

Weekly Commentary

2 July 2018



Pick 'n' mix

There was further evidence last week that conditions in the New Zealand economy are becoming more mixed. Business confidence took another step down with firms becoming increasingly nervous about the outlook for both the economy and activity in their own firm. However, households are seeing things slightly differently. Regional economic confidence was mixed and households are a little more upbeat about their employment prospects. Against this backdrop there was little change in the RBNZ's key message in last week's OCR Review. The OCR will remain on hold for a while yet.

Headline business confidence fell for a fourth consecutive month in June, with confidence in the outlook for the broader economy tumbling in most sectors. And while history suggests the headline business confidence measure tends to have a political bias (with confidence generally weaker under a left-of-centre government than the level of economic activity might suggest), checking beneath the hood the underlying details of the survey were also pretty soft.

Overall, firms were also less optimistic about the outlook for their own activity and profits, and they expected to employ fewer people. Comparing sectors, retailers were the most downbeat about their own prospects. That's unsurprising given the headwinds currently facing the household sector. Most notably, the housing market has slowed, dragging retail spending along for the ride.

Confidence has also been particularly soggy in the construction sector in recent months. Particularly for commercial construction activity where firms have faced rising costs, capacity constraints and difficulties accessing finance.

Residential construction activity has also tracked sideways, albeit at high levels, over the last year or so and we had been expecting growth to remain slow. However, that view

has been challenged by recent consent data. Last week saw a surprising surge in residential building consent issuance in May with the number of consents issued in the month the highest in 14 years. The vast majority of the lift was centred in Auckland which saw a large increase for both standalone houses and apartments and medium density houses (with this 'multiples' category now accounting for more than half of all new housing consents in Auckland). We will be watching this data closely in the coming months.

Downbeat sentiment in the business sector is one thing, but where the rubber really hits the road for the New Zealand economy is if this pessimism translates to hiring and investment decisions. The view underpinning our forecasts is that it will, albeit temporarily and with a lag. To date, business investment has remained relatively strong. However, recent merchandise trade data suggests the growth in imports of plant and machinery equipment (a key leading indicator of investment activity) is starting to wane. While it is early days yet, and capital equipment imports remain at a very high level, we'll be keeping a close eye on the data for further evidence that firms' appetite to invest is reducing.

Importantly, we expect the lull in investment and hiring to be temporary. As the dust settles following the change in Government, and additional Government spending boosts

Pick 'n' mix ... continued

growth in the broader economy, we're expecting to see a pickup in business investment in 2019.

Of course some of the developments that are concerning business owners and managers such as difficulty in finding staff or rising wage costs, are viewed as positives by households. The Westpac McDermott Miller Employment Confidence index edged higher in June as workers reported feeling more optimistic about both the security and availability of jobs. However, there were hints that households think this may be as good as it gets. There are expected to be slightly fewer job openings over the next year.

There is also a regional dimension to the changing mix of economic activity. This was illustrated in the June Westpac McDermott Miller Regional Economic Confidence Survey. Households were more optimistic about their region's prospects in 6 of the 11 regions surveyed. Confidence was noticeably stronger in regions with exposure to industries such as horticulture, forestry and tourism which are coming to the fore as drivers of growth. In contrast, households in Auckland were the most pessimistic about their region's prospects over the next year, perhaps because the Auckland economy is most exposed to the house price and consumer spending slowdown.

The mixed outlook for growth also underpinned the Reserve Bank's June OCR Review. The key message from the RBNZ was unchanged. The Bank reiterated that the OCR is

expected to remain low. In line with its May Statement it gave no guidance about the timing or direction of the next move.

The detail of the Statement was a little more dovish than expected. The RBNZ's reference to weaker economic data and global trade tensions weren't surprising. However, the comment that "The Government's projected spending impulse is also slightly lower and later than anticipated" did leave us scratching our heads.

Our own view is that the Government's most recent Budget was more stimulatory than previously signalled. Similarly the Treasury's summary measure of fiscal stimulus, which assesses how the Government's policy changes will impact GDP, suggested that the Budget spending plans would boost the economy by about one percent of GDP extra in 2020/21 compared to the previous forecast. And even that's likely to be too mild given we think that Government consumption is set to grow more strongly than the Treasury is forecasting in the coming years.

