

Weekly Commentary

8 July 2019



Stone Store, Kerikeri

Under pressure

With a deepening malaise in the business sector, as well as softness in some other parts of the economy, an August rate cut from the RBNZ is looking increasingly likely. These developments also mean that the RBNZ could leave the door open for a third cut. However, with a policy related firming in growth on the cards over the coming year, we think it's more likely that 1.25% will be the low for the Official Cash Rate.

We have revised down our forecast for GDP growth in mid-2019. We now expect growth of only 0.4% in the June quarter (down from our earlier forecast of 0.6%). That would see annual GDP growth slowing to 2.4% - a pace that's not much faster than the rate of population growth over the past year.

Signs that the economy has been losing steam have been mounting in recent months, and we were already forecasting some deceleration in GDP growth. However, the latest Quarterly Survey of Business Opinion (QSBO) indicates that the slowdown in business activity has been even more pronounced than we had expected. This survey is one of the most reliable gauges of New Zealand economic conditions and doesn't show the same sort of political bias that other surveys do. The latest update revealed that business confidence has fallen to a ten-year low. Businesses are reporting weaker trading conditions and ongoing pressure on profitability in the face of rising costs but limited ability to raise prices. There has also been a related pullback in business hiring intentions, as well as continued weakness in investment spending.

This downbeat reading in the QSBO reinforces the message from other recent surveys of business activity. It also comes atop of softness in the housing market and sluggish household spending in recent months.

We've also been hearing concerns about the economic backdrop in our own talks with businesses in recent weeks. However, those talks have also highlighted some big differences in economic conditions across the country. There's definitely been softness in Auckland and Canterbury. In contrast, businesses in many other areas are feeling quite upbeat, especially in those areas with an agricultural backbone. Wellington is also looking in fine fettle, supported by growth in the Government sector.

In addition to the softening in domestic conditions, we are encountering headwinds on the external front. Notably, prices for our dairy exports have fallen in the past four auctions, leaving overall prices back at levels we last saw in January. We were always expecting auction prices to fall over the course of this year. However, this has come through faster than we anticipated. In response, we've lowered our farmgate milk price forecast for the 2019/2020 season to \$6.90/kg (down from our earlier forecast of \$7.20). On top of that, the NZ dollar has pushed higher in recent weeks, rising to around 67 cents against the USD.

These developments will certainly have raised some flags at the RBNZ. They've been wrestling with low inflation for years now and have been looking for a reacceleration in growth to offset this. However, it now looks like GDP growth in 2019 will fall well short of the rates the RBNZ had factored into their last set of published projections.

Under pressure

This has reinforced our expectation that the RBNZ will cut the cash rate to 1.25% at the August policy meeting. It also means that they could leave the door open for another cut.

But while we do see some chance of a follow up rate cut after the August policy meeting, we think it's more likely that the RBNZ will hold fire. That's because a reacceleration in growth is on the cards through the back half of 2019 and into 2020, and will likely leave them feeling a little more comfortable about the outlook for inflation.

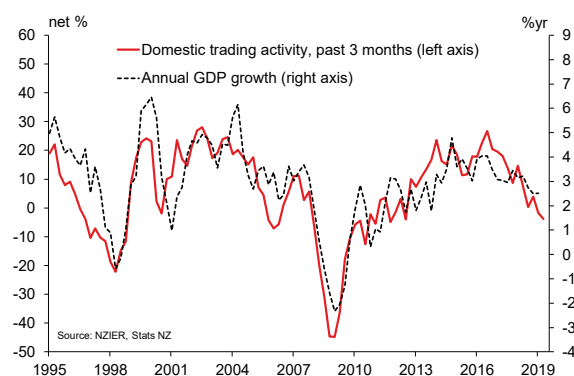
Several major factors are expected to support growth over the coming year. First are the large increases in fiscal spending that are now being rolled out. And with spending plans ramped up again in May's Budget, the related boost to demand will now be even stronger than we had previously anticipated.

On top of that, we're continuing to see positive signs for construction activity over the coming year. Data over the past week showed that residential building consents rose 13% in May to a 45-year high. There is also a large pipeline of commercial and infrastructure work planned.

