Weekly Commentary

27 May 2019

Hundertwasser Toilets, Kawakawa

Game changer

The New Zealand economy lost some momentum in the second half of last year, and looks to have remained subdued in the early part of this year. But our latest quarterly *Economic Overview* highlights that some change is already on the way. Lower interest rates will help to boost the housing market and spur consumer demand. Combined with the already-planned fiscal stimulus, we expect this to lift growth above 3% again in 2020.

New Zealand's GDP growth has slowed from a peak of 4% in 2016 to around 2.5% today. Initially, the slowdown was led by consumers reacting to a cooling housing market. House price inflation peaked at 15% in 2016, but has since slowed to around 2% nationwide, largely due to a flattening off in prices in Auckland and Canterbury. The pace of growth in household spending has accordingly slowed from its peaks, though it continues to be supported by household income growth via rising employment and wages.

In more recent times the slowdown has become business-led. Surveys of business confidence have been sharply weaker since the change of government in late 2017, but only recently have there been signs of this manifesting in business decisions. Even though firms are citing capacity constraints and difficulty in finding workers, growth in business investment has been sluggish and private sector job advertisements have flattened off.

No doubt some of this grumpiness relates to dissatisfaction with Government policies that have added to business costs, such as minimum wage increases, changes to employment law, and increased regulatory requirements. But an equally important aspect is that firms are not confident about their ability to pass on these cost increases. Technology changes and international competition have put more power in the hands of consumers, and moreover, demand isn't expanding quickly enough for firms to be able to justify price rises. As a result, firms are seeing a squeeze on their profitability and are scaling back their expansion plans accordingly.

The factors that have weighed on growth recently are likely to stick around for a while yet. Nevertheless, we think that the mix of government policy will support a lift in growth over the next couple of years.

The first factor is a significant shift in the stance of monetary policy. The subdued growth and competitive pressures that have weighed on business confidence have also led to persistently low inflation. Consumer prices rose 1.5% in the year to March, putting it within the lower half of the Reserve Bank's 1-3% target range. In fact, aside from some short-term volatility in fuel prices, inflation has remained below the 2% midpoint for seven years running.

For some time the RBNZ has been forecasting that an extended period of low interest rates would boost growth, increase capacity pressures and bring inflation towards the 2% midpoint. But by May it had decided that more stimulus would be needed to achieve this, and it reduced the OCR to a new record low of 1.50%. That's led to a sharp drop in fixed-term mortgage rates in recent months, and history suggests that this will have a powerful impact on the housing market.

The other major development for the housing market is that in April the Government announced that will it not proceed with its proposal for a capital gains tax, and the Labour Party said

Game changer

it will not campaign on introducing one for the foreseeable future. In our previous forecasts we had assumed that a CGT would be introduced in some form, if not the full-blooded version that was proposed. Ruling it out it altogether was a major surprise, and combined with the impact of lower interest rates, we are now expecting a 7% lift in house prices in 2020.

Scrapping the proposed CGT – which would have covered business assets as well as investment properties – could also go some way towards lifting the malaise among businesses, though this was far from the only concern on their minds. Wednesday's business confidence survey, the first one since the CGT announcement, will shed some light on the matter.

We are also expecting fiscal policy to support GDP growth over the coming year. Last year's Budget incorporated a substantial lift in spending on public services, an increase in transfers to low-income households, and plans for a substantial ramp-up in capital spending over the next few years. Fiscal stimulus is certainly not a new part of our economic forecasts, but we think that a significant part of its impact is yet to be felt.

The 2019 Budget, to be unveiled on Thursday, will confirm that the planned fiscal boost is on track. That's despite a weaker than expected starting point for the economy, which will reduce projected tax revenues over the coming years. We expect that will result in smaller projected surpluses and a higher borrowing requirement, rather than any belt-tightening on the expenditure side.

The Government has said that this Budget will comply with its self-imposed fiscal responsibility rules, which include reducing net core Crown debt to 20% of GDP within five years of taking office (ending in 2022). However, the Finance Minister announced last week that beyond 2022 the Government will target a range of 15 to 25% of GDP, providing additional breathing space in the event of a recession, or if the Government sees opportunities for investment. Given that governments will always see opportunities for investment, in practice it's likely that 25% of GDP will become a debt ceiling, with the lower end of the range rendered irrelevant.

