

Weekly Commentary

25 March 2019



Larnach Castle, Dunedin

Reacceleration to stay the RBNZ's hand

While the economy lost some steam through the back half of 2018, that slowdown wasn't as stark as we feared, and a reacceleration in GDP growth is on the cards in 2019. Against that backdrop, we're not expecting any big changes from the RBNZ at this week's policy announcement.

Our hearts remain with those affected by the terrorist attack in Christchurch. While the economic consequences of those events are second order, there may be an indirect economic impact via political conditions.

New Zealand's GDP grew by 0.6% in the December quarter, a result that was stronger than we expected, but which was in line with market forecasts. That followed a modest 0.3% gain in the September quarter and saw annual GDP growth slowing to 2.8% - the first time it's been below 3% since September 2014.

But while the economy lost some momentum through the second half of last year, the extent of that slowdown hasn't been as stark as we had feared. Notably, the December quarter saw continued firmness in domestic demand, particularly household spending.

Coming into 2019, the data pulse has been a little mixed. On the downside, we've seen our own Westpac McDermott Miller survey of consumer confidence falling to below average levels, as well as ongoing weakness in business confidence. There's also been softness in house sales. However, on the other side of the ledger has been firmness in both retail spending and building consents, as well as strength in the global prices for New Zealand's key commodity exports (including dairy). On balance, recent developments leave us comfortable with our forecast for a reacceleration in GDP growth over 2019, particularly given the large increases in government spending now hitting the economy.

From the perspective of the RBNZ, we doubt that recent developments will have prompted a material shift in thinking ahead of Wednesday's Official Cash Rate review. We expect the Reserve Bank to issue a statement very similar to the February press release, repeating the key phrases: "We expect to keep the OCR at [1.75%] through 2019 and 2020" and "The direction of our next OCR move could be up or down." The details of the statement will continue to emphasise global risks but will talk up the chances of New Zealand's economy picking up.

Financial markets are primed for a more dovish statement from the RBNZ than we are anticipating. Many global central banks have shifted to a more dovish stance recently, and financial markets probably believe that the Reserve Bank is going to follow suit. If the RBNZ actually issues a largely unchanged statement, as we expect, then swap rates and the exchange rate would rise on the day.

Looking beyond this week's announcement, we continue to think that financial markets are overestimating the chances of an OCR cut from the RBNZ. Financial markets have priced in an 80% chance of a rate cut by the end of 2019, with a cut almost fully priced in by the end of 2020. In contrast, we're forecasting no change in the OCR through 2019, 2020 and 2021, with the risks around that outlook evenly balanced.

Reacceleration to stay the RBNZ's hand

The coming months will see some softening in headline inflation on the back of lower petrol prices. However, core inflation remains close to target and the labour market has been gradually tightening. Looking forward, a lift in domestic demand to firm levels is on the cards over the coming year, including large increases in government spending and a further leg higher in construction activity (the RBNZ expects the latter will be an important contributor to cyclical pressures). That combination of conditions doesn't point to an economy in desperate need of additional support from monetary policy at this stage.

However, we are conscious that the NZ dollar has strengthened recently as rhetoric from the US Federal Reserve has become more dovish. And with the potential for a cut from the RBNZ looking overpriced, there is the chance of a further rise over the coming weeks. Consistent with that, we have revised up our forecasts for the NZ dollar this past week. The NZD/USD is currently sitting around 69 cents and we now forecast that it will decline to 67 cents by the end of this year (previously we expected a fall to 65 cents). The potential drag on activity from a higher NZ dollar and related risks for imported inflation (which has continually surprised the RBNZ and other forecasters to the downside) will test the Reserve Bank's mettle over the coming months.

The turn in the current account

After shrinking to 2.2% of GDP in 2016, the annual current account deficit grew to 3.7% of GDP at the end of 2018. While that's not a very large turn around by historical

standards, it's still a bit beyond what we would consider to be sustainable over the long term.

However, much of last year's deterioration in the current account balance was due to temporary factors which have now reversed, including earlier disruptions to agricultural exports and last year's spike in oil prices. Combined with the recent firming in commodity prices, we expect the current account deficit will narrow to more sustainable levels of around 3% of GDP over the coming year.

Kia kaha Christchurch – As-salamu alaykum

We would like to extend our deepest sympathy and condolences to those affected by the terrorist attack in Christchurch on 15 March.

