



Len Lye Centre, New Plymouth

# Weekly Economic Commentary.

## A narrowing of differences.

The nature of New Zealand's economic slowdown has started to change. Smaller, more export focussed regions of New Zealand are still outperforming big metropolitan regions, such as Auckland and Canterbury. However, the gap is narrowing, and this is likely to continue over the coming year.

New Zealand's economic slowdown, which began in 2016, is now firmly established. At first this was a consumer driven phenomenon, and mostly of a domestic nature, with slowing net migration and a cooling housing market helping to dampen household spending. Nowhere was this more evident than in the heavyweight Auckland and Canterbury regions, which together account for about half the country's economic output. Canterbury was also affected by the winding down of rebuilding activity, which effectively sent the region's construction sector into reverse.

At the same time as these big regions were feeling the heat, others in New Zealand were powering ahead. These tended to be smaller regions, usually with a large rural backbone, heavily focused on exports. Times were good and although weather events sometimes played havoc with production, elevated prices for dairy, logs, meat and horticulture products meant that the money kept rolling in.

Times were also good for those regions heavily dependent on tourism. New Zealand was clearly the flavour of the month for quite some time, attracting huge numbers of overseas travellers to these shores. Regions like Otago and Southland were bursting at the seams. Even some non-traditional tourist regions were enjoying bumper seasons, evidenced in part by the arrival of an increasing number of cruise ships and backpackers that filled up bed and breakfast establishments.

In essence, we had a two-speed economy. One in which smaller, rural regions were powering ahead, leaving their metropolitan counterparts in their wake. The exception to this was perhaps Wellington, which was also booming, in large part because of a change in Government.

At its height, the gap was big. However, as New Zealand's economic slowdown has deepened, we've started to see this gap narrow.



For the most part this is because economic growth in regions that were previously top performers has been cooling. Erstwhile laggards such as Auckland and Canterbury remain in the doldrums, so not much change there. Pessimism remains a consistent theme and consumers in these big cities are not throwing themselves into a headlong rush to the stores.

For the smaller regions, the dip in economic performance largely reflects the impact of a weakening external environment. The world has become a far more uncertain place in recent times and signs are that economic growth in some of the world's biggest economies has begun to slow. The US and China trade dispute, which is becoming more protracted by the day, has hardly helped matters.

Reflecting this, some commodity prices have begun to fall. But not all. Prices for meat, for example, are still rising, mainly because of the outbreak of African swine fever in China, while regions like the Bay of Plenty and Hawke's Bay continue to benefit from elevated prices for horticultural products, notably kiwifruit and avocados.

That said, export price for logs tumbled in June, mainly because of global supply side disruptions. Harvesting activity in New Zealand soon followed, resulting in some forestry crews being put out of work, and others operating at reduced levels. We think more will follow, which could contribute to higher unemployment, especially in regions on the east coast and north of the North Island.

Tourism to New Zealand has also slowed. Slowing growth in tourist arrivals has been felt across New Zealand, although more acutely in tourist dependent regions in the South Island, notably Otago and Southland. Given the likelihood of weaker economic growth in key source markets, things are likely to get worse before they get any better.

Meanwhile, dairy prices have largely moved sideways. The concern here, however, is less about prices, but more about sentiment among dairy farmers, which has plummeted recently amid concerns about how government policy might impact on their operations. Recently proposed freshwater reforms and future greenhouse gas obligations loom large, while worries about how negatively farming is being perceived in general are unlikely to have helped matters. This is likely to have affected spending in key dairy producing regions like the Waikato, Taranaki, Manawatu and Southland.

We think that economic conditions in New Zealand will worsen before they get better, especially for regions with big exposures to tourism, dairying, forestry and even manufacturing, which is likely to face increasingly stronger competition in global markets. No region will be completely immune to the general economic slowdown, although we think the smaller, more export focussed regions will be most affected.

Looking further out, we are a bit more optimistic. We expect that ultra-low interest rates will lead to higher house prices. Nationwide, we expect house price inflation will accelerate from about 2% currently to about 7% next year. We are picking the biggest impacts to be in Auckland and Canterbury, where growth is likely to switch from negative to positive.