The announcement itself came as a surprise, but it felt somewhat inevitable. While the Government had not previously made any commitments beyond 2022, the Treasury's longer-term projections had shown net debt falling even further below 20% of GDP in later years, based on current tax and spending plans. There would have been little political advantage in continuing with such restraint, given the ongoing demands on the public purse. Our forecasts already assumed some increase in the Government's spending allowances beyond what had already been announced; last week's decision provides even more scope to do so.

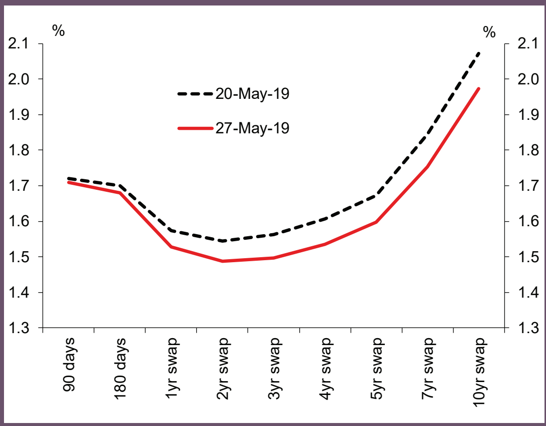
Fixed vs Floating for mortgages

We expect floating and one-year fixed mortgage rates to be fairly stable at current levels over the year ahead, then to gradually rise in subsequent years.

Based on that expectation, we regard today's three-year rates at the best value on offer. One- and two-year rates are also fairly good value, with neither particularly preferred to the other. Four- and five-year fixed rates are a little higher than where we expect shorter-term rates to go over the relevant timeframe, but they do offer the borrower certainty. Floating mortgage rates are expensive for borrowers, but they may be the preferred option for those who require flexibility in their repayments.

The big uncertainty is what the Reserve Bank does with the OCR. Our views are based on the Reserve Bank keeping the OCR at 1.5% for the foreseeable future. If they instead cut the OCR, floating and one-year fixed rates could fall.

NZ interest rates



The week ahead

NZ May ANZ Business confidence

May 29, Last -37.5

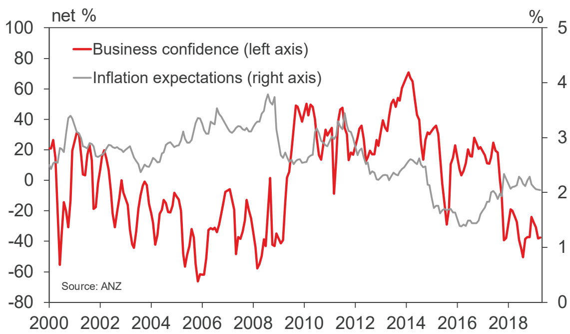
- The May business confidence survey will give us our first gauge of how business confidence has responded to the Government's surprise announcement that it will not be pushing ahead with any form of capital gains tax.
- This is likely to see an improvement in headline confidence. However, the impact on other components of the survey such as investment intentions is less clear.
- Pricing intentions and expected inflation have been relatively stable of late.

NZ Apr dwelling consents

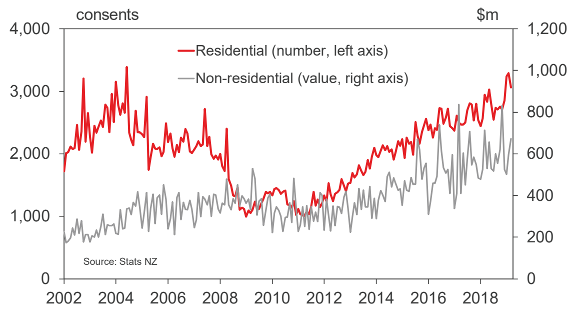
May 30, Last: -6.9%, WBC f/c: -2%

- Residential dwelling consent issuance fell by 6.9% in March. That followed a strong lift earlier in the year and left annual consent issuance at multi-decade highs. While much of this strength has been centred on Auckland, consent issuance has also been strong in many other regions.
- With at least some of the recent strength in consents related to lumpy categories like apartments, we expect a 2% pullback in April. That would still leave the annual level of issuance around multi-decade highs.

