



Bath House, Rotorua

Weekly Economic Commentary.

One down, one to go.

The lead-up to Christmas is proving to be a busy time for policymakers in New Zealand. Last week saw the Reserve Bank hand down its final decisions on its long-running review of bank capital, which saw only modest changes from the original proposal. This Wednesday the Government delivers its half-year fiscal update, which has been enlivened by the promise of a big lift in infrastructure spending.

Capital raising...

The final outcome of the RBNZ's bank capital review was broadly as we expected: a modest softening compared to the initial proposal, but banks will still have to increase their levels of capital significantly over the coming years. The current requirement is 10.5% of risk-weighted assets; this will be increased to 18% for the four largest banks and 16% for the smaller local banks, to be phased in over a seven-year period.

The stated aim of the capital review was to ensure that banks could endure up to a 1-in-200-year shock to the system. While major bank failures are rare, they have the potential to inflict significant harm on the economy, so there's value in taking out some additional insurance against such a risk. But

like any insurance policy, this comes with an ongoing cost during normal times. Higher required levels of capital will increase banks' overall cost of funding, resulting in higher interest rates on loans, reduced lending, and a lower level of economic activity than otherwise.

The RBNZ has estimated that the effects of the new bank capital requirements would increase bank lending rates by 0.2% relative to the OCR. Our own analysis suggests that the impact could be twice that much.¹ Either way, these estimates relate to the end of the phase-in period in 2027, so they don't suggest a need to adjust the OCR lower in the near term. Indeed, the RBNZ's most recent projections show that it expects to be hiking rates long before then. The more likely response on the monetary policy side would be to keep the OCR low for longer.

¹ For more detail, see www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Bank-Capital-Announcement-Dec-2019-Westpac-NZ.pdf



The decisions that were announced last week have no real impact on our outlook. We've been factoring the prospect of higher bank capital into our forecasts since early this year, albeit allowing for the possibility that some of the details could be softened. The changes from the initial proposal – accepting preference shares as capital, a longer phase-in period, and a lower minimum capital ratio for the smaller banks – were broadly consistent with what we had allowed for.

...and capital spending

The Government presents its Half-Year Economic and Fiscal Update (HYEFU) on Wednesday. This year's one is set to be particularly lively: at the Labour Party's annual conference, the Finance Minister announced that the Government will be unveiling plans for a significant ramp-up in infrastructure spending over the next few years.

We saw a lift in government spending as inevitable – the surpluses are there to be spent, there are widespread calls for more investment by government, and there's an election next year that still hangs in the balance. The only questions were when the stimulus would be announced, and how much.

For the forecasts in our latest *Economic Overview*, we assumed an additional \$1.5bn per year spending allowance for each of the next two Budgets, adding up to more than \$10bn over a four-year horizon. We think that an increase of this size is achievable given the economic outlook, and would still fit within the Government's self-imposed fiscal responsibility rules. However, that doesn't mean next week's announcement will be on this scale – we imagine they will want to leave themselves room to deliver some 'surprises' in next year's Budget as well.

We're not going to try to anticipate what form this spending might take. The Finance Minister noted that they have sought out a number of short- to medium-term infrastructure projects, spread across the country. The one detail announced so far is

\$400m of grants to schools for upgrades and maintenance, with the condition that it's spent within two years.

We'd also point out that as well as seeking quick wins, the Government will be looking at its spending plans through its 'Wellbeing Framework', with a broader focus than just physical capital. Warm, dry classrooms clearly tick both boxes; major roading projects are less likely to make the cut.

While there is a good case for a lift in infrastructure spending, we're cautious about what's achievable in the near term. The Budget already assumed a sizeable ramp-up in the pace of capital spending, from \$5.7bn last year to \$7.6bn next year (not counting contributions to the Super Fund). Indeed, every Budget for the last several years has included a similar near-term lift in spending; the actual delivery has fallen well short. Before adding even more spending to the list, the Government would need to find ways to address the bottlenecks associated with planning, labour shortages and other capacity constraints.

As for the HYEFU itself, we're not expecting significant changes in the Treasury's forecasts of the economy or government revenue. Forecasts of real GDP growth will have to be revised down, given the softer than expected starting point. However, nominal GDP – which matters more for forecasting tax revenue – is running closer to forecast.

The Government reported a \$7.5bn operating surplus in the June 2019 year, much higher than expected. However, that was boosted by a change in the accounting treatment for KiwiRail, and an IT upgrade that has resulted in tax revenue being booked earlier than previously. Neither of these are recurring factors, and without them the surplus was in line with forecast. Surpluses were already projected to be narrower over the next couple of years – and could be smaller again, depending on the extent to which this week's spending announcements are treated as operational or capital spending.

