

# Weekly Commentary

13 August 2018



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## Snap back to reality

As expected, the Reserve Bank repeated its line that the OCR will stay low for an extended period and that the next move could be up or down. However, the RBNZ's interest rate projections and some subsequent comments have made clear the extent to which the 'down' scenario is a real prospect. We're taking seriously the possibility of a rate cut within the next year, and we think that financial markets should too. However, we expect that some better-than-expected economic data will stay the RBNZ's hand in the near term.

The August *Monetary Policy Statement* shifted broadly in the direction that we expected. We were saying at the start of this year that the RBNZ's growth forecasts were too optimistic, and that as they came to realise this they would shift to a more dovish stance. This has now come to pass. At the time, financial markets and many forecasters were still predicting OCR hikes this year; the centre of gravity has now shifted towards a much later move.

However, the RBNZ has shifted its assessment even further than we expected. Their updated projection for the OCR is flat until September 2020, a year later than in the May *MPS*. From there, the next projected move is up, but at a very gradual pace.

At face value, the RBNZ's assessment of the economy certainly wasn't ringing alarm bells. The RBNZ is forecasting growth to accelerate again after a recent slowdown, supported by low interest rates, increased government spending and a rebound in export volumes. The Kiwibuild programme will help to boost construction activity, although the RBNZ has adopted the Treasury's view that Kiwibuild will ramp up more slowly than previously expected. Above-potential growth would lead to greater capacity pressures and a lift in wage and price inflation.

The most substantial change compared to the May *MPS* was a cut to the GDP growth forecasts for the rest of this year,

reflecting the softness in business confidence and other recent indicators. However, this slowdown was regarded as temporary.

The risk scenarios in the *MPS* were more revealing. On the one hand, the possibility of a faster than expected pickup in inflation would ultimately require higher interest rates than otherwise. But even then it wouldn't require a sharp response, as it would actually serve to get the RBNZ closer to its inflation target.

On the other hand, the downside scenario considered a slower pickup in GDP growth (though still accelerating from its recent pace). A slower than expected pickup in activity could see the RBNZ fall short on both its inflation and employment goals, and would warrant a substantially lower OCR.

The potential for a cut was reinforced in a later interview with the RBNZ's Assistant Governor McDermott, who commented that "we've been pushed nearer to that trigger point". McDermott went on to highlight that the RBNZ will need to see a lift in GDP growth in the September quarter (when increased fiscal stimulus should start to come through) to be convinced that it is on the right track.

These comments suggest that the risk of an OCR cut is real, but not imminent. September quarter GDP isn't published

# Snap back to reality... continued

until late December, though there will be some indicators out in time for the November *MPS*.

Moreover, our view is that the RBNZ won't have to wait that long for some reassurance. The RBNZ expects June quarter GDP to rise by 0.5%; the information that we have to date suggests an outturn closer to 1%. Of course, quarterly GDP outturns can be volatile – we think that the 0.5% rise in the March quarter probably understated the underlying pace of growth, and that the June quarter will almost certainly overstate the case. But there are some genuine positives in there as well. For instance, the June quarter labour market surveys showed a surprisingly strong lift in employment and hours worked in the June quarter.

Perhaps less significantly, we're also expecting the next inflation print to top the RBNZ's forecast. The RBNZ is expecting a 0.4% rise in September quarter prices, with a particularly soft result for tradable goods prices. We're expecting a 0.7% rise for the quarter, with fuel prices set to make another sizeable contribution. However, this is the kind of inflation surprise that the RBNZ has scope to look through.

We should emphasise that not all of the upcoming economic news is going to be more favourable. The housing market is likely to remain subdued this year, as various Government policies aimed at dampening housing market speculation come into effect. That's also likely to weigh on growth in household spending.

In addition, we expect the recent slowdown in growth to filter through to the labour market with a lag. That implies the uptick in the unemployment rate in the June quarter could run further in the near term, before the effects of fiscal stimulus push it lower again next year. It's not clear to what extent the RBNZ would be willing to tolerate a move in unemployment in the wrong direction, so we will be watching vigilantly for any labour market developments that could trigger a rate cut next year.

