

Weekly Commentary

4 March 2019



Larnach Castle, Dunedin

Ups and downs

The recent data for New Zealand has taken on a distinctly mixed complexion. But at the least it has provided some support for our view that last year's spike in petrol prices was a temporary hindrance to activity.

Developments in household spending have been something of a puzzle in recent times. Employment has been rising at a solid pace, and wage growth has picked up to some degree. On top of this, the Government's Families Package came into full force in July, putting more money into the pockets of lower income households. Yet retail sales volumes in the September quarter were close to flat.

We took the view that the impact of the Families Package was being cancelled out by a spike in petrol prices, which reached new record highs in September and early October. That increase siphoned at least \$130 million out of households' wallets between July and October, leaving them with less to spend on other items.

The spike in petrol prices has since been completely unwound, giving household budgets some relief. Combined with the ongoing payments from the Families Package, we expected retail spending to regain some momentum again.

That turned out to be the case. Retail sales in the December quarter rose by 1.7%, bouncing back by even more than we expected. There were gains across most categories, including large gains in areas such as supermarkets and dining out.

It remains true that the pace of growth in retail spending has come off its highs in the last couple of years. Slowing population growth has been one factor. And the household wealth effect is alive and well – spending growth has

slowed as house price inflation has cooled off. Both of these factors are likely to weigh further on spending growth in the coming years.

Elsewhere, the theme of mixed data continued last week. On the positive side, building consents were surprisingly strong in January, with a 16% jump in seasonally adjusted terms. (In raw terms, the consent numbers were up slightly from December in what is normally a quiet period.) The monthly gain was centred on Auckland, and was driven by both apartments and standalone houses.

Over 13,200 new homes were consented in Auckland in the last year, the highest level in several decades (the official figures go back to 1990). The number of homes being consented is now roughly in line with changes in the population. And with population growth itself set to slow down in the coming years, we think the construction cycle is nearing a peak.

Another positive development – of sorts – was an upgrade to Fonterra's farmgate milk price forecast for this season to \$6.30-6.60 per kg (previously \$6.00-6.30). However, the higher payout reflects an expected shortfall in milk collections over the remainder of the season, as a result of the unusually hot and dry weather over the past month.

Prices in the twice-monthly GlobalDairyTrade auctions have risen by 15% since the start of year, which to some degree will already reflect an awareness of the recent climatic

Ups and downs continued

conditions. Nevertheless, it will be interesting to see how this week's auction fares after the Fonterra announcement.

The less welcome news last week came from the ANZ business confidence survey, where the modest recovery in confidence we saw over the last quarter of 2018 was unwound in February (the survey is not held in January). There was a deterioration across most activity indicators including expectations of profitability, employment, investment and export intentions. The results were mixed across sectors, with a particularly sharp fall in expectations for firms in the construction sector.

Business confidence has been markedly weaker since the change of government in 2017, much more so than other indicators that point to modest growth in economic activity. There has no doubt been an element of 'protest vote' to the survey responses, though there were signs that this aspect

was easing off by the end of 2018. It will be interesting to see how confidence fares in the March survey, after the release of the Tax Working Group's final report which, among other things, recommended the introduction of a capital gains tax on investment properties, farms, and businesses.

This week brings the last of the sectoral surveys that will be used to calculate December quarter GDP, including manufacturing, wholesaling and building activity. Notwithstanding the strong retail trade figures, the sectoral details that we have to date have been on the soft side; we're currently forecasting just a 0.3% rise in GDP.

We think there's a good chance that some of this weakness has just been survey noise, or issues of timing. Our view remains that GDP growth will pick up again over 2019, supported by rising government spending and a lift in construction activity.

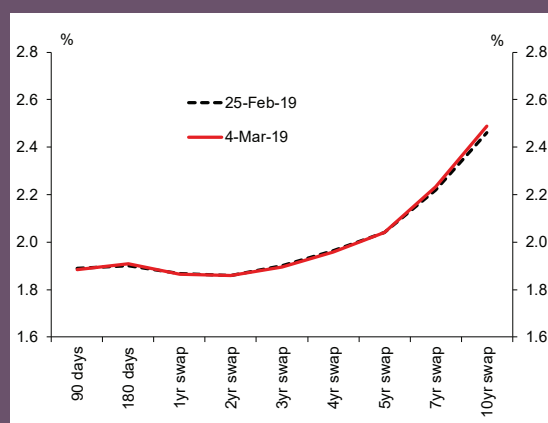
Fixed vs Floating for mortgages

The rise in wholesale interest rates following the Reserve Bank's February Monetary Policy Statement has reduced the downward pressure on retail mortgage rates. With cash rate hikes still a distant prospect, we expect retail fixed mortgage rates to remain relatively steady in the near term.

