Len Lye Centre, New Plymouth

Weekly Economic Commentary.

Signs of spring.

Our long-held view has been that, after the economic slowdown over the past year, we will see a reacceleration in economic growth underpinned by increases in fiscal spending and supportive monetary policy. Recent data indicate that just such a reacceleration is underway, and it's likely to continue over the coming years. With much of the pickup in activity centred on the housing market, stability concerns are back on the radar. As a result, we expect the RBNZ will keep the current loan-to-value restrictions unchanged when it releases its latest *Financial Stability Report* later this week.

The wind has come out of the New Zealand economy's sails, with GDP growth estimated to have slowed to 2.3% in the year to September. That's well down on the rates of 3 to 4% per annum that we saw over the past few years.

A range of factors has contributed to this deceleration in economic growth. The global backdrop has been rocky, with trade disputes and geopolitical tensions weighing on growth in many major economies. Closer to home, business confidence has fallen to low levels. There's also been a slowdown in household spending, with a cooling in population growth and a downturn in parts of the housing market.

At the same time, the inflation backdrop has remained benign. Domestic inflation pressures have firmed and are set to continue strengthening over the coming year. However, that's balanced against ongoing softness in import prices and continued strong competition in the retail sector. This combination of conditions means that inflation continues to linger at levels a little below 2%.

But while GDP growth has cooled, it looks like the worst is now behind us. As we discuss in our recently released *Economic Overview*,[1] our long-held view has been that the economy will be dragged out of its recent funk by increases in government

1 Available here: https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Westpac-QEO-November-2019-Final.pdf

spending and accommodative monetary policy. And over the past few months, we've started to see the early signs of a turn in activity, including a strengthening in the housing market and a lift in household spending. That comes atop continued strength in construction and firmness in prices for some of our key commodity exports. We expect that this strengthening in activity will continue over the coming years, with GDP growth to reaccelerate back to 3% in mid-2021.

A crucial part of our view has been that supportive monetary policy will underpin a firming in the housing market and household spending. When we announced that forecast back in April, it was greeted with widespread scepticism. However, the pick-up in the housing market is now undeniable. Following the steep slide in mortgage rates that began in April, along with the shelving of the proposed capital gains tax, house sales have lifted by 14% from their lows, and house prices have risen by 3.2% in the last three months (having risen just 1.5% in the year before that). Notably, there are also tentative signs that the housing market is helping to support consumers' spending appetites, with electronic card spending picking up over the past few months after effectively stalling through the first half of the year.

Looking ahead, with inflation still struggling to reach 2%, we think that the RBNZ will cut the cash rate again in early 2020 and keep it at low levels for an extended period. That will support a further acceleration in the housing market and household spending over the coming years. In fact, our forecast for nationwide house price inflation of 7% in 2020 could come good even sooner.

Fiscal stimulus will also remain a key feature of the economic environment over the next few years. Recent data show that government spending is up 8% over the past year. And with the recent announcement of large surpluses, there is more where that came from. We expect next year's Budget will feature a substantial increase in projected spending – not least because of election-year considerations.

No change in lending restrictions.

With much of the pickup in activity centred on the housing market, stability concerns are back on the radar. The Reserve Bank will be releasing its six-monthly *Financial Stability Report* at 9am this Wednesday, and we expect that they will keep the loan-to-value ratio restrictions (LVRs) unchanged.

The RBNZ has two conditions for loosening the LVRs. The first is that house price and credit growth are well contained, i.e. in line with household income growth. Right now, this appears to be met – nationwide average house prices are up by 3.9% on a year ago, while credit growth is running a bit faster than that at 6.5%yr. Both measures are only slightly higher than they were on the two previous occasions that the LVRs were loosened.

The second condition is that the RBNZ must be satisfied that loosening the LVRs won't lead to a resurgence in the housing market and hence in financial stability risks. We think that this will be the sticking point. The housing market is already accelerating on the back of a steep fall in mortgage rates and the removal of the prospect of a capital gains tax. Loosening the LVRs would add even more fuel to the fire.

There has been speculation that the RBNZ's recent on-hold OCR decision signalled an intention to loosen the LVR rules instead. That's not generally the way it works at the RBNZ – each tool is assessed separately. And in any case, such a combo would shift the mix of credit conditions in the opposite direction to what we think the RBNZ would want. It's business lending, not housing lending, where banks have been tightening up recently, and the proposed increase in bank capital requirements will push further in this direction. Housing is not the area that could do with some relief.