The economic consequences of those events are second order to the incalculable human impact. However, we have received some questions on the possible economic impacts which we will briefly try to address here. The international literature indicates that there is unlikely to be any significant direct macroeconomic impact. In particular, the speculation that tourism will be impacted is not supported by international evidence. For example, there was no discernible tourism impact following the 2011 terrorist attack in Norway.

However, there will be an indirect economic impact via political conditions. The Prime Minister is widely credited with handling this crisis excellently, and that will improve Labour's electoral chances at the next election. One of the many political consequences of that is that it improves the chances of a capital gains tax being successfully introduced.

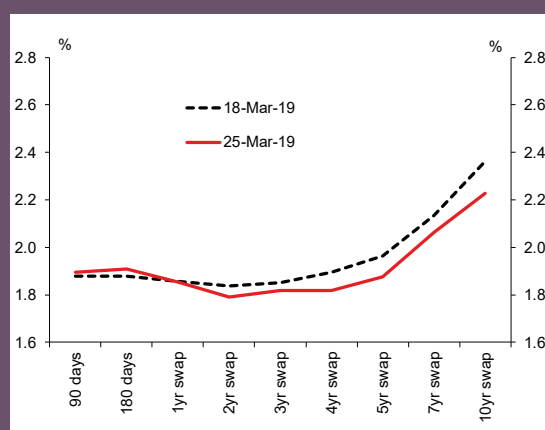
Fixed vs Floating for mortgages

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.

Two-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



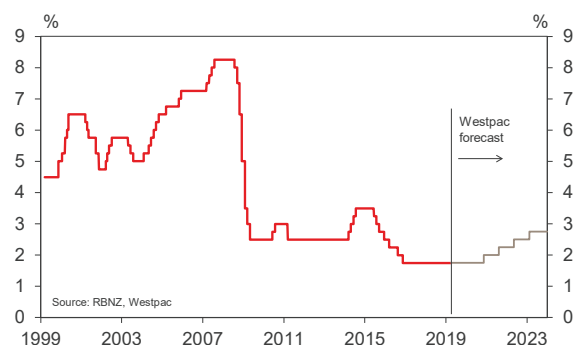
The week ahead

NZ RBNZ Official Cash Rate review

Mar 27, Last: 1.75%, Mkt: 1.75%, WBC: 1.75%

- The RBNZ is likely to repeat the key messages from February, including "OCR on hold through 2019 and 2020" and "the next move could be up or down."
- The details of the statement will also be similar to February, emphasising global risks and a positive domestic outlook.
- Recent developments have been in line with RBNZ expectations, so there is no reason for the RBNZ to change stance.
- The impending move to a Monetary Policy Committee is another reason for the RBNZ to avoid rocking the boat right now.
- Markets would be surprised by an unchanged statement from the RBNZ. Swap rates and the exchange rate would rise a bit.

RBNZ Official Cash Rate

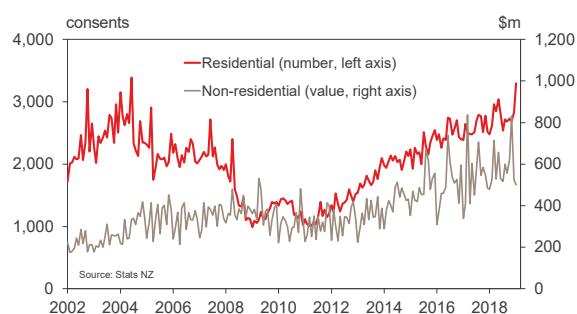


NZ Feb dwelling consents

Mar 29, Last: +16.5%, WBC f/c: -10%

- Residential dwelling consent numbers rose a massive 16.5% in January. That took annual consent numbers to a 44-year high, and we expect that this will be reflected in a further rise in construction activity over 2019.
- At least some of January's rise in consents related to 'lumpy' categories like apartments. Seasonal adjustment may also have exaggerated the monthly increase. As a result, we're expecting a 10% pull back in February. That will still leave annual consent numbers around multi-decade highs.
- We expect monthly consent issuance will remain strong for some time. However, smoothing through the normal month-to-month swings, we expect 2019 will see issuance levels flattening off with the peak in the construction cycle now in sight.

