



Bath House, Rotorua

Weekly Economic Commentary.

2020: The good, the bad, and an election.

For our first issue of 2020, we're taking a look at how the New Zealand economy has been tracking, and some of the key areas that we'll be watching over the year ahead.

Some of the wind came out of the economy's sails last year, with GDP growth slowing sharply in the first half of 2019. However, that slowdown followed solid growth in previous years. In fact, the latest updates on New Zealand's GDP have revealed that economic activity in recent years has been substantially stronger than initially thought. While earlier estimates suggested that economic growth had been tapering off through 2018, more detailed information on economic conditions have become available over time, and they've revealed that the economy grew by 3.2% over 2018 - a pace that was on par with the previous year. That result is even more impressive given that population growth was slowing during that time.

It now looks like economic activity is turning up again. However, we're still seeing mixed conditions across the economy, which suggests that the pick-up in growth could be gradual (at least in the near term).

GDP growth was a respectable 0.7% in the September quarter. In addition, the final months of 2019 have seen signs of resurgent household demand, with consumer confidence on the rise and nominal retail card spending up a solid 1.8% over the December quarter. There's also a large and growing pipeline of both residential and non-residential construction work.

However, it's a mixed picture when we look at the business sector. Recent surveys of business activity point to continued sluggishness in demand, especially in the services sector. In addition, many New Zealand businesses are wrestling with a number of big challenges. Operating costs, including wages, have been pushing higher in recent years, while fierce competitive pressures have limited price increases in a number of sectors. That combination of sluggish demand and pressure on profit margins means that many businesses are reluctant to take on new staff or expand their operations.



Despite such challenges, we still think that a pickup in New Zealand GDP growth is on the cards over 2020. That's due to continued support from monetary and fiscal policy, which together are giving the economy a powerful shot in the arm.

In terms of monetary policy, the boost to the economy from low interest rates is now undeniable and has been seen most clearly in the housing market. House prices have continued to push higher, with annual house price inflation rising to 6.6% in the year to December. Westpac has long predicted this upswing in house prices, and our forecast for 7% house price growth may come good even sooner than we expected. Gains in prices have been widespread, with prices in Auckland up 4% and other regions up an average of 8.9%. We think continued solid gains are on the cards in the early part of 2019.

This strength in the housing market is important for two reasons. First, New Zealander's hold large amounts of their wealth in owner-occupied or investment properties, and the pick-up in house prices over the past year has seen households opening up their wallets again. With house price growth set to take another step higher over the coming months, we expect that their will be related strength in household spending.

The second reason why the pick-up in the housing market is important is that the RBNZ is likely to be more circumspect about the need for further OCR reductions. Economic activity has already been a little hotter than the RBNZ had been

assuming. And with signs that house prices and spending are heating up, they're likely to feel comfortable staying pat for some time yet. Consistent with that, we made a change to our forecasts for the Official Cash Rate late last year. We no longer expect the RBNZ will cut the OCR in February, or at any point over the first half of 2020.

We still think that the longer-term risks for the OCR are to the downside and have pencilled in a rate cut for August. That's because even with an extended period of solid economic growth, inflation is struggling to reach the 2% mid-point of the RBNZ's target band (on this front, we expect that this week's CPI report will show that headline inflation has risen to 1.8%, but core inflation is struggling to break higher). There's also the risk of continued softness in the global economy. We will continue to update our OCR forecasts as and when required by new information.

The other big factor that will boost demand over the coming year is fiscal policy. Large increases in fiscal spending have been announced in previous years, and late last year the Minister of Finance announced a further \$12bn of new investment spending focused mainly on transport projects. With the 2020 election coming into sight, we think that further sizable spending increases will be coming. That's likely to include increases in transfer payments, pay rises for public sector employees, and some boost to health and education services.

