



Bath House, Rotorua

Weekly Economic Commentary.

Cautiously positive.

Last week brought a grab-bag of data releases that were mostly on the positive side for the domestic economy, though with some lingering points of weakness. The Reserve Bank's six-monthly review of the financial system didn't offer up any surprises. The real highlight will be this Thursday's announcement on its proposed changes to bank capital requirements.

Kicking off last week was retail spending, which rose by 1.6% in the September quarter after a subdued 0.2% rise in the June quarter. The gains were widespread across store types, including strong gains in home furnishings and recreational goods. The pickup in spending was consistent with the recent firming in the housing market, which will have given households a little more confidence about opening up their wallets.

While the rise in retail spending was well above market forecasts, it was close to our own forecast and doesn't alter our view that overall GDP for the September quarter is likely to be soft. We expect that gains in retail, agriculture and construction will be largely offset by weakness in personal and business services and in manufacturing. We're expecting GDP growth of just 0.3% for the quarter, a forecast that we'll firm up as other sectoral indicators are released over the next two weeks.

As we noted in our latest quarterly *Economic Overview*, while we've marked down our expectations for September quarter GDP over the last few months, we've also become more confident that this will mark the low point for growth. The remainder of last week's data releases, all pertaining to the December quarter, have bolstered that view.

Residential building consents fell by 1.1% in October, meaning that they largely held on to their 7.4% jump in September. Over the past year just under 37,000 new dwellings were consented, the highest number since 1974. That points to a substantial pipeline of building work across the country, and we expect building activity to rise further over the coming year and through 2021.

Business confidence posted a solid gain in November, rising to its highest level in a year. Firms were feeling more positive about their own operations, and there was also a lift in



investment and hiring intentions. Confidence remains well down from its earlier highs, and has arguably been lower than what economic conditions would warrant. Nevertheless, it has proven to be a useful indicator of near-term GDP, and the latest reading supports our forecast that December quarter growth will be modestly stronger than September.

The one data release last week that struck a note of caution was Stats NZ's newly-launched monthly employment indicator. The new measure is drawn from tax data, giving it wider and more timely coverage compared to the existing quarterly household and employer surveys. Filled jobs fell by 0.4% in October, following a 0.3% fall in September. There is some inevitable choppiness in the monthly figures, but there has been a clear softening in the trend in recent months, which is consistent with the slowdown in job advertisements this year. We've been expecting unemployment to worsen in the near term, before stronger GDP growth sees it resume its downward path in 2021. The monthly indicator certainly suggests some softness to come in the next quarter or so.

You can take that to the bank.

As we expected, the Reserve Bank's latest six-monthly *Financial Stability Report* did not result in any changes to the loan-to-value ratio (LVR) restrictions on mortgage lending. With the renewed strength in the housing market in recent months on the back of lower mortgage rates, the RBNZ concluded that "it would not be appropriate to ease LVR restrictions further at this point".

The more significant event for the banking sector will come on Thursday, when the RBNZ reveals its final decisions on its review of bank capital requirements. This has been a long time coming – the initial proposal was released almost a year ago, and has been through a long process of consultation and review.

We expect that the heart of the original proposal will remain unchanged: an increase in the minimum level of capital that banks must hold from 8.5% to 16% of risk-weighted assets. That's the level that the RBNZ has judged to be enough to protect the banking system against a 1-in-200-year shock. Banks currently hold much more than the current minimum level of capital, but would still need a substantial further increase over the coming years.

Higher capital requirements would increase banks' overall cost of funding, which would be passed on to some extent as higher interest rates on lending, and ultimately a lower level of economic activity. Based on the initial proposal, we've estimated that lending rates would rise by about 50 basis points relative to the OCR, and the long-run level of GDP would be 1% lower than otherwise.

Importantly, we've already largely built this impact into our forecasts – though not fully, allowing for the possibility that the RBNZ softens some of the details of the proposal. In particular, the RBNZ has indicated that it will look at the length of the phase-in period (initially proposed to be five years for the major banks, and longer for the smaller banks), and whether it will accept less costly forms of capital such as bonds that are convertible to equity.

It's also important to note that, even if the impact on lending rates is as large as we've estimated, the long phase-in period means that it wouldn't necessarily require a monetary policy response in the near term. The RBNZ's most recent projections imply OCR hikes by 2022; we think the more likely response would be to keep the OCR low for longer, rather than a lower terminal point.