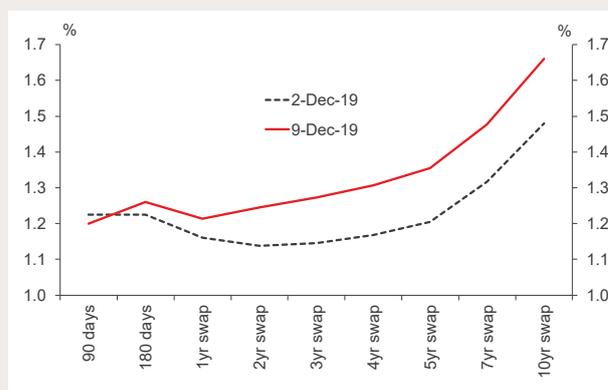
Fixed vs Floating for mortgages.

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



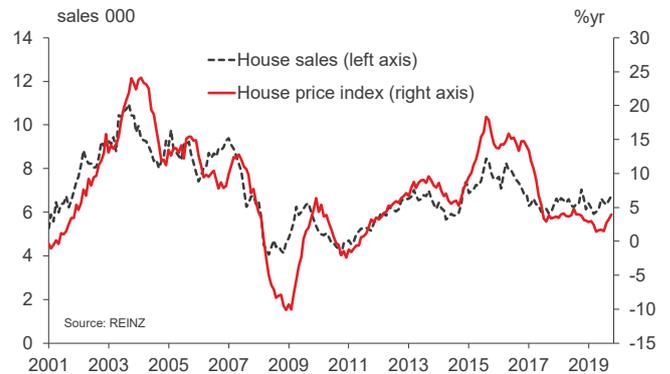
The week ahead.

NZ Nov REINZ House Price Index

Dec 10-13 (TBC), Last: 0.9%

- The past three months of housing market data have been very strong, with price increases of around 1% per month and a sharp lift in sales activity.
- We expect another strong month for November, based on data already observed from real estate websites and a real estate agency.
- Back in April we forecast that annual house price inflation would accelerate from 1% at the time to 7% by the end of 2020. We were the only major forecasters with that view at the time. Now there is wide acceptance that the housing market has turned, and 7% is likely to be reached even earlier than we initially predicted.

REINZ house prices and sales

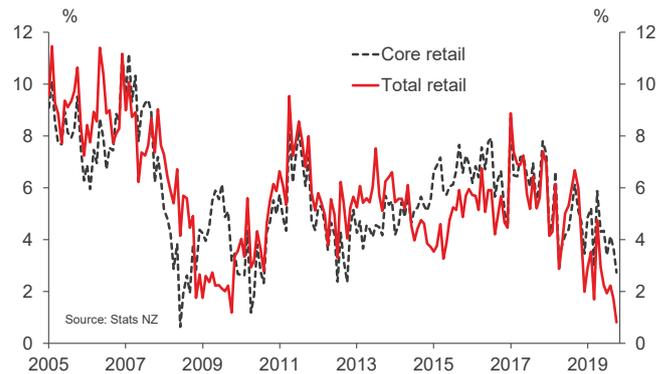


NZ Nov retail card spending

Dec 11, Last: -0.6%, WBC f/c: +1.0%

- Households wallets and purses snapped closed in October, with retail spending falling 0.6% over the month. However, that followed solid gains in the previous two months and still left spending running at levels well above those that prevailed through the first half of the year.
- We're expecting a re-acceleration in retail spending in November and are forecasting a 1% increase, underpinned by a 0.8% rise in core (ex-fuel and motor vehicle) categories. A continuing pickup in the housing market is buoying sentiment in the household sector. The increasing prevalence of Black Friday sales among domestic retailers is also likely to have boosted spending late in the month.

