

# Weekly Commentary

26 March 2018



## Start of a new era

This week marks the start of a new era at the Reserve Bank. Along with a change in the Governor, the latest Policy Targets Agreement has widened the RBNZ's policy focus to include labour market conditions. Going forward, changes in the RBNZ's governance structure are also on the cards.

### The RBNZ left the OCR on hold at the February meeting

Last week's Reserve Bank Official Cash Rate review was largely a paint-by-numbers affair. Governor Spencer, in his last turn at bat, left the OCR on hold at 1.75%. The forward guidance paragraph was also unchanged, with the RBNZ reiterating that *"Monetary policy will remain accommodative for a considerable period. Numerous uncertainties remain and policy may need to adjust accordingly."*

There's been very little to shift the RBNZ from the position it's held in recent years. Inflation is below target, and the RBNZ expects it to slow further over the coming year. Against this backdrop, the Reserve Bank has signalled it expects to keep the OCR at its current low level until mid- to late-2019. Combined with expansionary fiscal policy, this is expected to produce accelerating economic growth and, in time, higher inflation.

Our forecasts for the economy are a bit different from the RBNZ's. In particular, we doubt that growth will accelerate this year due to softening housing market conditions. However, we also expect a lower NZ dollar, leaving us with a forecast for inflation that is only slightly weaker than the RBNZ's. On balance, we think there is slightly less need to hike the OCR than the RBNZ is projecting, but the difference is minor (we don't expect a rate hike until the final quarter of 2019).

The main point is that both we and the RBNZ are much more dovish than current financial market pricing – comfortably so, in both cases. Financial markets have priced in a 50% chance of a hike by February. But given the lingering softness in inflation and softening momentum in growth, that still seems too soon to us.

The details of the RBNZ's policy statement provided few surprises, except that there was no mention of the New Zealand dollar. The RBNZ had previously expressed discomfort with the degree of market attention paid to its exchange rate commentary, with minor wording differences causing the New Zealand dollar to jump up or down unnecessarily in the immediate aftermath of every monetary policy missive. This time around, however, the exchange rate has traded very much in line with the RBNZ's previous forecast, and is at a level that they are comfortable with. This handed the RBNZ what we suspect was a welcome opportunity to reduce the focus on the exchange rate.

### Changes to the RBNZ's policy targets and governance

The review of the OCR was really the warm up act for this main event on the monetary policy stage. The Minister of Finance and the Reserve Bank today released the Policy Targets Agreement under which Governor designate Adrian Orr will operate. They also issued a press release detailing progress towards Phase One of reform to the Reserve Bank Act.

# Start of a new era... continued

The key points announced were:

**The RBNZ will continue to target 1% to 3% inflation, with a focus on keeping future inflation near the two percent midpoint.** Retaining the two percent midpoint was not guaranteed, and was important. Removal might have signalled higher average inflation in the future.

**The RBNZ's policy targets have been expanded to include a focus on employment, as well as price stability.** This change had been well signalled. Employment is mentioned three times in the new PTA. The conduct of monetary policy must contribute to supporting maximum sustainable employment; monetary policy must avoid unnecessary instability in employment; and the RBNZ must explain how it is contributing to supporting maximum sustainable employment. The way this is worded allows for the RBNZ to symmetrically target some natural level of employment – that is, it allows for the RBNZ to raise interest rates because the labour market is overheating, as well as to lower interest rates when the labour market is slack. The wording also allows for the fact that the best long-term contribution monetary policy can make to employment levels is to maintain low and stable inflation. It is not obvious to us that the RBNZ will implement OCR settings much differently under this wording, although its communication and analytical methods might pivot towards the labour market.

**The reference to monitoring asset prices has been removed from the PTA.** This surprised us. Our first impression is that it reinforces the separation between monetary policy and financial stability. This reflects what the RBNZ already does – for example, the OCR and LVRs have gone in opposite directions in recent years.

**The RBNZ will shift to a committee of five to seven members in 2019, with a majority of RBNZ internal members and a minority of external members.** There will also be a non-voting Treasury observer. Members will be appointed by the Minister of Finance on the recommendation of the Board for four-year terms. This will be a voting committee, with non-attributed votes published and non-attributed records of the meetings published. The Governor will chair the committee, and will be its sole spokesperson. A Monetary Policy Committee Charter agreed between the MPC and the Minister of Finance will replace the Policy Targets Agreement.

