Cardboard Cathedral, Christchurch

Weekly Commentary.

Can we build it? Yeah...nah.

This week we take a look at recent signs that the economy has continued to lose momentum through mid-2019. We also take a look at the re-set of the Government's KiwiBuild program.

Stalling.

Recent updates have provided a clearer picture of the state of the economy in mid-2019, and they have reinforced our expectation for only modest GDP growth of 0.5% in the June quarter (GDP data is due for release on 19 September). That leaves us with a picture of an economy where per capita GDP growth has stalled in the first half of this year.

Much of the recent softness in economic activity has been due to sluggish conditions in the household sector. That's been seen most clearly in the June retail trade report, with the volume of sales up only 0.2% over the quarter (as a comparison, New Zealand's population increased by around 0.4% over the same period). A range of other indicators like house sales and consumer confidence also point to subdued household demand in mid-2019.

Adding to this picture of softness, the June quarter also saw a 1.3% fall in construction activity. That was a fairly modest pull-back and was mainly due to a drop off in non-residential work after earlier large gains.

Those developments come atop of other indicators which have signalled a sharp slowdown in the business sector in recent months, with particular weakness in areas like manufacturing.

Putting all that together, we're left with a picture of an economy which has had the wind come out of its sails. And all signs point to continued softness through to the close of 2019, with a deepening malaise in the business sector and growing external headwinds.

KiwiBuild?

The past week saw the long-awaited reset of the Government's KiwiBuild program. This was a flagship policy of the Labour Government when it entered office, and aimed to support the construction of 100,000 affordable homes over a ten year period.

When this program was announced, we had doubts about whether it would live up to the hype, noting that *"it will be a slow grind higher, and more gradual than even the Treasury's forecasts assume."* As it turns out, the program was less successful than even we expected. The Government was aiming to build 1000 homes in its first year (1% of the total program). Only 258 new homes have been completed to date.

The first part of the KiwiBuild reset has been the scrapping of the program's numerical targets, with the new Minister of Housing instead stating that the Government will aim to build *"as many homes as we can, as fast as we can in the right places"*.

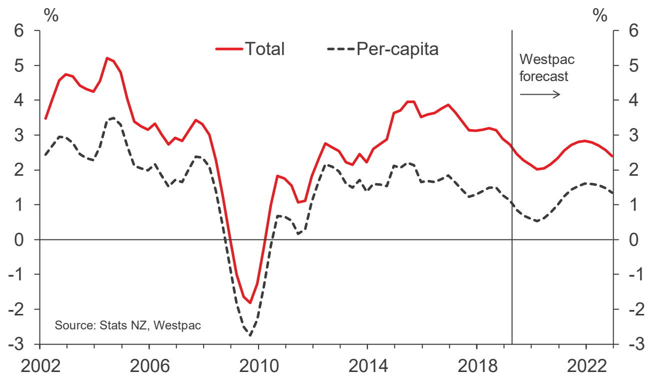
But it's not just that the targets are gone. What was conspicuously absent from this week's policy announcement were any concrete plans to boost the supply of new affordable homes (i.e. the 'build' component of KiwiBuild). That amounts to the Government flying a white flag as far as boosting housing supply.

In place of its previous focus on increasing the supply of housing, the Government instead use the KiwiBuild reset to introduce a range of policies that will boost the demand for homes. That includes reducing the deposit required for a government-backed mortgage and progressive home ownership schemes (including a shared equity scheme and measures to support renters saving for a deposit).

We're still waiting to see the precise details of the new policies. However, it's worth keeping in mind that the past few years have already seen a significant increase in housing affordability. That's due to the reductions in the OCR and related record low level of mortgage rates, which means that servicing a mortgage is now much more affordable (although, the major hurdle for many families is still saving for a deposit).

Putting this altogether, we're left with a combination of policies that will add to demand, but will do little to boost supply. And that points in only one direction for prices: up. We expect that house price inflation will accelerate from around 1% now to around 7% per annum for the next two years.

Total and per-capita GDP growth



Fixed vs Floating for mortgages.