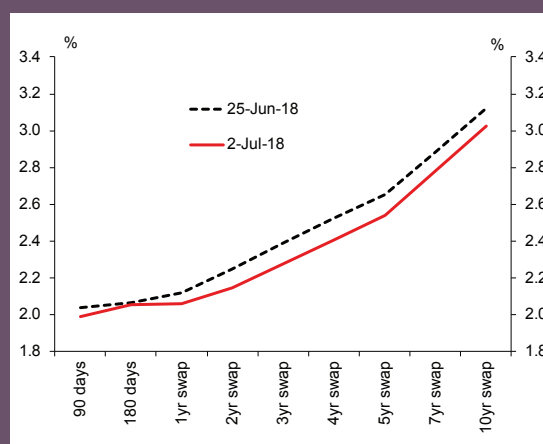
For now we'll agree to disagree. But this take, along with signs that the housing market is losing altitude more quickly than the RBNZ anticipated, does mean the RBNZ could publish a lower OCR forecast in the August MPS. Crucially, much will depend on what happens with the exchange rate between now and then. If the NZ dollar continues to fall, the inflationary consequences might be enough to balance the slowing economy and housing market.

Fixed vs Floating for mortgages

For borrowers with a deposit of 20% or more, the best value lies in the two-year rate or shorter fixed terms. Three-to-five-year rates seem high relative to where we think short-term rates are going to go over that time. Some lending and deposit rates have been falling recently, so it may be worth waiting to see if there are further modest reductions in fixed-term rates.

Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates such as the six-month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

NZ interest rates



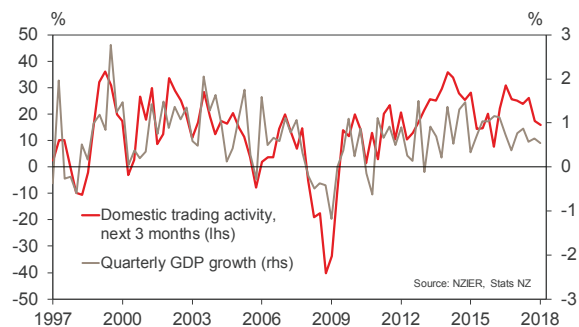
The week ahead

NZ Q2 Survey of Business Opinion

Jul 3, Domestic trading activity - Last: +15

- After falling in the wake of last year's election, business confidence improved in the March quarter, but only a little. Firms' outlook for their own activity over the next quarter was relatively unchanged.
- Since then monthly business surveys have seen falls in both confidence and own activity measures. However, these surveys tend to be both more volatile and less well correlated with GDP growth than the quarterly QSBO survey.
- Any changes in the survey's key inflation gauges will be of interest. Forward looking inflation indicators eased in March but since then we have seen a lift in petrol prices and an increase in the minimum wage.

QSBO domestic trading activity and GDP



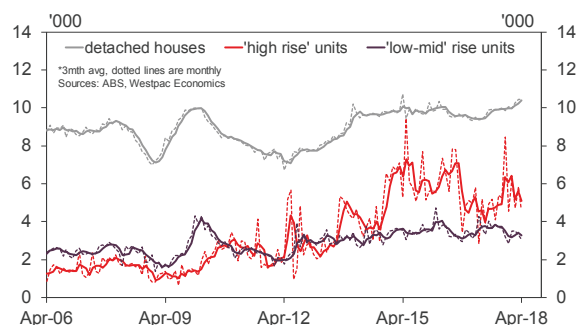
Aus May dwelling approvals

Jul 3, Last: -5.0%, WBC f/c: -4.0%

Mkt f/c: 0.0%, Range: -4.0% to 5.0%

- Dwelling approvals fell 5% in April, with the detail on the soft side. Private detached house approvals were flat but supported by an abnormally large 20% jump in WA that looks likely to be a one-off spike. Meanwhile units posted a sharp 11.5% drop, the detail volatile but starting to point to a second leg lower in high rise approvals.
- We expect another weak read in May with declines across both high rise and non high rise segments. On the latter, construction-related housing finance approvals have shown a notable weakening in recent months. Overall, total approvals are expected to be down 4% in the May month - the usual warnings about high monthly volatility applying as always.

