Weekly Commentary

4 February 2019

Larnach Castle, Dunedin

A smaller boost to the economy

Updated estimates have revealed that long-term migration has been much lower than initially thought. This will be important for many businesses. Smaller population increases mean than an 'easy' source of demand growth that they've enjoyed in recent years is dissipating even faster than expected. It also signals the need for fewer new houses than previously thought.

One of the key drivers of economic activity in recent years has been rapid population growth on the back of high levels of net migration. Strong inflows of new migrants and low departures of New Zealanders have provided a powerful boost to spending and also generated a strong need to build homes. At the same time, the related increases in the labour force have boosted the economy's productive capacity and helped to address skill shortages in some sectors.

Stats NZ has recently taken a closer look at movements in and out of the country over the past few years, and this has revealed some important trends. It turns out that a larger proportion of the people who arrived in recent years only came on a temporary basis. This means that the increase in permanent and long-term migration, and the related change in New Zealand's resident population, has been smaller than was thought. Earlier estimates had suggested that annual long-term migration had risen to a peak of 72,500 in mid-2017. However, Stats NZ's updated estimates have revealed that long-term migration actually peaked at a lower level of around 64,000 back in mid-2016. The latest estimates have also shown that net migration has now fallen to an annual rate of around 43,000 – a level that's around 20,000 lower than initially thought. Looking at the past four years as a whole, this means that around 47,000 fewer people settled in New Zealand on a long-term basis than had been estimated (that's close to 1% of New Zealand's total population).

The size of this revision may seem surprising given that New Zealand keeps tight control on the number of people crossing its borders. But while we have good information on the numbers of people entering and leaving the country, the duration of their stay can be harder to track. Some people who plan to visit for a temporary period may end up staying permanently. Alternatively, some of those who plan to stay on a long-term basis might end up departing sooner than expected. The difference is important. Permanent or long-term migrants (those who remain onshore for more than a year) will have a larger impact on the country in terms of their spending, employment, and their housing needs. Those who enter the country on a shorter-term basis (less than a year) still contribute to the economy, but the impact is likely to be smaller and less enduring.

Previously, Stats NZ used people's stated intentions on arrival and departure cards to estimate how long people planned to stay in the country (this is sometimes referred to as the 'intentions' approach). They are now using an 'outcomes' based approach that looks at actual movements in and out of the country. This is a bit more complex to estimate given the time needed to track people's movements across borders. But over time, it should give a more accurate estimate of what's actually happening to migration flows.

The updated migration estimates have shown that both long- term arrivals and long-term departures have been

A smaller boost to the economy continued

higher than previously thought. The revision to departures has been the bigger of the two, meaning that the level of net migration has been lower. The difference has been heavily centred on those aged 20 to 29. This age group will include a large proportion of international students, as well as those on temporary work or working holiday visas – all groups that tend to be highly mobile. In other words, more young foreign people have been leaving New Zealand than initially thought.

This still leaves us with a picture of strong overall inflows into the country in recent years. However, a greater proportion of those inflows were on a short–term or temporary basis. Those temporary arrivals will have added to demand and they still needed somewhere to stay, but have probably provided a smaller boost to economic conditions than permanent migrants would have.

Lower long–term migration will have a number of important implications for the economy and it reinforces our expectations for a cooling in GDP growth and the housing market over the next few years. This will also be important for the labour market.

Lower longer–term migration means that population growth has been slower than expected in recent years. Stats NZ's next update on the population level won't be out for a few weeks. When released, we expect that those figures will reveal New Zealand's population is currently smaller than previously believed. We estimate that annual population growth peaked at 2% in 2016 and has since slowed to 1.5%. Those are still solid rates of population growth, but would be a fair bit slower than was initially thought. Furthermore, with net migration continuing to trend down, it implies smaller increases in the nation's demand base over the next few years. That will be important for many businesses, meaning than an 'easy' source of demand growth that they've enjoyed in recent years is dissipating even faster than expected.

