

# Weekly Commentary

19 August 2019



Cardboard Cathedral, Christchurch

## Not out of firepower yet

Evidence of the current slowdown in the NZ economy continued to trickle in last week. Data showed further sluggishness in household spending with news that retail card spending fell 0.1% in July. Core spending (excluding fuel and vehicle spending) was even weaker than this, down 0.5% in July and essentially flat since the start of the year.

One factor that has weighed on retail spending this year has been the slowdown in the housing market. Annual house price inflation fell from 3.6% a year ago to around 0.9% now. And measured across New Zealand as a whole, June was the first quarter of falling house prices since December 2010. This weakness has weighed on consumer spending, with spending on durables particularly weak.

Our view, however, is that the housing market won't stay this weak forever. Wholesale interest rates have fallen dramatically in recent weeks and this is being passed on via another round of reductions in mortgage rates. For our part, we are steadfast in our view that these lower interest rates will have consequences, most notably in the housing market. We're forecasting annual house price inflation to 7% next year from about 1% now.

With such a significant turnaround predicted, we've been closely examining housing market data to assess how this forecast is panning out. Last week REINZ data showed seasonally adjusted house sales fell 5% in July after a 9% increase the previous month. Accounting for usual delays in some sales being reported it's probably a bit stronger, more like a 2% fall. While that's still softer than June sales, it is still well up on the March lows. While not conclusive, for now we're happy to say that house sales have been gradually improving over the last couple of months, although a more definitive assessment of the trend can't be made for a few more months yet.

The pickup in house sales is important because it's a very reliable indicator of what's going to happen to house prices 3-6 months down the track. If our house price view is right, we'd expect to see house sales continue trending higher in the coming months.

The other recent development that has given us some confidence in our view of a revival in the housing market next year has been the drop in the stock of unsold homes. Again it's early days, but Realestate.co.nz has reported that the stock of unsold homes on their website fell quite sharply in June and July (mostly in Auckland).

Our forecast of a housing market pickup along with strong construction activity and increases in fiscal spending next year underpins our view that we will see growth improving. But with the OCR already having fallen to 1%, and expected to drop to 0.75% in November, questions are being asked about what other measures the RBNZ may need to employ if the economy were to turn out weaker than expected.

The short answer is that there are plenty of tools the RBNZ could choose to employ if the OCR got to zero. The first cab off the rank is likely to be negative interest rates. Indeed, in an interview following the recent OCR decision, RBNZ Governor Orr expressed a preference for negative interest rates over other forms of quantitative easing. Setting the OCR below zero would incentivise banks to reduce their lending rates. To a point. We think the OCR could fall to

# Not out of firepower yet

around -0.5% before the pass-through to retail rates would fade. At this point if further monetary policy stimulus was required, the RBNZ could turn to other measures.

The next step would probably be large scale asset purchases known as quantitative easing. The RBNZ could create new reserves (metaphorically 'printing money') and use these to buy long-term bonds from the government or private sector. The extra demand would drive up the price of the bond and drive down interest rates. In New Zealand, there were also be an impact via the exchange rate. With a limited pool of domestic bonds, the sellers of the bond will be left with cash to invest elsewhere. If that cash is used to buy foreign assets, this outflow of funds would put downward pressure on the NZ dollar. Indeed, the RBNZ could choose to use its NZ dollar reserves to buy foreign bonds directly to put downward pressure on the NZ dollar.

Another option for the RBNZ would be to participate directly in the swaps market to push down interest rates. Because swaps are a derivative contract this wouldn't affect the money supply, but it would put downward pressure on interest rates and wouldn't be constrained by the size of the local bond market.

All in all we think there's plenty of unconventional monetary policy tools available for the RBNZ to pull out of its tool box if it thinks they are required to support growth. And while our current forecasts don't imply they will be, we're all too aware how quickly forecasts can change.

