
Bath House, Rotorua

Weekly Economic Commentary.

Spotlight on exports.

This week we're taking a look at conditions in New Zealand's external sector and the latest inflation outturn. We also review the outlook for the New Zealand dollar.

New Zealand's export sector.

Uncertainty around the global economy and the potential spill-overs to New Zealand's export sector have been dark clouds on the economic horizon over the past year. But in recent months we have seen long awaited progress on two of the key areas of uncertainty that we've previously highlighted. The US and China have agreed the first phase of a trade deal, which has helped to alleviate some of the concerns we have about tensions between the two economies. We've also seen the newly-elected UK government pushing ahead with its much delayed plans for Brexit.

But while we are seeing progress in some areas, other events have come on to the radar in recent weeks that have added to the uncertainty for global growth. That includes simmering tensions between the US and Iran, the coronavirus and the bush fires in Australia.

Nevertheless, financial markets are in a buoyant mood, and have pushed equity prices to record highs. We think this has more to do with the "central bank put" than with actual economic data. Low inflation has allowed central banks to reduce interest rates. This has boosted asset prices by (a) creating a search for yield environment and (b) convincing markets that central banks will bail them out of any adverse scenario. However, actual economic data remains fairly sluggish. The paucity of business investment in the US particularly concerns us. We expect this will soon lead to slower US economic growth, limiting global economic growth to 3.0% in 2020, similar to 2019.

New Zealand's key export sectors are weathering the sluggish global economy better than expected, although there are some areas of weakness.

Looking at the primary sector, the firmness in dairy prices seen over much of 2019 has continued in the early part of 2020, with prices up 4.5% over the past two auctions. That's prompted us to revise up our forecasts for the farmgate milk price for the 2019/20 season from $7.10/kg to $7.40/kg (in the middle of Fonterra's forecast range). We've also pencilled in another above average payout of $7.30/kg for the following season. Dry weather is creating a risk that prices could go even higher in the short term. Areas including Northland, the Waikato and Canterbury are all seeing much dryer than usual conditions. That will hurt farm incomes, but will also push milk prices higher.

It's a more mixed picture for many of our other commodity exports. Beef and lamb prices have given up some of last year's strong gains as the earlier surge in Chinese demand has moderated. A further easing in prices is on the cards in early 2020 due to delayed slaughter and increasing dry conditions. Meanwhile, export prices for logs fell sharply in mid-2019, and have only partially recovered since then.

On the manufacturing front, many New Zealand businesses have been wrestling with subdued demand over the past year, with the value of non-food manufactured exports falling nearly 2% in the year to September 2019. That's come at the same time as operating costs have been pushing higher. Combined, those conditions have prompted many manufacturers to scale back plans for capital expenditure and have also weighed on hiring in the sector. Looking ahead, activity indicators generally point to continued sluggish trading conditions in the early part of 2020.

Finally, softness in the global economy has also seen some of the gloss coming off New Zealand's services sector, with the volume of services exports effectively stalling over 2019. In part, that's been related to the flattening off of international visitor numbers, which have reached a plateau over the past year following very strong growth between 2012 and 2018. New Zealand is still attracting a large number of tourists, with around 3.9 million people visiting our shores last year. However, growth has stalled in the face of competition for tourist dollars from other regions and slowing economic activity in key markets like Australia.

Inflation slightly stronger than expected.

The CPI rose by 0.5% in the December quarter. That saw annual inflation rising from 1.5% to 1.9%. That was a larger increase than we or the RBNZ had expected.

While domestic inflation was as expected, there was a larger than expected increase in tradables prices (mainly imports). That comes atop an acceleration in household spending. Together, those developments indicate that the retail pricing environment may be starting to firm.

Following the stronger than expected Q4 result, we are likely to see annual inflation rising to 2% over 2020, and it could go above that level for a period. That would be ahead of the RBNZ's forecasts, and the first time that inflation has been consistently at the target mid-point for 8 years. That reinforces our expectation for no OCR cut over the first half of 2020.

The New Zealand dollar.

We have pushed out the expected timing of rate reductions from the RBA and US Federal Reserve. In the case of the RBA, we now expect cuts in April and August (previously we expected cuts in February in June) which will take the cash rate to 0.25%. With regards to the Fed, we previously envisaged three cuts beginning in March. We now expect that process to begin in June, with cuts in September and December likely. [1]

As a result of these changes, we expect the NZD/AUD to fall to 1.01 cents through the first half of 2020. In contrast, we expect the NZD/USD cross rate to remain around current levels. Risk-off sentiment in financial markets is likely to be a counter-balance to the change in interest rate differentials.

