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Weekly Economic Commentary.

Hold the horses.

We are no longer expecting the Reserve Bank to reduce the OCR at its next *Monetary Policy Statement* on 13 November. Slowing economic growth and subdued inflation mean that interest rates will need to remain low for a long time. But we don't think that there is enough accumulated evidence to prompt a further rate cut at this stage. However, the RBNZ will keep the door open for further easing, and we do expect a cut in February next year based on a renewed deterioration in global conditions.

An on-hold decision in November would come as a surprise to financial markets, and might lead to accusations that the RBNZ is acting inconsistently. We don't see it that way. It's important to recognise that the RBNZ has never made any commitment towards a rate cut at the November review. The projections in the August *Monetary Policy Statement* had the OCR bottoming out at 0.9%, implying no more than half a chance of another OCR cut at some point.

Moreover, those projections were based on a gradual downward path for the OCR, before the Monetary Policy Committee decided to deliver 50 basis points of easing in one go. It's likely that the committee's thinking was at least in part influenced by the idea that by acting earlier, they might end up having to do less.

That stance was reinforced at the September OCR review, where it stated that "new information since the August *Monetary Policy Statement* did not warrant a significant change to the monetary policy outlook". More recently, RBNZ Assistant Governor Hawkesby commented that they were "very happy" with how the interest rate cuts to date were being transmitted through the economy.

Our view was that by the November review the RBNZ would have seen a rash of downside surprises on the economy, prompting it to cut the OCR again. But that's not the way the dice have fallen: there has been a mix of both positive and negative economic news recently, but with the balance coming out distinctly on the higher side of market forecasts.



It's true that economic growth remains subdued and business confidence is very low. GDP is patently not living up to the RBNZ's forecast of 0.6% growth in the September quarter – we are thinking more along the lines of a 0.3% rise. The RBNZ will have to downgrade its near-term GDP forecasts, and that will put downward pressure on its inflation and employment forecasts.

However, there have been other developments that will put upward pressure on the RBNZ's inflation forecast, and to a lesser extent on employment.

First, recent high-frequency data has been stronger. The housing market is clearly picking up in response to lower mortgage rates. Second-tier data such as electronic card transactions, job ads and car sales have improved recently, after a subdued first half of the year. Meanwhile, building consents have gone from strength to strength.

Inflation was stronger than expected. The RBNZ was braced for annual inflation to drop to 1.3% in the September quarter, but it actually only fell to 1.5%. Importantly, the domestically-generated, non-tradable part of inflation is now lifting more rapidly than the RBNZ anticipated. This will support the RBNZ's forecast of inflation returning to 2% by 2021.

The exchange rate is much lower. On a trade-weighted basis the exchange rate has plunged since August, and is now more than 4% below the RBNZ's previous forecasts. A lower exchange rate tends to boost inflation, reducing the need for OCR cuts.

Finally, global financial market sentiment has improved, and the US and Australian central banks are suggesting that they have cut rates far enough for now. If central banks 'knew something' about their respective economies when they were cutting rates earlier this year, then we can equally infer something from their shift to an on-hold stance.

We recognise that the November OCR decision remains a close call. Between now and then there are two key data releases that could either cement our on-hold forecast or tip the balance back in favour of a cut.

The first is the September quarter labour market surveys, which are released on Wednesday. We're expecting the unemployment rate to rise from 3.9% to 4.2%, reversing its surprise fall to an 11-year low in the previous quarter. In its August statement the RBNZ was forecasting a 4.4% unemployment rate for the September quarter. However, this forecast was prepared before the surprisingly low June quarter result was published. Setting that aside, the RBNZ is already braced for unemployment to worsen in the near term before it gets better, and it would take a substantially worse result than what we're expecting to warrant switching our OCR forecast back to a November cut.

The second important release is the RBNZ's survey of inflation expectations, which fell sharply just prior to the August MPS and was cited several times as a factor in the 50 basis point OCR cut. The RBNZ will have the latest survey as part of their deliberations, but it won't be published until the day before the November MPS. We expect surveyed inflation expectations to hold roughly steady, but if they drop further, we would probably revert to calling a November cut.

We still think that the RBNZ will cut the OCR to a low of 0.75%, but we now expect that will occur in February next year. By that stage, we forecast that the current phase of improving global market sentiment will have given way to renewed uncertainty, particularly as the US presidential election race heats up. We expect that both the US Federal Reserve and the Reserve Bank of Australia will have to restart their easing cycles, creating conditions more conducive to an RBNZ cut.