Card transactions, annual % change

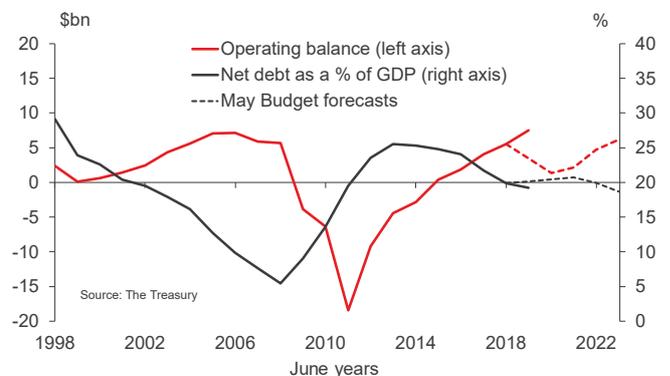


NZ Half-Year Fiscal and Economic Update

Dec 11

- The Government has signalled that it will announce a significant lift in infrastructure spending at the HYEFU. This will consist of a large number of short- to medium-term projects spread across the country.
- There was no guidance as to the magnitude of the spending increase, but we note that there is room for several billion dollars more with the Government's fiscal responsibility rules. Indeed, we had already factored in an increase in spending allocations ahead of next year's election.
- We expect little change in the HYEFU forecasts of the economy and of government revenue. Real GDP growth has been softer in the near term, but nominal GDP and tax revenue have continued to grow at a solid pace.

NZ fiscal position



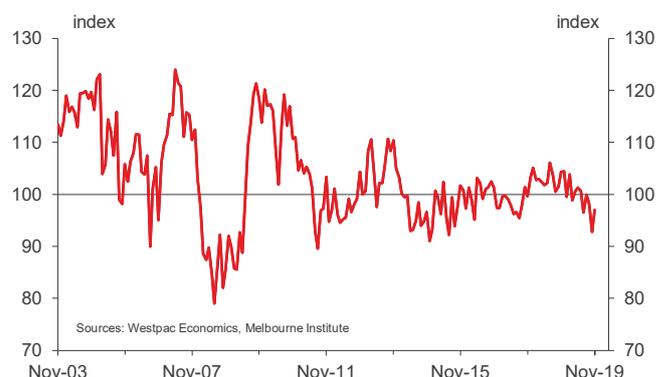
The week ahead.

Aus Dec Westpac-MI Consumer Sentiment

Dec 11 Last: 97.0

- Consumer sentiment recovered in November, rising 4.5% after a sharp 5.5% fall in October but remaining in pessimistic territory overall. The pattern of confidence falling in response to a rate cut and recovering when the RBA remains on hold supports the view that consumers are becoming increasingly unnerved by low rates. Looking through month to month volatility the Index has fallen by 4% since the RBA started cutting the cash rate in June.
- The latest survey is in the field over the week to December 7. The backdrop again looks unsettling. In particular, the September quarter national accounts released mid-way through the survey week disappointed with growth continuing to run at a sluggish 1.7%/yr.

Consumer Sentiment Index



US FOMC policy decision

Dec 10-11, federal funds rate last: 1.625%, WBC: 1.625%

- Following a third consecutive cut for 2019, the FOMC made clear in their October communications that, at least for now, their job was done.
- While business investment remains weak, the US consumer has continued to show strength. The FOMC is holding onto this positive and the robust employment gains that have supported it. Greater optimism over US/China trade relations in recent months also justifies the FOMC going on hold.
- While we firmly believe that the FOMC will be on hold in December and in January, their first meeting for 2020, by March we believe the FOMC will need to start a new cycle of cuts as softer employment and consumption growth take hold, leaving GDP growth below trend and at risk.

US employment

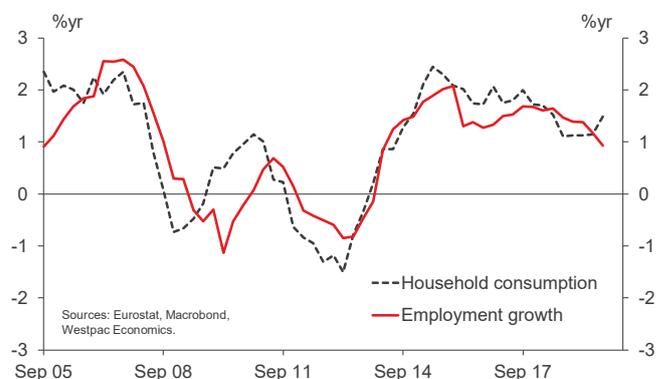


Eur ECB policy decision

Dec 12, deposit rate, Last: -0.5%, WBC: -0.5%

- The last meeting in October was a quiet one following the ECB's September stimulus package. Questions focussed on disagreement within the ECB on the easing package.
- Economic growth remains subdued. Euro area GDP growth has held a 1.2%/yr annual pace since Q4 2018. That slightly below trend pace is held back by external demand and weakness in the manufacturing sector. Propping up demand, household consumption growth is at a moderate pace with the unemployment rate near a historic low and wages growth continuing to pick up.
- We think policy will be on hold in December despite our opinion that there is a need for more stimulus. It will be President Lagarde's first meeting, and, given disagreement within the Governing Council, there will be challenges in taking decisive action. But that will change in time. We are forecasting a 10bp cut in the deposit rate to -0.60% in March.

