

Weekly Commentary

8 April 2019



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Starting with a bang

In its April OCR Review, the RBNZ surprised by advising that “*more likely direction of the next OCR move is down.*” This announcement was followed by broad-based weakness in last week’s Quarterly Survey of Business Confidence. We now expect the RBNZ to cut the OCR in May – the first decision by the newly appointed Monetary Policy Committee. On the back of this change in view we have revised our interest rate and exchange rate forecasts.

We now expect the RBNZ to cut the OCR to 1.5% at its next meeting in May. In its April *Statement*, the RBNZ was clearly getting nervous about the global economic outlook. The fact that foreign central banks are moving towards more dovish monetary policy stances has been particularly important. If New Zealand fails to follow suit, the RBNZ is worried that the exchange rate could rise, putting downward pressure on inflation which is already struggling to reach the 2% mid-point of the RBNZ’s target band.

The RBNZ is also becoming increasingly doubtful that New Zealand GDP growth will accelerate to the extent it is forecasting in 2019. Recent data has on that has been mixed. Consumer spending and construction data has been strong but last week’s Quarterly Survey of Business Opinion was weak. Not only did headline business confidence fall to within cooee of September’s 9-year low, but there was also a broad-based deterioration across most of the key activity and investment indicators. Profits are being squeezed by rising costs and a perceived inability to pass these on to customers, increasing the chances that weak confidence will become self-fulfilling. The survey suggests March quarter GDP growth is likely to be around 0.5%. That’s weaker than the RBNZ’s forecast of 0.8%, and is consistent with an economy that is ticking over rather than picking up.

The labour market leg of the RBNZ’s dual mandate gives less basis for cutting the OCR – unemployment is low and as we saw in this week’s QSBO, firms continued to report

that both skilled and unskilled workers remain hard to come by. And while there has been limited upward pressure on wage growth to date, with the unemployment rate expected to linger around its maximum sustainable level for some time yet, we are expecting to see stronger wage growth this year. But with the maximum sustainable level of employment still relatively uncertain, the employment target is unlikely to get in the way if a modest OCR reduction is warranted on inflation grounds.

The May OCR decision will be the first made by the RBNZ’s newly formed Monetary Policy Committee, making this something of a “blank slate” decision. Could a fresh committee conclude that a lower OCR is the way to go? We think yes. Critically, inflation has been below two percent for 7 years (aside from a one quarter petrol induced spike in 2017). And while measures of core inflation are rising, they are still only around 1.5% to 1.7%. Looking ahead, there remains more risk of inflation undershooting the target than overshooting. The big risk with cutting the OCR is the housing market. An OCR reduction could cause mortgage rates to fall even further, increasing the risk of stoking the housing market which is already booming in many regions beyond Auckland. Which option to go with is a matter of judgement. But with nationwide house price inflation currently at 2.6% and inflation flagging, it is now looking more reasonable to opt for a modestly lower OCR than it looked last year.

Starting with a bang

When it cuts in May, the RBNZ will leave the door open to a follow-up cut. There is a risk that they follow through on that, but more likely they will keep the OCR at 1.5% for the remainder of 2019. By the second half of the year the New Zealand economy will be showing clearer signs of improvement due to fiscal stimulus, lower petrol prices and strong construction activity in Auckland and sentiment about the global growth outlook should be improving. In addition, the sharp fall in interest rates we've seen in recent weeks is set to put downward pressure on mortgage rates which will be a very large stimulus for the housing market.

While we don't think a second OCR cut in 2019 will be justified, by the early 2020s the introduction of a capital gains tax, the end of the construction boom, and slowing population growth will likely see that change, justifying a lower level of the OCR. We have pencilled in a second cut for May 2020, which would take the OCR down to 1.25%.

This new outlook for interest rates means we now see the outlook for the NZ dollar and longer term interest rates differently. The NZ dollar fell sharply following the RBNZ's dovish shift. The NZD/USD is currently around 67.30. We expect it to fall further in the coming months and are forecasting 65c by the end of June. However, with markets pricing in a high likelihood of two rate cuts by the end of the year, there's scope for disappointment (and a slightly stronger NZD/USD) if the RBNZ fails to deliver a second rate cut – as we expect. We forecast the NZD/USD to temporarily rebound in late 2019 before heading south again by the middle of next year as RBNZ cuts once more.