Add to this a long-awaited lift in government spending via transfers to households, higher pay for many state employees, and the provision of additional services, and we think that consumers are going to be a little more willing to open their wallets than they have been.

A recovery in consumer spending is likely to benefit service industries in the cities more than in the primary industries in rural regions. Given this, we think that the narrowing of the gap of economic performances between regions will continue over the year ahead.

## Fixed vs Floating for mortgages.

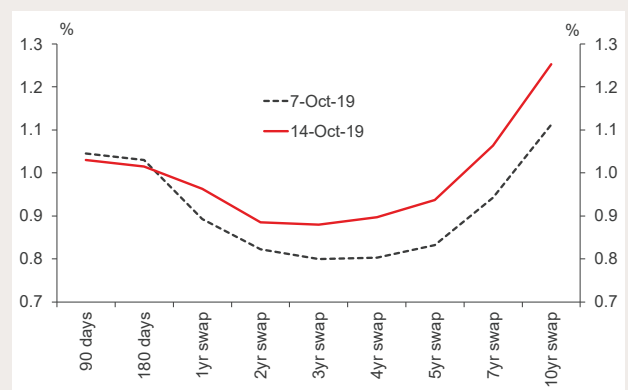
Mortgage rates are falling, and with the Reserve Bank expected to cut the OCR once more, we think they will keep falling. This means there is no hurry to fix.

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



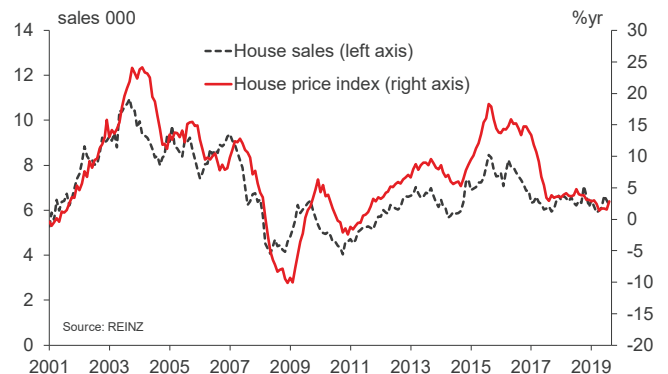
# The week ahead.

## NZ Sep REINZ House Price Index

**Oct 14-15, last: 1.3%**

- The August update from REINZ provided a surprising mix of developments. Sales were down 3.4% over the month (though that probably understates the strength of demand). Over the same period, prices rocketed higher, rising 1.2% in Auckland and 1.4% in the rest of the country.
- August's strong increase in prices 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.

## REINZ house prices and sales

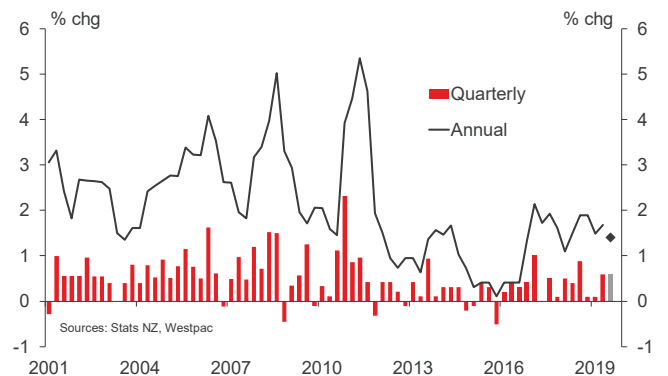


## NZ Q3 CPI

**Oct 16, Last: 0.6%, Westpac f/c: 0.6%, Mkt f/c: 0.6%**

- We expect a 0.6% rise in the Consumer Price Index for the September quarter. This would see annual inflation fall from 1.7% to 1.4%, as last year's unusually large increases in fuel prices and local body rates drop out.
- Our forecast is slightly above the Reserve Bank's estimate, particularly on the non-tradables side. Easy monetary policy has supported a gradual lift in non-tradables inflation over the last couple of years. In contrast, tradables inflation remains weak.

