Len Lye Centre, New Plymouth

Weekly Economic Commentary.

The RBNZ kicks for touch.

As expected, the Reserve Bank kept the Official Cash Rate unchanged at 1.00% at its September interest rate review, and left the door open for possible future OCR reductions. But while the RBNZ is open to another cut if conditions warrant, their latest policy statement didn't give the impression that they have plans to do so at the upcoming November policy meeting. We are sticking to our forecast that the RBNZ will cut again in November, but we now consider it a close call that will depend on the evolution of the economy over the next few weeks.

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As expected, the Reserve Bank left the OCR unchanged at 1.00% at its September interest rate review. Importantly, while the RBNZ noted that *"there remains scope for more fiscal and monetary stimulus, if necessary,"* they don't appear to be in any rush to cut rates again. In fact, the tone of the press statement and accompanying minutes, as well as a subsequent speech from Governor Orr, indicated that the RBNZ think their actions to date may be enough. Their description of the outlook noted that although economic growth is currently slow, OCR cuts to date have led to lower lending rates and a lower exchange rate. And they continue to expect that monetary and fiscal stimulus will generate a pickup in domestic demand over the coming year.

So where to next for the OCR? Back in August, when the RBNZ last published detailed economic projections, their forecasts showed the OCR reaching a low of 0.9%, implying a roughly 50 / 50 chance of one more cut. That means some form of negative data surprise will be needed to prompt a November rate cut. We're sticking to our forecast of a November cut, as we think such downside surprises could well be coming on several fronts:

- Offshore, we are forecasting cuts from both the Federal Reserve and the Reserve Bank of Australia between now and November. This could raise the threat of the exchange rate rising in the RBNZ's mind.
- Domestically, we think economic growth will undershoot the RBNZ's fairly optimistic expectations through the back half of 2019 and 2020. GDP figures for the September quarter won't be out until December. However, recent data and anecdotes have already highlighted softening conditions in the business sector. On top of that, our own Westpac McDermott Miller survey of consumer sentiment pointed to flagging confidence among households and a growing reluctance to spend. The next major read on economic conditions is Tuesday's Quarterly Survey of Business Opinion. This is one of the most reliable leading indicators of economic growth in New Zealand, and one which the RBNZ tends to watch closely. A weak reading on this survey could be very influential on their thinking.
- In addition to slowing GDP growth, we expect unemployment to rise in the September quarter after an unexpectedly sharp fall in June (the data will print a week before the November MPS).
- Finally, with inflation effectively lingering below the 2% target mid-point for eight years now, the RBNZ has become increasingly conscious of the downside risks for inflation expectations. Indeed, the weak inflation expectations data out just before the August policy statement was a key factor underlying the decision to cut 50 bps. The RBNZ's preferred measure of inflation expectations won't be published until just before the November MPS (though the RBNZ will have the data a week before the market). While the result could go in either direction, continued weakness would certainly strengthen the odds of a November cut.

Putting this altogether, the balance of risks still favours a cut in November. However, this is far from a done deal. Markets are currently pricing around a 75% chance of a rate cut in November and a strong chance of another cut in early 2020. In contrast, we think that this is a much closer call and expect that 0.75% will be the bottom of the current cycle.

Our expectations for a 0.75% low in the cash rate is at the more hawkish end of New Zealand forecasters. The reason why we expect the RBNZ to pause at this level is that we think that monetary policy will be effective in stimulating the economy. It's true that even after the 75 bps of rate cuts this year, there is still lingering nervousness in many corners of the business sector. However, monetary policy's main impact on the economy is not directly through the business sector; it's through the exchange rate and asset markets.

The RBNZ's 'lower for longer' stance has already pushed the exchange rate lower.

With regards to asset prices, New Zealand has entered a 'search for yield' environment, with investors shunning bank deposits in favour of assets that have the potential for higher returns or capital gains. Our long-held view has been that it would only be a matter of time before we saw house prices picking up in response. We expected this to become apparent only around the turn of the year. But the August Real Estate Institute price data was very strong – the 1.4% increase in seasonally adjusted nationwide prices was the largest in a single month since mid-2016. That might have been an aberration. But with fixed mortgage rates down, and plans for a capital gains tax now shelved, house prices look set to push higher over the coming year. That will be very important for economic conditions more generally. New Zealanders hold the bulk of their wealth in housing assets, and increases in house price growth are likely to support a related lift in household confidence and spending.