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

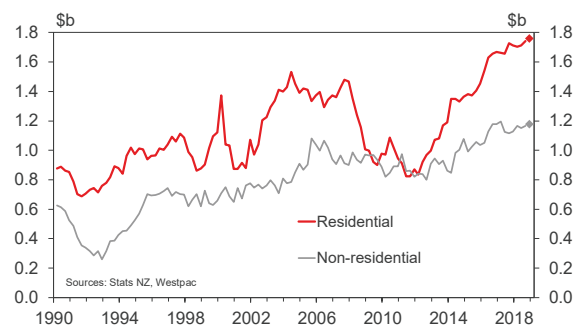
NZ Q4 building work put in place

Mar 8, Last 0.7%, Westpac f/c: 1.0%

Mkt f/c: 1.0%, Range: -0.8% to 1.5%

- Construction activity rose by 0.7% in the September quarter, and was up 2.1% over the year. The September quarter rise was underpinned by a 1.2% increase in residential building centred on Auckland, while non-residential construction was flat over the quarter.
- We're expecting another quarter of modest growth in December, with total building activity expected to increase by 1%. That's being supported by modest gains in both residential and non-residential building.
- Building activity is set to take another step up over 2019 as home building in Auckland picks up. However, the construction cycle is close to peaking, especially with post-earthquake reconstruction winding down.

NZ real building work put in place



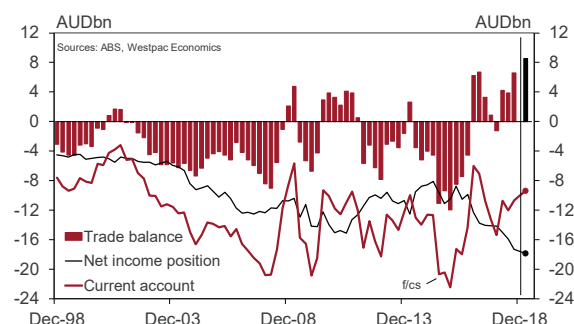
Aus Q4 current account, AUDbn

Mar 5, Last: -10.7, WBC f/c: -9.4

Mkt f/c: -9.2, Range: -11.5 to -8.5

- Australia's current account deficit is relatively well contained currently, at 2.2% of GDP in the September quarter, well below the post 1990s average of 4.2%.
- For Q4, the current account deficit is expected to narrow a little to a forecast \$9.4bn.
- The trade surplus widened to \$8.5bn. Key to this improvement, export earnings were boosted by higher commodity prices. The terms of trade rose by around 2.5% we estimate.
- The net income deficit is expected to widen further, to \$17.9bn, as the higher commodity prices boost returns to foreign investors in the mining sector.

Aus current account: f/c -\$9.4bn in Q4



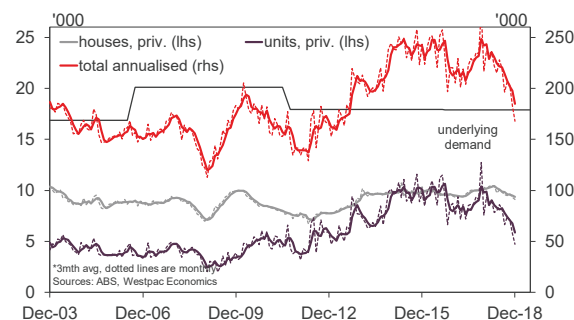
Aus Jan dwelling approvals

Mar 4, Last: -8.4%, WBC f/c: -1.0%

Mkt f/c: 1.5%, Range: -5.0% to 8.0%

- Dwelling approvals slid sharply into year end – declining 8.4% in the final month to be down 26% over the fourth quarter. The composition also showed a notable shift with a continued decline in high rise approvals but weakness starting to show through in other segments as well.
- High rise approvals are likely to settle around current low levels. While there is a risk of a technical bounce following two big negatives, we expect the Jan update to reflect the 'one-way traffic' in housing markets evident through late 2018. On balance we expect Jan to show a 1% decline. As always, risks are compounded by the very low activity over the holiday season which means moves can be significantly amplified by seasonal adjustment.