## NZ CPI inflation

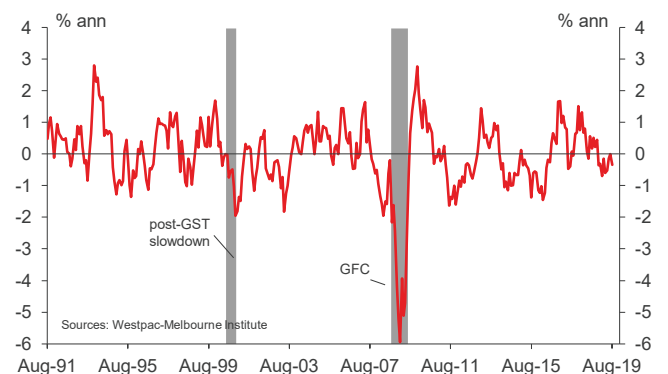


## Aus Sep Westpac-MI Leading Index

**Oct 16, Last: -0.35%**

- The Leading Index growth rate fell from +0.01% in July to -0.35% in August, moving back firmly into negative territory where it has been stuck for eight of the last nine months, indicating that the economy will continue to be operating at a below trend growth pace into late 2019 and early 2020.
- That weakening signal looks likely to have been reinforced further in September. This month's read will include several significant negatives including: a sharp fall in the Westpac-MI Consumer Expectations Index (-6.3%); further declines in commodity prices (-3.5% in AUD terms vs -2.3% last month) and dwelling approvals (-1% vs -9.7% last month).

## Westpac-MI Leading Index



# The week ahead.

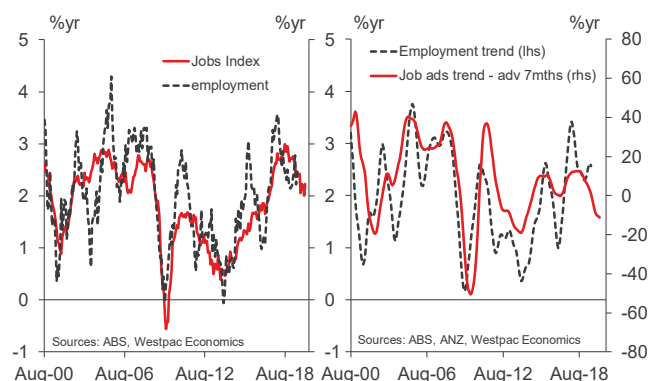
## Aus Sep Labour Force Survey – employment '000

**Oct 17, Last: 34.7k, WBC f/c: 17k**

**Mkt f/c: 15k, Range: -11k to 32k**

- The August Labour Force Survey reported a 34.7k gain in total employment. Employment remains robust, even if it has moderated a touch, with a three month average of +24.0k in August compared to 25.9k in July and +31.2k in June.
- In the year to August, employment grew 310.7k or 2.5%. The pace of employment growth has eased from 2.8%/yr in May but it is still stronger than the 2.2%/yr at the end of 2018. Our Jobs Index suggests employment should be growing around 2.4%/yr currently before slowing to 2.1%/yr through Q4.
- Given the strong run of employment prints in contrast to the moderating leading indicators, it would be tempting to forecast a soft print for September. However, the outgoing rotation group has a lower employment to population ratio than the sample as a whole. We are forecasting a 17k increase, but given robust population growth, we feel there is a clear risk for an even more positive print in September.

## Leading indicators of employment



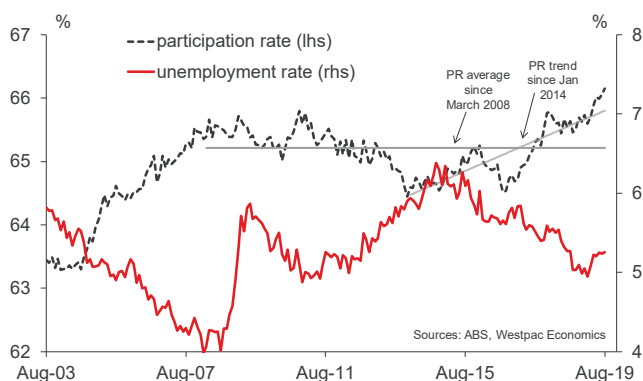
## Aus Sep Labour Force Survey – unemployment %

