

Weekly Commentary

15 October 2018



Glow Worm (*Arachnocampa Luminosa*)

Rolling along

After recent weak business confidence headlines, we had several reminders last week of why we're actually looking for the "hard data" to show a tick up in momentum over the next couple of months. Most notably, retail spending growth exceeded expectations for a second month in a row, and the Government's books for the year to June are in even better shape than forecast. Looking ahead to this week, we outline what we expect to see in the September quarter CPI release.

While weak confidence data continues to hog the headlines, other indicators of how the New Zealand economy is tracking still paint a more resilient picture of economic activity. Last week's electronic transactions data showed retail spending beat expectations for a second consecutive month. While part of the lift was down to higher fuel prices, that wasn't the entire story. Core retail spending (which excludes spending on fuel and other auto-related spending) was up a healthy 1.1% in September, and 5.1% higher than a year ago. So while we remain on alert for signs record high fuel prices will eventually put the squeeze on household spending, the data suggests that's not happening yet.

One reason spending seems to be holding up reasonably well in the face of rising petrol prices might be the boost low and middle-income households are receiving from the Government's flagship Families Package. A number of elements of this package came into effect on July 1, and the package will pump \$1.2bn dollars into household incomes in the year to June 2019, rising to \$1.5bn a year by the time the package is fully implemented in 2020/21.

The release of the final fiscal accounts for the year to June 2018 showed that the package was certainly one the Government can afford. The Government's books were in much better shape than expected, with higher than forecast revenues and less spending than planned leading to a \$5.5bn surplus. That's \$2.4bn higher than was forecast in the May Budget. This larger than expected surplus meant that

net core Crown debt fell by \$2bn over the June 2018 year, taking net debt down to 19.9% of GDP. That's already inside the 20% of GDP level the Government set as a self-imposed debt target under its Budget Responsibility Rules. What's more it has met this target 4 years ahead of schedule.

Delays in capital spending also contributed to the lower borrowing requirement. This is not a new trend. As we have been pointing out, spending as much as they'd like on infrastructure has proved difficult for governments in recent years, with capacity constraints the main hindrance to a lift in infrastructure spending.

So far politicians have been keen to hose down expectations of a spending spree on the back of the better than expected fiscal accounts. However, these calls will no doubt intensify in the lead-up to the 2019 Budget, especially if the economy continues to trundle along at a reasonable pace. This could allow the Government to announce even more spending than it already has planned. The stronger than expected starting point also provides some leeway if economic growth fails to live up to the Treasury's upbeat forecasts.

Another reason household spending may hold up reasonably well over as we head into the end of the year is slightly more positive news on the housing front. The latest housing market data for September suggested that the New Zealand housing market remains steady, with

Rolling along continued

nationwide prices rising slowly. While we remain downbeat on the long-run outlook for the housing market due mainly to tax changes and the foreign buyer ban, in recent weeks the more dovish tone from the RBNZ has resulted in a sharp drop in fixed mortgage rates. This is likely to support a modest pickup in housing market activity in the coming months. It's probably too early to see an impact from this change yet but, there were a few hints in the REINZ September data. Auckland house prices (which seem to be most sensitive to changes in mortgage rates) increased 0.5% in the month – the first monthly lift in prices in the region since February 2018.

Looking ahead to this week, the focus will be on the September quarter CPI release on Tuesday. We expect a 0.7% rise in the Consumer Price Index (CPI) for the September quarter, taking annual inflation up to 1.7%.

That's well above what the RBNZ was thinking back in August when it forecast 1.4% inflation in September. However, unlike our forecast, the RBNZ's pick won't fully account for the lift in fuel prices we've seen since August.

This lift in fuel prices will make a significant contribution to September quarter inflation. However the weaker NZ dollar is also playing a broader role, pushing up prices for imported goods. Both these factors are also likely to feature in the December quarter, which could mean inflation briefly nudges above the 2% mid-point of the RBNZ's target band. Inflation above 2% could make rate cuts a harder sell for the RBNZ in the near term. Despite this the RBNZ remains squarely focused on risks to the growth outlook. Should growth falter, we don't think inflation marginally above the mid-point of the target band would stop the RBNZ cutting the OCR.

