

# Weekly Commentary

16 July 2018



## A game of two halves

Caution among consumers has played an important part in the economy's loss of momentum this year. While we expect growth to remain subdued, there's reason to think that households' fortunes will look a bit better in the second half this year than they did in the first. The inflation picture for New Zealand could also look somewhat different by year-end.

While consumer spending has seen some moderate gains in recent months, the trend has clearly softened over the first half of 2018. The latest credit and debit card figures showed a 0.8% increase in retail spending in June, which was a little stronger than forecast. But comparing the three months to June with the preceding three months, spending levels have essentially been flat.

Last week we noted that financial markets have been slow to recognise the cooling in the New Zealand economy this year. In contrast, we've been flagging the likelihood of a first-half slowdown for some time. In particular, the softness in consumer spending is in line with the slowdown that we've seen in the housing market, as a range of new Government policies have weighed on house prices and sales.

We've also been pointing out that things could look different again by next year, as increased fiscal stimulus starts to fill in some of the gaps left by a more subdued private sector. For households, that turning point may have already arrived. From 1 July the Government's Families Package came into full force. The package includes winter energy payments for the elderly and those on benefits, a tax credit for newborns, and increases in Working for Families payments. That's on top of an increase in the accommodation supplement that came into effect in April.

All together, this amounts to more than a billion dollars a year going into people's pockets. And importantly, it's

targeted towards lower-income households who are more likely to spend than save it.

That said, we still expect households to face some headwinds over the second half of this year. One is that the housing market is likely to remain soft as the Government continues with its measures to dampen housing speculation. Restrictions on foreign buyers of property are expected to come into force sometime next month. Then from early next year, the use of negative gearing by property investors will start to be phased out. These measures will weigh on property values, and as a result are likely to weigh on people's willingness to spend as well.

Another issue is the cost of fuel. The rise in world oil prices and a weaker New Zealand dollar meant that petrol prices had already risen to new highs by early June. The Auckland regional fuel tax (from July) and a national increase in excise duty (expected to be from September) will add further to the cost of filling up over the second half of the year. Higher fuel prices tend to detract from spending in other areas.

On balance, though, we think that households will fare a little better over the second half of this year than they did in the first half. We'll be watching for signs of a pickup in spending growth over the coming months.

Looking ahead to this week, the highlight is likely to be the June quarter CPI on Tuesday. We expect a 0.6% rise for

# A game of two halves ... continued

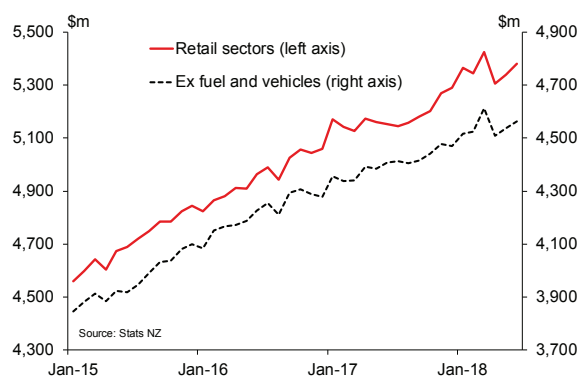
the quarter, which would see the annual inflation rate rise from 1.1% to 1.7%. Fuel and food prices are likely to make the biggest positive contributions. We also expect that the lower New Zealand dollar over the last year will put some upward pressure on the retail prices of imported goods.

More importantly, we expect these same factors to push inflation just above 2% by the end of this year – putting it in the upper half of the Reserve Bank’s target range for only the second time in seven years. In contrast, the Reserve Bank’s forecasts in its May *Monetary Policy Statement* didn’t see inflation reach 2% until the end of 2020.

We don’t think that the rise in inflation this year will necessarily be sustained. Domestic inflation pressures are growing as the economy uses up its spare capacity, but this tends to be a gradual process. In the meantime, the tradables portion of the CPI is still driving most of the variation in the inflation rate. That means that maintaining inflation around 2% next year would require a further surge in world oil prices and/or a continued slide in the exchange rate.

Nevertheless, a near-term pickup in inflation will help to dampen the recent talk in financial markets about the possibility of further OCR cuts. Rising costs for businesses, a lower exchange rate, government stimulus and a growing pipeline of building work together suggest that the picture of inflation pressures in New Zealand will look somewhat different by the end of the year.