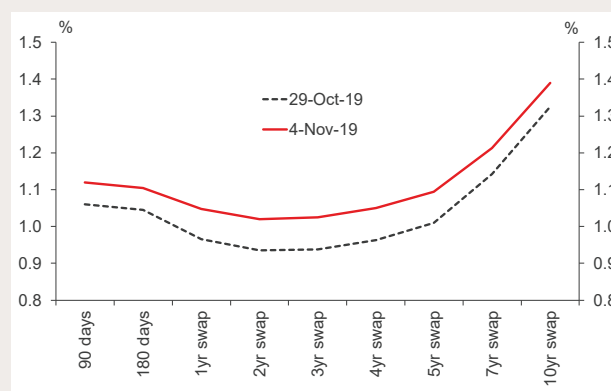
Fixed vs Floating for mortgages.

Taking a fixed mortgage is becoming more attractive. Fixed mortgage rates have tumbled over the past six months, but the period of decline may be drawing to a close. Wholesale fixed rates have risen, and the Reserve Bank does not have much further to go in the current OCR reduction cycle.

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



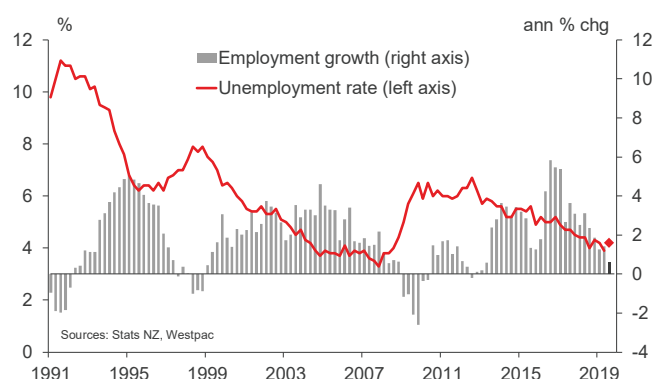
The week ahead.

NZ Q3 Household Labour Force Survey

Nov 6, Employment, Last: +0.7%, WBC f/c: +0.1%, Mkt f/c: +0.2%, Unemployment, Last: 3.9%, WBC f/c: 4.2%, Mkt f/c: 4.1%

- We expect the unemployment rate to rise to 4.2% in the September quarter, reversing its surprising drop to an 11-year low in June.
- Indicators of employment growth have softened over the last year as economic growth has slowed.
- However, unemployment has remained surprisingly low to date. Older workers exiting the workforce may be a factor.
- We expect the Reserve Bank to keep the OCR on hold at its 13 November review. The RBNZ is already braced for a rise in unemployment in the near term, so it would take a worse outcome than what we are forecasting to prompt a change to the OCR outlook.

Household Labour Force Survey

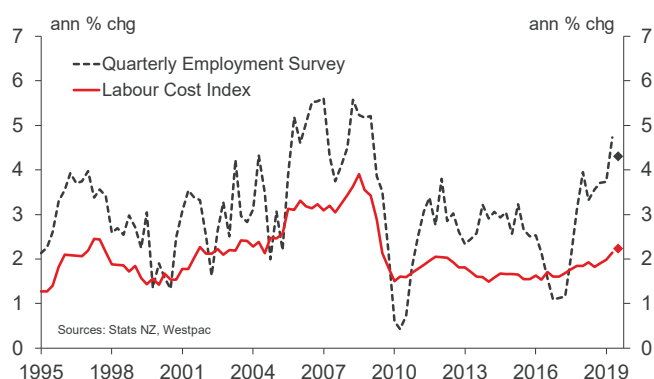


NZ Q3 Labour Cost Index, Private Sector

Nov 6, Last: +0.8%, WBC f/c: +0.6%, Mkt f/c: +0.6%

- We expect a 0.6% rise in the Labour Cost Index for the September quarter, which would lift annual growth to a ten-year high of 2.2%.
- Some of the recent lift in wage growth has been due to government policies rather than market forces. In particular, the 0.8% rise in the June quarter was boosted by a large 7.3% increase in the minimum wage. There's nothing quite as significant on the cards for the September quarter, but there are a few factors to note, including the first round of the primary teachers' pay settlement, and the next round of last year's nurses pay agreement.
- The Quarterly Employment Survey measure of average hourly earnings has accelerated over the past year. We expect a 1% rise in average hourly earnings for the September quarter, which would keep annual growth above 4%.