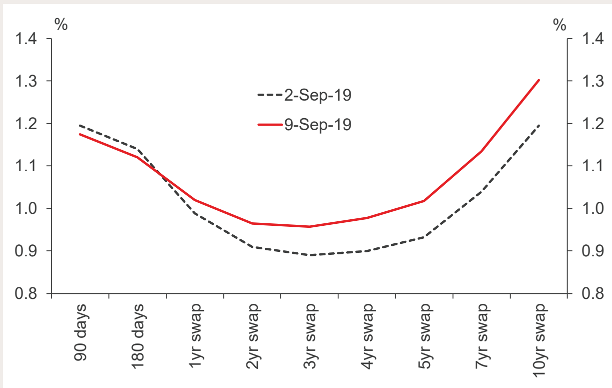
Mortgage rates are falling, and with the Reserve Bank expected to cut the OCR once more, we think they will keep falling. This means there is no hurry to fix.

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



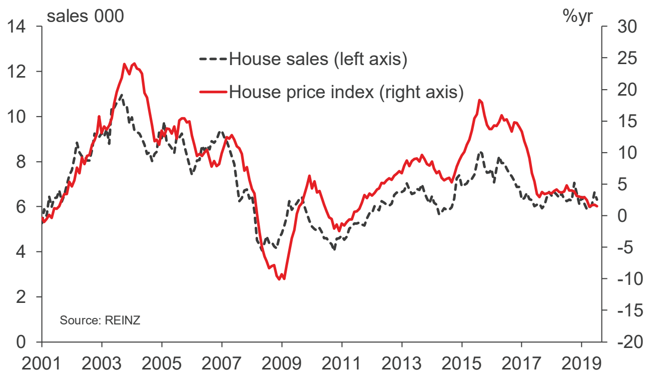
The week ahead.

NZ Aug REINZ House Price Index

9 – 13 Sep, Last: 0%

- We are forecasting a pickup in annual house price inflation from 1% now to 7% next year. The first thing we ought to see is rising house sales – price data will remain weak at first.
- Seasonally adjusted house sales rose 10% from March to July. For this month's data, we will be looking for signs of a further pickup in sales.
- One thing to be cautious of is that REINZ always undercounts sales initially, then revises the number higher the following month. House sales are in fact normally about 2% stronger than REINZ's initial report.

REINZ house prices and sales

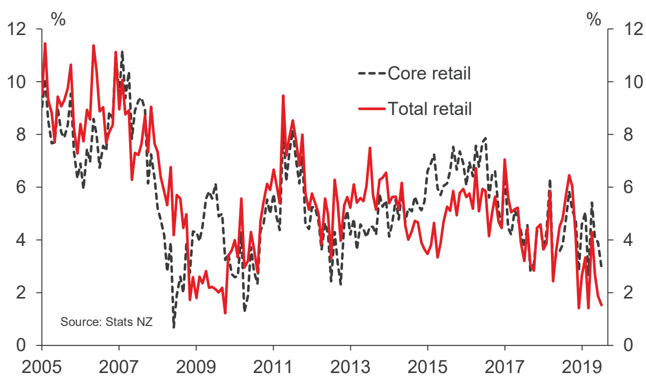


NZ Aug retail card spending

Sep 10, Last: -0.1%, WBC f/c: +0.6%

- Retail spending levels were down 0.1% in July, and spending in core (ex-fuel) categories has been flat since the start of this year. That softness reflects the dampening impact the weak housing market and low confidence have had on spending appetites.
- We're expecting spending levels to rise by 0.6% in August. That's underpinned by a moderation in petrol prices that has freed up funds for spending in other categories. There's also likely to be a bounce in categories like durables after earlier softness.
- However, even assuming a pickup in August, we're still left with a picture of subdued spending appetites in mid-2019,