Finally, with borrowing rates already at very low levels, conditions are ripe for a rise in asset prices. Globally, we've already seen low interest rates providing a powerful shot in the arm to equity markets, even as economic growth in

many regions has cooled. Here in New Zealand, we expect that the impact of low borrowing rates will be seen most clearly in the housing market, especially given the lift in purchasers' appetites following the cancellation of the proposed capital gains tax. We were already forecasting a lift in nationwide house price inflation from around 2% now to 7% next year, along with a related rise in household spending. Another rate cut in August could push mortgage rates lower still, resulting in even larger increases on both of those fronts.

QSBO domestic trading activity and GDP growth



Fixed vs Floating for mortgages

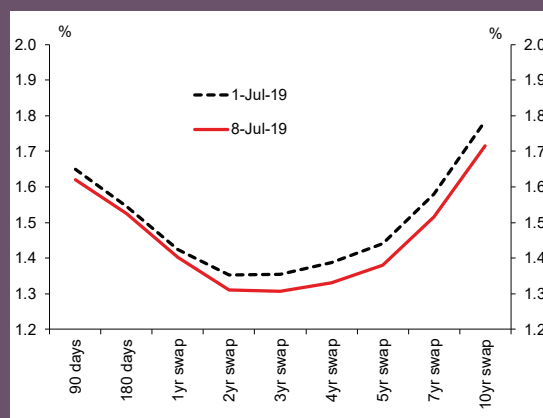
We expect the Reserve Bank will lower the OCR in August. If that is correct, both floating and fixed mortgage rates may fall over the coming month or two. However, we expect the OCR to rise again in the early 2020s, pushing mortgage rates up at that time.

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



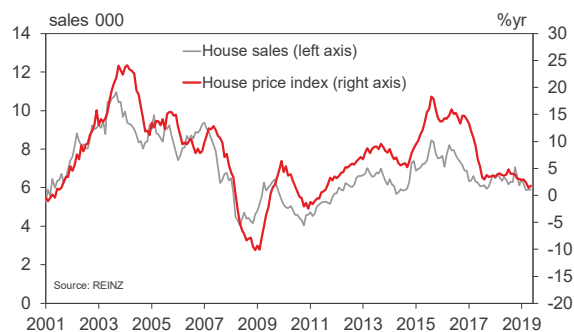
The week ahead

NZ Jun REINZ House Price Index

Jul 8–12, Last: +0.2%

- The housing market slowdown has intensified recently. Turnover dropped early in the year, followed by a decline in prices in April that did not rebound in May.
- We are looking for a turnaround in the housing market following a dramatic drop in fixed mortgage rates and the cancellation of capital gains tax.
- If that's correct, we ought to see house sales picking up a bit in June but it is too early to expect any lift in prices.

REINZ house prices and sales

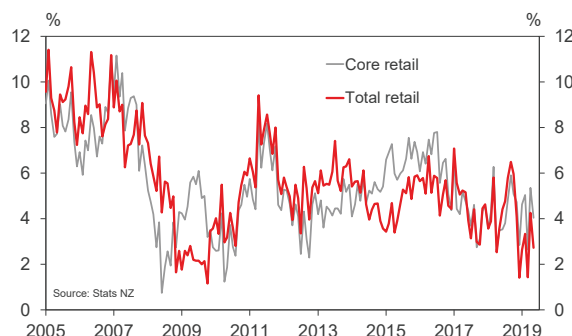


NZ May retail card spending

Jul 11, Last: -0.5%, WBC f/c: +0.7%

- Retail spending fell by 0.5% in May. That fall was wide-spread across retail categories. In part, that decline may have been due to the continued high level of petrol prices which has siphoned money out of households' wallets and constrained spending in other areas. There has also been a flattening off of households' spending on durable items, which likely reflects the softening in the housing market over the past year.
- With petrol prices easing a bit over the past month, we expect some pick up in core (ex-fuel) categories. We expect that will see retail spending rising by 0.7% in May. Lingering softness in the housing market remains a drag.

