	–	... but European services are holding up.
US	Mar Markit manufacturing PMI flash	53.0	54.0	–	Continues to point to robust growth...
	Mar Markit services PMI flash	56.0	56.5	–	... across both manufacturing and services.
	Feb existing home sales	–1.2%	3.2%	–	Interest rates and incomes supportive; supply not.
	Feb monthly budget $bn	9	–230	–	Deficit continues to grow. Little–to–no market concern.

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	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	1.7	1.7
Unemployment %	5.8	5.7	5.5	5.0	5.5	5.7
Current Account % GDP	-4.7	-3.1	-2.6	-2.1	-0.9	-2.2
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	1.4	1.0	1.7	1.1	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.9	2.4	1.8	1.2	1.4
United Kingdom						
Real GDP %yr	2.3	1.8	1.7	1.3	1.2	1.4
China						
Real GDP %yr	6.9	6.7	6.9	6.6	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	4.0	4.5	4.4	4.2	4.3
World						
Real GDP %yr	3.5	3.3	3.7	3.7	3.5	3.5
Forecasts finalised 13 March 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	1.85	1.95	1.70	1.40	1.40	1.40	1.40	1.40
10 Year Bond	1.99	1.95	1.85	1.90	1.90	1.90	1.95	1.95
International								
Fed Funds	2.375	2.375	2.375	2.625	2.625	2.625	2.625	2.625
US 10 Year Bond	2.63	2.70	2.75	2.80	2.75	2.70	2.65	2.60
ECB Deposit Rate	−0.40	−0.40	−0.40	−0.40	−0.30	−0.20	−0.10	0.00

Exchange Rate Forecasts	Latest	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.7093	0.70	0.68	0.68	0.69	0.69	0.70	0.70
USD/JPY	111.73	113	114	113	112	110	108	106
EUR/USD	1.1326	1.10	1.10	1.10	1.11	1.12	1.14	1.17
GBP/USD	1.3255	1.31	1.33	1.36	1.36	1.37	1.37	1.38
AUD/NZD	1.0352	1.04	1.05	1.05	1.06	1.06	1.06	1.06

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