Euro area consumer spending and employment



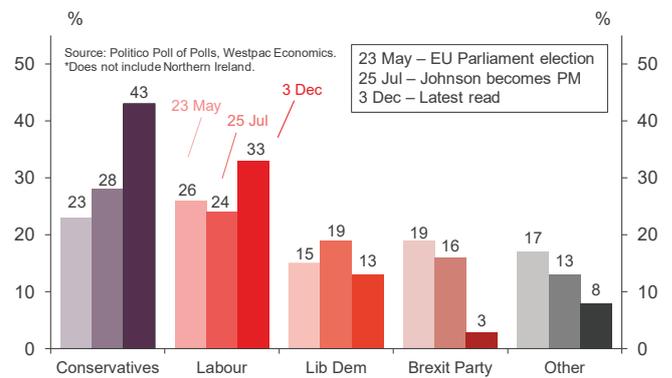
The week ahead.

UK general election

Dec 12

- The UK general election will take place on December 12. Polling is open from 7am to 10pm (6pm to 9am GMT). Votes will then be counted in two stages with the process typically ending around 2am (1pm GMT). The winner is announced shortly after.
- Opinion polls currently have the vote share as Conservatives on 43% and Labour on 33%. Each seat is decided by a first-past-the-post system. Our base case is for a Conservative working majority in the new Parliament – bookies odds imply around a 70% chance of this occurring.
- Regarding Brexit, that will then allow Johnson to pass the withdrawal agreement bill (WAB) already accepted by the EU. If a hung Parliament is returned or a labour coalition wins, a second referendum is most likely. While the WAB would see a smooth Brexit on January 31, future arrangements between the UK and EU will still need to be agreed over 2020.

UK politics opinion polling

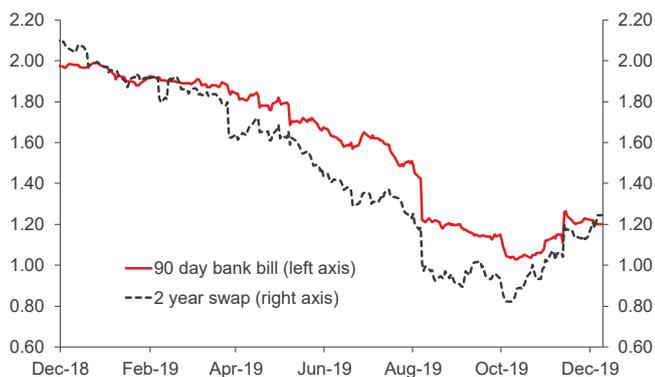


New Zealand forecasts.

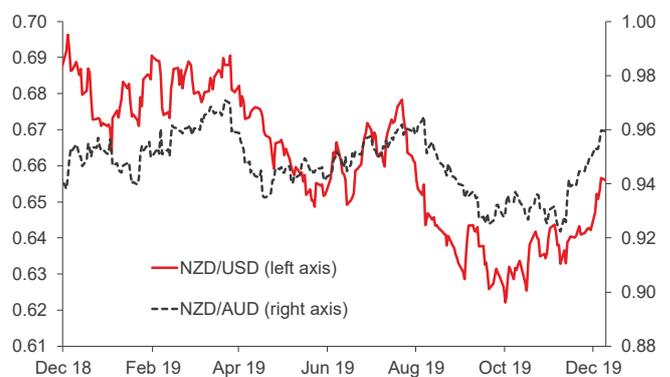
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019f	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	0.5	0.3	0.5	0.7	2.8	2.2	2.6	2.9
Employment	0.6	0.2	0.4	0.3	1.9	1.2	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.4	4.3	4.3	4.2	3.9
CPI	0.6	0.7	0.3	0.5	1.9	1.7	1.8	1.9
Current 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 9 December 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.19%	1.19%	1.14%
60 Days	1.20%	1.20%	1.15%
90 Days	1.20%	1.02%	1.15%
2 Year Swap	1.25%	1.14%	1.06%
5 Year Swap	1.36%	1.22%	1.19%