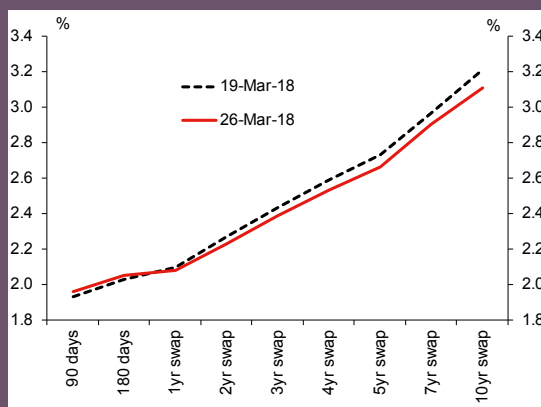
This is not the final word. Today's PTA was only a "bridge in the direction" of giving the RBNZ a dual mandate of both employment and inflation. There is still a possibility of further change when the new RBNZ Act is brought in, although there was no hint that any further change would alter the flavour of what has been released today.

## Fixed vs Floating for mortgages

For borrowers with a deposit of 20% or more, the best value lies in the two-year rate or shorter fixed terms. Three-to-five-year rates seem high relative to where we think short-term rates are going to go over that time. Some lending and deposit rates have been falling recently, so it may be worth waiting to see if there are further modest reductions in fixed-term rates.

Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates such as the six-month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

NZ interest rates



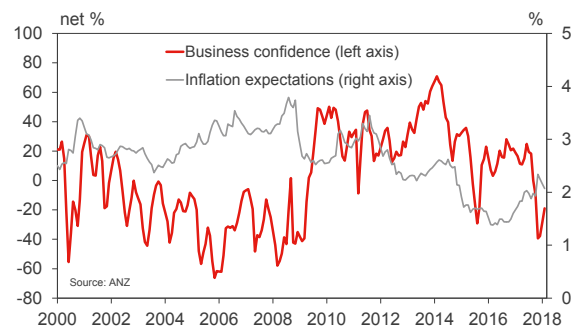
# The week ahead

## NZ Mar ANZ business confidence

Mar 28, Last: -19.0

- General business confidence rose in February, unwinding some of its sharp fall after the formation of the new centre-left Government. However, confidence remained below its long-term average, and there was little improvement in the own-activity outlook.
- We have no particular leaning as to where the March survey will go. The economic and political backdrop has generally been steady over the last month. The survey will have largely predated the release of the weaker than expected GDP figures for the December quarter.
- Inflation expectations for the year ahead fell in February, after the softer than expected December quarter CPI. This measure generally doesn't change much outside of CPI releases.

## NZ business confidence and inflation expectations



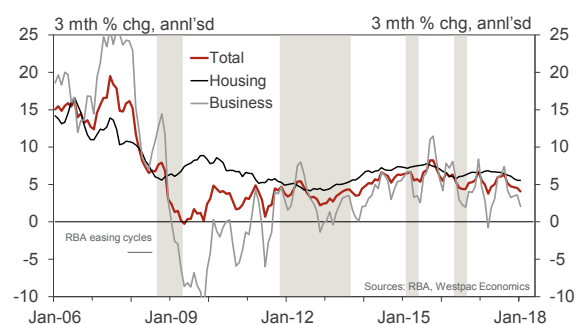
## Aus Feb private credit

Mar 29, Last: 0.3%, WBC f/c: 0.4%

Mkt f/c: 0.3%, Range: 0.3% to 0.5%

- Credit to the private sector is expanding at a modest pace as the housing sector cools. In 2017, credit grew by 4.9%, slowing from 5.6% for 2016, with a Q4 average of 0.4% per month. The January outcome was a 0.3%, 4.9%/yr. For February, we anticipate a rise of 0.4%. Housing credit, at this late stage of the cycle, is slowing in response to tighter lending conditions. The 3 month annualised pace is 5.6% currently, down from 6.8% in March. In January, housing credit grew by 0.48%, 6.2%/yr. Business credit is volatile month to month around a modest upward trend, up 3.4%/yr, as businesses expand investment in the real economy. December and January saw a temporary consolidation, with prints of +0.1% and -0.1%. For February, we anticipate an outcome more in line with the recent average of 0.3%.

