



Len Lye Centre, New Plymouth

Weekly Economic Commentary.

Balancing act.

Falling business confidence supports our view that economic growth will be softer again over the second half of this year, prompting another interest rate cut by the Reserve Bank in November. But with a substantial amount of stimulus already in place, there are competing arguments for and against any more easing beyond this.

The latest *Quarterly Survey of Business Opinion* found that a net 11% of businesses saw a downturn in trading activity in the September quarter, compared to a net 4% in the previous quarter. This was the weakest reading since 2010, and provided further evidence of a slowing in the New Zealand economy. Firms were slightly more positive about their prospects for the next three months, but this measure remains at a relatively low level.

This survey followed the RBNZ's surprisingly large 50 basis point OCR cut back in August, which was aimed at shoring up the economy in the face of global headwinds and softening demand. Since that time, we've seen falls in borrowing rates and a decline in the NZ dollar. But despite this, businesses are still down in the mouth.

Looking into the details of the report, it's not hard to see why. Businesses are highlighting both softness in demand and a

squeeze on their margins due to rising costs. Against this backdrop, it's no surprise that firms are scaling back their expansion plans. The September survey saw a further easing in the number of businesses planning to take on more staff. And there was a steep drop in investment intentions – firms are just not buying the line that super-low interest rates mean it's a great time to invest.

The ongoing weakness in business confidence adds to the likelihood of another OCR cut at the November *Monetary Policy Statement*, despite the RBNZ's seemingly noncommittal comments at its September review. We've been saying that weaker data between the two review dates would prompt the RBNZ into action; the business confidence survey certainly fits that bill.

Market thinking has gone even further than this, with some forecasters now predicting an additional OCR cut in February



next year. Interest rate markets are pricing in some chance that the November move cut will be 50 rather than 25 basis points, no doubt with an eye to the precedent set in August.

Our view is that the case for more easing – beyond what was already expected – is not clear cut. On the ‘more easing’ side of the debate, it’s apparent that the economy is not living up to the RBNZ’s forecasts of a gradual pick-up in growth over the second half of this year. We were already forecasting GDP growth to slow to 0.4% in the September quarter, and the business confidence results were broadly in line with that view.

On top of this, we’re not seeing signs of a build-up in inflation pressures. The number of businesses who have increased their prices, as well as the number who are planning to do so, dropped back in the latest survey. The RBNZ’s survey of inflation expectations fell substantially last quarter and proved to be a major motivation for the 50bp rate cut in August; we suspect that the next reading (which will be available to the RBNZ just before its November meeting) will remain subdued.

There are also signs of increasing slack in the labour market. Firms are reporting less difficulty in finding workers, unemployment benefit numbers have risen, and job ads have fallen. Ironically, the odd one out has been the official unemployment measure, which fell to an 11-year low of 3.9% in the June quarter. But this measure can be volatile, and we expect it to pop higher again in the near term.

The counterargument to more easing is that there is already a substantial amount of stimulus working its way through the economy. While businesses don’t appear to have been enlivened by the interest rate cuts to date, we argue that the

more important channels for monetary policy in New Zealand are through asset prices and the exchange rate. And we’re clearly seeing some results on both fronts.

Turnover in the housing market has picked up in recent months as mortgage rates have fallen. Listings data from Realestate.co.nz shows a further drop in the number of unsold homes in September, especially in the previously subdued Auckland region. It’s far from a rampant housing market – both new listings and sales remain at historically low levels – but it does appear to be tightening up again.

The REINZ house sales figures for September, due sometime this week, will give us a steer on what this has meant for prices. After several months of muted price gains there was a surprisingly large 1.3% jump in prices in August, though it’s uncertain whether this sort of pace can be maintained.

Meanwhile, the New Zealand dollar has fallen by around 7% from its most recent peak in July. Much of that reflects broad-based strength in the US dollar, but the surprise 50bp OCR cut in August undoubtedly helped along the NZ dollar’s decline. The impact on inflation is modest – we estimate that a sustained 10% drop in the currency adds around 0.5% to consumer prices over the following year – but it’s enough to make a difference in terms of the RBNZ meeting its inflation target. However, the key word is ‘sustained’: if the NZ dollar were to regain some of its lost ground in the near term, the case for more OCR cuts would be stronger.

Overall, it’s a difficult balancing act for monetary policy. Given that interest rates have already fallen sharply in a short space of time, the RBNZ may be wary of piling on even more stimulus before the effectiveness of its actions to date are apparent.

Fixed vs Floating for mortgages.