NZ foreign currency mid-rates as at 9 December 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6561	0.6413	0.6348
NZD/EUR	0.5934	0.5818	0.5747
NZD/GBP	0.5000	0.4990	0.4953
NZD/JPY	71.29	69.72	69.16
NZD/AUD	0.9596	0.9437	0.9224
TWI	72.76	71.22	70.05

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 09					
Chn	Nov new loans, CNYbn	661	1200	-	Households' appetite for mortgage credit strong.
	Nov M2 money supply %yr	8.4%	8.4%	-	Businesses losing out as shadow credit held back.
Eur	Dec Sentix investor confidence	-4.5	-	-	Investors remain downbeat despite lift in Nov.
Tue 10					
Aus	RBA Governor Lowe speaks	-	-	-	AusPayNet Summit, Sydney, 9:05am (with media Q&A)
	RBA Asst. Gov. Bullock speaks	-	-	-	Panel participation at AusPayNet Summit, 1:45pm
	Nov NAB business survey	3	-	-	Conditions & confidence weak. Sign of a "Black Friday" boost?
Chn	Nov CPI %yr	3.8%	4.3%	-	Food prices driving headline outcomes.
	Nov PPI %yr	-1.6%	-1.5%	-	Upstream price pressures absent.
Eur	Dec ZEW survey of expectations	-1	-	-	Bounced off lows but still below average.
US	Nov NFIB small business optimism	102.4	103.1	-	Remain very optimistic.
Wed 11					
NZ	Nov retail card spending	-0.6%	-	1.0%	Spending appetites firming as the economy picks up.
	Half-Year Econ and Fiscal Update	-	-	-	Details on planned increase in infrastructure spending.
Aus	Dec WBC-MI Consumer Sentiment	97.0	-	-	Some clues on consumers' (un)willingness to spend.
US	Nov CPI %yr	1.8%	2.0%	-	Core holding at 2.3%/yr.
	FOMC policy decision, midpoint	1.625%	1.625%	1.625%	On hold for now, but three cuts to come in 2020.
	Nov monthly budget statement	-134.5	-	-	Deficit to continue rising in 2020 and beyond.
Thu 12					
NZ	Oct net migration	3440	-	-	Annual migration holding at firm levels.
	Nov food price index	-0.3%	-	-0.7%	Seasonal drop in Nov, but annual growth has picked up.
Aus	Dec MI inflation expectations	4.0%	-	-	Inflation pressures muted.
	RBA Bulletin	-	-	-	Research articles.
Eur	Oct industrial production %yr	-1.7%	-2.3%	-	Manufacturing the key area of weakness.
	ECB policy decision	-0.5%	-	-	Lagarde's first meeting and press conference.
UK	General election	-	-	-	Bookies have odds of Conservatives majority at 70%.
US	Nov PPI	0.4%	0.2%	-	Inflation pressures absent across economy.
	Initial jobless claims	203k	-	-	Hiring slowing, but no signs of firing accelerating.
Fri 13					
NZ	Nov manufacturing PMI	52.6	-	-	Business conditions have been firming in late 2019.
	Nov REINZ house sales	3.1%	-	-	Due this week. The recent firming in the housing market...
	Nov REINZ house prices %yr	3.9%	-	-	...is expected to continue through November.
US	Nov import price index	-0.5%	0.2%	-	Strong dollar has offset import price growth.
	Nov retail sales	0.3%	0.4%	0.3%	Consumer demand to slow in 2020, in line with jobs.
	Oct business inventories	0.0%	0.2%	-	To remain a risk for growth into 2020.
	Fedspeak	-	-	-	Williams on monetary policy.

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	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
Australia								
Cash	0.75	0.50	0.25	0.25	0.25	0.25	0.25	0.25
90 Day BBSW	0.89	0.70	0.45	0.45	0.45	0.50	0.50	0.50
10 Year Bond	1.12	0.90	0.90	0.90	0.90	0.95	1.00	1.20
International								
Fed Funds	1.625	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.79	1.50	1.45	1.45	1.50	1.55	1.60	1.80
ECB Deposit Rate	-0.50	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60

Exchange rate forecasts	Latest	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Dec-21
AUD/USD	0.6839	0.66	0.66	0.67	0.67	0.68	0.69	0.72
USD/JPY	108.68	107	106	105	105	106	107	109
EUR/USD	1.1108	1.09	1.10	1.11	1.12	1.13	1.14	1.15
GBP/USD	1.3159	1.33	1.32	1.32	1.31	1.31	1.31	1.32
USD/CNY	7.0487	7.10	7.05	6.95	6.90	6.80	6.75	6.60
AUD/NZD	1.0435	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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