Aus dwelling approvals



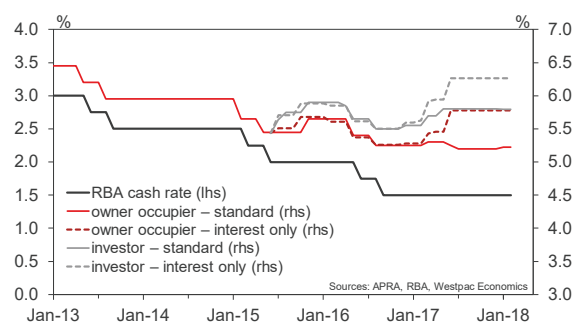
Aus RBA policy announcement

Mar 5, Last: 1.50%, WBC f/c: 1.50%

Mkt f/c: 1.50%, Range: 1.50% to 1.50%

- On February 21 Westpac announced a change in view for the outlook for the cash rate to a 25bps cut in August and another 25bps cut in November. We would be very surprised if the Board decided to move next week but, given our change of view, must accept that as we move closer to our August target, meetings will become increasingly "live".
- At 9 am on Wednesday, Governor Lowe is speaking on "The Housing Market and the Economy". In his most recent speech on February 22nd, he noted possible spill-overs from declining house prices to weaker consumption and dwelling construction. Nonetheless, he reiterated the RBA's view that the "adjustment in the housing market is not expected to derail the economy". Westpac believes these spill-overs will be more material.

RBA cash rate and mortgage interest rates



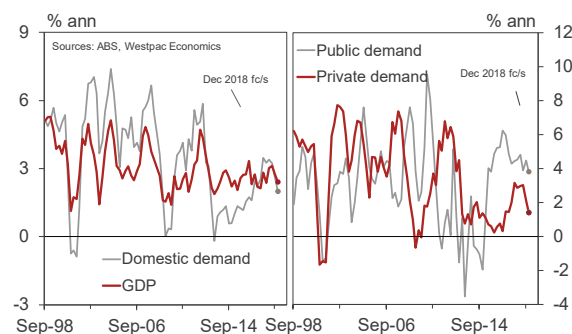
The week ahead

Aus Q4 GDP

Mar 6, Last: 0.3%qtr, 2.8%yr, WBC f/c: 0.2%qtr, 2.4%yr
Mkt f/c: 0.5%, Range: 0.1% to 0.6%

- The Australian economy lost considerable momentum between the first and second half of 2018, from a 4% annualised pace to our forecast of only a 1% pace. The slowing was centred on housing and the consumer as lending conditions tightened and wages remained sluggish.
- For Q4, we expect real GDP growth of 0.2%qtr, 2.4%yr. The arithmetic is: domestic demand, 0.2%, inventories +0.1ppt and net exports, -0.1ppt.
- Partialials suggest / reveal that: retail sales stalled (+0.1%, including a -1.1% for NSW); construction activity declined sharply, -3.1% (a sizeable fall in housing, sharp drop in public works and softness in business); and exports likely stalled (dented by rural goods reflecting the ongoing drought).

Australian economic conditions

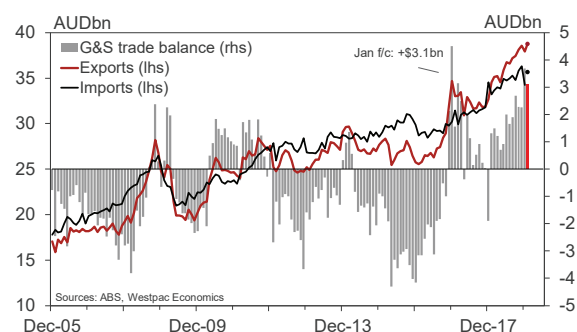


Aus Jan trade balance, AUDbn

Mar 7, Last: 3.7, WBC f/c: 3.1
Mkt f/c: 3.0, Range: 2.2 to 4.5

- Australia's trade account is expected to begin the 2019 year in surplus, for a 13th consecutive month.
- In December, the surplus jumped by \$1.4bn to \$3.7bn largely on a sharp drop in imports.
- For January, we expect a partial reversal, to a surplus of \$3.1bn, on a likely rebound in imports.
- Export earnings over the past year have been boosted by higher commodity prices - a dynamic that has extended in to 2019.

