Len Lye Centre, New Plymouth

Weekly Economic Commentary.

Changing fortunes.

In the past week we published new research on commercial property and the metallic and non-metallic minerals sector. One is set to remain an attractive investment. The other faces some big challenges, as customer demands change and global competition intensifies.

New Zealand's commercial property sector.

New Zealand's commercial property sector has enjoyed a solid run in recent years. As we discuss in our recent report,[1] an extended period of economic growth and rapid increases in the population have fuelled occupier demand for commercial space. The related rise in rents and very low interest rates have made commercial property an attractive investment, boosting property sales and supporting firm levels of non-residential building activity.

These positive trends in the commercial property sector have continued through 2019. However, the underlying economic conditions that have supported demand have been changing. GDP growth has slowed from rates of over 3% through 2018 to 2.4% in the year to June 2019. Population growth has cooled from rates of around 2% in 2016 to 1.6% now. And on top of those developments, the global backdrop has become increasingly rocky.

Against this backdrop, business confidence has plunged and businesses' plans for expansion have been scaled back. We've also seen the Reserve Bank cut the Official Cash Rate to a record low of 1%, and we expect another cut in November.

In the near-term, the slowdown in economic growth and confidence will dampen tenants' demand for new space and could impact the extent of rent increases.

Nevertheless, the outlook for investor demand and commercial property prices over the coming few years is positive. Although the economy is slow, interest rates are very low and are likely to remain so for some time. That's making commercial property an attractive option compared to many other forms of investment.

1 https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Commercial-Property-Economic-Insight-Oct-19-Westpac-NZ.pdf

A key risk to the outlook for commercial property is the potential for a continued deterioration in economic conditions, which could dent demand from both occupiers and investors.

Metallic and non-metallic minerals manufacturing sector.

Many of the factors that have supported commercial property in recent years have also boosted the fortunes of the many firms that manufacture of metals and metal products, cement, concrete and fabricated glass products. As discussed in our recent Industry Insight report,[2] what happens in the construction sector really matters. Also important is downstream manufacturing, which incorporates metal and glass in many of the products that it produces.

However, performances here have been mixed. While residential and non-residential building activity has been relatively buoyant, downstream manufacturing, especially outside of food, has struggled.

Looking forward, we think that the metallic and non-metallic mineral products sector will face some testing times. Growing global headwinds are likely to mean softer prices for many of the products produced by the sector. Indeed, we are already seeing this in global steel and aluminium prices, which have trended lower over the past year.

Add to that a softer outlook for domestic demand, with construction activity expected to top out soon and downstream manufacturing likely to remain under the cosh.

None of this is great news for firms in the metallic and non-metallic minerals product sector, which are likely to experience tighter margins as a result. Indeed, there is evidence to suggest this is already happening, with at least one high-profile firm already touting the possibility of closure.

Further out, ongoing industrialisation in Asia will continue to provide structural support for demand for this sector's products. However, it's likely to be India rather than China that takes up the growth baton. Demand in New Zealand should continue to grow, mainly because more construction will be needed to address the needs of a growing population.

However, the positive impact of these structural factors on demand are likely to be more than offset by rapid technological changes and intensifying environmental pressures, which will not only fundamentally change what, how and where we produce things, but also how we consume them. This will have big implications for firms that operate in this sector.

Keeping up with these changes will come at a cost – and a big one at that. Even if firms operating in New Zealand can afford it, there is no guarantee that they will invest. What really matters are the returns on investment. and if they don't stack up, there is every chance that firms operating in New Zealand will close their doors.

For smaller firms operating in New Zealand that produce to order, the impacts could be even more dramatic. Simply put, most will not be able to afford the investment required and will face increasing competition from abroad as a result. Over time this will result in more manufacturing moving overseas, leaving those that remain to focus on highly specialised niches or becoming design houses, working with customers to develop solutions rather than manufacturing them.

2 https://www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Industry-Insight-Metallic-and-non-metallic-minerals-October-2019-Westpac-NZ.pdf

Fixed vs Floating for mortgages.