NZ building consents

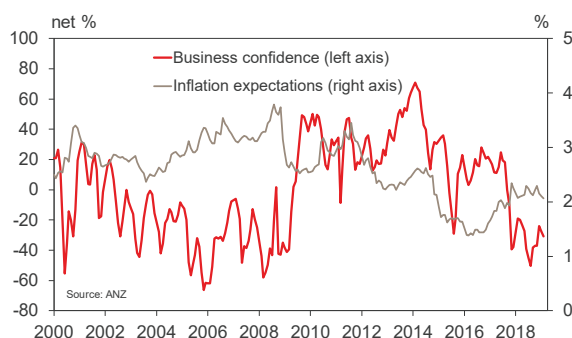


NZ Mar ANZ Business confidence

Mar 27, Last -30.9

- After improving in the final months of 2018, business confidence took a step down in the first reading of 2019.
- Confidence could take a bigger hit this month following the release of the Tax Working Group's final recommendation to the Government on 21 February. The most widely publicised aspect of the report was the recommendation of a broad-based capital gains tax on all assets excluding of the family home.
- While the Government is yet to announce how it will respond to the recommendations in the report and which of the recommendations it will adopt, the report was roundly criticised by many in the business community.
- Price gauges have been relatively stable in recent surveys and continue to hover near 2%.

NZ business confidence and inflation expectations



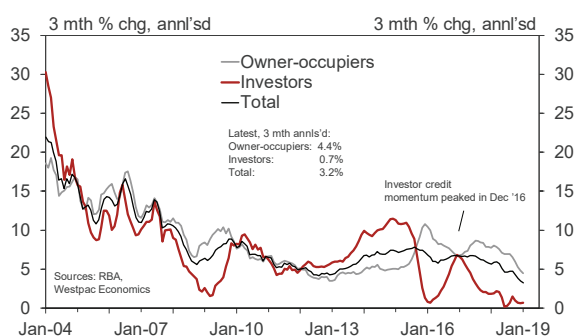
Aus Feb private credit

Mar 29, Last: 0.2%, WBC f/c: 0.2%

Mkt f/c: 0.2%, Range: 0.2% to 0.4%

- Private sector credit growth has slowed to a sluggish pace as the housing sector weakens. In January, credit grew by 0.2%, matching the December outcome. Annual growth has slipped to 4.3% and the 3 month annualised pace is 3.1%
- Housing credit grew by 0.24% in January - below the July 2012 low of 0.3% and the weakest monthly result since a one-off negative in July 1984. Annual growth is 4.4%. Lending to both investors and owner-occupiers is in decline.
- Business credit, 5.2% above the level of a year ago, is volatile around a moderate uptrend as businesses increase investment in the real economy. A strong burst over 2018H2, +6.6% annualised, has given way to more modest gains at the turn of the year. We anticipate another more modest increase in February.

Housing credit weakens

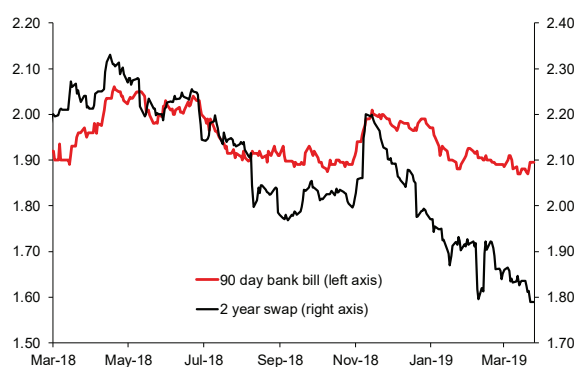


New Zealand forecasts

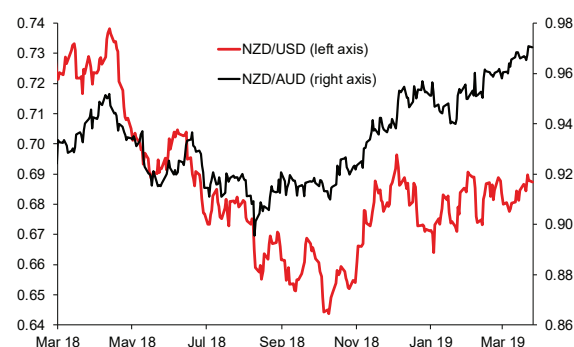
| Economic Forecasts | Quarterly | | | | Annual | | | |
|----------------------------------|-----------|------|------|------|--------|-------|-------|-------|
| | 2018 | 2019 | | | | | | |
| % change | Dec (a) | Mar | Jun | Sep | 2018 | 2019f | 2020f | 2021f |
| GDP (Production) | 0.6 | 0.7 | 0.8 | 0.8 | 2.8 | 2.7 | 2.8 | 2.0 |
| Employment | 0.1 | 0.2 | 0.3 | 0.4 | 2.3 | 1.2 | 1.6 | 1.3 |
| Unemployment Rate % s.a. | 4.3 | 4.4 | 4.3 | 4.2 | 4.3 | 4.2 | 4.0 | 4.0 |
| CPI | 0.1 | 0.2 | 0.5 | 0.7 | 1.9 | 1.7 | 2.1 | 2.1 |
| Current Account Balance % of GDP | -3.7 | -3.4 | -3.2 | -3.1 | -3.7 | -2.9 | -2.8 | -2.8 |