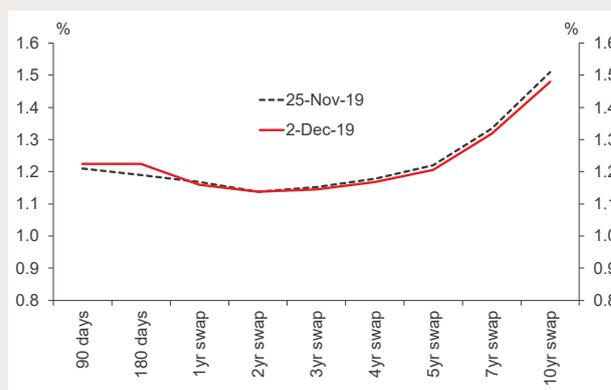
Fixed vs Floating for mortgages.

Now is a good time to take a fixed mortgage. Fixed mortgage rates have tumbled over the past six months, but they will not go lower any time soon because the Reserve Bank has paused its series of OCR reductions.

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



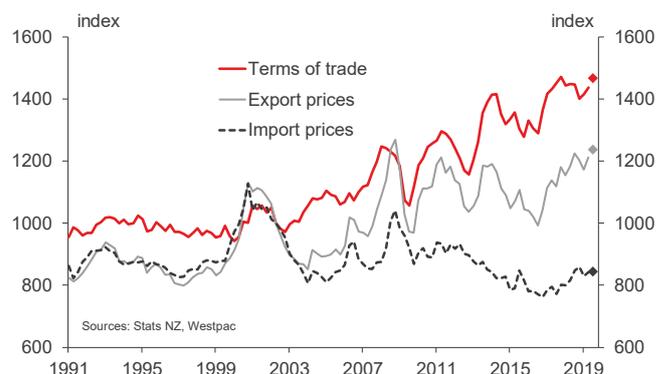
The week ahead.

NZ Q3 terms of trade

Dec 2, Last: +1.6%, WBC f/c: +2.0%

- We expect a 2% rise in New Zealand's terms of trade for the September quarter. That would bring them almost back to the all-time highs reached in 2017.
- Export prices rose by an estimated 2% for the quarter, with strong gains in dairy and meat prices on the back of Chinese demand. This was partly offset by a mid-year plunge in log export prices, though they have regained some ground in the last few months.
- We expect import prices to be flat. Oil prices fell a little, but a lower exchange rate is likely to have bumped up prices for other imported goods.

NZ terms of trade

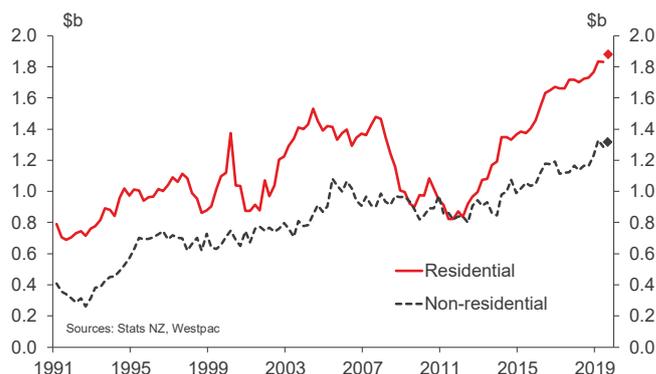


NZ Q3 building work put in place

Dec 5, Last: -1.5%, WBC f/c: +2.5%

- Total construction activity fell 1.5% in the June quarter. That fall was mainly due to a sharper than expected 3.4% fall in non-residential construction. Residential construction was essentially flat for the quarter.
- We're forecasting a 2.5% increase in total building activity in the September quarter, with gains spread across both the residential and non-residential components. Recent months have seen strong dwelling consent issuance. There's also likely to be a rebound in the 'lumpy' non-residential category after last quarter's unexpected weakness.
- The underlying trend in construction is expected to remain firm through the remainder of 2019 and 2020.