## Fixed vs Floating for mortgages

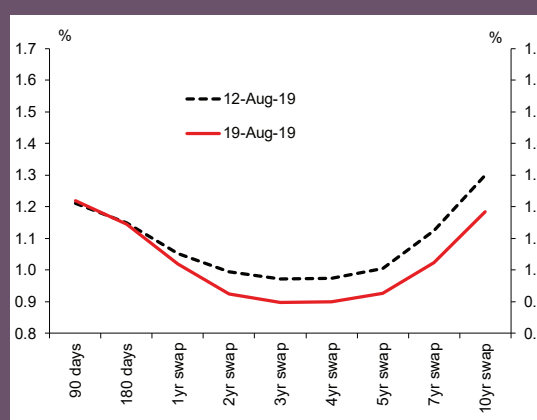
We expect the Reserve Bank to lower the OCR once more in November. If that is correct, both floating and fixed mortgage rates may fall further over the coming months. However, mortgage rates could rise again in the early 2020s.

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



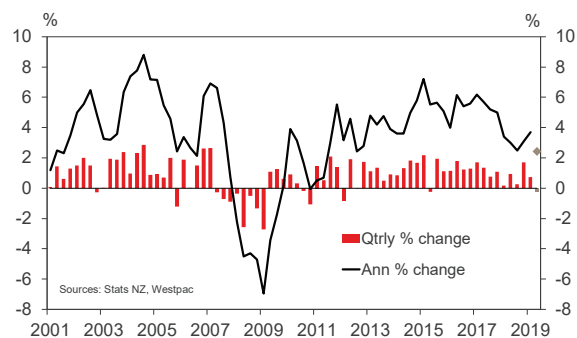
# The week ahead

## NZ Q2 real retail sales

Aug 22, Last: +0.7%, WBC f/c: -0.3%, Mkt: +0.2%

- Retail spending rose by 0.7% in the March quarter. That followed solid gains over 2018. Increases in spending were seen in many categories.
- Mid-2019 has seen only muted gains in monthly gauges of spending. That's consistent with the falls in consumer confidence and ongoing weakness in the housing market. Petrol prices also pushed higher over the quarter, constraining spending in other areas.
- We're expecting that the June quarter report will show that nominal spending growth was subdued over Q2, with volumes down slightly. Price growth is expected to remain limited (other than petrol).

## NZ real retail sales

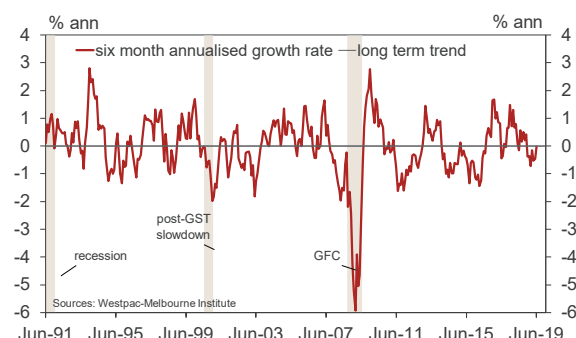


## Aus Jul Westpac-MI Leading Index

Aug 21, Last: -0.02%

- The Leading Index growth rate rose from -0.47% in May to -0.02% in June. Despite choppy monthly moves, the index growth rate remained below trend for a sixth successive month.
- The July update could see a further improvement that proves to be temporary. Several components will see positive updates for the month that look set to reverse sharply next month. In particular: the ASX200 recorded a 2.9% rise in July but has fallen by 6% in the first half of August; Australia's commodity prices rose 2.2% in July (in AUD terms) but have also seen sharp falls in August (spot iron ore prices down 20%); and the yield spread widened following the RBA's rate cut in July but has since narrowed sharply as bond yields have tumbled to historic lows. Other components will also lend some support to the July update with consumer sentiment and labour market measures improving marginally.