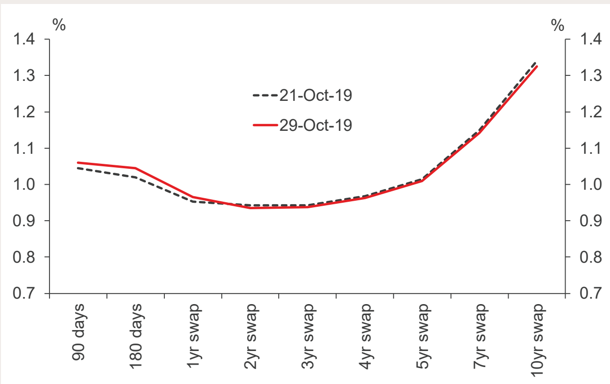
Mortgage rates are falling, and with the Reserve Bank expected to cut the OCR once more, we think they will keep falling. This means there is no hurry to fix.

Among the fixed rates on offer, we think the best value at present is the one-year rate. It is lower than the floating or six-month rates, yet it may still allow borrowers to roll onto lower rates at the end of the fixed term. Fixing for a longer term may mean that borrowers miss out on re-fixing at the lowest rates, at least according to our forecasts.

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



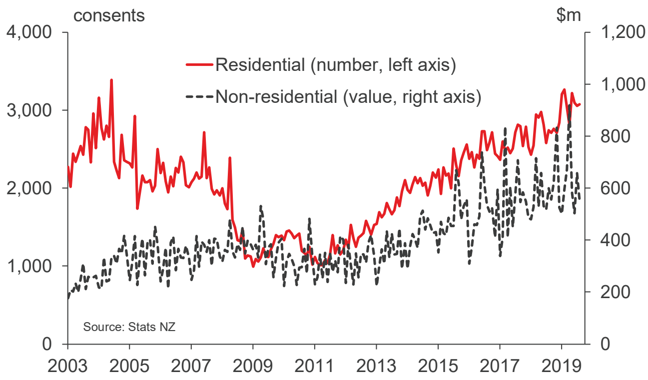
The week ahead.

NZ Sep dwelling consents

Oct 31, Last: +0.8%, WBC f/c: +0.5%

- Residential dwelling consent issuance rose 0.8% in August. While that was a modest gain, it followed strong issuance over the past year and left annual consent numbers at a multi-decade high.
- We expect that consent numbers will nudge higher again in September, with continued strong issuance in Auckland and elsewhere.
- The key source of uncertainty for the monthly consent figures are medium-density developments, which account for a growing share of total consents. These tend to come in lumps, meaning the month-to-month growth rates can be volatile.
- Annual issuance is expected to remain strong for some time.

NZ building consents

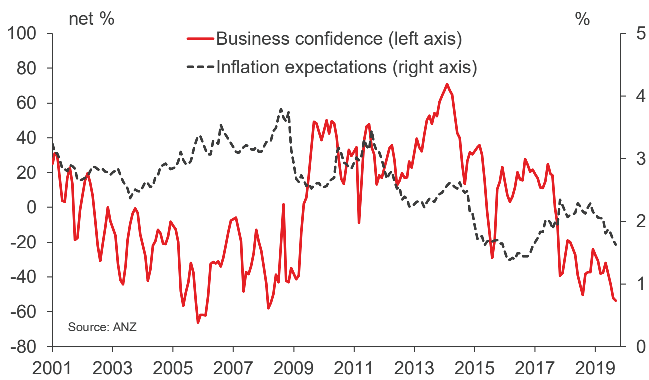


NZ Oct ANZ business confidence

Oct 31, Last –53.5

- Business confidence nudged down again in September, falling to its lowest level since 2008. There was also a further deterioration in businesses' expectations for their own trading activity.
- Recent economic developments have been mixed. The global backdrop remains rocky, and conditions in sectors such as manufacturing remain challenging. However, we're also seen a firming in the housing market and household spending. On balance, we expect that business confidence will remain at low levels in October.
- The RBNZ has highlighted the importance of inflation expectations in its policy deliberations. With this in mind, we'll be paying close attention to the survey's price gauges which have trended down in recent months.