NZ business confidence and inflation expectations



NZ building consents

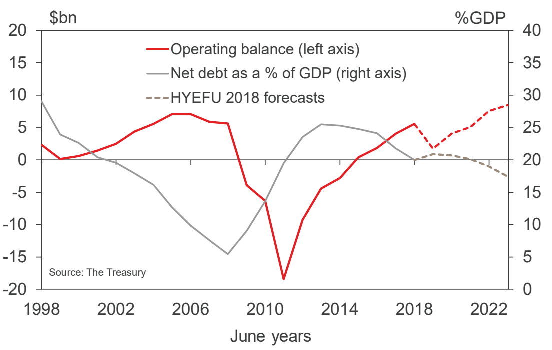


NZ Budget 2019

May 30

- The long awaited "Wellbeing Budget" will be delivered next week. The accompanying array of Budget documents will cover a much broader range of topics than usual.
- The fiscal accounts are likely to show the Government is running out of wiggle room. The weaker than expected starting point for the economy will be weighing on the Treasury's revenue projections, and the recent run of surprisingly strong tax revenues has come to an end.
- We expect little additional spending to be announced in next week's Budget although we could see some reprioritisation of spending. Despite this, the Government is still likely to need to borrow a bit more. Beyond 2021/22 the Government has given itself some extra headroom by softening its net debt to GDP target. That could leave room for more of a spend-up in future years.

NZ fiscal position

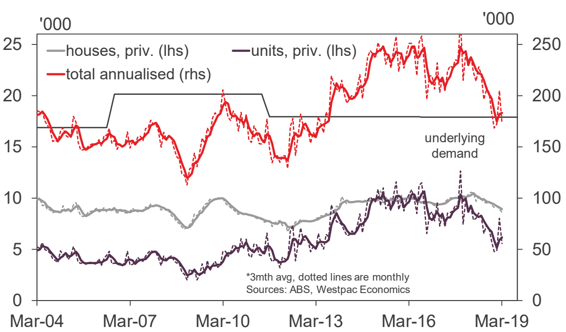


Aus Apr dwelling approvals

May 30, Last: –15.5%, WBC f/c: –1.0%
Mkt f/c: flat, Range: -5.0% to 8.0%

- Dwelling approvals have been volatile in recent months, a spike in high rise approvals producing a 19.1% jump in Feb that mostly unwound in March with a 15.5% drop. The underlying trend elsewhere has been weak, non high rise approvals down about 2% March following a 4% fall in Feb.
- For the Apr update, high rise approvals still look to retrace further, the March level still well above the average over the last few months (excluding the Feb spike). Construction-related finance approvals have been a touch firmer in recent months suggesting weakness in non high rise segments should diminish. Overall, we expect a modest 1% decline in total dwelling approvals for Apr. Note that the timing of Easter and its close proximity to the ANZAC day public holiday might cause some volatility.

Australian dwelling approvals



The week ahead

Aus Q4 private business capex

May 30, Last: +2.0%, WBC f/c: +0.2%
Mkt f/c: 0.5%, Range: -0.5% to 2.7%

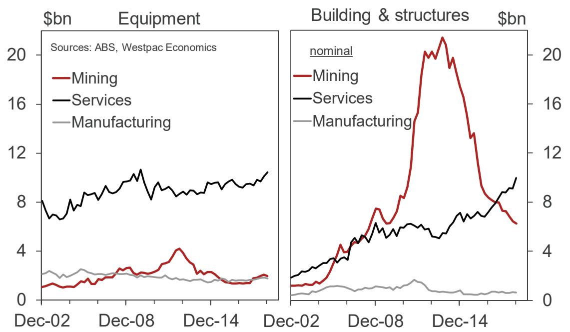
- Private business spending on capex moved a little higher in 2018, up 2%, with an 8% lift in equipment spending outweighing a further retreat in Building & structures, -3%.
- For Q1, we anticipate only a small rise, +0.2%, with - once again - an uneven result, equipment up and building & structures down.
- Equipment spending is forecast to advance in Q1 by 0.8%qtr, 5%yr. The uptrend in equipment investment during 2018 was broadly based across services, manufacturing and mining.
- Building & structures activity has been in a downtrend, led lower by mining investment as work on the remaining gas projects was finalised. This dynamic has extended into 2019, with a forecast decline of -0.3%.