Dwelling approvals: houses, low-mid & high rise

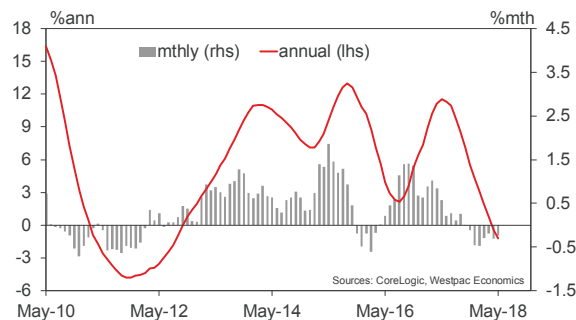


Aus Jun CoreLogic home value index

Jul 3, Last: -0.2%, WBC f/c: -0.3%

- Australia's housing market continues to correct. The CoreLogic home value index dipped 0.2% in May to be down 1.9% from September's peak. The correction remains both relatively shallow and narrowly-based, concentrated in the previously strong Sydney and Melbourne markets.
- The daily index points to a further 0.3% decline in June that will take the annual pace of decline to -1.7%yr nationally. Auction clearance rates weakened notably through May-June, suggesting an additional drag from tightening loan criteria and longer approval processing times. Buyer sentiment has lifted off last year's lows but the change in credit conditions looks to have overshadowed any positives from the marginal improvement in affordability.

Australian dwelling prices



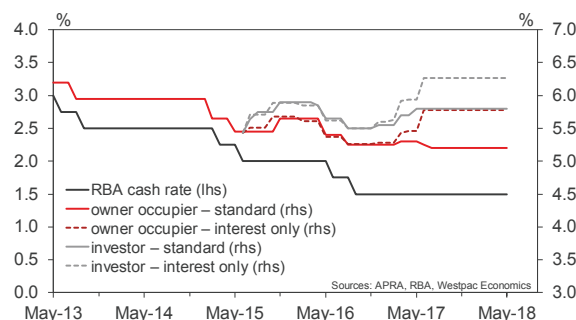
Aus RBA policy decision

Jul 3, Last: 1.50%, WBC f/c: 1.50%

Mkt f/c: 1.50%, Range: 1.50% to 1.50%

- The RBA will hold rates unchanged at their July meeting, as they have since they last cut rates in August 2016. The Governor's decision statement is likely to repeat the line that: "further progress in reducing unemployment and having inflation return to target is expected, although this progress is likely to be gradual".
- Updates over the last month have likely reinforced this 'gradual' view. While the stronger than expected March GDP result will be of some comfort, the detail around consumers was less upbeat with labour market updates continuing to show slower job gains. The outlook for labour markets and the wider nexus between labour markets, wage incomes and spending remain key areas of uncertainty.

RBA cash rate and mortgage interest rates



The week ahead

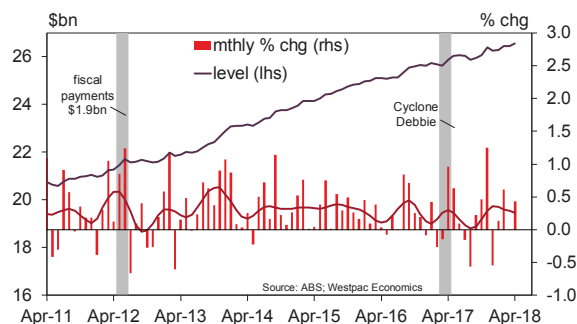
Aus May retail trade

Jul 4, Last: 0.4%, WBC f/c: 0.3%

Mkt f/c: 0.3%, Range: 0.0% to 0.6%

- Retail sales recorded a 0.4% lift in April, better than the flat March result and following a patchy period through Dec-Feb.
- Indicators are a bit softer for May. The mild consumer optimism at the start of the year continued to fade, the detail showing ongoing pressure on finances. Slowing job gains will be impacting aggregate incomes. Private business surveys have been mixed. Price discounting likely remains a significant drag on the dollar value of sales. Overall, we expect May to show a 0.3% gain.
- Looking forward, price discounting may ease a touch with the new GST on low value imported goods from July 1, affecting the pricing and availability of offshore based online retailers. However, the housing slowdown is likely to have some dampening impact on spending as well.