NZ business confidence and inflation expectations

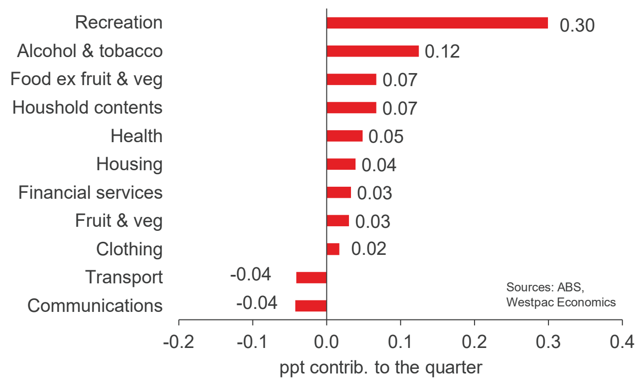


Aus Q3 CPI

Oct 30, Last: 0.6%, WBC f/c: 0.6%
Mkt f/c: 0.5%, Range: 0.4% to 0.9%

- The CPI lifted 0.6% in the June quarter compared to a market median (and Westpac's) forecast of 0.5%. The annual rate lifted to 1.6%yr from 1.3%yr. There was some AUD depreciation pass-through boosting consumer goods prices but falling dwelling prices and flat rents along with falling food prices provided some offset. The trimmed mean rose 0.4%qtr/1.6%yr.
- Westpac is forecasting a 0.6% rise in the September quarter CPI lifting the annual pace to 1.8%yr from 1.6%yr. Boosting the CPI is holiday travel & accommodation (with domestic lifting 6% and international rising 3% in the quarter), alcohol & tobacco (mostly the annual re-indexing of the tobacco excise) and food (drought offsetting normal seasonal softness). Housing costs are to rise 0.2% as the solid 3% seasonal rise in property rates & charges offsets flat rents, and falling dwelling purchases and utilities prices.
- Westpac is forecasting 0.3%/1.5%yr trimmed mean inflation.

Contributions 2019 Q3 CPI 0.6%qtr forecast



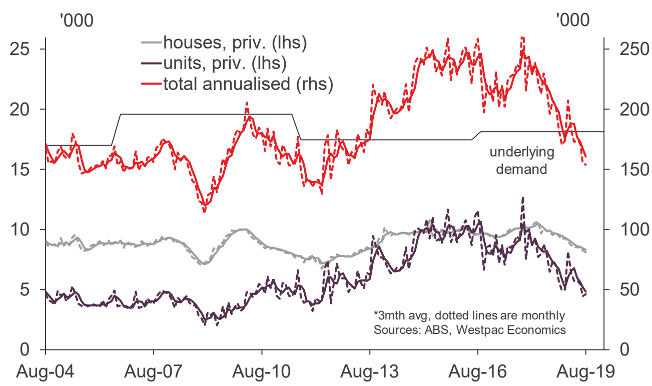
The week ahead.

Aus Sep dwelling approvals

Oct 31, Last: –1.1%, WBC f/c: 0.5%
Mkt f/c: 0.0%, Range: -5.7% to 2.0%

- Dwelling approvals disappointed in August, recording a further 1.1% decline following a sharp 9.7% drop in July. The slide that began in late 2017 and paused in early 2019 has resumed and has yet to form a clear base. Approvals are now at their lowest level since the start of 2013 and 31% below the average level prevailing through mid 2018.
- Australia's housing markets have shown a clear improvement since mid-year but any flow on boost to construction activity looks likely to come through slowly and be overshadowed by ongoing weakness in the high rise segment where downside risks still dominate. Construction-related finance approvals have been pointing to a firmer tone for non high rise activity in recent months, suggesting this segment should start to stabilise. That in turn should be enough to see total approvals edge up slightly by 0.5% in the month although that will still leave them down 10% for Q3 as a whole and the high rise segment continues to pose downside risks.