Aus 2018/19 & 2019/20 capex plans

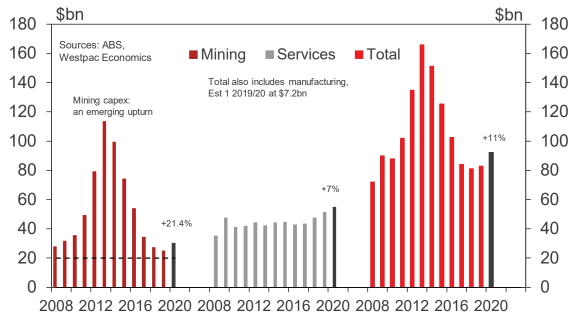
May 30, Last: Est 5 for 2018/19: $118.4bn, +3.6%
May 30, Last: Est 1 for 2019/20: $92.1bn, +11%

- Recall Est 5 is $118.4bn, some 3.6% ($4.0bn) above Est 5 a year ago, with strength in services, +9% ($6.1bn) and mining taking one last leg lower, -7% (-$2.5bn).
- Est 1 for 2019/20 is 11% (+$9.2bn) above Est 1 a year ago, with mining +21.4% (+$5.3bn) and services +6.8% (+$3.5bn).
- This update may be less upbeat, but not substantially so. Business conditions have weakened, so too global growth. However, services investment strength is in transport (spill-overs from public infrastructure) and power generation (renewable energy).
- As to Est 2 for 2019/20, we caution that often the initial two estimates are an unreliable guide to actual spending.

Aus CAPEX: by industry by asset



Aus Capex plans, by industry: Estimate 1

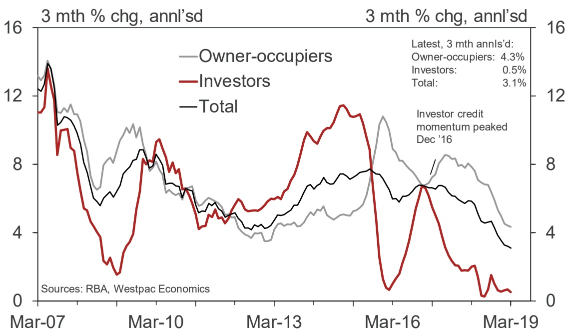


Aus Apr private credit

May 31, Last: 0.3%, WBC f/c: 0.2%
Mkt f/c: 0.3%, Range: 0.2% to 0.4%

- Private sector credit growth has slowed to a sluggish pace as the housing sector weakens. In March, credit grew by 0.3%, fractionally above the average of the previous 3 months (0.23%).
- For April, we anticipate a reversion to a gain of 0.2%, with the risk that business credit expands at a more modest pace.
- Housing credit growth is weak at an historic low of 4.0%yr and 3.1% annualised for the 3 months to March. Another soft update is in the offing.
- Business credit grew by 4.9% over the past year as investment in the real economy expanded. Recently, new lending has softened, pointing to some loss of momentum.

Housing credit weakens

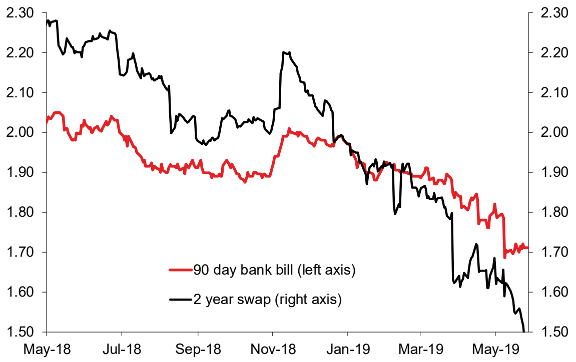


New Zealand forecasts

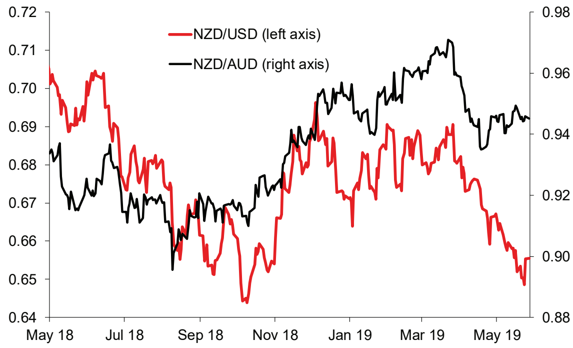
Economic Forecasts	Quarterly				Annual			
	2018	2019						
% change	Dec (a)	Mar	Jun	Sep	2018	2019f	2020f	2021f
GDP (Production)	0.6	0.5	0.6	0.7	2.8	2.3	3.1	2.4
Employment	0.0	-0.2	0.8	0.3	2.3	1.3	2.0	1.8
Unemployment Rate % s.a.	4.3	4.2	4.3	4.3	4.3	4.2	3.9	3.7
CPI	0.1	0.1	0.6	0.6	1.9	1.7	1.9	2.1
Current Account Balance % of GDP	-3.7	-3.4	-3.3	-3.4	-3.7	-3.4	-3.6	-3.8