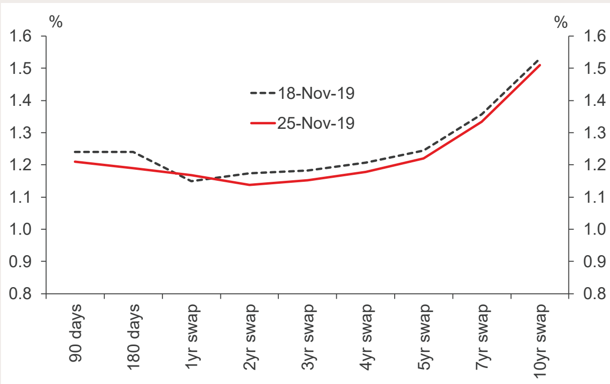
Fixed vs Floating for mortgages.

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



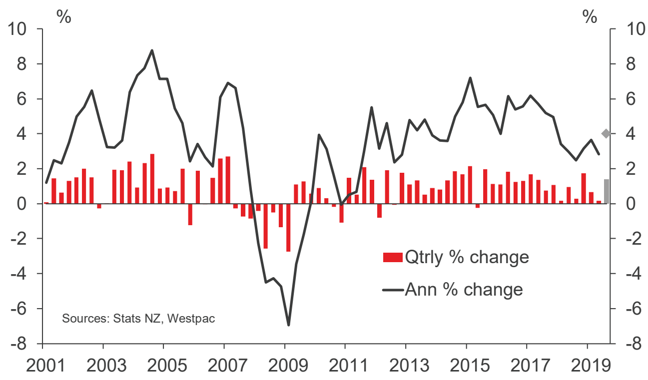
The week ahead.

NZ Q3 retail spending

Nov 26, Last: +0.2, WBC f/c: +1.4%

- Retail sales posted a modest 0.2% gain in the June quarter, with spending patterns mixed across sectors. On the upside, there were gains in areas like electronics and recreational goods. However, on the downside, spending on groceries and home furnishings fell. Part of the reason for that softness is likely to have been the earlier weakness in the housing market.
- We're expecting a 1.4% rise in spending through the September quarter, underpinned by a solid 1.6% rise in core spending. With interest rates down and a firming in the housing market, households spending appetites have firmed recently. Monthly spending gauges have picked up through the September quarter, with notable increases in spending on hospitality and durables.

NZ real retail sales

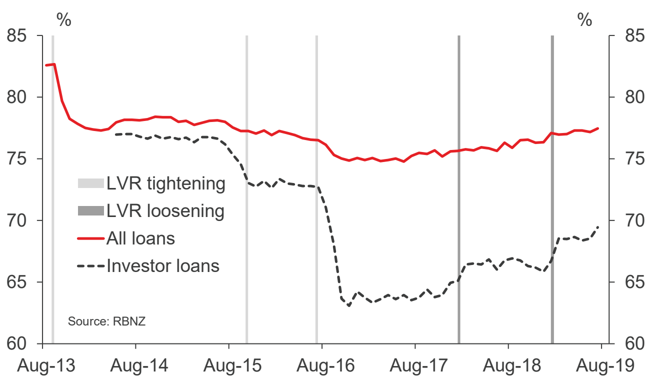


NZ RBNZ Financial Stability Report

Nov 27

- The RBNZ's six-monthly review of the financial system often serves as a window for reviewing the loan-to-value restrictions on mortgage lending. The LVR restrictions have been loosened twice so far, in November 2017 and 2018.
- We do not expect a further change at this review. House prices are up by just 3.9% in the last year, but there has been a marked acceleration in recent months as mortgage rates have fallen sharply and the threat of a capital gains tax has been removed. The RBNZ will be wary of adding more stimulus at this point.
- The RBNZ is unlikely to make any substantial comment on its proposal to increase bank capital requirements, ahead of the announcement scheduled for 5 December.