LCI and QES salary and wages, all sectors

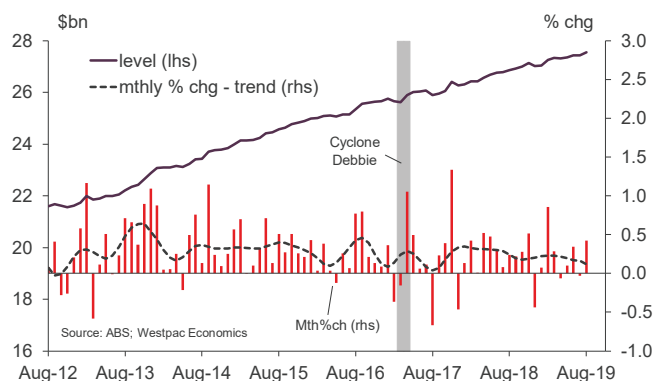


Aus Sep retail trade

**Nov 4, Last: 0.4%, WBC f/c: 0.5%
Mkt f/c: 0.4%, Range: 0.0% to 0.7%**

- Retail sales have disappointed in recent months, a 0.4% gain in August following a flat result in July. While slightly positive the gains are lacklustre given the scale of the policy boost to disposable incomes - the combined effect of rate cuts in June and July and the tax relief from July 1 adding around \$3bn a month through Q3. As it stands, the 'cash splash' is barely a trickle for sales so far.
- This muted response looks to have mostly continued into September with only a slight improvement. Responses to a special question on the tax payments in our Westpac Consumer survey indicate recipients plan to spend about half of the cash. However, the boost looks likely to be spread out over multiple months rather than a sharp one-off rise. On balance we expect sales to show a 0.5% gain for September, enough to lift annual growth to 2.9%/yr but still slow by historical standards.

Monthly retail sales



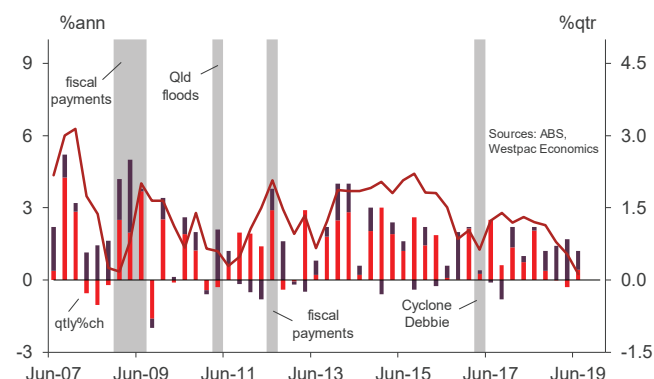
The week ahead.

Aus Q3 real retail sales

Nov 4, Last: 0.2%, WBC f/c: 0.4%
Mkt f/c: 0.3%, Range: -0.3% to 0.5%

- Real retail sales rose 0.2% in Q2, a dismal pace taking annual growth to just 0.2%yr – weaker than during the GFC and the slowest pace since the early-90s recession.
- Despite significant policy stimulus, the September quarter looks to have produced only a slight improvement. Nominal retail sales are tracking towards a 0.8% gain vs 0.6% in Q2. On the price side the CPI detail showed a firmer quarter for basic food and clothing but we suspect this will wash out with the retail deflator which is more sensitive to shifts in spending patterns (i.e. as consumers substitute in response to price moves for specific items). Overall we expect the quarter to show a slightly better outturn for volumes with a 0.4% gain although annual growth will remain very weak at 0.4%yr. That could be weaker still if retail prices show a lift in the quarter.

Quarterly retail volumes and prices



Aus RBA policy decision

Nov 5, Last: 0.75%, WBC f/c: 0.75%
Mkt f/c: 0.75%, Range: 0.75% to 0.75%

- The Reserve Bank is in an easing cycle, lowering the cash rate in June, July, and October, down from 1.50% to 0.75%.
- This mirrors global developments as heightened uncertainty around international trade erodes business confidence and dents investment plans. The US Fed and the RBNZ have also lowered policy rates by 75bps this year.
- The domestic backdrop is challenging. Economic growth is declining in per capita terms and unemployment is rising. Real wages are flat, constraining consumer spending, and construction activity is in a cyclical downturn, led by housing.
- In November, the RBA will leave rates on hold as the Board monitors the response to recently deployed stimulus.
- Westpac expects rates to be lowered to 0.50% in February - as an additional response to the headwinds impacting the economy.