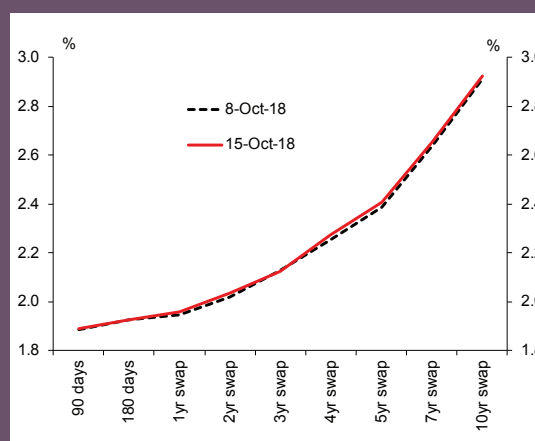
Fixed vs Floating for mortgages

Fixed-term mortgage rates are currently falling, as the market adjusts to the Reserve Bank's softer stance. Looking further ahead, we expect floating and short-term fixed rates to rise gradually over the next few years, so taking a fixed rate may prove worthwhile once they have settled down.

One-year fixed rates are currently 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.

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.

NZ interest rates



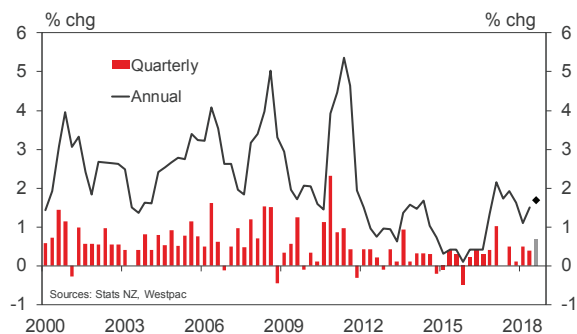
The week ahead

NZ Q3 CPI

Oct 16, Last: 0.4%, Westpac f/c: 0.7%, Mkt f/c: 0.7%

- We expect a 0.7% rise in consumer prices for the September quarter, taking annual inflation up to 1.7%.
- Higher fuel prices account for much of the quarterly rise. We also expect the lower exchange rate over the last year to have an impact on prices of imported goods.
- Inflation is set to rise above the 2% midpoint of the Reserve Bank's target range by year-end. A petrol-induced rise in inflation could make OCR cuts a harder sell in the near term, though it certainly wouldn't preclude rate cuts if the economy faltered.

NZ CPI inflation



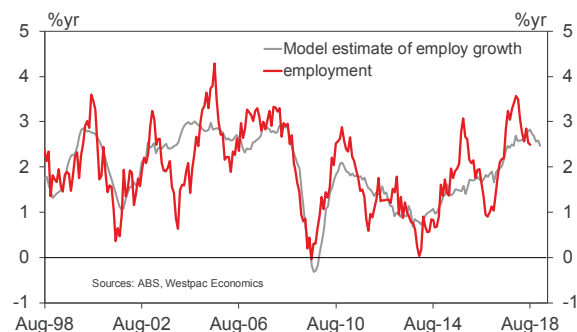
Aus Sep Labour Force, employment '000

Oct 18, Last: 44k, WBC f/c: 15k

Mkt f/c: 15k, Range: 5k to 30k

- Employment lifted 44.0k in Aug with full-time rising a solid 33.7k (+20.1k in July) and part-time putting in a sound gain of 10.2k (not fully reversing the Jul -24.4k). The annual pace was flat at 2.5%/yr (+310.4k in the year) with the six month annualised pace lifting to 2.2%/yr from 1.4%/yr. The momentum in employment has eased from its above trend pace but is likely to hold around 2%/yr to end 2018.
- Our forecast for a 15k rise in employment will see an annual, and a six month annualised, pace of 2.4%.
- The ABS notes that the outgoing rotation group in the September Labour Force Survey has a lower employment to population ratio than the average for the sample as a whole. As such the risk to our forecast lie to the upside.