1 These changes are discussed in full here: https://westpaciq.westpac.com.au/wibiqauthoring/_uploads/file/Australia/2020/January/er20200124BullDelayRBACashRate.pdf

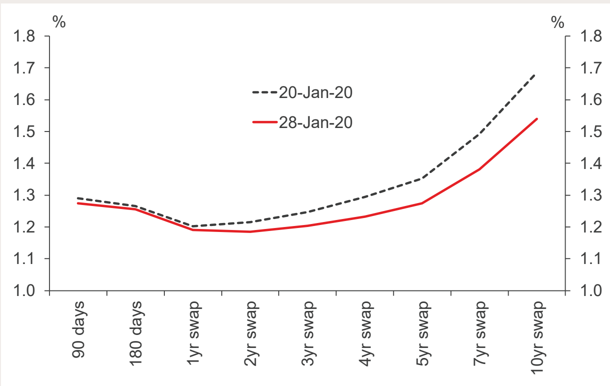
Fixed vs Floating for mortgages.

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



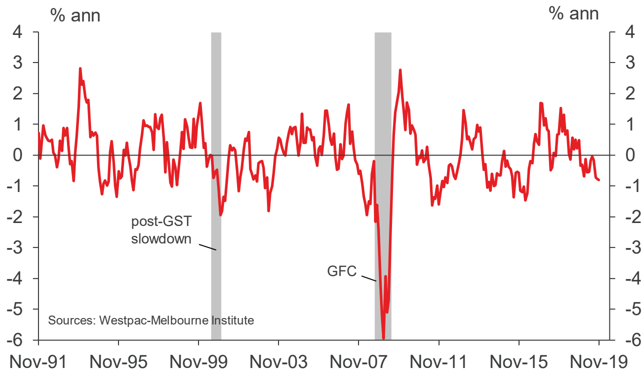
The week ahead.

Aus Dec Westpac–MI Leading Index

Jan 29, Last: –0.81%

- The Leading Index growth rate fell from –0.78% in Oct to –0.81% in Nov, extending the below trend readings now posted for twelve consecutive months and pointing to weak momentum heading into 2020.
- The December update looks likely to see another weak read.
- Components have had mixed moves over the last month. Those relating to consumer sentiment andi the sharemarket have seen falls. By contrast, dwelling approvals recorded a sharp rebound and other components such as US industrial production, hours worked and commodity prices have been firmer.

Westpac-MI Leading Index

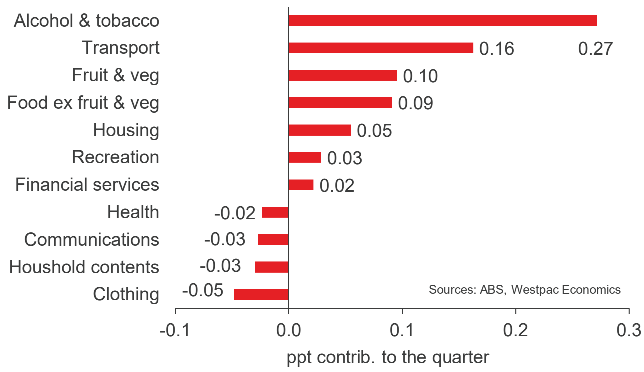


Aus Q4 CPI

Jan 29, Last: 0.5%, WBC f/c: 0.6%
Mkt f/c: 0.6%, Range: 0.4% to 0.8%

- The Q3 CPI lifted 0.5% compared to the market median of 0.5%. The annual rate lifted to 1.7%yr, from 1.6%yr, and while a modest acceleration from 1.3%yr in Q1 it remains below the bottom of the RBA's target band. The trimmed mean was a benign 0.4%qtr/1.6%yr.
- Westpac is forecasting a 0.6% rise in Q4 lifting the annual pace to 1.8%yr. Our trimmed mean forecast is 0.4%qtr/1.5%yr and the weighted median is 0.3%qtr/1.1%yr.
- Boosting the CPI is an 8.5% rise in tobacco and the 5.5% rise in auto fuel prices which combined make a 0.47ppt contribution. There is something of a drought impact in food prices (1.2%qtr/0.19ppt) but as yet no bushfire effect which, if present, could appear in Q1 2020.