Australia's trade balance

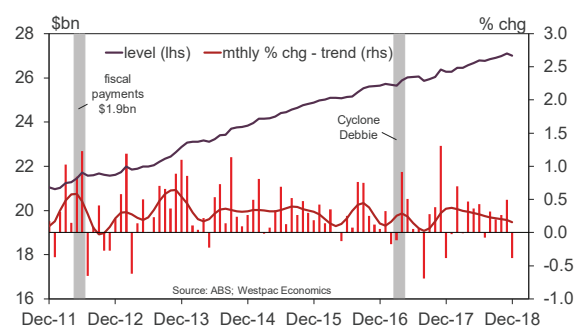


Aus Jan retail trade

Mar 7, Last: -0.4%, WBC f/c: -0.1%
Mkt f/c: 0.3%, Range: -0.1% to 0.7%

- Retailers recorded a weak finish to 2018, monthly sales dipping 0.4% in December. While some of this likely reflects 'residual seasonality' with the ABS struggling to adjust for the shifting in timing of sales around the Christmas period (the rising popularity of 'Black Friday' and new year sales in particular) the underlying trend is still clearly weak. At 2.8%yr, annual growth is sluggish at best with the six month annualised pace below 2%.
- Consumer sentiment had a shaky start to 2019, dipping into net pessimistic territory for the first time since 2017 but recovering in Feb. Private sector business surveys suggest there has been no respite for retailers with a sharp deterioration in conditions in Dec extending into Jan. We expect total retail sales to show a 0.1% dip for the Dec month.

Monthly retail sales

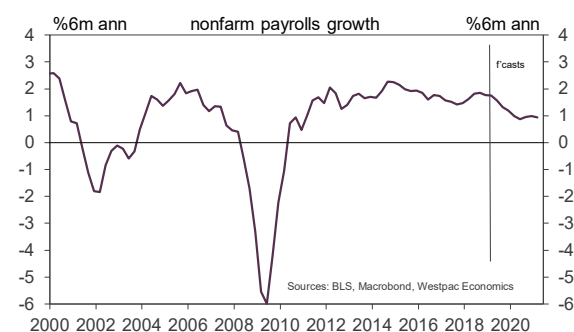


US Feb employment report

Mar 8, nonfarm payrolls, last 304k, WBC 175k
Mar 8, unemployment rate, last 4.0%, WBC 3.9%

- After a strong 2018, employment growth started 2019 with extraordinary vigour, nonfarm payrolls rising 304k in the month. Admittedly, employment in the prior two months was revised down by 70k. Still, the net addition of 234k is unquestionably strong.
- Come February, we look for a moderation back to around 175k for monthly employment growth. If seen in both February and March, this pace would result in a Q1 monthly-average pace in line with 2018's.
- Looking ahead, employment gains in 2019 are expected to be softer than in 2018, but still ahead of labour force growth. The consequence will be a steady drift lower in the unemployment rate towards 3.5%.

Employment growth to dissipate slowly



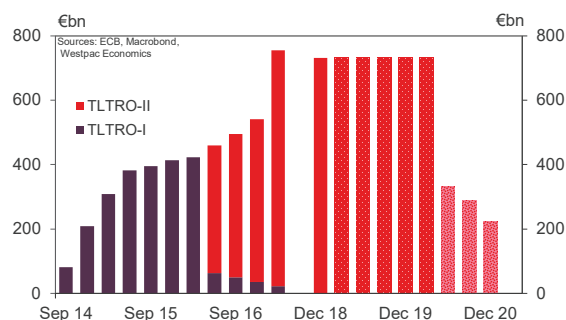
The week ahead

Euro Area ECB policy decision

Mar 7, deposit rate: -0.4%

- March will focus on projections, guidance, and liquidity.
- The ECB have downplayed the current slowdown's impact on the medium-term outlook, highlighting temporary factors. Nevertheless, a high level of geopolitical uncertainty underscores caution.
- In terms of the implications for policy rate forward guidance, the Bank of France Governor noted that if the downturn continues into summer, then the ECB will be "ready to adapt their monetary policy guidance". For now, there is sufficient 'state-contingency' contained in the current guidance with rates on hold "at least through the summer of 2019".
- The liquidity discussion is on the maturing first €400bn operation of TLTRO-II in June 2020. This will affect banks in June 2019 due to regulatory funding ratios. The question is on how the ECB may extend loans to avoid "cliff effects".