## Credit: housing slowdown underway

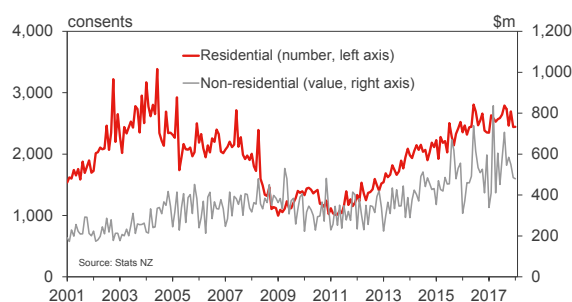


## NZ Feb residential building consents

Mar 29, Last: -0.2%, WBC f/c: 1%

- After some volatility in recent months, we expect consent issuance to return to trend in February, and are forecasting a modest 1% rise over the month.
- The key thing to watch will be the regional breakdown. Issuance in Auckland is expected to have remain firmed, underpinned by strong population growth and increasing housing market tightness. At the same time, dwelling consent numbers in Canterbury are likely to remain low for some time.
- The greater uncertainty, however, is what's happening in other regions. Despite positive housing market conditions and firm population growth, consent issuance in regions outside of Auckland and Canterbury has been easing off in recent months. We'll be watching to see if this continued through February.

## NZ building consents



## US Feb PCE report

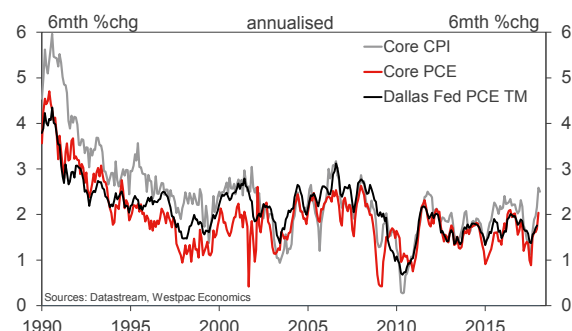
Mar 29, personal income, last 0.4%, WBC 0.3%

Mar 29, personal spending, last 0.2%, WBC 0.2%

Mar 29, personal deflator, last 0.2%, WBC 0.2%

- The PCE report provides a broad snapshot of the consumer each month, their income; spending and the prices they pay. For income, the Jan outcome was robust, with solid underlying wages growth and an additional boost coming from December's tax cuts. Come Feb, the initial boost from lower taxes should recede; however, in the months to come, further indirect gains should be seen. At this stage, the boost to incomes is yet to flow through to spending. This was apparent in the below-expectations retail sales print for Feb, which followed weak outcomes in Dec and Jan. Another subdued gain is expected in Feb. On inflation, food and energy prices are expected to be neutral in Feb. Core and headline prices are to rise 1.6%/1.7%/yr.