Lower net migration and population growth will also have a major impact on residential construction. For some time, we have been highlighting that the rate of dwelling construction was catching up with population growth. We predicted that as population growth slowed, housing shortages would begin to ease in the coming few years, and therefore the outlook was for moderate growth in construction activity. These data revisions reinforce that view. We'll still need a large number of new homes over the coming years. But with fewer migrants settling here on a long-term basis, the number of homes that will eventually be required is lower than previously thought. In addition, it looks as though residential consent issuance has already risen to the level required to keep up with population growth.

These trends will be particularly important for Auckland which has experienced an especially large population cycle. However, their impact will be felt more widely. Many other regions are currently seeing high levels of home building, and the durability of those cycles looks increasingly doubtful, especially given the policy– induced slowdown in the housing market already in train. We'll take a closer look at the extent of changes in the construction outlook in our upcoming February *Economic Update*.

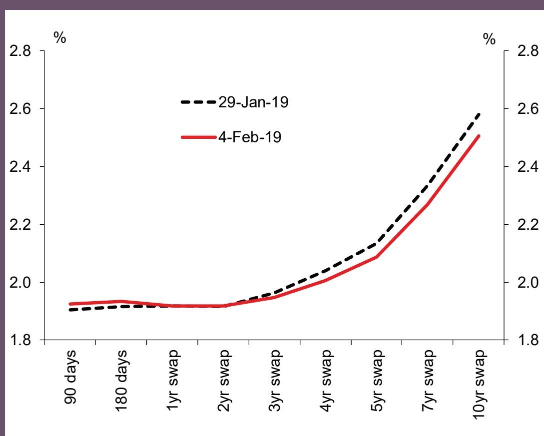
Fixed vs Floating for mortgages

Fixed-term mortgage rates fell sharply during spring, but have now settled down. From here, we expect wholesale fixed interest rates to remain stable or rise slowly. This means that retail fixed mortgage rates are more likely to rise than fall, although there are uncertainties around any forecast.

One-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 Dec residential building consents

Feb 4, Last: –2.0%, WBC f/c: +3.5%

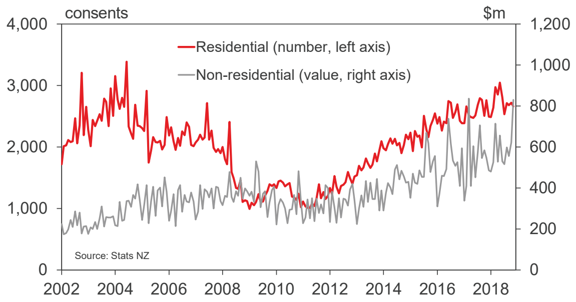
- Residential dwelling consent issuance fell by 2% in November. That decline related mainly to apartment consents, which can be lumpy on a month–to–month basis. The underlying level of consents remains elevated.
- We expect to see a modest 3.5% gain in consent issuance in December with issuance in Auckland and other regions remaining firm, while activity in Canterbury continues its gradual downtrend.
- We expect that building activity will remain at firm levels over the next few years. However, with consent issuance now running at levels commensurate with population growth, further increases are likely to be moderate.

NZ Q4 Household Labour Force Survey

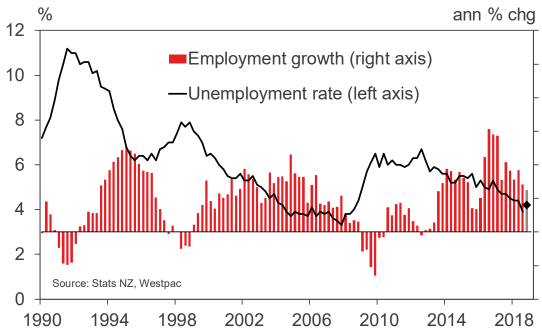
Feb 7, Employment last: +1.1%, WBC f/c: +0.2%, Mkt f/c: +0.3%
Unemployment last: 3.9%, WBC f/c: 4.2%, Mkt f/c: 4.1%

- A range of evidence points to an increasingly tight labour market over 2018. Firms are having increasing difficulty in finding workers, and households' perceptions of job opportunities are at a ten–year high.
- However, the drop in the unemployment rate from 4.4% to 3.9% in the September quarter was unusually large, and looks vulnerable to a correction. We're assuming a partial unwind to 4.2% in the December quarter, which would still be consistent with an improving trend.
- Similarly, we expect that last quarter's 1.1% surge in employment (despite weak GDP growth of just 0.3%) will be followed by a subdued December quarter result.