RBA: Westpac forecast and market pricing

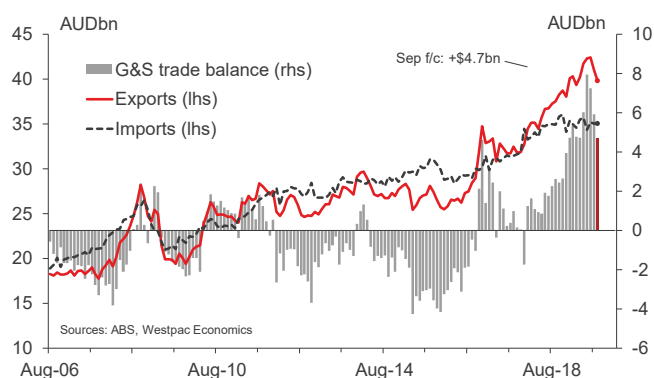


Aus Sep trade balance, AUDbn

Nov 7, Last: 5.9, WBC f/c: 4.7
Mkt f/c: 5.1, Range: 4.5 to 6.0

- Australia's trade surplus, while still sizeable, is in retreat from the June record high of \$7.9bn.
- For September, we expect the surplus to narrow to \$4.7bn, down from \$5.9bn in August.
- Export earnings are forecast to moderate by 2.9%, but still be 6% higher than a year ago. Prices and volumes for iron ore and coal were lower in the month.
- Notably, the iron ore spot price at a little over US\$90/t is down from the peak of around \$120/t - when supply was disrupted by Brazil's tailing dam disaster.
- Imports are expected to be flat in the month and broadly unchanged over the past year. Import volumes have declined against the backdrop of weak domestic demand and higher import prices due to the lower dollar.

Australia's trade balance



The week ahead.

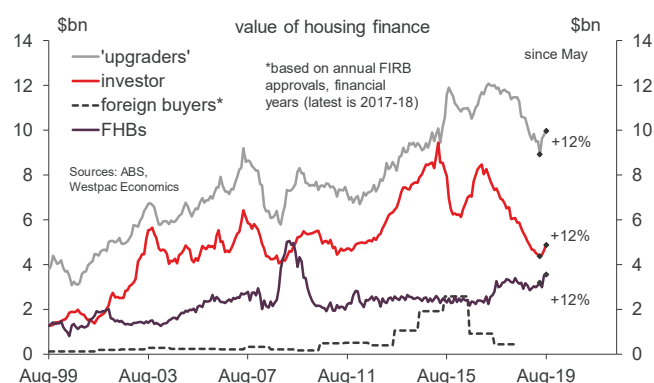
Aus Sep housing finance approvals

Nov 8, Last: 0.7%, WBC f/c: 1.0%

Mkt f/c: 1.1%, Range: 0.0% to 2.0%

- The August housing finance approvals update was a bit of a mixed bag with the number of owner occupier loan approvals up a modest 0.7% but a much stronger 5.7% gain in the total value of investor loans. The big picture is still of a clear lift in finance activity since mid year – boosted by interest rate cuts and the reduced uncertainty around tax policy following the Federal election – but the mix is now seeing gains more evenly spread across owner occupiers and investors.
- All indications are that this shift gathered pace in September with auction markets, prices and buyer sentiment all consolidating on previous gains. Turnover has also started to lift, albeit at a more modest pace and from a very low base. Industry data covering the major banks suggests finance approvals posted a solid 1% gain in September with growth in the total value of loans closer to 1.5% in the month.