Fixed vs Floating for mortgages.

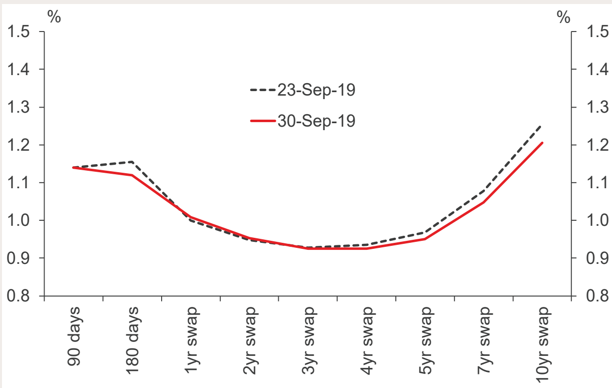
Mortgage rates are falling, and with the Reserve Bank expected to cut the OCR once more, we think they will keep falling. This means there is no hurry to fix.

Among the fixed rates on offer, we think the best value at present is the one-year rate. It is lower than the floating or six-month rates, yet it may still allow borrowers to roll onto lower rates at the end of the fixed term. Fixing for a longer term may mean that borrowers miss out on re-fixing at the lowest rates, at least according to our forecasts.

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



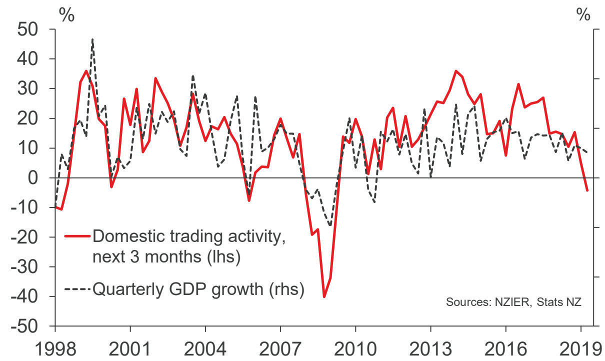
The week ahead.

NZ Q3 Survey of Business Opinion

Oct 1, General business situation, Last: -31
Domestic trading activity, Last: -4

- The QSBO is one of the most reliable and timely indicators of GDP growth in New Zealand. This survey will be closely watched by the RBNZ. We think it is likely to signal softness in GDP growth through the back half of 2019, and downside risk to the RBNZ's forecasts.
- The previous survey showed that general business confidence had fallen to a 10-year low. Businesses' expectations about their own activity were also weak. Businesses have been particularly concerned about the combination of rising costs and strong competitive pressures.

QSBO domestic trading activity and GDP

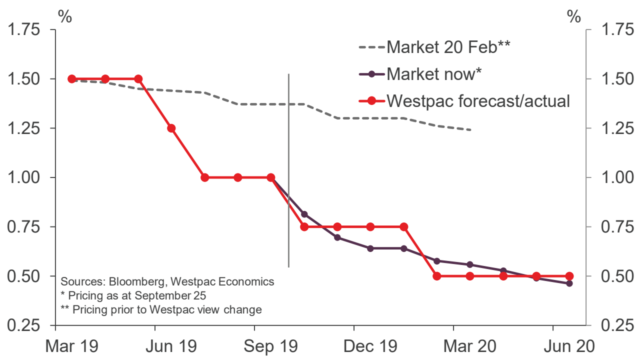


Aus RBA policy announcement

Oct 1, Last: 1.00%, WBC f/c: 0.75%
Mkt f/c: 0.75%, Range: 0.75% to 1.00%

- The Reserve Bank is in an easing cycle following 3 years of steady rates. Rates were lowered in June and again in July, from 1.5% to 1.0%, with the prospect of further falls.
- Westpac Economics expects the RBA Board to trim rates to 0.75% in October, and then to 0.50% in February 2020.
- Powerful headwinds are impacting the economy, notably: (1) a global slowdown; (2) structural challenges around weak wages and productivity growth; and (3) a period of cyclical weakness centred on the construction / housing sectors.
- We assess that the case for a further cut has been made. The RBA Governor's recent speech appears to support this view. Domestically, the starting position for the economy is weaker than anticipated. Globally, policy is being eased - a development that if ignored by the RBA would see upward pressure on the currency. A rise in the AUD would be unwelcome in the current environment.