## Core inflation tending toward target



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 26</b>					
<b>NZ</b>	RBNZ Policy Targets Agreement	-	-	-	New PTA, along with the review of monetary policy.
	Feb trade balance, \$m	-566	-100	100	Assuming 'normal' month after volatility in export volumes.
<b>Eur</b>	ECB Weidmann speaks	-	-	-	On "New Momentum in Europe".
<b>US</b>	Feb Chicago Fed activity index	0.12	-	-	Has eased back since October peak.
	Mar Dallas Fed index	37.2	33.0	-	Still very strong.
	Fedspeak	-	-	-	Dudley on future of financial regulation.
<b>Tue 27</b>					
<b>NZ</b>	RBNZ Governor	-	-	-	Adrian Orr begins term as Governor.
<b>Eur</b>	Feb M3 money supply %yr	4.6%	4.6%	-	Credit data also due.
	Mar economic confidence	114.1	113.2	-	Confidence strong across the continent...
	Mar business climate indicator	1.48	1.41	-	... through all business sectors...
	Mar consumer confidence final	0.1	0.1	-	... and amongst households.
<b>US</b>	Jan S&P/CS home price index %yr	6.27%	-	-	Continue to rise at robust annual pace despite rates.
	Mar Richmond Fed index	28	21	-	Remains very positive.
	Mar consumer confidence index	130.8	131.0	-	Labour market key for consumer confidence.
	Fedspeak	-	-	-	Mester on policy, Quarles & Bostic at economics conference.
<b>Wed 28</b>					
<b>NZ</b>	Mar ANZ business confidence	-19.0	-	-	Recovered some of its post-election plunge, but still low.
<b>Chn</b>	PBOC deputy governor speaks	-	-	-	Gongsheng regulatory address - China DCM Summit (TBC).
<b>UK</b>	Mar Nationwide house prices	-0.3%	-	-	Tentative date. Uncertainty continuing to weigh on demand.
	Mar GfK consumer confidence	-10	-10	-	Confidence remains well below pre-referendum levels.
<b>US</b>	Feb wholesale inventories	0.8%	-	-	A wild card positive for Q1 2018.
	Q4 GDP 3rd estimate	2.5%	2.7%	2.7%	Slight upward revision, but focus now on 2018 Q1.
	Feb pending home sales	-4.7%	2.0%	-	A lead for existing sales; volumes very low.
	Fedspeak	-	-	-	Bostic to finance professionals in Atlanta.
<b>Thu 29</b>					
<b>NZ</b>	Feb building consents	0.2%	-	1.0%	Strong activity, but constraints limiting rate of increase.
<b>Aus</b>	Feb private sector credit	0.3%	0.3%	0.4%	Housing slowing, business volatile around modest uptrend.
<b>Chn</b>	Q4 current account balance final bn	62.2	-	-	Very dated data, but great detail.
<b>UK</b>	Feb net lending sec. on dwellings, £bn	1.4	-	-	The slowdown in the housing market...
	Feb mortgage approvals	67.5k	66.0k	-	...has seen credit growth flatten over the past year.
	Q4 current account balance, £bn	-22.8	-23.5	-	Improved export conditions flattering the external accounts.
	Q4 GDP (final)	0.4%	0.4%	0.4%	Rise in investment has offset the drag from trade.
<b>US</b>	Feb personal income	0.4%	0.4%	0.3%	Uptrend in incomes to persist; tax benefitting too.
	Feb personal spending	0.2%	0.2%	0.2%	Spending restricted by low savings.
	Feb PCE deflator	0.4%	0.2%	0.2%	Core price also likely to rise 0.2% in month.
	Initial jobless claims	229k	-	-	At historic lows.
	Mar Uni. of Michigan sentiment final	102.0	102.0	-	Labour market key for consumer confidence.
	Fedspeak	-	-	-	Harker on the economic outlook.
<b>Fri 30</b>					
<b>Aus, NZ</b>	Good Friday	-	-	-	Public holiday.
<b>US</b>	Mar Chicago PMI	61.9	61.5	-	Very strong signs for region.

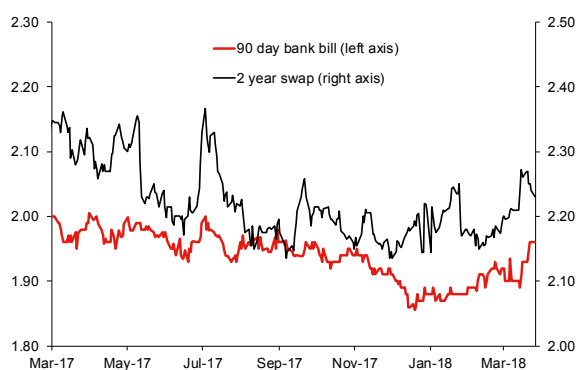
# New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2017	2018			Calendar years			
% change	Dec(a)	Mar	Jun	Sep	2016	2017	2018f	2019f
GDP (Production)	0.6	0.6	0.6	0.7	4.0	2.9	2.7	3.0
Employment	0.5	0.4	0.4	0.4	5.8	3.7	1.4	1.0
Unemployment Rate % s.a.	4.5	4.4	4.4	4.4	5.3	4.5	4.5	4.7
CPI	0.1	0.5	0.4	0.6	1.3	1.6	1.7	1.5
Current Account Balance % of GDP	-2.7	-2.2	-2.3	-2.5	-2.2	-2.7	-2.4	-2.7