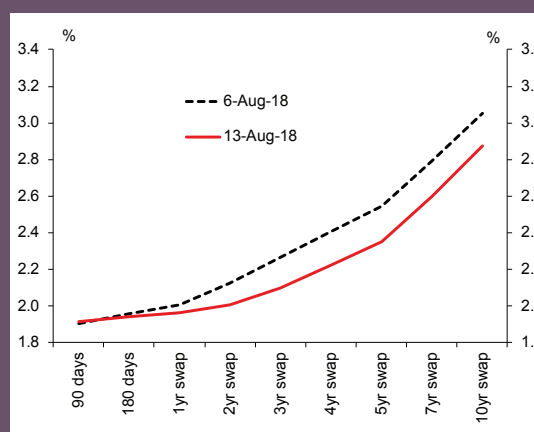
Financial markets have now removed any pricing for OCR hikes, and are now giving a 20% chance of a cut in the next year. We think that that shift has been appropriate, and is likely to go even further in the coming weeks. That in turn implies lower borrowing rates and a lower exchange rate, which would serve the RBNZ's purposes.

## Fixed vs Floating for mortgages

Floating mortgage rates usually work out to be more expensive for borrowers than fixed rates. However, floating may still be the preferred option for those who require flexibility in their repayments.

We expect floating and short-term fixed mortgage rates to rise gradually over the coming few years, meaning that taking a fixed rate may prove worthwhile. One-year fixed rates are usually the lowest on offer, and appear to offer good value for borrowers. Longer-term fixed rates are high relative to where we think one-year fixed rates are going to go. However, longer-term rates offer security against the possibility of mortgage rates rising more rapidly than expected in the future.

NZ interest rates



# The week ahead

## NZ Jul REINZ house sales and prices

Due this week, Sales last: -5.1%. Prices last: 3.8%/yr

- The housing market has weakened over the past few months. Prices are falling in Auckland and Canterbury, and price growth has weakened elsewhere. June data was particularly weak, with a 5.1% drop in nationwide sales.
- The slowdown in the housing market comes against a backdrop of significant policy changes targeting housing affordability and supply. We expect that these measures will result in further weakness in July.
- Looking further ahead, restrictions on foreign buyers are likely to reinforce the other factors weighing on house price growth, although falling fixed interest rates might be a partial countervailing force.

## REINZ house prices and sales



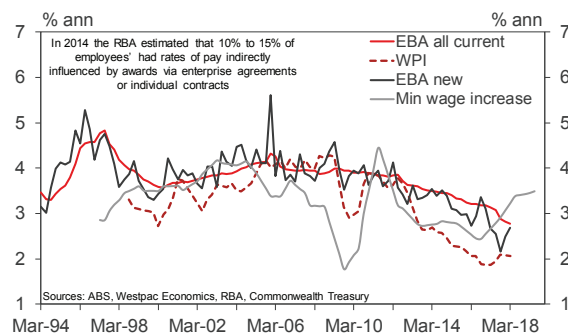
## Aus Q2 Wage Price Index - %qtr

Aug 15, Last: 0.5%, WBC f/c: 0.6%

Mkt f/c: 0.6%, Range: 0.5% to 0.8%

- There has been some removal of excess slack in the labour market as well as the annual boost from the lifting of the minimum wage. And yet, we are still to observe a meaningful pickup in wage inflation. Total hourly wages ex bonuses gained 0.5% in Q1, again slightly less than market expectations of 0.6% holding the annual rate at 2.1%/yr.
- In Q1, private sector wages grew 0.5% holding the annual rate at 1.9%/yr. Public sector wages grew 0.5% with the gains coming from education (0.8%) and public administration (0.5%). Public sector wage inflation has eased back to 2.3%/yr from 2.4%/yr which is on par with the 2016 record low of 2.3%/yr.

## As WPI stabilises, EBA wages moderate

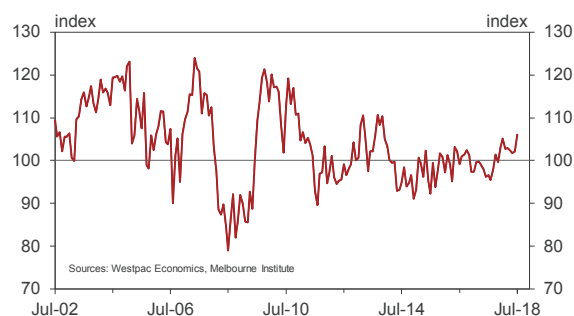


## Aus Aug Westpac-MI Consumer Sentiment

Aug 15, Last: 106.1

- The consumer mood showed a clear improvement in July, the index rising 3.9% to 106.1, the most positive since November 2013. That said, the overall level of sentiment is still not strong – the index averaged 108.3 over the ten years prior to the GFC with peaks well above the 110 mark. Much of the improvement over the last year reflects a more balanced growth profile across states.
- The August survey is in the field from August 6-11. Factors that may influence this month include: the RBA's decision to leave official rates on hold, recent comments emphasising that any move is still a long way off; continued slippage in dwelling prices. Financial markets have been relatively steady, the ASX up marginally since the last survey and the AUD down slightly. Offshore, global trade tensions have again been to the fore.