RBA: Westpac forecast and market pricing

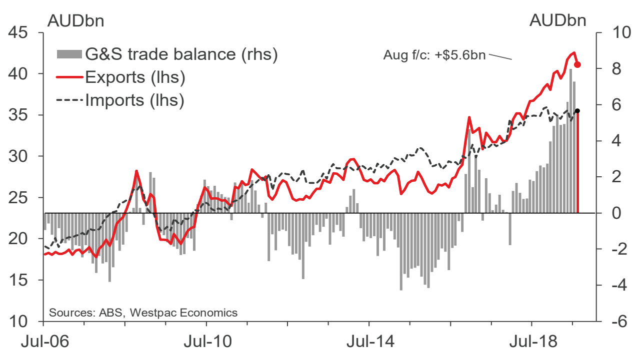


Aus Aug trade balance, AUDbn

Oct 3, Last: 7.3, WBC f/c: 5.6
Mkt f/c: 6.0, Range: 5.0 to 7.6

- Australia's trade surplus surged over the first half of 2019, climbing to record highs as rising commodity prices boosted export earnings.
- The surplus hit a fresh high of $8.0bn in June and remained elevated at $7.3bn in July.
- For August, the surplus is expected to moderate to $5.6bn as commodity prices pull-back.
- Export earnings are forecast to decline by 3.5%, -$1.5bn. Falls are likely to be centred in metal ores (-$0.9bn) and coal (-$0.5bn) due to lower prices, as well as gold (-$0.4bn) which is retracing from a high starting position.
- For imports, we anticipate a rise of 0.6%, $0.2bn. This is largely on higher prices associated with the lower currency, down 3% against the US dollar and down 1.7% on a TWI basis.

Australia's trade balance



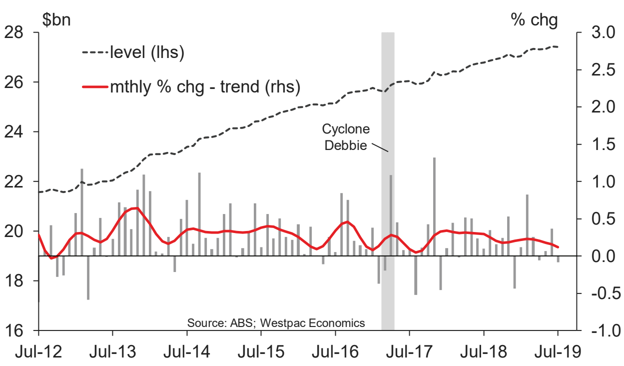
The week ahead.

Aus Aug retail trade

Oct 4, Last: –0.1%, WBC f/c: 1.0%
Mkt f/c: 0.5%, Range: 0.2% to 1.0%

- The July retail update showed sales down 0.1% in the month and annual growth holding at 2.4%yr, the slowest pace since early 2018. The result was disappointing, implying little or no boost from recent policy measures. The combined effect of rate cuts and tax offset payments are set to add around $16bn to disposable incomes over the year to June 2020.
- Even if much of this boost is saved, the portion spent is likely to give a sizeable lift to retail sales, which run at $27bn a month. Responses to a special question in the Westpac Consumer Sentiment survey show about half of those eligible had received tax offset refunds by early Sep, with recipients planning to spend about half of the cash.
- Against this, private sector business surveys and anecdotal reports suggest little impact as at Aug with underlying consumer conditions still clearly soft. A 'slow pass through' from stimulus effects should still see a reasonable 1% gain in Aug retail sales with a more meaningful boost in Sep.