Dwelling approvals

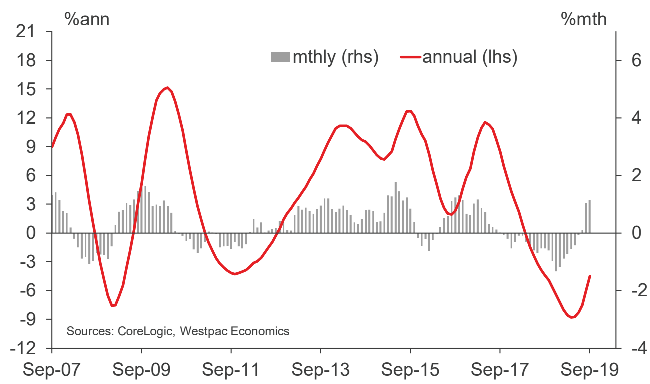


Aus Oct CoreLogic home value index

Nov 1, Last: 1.0%, WBC f/c: 1.0%

- The correction in Australian dwelling prices that began in late 2017 ended in mid-2019 with prices showing a clear lift since mid-year. The CoreLogic home value index, covering the eight major capital cities, posted gains around 1%mth in both August and September after stabilising in June-July. Prices are still down 4.3%yr but the turning point has clearly passed.
- The daily index shows prices on track for another solid 1% gain in October. Sydney and Melbourne leading the way with prices now up 4.7-5.3% from their May lows. Conditions remain more mixed across other markets although most have improved in the month with a notable quickening in Brisbane.

Australian dwelling prices

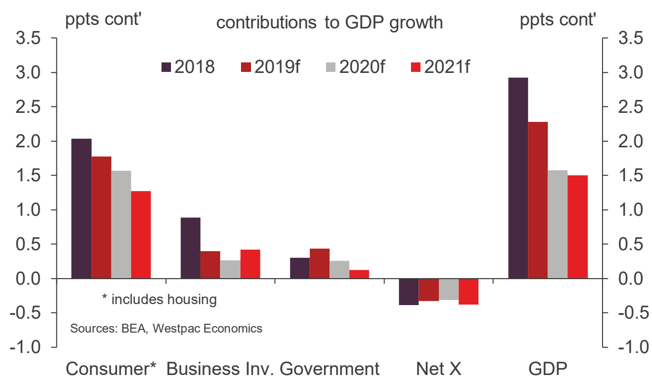


US Q3 GDP

Oct 30, last: 2.0%, WBC: 1.8%

- 2019 is seeing a significant but well-mannered deceleration in US GDP growth. Having printed at 3.1% in Q1, annualised GDP growth slowed to 2.0% in Q2 and is expected to come in at 1.8% in Q3.
- Behind this slowdown is a marked deterioration in business investment growth, as 2017/18's fiscal tailwind is lost and global uncertainties weigh, and persistent weakness in residential construction – despite historically low interest rates. Net exports were broadly neutral to June for growth, but will likely be a drag come Q3.
- For both Q3 and the months thereafter, the biggest question for policy makers is whether consumer demand will follow business investment's lead. We anticipate solid outcomes, but growth will still slow to trend by year end – and risks will remain skewed.

US growth to decelerate below trend



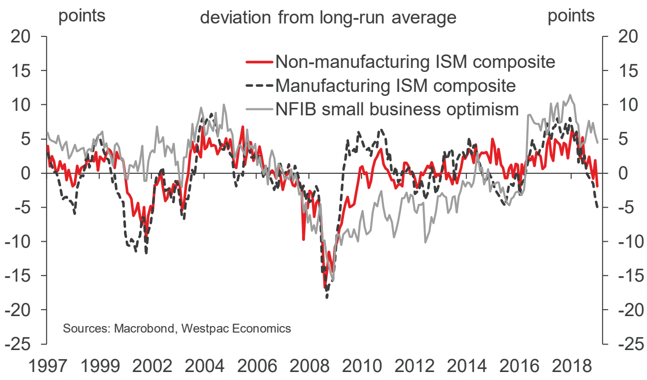
The week ahead.