Monthly retail sales



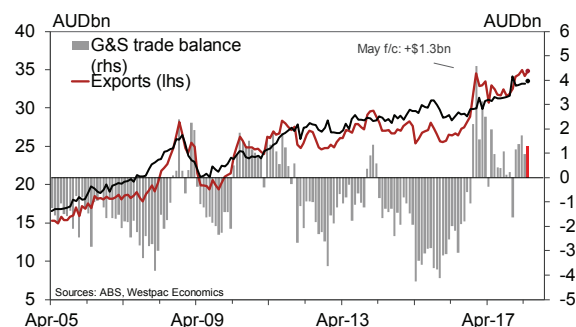
Aus May trade balance, AUDbn

Jul 4, Last: 1.0, WBC f/c: 1.3

Mkt f/c: 1.2, Range: 0.6 to 1.8

- Australia's monthly trade account has been in surplus so far in 2018, with a monthly average of \$1.4bn for Q1.
- For May, we anticipate another trade surplus, widening a little to \$1.3bn, up from \$1.0bn in April.
- The import bill is expected to increase by 1%, +\$0.3bn, largely on higher prices, particularly rising global energy costs.
- Export earnings are expected to expand by 2%, \$0.6bn, reflecting: higher prices associated with a lower currency (down 2% against the US dollar to 75.3¢); higher energy prices; modest gains in coal and iron ore shipments; as well as a lift in service exports.

Australia's trade balance



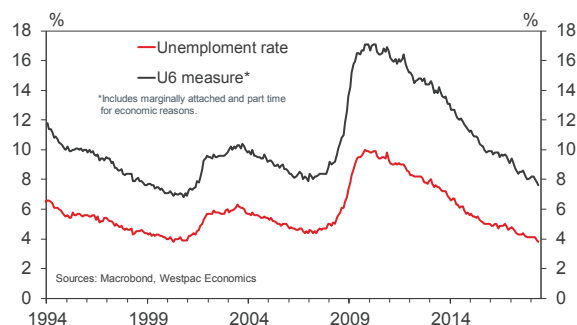
US Jun employment report

Jul 6, nonfarm payrolls, last 223k, WBC 205k

Jul 6, unemployment rate, last 3.8%, WBC 3.8%

- The US labour market has continued to strengthen at a rapid pace in recent months. Job gains have averaged 179k over the past three months, well ahead of population growth. This is despite the unemployment rate trending down below 4.0%.
- Come June, we look for another strong gain of 205k. Participation rate pending, that will see the unemployment rate remain at 3.8%.
- As we move through the remainder of this year, employment growth should slow, but only modestly. Support for wage inflation will build, but only at a measured pace as prime-aged participation returns to pre-GFC levels. Once that occurs, available labour resources will be fully employed, pushing employers to improve compensation to attract staff.