Electronic card spending

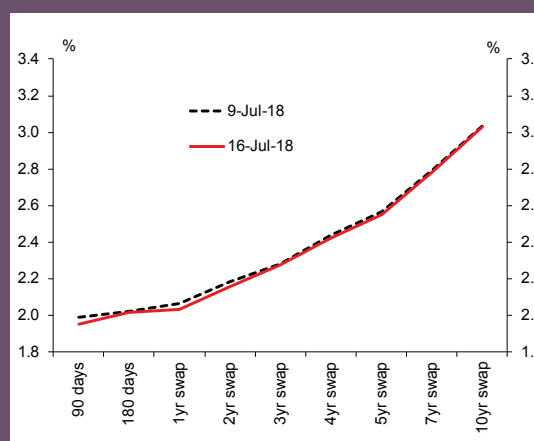


## Fixed vs Floating for mortgages

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 Jun REINZ house sales and prices

Jul 17, Sales, Last: +0.8%. Prices, Last: 3.7%/yr

- After a brief resurgence around the turn of the year, the New Zealand housing market has cooled again. Prices are now falling in Auckland, Wellington and Christchurch, and rising slowly elsewhere. Measured nationwide, house prices have been roughly flat.
- The 'bright-line' test for taxing capital gains was extended from two to five years in late March, and this is impacting the market at present. The next negative factor for the market will be the foreign buyer ban, set to become law within a month. However, one offsetting positive for the market at present is falling mortgage rates.
- The June REINZ data (delayed from last week) is expected to continue the recent trend of slowing sales and flat prices.

## REINZ house prices and sales

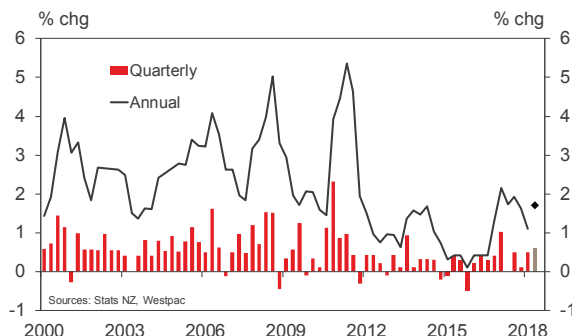


## NZ Q2 CPI

Jul 17, Last: 0.5%, Westpac f/c: 0.6%, Mkt f/c: 0.5%

- We expect a 0.6% rise in consumer prices for the June quarter. This would see the annual inflation rate rise to 1.7%, after a brief drop to 1.1% in the March quarter.
- The biggest positive contributions will be from higher fuel prices and a largely seasonal rise in food prices. We also expect a modest uptick in imported goods prices, as a result of the lower New Zealand dollar over the past year. Domestic airfares and accommodation will see seasonal declines as the peak tourist period comes to an end.
- We expect annual inflation to reach 2.1% by the end of this year, as fuel prices turn from a drag to a boost. However, we're not convinced that this effect will persist into next year.

## NZ CPI inflation



## Aus Jun Westpac-MI Leading Index

Jul 18, Last: 0.11%

- The six month annualised growth rate in the Leading Index dropped from +0.83% in April to +0.11% in May. This was the weakest read since September last year with a clear shift lower in the first half of 2018, albeit with the index growth rate still pointing to momentum running slightly above trend.
- The June reading will include a mixed bag of component updates. On the positive side: the ASX200 is up 3.0% vs 0.5% last month; the Westpac-MI Consumer Expectations Index, rose 5.1% vs a 1% fall last month; and the Westpac-MI Unemployment Expectations Index improved slightly. On the downside: commodity prices slipped 0.6% (in AUD terms) vs +0.6% last month; dwelling approvals were down 3.2% vs a 5% fall last month; and the yield spread narrowed 20bps, partly reflecting rising short term rates.

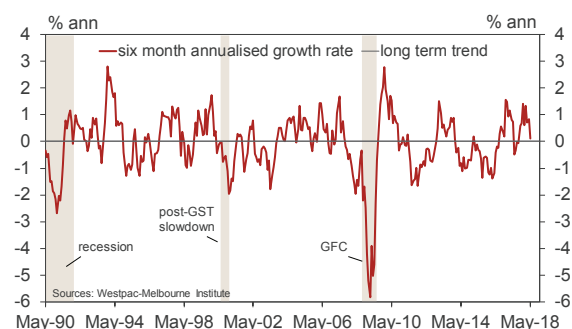
## Aus Jun Labour Force - total employment '000

