

# Weekly Commentary

24 June 2019



Stone Store, Kerikeri

## Another step down

New Zealand's economic growth has slowed in the last year, which we put down largely to domestic factors. While we expect growth to turn more positive over the coming year, the near-term picture remains subdued and the risks to the global economy have deepened. The outlook for monetary policy is highly uncertain, but we think that the odds now favour an OCR cut in August.

GDP expanded by 0.6% in the March quarter, in line with our forecast. There were some small upward revisions to the previous two quarters, which lifted annual growth to a slightly stronger than expected 2.5%. That compares to a peak of around 4% growth in 2016.

On the positive side, household spending has continued to grow at a modest pace, though it has slowed from its earlier peaks. That fits with the loss of momentum in the housing market, which has slowed from double-digit price growth to around 2% today. The housing wealth effect tends to be a major driver of household spending in New Zealand, though it's not the only source of support. Increased government transfers (through the Families Package) and rising employment and wages have also helped lift household incomes in the last year.

Construction was a highlight of the March quarter, with strong gains in both residential (+2.7%) and non-residential building (+9.9%). The result was tempered by another steep fall in civil construction (-6.4%), which in part reflects the wind-down of quake-related repairs. Building consents are clearly pointing to a strong pipeline of building work for the next year, though it was surprising to see how much of it came through in the March quarter.

Exports have also seen solid gains, underscoring that the slowdown in GDP growth has been due to local rather than global developments. Export volumes were particularly

strong in the March quarter, though much of that will have come out of inventories – dairy production itself was down for the quarter, due to dry weather in late summer.

Where the slowdown has been increasingly apparent is in business investment. Investment in plant and machinery has been flat to falling over the last year, after having seen strong growth in previous years. Business confidence has been stubbornly low, with an increasing number of firms highlighting concerns about rising costs and an inability to pass these on as higher prices. In turn, this is now weighing on firms' hiring and investment plans.

We're forecasting a gradual pick-up in the pace of GDP growth, peaking at around 3% next year. Fiscal stimulus has been modest to date, but last month's Budget shows that government spending is set to ramp up over the coming year. Building activity has further to rise, though now that it's reaching the levels needed to address population pressures, it won't necessarily be a source of growth beyond 2020. And critically, lower interest rates and the ruling-out of a capital gains tax will give fresh legs to the housing market, in turn boosting households' willingness to spend.

While we're confident about a pick-up in growth by next year, we acknowledge that the near-term picture has been soft. In recent weeks we've seen declines in electronic card spending, job advertisements and the PMI manufacturing index. Both business and consumer confidence have

# Another step down

remained low, despite the ‘relief’ of the cancellation of capital gains tax.

In addition, we note that the 0.6% rise in March quarter GDP benefited from sharp gains in a few sectors – construction, food manufacturing and mining – that could be unwound in the next quarter. Altogether, the risks for June quarter GDP look to be to the downside of our 0.6% forecast.

From the Reserve Bank’s perspective, the local economy is tracking broadly in line with expectations. The May Monetary Policy Statement showed that the RBNZ was already braced for a weak 0.4% gain in March quarter GDP, so this week’s report was a mildly positive surprise. On the other hand, the June quarter is shaping up softer than expected.

We expect the RBNZ to leave the OCR on hold at this Wednesday’s review, and to reiterate its easing bias. However, we think that the odds now favour a cut in the OCR to a new low of 1.25% in August.

At the time of the May MPS we said it was a finely balanced call as to whether the RBNZ would eventually cut the OCR further. We thought no cut was slightly more likely, because we expected an economic improvement later this year on both the global and New Zealand stages.

The key change in our view has been in the global economic outlook. Evidence of a global slowdown in manufacturing

and trade has deepened over the past few months. China and Australia, our two biggest trading partners, both posted lower-than-expected GDP growth in the March quarter. And although GDP data in the US has remained strong, other recent data has been on the weak side.

The RBNZ this year has put particular emphasis on global economic risks and the actions of foreign central banks, especially the US Federal Reserve. A worldwide trend of central banks abandoning previous plans to lift interest rates was a key ingredient to the RBNZ’s decision to cut in May. Things have now moved much further in that direction – the US and European central banks are talking about rate cuts, and the Reserve Bank of Australia has actually cut its cash rate.

Although we are optimistic on the domestic economy over the coming year, we doubt that signs of a domestic upturn will be sufficient by August to offset the RBNZ’s global concerns.

A further OCR cut would only reinforce our view that the domestic economy will strengthen over the next year. Pushing mortgage rates even lower would create even more stimulus for the housing market, and by extension consumer spending. If we’re correct, the RBNZ may have to start hiking the OCR again by late next year.