**Oct 17, Last: 5.3%, WBC f/c: 5.3%**

**Mkt f/c: 5.3%, Range: 5.2% to 5.4%**

- With strong growth in working age population (1.7%/yr), and rising participation, employment has not been strong enough to prevent rising unemployment. Participation hit a record high of 66.2% in August resulting in the unemployment rate drifting up to 5.3% from 5.2% despite the very robust print from employment.
- In August underemployment also moved higher, 8.56% from 8.42% in July, and is now back to par with the recent high in May 2019. This drift higher in underemployment is a further sign the labour market is not as robust as the growth in employment suggests.
- Holding the participation rate steady at 66.2%, and maintaining the trend in working age population growth, then the labour force is forecast to grow around 25k which is not enough to see the unemployment rate round upwards. As such, we expect unemployment to hold at 5.3%.

## Unemployment and participation rates

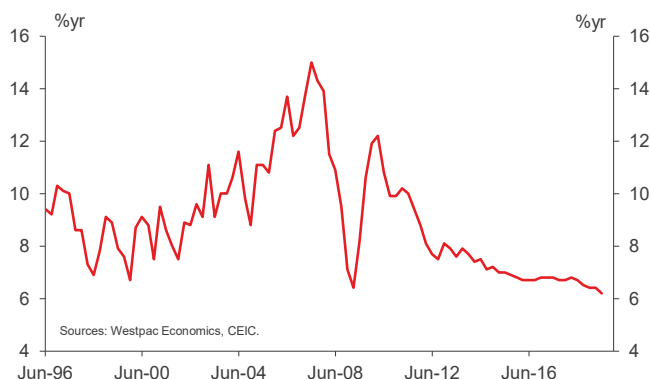


## China Q3 GDP

**Oct 18, last: 6.2%, WBC: 6.1%**

- 2019 is proving to be a particularly challenging year for China.
- Tensions between the US and China over trade and the global growth slowdown have weighed heavily on external demand. While out of the spotlight, weak domestic investment – the result of authorities' drive for structural economic and financial sector reform – has also cost growth.
- In the second half of 2019, little is expected to change. Authorities are continuing to increase their support of the economy, but only slowly, and the pass through to activity remains limited. Full resolution of trade tensions with the US also seems improbable.
- Regarding the consumer, discretionary spending is expected to remain under pressure given weak employment and wage prospects and deteriorating housing affordability.

