

Weekly Commentary

5 August 2019



Cardboard Cathedral, Christchurch

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The big news last week was that the Federal Reserve cut the US policy interest rate by 25 basis points. However, the Fed declined to signal further rate reductions – Chair Powell said that this was a “mid-cycle adjustment” and “not the beginning of a long series of rate cuts.” That disappointed markets, which had been pricing a much deeper series of cuts. Financial markets reacted by reducing equity prices and strengthening the US dollar. For New Zealand, that meant a drop in the NZD/USD exchange rate, which has fallen from almost 68 cents to 65.6 cents in the space of two weeks.

Just a day later however, considerable doubt was cast over the Fed’s stance following President Trump’s decision to impose a new 10% tariff on the \$300bn of Chinese imports to the US previously unaffected by the trade war. We expect that will have a considerable adverse effect on the US economy, and consequently we are now forecasting three more interest rate cuts from the Federal Reserve before the end of the year. That will keep the pressure on the Reserve Bank of New Zealand to reduce the OCR this year.

This week, all and sundry are expecting a 25 basis point OCR cut from the RBNZ. We expect that the RBNZ will strongly signal the possibility of further cuts without making any commitment. Wording in the press release might be something like “*The OCR may need to be lowered again, depending on the data*”, and the RBNZ’s OCR forecast will probably drop to 1.1%.

We expect the RBNZ’s focus will shift a little at this MPS. In March, May and June the RBNZ’s dovish commentary was very much focussed on the slowing global economy and the fact that overseas central banks were minded to reduce interest rates. The RBNZ will continue to comment on the global slowdown, but this time we also expect more commentary on the domestic economy. Previously, both the RBNZ and we were expecting the New Zealand economy to pick up in response to a large dose of fiscal stimulus and

lower interest rates, but instead a swathe of recent data has suggested that economic growth remains slow.

Yet another example of this was the July ANZ business confidence survey, which was released last week and registered an across-the-board fall. Businesses reported weaker activity expectations, less inclination to invest or to hire, and especially low profit expectations. Importantly, price gauges in the survey also eased, with fewer firms expecting higher costs or prices.

That said, it has not been all doom and gloom. Data last week showed that the number of dwelling consents issued fell just 3.9% in June, after a massive 13.9% lift in May. This reinforced the impression that the residential construction industry is booming at present, although the growth is concentrated in Auckland – construction in many other regions has been stable. This latest Auckland construction upturn will probably last into 2020, which will partially offset the gloom being felt in other sectors of the economy. However, we do think the construction sector is going to peak soon – beyond 2020 we are forecasting flat-to-falling construction activity due to slowing population growth and the wind down of post-earthquake reconstruction.

The labour market has been strong in recent years, but any sign of emerging weakness will be like a red rag to a bull

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for the RBNZ (or in this case, a red rag to a dove). There is mounting evidence that the jobs market is indeed softening. First business confidence surveys started telling us that firms are becoming reluctant to hire, and that labour is getting easier to find. And now we are seeing weakness in job ads – last week’s figures showed a 0.6% drop in online job ads for the June quarter. However, the Westpac McDermot Miller Employment Confidence Index, which asks households about their experience of the jobs market, actually rose in the June quarter, so the picture is not completely conclusive.

This week’s swathe of labour market data from Stats NZ will not necessarily clarify the labour market picture – instead, we expect it have a decidedly mixed feel to it, for technical reasons. For the Household Labour Force Survey (HLFS), we expect a small rise in the unemployment rate from 4.2% to 4.3%, but we anticipate a solid 0.8% rise in employment. The previous quarter saw both measures drop unexpectedly, due to a sharp fall in the labour force participation rate. Looking at the details suggests that the fall in participation was due to a jump in retirees – more than what seems plausible in the space of three months. We’ve assumed that this will be partially reversed this time.

Meanwhile, wage growth will probably have its strongest quarter since 2008, with a 0.7% rise in the Labour Cost Index (LCI) expected to lift annual wage growth to 2.1%. Much of the acceleration will reflect the recent 7.3% rise in the minimum wage, the biggest annual increase since 2007. There will be an even bigger impact on the more volatile QES average hourly earnings measure. The minimum wage hikes over the next two years are likely to have an even greater impact on wage costs, as each successive increase will affect a greater share of the workforce.