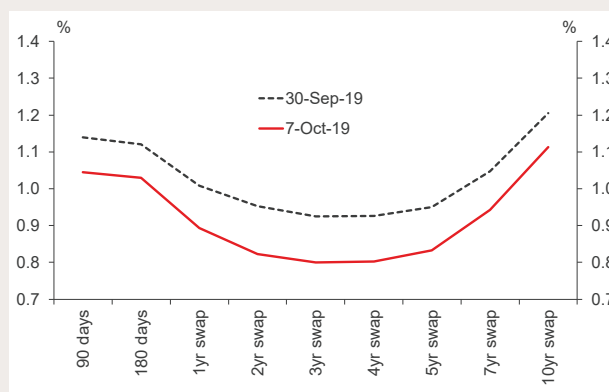
Mortgage rates are falling, and with the Reserve Bank expected to cut the OCR once more, we think they will keep falling. This means there is no hurry to fix.

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



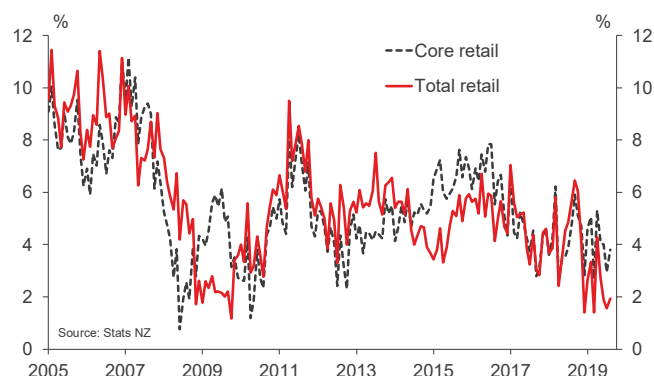
The week ahead.

NZ Sep retail card spending

Oct 11, Last: +1.1%, WBC f/c: Flat

- Retail spending levels surprised to the upside in August with a 1.1% rise over the month. Some of that rise was due to a fall in petrol prices which freed up funds for spending in other areas. There was also a solid 1.3% rise in core (ex-vehicle categories), including sizeable gains in spending on household durables, hospitality and apparel.
- We're expecting retail spending levels to remain steady in September. In part, that's due to a moderation in fuel spending. We're also likely to see some pull back in spending in areas like durables following strength last month. Even so, spending in core categories is expected to be up 0.2% over the month.

Card transactions, annual % change



NZ Sep REINZ House Price Index

Oct 10-15, last: 1.3%

- The August update from REINZ provided a surprising mix of developments. Sales were down 3.4% over the month (though that probably understates the strength of demand). Over the same period, prices rocketed higher, rising 1.2% in Auckland and 1.4% in the rest of the country.
- August's strong increase in prices might have been an aberration. But with fixed mortgage rates down, and plans for a capital gains tax now shelved, house prices look set to push higher over the coming year. That will be very important for economic conditions more generally. New Zealanders hold the bulk of their wealth in housing assets, and increases in house price growth are likely to support a related lift in household confidence and spending.

REINZ house prices and sales

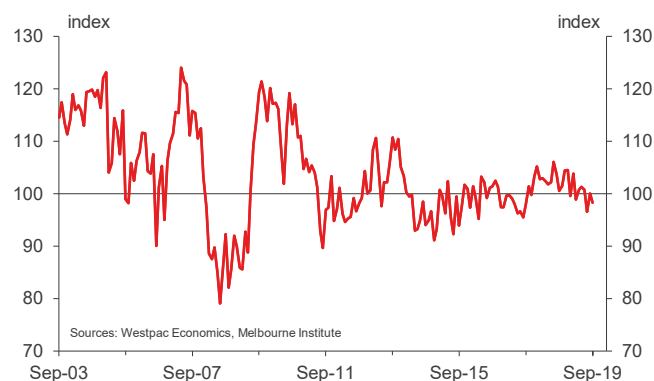


Aus Oct Westpac-MI Consumer Sentiment

Oct 9 Last: 98.2

- The Westpac Melbourne Institute Consumer Sentiment Index declined 1.7% in Sep, lapsing back into slight negative territory as pressures on family finances and concerns about the near term outlook continue to weigh on sentiment.
- The latest survey is in the field over the week to Oct 6. The RBA cut the cash rate a further 25bps to 0.75% at its Oct 1 Board meeting. However, any associated sentiment boost may be undermined by concerns about what the new record low for rates implies about economic conditions and the partial pass-through to mortgage rates – the major banks reduced standard variable rates by 13-15bps following the RBA move. Notably, sentiment slipped lower following previous cuts in June-July. Other developments also look likely to weigh on sentiment with more signs of deteriorating conditions abroad, the ASX down 2.3% since the Sep survey and petrol prices also starting to push higher locally. The main bright spot has been around housing markets which have continued to see prices recover over the last month.