## Consumer Sentiment Index



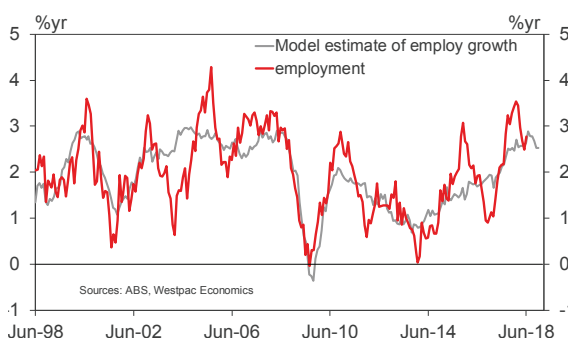
## Aus Jul Labour Force Survey - Employment '000

Aug 16, Last: 51.9k., WBC f/c: -5.0k

Mkt f/c: 15k, Range: -22k to 30k

- Australian employment increased by 51k in June beating the market consensus expectation of +16.5k and Westpac's +17k. With full-time contributing most of the gain, +41k, part-time rose +10k while hours worked increased by 0.6%.
- Employment in the business surveys softened in the last few months, something we are watching closely. Of note the June survey was associated with a strong rise in employment & participation. The ABS notes that in July, the outgoing rotation group has higher employment and participation ratios than the average for the whole sample. If the incoming sample is more like the average, then it will drive both a softer employment and participation print hence we see the risk for a negative print. Our -5k forecast will see the three month average fall to 19.8k.

## Jobs Index model of employment



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# The week ahead

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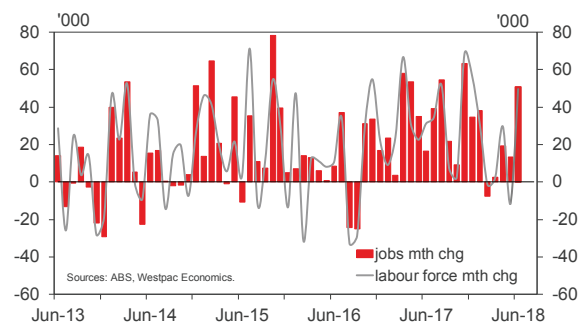
## Aus Jul Labour Force Survey - Unemployment %

Aug 16, Last: 5.4%, WBC f/c: 5.4%

Mkt f/c: 5.4%, Range: 5.3% to 5.5%

- The Australian unemployment rate held at 5.4% as the participation rate reversed last month's decline to lift to 65.7% from 65.5%. In part, this highlights the responsiveness of labour supply to stronger employment that we have been seeing over the past few years. As such, the unemployment rate has been sticky around 5 ½ per cent.
- But we also note above that some of the monthly volatility can be driven by sample volatility. We suspect some of the rise in both employment and the labour force in the June survey was due to the sample rolling in having a much higher attachment to the labour force. If the sample rolling in July is more like the sample average then we will see not only a softer employment print but also softer participation.