NZ building consents



NZ Household Labour Force Survey



NZ Q4 Labour Cost Index

Feb 7, Private sector last: 0.5%, WBC f/c: 0.5%, Mkt f/c: 0.6%

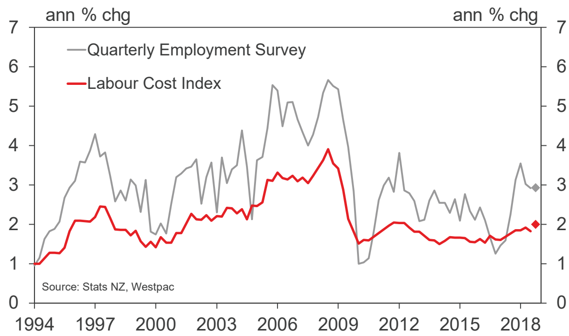
- We expect a 0.5% increase in private sector wages for the December quarter, with the recent nurses' pay agreement boosting total wage growth to 0.6%.
- Despite a tight labour market, there has been limited evidence of a pickup in wage growth so far, outside of government–mandated increases such as fair pay agreements and minimum wage hikes.
- However, the LCI is by design a slow–moving series. The QES average hourly earnings measure tends to be more responsive, and has seen a more substantial pickup compared to the LCI in recent times.

Aus Dec dwelling approvals

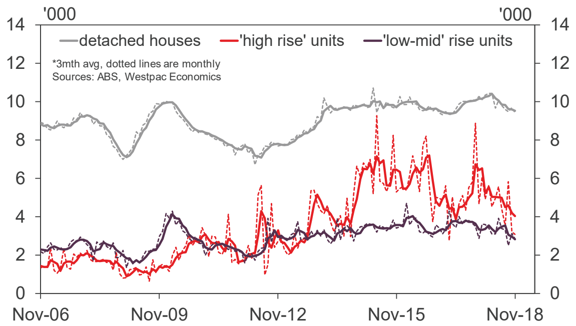
Feb 4, Last: –9.1%, WBC f/c: 1.5%
Mkt f/c: 2.0%, Range: 0.0% to 5.0%

- Dwelling approvals dropped 9.1% in Nov, a sharp fall following a 1.4% decline in Oct. 'Units' lead the fall, dropping 18% in the month, the detail suggesting weakness was across both 'high rise' and 'mid–rise'. Private detached house approvals were also down 2.6%, a sizeable decline for a more stable component.
- High rise approvals are likely to show a 'technical' bounce in Dec simply from monthly noise. However, this is expected to be muted with activity in the segment still taking a sharp move lower – recent monthly levels are where we expect high rise approvals to eventually settle. Importantly, finance indicators suggest the weakness in the larger 'non high rise' segment is likely to continue. On balance, we expect only a modest 1.5% gain for total approvals in the Dec month, leaving a clear underlying downtrend firmly intact.