| Financial Forecasts | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-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 | 1.95 | 2.00 | 2.05 | 2.10 |
| 5 Year Swap | 2.05 | 2.10 | 2.15 | 2.20 | 2.25 | 2.30 |
| 10 Year Bond | 2.10 | 2.15 | 2.20 | 2.20 | 2.25 | 2.35 |
| NZD/USD | 0.69 | 0.67 | 0.67 | 0.66 | 0.66 | 0.66 |
| NZD/AUD | 0.98 | 0.98 | 0.98 | 0.96 | 0.96 | 0.94 |
| NZD/JPY | 77.7 | 76.2 | 75.4 | 74.1 | 72.6 | 71.3 |
| NZD/EUR | 0.62 | 0.61 | 0.61 | 0.60 | 0.59 | 0.58 |
| NZD/GBP | 0.53 | 0.50 | 0.49 | 0.49 | 0.48 | 0.48 |
| TWI | 75.7 | 74.2 | 73.8 | 72.5 | 71.7 | 71.0 |

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 25 March 2019

| Interest Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| Cash | 1.75% | 1.75% | 1.75% |
| 30 Days | 1.86% | 1.87% | 1.85% |
| 60 Days | 1.88% | 1.87% | 1.87% |
| 90 Days | 1.90% | 1.88% | 1.89% |
| 2 Year Swap | 1.79% | 1.84% | 1.86% |
| 5 Year Swap | 1.88% | 1.97% | 2.04% |

NZ foreign currency mid-rates as at 25 March 2019

| Exchange Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| NZD/USD | 0.6873 | 0.6792 | 0.6844 |
| NZD/EUR | 0.6085 | 0.6045 | 0.6034 |
| NZD/GBP | 0.5208 | 0.5240 | 0.5238 |
| NZD/JPY | 75.49 | 75.41 | 75.76 |
| NZD/AUD | 0.9703 | 0.9659 | 0.9595 |
| TWI | 74.70 | 74.18 | 74.26 |