Jobs Index model of employment

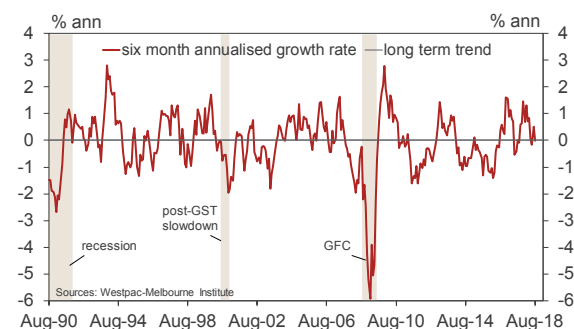


Aus Sep Westpac-MI Leading Index

Oct 17, Last: -0.02%

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, fell from 0.5% in July to -0.02% in August. While the signal has been volatile this year, the signal points to slowing growth momentum heading into year end and early 2019.
- The September read will again include a mixed bag of updates. Components with weaker reads include: dwelling approvals, down sharply by -9.4%; the ASX200, down -1.8% vs 0.6% last month; and the Westpac-MI Unemployment Expectations Index which deteriorated marginally after a significant improvement last month. This will be balanced by more positive reads for the Westpac-MI Consumer Expectations Index (up 0.9%); commodity prices (up 2% in AUD terms); and a modest widening in the yield spread (+7bps).

Westpac-MI Leading Index



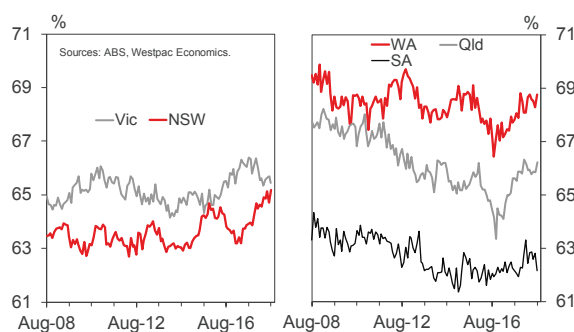
Aus Sep Labour Force, unemployment %

Oct 18, Last: 5.3%, WBC f/c: 5.3%

Mkt f/c: 5.3%, Range: 5.1% to 5.4%

- The robust Aug employment gains were matched by a rise in participation to 65.7%, from 65.6%, boosting the labour force by 49.6k. This was enough to hold the unemployment rate flat at 5.3%. The record high for participation is 65.8% set in November 2010. August saw solid gains in both male (71.1% from 70.9%) and female (61.5% from 60.4%) participation and this mix saw male unemployment fall to 5.2% (from 5.3%) while female unemployment rose to 5.4% (from 5.2%).
- The rise in participation has been driven by NSW, and in particular, females in NSW where it is hitting record highs. While we may be nearing the peak for participation in NSW, other states have room to grow. As such, we expect participation to hold at 65.7%, leaving the unemployment rate at 5.3%.

Total participation rate by state



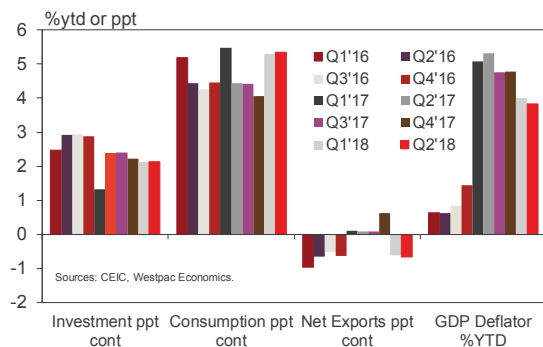
The week ahead

China Q3 GDP

Oct 19, last 6.7%, WBC 6.6%

- 2018 has been a year of change for China's economy, some voluntary, some forced upon it. Throughout, we have held to a sub-consensus view on growth to highlight the risks to investment (a result of ongoing structural change in their financial system and a clear focus on the quality of growth) and, more recently, from building tensions with the US and slower global growth.
- Come Q3, we believe a softer pulse for the consumer (after a particularly strong first half) along with lingering weakness in business and government investment will weigh on growth. However, the race to minimise the cost of tariffs on exporters should see net exports add to momentum, having been a negative early in 2018. The net effect should be an annualised pace of gain consistent with our sub-consensus view of 6.3% for the year (1.6% q/q), but an annual rate at 6.6%/yr.