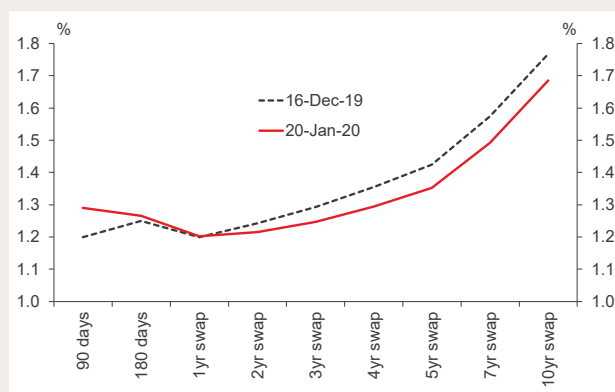
Fixed vs Floating for mortgages.

Now is a good time to take a fixed mortgage. Fixed mortgage rates have tumbled over the past six months, but they are now starting to creep higher again as the chances of further OCR cuts fade.

Among the fixed rates on offer, we think the best value is in the one- and two-year rates. Longer-term rates are high relative to where we think future short-term rates will go. 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



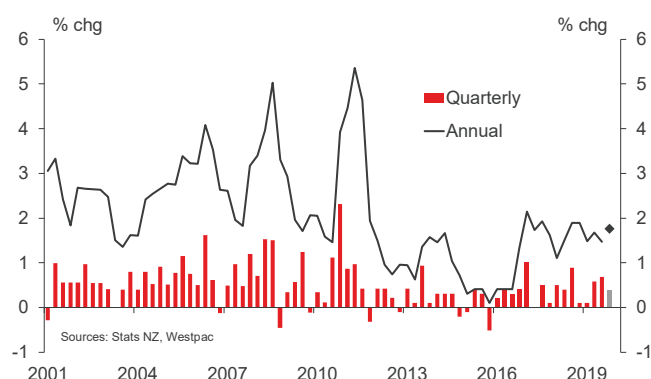
The week ahead.

NZ Q4 CPI

Jan 24 Last: +0.7%, Westpac f/c: +0.4%, Mkt f/c: +0.4%

- We expect a 0.4% rise in the Consumer Price Index for the December quarter. That would take annual inflation to 1.8%, up from 1.5% in September.
- Adding to inflation in the December quarter will be the annual increase in the tobacco excise tax, as well as the seasonal increase in international airfares. There have also been solid increases in construction costs. On the downside, we're continuing to see muted growth in the prices of many retail goods.
- Our forecast for inflation is above the RBNZ's forecast for a quarterly rise of 0.2%. The difference relates to the more volatile tradable components.
- We expect that measures of core inflation will remain a little below 2%.

NZ CPI inflation



Aus Jan Westpac-MI Consumer Sentiment

Jan 22 Last: 95.1

- Consumer Sentiment declined 1.9% to 95.1 in December from 97.0 in November. The index has fallen 6.1% since the RBA started cutting the cash rate in June and has been below the 100 level, indicating pessimists outnumber optimists, throughout the second half of the year.
- The January survey is in the field over the week beginning January 13. It will capture the impact of the bushfire emergency affecting much of Australia's south east that has included widespread smoke pollution in the major capital cities. As the survey is being conducted, much needed rain is falling across parts of NSW, as well as some areas in Qld. Recent conflict between the US and Iran may also impact sentiment.
- Note that the headline measure is adjusted to remove a regular 'holiday bump' worth about 4pts in January.