Excess supply continues to be reduced



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 02					
Aus	Jun AiG PMI	57.5	-	-	Man'fg expanding, on construction upswing & lower AUD.
	Jun CoreLogic home value index	-0.2%	-	-0.3%	Prices now down over 2% nationally since Sep.
	Jun MI inflation gauge	2.1%	-	-	Rising petrol prices should boost the headline print.
	Jun ANZ job ads	1.5%	-	-	Will it point to a turning point for the current soft patch?
Chn	Jun Caixin China PMI	51.1	51.1	-	Follows release of NBS measures at the weekend.
Eur	Jun Markit manufacturing PMI final	55.0	55.0	-	Still pointing to robust growth.
	May unemployment rate	8.5%	8.5%	-	Progress looks to be slowing.
UK	Jun Markit manufacturing PMI final	54.4	54.3	-	Conditions eased, including weakness in forward orders.
US	Jun Markit manufacturing PMI final	54.6	-	-	Not fully in sync with ISM's, but both measures positive.
	May construction spending	1.8%	0.4%	-	Public and private growth has been strengthening.
	Jun ISM manufacturing	58.7	58.0	-	Remains at very elevated level.
Tue 03					
NZ	Q2 QSBO general business situation	-9.1	-	-	Confidence has been sliding in monthly surveys
Aus	May dwelling approvals	-5.0%	1.0%	-4.0%	Further pull back in both high rise and non high rise likely.
	RBA policy decision	1.50%	1.50%	1.50%	RBA firmly on hold.
US	May factory orders	-0.8%	0.0%	-	Durable goods orders mixed in Apr/May.
Wed 04					
NZ	GlobalDairyTrade auction	-1.2%	-	-	Prices likely to remain relatively stable.
	Jun ANZ commodity prices	1.5%	-	-	Easing dairy & beef partly offset by other sectors strength.
Aus	May retail sales	0.4%	0.0%	0.3%	Sub-par pace continues, indicators a touch softer in May.
	May trade balance \$bn	1.0	1.0	1.3	Imports +1%, Exports +2% see box for detail.
	Jun AiG PSI	59	-	-	Services up 7pts from end 2017, led by business segments.
Chn	Jun Caixin China PMI services	52.9	52.7	-	Dated compared to NBS measure
Eur	Jun Markit services PMI final	55.0	55.0	-	Domestic demand key for services...
UK	Jun Markit services PMI	54.0	53.9	-	Weather disruptions passed, but conditions still subdued.
Thu 05					
Aus	RBA Head of Econ. Analysis Heath	-	-	-	Speaks at the Urban Development Institute of Aus, 1:05 pm.
Eur	ECB Weidmann speaks	-	-	-	Bundesbank President on strengthening EMU.
UK	BOE Governor Carney	-	-	-	Speaking at event in Newcastle.
US	Jun ADP employment change	178k	190k	200k	Has underperformed of late.
	Initial jobless claims	227k	-	-	Very low.
	Jun Markit service PMI	56.5	-	-	A little less positive than ISM...
	Jun ISM non-manufacturing	58.6	58.0	-	... which remains very strong.
	FOMC meeting minutes	-	-	-	Risks of delay versus flattening curve, which wins out?
Fri 06					
UK	Jun Halifax house prices	1.5%	-	-	Annual inflation seems to be bottoming but remains soft.
US	Jun non-farm payrolls	223k	193k	205k	Another strong month expected.
	Jun unemployment rate	3.8%	3.8%	3.8%	Unemployment rate to move lower in coming months.
	May trade balance US\$bn	-46.2	-45.4	-	Exports narrowing deficit.
Sun 08					
Chn	Jun foreign direct investment %yr	7.6%	-	-	FDI desired by China, in particular areas of economy.

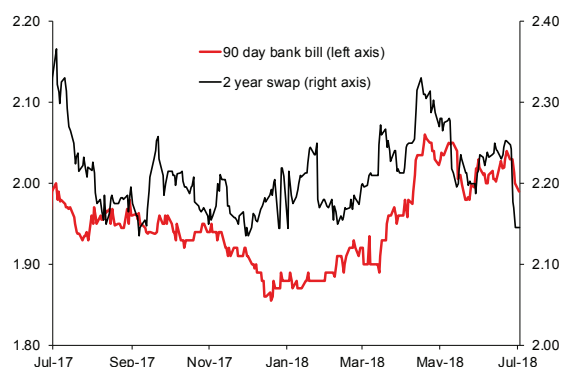
New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2018				Calendar years			
% change	Mar (a)	Jun	Sep	Dec	2016	2017	2018f	2019f
GDP (Production)	0.5	0.7	0.8	0.7	4.0	2.8	2.6	3.2
Employment	0.6	0.2	0.3	0.3	5.8	3.7	1.4	1.4
Unemployment Rate % s.a.	4.4	4.4	4.5	4.6	5.3	4.5	4.6	4.6
CPI	0.5	0.6	0.7	0.3	1.3	1.6	2.1	1.4
Current Account Balance % of GDP	-2.8	-3.1	-3.5	-3.6	-2.2	-2.7	-3.6	-3.7