## China real GDP slowly decelerating

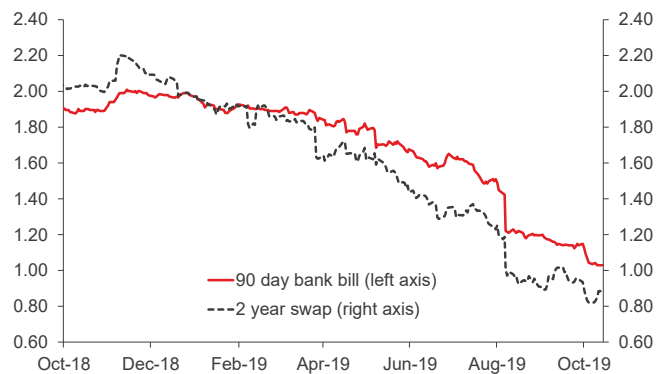


# New Zealand forecasts.

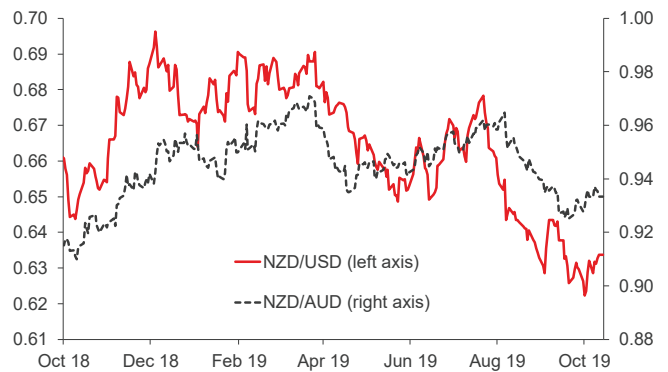
Economic forecasts	Quarterly				Annual			
	2019	2020			2018	2019f	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	0.5	0.4	0.5	0.6	2.8	2.2	2.3	2.8
Employment	0.8	0.2	0.4	0.4	2.3	1.4	1.8	2.0
Unemployment Rate % s.a.	3.9	4.1	4.2	4.3	4.3	4.2	4.2	3.8
CPI	0.6	0.6	0.3	0.5	1.9	1.6	1.7	1.8
Current 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	1.05	1.10	1.20	1.25
10 Year Bond	1.00	1.05	1.15	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	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 14 October 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.17%	1.19%	1.20%
60 Days	1.10%	1.16%	1.16%
90 Days	1.03%	1.14%	1.15%
2 Year Swap	0.89%	0.95%	1.02%
5 Year Swap	0.94%	0.95%	1.09%

NZ foreign currency mid-rates as at 14 October 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6337	0.6296	0.6375
NZD/EUR	0.5726	0.5756	0.5751
NZD/GBP	0.5015	0.5124	0.5103
NZD/JPY	68.61	67.95	68.65
NZD/AUD	0.9334	0.9307	0.9280
TWI	70.56	70.47	70.80



# Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 14</b>					
NZ	Sep BusinessNZ PSI	54.6	-	-	Business conditions have weakened through H2 2019.
	Sep REINZ house sales	-3.4%	-	-	TBC. Signs that sales are starting to firm...
	Sep REINZ house prices % <sub>yr</sub>	2.9%	-	-	...with a rise in prices expected to follow in later months.
Chn	Sep trade balance USDbn	34.8	35.0	-	Tensions with the US continue to take their toll.
Eur	Aug industrial production	-0.4%	-	-	Manufacturing weakness is worsening.
Int	Annual IMF meeting	-	-	-	Oct 14-20 with forecast updates.
<b>Tue 15</b>					
NZ	Aug net migration	5100	-	-	Annual migration has flattened off, still at high levels.
Aus	RBA minutes	-	-	-	Further detail around October's decision to cut.
Chn	Sep CPI % <sub>yr</sub>	2.8%	2.9%	-	Food inflation is strong...
	Sep PPI % <sub>yr</sub>	-0.8%	-1.2%	-	... but elsewhere price pressures are largely absent.
Eur	Oct ZEW survey of expectations	-22.4	-	-	Expectations continue to deteriorate.
UK	Aug ILO unemployment rate	3.8%	3.8%	-	Labour market in good shape.
	BOE Governor Carney speaks	-	-	-	At Treasury Committee session on Financial Stability Report.
US	Oct Fed Empire state index	2	0	-	US manufacturing has been hit hard by tariffs/ dollar.
	Fedspeak	-	-	-	Bullard (in London), Bostic, George and Daly.
<b>Wed 16</b>					
NZ	GlobalDairyTrade auction	0.2%	-	-	Chinese demand remains robust.
	Q3 CPI	0.6%	0.6%	0.6%	Modest, largely seasonal price gains.
Aus	Sep Westpac-MI Leading Index	-0.3%	-	-	Continues to point to below trend growth.
Eur	Aug trade balance €bn	19.0	-	-	Surplus led by Germany.
	Sep core CPI % <sub>yr</sub> final	1.0%	1.0%	-	Remains stuck around 1%.
	ECB speak	-	-	-	Chief Economist Lane speaks in Washington.
UK	Sep CPI % <sub>yr</sub>	1.7%	1.9%	-	Core inflation has cooled back.
	BOE Governor Carney speaks	-	-	-	On panel at IMF event.
US	Sep retail sales	0.4%	0.3%	0.4%	Job & wage g'th deceleration to slow spending in late-2019.
	Oct NAHB housing market index	68	68	-	Low rates a big positive for real estate sector.
	Aug business inventories	0.4%	0.3%	-	Inventories likely to be run down into year end.
	Fedspeak	-	-	-	Evans on policy and Brainard at Crypto Currency Conf.
	Federal Reserve's Beige book	-	-	-	Report on trends in the twelve districts.
<b>Thu 17</b>					
Aus	RBA Dep. Gov. Debelle speaks	-	-	-	At CFA Societies Aus. Investment Conf., Sydney 9:10 am.
	Sep employment	34.7k	15k	17k	A moderate rise expected...
	Sep unemployment rate	5.3%	5.3%	5.3%	... to see the unemployment rate hold at 5.3%.
Eur	EU Summit	-	-	-	Oct 17-18. Brexit the key issue ahead of Oct 31 deadline.
UK	Sep retail sales	-0.2%	-	-	Core sales have slowed from the beginning of the year.
	BOE Governor Carney speaks	-	-	-	On panel with Larry Summers at Harvard.
US	Aug total net TIC flows	43.8	-	-	Long-term bond flows.
	Sep housing starts	12.3%	-3.2%	-	Momentum in new construction to remain modest...
	Sep building permits	8.2%	-6.0%	-	... as uncertainties offset some of the low rate benefit.
	Oct Philly Fed index	12.0	7.1	-	US manufacturing has been hit hard by tariffs/ dollar.
	Initial jobless claims	210k	-	-	Hiring has throttled back, but firing still historically low.
	Sep industrial production	0.6%	-0.1%	-	Industrial activity to remain weak.
	Fedspeak	-	-	-	Evans and Bowman at Fed Listens event.
<b>Fri 18</b>					
Chn	Sep fixed asset investment ytd % <sub>yr</sub>	5.5%	5.5%	5.6%	Investment growth is set to remain modest...
	Sep industrial production ytd % <sub>yr</sub>	5.6%	5.5%	5.5%	... with manufacturing weak and other sectors mixed.
	Sep retail sales ytd % <sub>yr</sub>	7.5%	7.8%	-	Employment prospects have deteriorated, affecting spend.
	Q3 GDP % <sub>yr</sub>	6.2%	6.1%	6.1%	Growth to continue slowing.
US	Sep leading index	0.0%	0.1%	-	Points to growth at trend.
	Fedspeak	-	-	-	Williams (7:20am AEDT), Kaplan, George and Clarida.
<b>Sat 19</b>					
UK	Special Parliamentary sitting	-	-	-	On date of Benn act deadline for extension request.