Housing finance approvals by segment

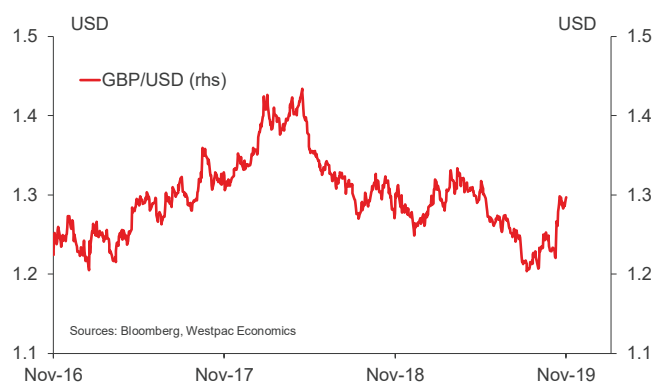


UK Bank of England Bank Rate Decision

Nov 7, Last: 0.75%, WBC f/c: 0.75%, Mkt: 0.75%

- At its September meeting, the BOE left the bank rate on hold and maintained its gradual and limited (as well as Brexit dependent) tightening bias. November is likely to be more of the same but will also contain an updated quarterly Monetary Policy Report (formerly the Inflation Report).
- In the previous August Inflation Report, the BOE trimmed its GDP projections but continued to forecast inflation around target. Since then, growth stabilised after the Q2 contraction which will allow the Bank to broadly retain its forecasts.
- Sentiment around Brexit will be more positive than the last report. We now have a confirmed extension of the deadline to January 31 and a general election will be held on December 12. Due to such events, GBP/USD has appreciated by around 4% since the last BOE meeting and this should reduce inflationary pressure. However, given Brexit is still yet to be resolved, a repeat of the conditional stance is all but assured.

BOE dependent on Brexit in the near-term

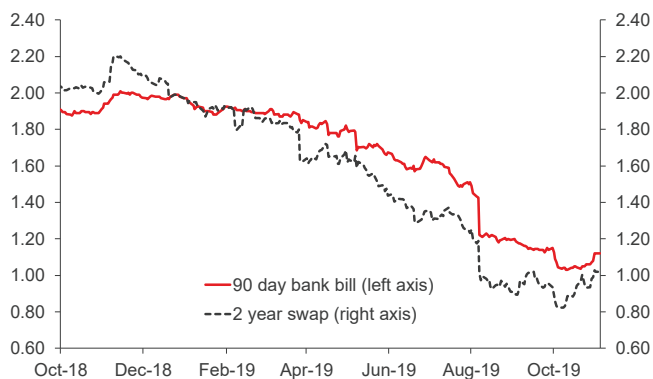


New Zealand forecasts.

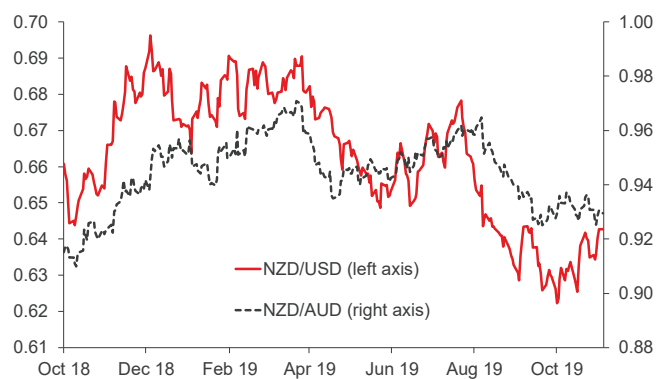
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019f	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	0.5	0.3	0.5	0.6	2.8	2.2	2.3	2.8
Employment	0.8	0.2	0.4	0.4	2.3	1.4	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.3	4.3	4.3	4.2	3.8
CPI	0.6	0.7	0.3	0.5	1.9	1.7	1.7	1.8
Current 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	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	0.85	0.90	0.95
5 Year Swap	1.05	1.00	1.05	1.10	1.20	1.25
10 Year Bond	1.10	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 4 November 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.13%	1.14%	1.19%
60 Days	1.13%	1.10%	1.12%
90 Days	1.12%	1.05%	1.05%
2 Year Swap	1.02%	0.94%	0.82%
5 Year Swap	1.09%	1.02%	0.83%

NZ foreign currency mid-rates as at 4 November 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6427	0.6379	0.6322
NZD/EUR	0.5760	0.5723	0.5756
NZD/GBP	0.4974	0.4938	0.5125
NZD/JPY	69.59	69.22	67.56
NZD/AUD	0.9295	0.9317	0.9363
TWI	71.02	70.71	70.64