NZ real building work put in place

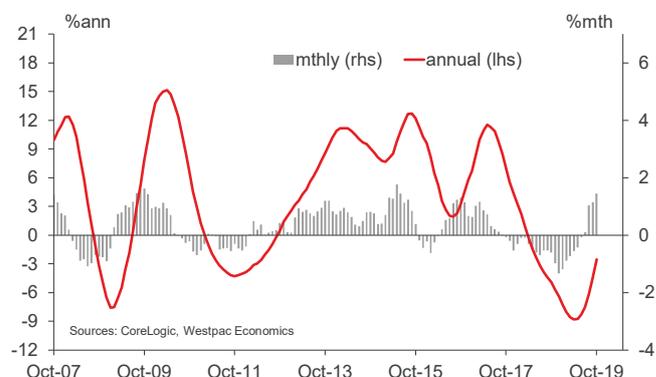


Aus Nov CoreLogic home value index

Dec 2, Last: 1.4%, WBC f/c: 1.8%

- After a material 10.7% correction over the previous two years, Australian dwelling prices have posted a clear recovery since mid-2019, prices rising 3.8% nationally over the four months to October, the pace accelerating month to month.
- The daily index shows a further pick up in November with the '5 capital city' measure tracking towards a 1.8% gain for the which would be the biggest since October 2003. Sydney is heading for a particularly strong 2.5% rise. The detail also suggests price momentum is quickening in Brisbane. The November result will lift annual growth out of negative for the first time since March 2018 with the national measure set for a 2.5% gain for the 2019 calendar year.

Australian dwelling prices



The week ahead.

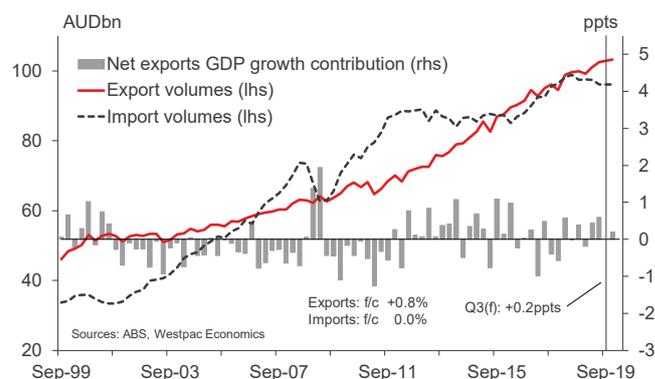
Aus Q3 net exports, ppt's cont'n

Dec 3, Last: 0.6, WBC f/c: 0.2

Mkt f/c: 0.1, Range: -0.1 to 0.3

- Net exports are adding to growth – a trend that extended into the second half of 2019.
- The export uptrend has resumed after stumbling in the second half of 2018, due to drought and mining supply disruptions. Imports are soft on weak domestic demand.
- For Q3, net exports are estimated to add 0.2ppts to growth.
- Export volumes rose by an estimated 0.8%, with resources and services up, more than offsetting further falls in rural and a pull-back in manufacturing after strong gains.
- Import volumes were broadly flat we estimate, constrained by weakness in capital goods and services (with the lower dollar making such imports more expensive).

Aus net exports



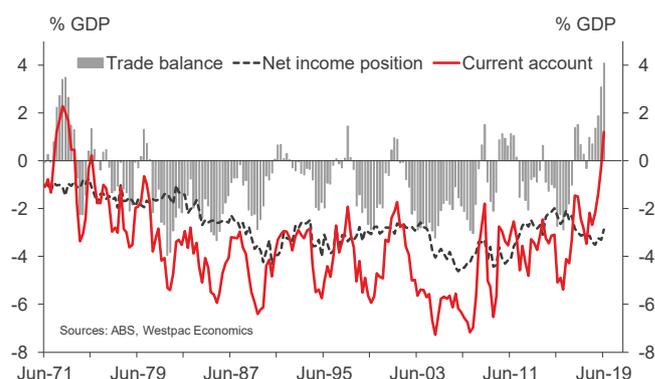
Aus Q3 current account, AUDbn

Dec 3, Last: +5.9, WBC f/c: +5.0

Mkt f/c: +6.1, Range: +4.0 to +7.8

- In the June quarter, the nation recorded the first current account surplus since June 1975! Now it is set to record back-to-back surpluses.
- In Q2, the current account deficit was \$5.9bn, including a trade surplus of \$19.9bn and a net income deficit of \$14.0bn.
- In Q3, the mix is a trade surplus widening to \$20.9bn and an expectation that the NID rebounds to \$15.9bn (unwinding the surprise dip in Q2).
- The trade surplus has improved on a higher terms of trade (up an estimated +0.5%) and a rise in real net exports.