## International forecasts.

Economic forecasts (Calendar years)	2016	2017	2018	2019f	2020f	2021f
<b>Australia</b>						
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	2.0
Unemployment %	5.7	5.5	5.0	5.4	5.6	5.3
Current Account % GDP	-3.1	-2.6	-2.1	0.4	-0.7	-2.0
<b>United States</b>						
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
<b>Japan</b>						
Real GDP %yr	0.6	1.9	0.8	0.7	0.3	0.4
<b>Euro zone</b>						
Real GDP %yr	2.0	2.4	1.8	1.2	1.1	1.2
<b>United Kingdom</b>						
Real GDP %yr	1.8	1.8	1.4	1.0	0.7	1.3
<b>China</b>						
Real GDP %yr	6.7	6.8	6.6	6.1	5.8	5.8
<b>East Asia ex China</b>						
Real GDP %yr	4.0	4.6	4.3	3.7	3.9	3.9
<b>World</b>						
Real GDP %yr	3.4	3.8	3.6	3.2	3.3	3.3

Forecasts finalised 4 October 2019

Interest rate forecasts	Latest	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Jun-21	Dec-21
<b>Australia</b>								
Cash	0.75	0.75	0.50	0.50	0.50	0.50	0.50	0.50
90 Day BBSW	0.84	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	1.00	0.95	1.00	1.15	1.20	1.25	1.40	1.50
<b>International</b>								
Fed Funds	1.875	1.375	1.125	0.875	0.875	0.875	0.875	0.875
US 10 Year Bond	1.66	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	0.6773	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	107.95	105	104	104	106	108	111	112
EUR/USD	1.1018	1.07	1.05	1.06	1.07	1.09	1.11	1.14
GBP/USD	1.2441	1.17	1.18	1.20	1.22	1.24	1.31	1.35
AUD/NZD	1.0708	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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