Monthly retail sales

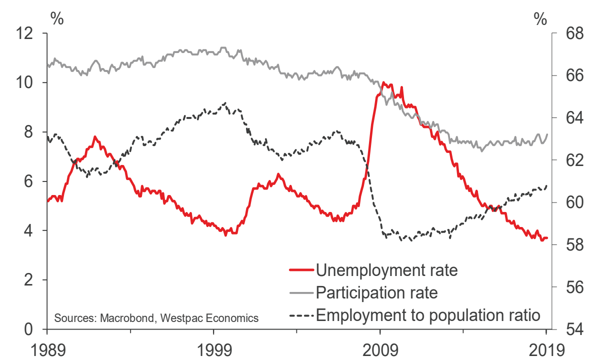


US Sep payrolls

Oct 4, nonfarm payrolls, last: 130k, WBC: 160k
Oct 4, unemployment rate, last: 3.7%, WBC: 3.7%
Oct 4, hourly earnings %yr, last: 3.2%, WBC: 3.3%

- Nonfarm payrolls employment has undergone a material deceleration in 2019, falling from around 220k in 2018 to average 150k per month in the past six months (to Aug). While we anticipate this downtrend will persist on a multi-month basis, month-to-month volatility will see a stronger outcome in Sep, circa 160k. Revisions are worth watching.
- The deceleration in employment growth in 2019 points to the unemployment rate being at its cycle low. Still, the unemployment rate is unlikely to move materially higher, thanks to the FOMC's rate cuts and low term interest rates.
- Finally on wages growth, a similar result to Aug is expected in Sep. In the near term, risks are to the upside, but in scale are immaterial.

US labour market

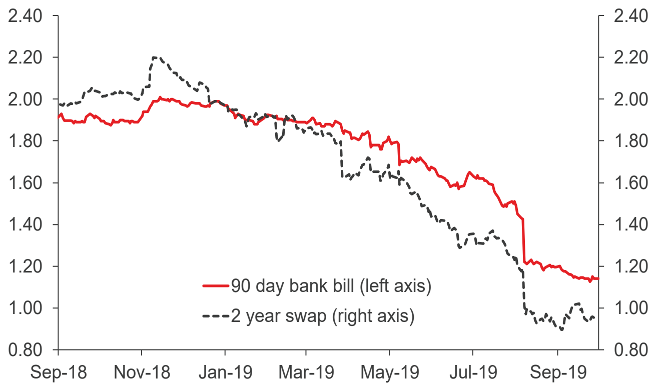


New Zealand forecasts.

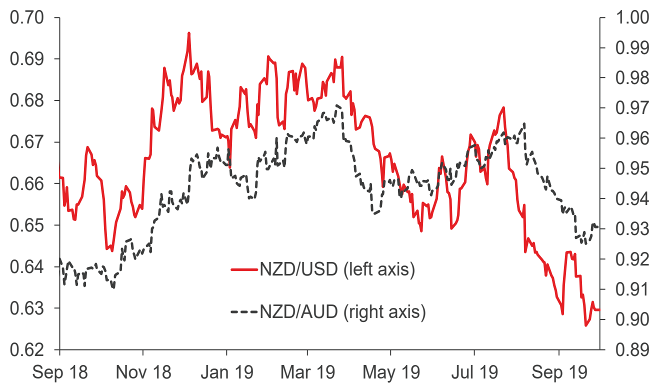
Economic forecasts	Quarterly				Annual			
	2019							
% change	Jun (a)	Sep	Dec	Mar	2018	2019f	2020f	2021f
GDP (Production)	0.5	0.4	0.5	0.6	2.8	2.2	2.3	2.8
Employment	0.8	0.1	0.4	0.3	2.3	1.2	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.4	4.3	4.3	4.3	3.8
CPI	0.6	0.6	0.3	0.4	1.9	1.6	1.7	1.8
Current Account Balance % of GDP	-3.4	-3.4	-3.2	-3.2	-3.9	-3.2	-3.0	-2.8