## Fixed vs Floating for mortgages

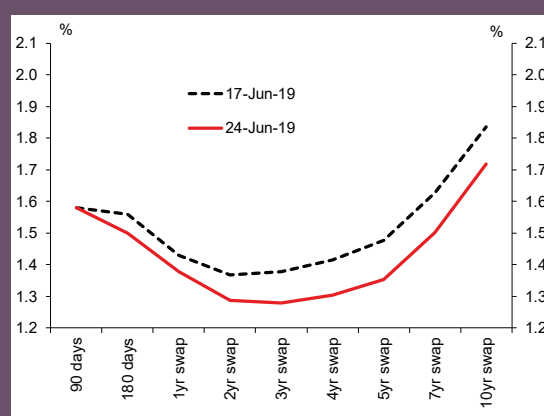
We are now expecting the Reserve Bank to lower the OCR in August. If that is correct, both floating and fixed mortgage rates may fall over the coming month or two. However, we expect the OCR to rise again in the early 2020s, pushing mortgage rates up at that time.

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



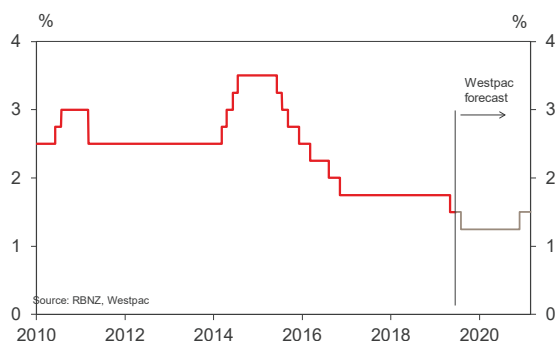
# The week ahead

## NZ RBNZ Official Cash Rate review

Jun 26, last: 1.50%, WBC f/c: 1.50%, Mkt: 1.50%

- In May the RBNZ cut the OCR and said that the outlook was finely balanced between having to cut once more at some stage, or leaving the OCR on hold at 1.5% for an extended period. The RBNZ has stated that it is now in "data watching mode", meaning it could jump either way depending on what happens.
- We expect the RBNZ will leave the OCR on hold at its upcoming June Review. The balance of risks has evolved in the direction of another cut (mainly due to global developments), but not so emphatically that the RBNZ needs to cut the OCR again so soon.
- As discussed in this week's essay, we now think the odds favour the RBNZ cutting the OCR to a new low of 1.25% in August.

## RBNZ Official Cash Rate

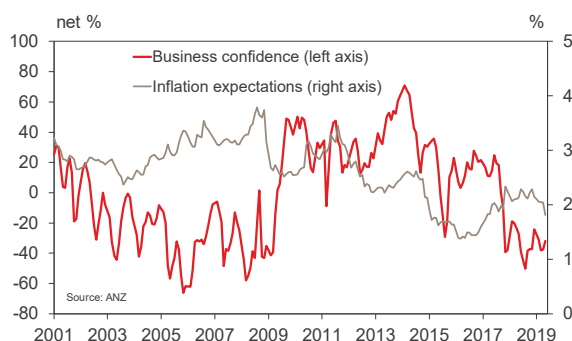


## NZ June ANZ Business confidence

Jun 27, Last -32.0

- Business confidence improved in May, but remained at relatively low levels.
- Since the time of the last survey, we've seen mortgage rates pushing down to new lows, which will likely give a boost to sentiment in property related sectors. The Government has also announced plans for additional spending.
- However, we're still seeing sluggish conditions in many sectors. That includes softness in retail spending growth and weakness in manufacturing. We've also seen global trade tensions simmering away. Against this backdrop, overall confidence levels are likely to remain low.
- Despite concerns about rising costs, inflation expectations have been moderate of late.

## NZ business confidence and inflation expectations



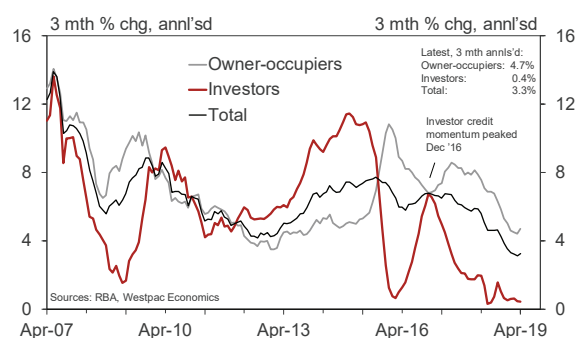
## Aus May private credit

Jun 28, Last: 0.2%, WBC f/c: 0.2%

Mkt f/c: 0.2%, Range: 0.2% to 0.3%

- Private sector credit growth has slowed to a sluggish pace as the housing sector weakened. Annual growth is 3.7% and the 3 month annualised pace is 2.9%.
- Housing credit growth is weak at an historic low of 3.9%yr and 3.3% annualised for the 3 months to April. For May, another soft update is likely. Looking ahead, the positive is that new lending is likely to stabilise with the RBA cutting rates and sentiment rebounding post the Federal election.
- Business credit grew by 4.5% over the past year as investment trended higher. More recently, new lending has cooled as the economy slows. Business credit was flat in April and the risk is for another soft reading.