Aus current account

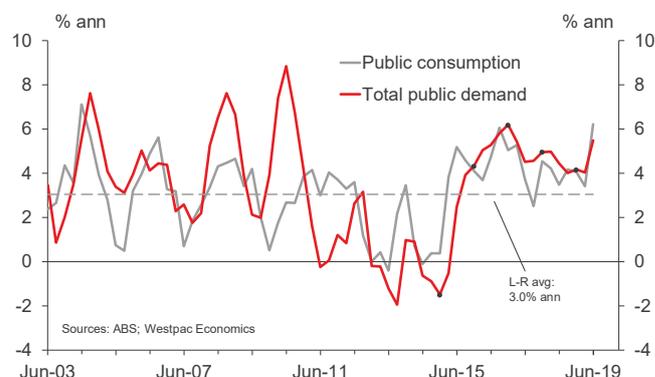


Aus Q3 public demand

Dec 3, Last: 1.4%, WBC f/c: 0.9%

- Public sector spending, in the form of public demand (directly accounting for a quarter of the economy) has been expanding at a brisk pace. It is a key growth driver and a key generator of jobs.
- Public demand grew by 1.4%qtr, 5.5%yr in Q2. Over the past year, this directly added 1.3ppts to activity (thereby accounting for almost all of the 1.4% increase in total output over the period).
- The focus is on health care (the introduction of the NDIS and the pharmaceutical benefit scheme) and on investment (including transport infrastructure).
- For Q3, we expect a solid rise of 0.9%, including a rebound in public construction work (up by 5.4%).

Aus public demand



The week ahead.

Aus Dec RBA policy decision

Dec 3, Last: 0.75%, WBC f/c: 0.75%
Mkt f/c: 0.75%, Range: 0.75% to 0.75%

- The Reserve Bank is in an easing cycle, lowering the cash rate in June, July, and October, taking the level down from 1.50% to 0.75%.
- This mirrors global developments as heightened uncertainty around international trade erodes business confidence and dents investment plans. The US FOMC and the RBNZ have also lowered policy rates by 75bps this year.
- The domestic backdrop is challenging. GDP in per capita terms has stalled and unemployment is rising. Real wages are flat, constraining consumer spending, and construction activity is in a cyclical downturn, led by housing.
- For now, the RBA has hit "pause" as the Board monitors the response to recently deployed stimulus.
- We expect further easing in 2020, with 25bp rate cuts in February and June, followed by QE in H2 2020.

RBA: Westpac forecast and market pricing

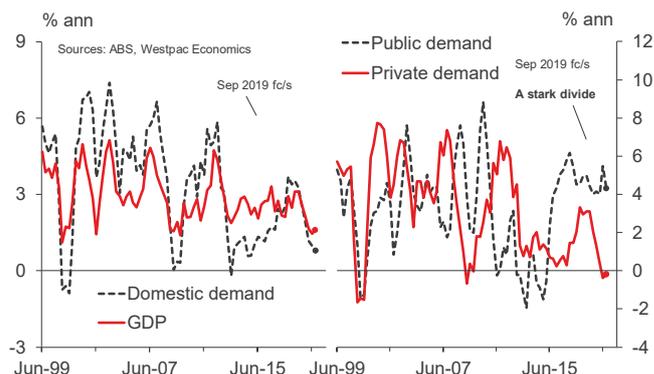


Aus Q3 GDP

Dec 4, Last: 0.5%qtr, 1.4%yr, WBC f/c: 0.6%qtr, 1.8%yr
Mkt f/c: 0.5%, Range: 0.3% to 0.6%

- The Australian economy has lost considerable momentum, with annual growth slowing from an above trend 3.1% in mid-2018 to 1.4% in mid-2019 – the slowest pace since 2009 Q3.
- Key dynamics are: cyclical weakness, centred on construction (notably housing, with lending standards tightened); structural headwinds around wages and productivity; and a slowing global economy.
- For Q3, we expect real GDP growth of 0.6%qtr, 1.8%yr.
- The arithmetic is: domestic demand, 0.2%; total inventories, +0.2ppts; and net exports, +0.2ppts.
- Domestic demand is weak on our figuring, at only 0.2%qtr, 0.8%yr. Private demand has stalled, at 0.0%qtr, -0.2%yr.

