



Cardboard Cathedral, Christchurch

Weekly Economic Commentary.

Neither here nor there.

Economic growth remains muted in New Zealand, though the June quarter GDP figures were no worse than expected and are unlikely to move the dial for the Reserve Bank. We expect no change in the OCR at this week's review, but we do expect a further cut in November. We think this cumulative stimulus will be enough to meet the RBNZ's goals, but it has options if more is needed.

GDP rose by 0.5% in the June quarter, following a 0.6% rise in the March quarter. Annual growth over the year to June slowed to 2.4%, the lowest since 2013 – though that was at a time when population growth was slower than it is today. In per capita terms, annual growth slowed to 0.8%, its lowest since 2011.

There have been several factors behind the slowdown in growth. Some of them were foreseeable and indeed inevitable: population growth has slowed as net migration has passed its peak, and earthquake reconstruction work is gradually running off after peaking several years ago. In the last couple of years, two more themes have been prominent: a slowdown in the housing market, and a sharp drop in business confidence.

The weak housing market has impacted households' willingness to spend via the wealth effect. Household consumption rose by 0.5% in the June quarter after a 0.4% rise in March, both of which were down on the pace seen in earlier quarters. However, we are expecting the housing market to pick up in response to the recent sharp drop in mortgage rates, which should shore up consumption.

Businesses are finding themselves under pressure and are becoming more cautious about their expansion plans. Consequently, investment in plant and machinery has flattened out after strong growth in previous years, and more recently there have been signs of a slowdown in hiring.

At the same time, there are some growth factors that have gained momentum. Construction has been a bright spot,



even with the rundown in quake-related work. Homebuilding is up by around 5% in the last year as it continues to rise to the levels needed to meet population growth. Commercial construction is also on the rise, however civil construction has lagged.

Government expenditure has been on the rise, though it has not provided as much of a boost to GDP as we anticipated. The stimulus appears to have come more through transfers to households and higher pay for public servants, which have prevented consumer spending from being even weaker than otherwise. We expect government spending to pick up further in coming years.

Finally, export volumes have continued to grow modestly, and New Zealand's terms of trade have remained close to their all-time highs. Despite the growing sense of gloom about the global economy, it appears that the growth slowdown in New Zealand has largely been due to domestic forces.

The latest GDP figures were in line with what the Reserve Bank expected in its August *Monetary Policy Statement*, making them neither here nor there in terms of Wednesday's OCR decision. After the surprisingly large 50 basis point rate cut last month, we think that the RBNZ will stay its hand this time and assess the impact of its actions so far.

Recent economic developments have been mixed. The global economic outlook remains shaky, but arguably no worse than was expected in August. Business surveys and anecdotes suggest that local business activity has softened further in the past few months, making untenable the RBNZ's forecast that GDP growth will accelerate over the second half of this year.

On the plus side, world prices for key export products such as milk and logs have risen a little in recent weeks, and the exchange rate is substantially lower than the RBNZ's previous forecast on a trade-weighted basis.

Perhaps the most significant factor in this week's OCR decision is that the RBNZ had already cut aggressively in August, a move that was justified as 'getting ahead of the game'. It's too soon to judge the effectiveness of that move, and recent developments don't suggest that the RBNZ is at risk of falling behind again, weakening the case for a follow-up cut.

While we don't expect a move this week, we still think that the RBNZ is inclined towards further easing. We expect another cut at the November *Monetary Policy Statement*, taking the OCR to a new low of 0.75%. Our view is that by that point, the cumulative stimulus from lower interest rates and increasing government spending will be enough to shore up the economy, get unemployment falling again, and set inflation on a path towards 2%.

However, if an even greater shock were to hit the economy, it's not unthinkable that the OCR could be reduced all the way to zero. While that would mark the limits of conventional monetary policy, the RBNZ would still have options, ranging from a negative OCR to large-scale bond purchases to foreign exchange intervention. We argue that such measures could be effective if used with sufficient vigour. Of course, there would be challenges with the design of each of these measures, and they are likely to have some distortionary effects on the economy. But these concerns apply equally to conventional monetary easing.¹

¹ For more detail, see our article at www.westpac.co.nz/assets/Business/Economic-Updates/2019/Bulletins-2019/Quantitative-easing-economic-insight-WEB.pdf

Fixed vs Floating for mortgages.

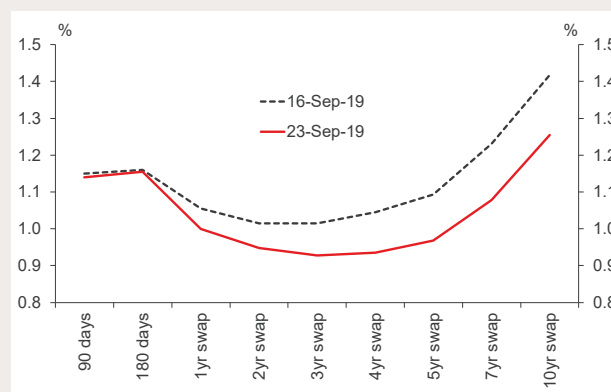
Mortgage rates are falling, and with the Reserve Bank expected to cut the OCR once more, we think they will keep falling. This means there is no hurry to fix.