China GDP: H1 saw strong consumer support

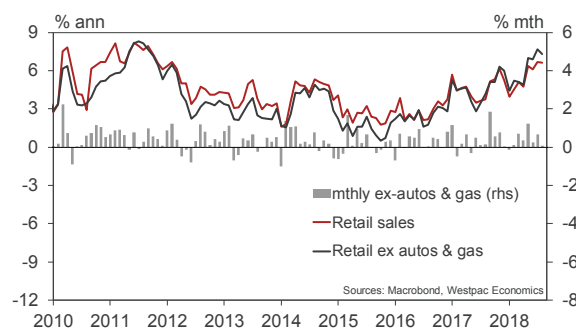


US Sep retail sales

Oct 15, last 0.1%, WBC 0.8%

- US retail sales have been decidedly mixed of late, with negative revisions offsetting an upside surprise to the latest actual or vice versa. Growth over the year remains robust though, at 6.6%/yr in August.
- The underlying supports for US consumption remain strong, with employment growth continuing at pace; wages growth firming; and consumer confidence strong. The elevated price of oil is a partial offset to these long-running positives.
- Come September, we look for a bounce in spending, a 0.8% gain for headline sales and a 0.5% rise for core activity. From those two forecasts, apparent is that spending on autos and gasoline will be positive in the month. This is also likely to be the case into year end, particularly for autos in regions hit by the 2018 hurricane season.