NZ LCI and QES salary and wages, all sectors



Aus dwelling approvals: houses, low-mid & high rise



The week ahead

Aus Dec retail trade

Feb 5, Last: 0.4%, WBC f/c: –0.2%
Mkt f/c: 0.0%, Range: –0.5% to 0.4%

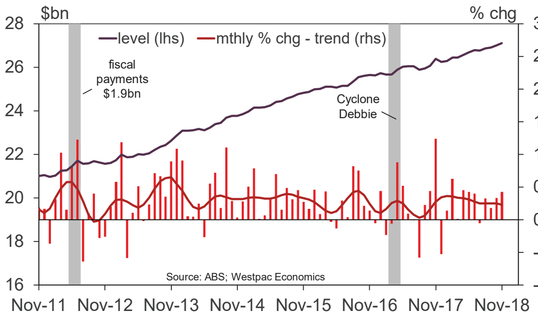
- Retail sales rose 0.4% in Nov following steady gains averaging 0.3%mth through Aug–Oct and a flat result in July. Sales growth is tracking a 3.3% annual pace over the six months.
- Some of the Nov gain looks to have been due to the increasingly popular 'Black Friday' sales event – our estimates suggest online retail sales were up over 6% in the month, implying retail ex online had a more subdued 0.1% gain. Some post event 'let down' is likely.
- With consumers turning cautious late in the year – Christmas spending plans down on a year ago – and both anecdotes and private sector business surveys pointing to disappointing holiday sales for retailers, we expect total retail sales to show a 0.2% dip for the Dec month.

Aus Q4 real retail sales

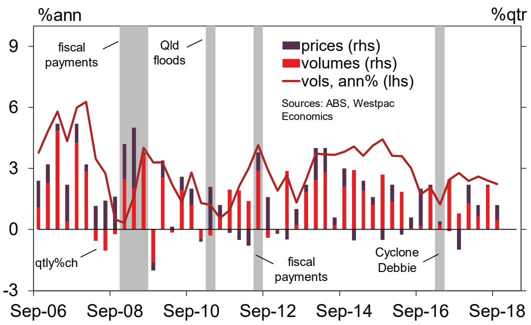
Feb 5, Last: 0.2%, WBC f/c: 0.2%
Mkt f/c: 0.5%, Range: 0.0% to 0.9%

- The Q3 retail report was soft with sales volumes rising just 0.2% compared to a 1% gain in Q2. Sales have been choppy quarter to quarter, annual growth slowing to a subdued 2.2%yr.
- The Q4 update is likely to show another soft read. Nominal sales are tracking towards a reasonable 0.8% gain for the quarter, up from 0.6% in Q3. However, the Q4 CPI detail shows retail prices were firmer with food, meals out and household goods all recording notable rises.
- Overall we expect the retail deflator to show a 0.6%qtr gain, vs +0.4% in Q3. That in turn points to retail volumes being up just 0.2% for the quarter. Back to back subdued results mark a break from the choppy quarterly profile over the last two years and will be the first confirmation of a more subdued growth trajectory for consumer demand.

Aus monthly retail sales



Aus quarterly retail volumes and prices



Aus Dec trade balance, AUDbn

Feb 5, Last: 1.9, WBC f/c: 2.8
Mkt f/c: 2.2, Range: 1.8 to 4.5

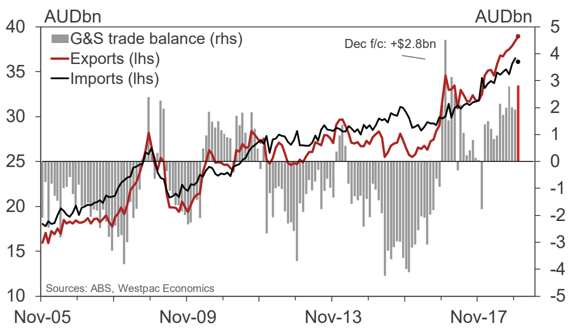
- Australia's trade account remains firmly in surplus, with the December update expected to make it 12 from 12 for 2018.
- The surplus is expected to move higher, to a forecast $2.8bn, following a $1.9bn outcome in November.
- We anticipate a moderation in the import bill, down –1.2%, following strong showings over October (+3.4%) and November (+1.7%).
- Export earnings are expected to rise, +1.2%, supported by a rise in coal (volumes and prices) and by the lower dollar – which was –0.8% vs USD and –1.3% on a TWI basis.
- As to risks: global energy prices fell sharply late in 2018 but to date this is not evident in the official trade data – we may yet see an impact on imports and more so on exports.