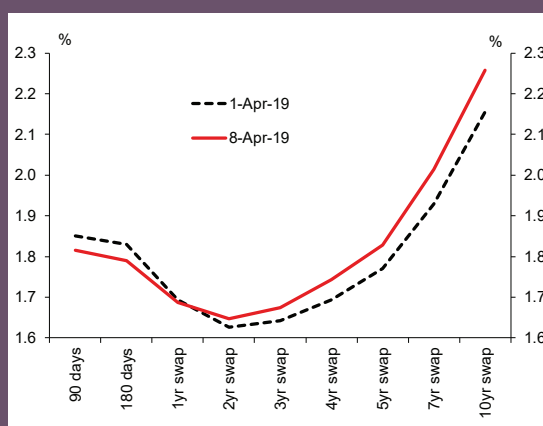
Fixed vs Floating for mortgages

Fixed mortgage rates have fallen recently, but they may fall even further in the near future. If the RBNZ cuts the OCR in May, fixed rates may drop again at that time.

At present, two-year fixed rates appear to offer the best value to borrowers. Some of the one and three year rates on offer are almost as good value. This is based on our view that the OCR will fall this year and in 2020, but will rise from 2022 onwards.

Longer term rates still seem high to us, but they do offer borrowers the opportunity to lock in low interest rates for a longer period. Floating mortgage rates are more expensive for borrowers, but may be the preferred option for those who require flexibility in their repayments.

NZ interest rates



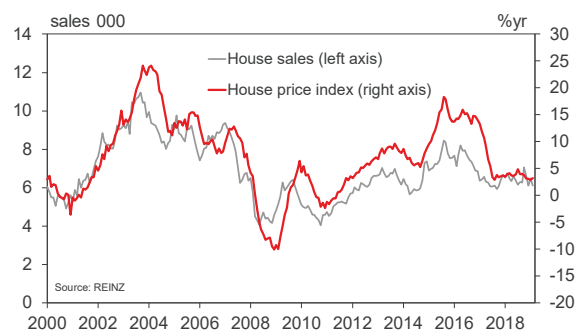
The week ahead

NZ Feb REINZ house sales and prices

Apr 8 – 13 (tbc), Sales last: -5.8%, Prices last: 3.2%/yr

- Over the past year house prices have been falling slowly in Auckland and Canterbury, and rising very rapidly in most other places. The pace of nationwide price inflation has picked up a little in recent months.
- We expect a mixed report this month. Over the past two months, sales have dropped sharply and available stock has increased in Auckland. This suggests Auckland prices will soon weaken further. But elsewhere, prices are expected to keep rising rapidly.
- Mortgage rates are plunging, which will stimulate the market later this year. But the Government may announce a capital gains tax, which will have the opposite effect.

REINZ house prices and sales



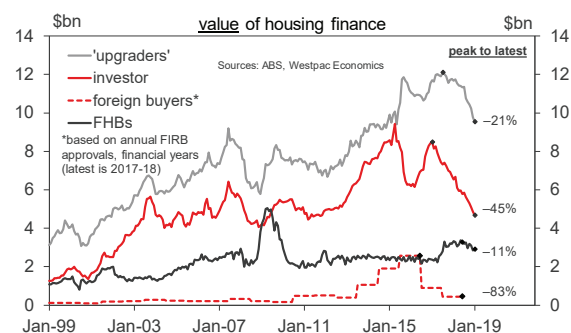
Aus Feb housing finance (no.)

Apr 9, Last: -1.2%, WBC f/c: 1.0%

Mkt f/c: 0.5%, Range: -3.1% to 1.8%

- Housing finance approvals posted a further decline in Jan, albeit a slightly milder one than in previous months for owner occupiers, the number of approvals ex refi down 1.2% vs average declines of 1.6% over the second half of 2018. The value of investor loans ex refi posted a larger 4.1% fall.
- Industry data covering the major banks suggests Feb was a touch firmer. We expect the number of owner occupier loans to edge 1% higher. However, the value of investor loans is expected to see further softening.