The labour market surveys will be released a day before the Reserve Bank’s *Monetary Policy Statement*, and in the midst of the Monetary Policy Committee’s deliberations. It’s important to note that the RBNZ’s previous forecasts had already factored in a rise in unemployment to 4.3%. As such, we don’t expect the labour market reports to have a bearing on the OCR decision itself, where there is already sufficient support for a rate cut. However, a weaker than expected result could affect the extent and timing of OCR moves later this year. We currently expect the RBNZ to cut the OCR for a third time in November, but a very weak labour market report would see us bringing that forward to September, and would create a risk that the OCR could fall below 1%.

Fixed vs Floating for mortgages

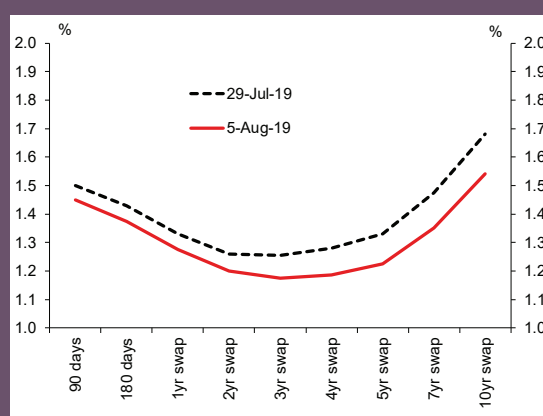
We expect the Reserve Bank will lower the OCR in August and November. If that is correct, both floating and fixed mortgage rates may fall over the coming month or two. However, mortgage rates could rise again in the early 2020s.

Based on our OCR forecasts, three-year fixed mortgage rates seem the best value on offer today. However, opportunities to fix at an even lower rate might emerge over the coming month or two. Today’s one- and two year rates are also fairly good value, with neither strongly preferred to the other.

Four- and five-year fixed rates are higher than where we expect shorter-term rates to go over the relevant timeframe, but longer-term fixed rates do offer insurance against the risk of future interest rate increases.

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

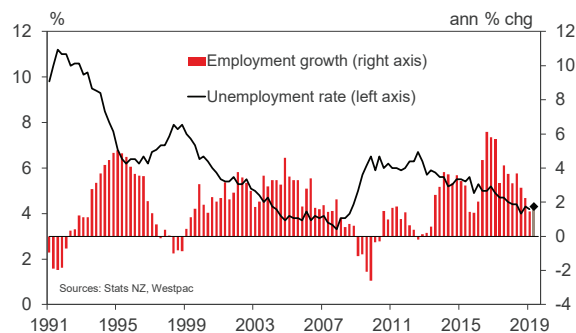
NZ Q2 Household Labour Force Survey

Aug 6, Employment Last: -0.2%, WBC f/c: +0.8%, Mkt f/c: +0.3%

Unemployment Last: 4.2%, WBC f/c: 4.3%, Mkt f/c: 4.3%

- We expect the unemployment rate to rise to 4.3% in the June quarter. There is mounting evidence that the New Zealand jobs market is softening. Business confidence surveys show a drop in hiring intentions, job advertisements are down on a year ago, and the share of people receiving the jobseeker benefit has risen further.
- However, we also expect some pick-up in employment and participation after they both unexpectedly fell in the previous quarter.
- The labour market surveys are released a day ahead of the RBNZ's next OCR decision. The RBNZ's last set of published forecasts assumed a 4.3% unemployment rate. A weaker than expected result could have a bearing on the timing and extent of further OCR cuts.