Consumer Sentiment Index



The week ahead.

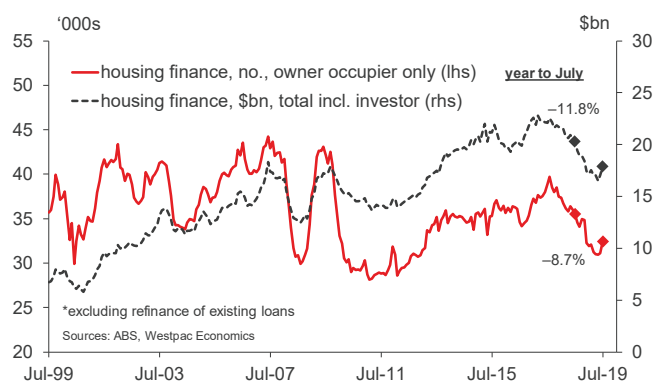
Aus Aug housing finance approvals

Oct 10, Last: 4.2%, WBC f/c: 2.5%

Mkt f/c: 2.3%, Range: -2.7% to 4.4%

- Housing markets have improved markedly since mid year with the number of owner occupier finance approvals posting a solid 4.2% gain in July and the value of investor loans up 5.3%. Both are still down on a year ago, but the momentum shift is clear.
- All indications are that this shift gathered pace in Aug-Sep with auction markets, prices and buyer sentiment all showing a further significant pick-up. While this still looks to be coming off a very low base for market turnover, industry data covering the major banks suggests finance approvals posted a solid gain in the August month, albeit off a July move that was considerably weaker than that shown by the ABS measure. On balance we expect the wider ABS measure to show a 2.5% gain in Aug – the recovery effectively consolidating – with growth in the total value of loans likely to be stronger.

New finance approvals*

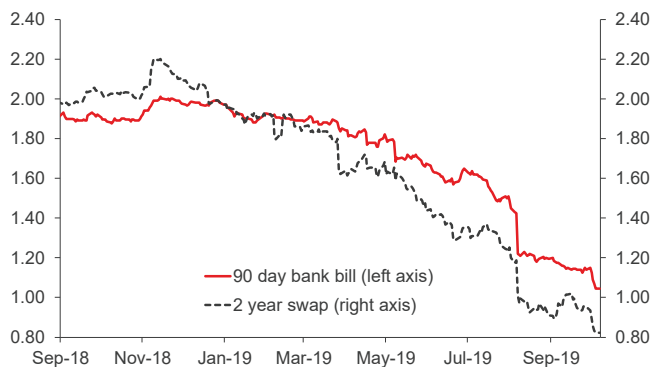


New Zealand forecasts.

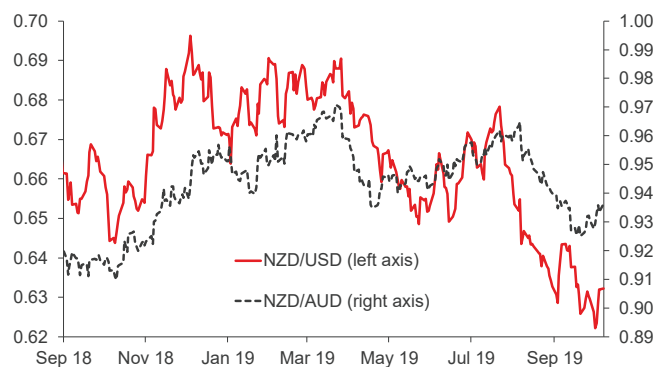
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019f	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	0.5	0.4	0.5	0.6	2.8	2.2	2.3	2.8
Employment	0.8	0.1	0.4	0.3	2.3	1.2	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.4	4.3	4.3	4.3	3.8
CPI	0.6	0.6	0.3	0.4	1.9	1.6	1.7	1.8
Current 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 7 October 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.19%	1.18%	1.19%
60 Days	1.12%	1.16%	1.17%
90 Days	1.05%	1.14%	1.18%
2 Year Swap	0.82%	0.95%	0.97%
5 Year Swap	0.83%	0.97%	1.02%