Card transactions, annual % change

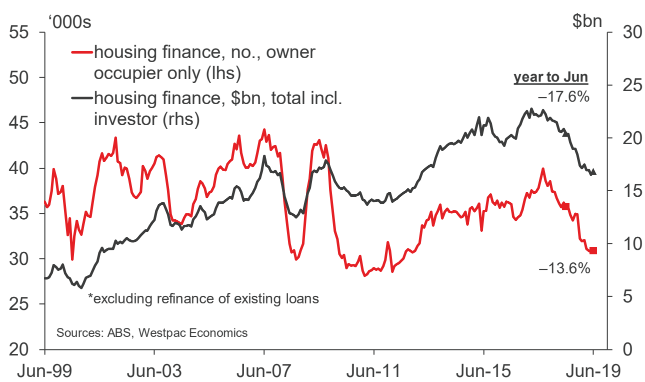


Aus Jul housing finance approvals

Sep 9, Last: 0.4%, WBC f/c: 1.0%
Mkt f/c: 1.5%, Range: -0.2% to 5.5%

- The June housing finance approval figures were consistent with stabilising market conditions through the middle of 2019. The number of owner occupier loan approvals rose 0.4%mth but were still down 13.6%yr. The total value of investor loans and the combined total value of owner occupier and investor loans rose as well but were sizeable May declines.
- Market conditions continued to stabilise through July-August with prices showing a notable lift in the most recent month. However, activity remains at very low levels. As such finance approvals are likely to be stable rather than lifting with any price effects on the total value of loans more likely to show through in Aug. Industry figures suggest the ABS measure will show a 1% gain for the July month, again more consistent with stabilising conditions than a pick up. Any boost form recent interest rate cuts is likely to show through more clearly from August on.

New finance approvals*



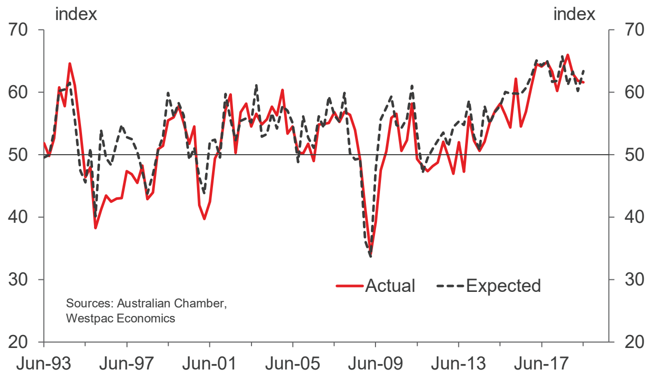
The week ahead.

Aus Q3 AusChamber–Westpac business survey

Sep 10, Last: 61.5

- The Australian Chamber–Westpac survey of the manufacturing sector provides a timely update on conditions in the sector and insights into economy-wide trends. The Q3 survey was conducted from August 8 to September 2.
- In Q2, the Actual Composite declined to 61.5 from 61.7 in March, extending the loss of momentum evident from around mid-2018. The Composite is supported by rising output, albeit at a slower pace; new orders; backlog; and overtime.
- As with the economy at large, conditions in the manufacturing industry vary. A downturn in the housing sector, a drought in NSW and Queensland, and weak consumer spending on the back of subdued income growth is presenting difficulties for many manufacturing firms. At the same time, the lower Australian dollar and strong public infrastructure investment are supporting others.

Westpac-AusChamber Composite indexes

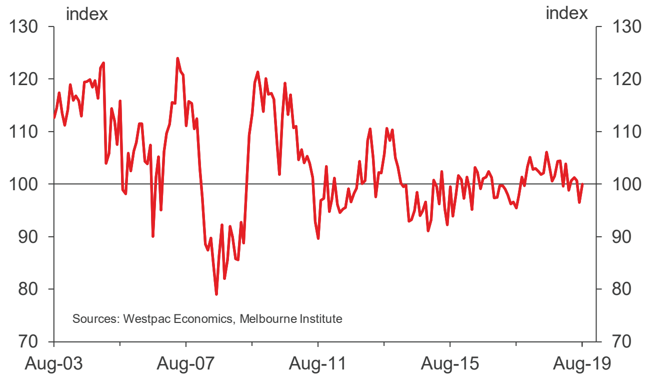


Aus Sep Westpac-MI Consumer Sentiment

Sep 11 Last: 100

- The Westpac Melbourne Institute Consumer Sentiment Index rose 3.6% to 100 in August from 96.5 in July. The lift came despite a turbulent backdrop with global financial markets roiled by escalating trade tensions between the US and China. Some of the gain looks to have been a recovery from previous months when sentiment was rattled by back to back rate cuts from the RBA.
- The latest survey is in the field over the week to September 8. Recent weeks have seen more volatility globally with a further escalation in the US-China trade war and financial markets slipping lower, the ASX now down 3% since May and the AUD off 2.5c US. Locally: the RBA left rates on hold again in September, but retained a clear easing bias. The Q2 national accounts showed annual growth slowing to a new post-GFC low of 1.4%. More positively, house prices rose in August and the Federal government's tax relief should be starting to see cash flow to some households.