Household Labour Force Survey

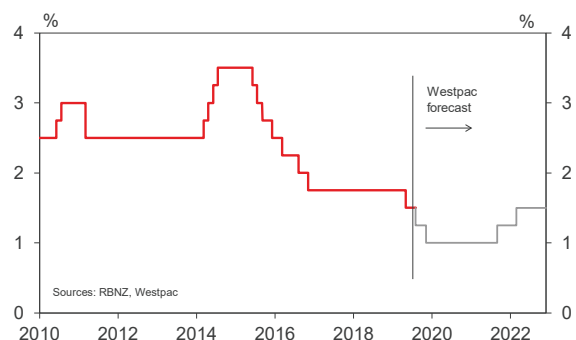


NZ RBNZ Monetary Policy Statement

Aug 7, Last: 1.75%, Mkt f/c: 1.25%, WBC f/c: 1.25%

- The RBNZ is likely to lower the Official Cash Rate to 1.25% at its August meeting. That follows signs that the New Zealand economy has softened in recent months.
- We also expect the RBNZ to signal that a further OCR reduction is possible, depending on the data. Consistent with that outlook, the RBNZ's published forecast for the OCR will likely drop to 1.1%.
- The commentary in the accompanying policy statement will still be conscious of the softness in global conditions that the RBNZ has previously commented on. However, we expect that there will be greater focus on the softening in domestic conditions, including in the labour market. Consistent with that, the RBNZ is likely to reduce its near-term GDP forecasts.

RBNZ Official Cash Rate

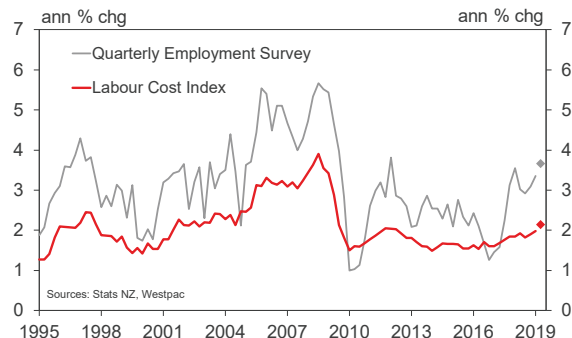


NZ Q1 Labour Cost Index, Private Sector

Aug 6, Last: +0.4%, WBC f/c: +0.7%, Mkt f/c: +0.7%

- We expect a 0.7% rise in the Labour Cost Index (LCI), with gains evenly split across the public and private sectors. That would see annual wage growth lifting to 2.1% – a ten year high.
- Much of that acceleration reflects a 7.3% rise in the minimum wage in April, the biggest annual increase since 2007. We estimate that this will add 0.2 percentage points to the LCI in the June quarter.
- The Quarterly Employment Survey (QES) measure of average hourly earnings has accelerated over the past year. We expect another 0.4% rise in the June quarter, which would leave annual earnings growth at 4%.

LCI and QES salary and wages, all sectors



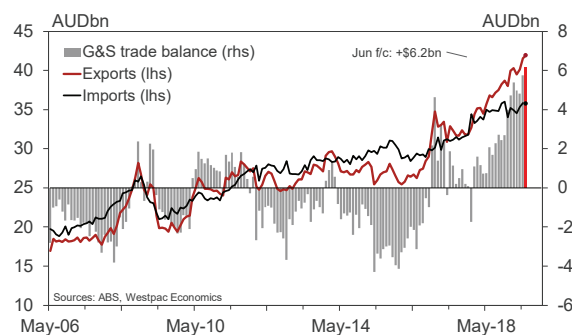
Aus Jun trade balance, AUDbn

Aug 6, Last: 5.7, WBC f/c: 6.2

Mkt f/c: 6.0, Range: 5.0 to 8.3

- Australia's trade surplus has widened in 2019, climbing to record highs, with export earnings boosted by higher commodity prices. For June, we expect the surplus to widen to \$6.2bn.
- Export earnings rise by a forecast 0.8%, \$0.35bn. Iron ore is the key positive, up an estimated \$0.8bn as the spot price spiked to US\$109/t, up from \$100. Likely negatives in the month are LNG (lower volumes) and coal (lower prices).
- Imports are expected to edge lower, -\$0.1bn, led by a weakening of global fuel prices.
- We will be watchful for any revisions, which are more prevalent in the last month of the quarter.