Financial forecasts	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Cash	0.75	0.75	0.75	0.75	0.75	0.75
90 Day bill	0.90	0.90	0.90	0.90	0.90	0.90
2 Year Swap	0.80	0.80	0.80	0.85	0.90	0.95
5 Year Swap	0.95	1.00	1.10	1.15	1.20	1.25
10 Year Bond	1.00	1.05	1.20	1.25	1.30	1.40
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	66.2	64.5	64.5	66.8	68.0	70.4
NZD/EUR	0.59	0.59	0.58	0.59	0.58	0.58
NZD/GBP	0.54	0.53	0.52	0.52	0.51	0.50
TWI	71.4	70.6	70.1	70.6	70.1	70.6

2 year swap and 90 day bank bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 30 September 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.19%	1.20%	1.18%
60 Days	1.16%	1.16%	1.18%
90 Days	1.14%	1.15%	1.20%
2 Year Swap	0.95%	1.02%	0.91%
5 Year Swap	0.95%	1.09%	0.93%

NZ foreign currency mid-rates as at 30 September 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6296	0.6375	0.6298
NZD/EUR	0.5756	0.5751	0.5730
NZD/GBP	0.5124	0.5103	0.5183
NZD/JPY	67.95	68.65	66.76
NZD/AUD	0.9307	0.9280	0.9376
TWI	70.47	70.80	70.62

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 30					
Aus	Sep MI inflation gauge	1.7%	–	–	Inflation well contained.
	Aug private sector credit	0.2%	0.3%	0.2%	Weak growth. RBA rate cuts to begin providing some support.
Chn	Sep manufacturing PMI	49.5	49.6	–	Chinese manufacturers to experience enduring pressure...
	Sep non-manufacturing PMI	53.8	54.0	–	... in months ahead, with consequences for services too.
	Sep Caixin China PMI	50.4	50.2	–	Greater focus on small and medium manufacturers than NBS.
Eur	Aug unemployment rate	7.5%	7.5%	–	Slowly trending lower.
UK	Q2 GDP (final)	–0.2%	–0.2%	–	Second estimate.
	Aug net mortgage lending £bn	4.6	4.1	–	Labour market supporting credit demand.
US	Sep Chicago PMI	50.4	50	–	US manufacturers impacted by tariffs and USD....
	Sep Dallas Fed index	2.7	1.5	–	... regional surveys remain volatile.
Tue 01					
NZ	Q3 Survey of Business Opinion	–31	–	–	Businesses have become increasingly downbeat.
Aus	Sep CoreLogic home value index	1.0%	–	1.0%	Prices up from lows on improved sentiment & rate cuts.
	Aug dwelling approvals	–9.7%	2.0%	2.5%	A (modest) lift after sharp fall in July (high rise, –13.5%).
	Sep AiG PMI	53.1	–	–	Choppy, +1.8pts in Aug. Trend slowing – construction downturn.
	RBA policy decision	1.00%	0.75%	0.75%	Rates to be cut in response to global & domestic challenges.
	RBA Governor Lowe	–	–	–	Remarks at RBA Board Dinner, Melbourne, 7.20pm.
Asia	Sep Nikkei manufacturing PMI	–	–	–	Kor, Idr, Myr, Twn, and Inr all due.
Chn	President Xi Jinping speaking	–	–	–	70th anniversary People's Republic. Financial mkts close for 7 days.
Eur	Sep Markit manufacturing PMI, final	45.6	45.6	–	Germany surpised to the downside, highlighting risks.
	Sep CPI %yr	1.0%	1.0%	–	Stuck well below target, and will remain so.
UK	Sep Markit manufacturing PMI	47.4	48.1	–	Brexit uncertainty and global uncertainty weighing heavily.
US	Sep Markit manufacturing PMI (f)	51.0	–	–	Broad-based weakness has been seen of late...
	Sep ISM manufacturing	49.1	50.5	–	... across production, orders, jobs and investment.
	Fedspeak	–	–	–	Evans and Bowman.
	Aug construction spending	0.1%	0.4%	–	Construction soft as firms wait and see.
Wed 02					
NZ	GlobalDairyTrade auction	2.0%	–	–	Futures markets pointing to broadly steady prices.
US	Sep ADP employment change	195k	138k	150k	Softer trend established. Monthly volatility to persist.
	Fedspeak	–	–	–	Barkin, Williams and Harker.
Thu 03					
NZ	Sep ANZ commodity prices	0.3%	–	–	Commodity prices have firmed in recent weeks.
Aus	Aug trade balance $bn	7.3	6.0	5.6	Surplus off peak. Exports –3.5%, lower commodity prices.
	Sep AiG PSI	51.4	–	–	Conditions patchy. Index volatile – rebounded 7.5pts in Aug.
Eur	Sep Markit services PMI, final	52.0	52.0	–	Strength of labour market offsetting manufacturing's impact.
	Aug PPI %yr	0.2%	–	–	Inflation pressures remain absent.
UK	Sep Markit services PMI	50.6	50.3	–	Disappointed in Aug, raising risks of recession.
US	Initial jobless claims	–	–	–	Deceleration in job growth driven by hiring not firing.
	Sep Markt service PMI (f)	50.9	–	–	Consumer aiding services sector...
	Sep ISM non-manufacturing	56.4	55.0	–	... but growth still looks to be moderating.
	Aug factory orders	1.4%	–0.5%	–	Durables trend remains weak.
	Fedspeak	–	–	–	Evans, Rosengren and Mester.
Fri 04					
Aus	Aug retail sales	–0.1%	0.5%	1.0%	Soft underlying pace. Tax cuts to provide temporary boost.
	RBA Financial Stability Review	–	–	–	Half yearly update.
	RBA Assist' Governor (Economic)	–	–	–	Luic Ellis, speech at Ai Group, Geelong, 12:00pm.
US	Sep nonfarm payrolls	130k	140k	160k	Softer trend established. Monthly volatility to persist.
	Sep unemployment rate	3.7%	3.7%	3.7%	Downtrend likely at, or very near, nadir.
	Sep average hourly earnings %yr	3.2%	3.2%	3.3%	Likely to settle around 3.5%yr for foreseeable future.
	Aug trade balance US$bn	–54.0	–54.8	–	USD and tariffs clear headwinds for non-oil exports.
	Fedspeak	–	–	–	Fed's Bostic Speaks at Tulane University.