Financial Forecasts	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20
Cash	1.50	1.50	1.50	1.50	1.50	1.50
90 Day bill	1.70	1.65	1.65	1.65	1.65	1.65
2 Year Swap	1.55	1.60	1.65	1.70	1.75	1.75
5 Year Swap	1.70	1.75	1.80	1.85	1.90	1.95
10 Year Bond	1.80	1.85	1.90	1.90	1.95	2.00
NZD/USD	0.65	0.64	0.65	0.65	0.66	0.66
NZD/AUD	0.94	0.94	0.98	0.98	0.99	0.99
NZD/JPY	72.8	72.3	73.5	72.8	73.3	72.6
NZD/EUR	0.59	0.58	0.59	0.59	0.59	0.58
NZD/GBP	0.50	0.48	0.49	0.49	0.50	0.49
TWI	71.6	71.0	72.3	71.8	72.3	71.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 27 May 2019

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.50%	1.50%	1.75%
30 Days	1.70%	1.66%	1.86%
60 Days	1.70%	1.68%	1.82%
90 Days	1.71%	1.70%	1.79%
2 Year Swap	1.49%	1.62%	1.64%
5 Year Swap	1.60%	1.75%	1.78%

NZ foreign currency mid-rates as at 27 May 2019

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6555	0.6589	0.6655
NZD/EUR	0.5849	0.5866	0.5964
NZD/GBP	0.5142	0.5068	0.5151
NZD/JPY	71.66	72.30	74.27
NZD/AUD	0.9452	0.9421	0.9456
TWI	72.36	72.35	72.89

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
Chn	Apr industrial profits %yr	13.9%	–	–	Aided by commodity prices.
Tue 28					
Eur	Apr M3 money supply %yr	4.5%	4.3%	–	Maintaining its pace.
	May business climate indicator	0.42	–	–	Should edge lower in the month.
	May economic confidence	104.0	103.5	–	Softer business senitment to offset consumer increase.
UK	May Nationwide house prices	0.4%	–	–	TBC. Housing market weakness continuing, esp. in London.
US	Mar FHFA house prices	0.3%	–	–	House price growth has slowed…
	Mar S&P/CS home price index	0.2%	0.6%	–	… but should stabilise around this level given lower rates.
	May consumer confidence index	129.2	130.5	–	Remains robust, aided by jobs and asset price gains.
	May Dallas Fed index	2.0	7.0	–	Manufacturing being hit by US dollar and tariff concerns.
Wed 29					
NZ	RBNZ Financial Stability Report	–	–	–	Unlikely to see further policy announcements at this stage.
	May ANZ business confidence	–37.5	–	–	First survey since the proposed capital gains tax was scrapped.
Eur	ECB Rehn speaks	–	–	–	At an event in London.
US	May Richmond Fed index	3	7	–	Manufacturing being hit by US dollar and tariff concerns.
Thu 30					
NZ	Apr building permits	–6.9%	–	–2.0%	Multiples to soften after earlier strength, level still strong.
	Budget 2019	–	–	–	Weaker starting point for the economy means smaller surpluses.
Aus	Apr dwelling approvals	–15.5%	flat	–1.0%	Feb high rise spike still unwinding. Holiday timing a factor?
	Q1 private new capital expenditure	2.0%	0.5%	0.2%	Softness in B&S, equipment expected to rise modestly.
	2018/19 capex plans, AUDbn	118.4	–	–	Est 5 is +3.6% vs Est 5 a yr ago.
	2019/20 capex plans, AUDbn	92.1	96.0	–	Est 1 is +11% vs Est 1 a yr ago – led by mining.
US	Q1 GDP 3rd estimate %annualised	3.2%	3.1%	3.1%	Only a negligible revision expected.
	Apr wholesale inventories	–0.1%	–	–	A big positive in Q1; could reverse in Q2.
	Initial jobless claims	211k	–	–	Very low.
	Apr pending home sales	3.8%	1.0%	–	Existing home market held back by supply.
	Fedspeak	–	–	–	Clarida is speaking NY.
Fri 31					
NZ	May ANZ consumer confidence	123.2	–	–	Consumer sentiment has been stable in recent months.
Aus	Apr private sector credit	0.3%	0.3%	0.2%	Has slowed to a subdued pace, led by housing downturn.
Chn	May non-manufacturing PMI	54.3	54.3	–	Investment becoming more supportive of growth.
	May manufacturing PMI	50.1	49.9	–	Manufacturing remains under pressure from tariffs.
Eur	ECB Visco speaks	–	–	–	At the Bank of Italy annual gathering.
UK	May GfK consumer sentiment	–13	–13	–	Heightening political tension to weigh further?
	Apr net mortgage lending, £bn	4.1	3.7	–	Credit growth weak as uncertainty weighs on housing demand.
US	Apr personal income	0.1%	0.3%	0.4%	Income growth has lost some momentum…
	Apr personal spending	0.9%	0.2%	0.3%	…. but is still robust, aiding spending.
	Apr PCE deflator	0.0%	0.2%	0.2%	Core PCE inflation to track back up to 2.0%yr in late 2019.
	May Chicago PMI	52.6	54.0	–	Manufacturing being hit by US dollar and tariff concerns.
	May Uni. of Michigan sentiment	102.4	101.5	–	Remains robust, aided by jobs and asset price gains.