Consumer Sentiment Index

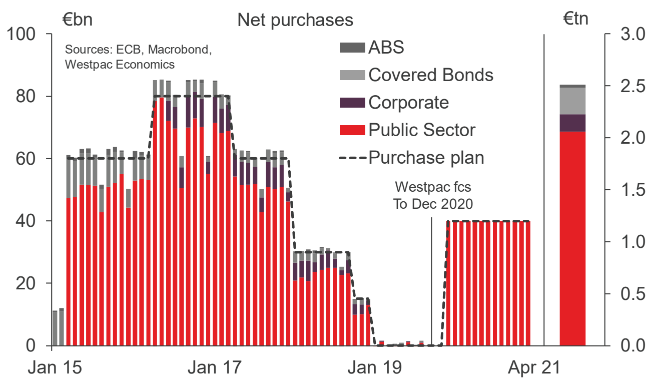


Eur ECB policy decision

Sep 12, deposit rate, Last: -0.4%, WBC: -0.5%

- The July ECB meeting met expectations by indicating that the deposit rate is likely to be cut very soon and that other stimulus measures are on the table.
- Concern over still low inflation and a new affirmation on the symmetry of their inflation target — suggest an even greater willingness to ease policy. In that context, the Governing council "have tasked the relevant Eurosystem Committees with examining options" ranging from reinforced forward guidance, a tiered reserves system and new asset purchases.
- Since July, ECB member Rehn called for a "significant and impactful" package to address concerns over the outlook. Against that, the more hawkish members voiced their opinion that the economy is not weak enough to restart QE.
- We expect a deposit rate cut at the September meeting and a commitment to restart asset purchases - in our view, sovereign bond purchases of €40bn per month.

ECB asset purchase program - QE



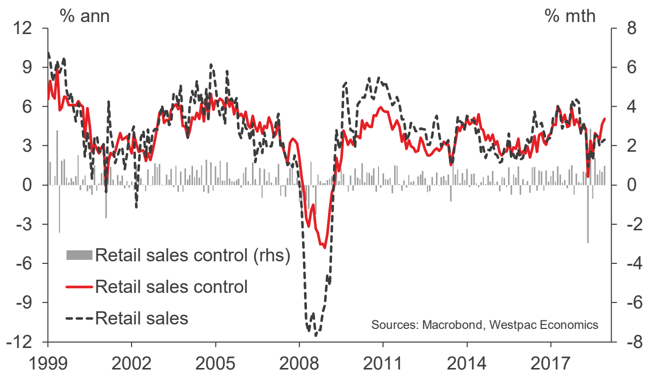
The week ahead.

US Aug CPI and retail sales

Sep 12, CPI, last: 0.3%, WBC: 0.1%
Sep 13, retail sales, last: 0.7%, WBC: 0.4%

- Headline inflation in the US remains below the FOMC's 2.0%yr target. This is due to recent weakness in the oil price along with a number of temporary factors still in the annual calculation. On a multi-month view, as these one-off's pass and oil stabilises, inflation should tend back towards 2.0%yr, but not materially above.
- The first half of 2019 witnessed a strong run higher in retail sales as the poor weather and the impact of the Dec/Jan government shutdown receded. Ahead however, momentum is set to moderate.
- Employment growth is currently slowing, and wages growth has stabilised. President Trump's actions have also shocked confidence. These factors are set to take spending growth from above trend to below over the coming year.

Retail sales have rebounded in Q2

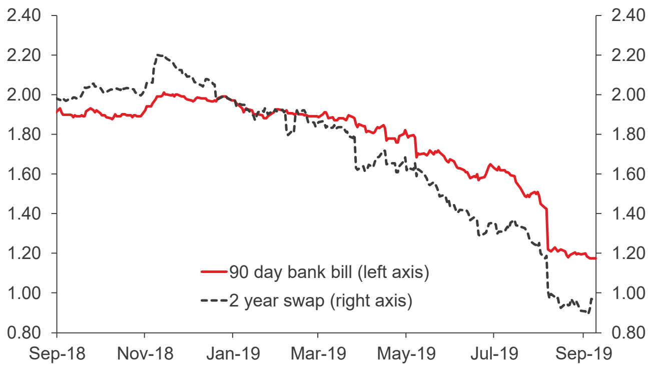


New Zealand forecasts.