Australia's trade balance



The week ahead

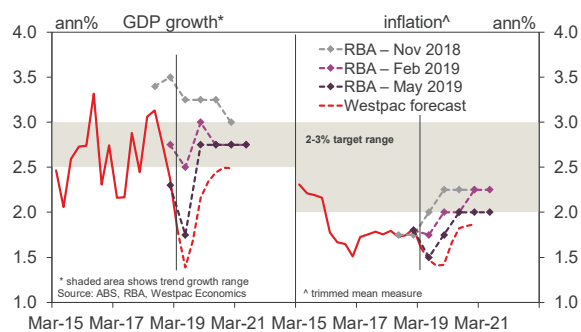
Aus RBA policy announcement

Aug 6, Last: 1.00%, WBC f/c: 1.00%

Mkt f/c: 1.00%, Range: 1.00% to 1.00%

- The Reserve Bank Board meets on August 6 to consider whether to extend the sequence of rate cuts in June and July. We think it is quite unlikely that the Board will decide to do a third consecutive cut at this meeting.
- Revised forecasts for growth, inflation and unemployment will be released with the August Statement on Monetary Policy on August 9. The unemployment rate forecast is likely to be a major problem for the RBA. At best, the RBA will be forecasting trend growth in 2020, challenging any forecast that the unemployment rate will fall from the current 5.25%.
- On July 25th, we revised our forecast of the timing of the next rate cut from November to October. In addition we extended the easing cycle to include another, and final, cut, in February 2019.

Growth and inflation forecasts



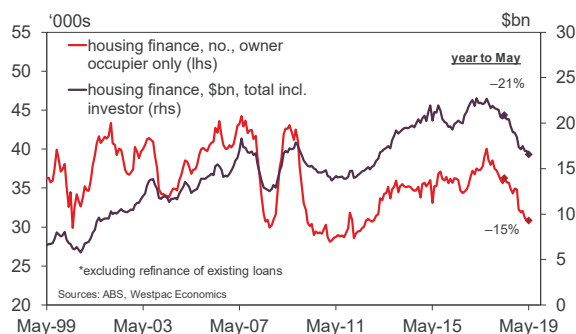
Aus Jun housing finance (no.)

Aug 7, Last: -0.1%, WBC f/c: 1.0%

Mkt f/c: 0.4%, Range: -1.5% to 1.0%

- Housing finance approvals were mixed in May, the number of owner occupier loan approvals essentially stable but the total value of both owner occupier and investor loans notably weaker, down 1.7%^{gmth} and 2.7%^{gmth} respectively.
- Other indicators show Australia's housing market correction started to stabilise through the middle of the year. Auction activity, turnover and prices all improving meaningfully in May, June and July.
- We expect the ABS measure to show a 1% rise in owner occupier approvals ex refi, consistent with the emerging pattern of stabilisation. Recent interest rate cuts should provide more of a lift as we head into the second half of the year.

New finance approvals*

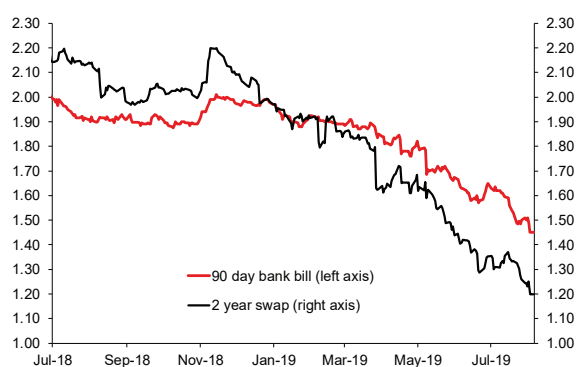


New Zealand forecasts

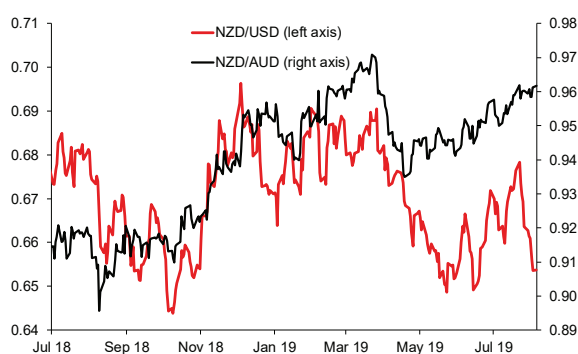
Economic Forecasts	Quarterly				Annual			
	2019							
% change	Mar (a)	Jun	Sep	Dec	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.4	0.6	0.8	2.9	2.3	3.0	2.4
Employment	-0.2	0.8	0.3	0.3	2.3	1.3	2.0	1.8
Unemployment Rate % s.a.	4.2	4.3	4.3	4.2	4.3	4.2	3.9	3.7
CPI	0.1	0.6	0.7	0.3	1.9	1.7	1.9	2.1
Current Account Balance % of GDP	-3.6	-3.4	-3.4	-3.4	-3.8	-3.4	-3.4	-3.6