US Oct FOMC meeting

Oct 29–30; federal funds mid, last: 1.875%, WBC: 1.625%

- In recent weeks, markets have taken on a much more positive view of the global outlook thanks to progress towards a Brexit deal and an easing of tensions between the US and China. That being said, there is still a pressing need for the FOMC to take out further insurance against downside risks.
- Evident in recent data is further weakness in investment as well as a significant deterioration in business conditions – as assessed by the ISMs. Of greater concern still, growth in employment and hourly earnings have both throttled back. If sustained, these trends will put consumer sentiment and spending at risk.
- We therefore expect the FOMC to cut the federal funds rate at the October meeting and to remain open to taking further action in coming months. A December cut and those we see in March and June will require a further slowing of growth.

Downside risks still dominant

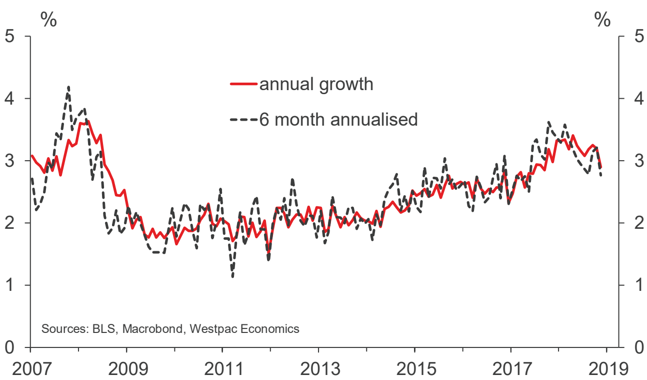


US Oct payrolls

Nov 1, nonfarm payrolls, last: 136k, WBC: 100k
Nov 1, unemployment rate, last: 3.5%, WBC: 3.6%

- At the start of this year, we anticipated that the US labour market would lose momentum through 2019. As the months have rolled on, the data has confirmed a material reduction in the pace of hiring albeit without any noticeable increase in firing.
- October will see a continuation of the first trend and this will be amplified by the GM strike, resulting in nonfarm payrolls printing around 100k. Having ticked down in September, the unemployment rate is expected to reverse course to 3.6%.
- Hourly earnings growth is also likely to be closely scrutinised, having slowed to 2.9%yr in September. The absence of a rebound in coming months would be clear evidence of firms reducing costs and hence downside risks for the consumer.

Hourly earnings trend looks to have turned

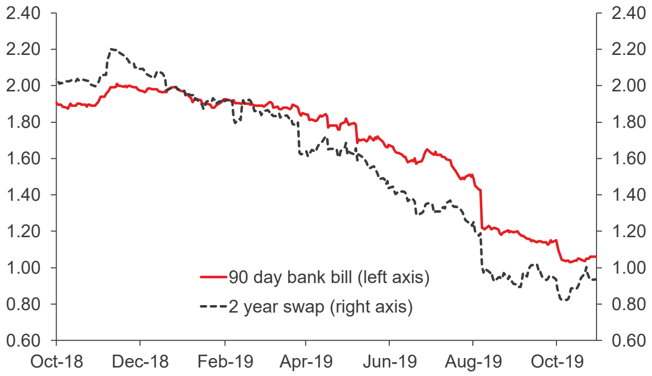


New Zealand forecasts.

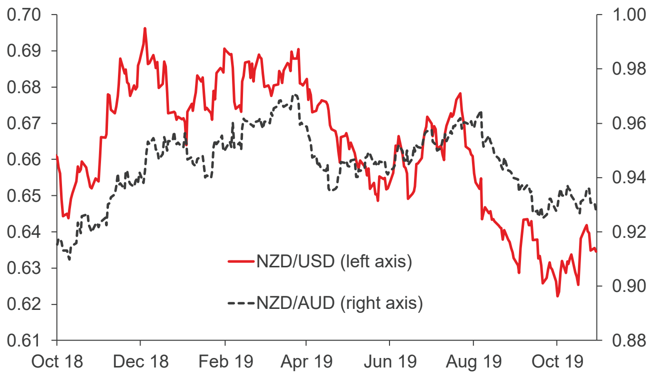
Economic forecasts	Quarterly				Annual			
	2019			2020				
% change	Jun (a)	Sep	Dec	Mar	2018	2019f	2020f	2021f
GDP (Production)	0.5	0.3	0.5	0.6	2.8	2.2	2.3	2.8
Employment	0.8	0.2	0.4	0.4	2.3	1.4	1.8	2.0
Unemployment Rate % s.a.	3.9	4.1	4.2	4.3	4.3	4.2	4.2	3.8
CPI	0.6	0.7	0.3	0.5	1.9	1.7	1.7	1.8
Current Account Balance % of GDP	-3.4	-3.4	-3.2	-3.2	-3.9	-3.2	-3.0	-2.8