Aus Consumer Sentiment Index

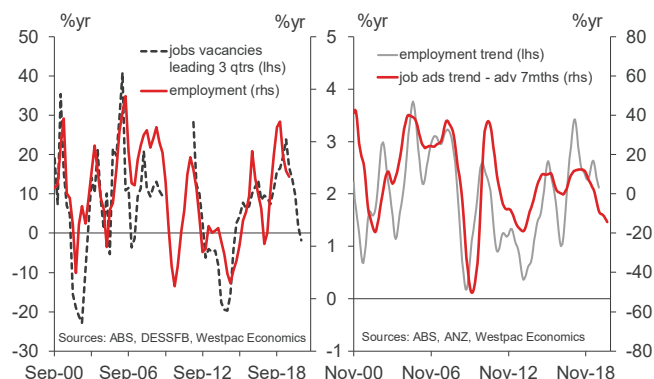


Aus Dec Labour Force: employment

**Jan 23, Last: 37.2k, WBC f/c: -5k
Mkt f/c: 12k Range: -10k to +20k**

- Employment bounced a robust 37.2k in Nov following the -24.8k fall in October. In the last three months the average monthly gain was just 9.5k compared to 8.9k in Oct and 31.2k in May. In the year employment grew 254.9k or 2.0% a moderation from 2.8%/yr in May. The six month annualised pace was 1.6%/yr.
- The various leading indicators, Job Ads, business surveys and Consumer Sentiment, all point to employment growth slowing to less than 2%/yr. And the latest update from the ABS Jobs Vacancies, the only survey of job vacancies rather than job ads, is pointing to a much more significant slowdown.
- Westpac -5k forecast allows for some statistical correction from the Nov bounce but we temper it due to the Nov incoming rotation group having lower employment to population than the sample as a whole. This fundamental strength cautions against a larger correction in Dec.

Leading indicators of Australian employment



The week ahead.

Aus Dec Labour Force: unemployment rate

Jan 23, Last: 5.2%, WBC f/c: 5.3%
Mkt f/c: 5.2% Range: 5.2% to 5.4%

- In Nov unemployment fell to 5.2% (5.18% at two decimal places) from 5.3% (5.31% at two decimal places). Participation was flat at 66.0% but it did lift modestly from 65.96% to 66.00% at two decimal places, enough to see a slightly larger than trend rise in the labour force of 23.4k. Nov also recorded a 0.2ppt fall in underemployment to 8.3%.
- The unemployment rate lifted from 5.0% at the end of 2018 and hit 5.3% in Jun but since then has tracked sideways around 5.2%-5.3%. Westpac is looking for a soft patch in employment in early 2020 to lift unemployment to 5.6% by the second quarter.
- Holding participation flat at 66% will see unemployment print 5.3% with Westpac's employment forecast of -5k. Female participation has been holding up total participation but lately there are signs of female participation easing in NSW as employment growth there slows.

Aus unemployment rate

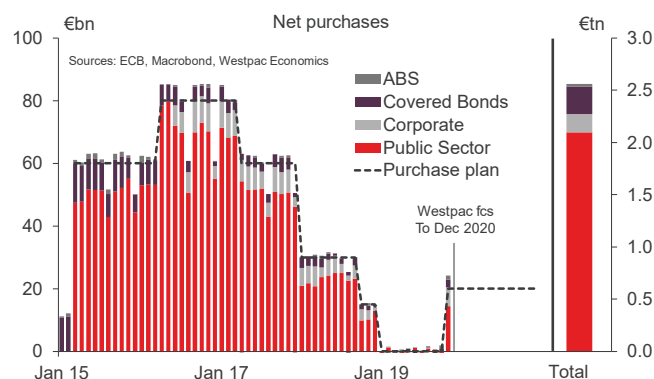


ECB Jan policy meeting

Jan 23, deposit rate last: -0.5%, WBC: -0.5%

- The minutes of the December policy meeting point to the Governing Council becoming more hopeful regarding the economic outlook into year end. This does not mean they anticipate a material strengthening in growth. Rather, they are positive because they see signs of stabilisation instead of a further loss of momentum.
- For policy, this points to an unchanged stance in January. That the renewed asset purchase program is now up and running also grants confidence as it eases financial conditions and provides ample liquidity to markets.
- If the US FOMC cuts the federal funds rate again in coming months, the ECB will likely follow suit to balance the relative policy stance and limit Euro upside. But a domestic justification for a deposit rate cut or asset purchase pace expansion seems unlikely for the foreseeable future.