Average LVR of new mortgage commitments

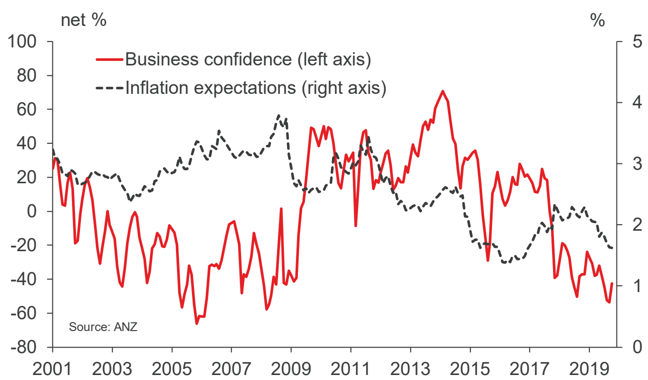


NZ Oct ANZ business confidence

Nov 28, Last: -42.4

- Business confidence picked up in October, but it remained at very low levels. We also saw businesses continuing to report extremely weak trading activity.
- We expect that overall business confidence and trading activity will remain low in the upcoming November survey. However, we may see some diverging conditions across sectors. Recent months have seen firming economic conditions in some parts of the economy, including the retail sector. But at the same time, conditions remain rocky in areas like manufacturing, where soft global conditions are a headwind.
- It will also be worth keeping an eye on the survey's gauges of inflation expectations which have remain muted in recent months, despite continued reports of rising costs.

NZ business confidence and inflation expectations



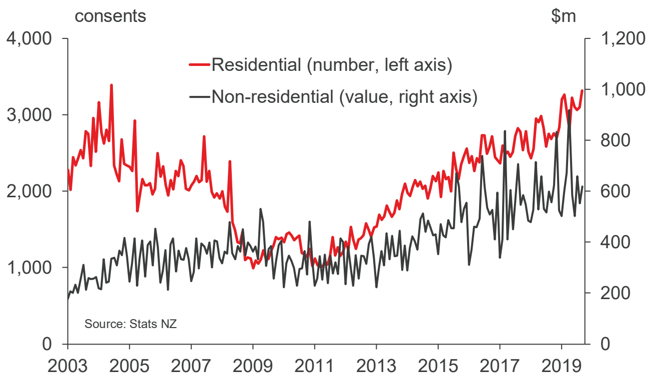
The week ahead.

NZ Oct dwelling consents

Nov 29, Last: +7.2%, WBC f/c: –8%

- Residential dwelling consent issuance rocketed higher in September, rising by 7.2%. That was underpinned by a large number of medium density consents, with those increases occurring in a number of regions.
- Given the lumpy nature of multi-unit consents, we expect to see some pull back in October and are forecasting an 8% decline. That would still leave annual consent issuance at a multi-decade high.
- Issuance is trending upwards in Auckland. In other regions, consent numbers are rising more gradually, but is at elevated levels.

NZ building consents

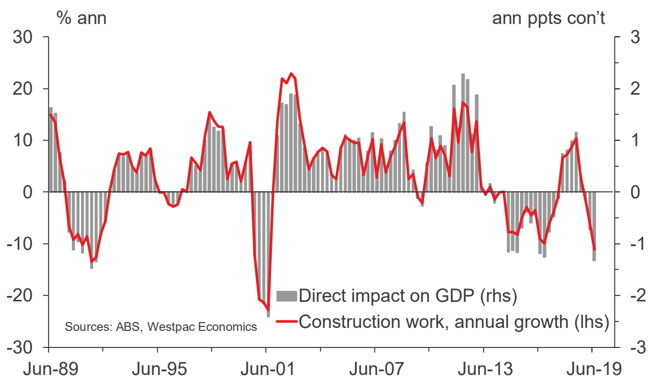


Aus Q3 construction work

Nov 27, Last: –3.8%, WBC f/c: –1.0%
Mkt f/c: –1.0%, Range: –3.5% to 1.0%

- Construction weakened from mid–2018, with falls in each of the past four quarters, to be 11% lower over the year (–$6.1bn). Infrastructure is down $3.8bn (both private and public) and private building work is $2.2bn lower (led by housing).
- For the September quarter, we anticipate a 1.0% fall, with downside risks.
- Private new home building activity (–5.3%qtr, –9.9%yr in Q2) has further to fall, with approvals taking another leg lower around mid–2019.
- Public works, while at a high level, moderated over the year (–0.8%qtr, –11.3%yr in Q2) reflecting a gap in the investment project pipeline. Another fall is a risk.
- Private infrastructure work (–2.5%qtr, –13.0%yr in Q2) may be at a turning point. In mining, a few projects have proceeded of late and the work pipeline has expanded.