Financial Forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Cash	1.25	1.00	1.00	1.00	1.00	1.00
90 Day bill	1.30	1.15	1.15	1.15	1.15	1.15
2 Year Swap	1.25	1.20	1.20	1.25	1.30	1.40
5 Year Swap	1.40	1.40	1.40	1.45	1.55	1.65
10 Year Bond	1.45	1.35	1.35	1.40	1.45	1.55
NZD/USD	0.65	0.65	0.65	0.66	0.66	0.66
NZD/AUD	0.96	0.96	0.98	0.99	0.99	0.99
NZD/JPY	68.9	68.3	69.6	71.0	72.4	73.0
NZD/EUR	0.57	0.57	0.58	0.58	0.59	0.59
NZD/GBP	0.52	0.52	0.52	0.52	0.51	0.51
TWI	71.8	71.6	72.0	72.5	72.4	72.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 5 August 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.50%	1.50%
30 Days	1.43%	1.54%	1.63%
60 Days	1.44%	1.53%	1.63%
90 Days	1.45%	1.53%	1.62%
2 Year Swap	1.20%	1.34%	1.31%
5 Year Swap	1.23%	1.41%	1.38%

NZ foreign currency mid-rates as at 5 August 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6537	0.6767	0.6625
NZD/EUR	0.5885	0.6035	0.5904
NZD/GBP	0.5382	0.5410	0.5288
NZD/JPY	69.67	72.93	71.80
NZD/AUD	0.9618	0.9608	0.9498
TWI	72.56	74.17	72.74

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 05					
NZ	Jul ANZ commodity prices	-3.9%	-	-	A mixed month with falling log prices and higher meat prices.
Aus	Bank Holiday	-	-	-	NSW (not a state-wide public holiday), ACT. Picnic Day NT
	Jul AiG PSI	52.2	-	-	Post election, services index rebounds from sub-50 Jan to Apr.
	Jul MI inflation gauge %yr	1.6%	-	-	Lack of inflationary pressure in the economy.
Chn	Jul Caixin China PMI services	52.0	52.0	-	Domestic conditions mixed.
Eur	Aug Sentix investor confidence	-5.8	-	-	Sentiment souring as global uncertainty heightens.
UK	Jul Markit services PMI	50.2	50.1	-	Service sector conditions remain subdued.
US	Jul Markit services PMI final	-	-	-	Services have been buoyed by the US' strong labour...
	Jul ISM non-manufacturing	55.1	55.5	-	... market, but growth is deteriorating and risks rising.
Tue 06					
NZ	Q2 unemployment rate	4.2%	4.3%	4.3%	Softening in business conditions and hiring in recent months.
	Q2 employment	-0.2%	0.3%	0.8%	Participation and jobs to recover after last quarter's declines.
	Q2 LCI wage inflation (pr, ord. time)	0.3%	0.7%	0.7%	Boost from minimum wage increase.
	Q3 RBNZ inflation expectations	2.0%	-	-	Inflation expectations remain close to target.
Aus	Jun trade balance, \$bn	5.7	6.0	6.2	To hit a fresh record high. Exports up on iron ore price spike.
	Jul ANZ job ads	4.6%	-	-	Labour market is in focus for the RBA.
	RBA policy decision	1.00%	1.00%	1.00%	Easing cycle to pause after back-to-back cuts.
US	Jun JOLTS job openings	7323	-	-	Hires, fires, quits and job openings.
	Fedspeak	-	-	-	Bullard to the National Press Club.
Wed 07					
NZ	GlobalDairyTrade auction	2.7%	-	-	Surprising improvement last auction.
	RBNZ policy decision	1.50%	1.25%	1.25%	RBNZ to cut and leave the door open for a further reduction.
Aus	Jul AiG PCI	43.0	-	-	Construction index sub-50 from last Sep, housing in downturn.
	Jun housing finance	-0.1%	0.4%	1.0%	First clear read post the Federal election.
Chn	Jul foreign reserves \$bn	3119	3109	-	Remain stable.
UK	Jul Halifax house prices	-0.3%	-	-	Ongoing housing market softness, especially in London.
US	Fedspeak	-	-	-	Evans holds a media breakfast on the economy (2pm AEST).
	Jun consumer credit	17.1	17.0	-	Autos benefitting from low rates.
Thu 08					
Aus	RBA Assis' Gov Fin. System speaks	-	-	-	Michele Bullock, Toowoomba Chamber of Commerce, 7:30am.
Chn	Jul trade balance USDbn	51.0	41.0	-	Trade pull-forward has ended, in time for another to start.
Eur	ECB bulletin	-	-	-	May have some insight on upcoming ECB stimulus package.
US	Initial jobless claims	215k	-	-	Remain historically low.
	Jun wholesale inventories final	0.2%	0.2%	-	Continue to grow, but at a lesser pace.
Fri 09					
NZ	Jun net migration	4240	-	-	Gradual down trend in annual migration continuing.
Aus	RBA Governor Lowe speaks	-	-	-	Parliamentary testimony, half year update, Canberra 9:30am
	RBA Statement on Monetary Policy	-	-	-	Activity and inflation forecasts updated.
Chn	Jul CPI %yr	2.7%	2.7%	-	Price pressures remain under control.
	Jul PPI %yr	0.0%	0.1%	-	Upstream, there is little inflation.
	Q2 current account balance	49.0	-	-	Full detail on trade and financial flows.
	Jul new loans, CNYbn	1663.6	1200.0	-	Credit growth taking time to strengthen.
UK	Q2 GDP	0.5%	0.0%	0.0%	Subdued growth expected in Q2...
	Jun industrial production	1.4%	0.0%	-	...as the earlier boost from restocking passes.
	Jun trade balance £bn	-2324	-2650	-	Global headwinds weighing on trade.
US	Jul PPI	0.1%	0.2%	-	Upstream price pressures muted.