ECB asset purchase program - QE

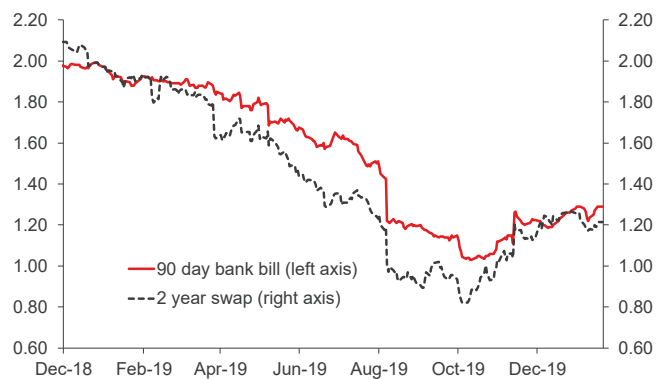


New Zealand forecasts.

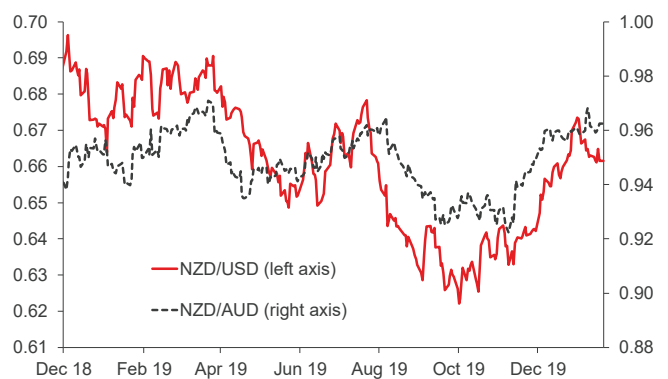
Economic forecasts	Quarterly				Annual			
	2019		2020		2018	2019f	2020f	2021f
% change	Sep (a)	Dec	Mar	Jun				
GDP (Production)	0.7	0.6	0.6	0.7	3.2	2.3	2.5	3.0
Employment	0.2	0.4	0.4	0.4	1.9	1.2	1.8	2.0
Unemployment Rate % s.a.	4.2	4.3	4.4	4.4	4.3	4.3	4.2	3.9
CPI	0.7	0.4	0.5	0.4	1.9	1.8	1.8	1.7
Current Account Balance % of GDP	-3.3	-3.1	-2.9	-2.8	-3.8	-3.1	-2.9	-3.2

Financial forecasts	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21
Cash	1.00	1.00	0.75	0.75	0.75	0.75
90 Day bill	1.20	1.10	0.90	0.90	0.90	0.90
2 Year Swap	1.00	1.00	1.00	1.00	1.00	1.05
5 Year Swap	1.10	1.15	1.20	1.25	1.30	1.35
10 Year Bond	1.20	1.20	1.20	1.25	1.35	1.40
NZD/USD	0.64	0.64	0.65	0.65	0.66	0.66
NZD/AUD	0.96	0.97	0.97	0.97	0.96	0.96
NZD/JPY	67.9	67.8	68.0	68.3	69.4	70.6
NZD/EUR	0.58	0.58	0.58	0.58	0.58	0.58
NZD/GBP	0.48	0.48	0.49	0.50	0.50	0.50
TWI	71.1	71.4	71.5	71.5	71.5	71.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 20 January 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.21%	1.20%	1.18%
60 Days	1.25%	1.24%	1.22%
90 Days	1.29%	1.28%	1.26%
2 Year Swap	1.22%	1.20%	1.26%
5 Year Swap	1.35%	1.35%	1.43%

NZ foreign currency mid-rates as at 20 January 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6615	0.6665	0.6607
NZD/EUR	0.5966	0.5969	0.5965
NZD/GBP	0.5083	0.5095	0.5081
NZD/JPY	72.87	72.03	72.30
NZD/AUD	0.9625	0.9585	0.9573
TWI	72.64	73.16	72.90