Australian economic conditions

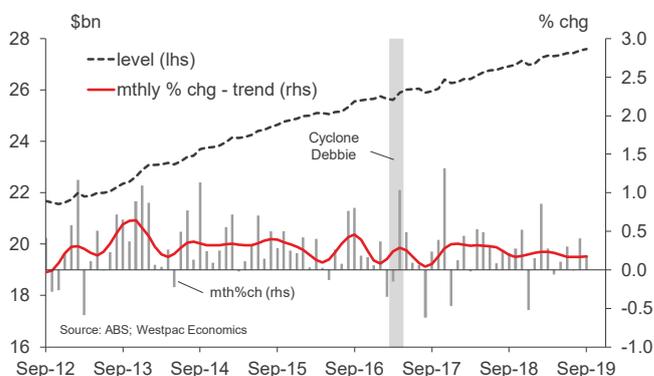


Aus Oct retail trade

Dec 5, Last: 0.2%, WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: -0.1% to 0.5%

- Retail sales rose 0.2% in September following a 0.4% gain in August. That's a slight improvement on the 0.1% average over April-July but a very disappointing result given the interest rate cuts in June-July and \$7.7bn in tax offset payments that started to go out from July (with retail sales running at \$28bn/mth, the results – 0.4% equates to \$110m – imply barely a sliver of this stimulus has been spent).
- Consumer and business surveys suggest there was little or no improvement in October – consumer sentiment falling sharply in the wake of the RBA's October rate cut and retailers reporting no improvement in business conditions in the month. While these measures are not good enough to give month to month point forecasts for sales and there is an outside chance that we start to see more of a policy boost show through, we expect the October sales result to again be on the disappointing side with a lacklustre 0.3% gain.

Aus monthly retail sales



The week ahead.

US Nov employment situation report

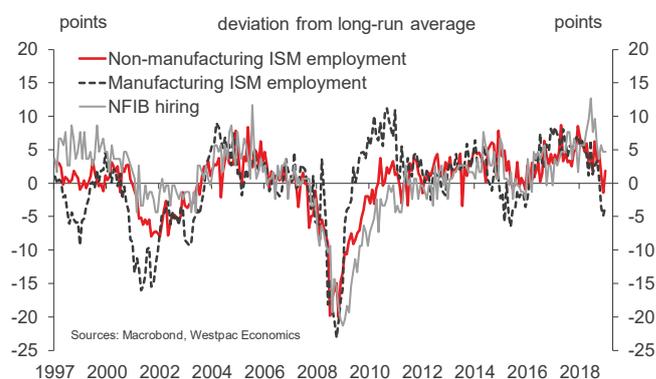
Dec 6, nonfarm payrolls last: 128k, WBC: 185k

Dec 6, unemployment rate last: 3.6%, WBC: 3.6%

Dec 6, hourly earnings growth last: 3.0%, WBC: 3.0%

- US employment growth has clearly slowed from 2018 to 2019. We expect this trend to persist as we head into 2020. That said, as GM workers return to work, a bounce in Nov to an above-average gain of 185k is anticipated.
- The unemployment rate is, in contrast, expected to remain unchanged at 3.6%. On a multi-month view, while we see employment growth slowing further, any rise in the unemployment rate should be marginal.
- An enduring absence of labour market slack is why we believe wages growth will remain sticky around 3.0%/yr, even as the heat comes out of employment growth. There is no reason for employers to bid-up wages aggressively, but equally no ability for them to force wages growth lower, with many an employment opportunity open to workers.

US hiring gauges

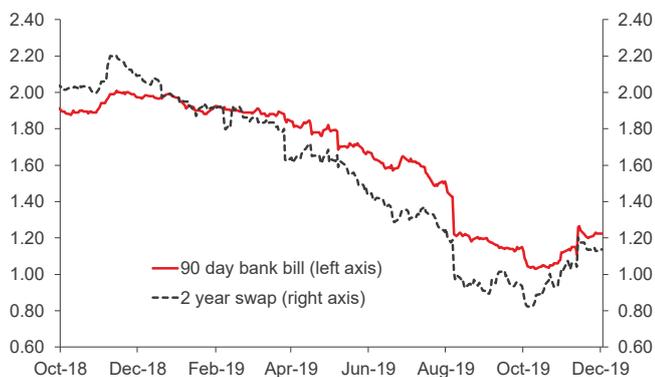


New Zealand forecasts.