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018	2019f	2020f
Australia						
Real GDP % yr	2.5	2.8	2.4	2.8	1.8	2.4
CPI inflation % annual	1.7	1.5	1.9	1.8	1.8	1.6
Unemployment %	5.8	5.7	5.5	5.0	5.4	5.6
Current Account % GDP	-4.7	-3.1	-2.6	-2.1	-0.3	-1.2
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.4	1.8
Consumer Prices %yr	0.1	1.4	2.1	2.4	1.8	1.9
Unemployment Rate %	5.3	4.9	4.4	3.9	3.5	3.5
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	1.2	0.6	1.9	0.8	0.7	0.4
Euro zone						
Real GDP %yr	2.1	2.0	2.4	1.8	1.2	1.4
United Kingdom						
Real GDP %yr	2.3	1.8	1.8	1.4	1.4	1.4
China						
Real GDP %yr	6.9	6.7	6.8	6.6	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	4.0	4.6	4.3	4.0	4.0
World						
Real GDP %yr	3.4	3.4	3.8	3.6	3.3	3.4

Forecasts finalised 5 July 2019

Interest Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Australia							
Cash	1.00	1.00	0.75	0.50	0.50	0.50	0.50
90 Day BBSW	1.01	0.95	0.85	0.70	0.70	0.70	0.70
10 Year Bond	1.09	1.10	1.10	1.10	1.10	1.10	1.10
International							
Fed Funds	2.125	1.875	1.375	1.375	1.375	1.375	1.375
US 10 Year Bond	1.88	1.85	1.60	1.60	1.65	1.70	1.70
ECB Deposit Rate	-0.40	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60

Exchange Rate Forecasts	Latest	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.6813	0.68	0.68	0.66	0.66	0.67	0.67
USD/JPY	107.10	106	106	107	108	110	111
EUR/USD	1.1078	1.09	1.08	1.08	1.08	1.09	1.11
GBP/USD	1.2103	1.18	1.19	1.21	1.22	1.24	1.26
AUD/NZD	1.0413	1.05	1.04	1.02	1.01	1.01	1.01

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