Card transactions, annual % change

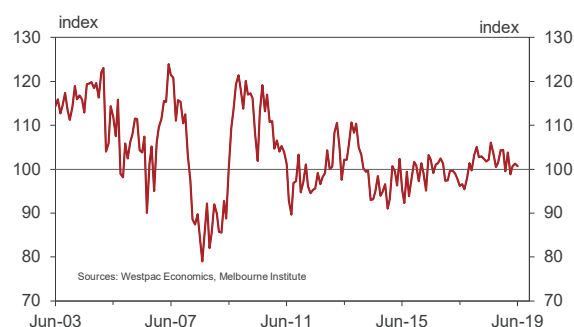


Aus Jul Westpac-MI Consumer Sentiment

Jul 10 Last: 100.7

- The Westpac Melbourne Institute Index dipped 0.6% to 100.7 in June from 101.3 in May. The small decline came despite a cut in official interest rates, the detail indicating deepening concerns about the economic outlook outweighed the boost from lower rates.
- The July survey is in the field over the week to July 6. Policy will again be a factor with the RBA cutting rates by a further 25bps at its July 2 meeting and the Federal government's tax package passing through Parliament. Other developments that may play positively for sentiment include: more signs that the Sydney and Melbourne housing markets are starting to stabilise and some calming in the US-China trade dispute. Financial markets have seen strong gains over the last month, the ASX surging 4.3% and the S&P500 hitting fresh record highs.

Aus Consumer Sentiment Index



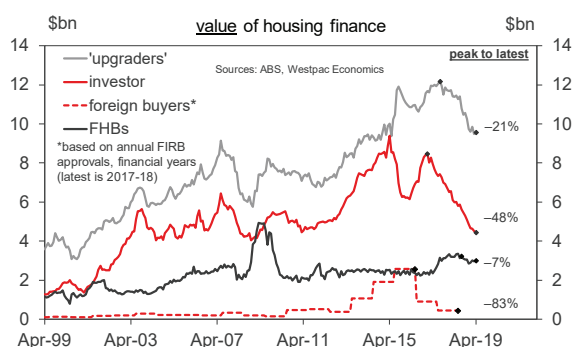
Aus May housing finance (no.)

Jul 11, Last: -1.1%, WBC f/c: -1.5%

Mkt f/c: -1.0%, Range: -3.0% to 1.0%

- The total number of owner occupier loan approvals ex refi declined 1.1% in April following a 2.6% fall in March. Notably, the total value of approvals was somewhat firmer and more consistent with the notion that key markets were starting to stabilise through the middle of the year. The value of investor loans ex refi fell 2.2% mth, coming off a similar-sized decline in March. The monthly tempo of falls in this segment has eased from the 4% pace seen over the second half of last year but is still a long way from stabilisation.
- Industry data covering the major banks points to a further decline in May - we expect 1.5% falls in both the number and value of owner occupier loans ex refi.