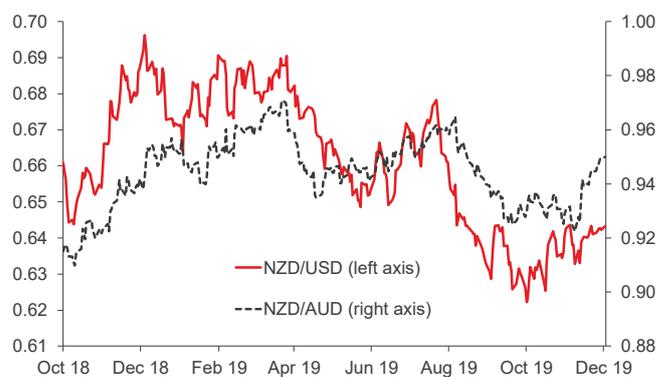
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019f	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	0.5	0.3	0.5	0.7	2.8	2.2	2.6	2.9
Employment	0.6	0.2	0.4	0.3	1.9	1.2	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.4	4.3	4.3	4.2	3.9
CPI	0.6	0.7	0.3	0.5	1.9	1.7	1.8	1.9
Current Account Balance % of GDP	-3.4	-3.3	-3.1	-3.0	-3.9	-3.1	-3.2	-3.6

Financial forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Cash	1.00	0.75	0.75	0.75	0.75	0.75
90 Day bill	1.10	0.90	0.90	0.90	0.90	0.90
2 Year Swap	1.10	1.00	1.00	1.00	1.00	1.00
5 Year Swap	1.20	1.10	1.15	1.20	1.25	1.30
10 Year Bond	1.30	1.20	1.20	1.20	1.25	1.35
NZD/USD	0.63	0.62	0.62	0.63	0.63	0.64
NZD/AUD	0.94	0.94	0.94	0.94	0.94	0.94
NZD/JPY	68.0	66.3	65.7	66.2	66.2	67.8
NZD/EUR	0.58	0.57	0.56	0.57	0.56	0.57
NZD/GBP	0.48	0.47	0.47	0.48	0.48	0.49
TWI	70.4	69.5	69.2	69.6	69.3	69.9

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 2 December 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.17%	1.23%	1.13%
60 Days	1.20%	1.24%	1.13%
90 Days	1.23%	1.24%	1.12%
2 Year Swap	1.14%	1.17%	1.02%
5 Year Swap	1.21%	1.24%	1.09%

NZ foreign currency mid-rates as at 2 December 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6432	0.6406	0.6427
NZD/EUR	0.5835	0.5795	0.5760
NZD/GBP	0.4985	0.4962	0.4974
NZD/JPY	70.45	69.71	69.59
NZD/AUD	0.9499	0.9401	0.9295
TWI	71.48	70.96	71.02