### Volatility in both employment & labour force



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 13</b>					
<b>NZ</b>	Jul REINZ house sales	-5.1%	-	-	Due this week. Trends to continue. Sales growth lacklustre ...
	Jul REINZ house prices, %oyr	3.8%	-	-	... and weakness in prices centred on Akd and Canterbury.
	Jul Business NZ PSI	52.8	-	-	Activity indicators have fallen, confidence subdued.
	Jul food price index	0.5%	-	0.4%	Seasonal gains, some pressure from minimum wage hike.
<b>Tue 14</b>					
<b>Aus</b>	Jul NAB business survey	15	-	-	Conditions elevated, confidence at average levels.
	ABS paper on annual CPI re-weight	-	-	-	Moving to annual should minimise any impact on CPI.
<b>Chn</b>	Jul retail sales YTD %oyr	9.4%	9.4%	-	Consumer was strong in H1; can momentum be sustained?
	Jul industrial production YTD %oyr	6.7%	6.6%	-	PMI's have held up well. Tariffs may bring forward activity.
	Jul fixed asset investment ytd %oyr	6.0%	6.0%	-	Market will be hoping for an upside surprise.
<b>Eur</b>	Jun industrial production	1.3%	-	-	PMI's look to have been stabilising.
	Q2 GDP 2nd estimate	0.3%	-	-	Detail is very slow in coming these days.
	Aug ZEW survey of expectations	-18.7	-	-	Investors aided by easy policy; but put off by tariffs.
<b>UK</b>	Jun ILO unemployment rate	4.2%	-	-	Firming growth in Q2, unemployment should remain low.
<b>US</b>	Jul NFIB small business optimism	107.2	106.8	-	Very optimistic.
	Jul import price index	-0.4%	0.1%	-	Stronger dollar will weigh in coming months.
<b>Wed 15</b>					
<b>Aus</b>	Aug WBC-MI Consumer Sentiment	106.1	-	-	Firmed a little in 18. Tax cuts a positive, housing a concern.
	Q2 wage cost index	0.5%	0.6%	0.6%	Minimum wage boost in Q3 so should be contained.
<b>UK</b>	Jul CPI	0.0%	-	-	Annual rate boosted by fuel costs. Core inflation easing.
	Jun house price index, %oyr	3.0%	-	-	Nationwide house price growth modest, London weaker.
<b>US</b>	Q2 productivity	0.4%	2.5%	-	An acceleration needed.
	Aug Fed Empire state index	22.6	20.0	-	At an elevated level.
	Jul retail sales	0.5%	0.1%	-	After a strong Q2 comes?
	Jul industrial production	0.6%	0.4%	-	Has not lived up to business survey hype.
	Jun business inventories	0.4%	0.1%	-	Will trade uncertainty impact stock levels?
	Aug NAHB housing market index	68	67	-	Very positive. But volumes weak.
	Jun total net TIC flows \$bn	69.9	-	-	Market to keep a close eye on China's holdings.
	Q2 Fed h/hold debt & credit report	-	-	-	Detailed view on US households' financial welfare.
<b>Thu 16</b>					
<b>Aus</b>	Aug MI inflation expectations	3.9%	-	-	Will they ease back with power prices?
	Jul employment, '000 chg	50.9	15	-5	Monthly volatility to drive a small negative but falling...
	Jul unemployment rate	5.4%	5.4%	5.4%	...participation should result in a flat unemployment rate.
<b>Eur</b>	Jun trade balance €bn	16.9	-	-	Weaker Euro a big positive.
<b>UK</b>	Jul retail sales	-0.6%	-	-	Sales growth moderated again following its mid-year lift.
<b>US</b>	Aug Philly Fed index	25.7	-	-	At elevated level.
	Initial jobless claims	213k	-	-	At very low level.
	Jul housing starts	-12.3%	7.9%	-	Highly volatile, but trend has flattened.
	Jul building permits	-0.7%	1.2%	-	New supply and higher rates to weigh on activity.
<b>Fri 17</b>					
<b>Aus</b>	RBA Governor Lowe speaks	-	-	-	Semiannual Testimony before the House of Representatives
	RBA Assistant Governor Ellis speaks	-	-	-	At the Australian National University, Canberra 5:30pm
<b>Eur</b>	Jul core CPI final %oyr	1.1%	-	-	Remains benign.
<b>US</b>	Jul leading index	0.5%	0.4%	-	Pointing to above-trend growth.
	Aug Uni. of Michigan sentiment prel.	97.9	97.9	-	Robust.

# New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2018				Calendar years			
% change	Mar (a)	Jun	Sep	Dec	2016	2017	2018f	2019f
GDP (Production)	0.5	0.7	0.8	0.7	4.0	2.8	2.6	3.2
Employment	0.6	0.5	0.1	0.4	5.8	3.7	1.6	1.6
Unemployment Rate % s.a.	4.4	4.5	4.5	4.6	5.3	4.5	4.6	4.6
CPI	0.5	0.4	0.7	0.3	1.3	1.6	1.9	1.4
Current Account Balance % of GDP	-2.8	-3.0	-3.2	-3.2	-2.2	-2.7	-3.2	-3.0