Retail sales growth robust over year



Data calendar

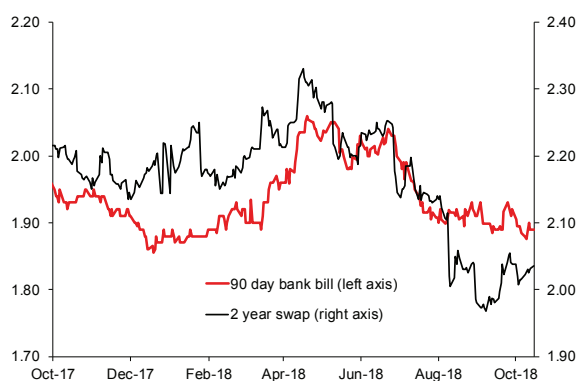
		Last	Market median	Westpac forecast	Risk/Comment
Mon 15					
NZ	Sep BusinessNZ PSI	53.2	-	-	Surveys are pointing to a loss of momentum through H2 2018.
Chn	Sep M2 money supply %yr	8.2%	8.5%	-	Tentative date.
	Sep new loans, CNYbn	1280	1340	-	Bank loans & market sourced funding to show improvement.
US	Oct Fed Empire state index	19.0	20.5	-	Still at a strong level.
	Sep retail sales	0.1%	0.7%	0.8%	Jul and Aug both delivered surprises; will Sep too?
	Aug business inventories	0.6%	0.5%	-	Q2 draw down of inventories to reverse in Q3.
Tue 16					
NZ	Q3 CPI	0.4%	0.7%	0.7%	Higher oil prices and the lower NZ dollar boosting inflation.
Aus	RBA minutes	-	-	-	More colour on the Board's thoughts.
Chn	Sep PPI %yr	4.1%	3.6%	-	Commodities supporting prices upstream...
	Sep CPI %yr	2.3%	2.5%	-	... but consumer inflation benign.
Eur	Aug trade balance €bn	12.8	-	-	Surplus edging back in 2018 on less trade and higher Euro.
	Oct ZEW survey of expectations	-7.2	-	-	Sentiment stabilised in recent months but still vulnerable.
UK	Aug ILO unemployment rate	4.0%	4.0%	-	Set to remain low with activity firmer in mid-2018.
US	Sep industrial production	0.4%	0.3%	-	Weaker than ISM's indicate.
	Oct NAHB housing market index	67	67	-	Builders remain very positive on outlook.
	Aug JOLTS job openings	6939	6900	-	Hires, fires, quits and job openings.
Wed 17					
NZ	GlobalDairyTrade auction	-1.9%	-	-	Strong growth in NZ milk production weighing on prices.
Aus	Sep Westpac-MI Leading Index	-0.02%	-	-	Volatile but pointing to slowing momentum into year end.
	RBA Dep. Gov. Debelle speaks	-	-	-	'The State of the Labour Market', Sydney 8:20 am.
Eur	Sep CPI core %yr final	0.9%	0.9%	-	Core inflation remains contained and below target.
	Bundesbank Weidmann speaks	-	-	-	In Berlin.
UK	Sep CPI	0.7%	0.3%	-	Core inflation at target with imported pressures easing.
	Aug house price index, %yr	3.1%	-	-	Prices in London particularly weak.
US	Aug total net TIC flows \$bn	52.2	-	-	Market keeping track of Chinese demand.
	Sep housing starts	9.2%	-5.0%	-	Residential construction forward indicators...
	Sep building permits	-4.1%	2.5%	-	... are flattening out.
	FOMC meeting minutes	-	-	-	Further detail on risks to the outlook in focus.
	Fedspeak	-	-	-	Brainard on Fintech and financial inclusion.
Thu 18					
Aus	Sep employment	44k	15k	15k	Leading indicators suggest momentum can hold to end '19...
	Sep unemployment rate	5.3%	5.3%	5.3%	... while robust participation will limit fall in unemployment.
	Q3 NAB business survey	7	-	-	Quarterly survey provides additional detail.
UK	Sep retail sales	0.3%	-0.3%	-	Boosted by summer weather, but signs the pickup is fading.
Eur	EU Summit	-	-	-	Migration, article 50 and more to be discussed.
US	Oct Philly Fed index	22.9	21.0	-	Remains very positive.
	Initial jobless claims	214k	-	-	Very, very low.
	Sep leading index	0.4%	0.5%	-	Pointing to above-average growth.
	Fedspeak	-	-	-	Bullard and Quarles speaking at separate events.
Fri 19					
NZ	Sep net migration	5010	-	4900	Downtrend in annual migration from high levels continuing.
UK	Sep public sect. net borrowing, £bn	5.9	-	-	Borrowing requirements have been lower than anticipated.
	BOE Governor Carney	-	-	-	Speaking at Economic Club of New York, text to be released.
Chn	Q3 GDP %yr	6.7%	6.6%	6.6%	Growth continues to decelerate, slowly.
	Sep retail sales ytd %yr	9.3%	9.3%	-	Consumer momentum likely to soften in H2 2018.
	Sep industrial production ytd %yr	6.1%	6.0%	-	Manufacturing remains positive.
	Sep fixed asset investment ytd %yr	5.3%	5.4%	-	A low for FAI growth has likely been seen.
US	Sep existing home sales	0.0%	-0.6%	-	Limited supply remains the biggest issue in most markets.
	Fedspeak	-	-	-	Kaplan and Bostic speaking at separate events.
Sat 20					
US	Fedspeak	-	-	-	Bostic speaking in Atlanta.