AU construction cycles

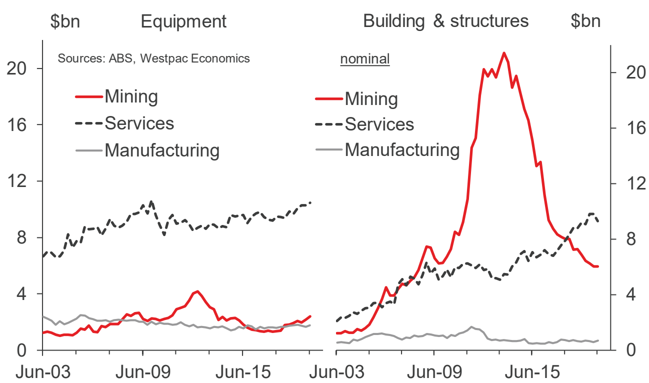


Aus Q3 private business capex

Nov 28, Last: –0.5%, WBC f/c: –0.5%
Mkt f/c: flat, Range: –1.4% to 1.0%

- Private business capex spending was mixed over the past year, including a Q2 outcome of –0.5%qtr, –1.0%yr.
- We expect a further decline in Q3, a forecast –0.5%.
- Building & structures capex trended lower from mid–2014, including a 6.6% fall over the past year, centred on mining ~ as work on the large gas projects was completed. With that wind–down behind us, we expect a small rise in Q3, +0.5%, as work on a few iron ore projects proceeds.
- Equipment capex has been mixed, with a broadly flat profile late in 2018 and early in 2019, followed by a (temporary) bounce in the June quarter, +2.5%. In the current challenging environment (both weak demand and an uncertain outlook) we see the risk of a pull–back in Q3, down a forecast 1.5%.

AU capital expenditure by industry by asset



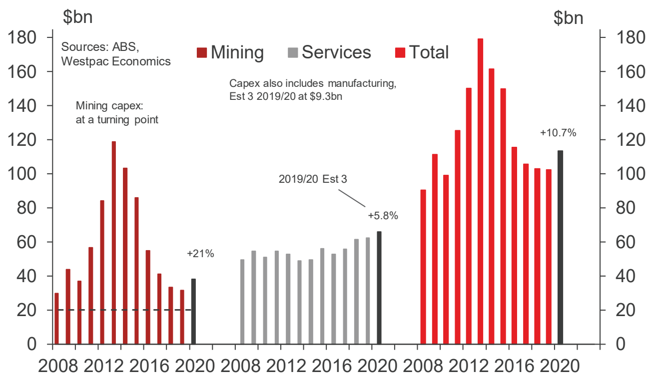
The week ahead.

Aus 2019/20 capex plans

Nov 28, Last: Est 3 2019/20: $113bn, +10.7% vs Est 3 a yr ago

- This survey, conducted in October and November, includes the 4th estimate of 2019/20 capex plans.
- Est 3 printed at $113.4bn, 10.7% above Est 3 of a year ago
- That headline number of +10.7% sounds like an upbeat outlook. However, we are sceptical. This figure, in our view, is flattered by weak base effects.
- More fundamentally, the challenging economic backdrop points to a more modest outlook for business capex – albeit one supported by an emerging uptrend in mining investment after 6 years of decline.
- We anticipate an Est 4 in the order of $120bn. By way of context, that is a 6% upgrade on Est 3, in line with the average upgrade of recent years, but well below the oversized 11% mark-up this time a year ago.
- An Est 4 of $120bn is 5.5% above Est 4 a year ago, well down on the +10.7% for Est 3 on Est 3.

AU capital expenditure plans, by industry: Estimate 3

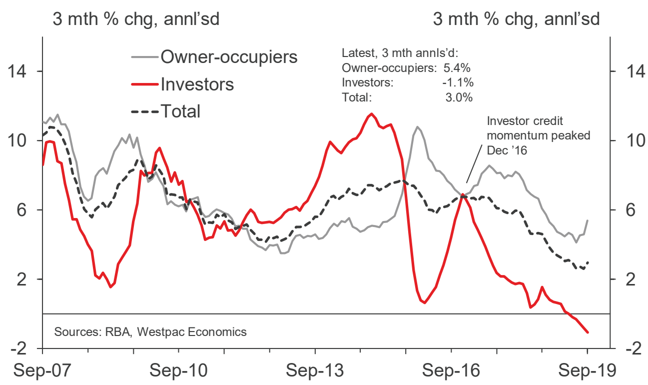


Aus Sep private credit

Nov 29, Last: 0.2%, WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: 0.2% to 0.3%

- Private sector credit growth has slowed to a weak pace led by the housing downturn. Annual growth is 2.7%, and is 2.8% on a 3 month annualised basis. Monthly gains have averaged 0.2% during 2019, including a 0.2% rise in September.
- For October, growth is expected to edge higher to 0.3%, supported by the boost from recent RBA rate cuts.
- Housing credit grew by 0.24%mth, 3.1%yr in September (and by 3.0% 3 month annualised). New lending has rebounded in response to the RBA's 75bps of rate cuts, which will see a pick-up in credit – although the pass through to date has been slow as repayments have been slow to adjust.
- Business credit grew by a modest 3.3% over the past year in what is a challenging environment. That said, there has been a rebound from the soft spot around the May Federal election, with the 3 month annualised pace jumping to 3.7% in September, up from 0.9% in June.