Financial forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Cash	0.75	0.75	0.75	0.75	0.75	0.75
90 Day bill	0.90	0.90	0.90	0.90	0.90	0.90
2 Year Swap	0.80	0.80	0.80	0.85	0.90	0.95
5 Year Swap	0.95	1.00	1.05	1.10	1.20	1.25
10 Year Bond	1.00	1.05	1.15	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	66.2	64.5	64.5	66.8	68.0	70.4
NZD/EUR	0.59	0.59	0.58	0.59	0.58	0.58
NZD/GBP	0.54	0.53	0.52	0.52	0.51	0.50
TWI	71.4	70.6	70.1	70.6	70.1	70.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 29 October 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.14%	1.17%	1.19%
60 Days	1.10%	1.10%	1.16%
90 Days	1.06%	1.03%	1.14%
2 Year Swap	0.94%	0.89%	0.95%
5 Year Swap	1.01%	0.94%	0.95%

NZ foreign currency mid-rates as at 29 October 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6346	0.6337	0.6296
NZD/EUR	0.5718	0.5726	0.5756
NZD/GBP	0.4934	0.5015	0.5124
NZD/JPY	69.16	68.61	67.95
NZD/AUD	0.9277	0.9334	0.9307
TWI	70.37	70.56	70.47

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 28					
NZ	Labour day	–	–	–	Public holiday.
Eur	Sep M3 money supply %yr	5.7%	–	–	Credit growth has remained solid.
	ECB President Draghi speaks	–	–	–	Farewell event.
UK	Oct Nationwide house prices %yr	0.2%	–	–	Price growth flat as brexit uncertainty persists.
US	Sep Chicago Fed activity index	0.10	–	–	Regional surveys have been volatile of late.
	Sep wholesale inventories	0.2%	–	–	Likely to be reduced as economy slows.
	Oct Dallas Fed index	1.5	0.0	–	Manufacturers under pressure.
Tue 29					
Aus	RBA Governor Lowe speaks	–	–	–	"Some Echoes of Melville", Canberra 5:45pm.
UK	Sep net mortgage lending £bn	3.9	–	–	Current lending still at pre-referendum level.
US	Aug S&P/CS home price index %yr	2.00%	–	–	Price growth has slowed right down despite low rates.
	Sep pending home sales	1.6%	1.0%	–	Existing home market continues to be held back by supply.
	Oct consumer confidence index	125.1	128.0	–	Conference Board current view still very positive.
Wed 30					
Aus	Q3 CPI	0.6%	0.5%	0.6%	Domestic holidays more than offsetting falling petrol prices...
	Q3 CPI %yr	1.6%	1.7%	1.8%	... boosting annual inflation to 1.8%yr...
	Q3 core CPI (trimmed mean)	0.4%	0.4%	0.3%	... but core remains a lacklustre 1.5%yr.
Eur	Oct economic confidence	101.7	–	–	Business mood is dour as...
	Oct business climate indicator	–0.22	–	–	... deepening contraction in manufacturing presents concerns.
US	Oct ADP employment change	135k	116k	–	Labour market has clearly slowed and risks are to downside.
	Q3 GDP %qtr annualised	2.0%	1.6%	1.8%	Weak investment to offset still-robust consumer spending.
	FOMC policy decision, midpoint	1.875%	1.625%	1.625%	Further insurance needs to be taken out.
Thu 31					
NZ	Sep building permits	0.8%	–	0.5%	Annual consent numbers to remain high, esp. in Akd.
	Oct ANZ business confidence	–53.5	–	–	Likely to linger at low levels
Aus	Sep dwelling approvals	–1.1%	0.0%	0.5%	Down around 20% in annual terms.
	Q3 import price index	0.9%	0.4%	0.3%	Prices up on lower AUD; lower fuel prices a partial offset.
	Q3 export price index	3.8%	–0.5%	–0.5%	Lower commodity prices outweigh impact from lower AUD.
	Sep private sector credit	0.2%	0.2%	0.2%	Growth remains weak ahead of any rate cut boost.