New Zealand forecasts

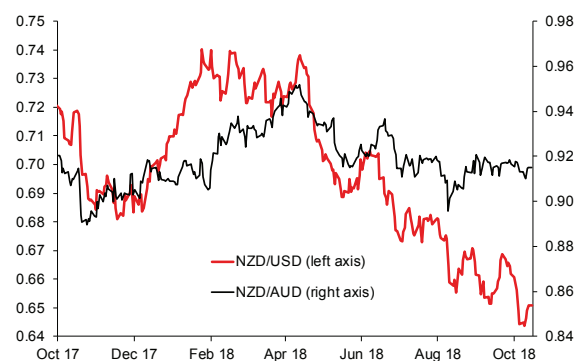
Economic Forecasts	Quarterly				Annual			
	2018			2019	2019			
% change	Jun (a)	Sep	Dec	Mar	2017	2018f	2019f	2020f
GDP (Production)	1.0	0.7	0.7	0.7	2.8	2.8	3.1	2.9
Employment	0.5	0.4	0.3	0.3	3.7	1.8	1.4	1.7
Unemployment Rate % s.a.	4.5	4.5	4.6	4.7	4.5	4.6	4.6	4.4
CPI	0.4	0.7	0.5	0.4	1.6	2.1	1.4	1.8
Current Account Balance % of GDP	-3.3	-3.5	-3.5	-3.2	-2.9	-3.5	-3.4	-2.9

Financial Forecasts	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.95	2.00	2.10
2 Year Swap	2.10	2.20	2.30	2.45	2.60	2.75
5 Year Swap	2.60	2.75	2.90	3.05	3.15	3.25
10 Year Bond	2.80	3.00	3.15	3.25	3.35	3.40
NZD/USD	0.66	0.65	0.64	0.64	0.65	0.65
NZD/AUD	0.92	0.92	0.91	0.91	0.90	0.90
NZD/JPY	75.2	74.1	72.3	71.7	72.8	72.2
NZD/EUR	0.57	0.57	0.57	0.56	0.56	0.55
NZD/GBP	0.52	0.53	0.52	0.52	0.53	0.53
TWI	72.4	71.6	70.6	70.4	70.8	70.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 15 October 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.82%	1.83%	1.82%
60 Days	1.86%	1.87%	1.85%
90 Days	1.89%	1.92%	1.89%
2 Year Swap	2.04%	2.04%	1.98%
5 Year Swap	2.41%	2.39%	2.31%

NZ foreign currency mid-rates as at 15 October 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6507	0.6624	0.6552
NZD/EUR	0.5630	0.5702	0.5636
NZD/GBP	0.4946	0.5079	0.5011
NZD/JPY	72.98	75.29	73.39
NZD/AUD	0.9149	0.9166	0.9152
TWI	71.36	72.21	71.49

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018f	2019f	2020f
Australia						
Real GDP % yr	2.5	2.6	2.2	3.3	2.7	2.8
CPI inflation % annual	1.7	1.5	1.9	1.7	1.8	1.6
Unemployment %	5.8	5.7	5.5	5.3	5.5	5.5
Current Account % GDP	-4.7	-3.1	-2.6	-2.5	-2.9	-3.8
United States						
Real GDP %yr	2.9	1.5	2.3	2.9	2.5	1.7
Consumer Prices %yr	0.1	1.4	2.1	2.5	2.0	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	1.4	0.9	1.7	1.1	0.8	0.7
Euro zone						
Real GDP %yr	2.1	1.8	2.5	2.0	1.5	1.5
United Kingdom						
Real GDP %yr	2.3	1.9	1.8	1.2	1.2	1.4
China						
Real GDP %yr	6.9	6.7	6.9	6.3	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	3.9	4.5	4.4	4.2	4.1
World						
Real GDP %yr	3.5	3.2	3.8	3.8	3.6	3.5

Forecasts finalised 5 October 2018

Interest Rate Forecasts	Latest	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	1.94	1.98	1.93	1.91	1.90	1.90	1.85	1.83
10 Year Bond	2.75	2.80	3.00	3.00	2.90	2.80	2.60	2.60
International								
Fed Funds	2.125	2.375	2.625	2.875	2.875	2.875	2.875	2.875
US 10 Year Bond	3.17	3.20	3.40	3.50	3.40	3.20	3.00	2.80
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	0.00	0.20

Exchange Rate Forecasts	Latest	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
AUD/USD	0.7122	0.72	0.71	0.70	0.70	0.72	0.74	0.75
USD/JPY	112.34	114	114	113	112	110	109	106
EUR/USD	1.1604	1.15	1.14	1.13	1.15	1.18	1.22	1.28
AUD/NZD	1.0924	1.09	1.09	1.09	1.09	1.11	1.12	1.10

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