Aus RBA policy announcement

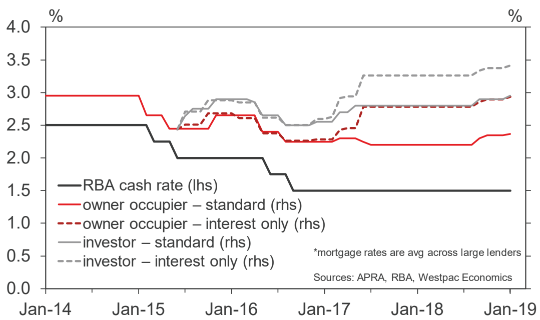
Feb 5, Last: 1.50%, WBC f/c: 1.50%
Mkt f/c: 1.50%, Range: 1.50% to 1.50%

- The Reserve Bank last moved rates in August 2016 (a cut) and last raised rates in November 2010.
- We expect the RBA to leave rates unchanged in 2019 and in 2020.
- While markets widely expect no move at the February meeting, the first for the year, there is speculation as to whether the Bank will soften their stance.
- We expect the RBA to remain positive on the outlook, albeit marking down their growth forecasts somewhat.
- The Bank will anticipate that further progress on inflation and unemployment will be (very) gradual – suggesting steady rates for some time yet.

Aus trade balance



RBA cash rate and mortgage interest rates



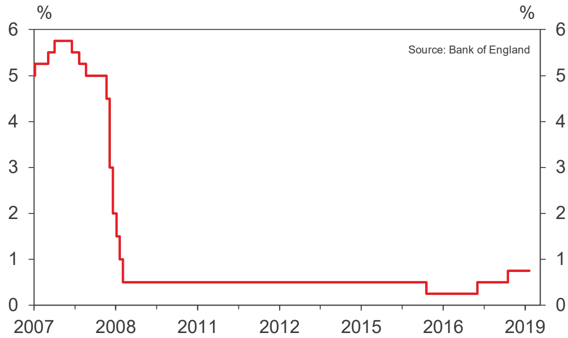
The week ahead

UK Bank of England Bank Rate

Feb 7, Last: 0.75%, WBC f/c: 0.75%

- With Brexit continuing to cast a long shadow over the economic outlook, there's no chance of a rate hike at the February MPC meeting.
- Once again, the focus will be on the BOE's rhetoric and its description of the risks around the outlook. In December, the BOE maintained a very modest tightening bias, noting that a gradual and limited tightening in the Bank Rate would be appropriate if the economy evolved as expected. However, the Bank's assessment was contingent on a smooth Brexit transition – an outcome that looks increasingly doubtful. The global backdrop is also looking softer than in December. Given these developments, the Bank is likely to re-emphasise the conditionality of its forecasts, and its (very) mild tightening bias could be further diluted.

Bank of England Bank Rate

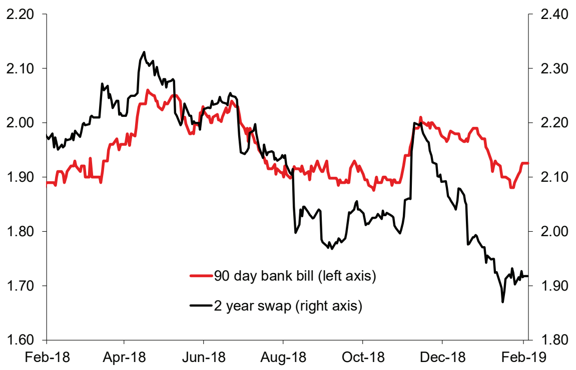


New Zealand forecasts

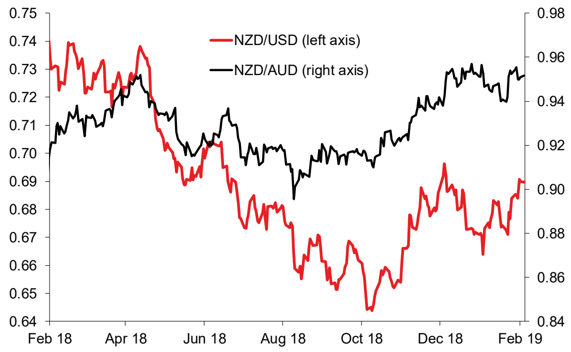
Economic Forecasts	Quarterly				Annual			
	2018		2019					
% change	Sep (a)	Dec	Mar	Jun	2017	2018f	2019f	2020f
GDP (Production)	0.3	0.8	0.7	0.9	3.1	2.9	3.0	3.1
Employment	1.1	0.2	0.2	0.3	3.7	2.5	1.1	1.5
Unemployment Rate % s.a.	3.9	4.2	4.3	4.2	4.5	4.2	4.1	4.0
CPI	0.9	0.1	0.3	0.5	1.6	1.9	2.0	2.1
Current Account Balance % of GDP	-3.6	-3.9	-3.6	-3.7	-2.9	-3.9	-3.6	-3.1