Aus housing finance approvals by segment

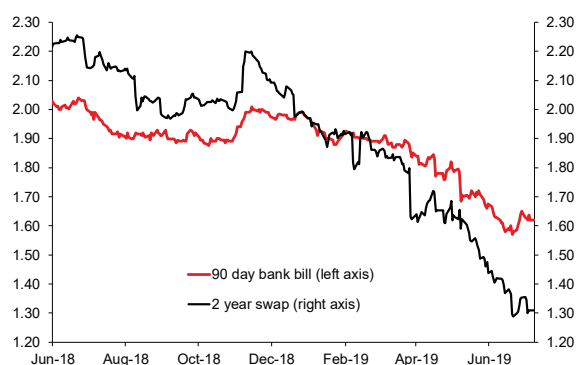


New Zealand forecasts

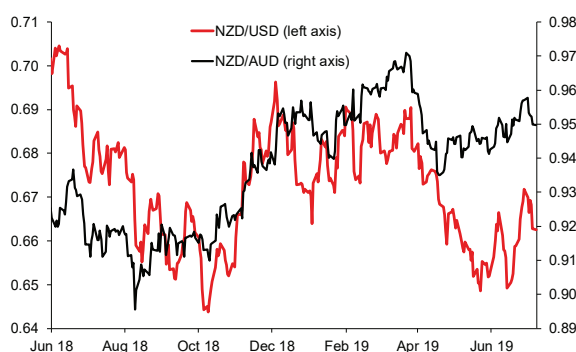
| Economic Forecasts | Quarterly | | | | Annual | | | |
|----------------------------------|-----------|------|------|------|--------|-------|-------|-------|
| | 2019 | | | | | | | |
| % change | Mar (a) | Jun | Sep | Dec | 2018 | 2019f | 2020f | 2021f |
| GDP (Production) | 0.6 | 0.4 | 0.6 | 0.8 | 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 | 0.7 | 0.8 | 0.3 | 1.9 | 1.9 | 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 | 1.25 | 1.25 | 1.25 | 1.25 | 1.50 |
| 90 Day bill | 1.40 | 1.40 | 1.40 | 1.40 | 1.55 | 1.65 |
| 2 Year Swap | 1.25 | 1.30 | 1.40 | 1.50 | 1.60 | 1.70 |
| 5 Year Swap | 1.40 | 1.50 | 1.60 | 1.70 | 1.80 | 1.90 |
| 10 Year Bond | 1.55 | 1.60 | 1.65 | 1.75 | 1.85 | 1.90 |
| 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 8 July 2019

| Interest Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| Cash | 1.50% | 1.50% | 1.50% |
| 30 Days | 1.63% | 1.61% | 1.66% |
| 60 Days | 1.63% | 1.60% | 1.64% |
| 90 Days | 1.62% | 1.58% | 1.63% |
| 2 Year Swap | 1.31% | 1.29% | 1.42% |
| 5 Year Swap | 1.38% | 1.35% | 1.55% |

NZ foreign currency mid-rates as at 8 July 2019

| Exchange Rates | Current | Two weeks ago | One month ago |
|----------------|---------|---------------|---------------|
| NZD/USD | 0.6625 | 0.6584 | 0.6662 |
| NZD/EUR | 0.5904 | 0.5787 | 0.5887 |
| NZD/GBP | 0.5288 | 0.5169 | 0.5234 |
| NZD/JPY | 71.80 | 70.68 | 72.34 |
| NZD/AUD | 0.9498 | 0.9498 | 0.9507 |
| TWI | 72.74 | 72.11 | 73.23 |