NZ foreign currency mid-rates as at 7 October 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6322	0.6260	0.6422
NZD/EUR	0.5756	0.5683	0.5824
NZD/GBP	0.5125	0.5019	0.5232
NZD/JPY	67.56	67.44	68.57
NZD/AUD	0.9363	0.9243	0.9386
TWI	70.64	69.85	71.65

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 07					
Aus	Sep AiG PCI	44.6	-	-	Residential construction is in downturn.
	Labour Day (NSW, Qld & SA)	-	-	-	Public holiday in Sydney.
Chn	Sep foreign reserves \$bn	3107	3104	-	Broadly stable.
Eur	Oct Sentix investor confidence	-11.1	-12.5	-	Sentiment is dour.
US	Aug consumer credit	23.294	-	-	Low rates supportive, but uncertainty to affect demand.
	Fedspeak	-	-	-	George at NABE Conference, Kashkari at community event.
Tue 08					
Aus	Sep ANZ job ads	-2.8%	-	-	Softening trend.
	Sep NAB business survey	1	-	-	Conditions and confidence remain below average.
Chn	Sep Caixin China PMI services	52.1	-	-	Services sector being hindered by manufacturing's woes.
UK	BOE Governor Carney speaks	-	-	-	On climate change at conference in Tokyo (3 pm AEDT).
US	Sep NFIB small business optimism	103.1	102.5	-	Will small business show same concern as big business?
	Sep PPI	0.1%	0.1%	-	Upstream price pressures absent.
	Sep monthly budget \$bn	119	93	-	Deficit to continue growing through 2020 and 2021.
	Fed Chair Powell speaks	-	-	-	At the NABE conference in Denver.
	Fedspeak	-	-	-	Evans at Chicago Rotary Club.
Wed 09					
Aus	Oct WBC-MI Consumer Sentiment	98.2	-	-	Returned back below 100 in Sep.
Chn	Sep M2 money supply %yr	8.2%	8.3%	-	Structural change in China's financial system...
	Sep new loans, CNYbn	1210	1360	-	... continues to hold back investment.
UK	Aug GDP	0.3%	-	-	Stabilising after Q2's 0.2% contraction.
US	Aug JOLTS job openings	7217	-	-	Hires, fires, quits and job openings.
	Aug wholesale inventories	0.4%	0.4%	-	Inventories likely to be run down through H2 2019.
	Fed Chair Powell speaks	-	-	-	At Fed Listens event Kansas City alongside George.
	FOMC minutes	-	-	-	Further detail on spread of opinions and key risks.
Thu 10					
NZ	Sep food price index	0.7%	-	-0.4%	Annual growth is up as meat prices have surged.
	Sep REINZ house sales	-3.4%	-	-	TBC. Signs that sales are starting to firm...
	Sep REINZ house prices %yr	2.9%	-	-	...with a rise in prices expected to follow in later months.
Aus	Aug housing finance	4.2%	2.3%	2.5%	Moderate gain in no. of owner occupier approvals expected.
US	Sep CPI	0.1%	0.1%	0.1%	Core expected to rise 0.2% in month, 2.4%yr.
	Initial jobless claims	219k	-	-	Higher firing rate a risk rather than central forecast.
Fri 11					
NZ	Sep manufacturing PMI	48.4	-	-	Business conditions have been weakening in late 2019.
	Sep card spending	1.3%	-	0.0%	Headline flat, core expected to rise modestly.
Chn	Sep foreign direct investment %yr	3.6%	-	-	FDI important part of China's development.
US	Sep import price index	-0.5%	0.0%	-	USD strength offsetting tariff impact, to a degree.
	Oct Uni. of Michigan sentiment	93.2	92.0	-	Susceptible to declines given rising uncertainty.
	Fedspeak	-	-	-	Mester (8:30 am AEDT), Bostic (9:30 am AEDT)...
	Fedspeak	-	-	-	... Kashkari in NY, Rosengren and Kaplan over the weekend.

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	0.84	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	0.89	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	1.54	1.45	1.40	1.45	1.50	1.55	1.70	1.80
ECB Deposit Rate	-0.50	-0.60	-0.70	-0.70	-0.70	-0.70	-0.70	-0.70

Exchange rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Jun-21	Dec-21
AUD/USD	0.6752	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	106.78	105	104	104	106	108	111	112
EUR/USD	1.0977	1.07	1.05	1.06	1.07	1.09	1.11	1.14
GBP/USD	1.2349	1.17	1.18	1.20	1.22	1.24	1.31	1.35
AUD/NZD	1.0685	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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