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
UK	Jan Rightmove house prices %/yr	0.8%	-	-	Subdued price growth to persist amid uncertainty.
US	Martin Luther King Jr Day	-	-	-	Public holiday.
Tue 21					
NZ	Dec BusinessNZ PSI	53.3	-	-	Service sector conditions remains subdued.
Int	Davos World Economic Forum	-	-	-	On between 21 and 24 January.
Eur	Jan ZEW survey of expectations	11.2	-	-	Confidence in outlook remains robust.
UK	Nov ILO unemployment rate	3.8%	3.8%	-	Labour market continues to show strength.
Wed 22					
NZ	GlobalDairyTrade auction	2.8%	-	-	Prices have been firm recently.
Aus	Jan Westpac-MI Consumer Conf'	95.1	-	-	Weakened in 2019, sliding into pessimistic zone.
US	Dec Chicago Fed activity index	0.56	-	-	Regional conditions mixed; but upside limited.
	Nov FHFA house prices	0.2%	0.3%	-	Rates and labour market big positives for housing.
	Dec existing home sales	-1.7%	1.5%	-	Supply remains existing market's big concern.
Thu 23					
NZ	Nov net migration	4120	-	-	Annual migration remains at firm levels.
Aus	Dec employment, '000	39.9	12	-5	Leading indicator point to a softening in the labour market...
	Dec unemployment rate	5.2%	5.2%	5.3%	...while robust participation points to rising unemployment.
Eur	ECB policy decision	-0.5%	-0.5%	-0.5%	On hold for now, but will act again if necessary.
	Jan consumer confidence	-8.1	-8.0	-	Remains around average.
US	Initial jobless claims, '000	204	-	-	Firing is not expected to lift materially in 2020.
	Dec leading index	0.0%	-0.2%	-	Pointing to growth near trend.
	Jan Kansas City Fed index	-8	-	-	Regional conditions mixed; but upside limited.
Fri 24					
NZ	Q4 CPI	0.7%	0.4%	0.4%	Seasonal rise in tobacco taxes. Retail prices still muted.
Eur	Jan Markit manufacturing PMI	46.3	46.7	-	Manufacturing continues to be heavily impacted by global...
	Jan Markit services PMI	52.8	52.8	-	... trade, but domestic demand is aiding services sector.
	ECB speak	-	-	-	Villeroy on panel in Davos.
UK	Jan Markit manufacturing PMI	47.5	48.1	-	Domestic headwinds also a concern for UK manufacturers...
	Jan Markit services PMI	50.0	50.7	-	... and their services sector, in addition to global growth.
US	Jan Markit manufacturing PMI	52.4	52.8	-	Much more positive than ISM. Smaller firms are benefitting...
	Jan Markt service PMI	52.8	52.5	-	... from domestic demand, so too the services sector.
Sat 25					
Asia	Lunar New Year	-	-	-	Celebrations and holidays - the Year of the Rat.
Sun 26					
Aus	Australia Day	-	-	-	Public holiday observed on Monday.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.5	2.7	1.8	2.1	2.5
CPI inflation % annual	1.5	1.9	1.8	1.7	1.9	1.9
Unemployment %	5.7	5.5	5.0	5.3	5.6	5.3
Current Account % GDP	-3.1	-2.6	-2.1	0.6	-0.5	-1.8
United States						
Real GDP %yr	1.6	2.4	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	3.8	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	0.8	0.1	0.3
Euro zone						
Real GDP %yr	1.9	2.5	1.9	1.2	1.0	1.2
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.3	0.8	1.5
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	4.5	4.3	3.6	3.6	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	3.0	3.2

Forecasts finalised 11 December 2019

Interest rate forecasts	Latest	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Australia								
Cash	0.75	0.50	0.25	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.87	0.70	0.45	0.45	0.45	0.50	0.50	0.50
10 Year Bond	1.18	0.90	0.90	0.90	0.90	0.95	1.00	1.20
International								
Fed Funds	1.625	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.82	1.50	1.45	1.45	1.50	1.55	1.60	1.80
ECB Deposit Rate	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60

Exchange rate forecasts	Latest	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
AUD/USD	0.6894	0.66	0.66	0.67	0.67	0.68	0.69	0.72
USD/JPY	110.17	107	106	105	105	106	107	109
EUR/USD	1.1136	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.3076	1.33	1.32	1.32	1.31	1.31	1.31	1.32
USD/CNY	6.8767	6.95	6.90	6.85	6.80	6.80	6.75	6.60
AUD/NZD	1.0391	1.04	1.03	1.03	1.03	1.04	1.05	1.08

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