Data calendar

| | | Last | Market median | Westpac forecast | Risk/Comment |
|---------------|-----------------------------------|--------|---------------|------------------|--|
| Mon 08 | | | | | |
| Aus | Jun ANZ job ads | -8.4% | - | - | Job ads now down -15%yr pointing to employment stalling. |
| Eur | Jul Sentix investor confidence | -3.3 | - | - | Sentiment dipped back again after trade dispute flare up. |
| US | May consumer credit | 17.5 | 15.0 | - | Lower rates providing support, as is the labour market. |
| Tue 09 | | | | | |
| Aus | Jun NAB business survey | 1 | - | - | May, conditions -2pts to only +1. In June, a post election bounce? |
| Chn | Jun M2 money supply %yr | 8.5% | 8.6% | - | Credit growth is slowly strengthening... |
| | Jun new loans, CNYbn | 1180 | 1658 | - | ... as SoEs and local government authorities up investment. |
| US | Jun NFIB small business optimism | 105.0 | - | - | Small business remains very positive on outlook. |
| | May JOLTS job openings | 7449 | - | - | Hires; fires; quits and job openings. |
| | Fedspeak | - | - | - | Bullard and Bostic speak at an event at Washington Uni. |
| Wed 10 | | | | | |
| NZ | Jun food price index | 0.7% | - | 0.9% | Boosted by higher prices for produce. |
| | Jun REINZ house sales | -0.2% | - | - | The housing market has remained soft in mid-2019... |
| | Jun REINZ house prices, %yr | 1.8% | - | - | ...with weakness in sales and a cooling in price growth. |
| Aus | Jul WBC-MI Consumer Sentiment | 100.7 | - | - | Survey in field over week to Jul 6. Cash rate cut to be a factor. |
| Chn | Jun CPI %yr | 2.7% | 2.7% | - | Inflation pressures remain benign... |
| | Jun PPI %yr | 0.6% | 0.3% | - | ... particularly upstream. |
| UK | May GDP | -0.4% | 0.2% | - | Growth remains sluggish... |
| | May industrial production | -2.7% | 0.8% | - | ...with headwinds from Brexit-related uncertainty... |
| | May trade balance £bn | -2740 | -3200 | - | ...and softening global activity. |
| US | May wholesale inventories final | 0.4% | 0.4% | - | Continue to support growth. |
| | Fed Chair Powell speaks | - | - | - | Semi-annual testimony before the House. |
| | Jun FOMC minutes | - | - | - | Further detail on balance of risks and trigger for cut. |
| | Fedspeak | - | - | - | Bullard at Washington Uni. |
| Thu 11 | | | | | |
| NZ | Jun retail card spending | -0.5% | 0.7% | 0.7% | Spending growth has flattened off though H1 2019. |
| | RBNZ Governor Orr | - | - | - | Speaking on phase 2 of the review of NZ monetary policy. |
| Aus | Jul MI inflation expectations | 3.3% | - | - | Has been on a moderating trend since Feb 2019. |
| | May housing finance | -1.1% | -1.0% | -1.5% | Number of owner occupier approvals to decline 1.5%. |
| | RBA Dep. Gov. Debelle speaks | - | - | - | Via videolink to FX conference in NY, 11:10 pm AEST. |
| Chn | Jun foreign direct investment %yr | 8.5% | - | - | Foreign investment necessary to build long-term capacity. |
| Eur | Jun ECB minutes | - | - | - | Easing bias was strengthened two weeks after June meeting. |
| US | Jun CPI | 0.1% | 0.0% | 0.1% | Core inflation to remain at 2.0% target in June. |
| | Initial jobless claims | 221k | - | - | Remain very low. |
| | Jun monthly budget statement | -207.8 | - | - | Deficit to continue growing. |
| | Fed Chair Powell speaks | - | - | - | Semi-annual testimony before the House. |
| | Fedspeak | - | - | - | Williams on revitalisation; Bostic on policy; Barkin in Idaho. |
| Fri 12 | | | | | |
| NZ | Jun BusinessNZ manuf. PMI | 50.2 | - | - | Businesses continue to highlight sluggish trading conditions. |
| Chn | Jun trade balance USDbn | 41.7 | 45.0 | - | Tariff pull-forward at an end. |
| Eur | May industrial production %yr | -0.4% | -1.6% | - | Manufacturing remains in contraction. |
| US | Jun PPI | 0.1% | 0.1% | - | Upstream price pressures non-existent. |
| | Fedspeak | - | - | - | Kashkari at townhall event in South Dakota. |

International forecasts

| Economic Forecasts (Calendar Years) | 2015 | 2016 | 2017 | 2018f | 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 | 0.75 | 0.75 | 0.75 | 0.75 |
| 90 Day BBSW | 1.13 | 1.10 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| 10 Year Bond | 1.28 | 1.30 | 1.40 | 1.45 | 1.60 | 1.70 | 1.75 |
| International | | | | | | | |
| Fed Funds | 2.375 | 2.125 | 1.875 | 1.875 | 1.875 | 1.875 | 1.875 |
| US 10 Year Bond | 1.94 | 2.00 | 2.05 | 2.10 | 2.20 | 2.25 | 2.30 |
| ECB Deposit Rate | -0.40 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 |

| Exchange Rate Forecasts | Latest | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 |
|-------------------------|--------|--------|--------|--------|--------|--------|--------|
| AUD/USD | 0.7025 | 0.68 | 0.68 | 0.66 | 0.66 | 0.67 | 0.67 |
| USD/JPY | 107.85 | 106 | 105 | 107 | 108 | 109 | 110 |
| EUR/USD | 1.1281 | 1.14 | 1.14 | 1.13 | 1.13 | 1.12 | 1.12 |
| GBP/USD | 1.2584 | 1.26 | 1.25 | 1.26 | 1.27 | 1.29 | 1.30 |
| AUD/NZD | 1.0514 | 1.05 | 1.04 | 1.02 | 1.01 | 1.01 | 1.01 |

Contact the Westpac economics team

Dominick Stephens, Chief Economist +64 9 336 5671

Michael Gordon, Senior Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
- (vi) steps by Compliance to ensure that the Chinese Wall/Cell arrangements remain effective and that such arrangements are adequately monitored.

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