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



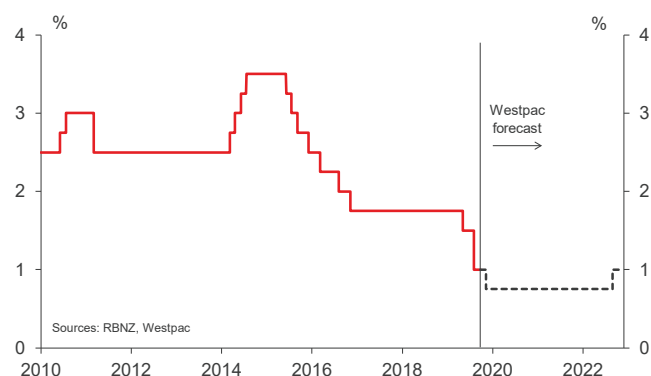
The week ahead.

RBNZ OCR Review

Sep 25, Last: 1.0%, Westpac f/c: 1.0%, Mkt: 1.0%

- We think the RBNZ will want to keep the OCR on hold and assess its previous action. The whole point of the RBNZ's jumbo-sized cut in August was to get ahead of the game.
- The RBNZ will probably use language about the "possibility" of a future cut rather than giving an overt signal of imminent easing.
- The domestic economy is shaping up weaker than the RBNZ's previous forecast; but offsetting that, the exchange rate is lower.

RBNZ Official Cash Rate

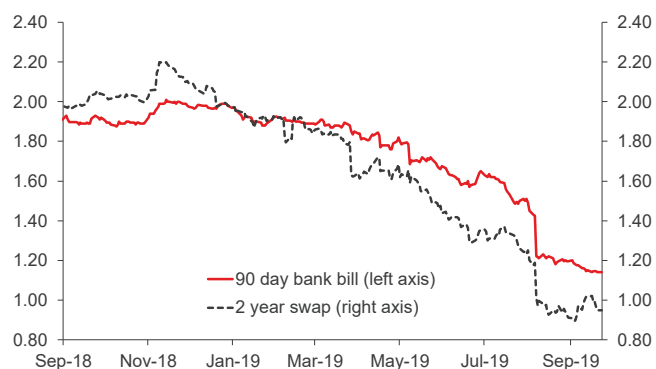


New Zealand forecasts.

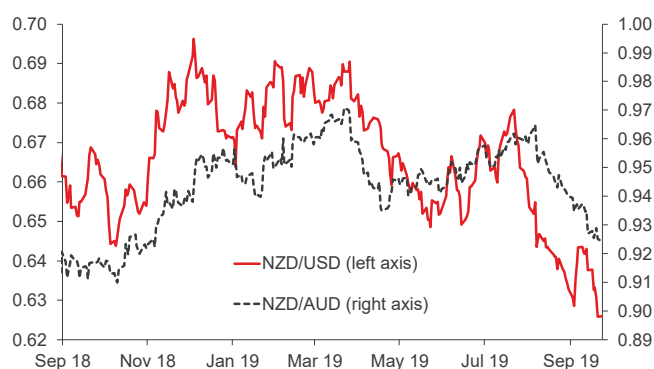
Economic forecasts	Quarterly				Annual			
	2019				2018	2019f	2020f	2021f
% change	Jun (a)	Sep	Dec	Mar				
GDP (Production)	0.5	0.4	0.5	0.6	2.8	2.2	2.3	2.8
Employment	0.8	0.1	0.4	0.3	2.3	1.2	1.8	2.0
Unemployment Rate % s.a.	3.9	4.2	4.3	4.4	4.3	4.3	4.3	3.8
CPI	0.6	0.6	0.3	0.4	1.9	1.6	1.7	1.8
Current Account 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 23 September 2019

Interest rates	Current	Two weeks ago	One month ago
Cash	1.00%	1.00%	1.00%
30 Days	1.18%	1.19%	1.17%
60 Days	1.16%	1.17%	1.17%
90 Days	1.14%	1.18%	1.20%
2 Year Swap	0.95%	0.97%	0.97%
5 Year Swap	0.97%	1.02%	1.00%

NZ foreign currency mid-rates as at 23 September 2019

Exchange rates	Current	Two weeks ago	One month ago
NZD/USD	0.6260	0.6422	0.6380
NZD/EUR	0.5683	0.5824	0.5719
NZD/GBP	0.5019	0.5232	0.5204
NZD/JPY	67.44	68.57	67.01
NZD/AUD	0.9243	0.9386	0.9468
TWI	69.85	71.65	71.33

Data calendar.