## Housing credit weak: emerging stabilisation

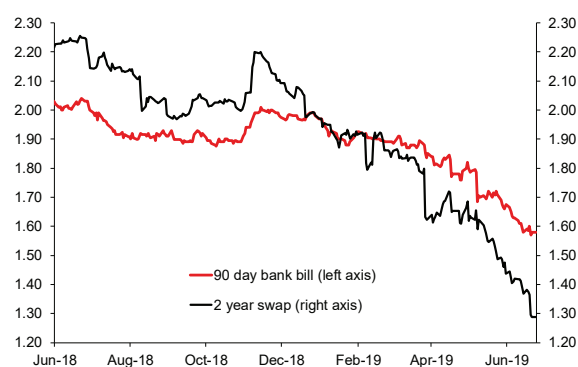


# New Zealand forecasts

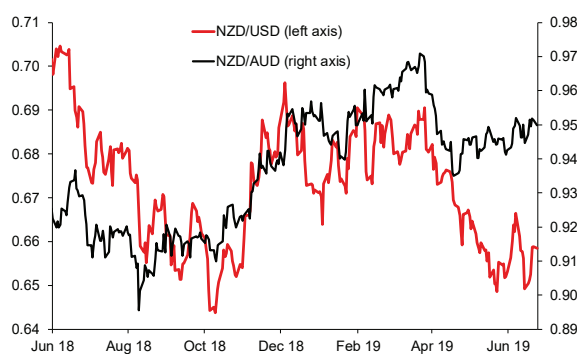
Economic Forecasts	Quarterly				Annual			
	2019							
% change	Mar (a)	Jun	Sep	Dec	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.6	0.7	0.8	2.9	2.5	3.1	2.4
Employment	-0.2	0.8	0.3	0.3	2.3	1.3	2.0	1.8
Unemployment Rate % s.a.	4.2	4.3	4.3	4.2	4.3	4.2	3.9	3.7
CPI	0.1	0.7	0.8	0.3	1.9	1.9	1.9	2.1
Current 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	1.25	1.25	1.25	1.25	1.25	1.50
90 Day bill	1.40	1.40	1.40	1.40	1.55	1.65
2 Year Swap	1.25	1.30	1.40	1.50	1.60	1.70
5 Year Swap	1.40	1.50	1.60	1.70	1.80	1.90
10 Year Bond	1.55	1.60	1.65	1.75	1.85	1.90
NZD/USD	0.64	0.65	0.65	0.66	0.66	0.66
NZD/AUD	0.94	0.96	0.98	0.99	0.99	0.99
NZD/JPY	68.5	68.9	69.6	71.0	71.9	73.0
NZD/EUR	0.57	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.50	0.51	0.51	0.51	0.51	0.51
TWI	70.8	71.7	72.1	72.1	72.1	72.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 24 June 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.50%	1.50%
30 Days	1.61%	1.66%	1.70%
60 Days	1.60%	1.64%	1.70%
90 Days	1.58%	1.63%	1.71%
2 Year Swap	1.29%	1.42%	1.49%
5 Year Swap	1.35%	1.55%	1.60%

NZ foreign currency mid-rates as at 24 June 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6584	0.6662	0.6555
NZD/EUR	0.5787	0.5887	0.5849
NZD/GBP	0.5169	0.5234	0.5142
NZD/JPY	70.68	72.34	71.66
NZD/AUD	0.9498	0.9507	0.9452
TWI	72.11	73.23	72.36

# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 24</b>					
<b>Aus</b>	RBA Governor Lowe speaks	-	-	-	On panel at ANU leadership forum, Canberra 9:30 am.
<b>US</b>	May Chicago Fed activity index	-0.45	0.10	-	Pointing to growth around trend.
	Jun Dallas Fed index	-5.3	1.0	-	Manufacturing is under pressure.
<b>Tue 25</b>					
<b>NZ</b>	May trade balance \$m	433	175	150	Impact of higher dairy prices now coming through.
<b>Aus</b>	RBA Assist. Gov. Bullock speaks	-	-	-	On Australian payments system, Berlin, (5:05 pm AEST).
<b>US</b>	Apr FHFA house prices	0.1%	-	-	Price momentum has slowed...
	Apr S&P/CS home price index %yr	2.7%	2.5%	-	... despite low interest rates and labour market strength.
	Jun Richmond Fed index	5	7	-	Manufacturing is under pressure.
	May new home sales	-6.9%	1.8%	-	A stabilisation expected after Apr jolt lower.
	Jun consumer confidence index	134.1	132.0	-	Consumers remain positive.
	Fed Chair Powell speaks	-	-	-	On economy at Council on Foreign Relations in NY.
	Fedspeak	-	-	-	Williams at finance forum, Bostic on housing, Barkin in Can.
<b>Wed 26</b>					
<b>NZ</b>	RBNZ policy decision	1.50%	1.50%	1.50%	OCR to remain on hold, policy statement to show an easing bias.
<b>UK</b>	BOE Governor Carney	-	-	-	Testimony to Parliament on the BOE's inflation report.
<b>US</b>	May wholesale inventories	0.8%	-	-	Positive for growth in 2019 to date.
	May durable goods orders	-2.1%	0.0%	-	Business investment remains weak.
	Fedspeak	-	-	-	Bullard gives welcoming remarks (8:30 am AEST).
<b>Thu 27</b>					
<b>NZ</b>	Jun ANZ business confidence	-32.0	-	-	Firms have highlighted ongoing concerns through mid-2019.
<b>Eur</b>	Jun economic confidence	105.1	104.9	-	Heightened trade tensions have...
	Jun business climate indicator	0.30	-	-	... seen weakening sentiment in other surveys.
<b>US</b>	Q1 GDP 3rd estimate	3.1%	3.2%	3.2%	Revisions to be minimal.
	Initial jobless claims	216k	-	-	Very low.
	May pending home sales	-1.5%	1.0%	-	Existing market restricted by supply.
	Jun Kansas City Fed index	4	-	-	Manufacturing is under pressure.
<b>Fri 28</b>					
<b>NZ</b>	Jun ANZ consumer confidence	119.3	-	-	We've seen ongoing nervousness in the household sector.
<b>Aus</b>	May private sector credit	0.2%	0.2%	0.2%	Sluggish growth, housing downturn, business mixed.
<b>Chn</b>	Q1 current account balance	58.6	-	-	Important detail on services and income flows.
<b>Eur</b>	Jun core CPI %yr	0.8%	-	-	A lift needed to avoid stimulus response.
<b>UK</b>	Jun GfK consumer sentiment	-10	-11	-	Political developments continuing to dampen sentiment.
	Q1 GDP	0.5%	0.5%	0.5%	A temporary boost from Brexit-related stock building.
	Jun Nationwide house prices	-0.2%	-	-	TBC. Price growth remains weak, esp. in London. Brexit a drag.
<b>US</b>	May personal income	0.5%	0.3%	0.3%	Wage growth looks to have slowed...
	May personal spending	0.3%	0.4%	0.5%	... but spending has momentum in Q2.
	May PCE deflator %yr	1.5%	1.5%	-	Inflation well below target...
	May core PCE deflator %yr	1.6%	1.6%	-	... but this weakness is expected to be transitory.
	Jun Chicago PMI	54.2	54.0	-	Manufacturing is under pressure.
	Jun Uni. of Michigan sent. final	97.9	97.1	-	Consumers remain positive.
<b>Intl</b>	G20 Summit	-	-	-	Trade deal or no deal?



# 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	1.8	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
<b>United States</b>						
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
<b>Japan</b>						
Real GDP %yr	1.2	0.6	1.9	0.8	0.7	0.6
<b>Euro zone</b>						
Real GDP %yr	2.1	2.0	2.4	1.8	1.2	1.4
<b>United Kingdom</b>						
Real GDP %yr	2.3	1.8	1.8	1.4	1.4	1.4
<b>China</b>						
Real GDP %yr	6.9	6.7	6.8	6.6	6.1	6.0
<b>East Asia ex China</b>						
Real GDP %yr	3.8	4.0	4.6	4.3	4.1	4.1
<b>World</b>						
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
<b>Australia</b>							
Cash	1.25	1.00	0.75	0.75	0.75	0.75	0.75
90 Day BBSW	1.22	1.15	1.00	1.00	1.00	1.00	1.00
10 Year Bond	1.28	1.30	1.40	1.45	1.60	1.70	1.75
<b>International</b>							
Fed Funds	2.375	2.125	1.875	1.875	1.875	1.875	1.875
US 10 Year Bond	2.00	2.00	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	0.6931	0.68	0.68	0.66	0.66	0.67	0.67
USD/JPY	107.07	107	106	107	108	109	110
EUR/USD	1.1304	1.13	1.14	1.13	1.13	1.12	1.12
GBP/USD	1.2713	1.27	1.28	1.28	1.29	1.29	1.30
AUD/NZD	1.0503	1.06	1.04	1.02	1.01	1.01	1.01

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- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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