Data calendar

| | | Last | Market median | Westpac forecast | Risk/Comment |
|---------------|-------------------------------------|-------|---------------|------------------|--|
| Mon 25 | | | | | |
| US | Feb Chicago Fed activity index | -0.43 | -0.25 | - | Regional surveys volatile. |
| | Mar Dallas Fed index | 13.1 | 9.6 | - | Regional surveys volatile. |
| | Fedspeak | - | - | - | Evans in Hong Kong. Harker in London. |
| Tue 26 | | | | | |
| NZ | Feb trade balance \$m | -914 | -200 | -100 | Expecting a rebound from unusually low exports in January. |
| Aus | RBA Assistant Governor Economic | - | - | - | Luci Ellis, at HIA Industry Outlook, Sydney 7:30am. |
| US | Feb housing starts | 18.6% | -1.6% | - | Jan recovered from Dec slump. |
| | Feb building permits | -0.7% | - | - | Trend flattened in 2018. |
| | Jan FHFA house prices | 0.3% | 0.4% | - | Still running at a multiple of income growth... |
| | Jan S&P/CS home price index %yr | 4.7% | - | - | ... and gains broadbased across nation. |
| | Mar Richmond Fed index | 16 | 12 | - | Investment intentions a focus for this survey. |
| | Mar consumer confidence index | 131.4 | 132.0 | - | Remains strong. |
| | Fedspeak | - | - | - | Rosengren in Hong Kong. Harker, Evans & Daly at diff. events. |
| Wed 27 | | | | | |
| NZ | RBNZ OCR review | 1.75% | 1.75% | 1.75% | RBNZ to maintain its firmly 'on hold' stance. |
| Aus | RBA Assist Gov Financial Markets | - | - | - | Chris Kent, on panel at FX Week Australia, 10:10am Sydney. |
| Chn | Feb industrial profits %yr | -1.9% | - | - | Reforms aimed at supporting profitability. |
| Eur | ECB President Draghi speaks | - | - | - | ECB and its watchers conference with Praet and de Guindos. |
| US | Jan trade balance \$bn | -59.8 | -57.3 | - | Deficit rose through 2018 as domestic growth picked up. |
| Thu 28 | | | | | |
| NZ | Mar ANZ business confidence | -30.9 | - | - | Likely to take a hit from capital gains tax proposals. |
| Eur | Feb M3 money supply %yr | 3.8% | 3.8% | - | Credit pulse integral to decision around TLTRO incentives. |
| | Mar economic confidence | 106.1 | 106.3 | - | Firms remain uncertain due to... |
| | Mar business climate indicator | 0.69 | 0.72 | - | ... pervasive geopolitical risks but sentiment has stabilised... |
| UK | Mar Nationwide house prices | -0.1% | - | - | TBC. Economic uncertainty still dampening prices. |
| US | Q4 GDP 3rd estimate %annualised | 2.6% | 2.3% | - | Market now focused on Q1 pulse. |
| | Initial jobless claims | 221k | - | - | Very low. |
| | Feb pending home sales | 4.6% | 0.5% | - | Supply still the main issue. |
| | Mar Kansas City Fed index | 1 | - | - | Investment intentions a focus for this survey. |
| | Fed Vice Chair Clarida speaks | - | - | - | On panel at Bank of France Conference. |
| | Fedspeak | - | - | - | Quarles, ECB conf. Williams in Puerto Rico. George & Bowman. |
| Fri 29 | | | | | |
| NZ | Mar ANZ consumer confidence | 120.8 | - | - | Confidence has been moderating in early 2019. |
| | Feb building permits | 16.5% | - | -10.0% | Pull back following last month's surge; level still elevated. |
| | RBNZ Governor Orr speaks | - | - | - | Discussing changes to NZ monetary policy framework. |
| Aus | Feb private sector credit | 0.2% | 0.2% | 0.2% | Has slowed to a sluggish pace, centred on housing. |
| Chn | Q4 current account balance \$bn | 54.6 | - | - | Dated, but detail of interest. |
| Eur | Mar core CPI %yr (preliminary) | 1.0% | 1.0% | - | Still stuck around 1% despite higher wages growth. |
| UK | Mar GfK consumer sentiment | -13 | -14 | - | Continued Brexit uncertainty a drag. |
| | Feb net mortgage lending £bn | 3.7 | 3.7 | - | Has been trending sideways since 2016's referendum. |
| | Q4 GDP 2nd estimate | 0.2% | 0.2% | 0.2% | Brexit related weakness in investment weighing on growth. |
| US | Feb personal income | -0.1% | 0.3% | - | Second run of PCE data this week... |
| | Jan personal spending | -0.5% | 0.3% | - | ... following shutdown delays... |
| | Jan PCE deflator | 0.2% | 0.2% | - | ... key partials for Q1 GDP expectations. |
| | Mar MNI Chicago PMI | 64.7 | 61.9 | - | Regional surveys volatile of late. |
| | Mar Uni. of Mich. sentiment (final) | 97.8 | 97.8 | - | Confidence and buying intentions robust. |
| | Feb new home sales | -6.9% | 2.5% | - | Interest rates & income to provide renewed support in 2019. |
| | Fedspeak | - | - | - | Bullard in Wisconsin. Quarles on macroprudential policy. |

International forecasts

| Economic Forecasts (Calendar Years) | 2015 | 2016 | 2017 | 2018 | 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 | 1.81 | 1.90 | 1.65 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 |
| 10 Year Bond | 1.85 | 1.85 | 1.75 | 1.80 | 1.80 | 1.80 | 1.85 | 1.90 |
| International | | | | | | | | |
| Fed Funds | 2.375 | 2.375 | 2.375 | 2.625 | 2.625 | 2.625 | 2.625 | 2.625 |
| US 10 Year Bond | 2.53 | 2.60 | 2.65 | 2.70 | 2.65 | 2.60 | 2.55 | 2.55 |
| 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 | 0.7105 | 0.70 | 0.68 | 0.68 | 0.69 | 0.69 | 0.70 | 0.70 |
| USD/JPY | 110.78 | 113 | 114 | 113 | 112 | 110 | 108 | 106 |
| EUR/USD | 1.1375 | 1.11 | 1.10 | 1.10 | 1.11 | 1.12 | 1.14 | 1.17 |
| GBP/USD | 1.3137 | 1.31 | 1.33 | 1.36 | 1.36 | 1.37 | 1.37 | 1.38 |
| AUD/NZD | 1.0313 | 1.02 | 1.02 | 1.02 | 1.04 | 1.05 | 1.06 | 1.06 |

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