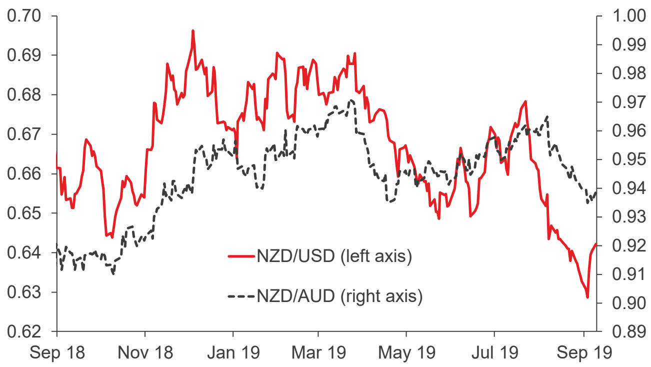
Economic forecasts	Quarterly				Annual			
	2019							
% change	Mar (a)	Jun	Sep	Dec	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.5	0.4	0.5	2.9	2.1	2.3	2.8
Employment	-0.1	0.8	0.2	0.4	2.3	1.3	1.8	2.0
Unemployment Rate % s.a.	4.2	3.9	4.1	4.2	4.3	4.2	4.2	3.8
CPI	0.1	0.6	0.6	0.3	1.9	1.6	1.7	1.8
Current Account Balance % of GDP	-3.6	-3.4	-3.3	-3.2	-3.8	-3.2	-2.9	-2.7

Financial forecasts	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Cash	1.00	0.75	0.75	0.75	0.75	0.75
90 Day bill	1.00	0.90	0.90	0.90	0.90	0.90
2 Year Swap	0.90	0.80	0.80	0.80	0.85	0.90
5 Year Swap	1.00	1.00	1.00	1.05	1.10	1.15
10 Year Bond	1.05	1.00	1.05	1.10	1.15	1.20
NZD/USD	0.64	0.64	0.63	0.63	0.64	0.64
NZD/AUD	0.96	0.96	0.95	0.95	0.96	0.96
NZD/JPY	67.8	67.8	67.4	68.0	70.4	71.0
NZD/EUR	0.59	0.59	0.58	0.58	0.59	0.58
NZD/GBP	0.54	0.54	0.53	0.52	0.52	0.51
TWI	71.9	72.2	71.4	71.0	71.6	71.1

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 9 September 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.19%	1.17%	1.12%
60 Days	1.17%	1.17%	1.17%
90 Days	1.18%	1.20%	1.21%
2 Year Swap	0.97%	0.97%	1.00%
5 Year Swap	1.02%	1.00%	1.01%

NZ foreign currency mid-rates as at 9 September 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6422	0.6380	0.6471
NZD/EUR	0.5824	0.5719	0.5777
NZD/GBP	0.5232	0.5204	0.5370
NZD/JPY	68.57	67.01	68.33
NZD/AUD	0.9386	0.9468	0.9537
TWI	71.65	71.33	72.09