Housing finance approvals by segment

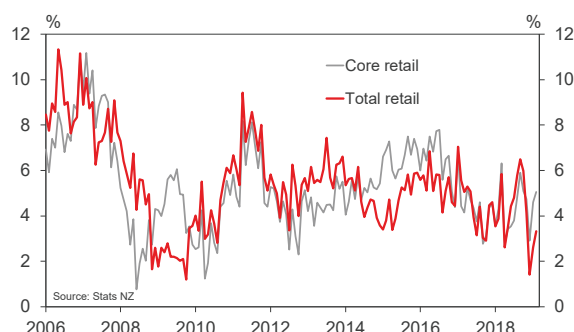


NZ Feb retail card spending

April 12, Last: +0.9%, WBC : +0.4

- Retail spending rose by 0.9% in February. That marked a return to trend for retail spending after some sharp swings in previous months. February's gain was supported by the reversal of earlier sharp oil price increases that dampened spending last year. Retail spending has also been boosted by the increases in government spending now rippling through the economy (including transfers to households as part of the Governments' Families Package).
- We're expecting a moderate 0.4% rise in retail spending in March, with only a small 0.1% gain in core (ex-fuel) categories. Recent increases in petrol prices will dampen spending in other areas. There has also been softness in the housing market that will dampen spending appetites. On top of those factors, March saw a softening in consumer confidence.

Card transactions, annual % change

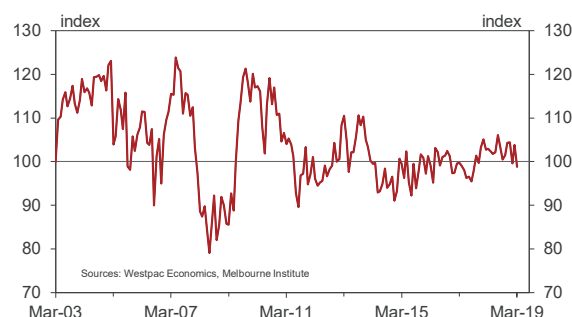


Aus Apr Westpac-MI Consumer Sentiment

Apr 10 Last: 98.8

- The Westpac Melbourne Institute Index fell 4.8% in March, the consumer mood clearly jolted by the disappointing December quarter national accounts released in the survey week. At 98.8, the March read is the lowest since September 2017, although this 'cautiously pessimistic' level is still above the average recorded in 2017.
- The April survey is in the field from April 1-6 and will capture reactions to the Federal Budget, which included additional tax relief measures for households. Concerns around the economic outlook are likely to linger. Other factors that may impact include: a continued lift in the ASX, now up nearly 10% from its late 2018 levels; but negatives around petrol prices (average pump prices nationally up 18c/l since early Feb) and continued declines in house prices.

Consumer Sentiment Index



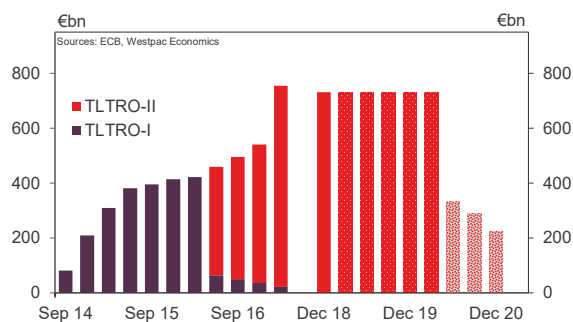
The week ahead

Europe Apr ECB meeting

April 10

- April's meeting follows a significant dovish shift in March. While before, the ECB held steady in their confidence that the growth slowdown would be temporary, in March they have factored in weakness persisting through H1 2019.
- All up, this saw large downward revisions in the economic projections, the extension of interest rate policy forward guidance to rates expected to be on hold at least through the end of 2019, and the announcement of a new Targeted Long-Term Refinancing Operations (TLTRO) package in response to the upcoming maturities. At first glance TLTRO-III appears less favourable than its predecessor, but the ECB have indicated that there will be incentives (as did TLTRO-II). We expect an announcement in June with April's discussion providing valuable clues.