AU housing credit

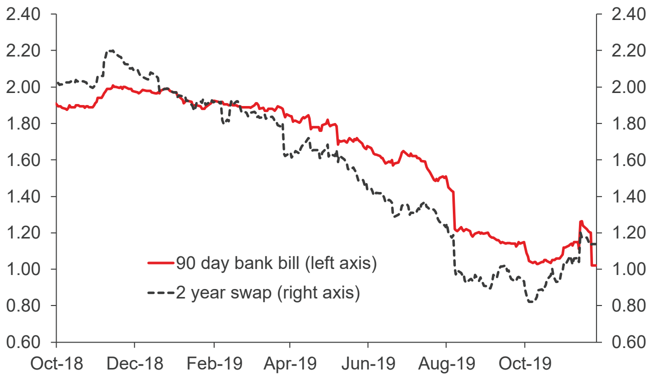


New Zealand forecasts.

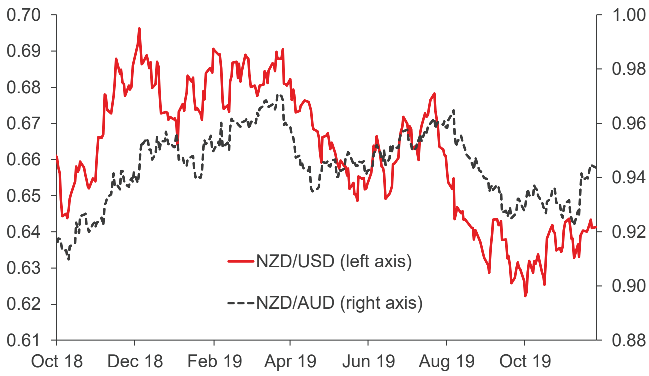
Economic forecasts	Quarterly				Annual			
	2019			2020				
% change	Jun (a)	Sep	Dec	Mar	2018	2019f	2020f	2021f
GDP (Production)	0.5	0.3	0.5	0.7	2.8	2.2	2.6	2.9
Employment	0.6	0.2	0.4	0.3	1.9	1.2	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.4	4.3	4.3	4.2	3.9
CPI	0.6	0.7	0.3	0.5	1.9	1.7	1.8	1.9
Current Account Balance % of GDP	-3.4	-3.3	-3.1	-3.0	-3.9	-3.1	-3.2	-3.6

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	0.48	0.47	0.47	0.48	0.48	0.49
TWI	70.4	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 25 November 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.19%	1.14%	1.14%
60 Days	1.20%	1.15%	1.10%
90 Days	1.02%	1.15%	1.06%
2 Year Swap	1.14%	1.06%	0.94%
5 Year Swap	1.22%	1.19%	1.01%

NZ foreign currency mid-rates as at 25 November 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6413	0.6348	0.6346
NZD/EUR	0.5818	0.5747	0.5718
NZD/GBP	0.4990	0.4953	0.4934
NZD/JPY	69.72	69.16	69.16
NZD/AUD	0.9437	0.9224	0.9277
TWI	71.22	70.05	70.37