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	2.1
Unemployment %	5.7	5.5	5.0	5.4	5.6	5.3
Current Account % GDP	-3.1	-2.6	-2.1	0.8	-0.5	-2.0
United States						
Real GDP %yr	1.6	2.2	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	3.9	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	0.7	0.3	0.4
Euro zone						
Real GDP %yr	2.0	2.4	1.8	1.2	1.1	1.2
United Kingdom						
Real GDP %yr	1.8	1.8	1.4	1.0	0.7	1.3
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	4.6	4.3	3.7	3.9	3.9
World						
Real GDP %yr	3.4	3.8	3.6	3.2	3.3	3.3
Forecasts finalised 11 September 2019						

Interest rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Jun-21	Dec-21
Australia								
Cash	1.00	0.75	0.50	0.50	0.50	0.50	0.50	0.50
90 Day BBSW	0.95	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	0.94	0.95	1.00	1.15	1.20	1.25	1.40	1.50
International								
Fed Funds	1.875	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.69	1.45	1.40	1.45	1.50	1.55	1.70	1.80
ECB Deposit Rate	–0.50	–0.60	–0.70	–0.70	–0.70	–0.70	–0.70	–0.70

Exchange rate forecasts	Latest	Dec–19	Mar–20	Jun–20	Sep–20	Dec–20	Jun–21	Dec–21
AUD/USD	0.6750	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	107.75	105	104	104	106	108	111	112
EUR/USD	1.0920	1.07	1.05	1.06	1.07	1.09	1.11	1.14
GBP/USD	1.2330	1.17	1.18	1.20	1.22	1.24	1.31	1.35
AUD/NZD	1.0720	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

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