TLTRO-II to be replaced with TLTRO-III

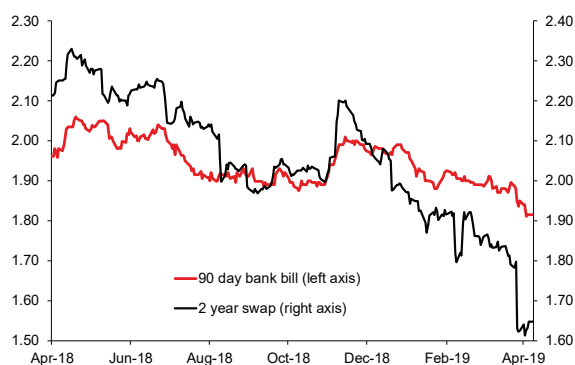


New Zealand forecasts

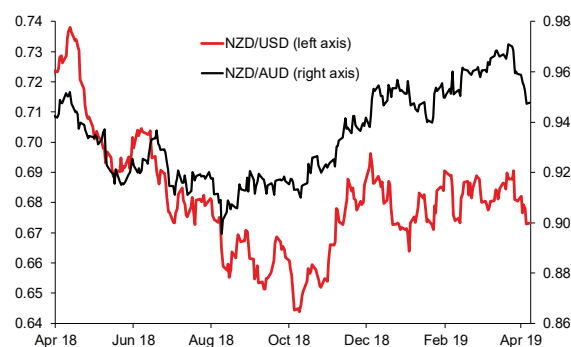
| Economic Forecasts | Quarterly | | | | Annual | | | |
|----------------------------------|-----------|------|------|------|--------|-------|-------|-------|
| | 2018 | 2019 | | | | | | |
| % change | Dec (a) | Mar | Jun | Sep | 2018 | 2019f | 2020f | 2021f |
| GDP (Production) | 0.6 | 0.5 | 0.8 | 0.8 | 2.8 | 2.5 | 2.8 | 2.0 |
| Employment | 0.1 | 0.2 | 0.3 | 0.4 | 2.3 | 1.2 | 1.6 | 1.3 |
| Unemployment Rate % s.a. | 4.3 | 4.4 | 4.3 | 4.2 | 4.3 | 4.2 | 4.0 | 4.0 |
| CPI | 0.1 | 0.2 | 0.5 | 0.7 | 1.9 | 1.7 | 2.1 | 2.1 |
| Current Account Balance % of GDP | -3.7 | -3.4 | -3.2 | -3.1 | -3.7 | -2.9 | -2.8 | -2.8 |

| Financial Forecasts | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 |
|---------------------|--------|--------|--------|--------|--------|--------|
| Cash | 1.50 | 1.50 | 1.50 | 1.50 | 1.25 | 1.25 |
| 90 Day bill | 1.60 | 1.60 | 1.60 | 1.50 | 1.40 | 1.40 |
| 2 Year Swap | 1.50 | 1.50 | 1.60 | 1.60 | 1.50 | 1.50 |
| 5 Year Swap | 1.70 | 1.75 | 1.85 | 1.85 | 1.85 | 1.85 |
| 10 Year Bond | 1.80 | 1.85 | 1.90 | 1.85 | 1.85 | 1.90 |
| NZD/USD | 0.66 | 0.65 | 0.66 | 0.66 | 0.65 | 0.65 |
| NZD/AUD | 0.94 | 0.96 | 0.97 | 0.96 | 0.94 | 0.93 |
| NZD/JPY | 74.6 | 74.1 | 74.6 | 73.9 | 71.5 | 70.2 |
| NZD/EUR | 0.59 | 0.59 | 0.60 | 0.59 | 0.58 | 0.57 |
| NZD/GBP | 0.50 | 0.49 | 0.49 | 0.49 | 0.47 | 0.47 |
| TWI | 72.6 | 72.2 | 73.0 | 72.2 | 70.6 | 69.9 |