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 25					
US	Oct Chicago Fed activity index	–0.45	–	–	Regional surveys remain volatile...
	Nov Dallas Fed index	–5.1	–2.9	–	... amid uncertainties, offset by consumer strength.
Tue 26					
NZ	Q3 real retail sales	0.2%	–	1.4%	Higher spending on durables and hospitality boosting core.
Aus	RBA Dep. Governor Debelle speaks	–	–	–	"Employment & wages", ACOSS, Canberra, 10:50am
	RBA Governor Lowe speaks	–	–	–	"Unconventional Monetary Policy ...", Sydney, 8:05pm
Eur	ECB Chief Economist Lane speaks	–	–	–	In London.
US	Oct wholesale inventories	–0.4%	–	–	Volatile.
	Sep FHFA house prices	0.2%	0.5%	–	House price growth has slowed materially...
	Sep S&P/CS home price index %yr	2.0%	2.1%	–	... across the nation.
	Nov Richmond Fed index	8	6	–	Manufacturers under pressure.
	Oct new home sales	–0.7%	0.8%	–	Modest growth likely into 2020.
	Nov consumer confidence index	125.9	126.8	–	Optimism supported by a tight labour market.
	Fed Chair Powell speaks	–	–	–	Greater Providence Chamber of Commerce (AEDT 11am).
	Fedspeak	–	–	–	Brainard on policy framework review.
Wed 27					
NZ	RBNZ Financial Stability Report	–	–	–	We expect no change to LVR restrictions this time.
	Oct trade balance $m	–1242	–	–1000	Meat exports rising strongly on Chinese demand.
Aus	Q3 construction work	–3.8%	–1.0%	–1.0%	Cyclical downturn to continue, housing further weakness.
US	Q3 GDP 2nd est %ann'd	1.9%	1.9%	1.9%	Growth to slow further in coming quarters.
	Oct durable goods orders	–1.2%	–0.5%	–	Weak investment trend to continue.
	Initial jobless claims	227k	–	–	Very low, and will remain so.
	Nov Chicago PMI	43.2	47.1	–	Manufacturers under pressure.
	Oct personal income	0.3%	0.3%	0.4%	Wages growth still solid.
	Oct personal spending	0.2%	0.3%	0.3%	Spending growth to slow into 2020.
	Oct PCE deflator %yr	1.3%	1.4%	1.4%	PCE measures modestly below target.
	Oct pending home sales	1.5%	0.2%	–	Existing market held back by supply.
	Federal Reserve's Beige book	–	–	–	Conditions across the districts.
Thu 28					
NZ	Nov ANZ business confidence	–42.4	–	–	Business conditions are soft, but have started to improve.
Aus	Q3 private new capital expenditure	–0.5%	flat	–0.5%	Mixed result. Expect equipment pull-back, f/c –1.5%.
	2019/20 capex plans, $bn	113.4	–	120	Est 3 on 3, was +10.7%. For Est 4, expect 'downgrade' to +5.5%.
Eur	Oct M3 money supply %yr	5.5%	5.5%	–	Credit growth remains robust.
	Nov economic confidence	100.8	101.0	–	Firms are concerned about the outlook...
	Nov business climate indicator	–0.19	–0.14	–	... as persistent weakness in manufacturing threatens.
US	Thanksgiving holiday	–	–	–	Public holiday.
Fri 29					
NZ	Nov ANZ consumer confidence	118.4	–	–	Continues to linger around average levels.
	Oct building permits	7.2%	–	–8%	Likely to fall after earlier surge in apartment numbers.
Aus	Oct private sector credit	0.2%	0.3%	0.3%	RBA rate cuts providing a boost to housing finance.
Eur	Oct unemployment rate	7.5%	7.5%	–	Close to the historical low of 7.3%.
	Nov core CPI %yr prelim.	1.1%	1.3%	–	Core inflation stuck around 1%yr.
UK	Nov GfK consumer sentiment	–14	–13	–	Holding just below average.
	Oct net mortgage lending £bn	3.8	–	–	Market stable, holding around three year average.
US	Day after Thanksgiving	–	–	–	Holiday in almost half of the states (Black Friday).
Sat 30					
Chn	Nov manufacturing PMI	49.3	49.5	–	Manufacturers to remain under pressure...
	Nov non-manufacturing PMI	52.8	53.7	–	... with consequences for services.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
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
United States						
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
Japan						
Real GDP %yr	0.6	1.9	0.8	0.8	0.2	0.4
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	1.0	1.2
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.3	0.8	1.1
China						
Real GDP %yr	6.7	6.8	6.6	6.1	5.8	5.8
East Asia ex China						
Real GDP %yr	4.0	4.5	4.3	3.6	3.7	3.9
World						
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
Australia								
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	1.10	1.10	0.90	0.90	1.00	1.10	1.30	1.50
International								
Fed Funds	1.625	1.625	1.375	1.125	0.875	0.875	0.875	0.875
US 10 Year Bond	1.77	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	0.6787	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	108.64	108	107	106	105	105	107	109
EUR/USD	1.1064	1.09	1.09	1.10	1.11	1.12	1.14	1.15
GBP/USD	1.2914	1.30	1.33	1.32	1.32	1.31	1.31	1.32
USD/CNY	7.0322	7.10	7.10	7.05	6.95	6.90	6.75	6.60
AUD/NZD	1.0598	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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