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 02					
NZ	Q3 terms of trade	1.6%	-	2.0%	Gains in dairy and meat export prices.
Aus	Oct dwelling approvals	7.6%	-1.0%	-2.0%	Downside risks to high-rise still dominate.
	Q3 company profits	4.5%	1.0%	-0.5%	Profits down: commodity prices slip, weak domestic sales.
	Q3 inventories	-0.9%	-0.2%	-0.5%	Down on weak demand. Adds 0.2ppts in Q3.
	Nov CoreLogic home value index	1.4%	-	1.8%	Prices growth picking up, turnover remains low.
	Nov AiG PMI	51.6	-	-	Manuf' conditions mixed, dented by housing downturn.
	Nov ANZ job ads	-1.0%	-	-	Fallen back to a January 2017 low.
Chn	Nov Caixin manufacturing PMI	51.7	-	-	Signs of stabilisation for manufacturing being seen.
Eur	Nov Markit manufacturing PMI final	46.6	-	-	Steadier in last few months.
	ECB President Lagarde speaks				Testimony to European Parliament.
UK	Nov Markit manufacturing PMI final	48.3	-	-	Small bounce was reversed.
US	Nov Markit manufacturing PMI final	52.2	-	-	US manufacturers better placed than most, but still at risk.
	Nov ISM manufacturing	48.3	49.5	-	Employment indexes to be watched closely for payrolls lead.
	Oct construction spending	0.5%	0.4%	-	Business investment remains weak.
Tue 03					
Aus	Q3 net exports, ppts cont'n	0.6	0.1	0.2	Export uptrend continues and imports flat.
	Q3 current account, \$bn	5.9	6.1	5.0	Back-to-back surpluses. Trade surplus at record highs.
	Q3 public demand	1.4%	-	0.9%	A key growth driver - focus on health and investment.
	RBA policy decision	0.75%	0.75%	0.75%	Temporary pause, monitoring impact of the three rate cuts.
Wed 04					
NZ	GlobalDairyTrade auction	1.7%	-	-	Futures prices flat since last auction.
	Nov ANZ commodity prices	1.2%	-	3.0%	Dairy, meat prices surged on Chinese demand.
Aus	Nov AiG PSI	54.2	-	-	Services index volatile around soft trend, +2.7pts in Oct.
	Q3 GDP	0.5%	0.5%	0.6%	Arithmetic is: domestic demand 0.2%; inventories +0.2ppts...
	Q3 GDP, %yr	1.4%	1.6%	1.8%	... and net exports +0.2ppts. Growth weak and uneven.
Chn	Nov Caixin China PMI services	51.1	-	-	Weak employment prospects impacting services.
Eur	Nov Markit services PMI final	51.5	-	-	Starting to soften, gap closing with manufacturing.
UK	Nov Markit services PMI final	48.6	-	-	Weaker Nov brings Composite into contraction.
US	Nov ADP employment change	125k	140k	150k	Trend moderation in employment apparent.
	Nov Markit services PMI final	51.6	-	-	Services continue to receive support from consumer.
	Nov ISM non-manufacturing	54.7	54.5	-	Employment indexes to be watched closely for payrolls lead.
	Fedspeak	-	-	-	Quarles on regulation to Congress.
Thu 05					
NZ	Q3 building work put in place	-1.5%	-	2.5%	Bounce back in commercial and strength in residential.
	RBNZ bank capital announcement	-	-	-	We expect little change from the initial proposal.
Aus	Oct retail sales	0.2%	0.3%	0.3%	Another lacklustre month of sales expected.
	Oct trade balance, \$bn	7.2	6.5	6.3	Surplus in descent from record high, exports lower, -2.8%.
Eur	Q3 GDP 3rd estimate	0.2%	0.2%	-	Annual pace holding at 1.2%/yr.
US	Initial jobless claims	213k	-	-	Very low. No signs of material increase in firing.
	Oct trade balance US\$bn	-52.5	-48.9	-	A trade deal is unlikely to materially affect deficit.
	Oct factory orders	-0.6%	0.1%	-	Durable goods orders surprised to upside on first estimate.
Fri 06					
Aus	Nov AiG PCI	43.9	-	-	Construction in cyclical downturn - led by home building.
US	Nov non-farm payrolls	128k	190k	185k	GM workers return to see payrolls bounce in Nov...
	Nov unemployment rate	3.6%	3.6%	3.6%	... but the unemployment rate will remain unchanged...
	Nov average hourly earnings %yr	3.0%	3.0%	3.0%	... as will wages growth.
	Oct wholesale inventories	0.2%	-	-	Likely to be a drag on growth hence.
	Dec Uni. of Michigan sentiment	96.8	97.0	-	Still above average, albeit off highs.

International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
Australia						
Real GDP % yr	2.8	2.4	2.7	1.8	2.4	2.7
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	0.2	0.4
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	1.1
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	3.7	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.0	3.0	3.2

Forecasts finalised 8 November 2019

Interest rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	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	0.85	0.70	0.45	0.45	0.45	0.50	0.50
10 Year Bond	1.02	0.95	0.90	0.90	0.90	0.90	1.00	1.20
International								
Fed Funds	1.625	1.625	1.375	1.125	0.875	0.875	0.875	0.875
US 10 Year Bond	1.77	1.70	1.50	1.45	1.40	1.50	1.60	1.80
ECB Deposit Rate	-0.50	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60

Exchange rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Jun-21	Dec-21
AUD/USD	0.6768	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	109.48	108	107	106	105	105	107	109
EUR/USD	1.1009	1.09	1.09	1.10	1.11	1.12	1.14	1.15
GBP/USD	1.2909	1.30	1.33	1.32	1.32	1.31	1.31	1.32
USD/CNY	7.0325	7.10	7.10	7.05	6.95	6.90	6.75	6.60
AUD/NZD	1.0540	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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

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