International forecasts

Economic Forecasts (Calendar Years)	2015	2016	2017	2018	2019f	2020f
Australia						
Real GDP % yr	2.5	2.8	2.4	2.8	1.8	2.2
CPI inflation % annual	1.7	1.5	1.9	1.8	1.8	1.6
Unemployment %	5.8	5.7	5.5	5.0	5.4	5.6
Current Account % GDP	-4.7	-3.1	-2.6	-2.1	-0.7	-2.0
United States						
Real GDP %yr	2.9	1.6	2.2	2.9	2.4	2.1
Consumer Prices %yr	0.1	1.4	2.1	2.4	1.8	1.9
Unemployment Rate %	5.3	4.9	4.4	3.9	3.5	3.5
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	1.2	0.6	1.9	0.8	0.7	0.6
Euro zone						
Real GDP %yr	2.1	2.0	2.4	1.8	1.2	1.4
United Kingdom						
Real GDP %yr	2.3	1.8	1.8	1.4	1.4	1.4
China						
Real GDP %yr	6.9	6.7	6.8	6.6	6.1	6.0
East Asia ex China						
Real GDP %yr	3.8	4.0	4.6	4.3	4.1	4.1
World						
Real GDP %yr	3.4	3.4	3.8	3.6	3.3	3.5
Forecasts finalised 10 May 2019						

Interest Rate Forecasts	Latest	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Australia								
Cash	1.50	1.25	1.00	0.75	0.75	0.75	0.75	0.75
90 Day BBSW	1.44	1.45	1.25	1.00	1.00	1.00	1.00	1.00
10 Year Bond	1.54	1.60	1.65	1.70	1.75	1.80	1.85	1.90
International								
Fed Funds	2.375	2.375	2.375	2.375	2.375	2.375	2.375	2.375
US 10 Year Bond	2.33	2.40	2.50	2.60	2.60	2.60	2.55	2.50
ECB Deposit Rate	−0.40	−0.40	−0.40	−0.40	−0.40	−0.30	−0.20	−0.10

Exchange Rate Forecasts	Latest	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.6886	0.69	0.68	0.66	0.66	0.67	0.67	0.68
USD/JPY	109.61	110	111	112	112	112	111	110
EUR/USD	1.1181	1.11	1.10	1.10	1.11	1.12	1.13	1.14
GBP/USD	1.2659	1.27	1.28	1.28	1.28	1.29	1.29	1.30
AUD/NZD	1.0569	1.06	1.06	1.02	1.02	1.02	1.02	1.01

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

Anne Boniface, Senior Economist +64 9 336 5669

Paul Clark, Industry Economist +64 9 336 5656

Any questions email: economics@westpac.co.nz

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