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
Aus	Sep retail sales	0.4%	0.4%	0.5%	Disappointing nominal reads over recent months...
	Q3 real retail sales	0.2%	0.3%	0.4%	... to see another subdued result for volumes.
	Oct MI inflation gauge	1.5%	-	-	Inflation pressures are muted.
	Oct ANZ job ads	0.3%	-	-	Down over the year.
Eur	Oct Markit manufacturing PMI final	45.7	-	-	Contraction led by Germany.
	Nov Sentix investor confidence	-16.8	-	-	Investors are downbeat.
	ECB President Lagarde speaks	-	-	-	In honour of Schaeuble in Berlin.
US	Sep factory orders	-0.1%	-0.5%	-	Investment outlook to remain cloudy.
Tue 05					
NZ	Oct ANZ commodity prices	0.0%	-	1.5%	Further gains in meat and dairy prices.
Aus	Oct AiG PSI	51.5	-	-	Soft conditions, little evidence of post stimulus bounce.
	RBA policy decision	0.75%	0.75%	0.75%	On hold. We expect a 25bp cut in February.
Chn	Oct Caixin China PMI services	51.3	51.5	-	Services firms being impacted by global & local headwinds.
Eur	Sep PPI %mth	-0.5%	-	-	No sign of inflation pressures.
UK	Oct Markit services PMI	49.5	49.8	-	Brexit uncertainty weighing on activity.
US	Sep trade balance US\$bn	-54.9	-53.0	-	Advance release points to a narrowing of the deficit.
	Oct Markit services PMI final	51.0	-	-	Flash pointed to weakness in employment...
	Sep JOLTS job openings	7051	-	-	... highlighting the broadening of the deceleration...
	Oct ISM non-manufacturing	52.6	53.4	-	... in growth across the US economy.
	Fedspeak	-	-	-	Daly in NY (9am AEDT), Barkin in Baltim., Kaplan in Dallas.
Wed 06					
NZ	GlobalDairyTrade auction	0.5%	-	-	Milk price futures are flat to slightly higher.
	Q3 employment	0.8%	0.2%	0.1%	Indicators of employment growth have softened.
	Q3 unemployment rate	3.9%	4.1%	4.2%	Expected to rebound after Q2, but remain at a low level.
	Q3 LCI wages (pvt, ord time)	0.8%	0.6%	0.6%	Wage growth is gradually accelerating.
Eur	Oct Markit services PMI	51.8	-	-	Services have been resilient but moved lower in Sep.
	Sep retail sales %yr	2.1%	2.4%	-	Consumer spending supported by solid labour market.
US	Fedspeak	-	-	-	Kashkari Q&A (10am AEDT), Evans in NY, Williams Q&A.
Thu 07					
Aus	Sep trade balance, \$bn	5.9	5.1	4.7	Exports -2.9%, lower prices & vols iron ore & coal.
	Oct AiG PCI	42.6	-	-	Construction contracting sharply - led by housing.
Chn	Oct foreign reserves \$bn	3092	3075	-	Remain stable.
Eur	EU Commission forecasts	-	-	-	Important update ahead of national budgets.
UK	BoE policy decision	0.75%	0.75%	0.75%	On hold for now, but downside risks clear.
US	Initial jobless claims	218k	-	-	Hiring is slowing, but firing remains historically low.
	Fedspeak	-	-	-	Harker on innovation (7:15am AEDT), Kaplan in Dallas.
Fri 08					
Aus	RBA Statement on Monetary Policy	-	-	-	Growth and inflation forecasts updated.
	Sep housing finance	0.7%	1.1%	1.0%	Clear lift in finance activity since mid-year.
Chn	Q3 current account balance	46.2	-	-	Full detail on trade and financial flows.
	Oct trade balance USDbn	39.7	41.0	-	PMI's highlighted persistent weakness in export demand.
US	Sep consumer credit	17.9	15.6	-	Rates and labour market supportive of demand.
	Sep wholesale inventories	-0.3%	-	-	Likely to be a drag on growth over coming year.
	Nov Uni. of Michigan sentiment	95.5	96.0	-	Looks to have stabilised at above average level.
	Fedspeak	-	-	-	Bostic in NY (11:10am AEDT), Daly and Brainard on climate.
Sat 09					
Chn	Oct CPI %yr	3.0%	3.2%	-	Food prices driving inflation outcomes.

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	0.93	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	1.10	0.95	1.00	1.15	1.20	1.25	1.40	1.50
International								
Fed Funds	1.625	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.70	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	0.6908	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	108.03	108	107	107	107	108	110	112
EUR/USD	1.1164	1.10	1.08	1.07	1.07	1.09	1.11	1.14
GBP/USD	1.2962	1.30	1.33	1.33	1.32	1.31	1.31	1.32
USD/CNY	7.0429	7.20	7.20	7.10	7.00	6.90	6.75	6.60
AUD/NZD	1.0736	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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