Financial Forecasts	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-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	2.20	2.25	2.30	2.35	2.40	2.50
10 Year Bond	2.40	2.45	2.60	2.60	2.65	2.75
NZD/USD	0.66	0.64	0.62	0.63	0.64	0.65
NZD/AUD	0.93	0.91	0.91	0.91	0.91	0.92
NZD/JPY	72.6	71.0	70.1	70.6	71.0	71.5
NZD/EUR	0.58	0.58	0.56	0.57	0.58	0.57
NZD/GBP	0.52	0.50	0.48	0.48	0.48	0.49
TWI	72.3	70.8	69.0	69.6	69.9	70.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 4 February 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.83%	1.85%
60 Days	1.89%	1.87%	1.89%
90 Days	1.93%	1.90%	1.93%
2 Year Swap	1.92%	1.92%	1.95%
5 Year Swap	2.09%	2.16%	2.18%

NZ foreign currency mid-rates as at 4 February 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6898	0.6753	0.6753
NZD/EUR	0.6017	0.5935	0.5904
NZD/GBP	0.5275	0.5252	0.5304
NZD/JPY	75.53	74.14	73.17
NZD/AUD	0.9517	0.9399	0.9476
TWI	74.56	73.39	73.57

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
NZ	Dec building permits	–2.0%	–	3.5%	A pick up after last month's apartment related volatility.
Aus	Dec dwelling approvals	–9.1%	2.0%	1.5%	Both high rise and non high rise tracking lower.
	Jan MI inflation gauge, %yr	1.9%	–	–	Dec saw signs of a pickup from a low base.
	Jan ANZ job ads	0.0%	–	–	Job ads flattened in the 2018 H2; where to in 2019?
	Banking Royal Commission	–	–	–	Final report of inquiry to be publicly released at 4.10pm SYD.
Eur	Feb Sentix investor confidence	–1.5	–	–	Has eased back to below mid–2016 levels.
	Dec PPI	–0.3%	–	–	Input inflation to edge lower.
US	Dec factory orders	–2.1%	0.3%	–	Preliminary and final release for durable goods to be...
	Dec durable goods orders	0.8%	1.7%	–	... released at same time due to shutdown delay.
	Fedspeak	–	–	–	Mester on economy at the 50 Club of Cleveland.
Tue 05					
Aus	Dec retail sales	0.4%	0.0%	–0.2%	Most indicators suggest Christmas sales were soft.
	Q4 real retail sales	0.2%	0.5%	0.2%	CPI detail had firmer retail prices implying sluggish real sales.
	Dec trade balance, $bn	1.9	2.2	2.8	Imports down from high levels, exports up on lower AUD.
	Jan AiG PSI	52.1	–	–	Will we see further evidence of a slow start to the year?
	RBA policy decision	1.50%	1.50%	1.50%	Markets looking for any signs of a 'neutral bias'.
Eur	Jan Markit services PMI final	50.8	50.8	–	Headline weighed on by France and Yellow Vest effect.
	Dec retail sales	0.6%	0.2%	–	Wage gains supportive of consumer but a disruptive Dec.
UK	Jan Markit services PMI	51.2	–	–	Signs demand has cooled as Brexit concerns cloud the outlook.
US	Jan Markit services PMI final	54.2	54.2	–	Both service PMI's continue to point to robust...
	Jan ISM non–manufacturing	58.0	57.3	–	... domestic demand in the US.
Wed 06					
Aus	RBA Governor Lowe speaking	–	–	–	National Press Club, Sydney, 12:30pm.
US	Q4 productivity	2.3%	1.7%	–	Will slow into 2019.
	Nov trade balance $bn	–55.5	–54.0	–	Pull forward ahead of tariffs a negative.
	Fed Chair Powell speaks	–	–	–	Brief introductory remarks at an event for educators.
	Fedspeak	–	–	–	Quarles on bank stress testing.
	Fedspeak	–	–	–	Clarida discusses global factor in neutral rates.
Thu 07					
NZ	GlobalDairyTrade auction	4.2%	–	–	Solid demand supporting firmer prices of late.
	Q4 unemployment rate	3.9%	4.1%	4.2%	Expecting a partial unwind of last quarter's steep drop...
	Q4 employment	1.1%	0.3%	0.2%	...but trend remains towards a tightening labour market.
	Q4 LCI wage inflation	0.5%	0.6%	0.5%	Pickup in wage growth emerging only gradually.
Aus	Q4 NAB business survey	3	–	–	Dec monthly survey reported business conditions collapsed.
Chn	Jan foreign reserves $bn	3072.71	–	–	Likely to stabilise again in coming months.
Eur	ECB Economic Bulletin	–	–	–	Followed by European Commission economic forecasts.
UK	Jan Halifax house prices	2.2%	–	–	Economic uncertainty continuing to dampen prices, esp. in London.
	BoE policy decision	0.75%	0.75%	0.75%	Uncertainty to keep BOE on hold, risk of dovish tilt.
US	Initial jobless claims	253k	–	–	At historically low level.
	Fedspeak	–	–	–	Bullard on economy at St. Cloud State University.
Fri 08					
Aus	RBA Statement on Monetary Policy	–	–	–	GDP growth forecasts to be lowered.
US	Dec consumer credit	22.1	16.0	–	Student and auto loans remain the driving force.
	Dec wholesale inventories	–	–	–	Pull forward of trade might shock inventories ahead.