July 19, Last 12k, WBC f/c: 17k

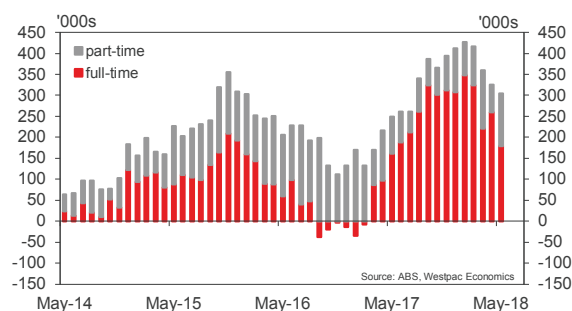
Mkt f/c: 16.5k, Range: 5k to 30k

- Australian employment rose 12.0k in May undershooting both the market (+19k) and Westpac's (+17k) forecasts. Full-time employment fell 20.6k while part-time employment rose 32.6k. Overall this can be taken as a soft update with total hours worked falling 1.4% in the month. But it should be noted that hours worked are very volatile month-to-month and they rose 1.2% in April.
- Our forecast for June is a 17k increase in employment. This is broadly in line with results over the last two months and around the middle of the 2018 ytd average of 12.4k and the year to May 2018 average of 25.3k.

## Westpac-MI Leading Index



## Annual change in full-time/part-time emp.



# The week ahead

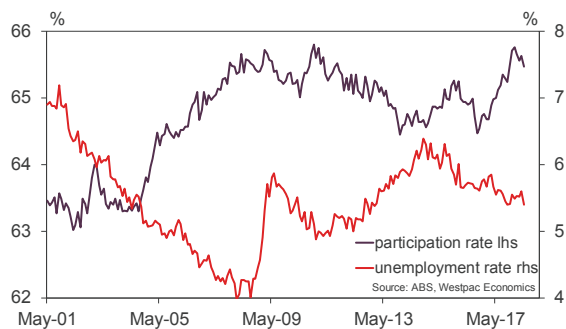
## Aus Jun Labour Force - unemployment rate %

July 19, Last 5.4%, WBC f/c: 5.4%

Mkt f/c: 5.4%, Range: 5.4% to 5.6%

- Despite the moderate increase in employment in May, the unemployment rate dipped to 5.4% from 5.6%, a significant drop in one month (5.40% from 5.60% at two decimal places).
- Driving the change in unemployment was a 14.8k decline in the labour force with the participation rate falling to 65.47% from 65.62% which was not too far off the recent high of 65.75%.
- Changes in the participation rate have tended to closely follow changes in employment. Participation rose during the employment upswing in the second half of 2017, and consequently moderated through the employment slowdown in 2018. As such, the unemployment rate has been relatively steady through this period.
- We are forecasting an unchanged unemployment rate of 5.4% and unchanged participation rate of 65.6%.

### Unemployment and participation rates

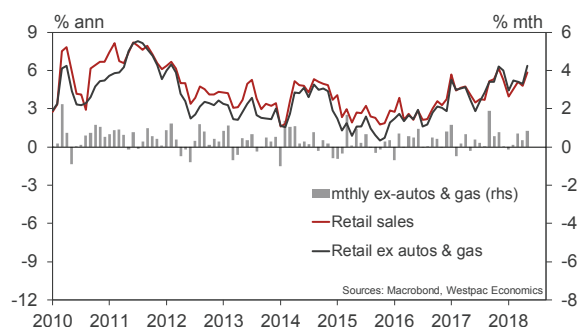


## US Jun retail sales

Jul 16, last 0.8%, WBC 0.7%

- Retail sales surprised in May, the 0.8% headline gain double the market's expectation. The Apr outcome was also edged higher to 0.4%. Highlighting the breadth of the sales gain, excluding autos & gas, May activity was also up 0.8%, while the control group gained 0.5%.
- Come June, a similar result is likely. We forecast a 0.7% rise in total sales, and circa 0.5% for core retail. Importantly, this does not mean we are expecting a strong Q2 consumption print when GDP is released in a few weeks time.
- Also available to May, the broader personal consumption data makes clear that total consumption (including services) has been weaker than retail sales of late. And also, that once deflated for inflation, spending growth in Q2 has only been a little stronger than the weather-affected Q1.