Contributions 2019Q4 CPI 0.6%qtr forecast

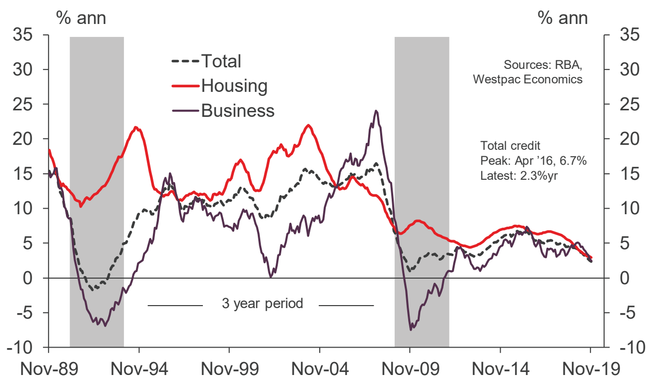


Aus Dec private credit

Jan 31, Last: 0.14%, WBC f/c: 0.2%
Mkt f/c: 0.2%, Range: 0.1% to 0.3%

- Credit was weak over the second half of 2019 against a challenging economic backdrop.
- In November, credit grew by 0.14%mth, 2.3%yr, That is a moderation from 4.3% for 2018 and is the weakest annual pace since 2009 (when the low was 0.8%).
- For December, another soft read is likely, a forecast 0.2%.
- Housing credit grew by only 0.18%mth, 2.9%yr in November. New lending is rebounding, which will see credit growth improve. However, the pass through has been slow as existing mortgage holders focus on paying down debt.
- Business credit is also soft, up 0.2%mth, 2.5%yr in November, moderating from 4.7% for 2018. Confidence has evaporated and investment is patchy.

Credit growth: slowest since the GFC



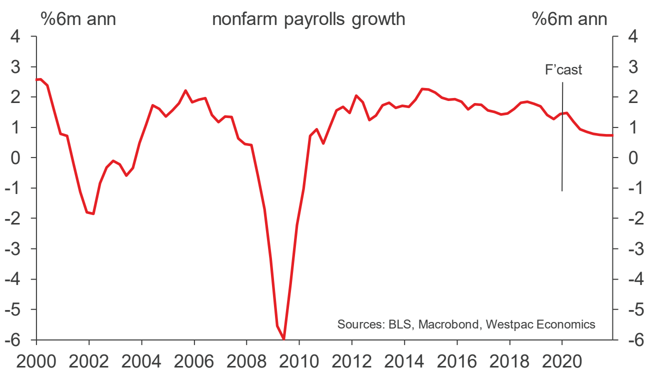
The week ahead.

US Jan FOMC policy meeting

Jan 28–29, federal funds rate last: 1.625%, WBC: 1.625%

- Since their last meeting, confidence in financial markets has continued to firm on the back of the now-signed stage 1 trade deal between the US and China. The US labour market has remained strong, and financial conditions are very accommodative.
- As a result, the FOMC will remain on hold in January and likely provide a sanguine baseline view for the outlook.
- That said, economic data into year end pointed to a decelerating growth trend. If this continues as we expect, then the FOMC's hopeful view will be tested in coming months.
- In gauging the potential timing of a dovish shift, the FOMC's assessment of the consumer's resilience will prove key, both in January meeting communications and thereafter.

Jobs to see FOMC reassess risks in 2020

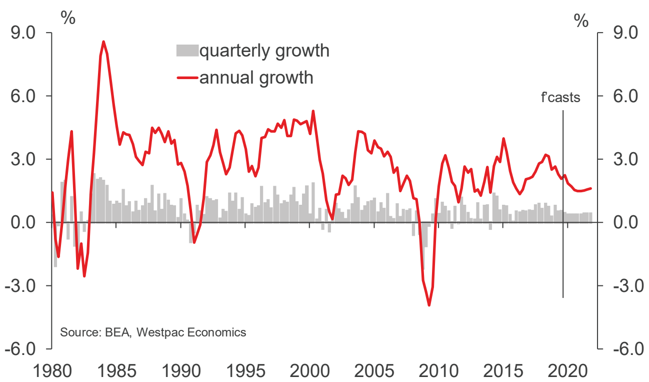


US Q4 GDP

Jan 30, last: 2.1%, WBC: 1.7%

- From 3.1% annualised at December 2018, US GDP growth slowed to 2.1% at September 2019. It is now set to slow further to 1.7% in Q4.
- The primary driver behind this trend has been the consumer. Having driven the above-trend GDP outcomes of 2018 and early 2019, momentum in consumer spending has since begun to slow, in line with job and income growth.
- A further loss of momentum in household income ahead will weigh on household demand and GDP growth, the latter throttling back to a below-trend pace mid-2020.
- An offset from other sectors is unlikely. Business investment growth will remain weak while tariffs remain in place and global growth soft. Government spending is also unable to mitigate a consumer-led slowing, with the sector already past peak growth stimulus on current policy.