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	2019f	2020f
Australia						
Real GDP % yr	2.5	2.8	2.4	3.0	2.4	2.8
CPI inflation % annual	1.7	1.5	1.9	1.7	1.8	1.7
Unemployment %	5.8	5.7	5.5	5.0	5.0	4.8
Current Account % GDP	-4.7	-3.1	-2.6	-2.4	-2.4	-3.0
United States						
Real GDP %yr	2.9	1.5	2.3	2.9	2.5	2.1
Consumer Prices %yr	0.1	1.4	2.1	2.4	1.9	1.9
Unemployment Rate %	5.3	4.9	4.4	3.9	3.6	3.6
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	1.4	0.9	1.7	0.9	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.8	2.5	1.9	1.5	1.5
United Kingdom						
Real GDP %yr	2.3	1.8	1.7	1.3	1.4	1.4
China						
Real GDP %yr	6.9	6.7	6.9	6.4	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	3.9	4.5	4.3	4.1	4.1
World						
Real GDP %yr	3.5	3.2	3.8	3.8	3.5	3.5
Forecasts finalised 12 December 2018						

Interest Rate Forecasts	Latest	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Dec-20
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	2.05	2.05	2.05	2.00	2.00	1.95	1.95	1.90
10 Year Bond	2.21	2.35	2.40	2.60	2.60	2.50	2.50	2.50
International								
Fed Funds	2.375	2.375	2.625	2.875	2.875	2.875	2.875	2.875
US 10 Year Bond	2.64	2.85	3.00	3.10	3.00	2.90	2.80	2.75
ECB Deposit Rate	–0.40	–0.40	–0.40	–0.40	–0.30	–0.20	–0.10	0.00

Exchange Rate Forecasts	Latest	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Dec-20
AUD/USD	0.7247	0.71	0.70	0.68	0.69	0.70	0.71	0.72
USD/JPY	108.89	110	111	113	112	111	110	106
EUR/USD	1.1443	1.13	1.11	1.10	1.10	1.11	1.14	1.20
AUD/NZD	1.0489	1.08	1.09	1.10	1.10	1.09	1.09	1.08

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