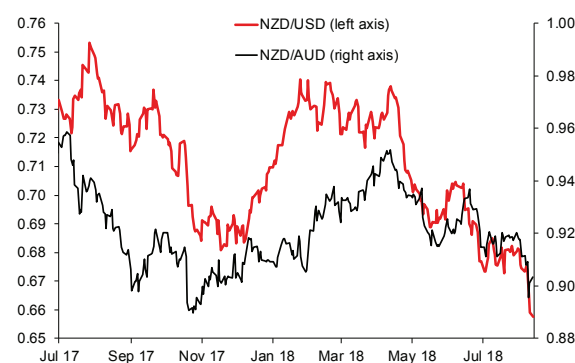
<sup>1</sup> Annual average % change

Financial Forecasts	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Cash	1.75	1.75	1.75	1.75	1.75	2.00
90 Day bill	2.00	2.00	2.00	2.00	2.10	2.20
2 Year Swap	2.20	2.30	2.40	2.55	2.70	2.80
5 Year Swap	2.70	2.85	3.00	3.15	3.25	3.30
10 Year Bond	2.90	3.15	3.30	3.35	3.40	3.45
NZD/USD	0.68	0.67	0.65	0.65	0.64	0.65
NZD/AUD	0.92	0.91	0.90	0.90	0.91	0.93
NZD/JPY	76.16	75.0	74.1	73.5	71.7	71.5
NZD/EUR	0.58	0.58	0.57	0.56	0.54	0.54
NZD/GBP	0.52	0.53	0.53	0.53	0.52	0.53
TWI	73.39	72.7	71.2	70.9	70.1	70.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 13 August 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.80%	1.81%	1.86%
60 Days	1.85%	1.86%	1.90%
90 Days	1.92%	1.92%	1.95%
2 Year Swap	2.01%	2.13%	2.16%
5 Year Swap	2.35%	2.54%	2.55%

NZ foreign currency mid-rates as at 13 August 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6576	0.6794	0.6763
NZD/EUR	0.5778	0.5829	0.5785
NZD/GBP	0.5152	0.5188	0.5114
NZD/JPY	72.71	75.38	75.88
NZD/AUD	0.9034	0.9184	0.9113
TWI	71.69	73.34	72.76

# International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
<b>Australia</b>						
Real GDP % yr	2.6	2.5	2.6	2.2	2.8	2.5
CPI inflation % annual	1.7	1.7	1.5	1.9	1.7	1.7
Unemployment %	6.2	5.8	5.7	5.4	5.5	5.6
Current Account % GDP	-3.0	-4.7	-3.1	-2.5	-2.4	-3.4
<b>United States</b>						
Real GDP %yr	2.6	2.9	1.5	2.3	2.9	2.5
Consumer Prices %yr	1.6	0.1	1.4	2.1	2.5	2.0
Unemployment Rate %	6.2	5.3	4.9	4.4	3.9	3.7
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
<b>Japan</b>						
Real GDP %yr	0.4	1.4	0.9	1.7	1.1	1.0
<b>Euro zone</b>						
Real GDP %yr	1.3	2.1	1.8	2.3	2.0	1.6
<b>United Kingdom</b>						
Real GDP %yr	3.1	2.3	1.9	1.8	1.2	1.5
<b>China</b>						
Real GDP %yr	7.3	6.9	6.7	6.9	6.3	6.1
<b>East Asia ex China</b>						
Real GDP %yr	4.2	3.8	3.9	4.5	4.4	4.3
<b>World</b>						
Real GDP %yr	3.6	3.5	3.2	3.8	3.8	3.7

Forecasts finalised 13 August 2018

Interest Rate Forecasts	Latest	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
<b>Australia</b>								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	1.96	2.02	2.00	1.97	1.97	1.92	1.92	1.87
10 Year Bond	2.59	2.75	3.05	3.20	3.10	3.10	3.00	3.00
<b>International</b>								
Fed Funds	1.875	2.125	2.375	2.625	2.875	2.875	2.875	2.875
US 10 Year Bond	2.89	3.00	3.35	3.50	3.50	3.40	3.20	3.10
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	-0.10

Exchange Rate Forecasts	Latest	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
AUD/USD	0.7297	0.74	0.74	0.72	0.72	0.70	0.70	0.72
USD/JPY	110.95	111	112	114	113	112	110	109
EUR/USD	1.1449	1.17	1.16	1.15	1.16	1.18	1.20	1.21
AUD/NZD	1.1086	1.09	1.10	1.11	1.11	1.09	1.08	1.09

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- (iii) and well defined wall/cell crossing procedures;
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