		Last	Market median	Westpac forecast	Risk/Comment
Mon 23					
Eur	Sep Markit manuf. PMI flash	47.0	47.5	-	Manufacturing remains weak...
	Sep Markit services PMI flash	53.5	53.2	-	... but services have to date been resilient.
	ECB President Draghi	-	-	-	Testimony to European Parliament.
US	Aug Chicago Fed activity index	-0.36	0.05	-	Manufacturing conditions are weak and likely to remain so...
	Sep Markit manufacturing PMI	50.3	50.3	-	... investment & employment in sector set to decelerate further.
	Sep Markit service PMI	50.7	51.5	-	Services at risk from global and manufacturing weakness.
	Fedspeak	-	-	-	Williams, Daly and Bullard.
Tue 24					
Aus	RBA Governor Lowe speaking	-	-	-	"An Economic Update", Armidale, 7:55pm.
UK	Aug public sector borrowing, £bn	-2.0	6.6	-	Borrowing in trend decline.
US	Jul FHFA house prices	0.2%	0.3%	-	House price growth has moderated over the past year...
	Jul S&P/CS home price index	0.0%	0.1%	- despite low rates and employment/ wage growth.
	Sep Richmond Fed index	1	2	-	Regional surveys are currently volatile.
	Sep consumer confidence index	135.1	134.0	-	Expectations materially weaker than current conditions.
Wed 25					
NZ	Aug trade balance \$m	-685	-1541	-1500	Dairy exports drop off sharply at the end of the season.
	RBNZ policy decision	1.00%	1.00%	1.00%	RBNZ to pause after last month's surprise 50bp cut.
US	Aug new home sales, %ann'd	-12.8%	2.8%	-	Construction activity remains subdued.
	Fedspeak	-	-	-	Evans, George and Kaplan.
Thu 26					
Eur	Aug M3 money supply, %yr	5.2%	5.1%	-	Credit growth robust, even before new stimulus.
	ECB President Draghi	-	-	-	Speaking in Frankfurt.
UK	BOE Governor Carney	-	-	-	Speaking on financial services in Frankfurt.
US	Q2 GDP, %ann'd	2.0%	2.0%	2.0%	A material revision unlikely in third estimate for Q2.
	Aug wholesale inventories	0.2%	-	-	Inventories remain volatile.
	Initial jobless claims	208k	-	-	Very low.
	Aug pending home sales	-2.5%	1.0%	-	Existing home sales continue to be held back by supply.
	Sep Kansas City Fed index	-6	-	-	Regional surveys are currently volatile.
	Fedspeak	-	-	-	Kaplan, Bullard, Clarida, Kashkari and Barkin.
Fri 27					
NZ	Sep ANZ consumer confidence	118.2	-	-	Uncertainty about the external environment is a drag.
Chn	Aug industrial profits, %yr	2.6%	-	-	Industry to remain under considerable pressure.
	Q2 current account balance	57.0	-	-	Final estimate for quarter.
Eur	Sep economic confidence	103.1	103.1	-	Businesses are becoming more fearful...
	Sep business climate indicator	0.11	0.11	-	... about the economic outlook.
UK	Sep GfK consumer sentiment	-14	-14	-	Supported by a strong labour market.
US	Aug durable goods orders	2.0%	-1.2%	-1.0%	Underlying trend weak and at risk of a further deterioration.
	Aug personal income	0.1%	0.4%	0.4%	Wages growth robust, but unlikely to accelerate further.
	Aug personal spending	0.6%	0.3%	0.3%	Spending expected to slow through the second half.
	Aug PCE deflator	0.2%	0.1%	0.1%	Core prices expected to rise 0.2% in month, 1.8%/yr.
	Sep Uni. of Michigan sentiment	92.0	92.1	-	Current and expected views have turned down.
	Fedspeak	-	-	-	Quarles and Harker.
Sat 28					
UK	Sep Nationwide house prices, %yr	0.6%	-	-	Brexit uncertainty weighing on housing market.

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	0.92	0.85	0.70	0.70	0.70	0.70	0.75	0.75
10 Year Bond	1.03	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	1.78	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	0.6788	0.67	0.66	0.66	0.67	0.67	0.69	0.72
USD/JPY	107.92	105	104	104	106	108	111	112
EUR/USD	1.1053	1.07	1.05	1.06	1.07	1.09	1.11	1.14
GBP/USD	1.2531	1.17	1.18	1.20	1.22	1.24	1.31	1.35
AUD/NZD	1.0787	1.06	1.06	1.06	1.06	1.06	1.07	1.08

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