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 8 April 2019

| Interest Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| Cash | 1.75% | 1.75% | 1.75% |
| 30 Days | 1.85% | 1.86% | 1.87% |
| 60 Days | 1.83% | 1.88% | 1.87% |
| 90 Days | 1.82% | 1.90% | 1.88% |
| 2 Year Swap | 1.65% | 1.79% | 1.84% |
| 5 Year Swap | 1.83% | 1.88% | 1.97% |

NZ foreign currency mid-rates as at 8 April 2019

| Exchange Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| NZD/USD | 0.6733 | 0.6873 | 0.6792 |
| NZD/EUR | 0.6002 | 0.6085 | 0.6045 |
| NZD/GBP | 0.5163 | 0.5208 | 0.5240 |
| NZD/JPY | 75.22 | 75.49 | 75.41 |
| NZD/AUD | 0.9477 | 0.9703 | 0.9659 |
| TWI | 73.28 | 74.70 | 74.18 |

Data calendar

| | | Last | Market median | Westpac forecast | Risk/Comment |
|---------------|-----------------------------------|-------|---------------|------------------|---|
| Mon 08 | | | | | |
| Aus | Mar ANZ job ads | -0.9% | - | - | Ads have fallen in 9 of the last 12 months (-4.3%/yr) |
| Eur | Apr Sentix investor confidence | -2.2 | -1.7 | - | Sentiment gauges have stabilised outside of manufacturing. |
| | Feb factory orders | 0.1% | -0.5% | - | Underlying trend for investment soft. |
| Tue 09 | | | | | |
| Aus | Feb housing finance | -1.2% | 0.5% | 1.0% | Industry data hints at stabilising after big falls in 2018 H2. |
| US | Mar NFIB small business optimism | 101.7 | 101.2 | - | Sentiment remains robust across economy. |
| | Feb JOLTS job openings | 7581 | 7566 | - | Hires; fires; quits and job openings. |
| Wed 10 | | | | | |
| NZ | Mar REINZ house sales | -5.8% | - | - | Due this week. Mixed across regions.... |
| | Mar REINZ house prices %yr | 3.2% | - | - | ...but prices to keep rising overall. |
| Aus | Apr WBC-MI Consumer Sentiment | 98.8 | - | - | How did the Federal Budget go over with consumers? |
| | RBA Deputy Governor Debelle | - | - | - | Speaks on 'The State of the Economy', Adelaide 12:30 pm. |
| Chn | Mar M2 money supply %yr | 8.0% | 8.2% | - | China credit starting to pick up steam... |
| | Mar new loans, CNYbn | 886 | 1225 | - | ... but acceleration will be modest in pace and scale. |
| Eur | ECB policy decision | -0.4% | -0.4% | - | Discussion on TLTRO incentives in focus. |
| | EU Summit | - | - | - | Special meeting called ahead of 12 April Brexit date. |
| UK | Feb trade balance £bn | -3825 | - | - | After a stronger than expected start to the year... |
| | Feb industrial production | 0.6% | - | - | growth is set to decelerate again... |
| | Feb construction output | 2.8% | - | - | ...with political uncertainty a key drag on investment... |
| | Feb GDP (monthly) | 0.5% | 0.2% | - | ...and some signs household demand is cooling. |
| US | Mar CPI | 0.2% | 0.3% | 0.3% | Inflation a non issue, headline and core at target. |
| | Mar monthly budget \$bn | -234 | -197 | - | Deficit trend clearly to the upside. |
| | Mar FOMC meeting minutes | - | - | - | Detailed view on risks in focus. |
| | Fedspeak | - | - | - | Vice Chair Clarida at a Minneapolis Fed event. |
| Thu 11 | | | | | |
| NZ | Mar food price index | 0.4% | - | 0.3% | Annual food price inflation running at about 1%. |
| Aus | Apr MI inflation expectations | 4.1% | - | - | The trend has been holding below 4% since Oct 2018. |
| | RBA Deputy Governor Debelle | - | - | - | Video link to ISDA annual meeting, HK 12:30 pm. |
| Chn | Mar CPI %yr | 1.5% | 2.4% | - | Inflation pressures well contained, for consumers... |
| | Mar PPI %yr | 0.1% | 0.4% | - | ... and industry. |
| | Mar foreign direct investment %yr | 6.6% | - | - | Not a focus currently, but opportunity to grow. |
| UK | Mar RICS house prices | -28% | -30% | - | Economic uncertainty continuing to dampen prices. |
| US | Mar PPI | 0.1% | 0.3% | - | Upstream price pressure muted. |
| | Initial jobless claims | 202k | - | - | Very low. |
| | Fedspeak | - | - | - | Clarida, Bullard, Quarles, Kashkari, Bowman at separate events. |
| Fri 12 | | | | | |
| NZ | Mar manufacturing PMI | 53.7 | - | - | Recent indicators point to an easing in business activity. |
| | Mar card spending | 0.1% | 0.4% | - | Petrol prices up, modest growth in core spending expected. |
| | Feb net migration | 6300 | - | - | Survey changes have prompted large swings in recent months. |
| Aus | RBA Financial Stability Review | - | - | - | Bi-annual report on financial stability. |
| Chn | Mar trade balance USDbn | 4.1 | 6.0 | - | Has been thrown around by tariffs and LNY. |
| Eur | Feb industrial production | 1.4% | -0.5% | - | Manufacturing remains weak. |
| UK | Scheduled exit from the EU | - | - | - | Ongoing political negotiations, risk of another extension. |
| US | Mar import price index | 0.6% | - | - | Higher USD keeping a lid on import prices. |
| | Apr Uni. of Michigan sentiment | 98.4 | 98.0 | - | Confidence remains robust. |