Chn	Oct manufacturing PMI	49.8	49.7	–	Recent GDP and investment data highlighted that China's...
	Oct non-manufacturing PMI	53.7	53.7	–	... economy is facing particularly challenging circumstances.
Eur	Sep unemployment rate	7.4%	–	–	Near historic lows...
	Q3 GDP 1st estimate	0.2%	–	0.2%	... as employment growth has defied soft output growth...
	Oct core CPI %yr preliminary	1.0%	–	–	... while core inflation remains stuck at 1%yr.
UK	Oct GfK consumer sentiment	–12	–	–	Broadly steady as unemployment is still low.
US	Q3 employment cost index	0.6%	0.7%	–	Hourly earnings points to labour cost being reined in.
	Sep personal income	0.4%	0.3%	–	Income growth still robust...
	Sep personal spending	0.1%	0.3%	–	... and without threat of job loss, households are spending...
	Sep core PCE inflation %yr	1.8%	1.7%	–	... however momentum will progressively slow from here.
	Initial jobless claims	–	–	–	Historically low.
	Oct Chicago PMI	47.1	49.0	–	Manufacturers under pressure.
Fri 01					
NZ	Oct ANZ consumer confidence	113.9	–	–	Indications that spending appetites are increasing.
Aus	Oct AiG PMI	54.7	–	–	Sep, +1.6pts. Mining & lower AUD +ves vs housing downturn.
	Oct CoreLogic home value index	1.0%	1.0%	–	House prices rebounding.
Chn	Oct Caixin China PMI	51.4	51.0	–	Cross-check for official NBS measures.
UK	Oct Markit manufacturing PMI	48.3	–	–	Manufacturing weak on global and brexit concerns.
US	Oct non-farm payrolls	136k	90k	100k	We expect employment growth to moderate further...
	Oct unemployment rate	3.5%	3.6%	3.6%	... through 2019/20, stabilising the unemployment rate.
	Oct average hourly earnings %yr	2.9%	3.0%	3.0%	Risk is of a more dramatic slowdown, which also hits wages.
	Oct ISM manufacturing	47.8	49.0	–	Regional PMIs suggest stabilisation in Oct.
	Fedspeak	–	–	–	Clarida speaks to the Japan society in New York.
	Fedspeak	–	–	–	Williams in Q&A; Quarles on Price System.

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	2.0
Unemployment %	5.7	5.5	5.0	5.4	5.6	5.3
Current Account % GDP	-3.1	-2.6	-2.1	0.4	-0.7	-2.0
United States						
Real GDP %yr	1.6	2.2	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	3.9	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	0.7	0.3	0.4
Euro zone						
Real GDP %yr	2.0	2.4	1.8	1.2	1.1	1.2
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.0	0.7	1.3
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	4.6	4.3	3.7	3.9	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.2	3.3	3.3
Forecasts finalised 4 October 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	0.88	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	1.05	0.95	1.00	1.15	1.20	1.25	1.40	1.50
International								
Fed Funds	1.875	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.75	1.45	1.40	1.45	1.50	1.55	1.70	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	0.6812	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	108.66	108	107	107	107	108	110	112
EUR/USD	1.1102	1.10	1.08	1.07	1.07	1.09	1.11	1.14
GBP/USD	1.2838	1.30	1.33	1.33	1.32	1.31	1.31	1.32
USD/CNY	7.0755	7.20	7.20	7.10	7.00	6.90	6.75	6.60
AUD/NZD	1.0695	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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