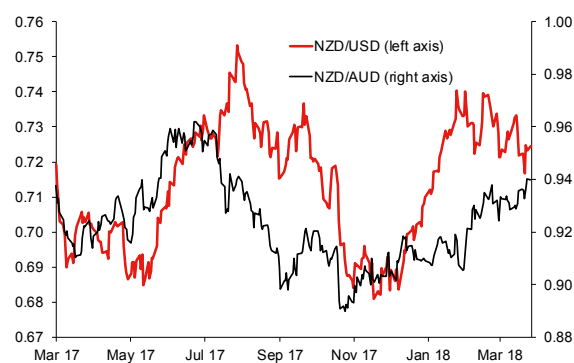
<sup>1</sup> Annual average % change

Financial Forecasts	Jun-18	Sep-18	Dec-18	Mar-18	Jun-19	Sep-19
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.90	1.90	2.05
2 Year Swap	2.10	2.20	2.30	2.40	2.55	2.70
5 Year Swap	2.70	2.80	2.95	3.10	3.20	3.30
10 Year Bond	3.00	3.10	3.30	3.40	3.45	3.50
NZD/USD	0.70	0.69	0.67	0.65	0.64	0.64
NZD/AUD	0.91	0.91	0.91	0.90	0.90	0.91
NZD/JPY	76.3	75.9	74.4	72.8	71.0	70.4
NZD/EUR	0.57	0.57	0.55	0.55	0.53	0.52
NZD/GBP	0.54	0.54	0.55	0.55	0.53	0.53
TWI	72.6	72.2	70.8	69.4	68.6	68.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 26 March 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.86%	1.78%	1.79%
60 Days	1.91%	1.84%	1.87%
90 Days	1.96%	1.90%	1.99%
2 Year Swap	2.23%	2.22%	2.18%
5 Year Swap	2.66%	2.75%	2.70%

NZ foreign currency mid-rates as at 26 March 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7237	0.7295	0.7292
NZD/EUR	0.5860	0.5926	0.5934
NZD/GBP	0.5119	0.5265	0.5216
NZD/JPY	75.73	77.91	77.94
NZD/AUD	0.9395	0.9290	0.9304
TWI	74.71	75.06	75.10

# International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
<b>Australia</b>						
Real GDP % yr	2.6	2.5	2.6	2.3	2.7	2.5
CPI inflation % annual	1.7	1.7	1.5	1.9	2.1	1.9
Unemployment %	6.2	5.8	5.7	5.5	5.4	5.5
Current Account % GDP	-3.0	-4.7	-3.1	-2.3	-2.2	-3.4
<b>United States</b>						
Real GDP %yr	2.6	2.9	1.5	2.3	3.0	2.5
Consumer Prices %yr	1.6	0.1	1.3	2.1	2.3	2.1
Unemployment Rate %	6.2	5.3	4.9	4.4	4.0	3.7
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
<b>Japan</b>						
Real GDP %yr	0.3	1.1	1.0	1.5	1.3	1.0
<b>Euroland</b>						
Real GDP %yr	1.3	2.0	1.8	2.4	2.1	1.6
<b>United Kingdom</b>						
Real GDP %yr	3.1	2.2	1.8	1.7	1.6	1.6
<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	4.3	4.3
<b>World</b>						
Real GDP %yr	3.6	3.4	3.2	3.8	3.9	3.7

Forecasts finalised 14 March 2018

Interest Rate Forecasts	Latest	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
<b>Australia</b>								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.94	1.84	1.83	1.82	1.81	1.80	1.78	1.78
10 Year Bond	2.70	2.80	2.95	3.15	3.20	3.10	3.20	3.15
<b>International</b>								
Fed Funds	1.375	1.875	2.125	2.125	2.375	2.625	2.625	2.625
US 10 Year Bond	2.83	2.90	3.10	3.35	3.50	3.40	3.40	3.30
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.20	0.00	0.00	0.00

Exchange Rate Forecasts	Latest	Jun-18	Sep-18	Dec-18	Mar-18	Jun-19	Sep-19	Dec-19
AUD/USD	0.7800	0.77	0.76	0.74	0.72	0.71	0.70	0.70
USD/JPY	106.30	109	110	111	112	111	110	110
EUR/USD	1.2306	1.23	1.22	1.21	1.19	1.21	1.23	1.26
AUD/NZD	1.0715	1.10	1.10	1.10	1.11	1.11	1.09	1.08

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