## Westpac-MI Leading Index

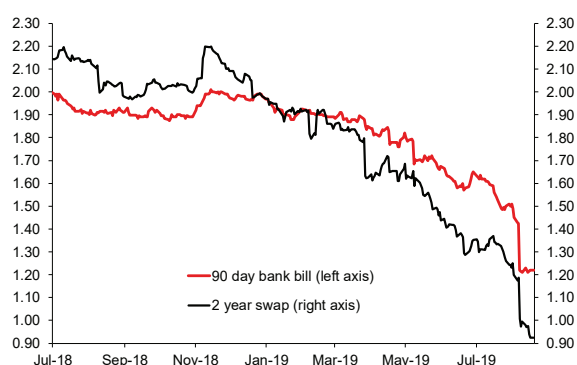


# New Zealand forecasts

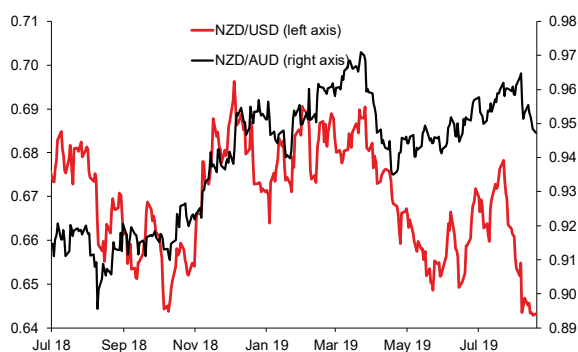
Economic Forecasts	Quarterly				Annual			
	2019				2018	2019f	2020f	2021f
% change	Mar (a)	Jun	Sep	Dec				
GDP (Production)	0.6	0.4	0.6	0.8	2.9	2.3	3.0	2.4
Employment	-0.1	0.8	0.3	0.3	2.3	1.3	2.0	1.8
Unemployment Rate % s.a.	4.2	3.9	4.3	4.2	4.3	4.2	3.9	3.7
CPI	0.1	0.6	0.7	0.3	1.9	1.7	1.9	2.1
Current 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	1.00	0.75	0.75	0.75	0.75	0.75
90 Day bill	1.00	0.90	0.90	0.90	0.90	0.90
2 Year Swap	0.90	0.80	0.80	0.80	0.85	0.90
5 Year Swap	1.00	1.00	1.00	1.05	1.10	1.15
10 Year Bond	1.05	1.00	1.05	1.10	1.15	1.20
NZD/USD	0.64	0.64	0.63	0.63	0.64	0.64
NZD/AUD	0.96	0.96	0.95	0.95	0.96	0.96
NZD/JPY	67.8	67.8	67.4	68.0	70.4	71.0
NZD/EUR	0.59	0.59	0.58	0.58	0.59	0.58
NZD/GBP	0.54	0.54	0.53	0.52	0.52	0.51
TWI	71.9	72.2	71.4	71.0	71.6	71.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 19 August 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.50%	1.50%
30 Days	1.15%	1.43%	1.54%
60 Days	1.18%	1.44%	1.53%
90 Days	1.22%	1.45%	1.53%
2 Year Swap	0.93%	1.20%	1.34%
5 Year Swap	0.93%	1.23%	1.41%

NZ foreign currency mid-rates as at 19 August 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6433	0.6537	0.6767
NZD/EUR	0.5801	0.5885	0.6035
NZD/GBP	0.5294	0.5382	0.5410
NZD/JPY	68.46	69.67	72.93
NZD/AUD	0.9473	0.9618	0.9608
TWI	71.71	72.56	74.17

# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 19</b>					
<b>NZ</b>	Jul BusinessNZ PSI	52.7	-	-	Businesses are reporting slowing activity.
<b>Eur</b>	Jul core CPI %ytr final	0.9%	0.9%	-	Still stuck around 1%.
<b>UK</b>	Aug Rightmove house prices	-0.2%	-	-	Brexit uncertainty dampening demand, esp. in London.
<b>Tue 20</b>					
<b>Aus</b>	RBA minutes	-	-	-	Some detail on the ease "if needed" stance.
<b>Wed 21</b>					
<b>NZ</b>	GlobaDairyTrade auction	-2.6%	-	-	Weak global commodity price backdrop may weigh on prices.
<b>Aus</b>	Jul Westpac-MI Leading Index	-0.1%	-	-	Growth is subdued.
<b>UK</b>	Jul Public sector net borrowing, £bn	7.2	-3.0	-	Borrowing requirements have been lower than expected.
<b>US</b>	Jul existing home sales	-1.7%	2.2%	-	Supply remains the main issue for existing market.
	FOMC minutes	-	-	-	Discussion of risks will be the focus.
	Fedspeak	-	-	-	Quarles on community development (8 am AEST).
<b>Thu 22</b>					
<b>Eur</b>	Aug Markit manuf. PMI flash	46.5	46.5	-	Continues to deteriorate...
	Aug Markit services PMI flash	53.2	52.8	-	... how long can services stay resilient...
	Aug consumer confidence prelim.	-6.6	-6.8	-	... and maintain a strong labour market?
	ECB minutes	-	-	-	Clues on the September package?
<b>US</b>	Initial jobless claims	220k	-	-	Remain very low.
	Aug Markit manuf. PMI flash	50.4	50.5	-	Tariffs and US dollar a heavy burden for US firms...
	Aug Markit services PMI flash	53.0	52.8	-	... across services as well as manufacturing.
	Jul leading index	-0.3%	0.2%	-	Points to growth at trend, or thereabouts.
	Aug Kansas City Fed index	-1	-	-	Regional surveys highly volatile at present.
<b>Fri 23</b>					
<b>NZ</b>	Q2 real retail sales	0.7%	0.2%	-0.3%	The momentum in spending has faded through mid-2019.
<b>US</b>	Jul new home sales	7.0%	-0.2%	-	Housing yet to accelerate despite low rates.
	Jackson Hole Symposium	-	-	-	Topic is on "Challenges for Monetary Policy".
	Fed Chair Powell speaks	-	-	-	Opening speech at Jackson Hole.
<b>Sat 24</b>					
<b>Aus</b>	RBA Governor Lowe speaks	-	-	-	At the Jackson Hole symposium.
<b>Int</b>	G7 meeting	-	-	-	August 24-26, Biarritz.

# 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	1.7	1.9
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	-1.5
<b>United States</b>						
Real GDP %yr	2.9	1.6	2.2	2.9	2.3	1.7
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	3.6	3.6
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	0.3
<b>Euro zone</b>						
Real GDP %yr	2.1	2.0	2.4	1.8	1.1	1.2
<b>United Kingdom</b>						
Real GDP %yr	2.3	1.8	1.8	1.4	1.2	1.4
<b>China</b>						
Real GDP %yr	6.9	6.7	6.8	6.6	6.1	5.8
<b>East Asia ex China</b>						
Real GDP %yr	3.8	4.0	4.6	4.3	3.8	4.0
<b>World</b>						
Real GDP %yr	3.4	3.4	3.8	3.6	3.2	3.3

Forecasts finalised 9 August 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	0.50	0.50	0.50	0.50
90 Day BBSW	0.97	0.95	0.85	0.70	0.70	0.70	0.70
10 Year Bond	0.87	0.90	0.90	1.00	1.00	1.10	1.10
<b>International</b>							
Fed Funds	2.125	1.875	1.375	1.375	1.375	1.375	1.375
US 10 Year Bond	1.54	1.60	1.55	1.60	1.60	1.65	1.65
ECB Deposit Rate	-0.40	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60

Exchange Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.6792	0.67	0.67	0.66	0.66	0.67	0.67
USD/JPY	106.21	106	106	107	108	110	111
EUR/USD	1.1100	1.09	1.08	1.08	1.08	1.09	1.11
GBP/USD	1.2087	1.18	1.19	1.20	1.22	1.24	1.26
AUD/NZD	1.0541	1.05	1.05	1.05	1.05	1.05	1.05



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