US GDP to continue softening in 2020

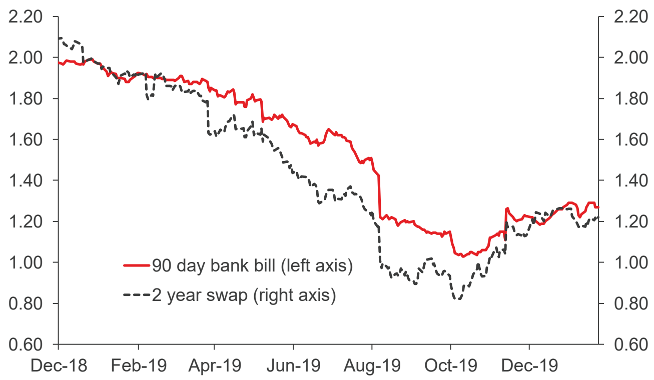


New Zealand forecasts.

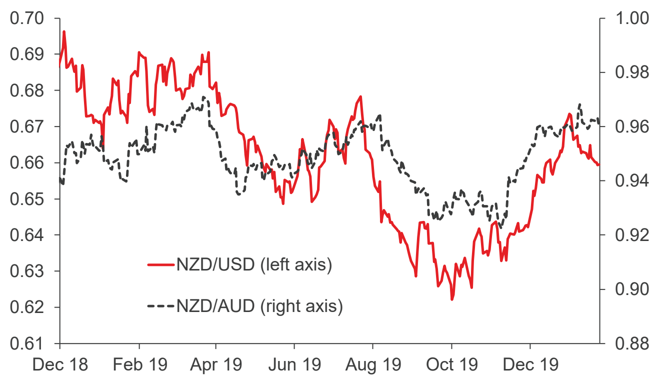
Economic forecasts	Quarterly				Annual			
	2019		2020					
% change	Sep (a)	Dec	Mar	Jun	2018	2019f	2020f	2021f
GDP (Production)	0.7	0.6	0.6	0.7	3.2	2.3	2.5	3.0
Employment	0.2	0.4	0.4	0.4	1.9	1.2	1.8	2.0
Unemployment Rate % s.a.	4.2	4.3	4.4	4.4	4.3	4.3	4.2	3.9
CPI	0.7	0.5	0.5	0.4	1.9	1.9	1.8	1.7
Current 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	1.10	1.05	1.00	1.00	1.00	1.05
5 Year Swap	1.25	1.20	1.20	1.25	1.30	1.35
10 Year Bond	1.35	1.25	1.25	1.25	1.35	1.40
NZD/USD	0.66	0.66	0.66	0.66	0.66	0.66
NZD/AUD	0.97	0.99	0.99	0.99	0.97	0.96
NZD/JPY	70.6	69.4	69.3	69.3	70.0	70.6
NZD/EUR	0.61	0.60	0.59	0.59	0.58	0.58
NZD/GBP	0.50	0.50	0.50	0.50	0.50	0.50
TWI	73.1	72.7	72.6	72.3	72.0	71.5

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 28 January 2020

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.20%	1.20%	1.18%
60 Days	1.24%	1.24%	1.22%
90 Days	1.28%	1.28%	1.26%
2 Year Swap	1.19%	1.20%	1.26%
5 Year Swap	1.27%	1.35%	1.43%

NZ foreign currency mid-rates as at 28 January 2020

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6551	0.6665	0.6607
NZD/EUR	0.5947	0.5969	0.5965
NZD/GBP	0.5018	0.5095	0.5081
NZD/JPY	71.42	72.03	72.30
NZD/AUD	0.9688	0.9585	0.9573
TWI	72.40	73.16	72.90