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 09					
Aus	Jul housing finance	0.4%	1.5%	1.0%	Housing market is stabilising.
Chn	Aug new loans, CNYbn	1060	1200	–	Credit availability an issue for small and medium business.
	Aug M2 money supply %yr	8.1%	8.2%	–	Further easing will prove necessary.
Eur	Sep Sentix investor confidence	–13.7	–16.0	–	Has deteriorated on trade and manufacturing concerns.
UK	Jul GDP	0.0%	–	–	Despite firmness in the household sector…
	Jul industrial production	-0.1%	–	–	…weakness in the business sector…
	Jul trade balance £bn	1779	–	–	…and global headwinds are weighing on growth.
US	Jul consumer credit	14.6	16.0	–	Low rates and employment remain supportive.
Tue 10					
NZ	Aug REINZ house sales	-4.7%	–	–	Expecting a further increase in seasonally adjusted sales.
	Aug REINZ house prices %yr	1.5%	–	–	Price rises to lag the firming in sales
	Aug retail card spending	1.5%	–	0.6%	Lower fuel prices boosting spending, trend still soft.
Aus	Q3 AusChamber-Westpac survey	61.5	–	–	Manufact'g sector cooling as construction activity weakens.
	Aug NAB business survey	2	–	–	Soft in July. Looking for any signs of a policy stimulus boost.
Chn	Aug CPI %yr	2.8%	2.6%	–	Consumer inflation under control…
	Aug PPI %yr	–0.3%	–0.9%	–	… upstream price pressures weak despite tariffs and CNY.
UK	Jul ILO unemployment rate	3.9%	–	–	Economic uncertainty likely to weigh on hiring.
US	Aug NFIB small business optimism	104.7	103.5	–	Concern over outlook likely to grow.
	Jul JOLTS job openings	7348	–	–	Hires; fires; quits and job openings.
Wed 11					
NZ	Jul net migration	3100	–	–	While still elevated, annual net migration is trending down.
Aus	Sep WBC–MI Consumer Sentiment	100	–	–	Bounced 3.6% in Aug.
Chn	Aug foreign direct investment %yr	8.7%	–	–	Continued inflow necessary to speed development.
US	Aug PPI	0.2%	–	–	Strength of US dollar offsetting trade tariffs.
	Jul wholesale inventories	–	–	–	Softening demand argues for run down of inventory.
Thu 12					
NZ	Aug food price index	1.1%	–	0.7%	Seasonal gains in vege prices.
Eur	Jul industrial production	–1.6%	0.1%	–	Manufacturing continues to be weak.
	ECB policy decision	-0.4%	-0.5%	–0.5%	Rate cut included in significant stimulus package expected.
US	Aug CPI	0.3%	0.1%	0.1%	Energy a negative influence; core prices up 0.2%
	Initial jobless claims	217k	–	–	Very low.
	Aug monthly budget statement	–119.7	–	–	Deficit to continue trending higher over coming year.
Fri 13					
NZ	Aug BusinessNZ PMI manuf.	48.2	–	–	Business conditions likely to remain soft.
Eur	Jul trade balance €bn	17.9	–	–	Surplus stabilising at a lower level.
	Labour costs %yr	2.4%		–	Moved higher but not passing through to inflation.
US	Aug import price index	0.2%	–0.5%	–	Strength of US dollar key.
	Aug retail sales	0.7%	0.2%	0.4%	Spending growth to moderate ahead.
	Sep Uni. of Michigan sentiment	89.8	90.2	–	Present situation and expectations moving lower.
	Jul business inventories	0.0%	0.3%	–	Softening demand argues for run down of inventory.

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	1.7	1.9
Unemployment %	5.8	5.7	5.5	5	5.4	5.6
Current Account % GDP	-4.7	-3.1	-2.6	-2.1	-0.2	-1.5
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.3	1.7
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	3.6	3.6
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	0.3
Euro zone						
Real GDP %yr	2.1	2	2.4	1.8	1.1	1.2
United Kingdom						
Real GDP %yr	2.3	1.8	1.8	1.4	1.2	1.4
China						
Real GDP %yr	6.9	6.7	6.8	6.6	6.1	5.8
East Asia ex China						
Real GDP %yr	3.8	4	4.6	4.3	3.8	4
World						
Real GDP %yr	3.4	3.4	3.8	3.6	3.2	3.3
Forecasts finalised 9 August 2019						

Interest rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Australia						
Cash	1.00	0.75	0.50	0.50	0.50	0.50
90 Day BBSW	1.00	0.85	0.70	0.70	0.70	0.70
10 Year Bond	1.08	0.95	0.90	0.95	1.00	1.05
International						
Fed Funds	2.125	1.375	1.125	0.875	0.875	0.875
US 10 Year Bond	1.57	1.45	1.40	1.45	1.50	1.55
ECB Deposit Rate	-0.40	-0.60	-0.70	-0.70	-0.70	-0.70

Exchange rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.6815	0.67	0.66	0.66	0.67	0.67
USD/JPY	107.07	105	104	104	106	108
EUR/USD	1.1035	1.07	1.05	1.06	1.07	1.09
GBP/USD	1.2324	1.17	1.18	1.20	1.22	1.24
AUD/NZD	1.0678	1.05	1.05	1.05	1.05	1.05

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