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 | 2.2 |
| CPI inflation % annual | 1.7 | 1.5 | 1.9 | 1.8 | 1.7 | 1.7 |
| Unemployment % | 5.8 | 5.7 | 5.5 | 5.0 | 5.5 | 5.7 |
| Current Account % GDP | -4.7 | -3.1 | -2.6 | -2.1 | -0.9 | -2.2 |
| United States | | | | | | |
| Real GDP %yr | 2.9 | 1.6 | 2.2 | 2.9 | 2.4 | 2.1 |
| 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 | 1.4 | 1.0 | 1.7 | 1.1 | 0.8 | 0.7 |
| Euro zone | | | | | | |
| Real GDP %yr | 2.1 | 1.9 | 2.4 | 1.8 | 1.2 | 1.4 |
| United Kingdom | | | | | | |
| Real GDP %yr | 2.3 | 1.8 | 1.7 | 1.3 | 1.2 | 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 13 March 2019

| Interest Rate Forecasts | Latest | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| Australia | | | | | | | | |
| Cash | 1.50 | 1.50 | 1.25 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| 90 Day BBSW | 1.73 | 1.90 | 1.65 | 1.40 | 1.40 | 1.40 | 1.40 | 1.40 |
| 10 Year Bond | 1.90 | 1.85 | 1.75 | 1.80 | 1.80 | 1.80 | 1.85 | 1.90 |
| International | | | | | | | | |
| Fed Funds | 2.375 | 2.375 | 2.375 | 2.625 | 2.625 | 2.625 | 2.625 | 2.625 |
| US 10 Year Bond | 2.53 | 2.60 | 2.65 | 2.70 | 2.65 | 2.60 | 2.55 | 2.55 |
| ECB Deposit Rate | -0.40 | -0.40 | -0.40 | -0.40 | -0.30 | -0.20 | -0.10 | 0.00 |

| Exchange Rate Forecasts | Latest | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|--------|
| AUD/USD | 0.7124 | 0.70 | 0.68 | 0.68 | 0.69 | 0.69 | 0.70 | 0.70 |
| USD/JPY | 111.72 | 113 | 114 | 113 | 112 | 110 | 108 | 106 |
| EUR/USD | 1.1225 | 1.11 | 1.10 | 1.10 | 1.11 | 1.12 | 1.14 | 1.17 |
| GBP/USD | 1.3080 | 1.31 | 1.33 | 1.36 | 1.36 | 1.37 | 1.37 | 1.38 |
| AUD/NZD | 1.0547 | 1.06 | 1.05 | 1.03 | 1.05 | 1.06 | 1.08 | 1.08 |

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