Euro Area TLTRO-II maturities



New Zealand forecasts

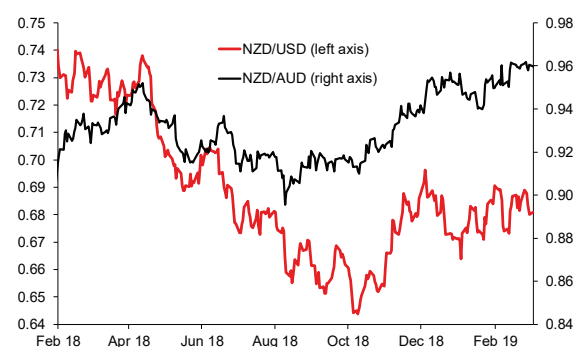
Economic Forecasts	Quarterly				Annual			
	2018		2019					
% change	Sep (a)	Dec	Mar	Jun	2017	2018f	2019f	2020f
GDP (Production)	0.3	0.3	0.8	0.8	3.1	2.7	2.6	2.8
Employment	1.1	0.1	0.2	0.3	3.7	2.3	1.1	1.7
Unemployment Rate % s.a.	4.0	4.3	4.4	4.3	4.5	4.3	4.2	4.0
CPI	0.9	0.1	0.2	0.5	1.6	1.9	1.8	2.1
Current Account Balance % of GDP	-3.6	-3.7	-3.3	-3.0	-2.9	-3.7	-2.9	-2.8

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	1.90	1.95	2.00	2.05
5 Year Swap	2.10	2.10	2.15	2.20	2.25	2.30
10 Year Bond	2.20	2.20	2.25	2.30	2.30	2.35
NZD/USD	0.67	0.66	0.64	0.64	0.65	0.65
NZD/AUD	0.94	0.94	0.94	0.94	0.94	0.94
NZD/JPY	73.7	73.3	72.3	71.7	72.2	71.5
NZD/EUR	0.59	0.59	0.58	0.58	0.59	0.57
NZD/GBP	0.53	0.52	0.49	0.48	0.49	0.49
TWI	73.4	73.0	71.3	71.0	71.2	70.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 4 March 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.85%	1.85%
60 Days	1.88%	1.88%	1.89%
90 Days	1.89%	1.90%	1.93%
2 Year Swap	1.86%	1.90%	1.92%
5 Year Swap	2.04%	2.08%	2.09%

NZ foreign currency mid-rates as at 4 March 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6809	0.6860	0.6898
NZD/EUR	0.5980	0.6074	0.6017
NZD/GBP	0.5136	0.5308	0.5275
NZD/JPY	76.14	75.77	75.53
NZD/AUD	0.9598	0.9610	0.9517
TWI	73.99	74.64	74.56