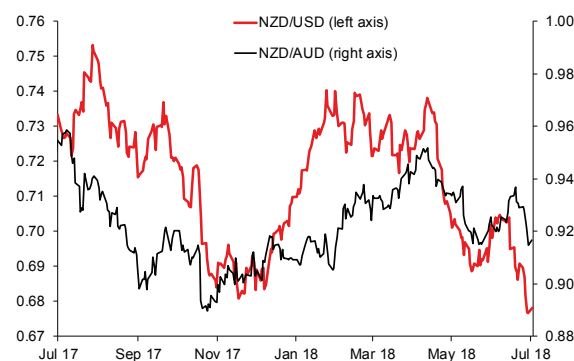
¹ Annual average % change

Financial Forecasts	Sep-18	Dec-18	Mar-18	Jun-18	Sep-19	Dec-19
Cash	1.75	1.75	1.75	1.75	1.75	2.00
90 Day bill	2.00	2.00	2.00	2.00	2.10	2.20
2 Year Swap	2.20	2.30	2.40	2.55	2.70	2.80
5 Year Swap	2.75	2.90	3.05	3.15	3.25	3.30
10 Year Bond	3.00	3.20	3.30	3.35	3.40	3.45
NZD/USD	0.68	0.67	0.65	0.65	0.64	0.65
NZD/AUD	0.91	0.91	0.90	0.90	0.91	0.93
NZD/JPY	75.5	75.0	74.1	73.5	71.7	71.5
NZD/EUR	0.58	0.58	0.57	0.56	0.54	0.54
NZD/GBP	0.52	0.53	0.53	0.53	0.52	0.53
TWI	72.0	71.6	70.2	70.0	69.1	70.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 2 July 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.90%	1.90%	1.89%
60 Days	1.94%	1.94%	1.95%
90 Days	1.99%	2.01%	2.01%
2 Year Swap	2.15%	2.24%	2.25%
5 Year Swap	2.54%	2.66%	2.68%

NZ foreign currency mid-rates as at 2 July 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6782	0.7028	0.7027
NZD/EUR	0.5813	0.5967	0.6009
NZD/GBP	0.5139	0.5239	0.5277
NZD/JPY	75.08	76.77	77.16
NZD/AUD	0.9166	0.9259	0.9189
TWI	72.68	73.88	73.81

International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
Australia						
Real GDP % yr	2.6	2.5	2.6	2.2	2.7	2.5
CPI inflation % annual	1.7	1.7	1.5	1.9	2.2	1.9
Unemployment %	6.2	5.8	5.7	5.4	5.5	5.6
Current Account % GDP	-3.0	-4.7	-3.1	-2.5	-3.0	-4.2
United States						
Real GDP %yr	2.6	2.9	1.5	2.3	2.8	2.5
Consumer Prices %yr	1.6	0.1	1.3	2.1	2.6	2.0
Unemployment Rate %	6.2	5.3	4.9	4.4	3.9	3.7
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	0.4	1.4	0.9	1.7	1.3	1.0
Euroland						
Real GDP %yr	1.3	2.1	1.8	2.3	2.1	1.6
United Kingdom						
Real GDP %yr	3.1	2.3	1.9	1.8	1.2	1.5
China						
Real GDP %yr	7.3	6.9	6.7	6.9	6.3	6.1
East Asia ex China						
Real GDP %yr	4.2	3.8	3.9	4.5	4.3	4.3
World						
Real GDP %yr	3.6	3.5	3.2	3.8	3.8	3.7

Forecasts finalised 14 Jun 2018

Interest Rate Forecasts	Latest	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	2.11	1.98	1.94	1.90	1.88	1.86	1.85	1.83
10 Year Bond	2.63	2.90	3.05	3.20	3.10	3.10	3.00	3.00
International								
Fed Funds	1.875	2.125	2.125	2.375	2.625	2.625	2.625	2.625
US 10 Year Bond	2.85	3.10	3.35	3.50	3.50	3.40	3.20	3.10
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.30	-0.30	-0.20	-0.10

Exchange Rate Forecasts	Latest	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
AUD/USD	0.7382	0.75	0.74	0.72	0.72	0.70	0.70	0.72
USD/JPY	110.68	111	112	114	113	112	110	109
EUR/USD	1.1637	1.17	1.16	1.15	1.16	1.18	1.20	1.21
AUD/NZD	1.0902	1.10	1.10	1.11	1.11	1.09	1.08	1.09

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