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
NZ	Auckland Anniversary	–	–	–	Markets open.
Aus	Australia Day holiday	–	–	–	Public holiday
Chn	New Year celebrations	–	–	–	Holidays from January 24 to 30.
US	Dec new home sales %mth	1.3	1.5	–	Conditions supportive for housing sector.
	Jan Dallas Fed index	–3.2	–1.6	–	Regions mixed of late.
Tue 28					
Aus	Dec NAB business survey	4	–	–	Conditions soft (at +4), confidence evaporated (at 0).
UK	Jan Nationwide house prices	0.1	0.2		House price growth weak.
US	Dec durable goods orders %mth	–2.1	1.2	–	Underlying trend remains weak.
	Nov S&P/CS home price index %yr	2.2	2.4	–	Price growth stabilising broadly in line with wages growth.
	Jan consumer confidence index	126.5	128.0	–	Confidence above average, thanks to strong labour market.
	Jan Richmond Fed index	–5	–3	–	Regions mixed of late.
Wed 29					
Aus	Dec Westpac-MI Leading Index	–0.81%	–	–	A below trend reading in Nov. Components mixed in Dec.
	Q4 CPI %qtr	0.5	0.6	0.6	Auto fuel & tobacco boosting the headline number & ...
	Q4 CPI %yr	1.7	1.7	1.8	... while there is some AUD passthrough the growing ...
	Q4 core CPI (trimmed mean) %qtr	0.4	0.4	0.4	... importance of the Black Friday Sales & lack lustre retail ...
	Q4 core CPI % yr	1.6	1.5	1.5	... suggests there is little inflationary pressure elsewhere.
Eur	Dec M3 money supply %yr	5.6	–	–	Credit data also due.
US	Dec wholesale inventories %mth	–0.1	–	–	Likely to drag on growth in coming quarters.
	Dec pending home sales %mth	1.2	0.7	–	Supply the prime hindrance to sales growth.
	FOMC policy decision, midpoint	1.625%	1.625%	1.625%	On hold for now, but cuts seen from June.
Thu 30					
NZ	Dec trade balance $m	–753	50	0	Seasonal lift in dairy exports.
Aus	Q4 import price index %qtr	0.4	0.4	0.5	Modest rise on lower dollar, as well as higher fuel prices.
	Q4 export price index %qtr	1.3	–5.2	–5.2	Sharply lower on commodity price pull-back, led by iron ore.
Eur	Jan economic confidence	101.5	102.0	–	Sentiment supported by policy stance...
	Jan business climate indicator	–0.25	–	–	... more positive view on global outlook...
	Dec unemployment rate	7.5%	–	7.5%	... and strength of labour market.
UK	BoE policy decision	0.75%	0.75%	0.75%	On hold in January, but a cut is close.
US	Q4 GDP %ann	2.1	2.2	1.7	Softening consumer pulse to see growth at trend in Q4.
	Initial jobless claims	211	–	–	Very low.
Fri 31					
Aus	Dec private sector credit %mth	0.1	0.2	0.2	Weakness in 2019 H2. Housing rebound a plus for 2020.
	Q4 PPI %qtr	0.4	–	–	Some upstream pressure from lower AUD but not much else.
Chn	Jan NBS manufacturing PMI	50.2	50.0	–	Soft global growth and tariffs weighing.
	Jan NBS services PMI	53.5	53.0	–	Improved investment climate to help services in time.
	Dec industrial production %mth	–1.0	0.7	–	Manufacturing to remain weak for some time.
Eur	Q4 GDP %qtr	0.2	0.2	0.2	Only a headline read. Growth currently below trend.
	Jan CPI %yr	1.3	1.4	–	Inflation pulse has improved, but still well below target.
UK	Jan GfK consumer sentiment	–11	–9	–	Outlook highly uncertain for UK economy.

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	0.75	0.50	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.89	0.95	0.70	0.45	0.45	0.50	0.50	0.50
10 Year Bond	1.08	1.05	0.95	0.90	0.80	0.80	0.85	1.05
International								
Fed Funds	1.625	1.625	1.375	1.125	0.875	0.875	0.875	0.875
US 10 Year Bond	1.73	1.65	1.50	1.45	1.40	1.45	1.50	1.70
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	0.6846	0.68	0.66	0.67	0.67	0.68	0.69	0.72
USD/JPY	109.46	107	106	105	105	106	107	109
EUR/USD	1.1053	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.3118	1.33	1.32	1.32	1.31	1.31	1.31	1.32
USD/CNY	6.9426	6.95	6.90	6.85	6.80	6.80	6.75	6.60
AUD/NZD	1.0343	1.03	1.01	1.02	1.02	1.03	1.05	1.07

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

Paul Clark, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Disclaimer.