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 04					
Aus	Q4 company profits	1.9%	3.0%	1.0%	Strength in mining profits, mixed elsewhere
	Q4 inventories	0.0%	0.3%	0.3%	A small rise, with domestic demand sluggish. Adds 0.1ppt.
	Jan dwelling approvals	-8.4%	1.5%	-1.0%	A bounce unlikely following recent sharp falls.
	Feb ANZ job ads	-1.7%	-	-	Declined through end 2018 into 2019.
Eur	Mar Sentix investor confidence	-3.7	-3.1	-	Sentiment is quite soft.
US	Dec construction spending	0.8%	0.2%	-	Q4 GDP pointed to modest structures investment growth.
Tue 05					
NZ	Feb ANZ commodity prices	2.1%	-	-	To benefit from the sharp lift in dairy prices.
Aus	Q4 current account, AUDbn	-10.7	-9.2	-9.4	Deficit narrows. Trade surplus up on higher commodity prices.
	Q4 public demand	1.5%	-	0.4%	Sharp fall in public construction a negative in Q4.
	Feb AiG PSI	44.3	-	-	Services index, -7.8pts in Jan. Fall overdone - a partial rebound?
	RBA policy decision	1.50%	1.50%	1.50%	We expect RBA to cut rates, likely timing Aug & Nov 2019.
Chn	Feb Caixin China PMI services	53.6	53.7	-	Services has been holding up better.
	Annual National People's Congress	-	-	-	Will affirm (again) focus on quality growth and easier policy.
Eur	Feb Markit services PMI final	52.3	-	-	Services is holding a decent level despite manuf. weakness.
	Jan retail sales	-1.6%	1.0%	-	Expected bounce from soft Dec.
UK	Feb Markit services PMI	50.1	50.1	-	Business are reporting softer activity as Brexit edges closer.
	BOE Governor Carney	-	-	-	Testimony to the House of Lords.
US	Feb Markit services PMI final	56.2	56.2	-	Continues to point to robust growth for manufacturers.
	Feb ISM non-manufacturing	56.7	57.2	-	Services sector benefitting from labour market strength.
	Dec new home sales	16.9%	-0.3%	-	Housing market to benefit from rates falling from 2018 peak.
	Fedspeak	-	-	-	Barker on the rural economy.
Wed 06					
NZ	GlobalDairyTrade auction	0.9%	-	-	Lower milk collection forecasts to provide support to prices.
Aus	RBA Governor Lowe speaks	-	-	-	"The housing market and the economy", Sydney, 9.10am
	Q4 GDP	0.3%	0.5%	0.2%	Partials weak: retail, housing, public construction, trade.
US	Feb ADP employment change	213k	185k	-	Rarely a good guide for monthly payrolls gain.
	Dec trade balance US\$bn	-49.3	-54.2	-	Pull-forward of trade affecting deficit.
	Fedspeak	-	-	-	Williams speaks in NY. Mester in a moderated discussion
	Federal Reserve's Beige book	-	-	-	Assessment of regional conditions.
Thu 07					
Aus	Jan retail sales	-0.4%	0.3%	-0.1%	Softness to extend into 2019.
	Jan trade balance, AUDbn	3.7	3.0	3.1	Imports down 8% in Dec, partial rebound likely.
Chn	Feb foreign reserves \$bn	3087.92	-	-	Broadly stable; will remain so.
Eur	Q4 GDP 3rd estimate	0.2%	0.2%	-	Soft qtr. Italy -0.2%. Germany flat but inventory -0.6ppt cont.
	ECB policy decision	-0.4%	-0.4%	-0.4%	Projections update, and discussion on bank loan renewals.
UK	Feb Halifax house prices	-2.9%	0.0%	-	Economic uncertainty a significant drag, especially in London.
US	Initial jobless claims	225k	-	-	Very low.
	Q4 productivity	2.3%	1.5%	-	Improved in 2018.
	Fedspeak	-	-	-	Brainard on the economy and policy.
Fri 08					
NZ	Q4 building work put in place	0.7%	1.0%	1.0%	Modest gains in residential and non-residential work expected.
	Q4 survey of manuf. (volumes)	-1.6%	-	-	Further softness expected in food manufacturing.
Chn	Feb trade balance USDbn	39.16	34.05	-	Pull-forward of trade and CNY creating volatility.
US	Jan consumer credit	16.554	-	-	Auto and student loans still the driving force.
	Feb non-farm payrolls	304k	185k	175k	Employment growth should (eventually) slow...
	Feb unemployment rate	4.0%	3.9%	3.9%	... though a trend decline in the U/E remains our expectation.
	Feb average hourly earnings %mth	0.1%	0.3%	0.2%	Wages growth should track towards 4.0%/yr in 2019.
	Jan housing starts	-11.2%	-	-	Construction activity has further to fall in 2019...
	Jan building permits	0.3%	-	-	... though g'th & rates should limit scale of decline.
Sat 09					
US	Fed Chair Powell speaks	-	-	-	Discusses monetary policy normalisation and review.

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	2019f	2020f
Australia						
Real GDP % yr	2.5	2.8	2.4	2.7	2.2	2.2
CPI inflation % annual	1.7	1.5	1.9	1.8	1.8	1.9
Unemployment %	5.8	5.7	5.5	5.0	5.5	5.7
Current Account % GDP	-4.7	-3.1	-2.6	-2.4	-2.0	-2.8
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.5	2.1
Consumer Prices %yr	0.1	1.4	2.1	2.3	1.8	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	1.0	1.7	1.1	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.9	2.4	1.8	1.4	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	6.6	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 22 February 2019

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	1.25	1.00	1.00	1.00	1.00
90 Day BBSW	1.87	2.05	2.05	1.75	1.50	1.45	1.45	1.40
10 Year Bond	2.15	2.10	1.95	1.85	1.90	1.90	1.90	1.95
International								
Fed Funds	2.375	2.375	2.375	2.375	2.625	2.625	2.625	2.625
US 10 Year Bond	2.72	2.70	2.70	2.75	2.80	2.75	2.70	2.60
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	0.7094	0.71	0.70	0.68	0.68	0.69	0.69	0.70
USD/JPY	111.71	110	111	113	112	111	110	106
EUR/USD	1.1372	1.13	1.11	1.10	1.10	1.11	1.14	1.20
AUD/NZD	1.0412	1.06	1.06	1.06	1.06	1.06	1.06	1.06

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