### Retail sales growth

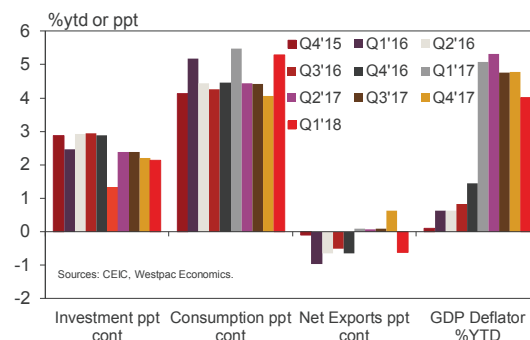


## China Q2 GDP

Jul 16, last 6.8%, WBC 6.6%

- The past few months have been an interesting time for China. Momentum in their PMIs has remained robust despite decelerating external demand. Against this however, the pursuit of 'quality development' has resulted in growth in non-bank lending being heavily restricted and only partly offset by increased lending by banks.
- For GDP, we therefore look for a deceleration in annual growth to 6.6%yr from 6.8%yr in Q1. On a quarter by quarter basis, that equates to a 1.6% gain, up on Q1's 1.4% but below the 1.8% increases of mid-2017.
- A further slowing in growth is expected in the second half of 2018, once the seasonal Q2 kick higher fades and as consumers remain unable/unwilling to accelerate their marginal consumption to offset.

### China national accounts: expenditure detail



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 16</b>					
<b>NZ</b>	Jun BusinessNZ PSI	57.3	-	-	Service sector conditions have picked up recently.
<b>Chn</b>	Q2 GDP %yr	6.8%	6.7%	6.6%	6.6%/6.7% marginal call, but multi-quarter trend clear.
	Jun retail sales ytd %yr	9.5%	9.4%	-	Consumer robust, but not able to accelerate growth.
	Jun industrial production ytd %yr	6.9%	6.8%	-	More subdued than PMIs.
	Jun fixed asset investment ytd %yr	6.1%	6.0%	-	Needs to bounce; credit a big headwind.
<b>Eur</b>	May trade balance €bn	18.1	-	-	Weaker Euro beneficial to export income.
<b>UK</b>	Jul Rightmove house prices	0.4%	-	-	Prices muted, weighed down by weakness in London.
<b>US</b>	Jun retail sales	0.8%	0.6%	0.7%	Another robust print likely; partly due to prices.
	Jul Fed Empire state index	25	20	-	Still very positive.
	May business inventories	0.3%	0.4%	-	Will add to growth in Q2.
<b>Tue 17</b>					
<b>NZ</b>	Jun REINZ house prices, %yr	3.7%	-	-	Tentative date. Expected to continue the recent trends ...
	Jun REINZ house sales	0.8%	-	-	... of lacklustre sales and flat prices.
	Q2 CPI	0.5%	0.5%	0.6%	Boosts from food and fuel. Annual rate to climb to 1.7%.
<b>Aus</b>	RBA minutes	-	-	-	Clarity on 'other factors' behind higher funding costs?
<b>UK</b>	May ILO unemployment rate	4.2%	4.2%	-	On recent firming in activity, unemployment to stay low.
<b>US</b>	Jun industrial production	-0.1%	0.5%	-	Well below what ISMs and Markit PMI would suggest.
	Jul NAHB housing market index	68	69	-	A lack of supply the housing sectors only real issue.
	May total net TIC flows \$bn	138.7	-	-	Dated, but likely to come into sharper focus in 18/19.
	Fed Chair Powell speaks	-	-	-	Semi-annual testimony to the Senate Banking Committee.
<b>Wed 18</b>					
<b>NZ</b>	GlobalDairyTrade auction	-5.0%	-	-	Watched closely following surprise fall in last auction.
<b>Aus</b>	Jun Westpac-MI Leading Index	0.11%	-	-	Dropped in May but still above trend.
<b>Eur</b>	Jun CPI core %yr final	1.0%	1.0%	1.0%	Core price pressures show little momentum.
<b>UK</b>	Jun CPI	0.4%	0.3%	-	Oil boost, but core contained as non-oil import prices ease.
<b>US</b>	Jun housing starts	5.0%	-1.9%	-	Volatile month to month, but...
	Jun building permits	-4.6%	1.8%	-	... still broadly supportive of investment in sector.
	Federal Reserve's Beige book	-	-	-	Conditions across the 12 districts.
	Fed Chair Powell speaks	-	-	-	Follow-up testimony to the House.
<b>Thu 19</b>					
<b>Aus</b>	Q2 NAB business survey	7	-	-	More detail than the monthly survey.
	Jun employment	12.0k	16.5k	17k	Employment growth slower in 2018 but ...
	Jun unemployment rate	5.4%	5.4%	5.4%	... lower participation seeing unemployment rate steady
<b>UK</b>	Jun retail sales	1.3%	0.2%	-	World Cup boosting spending, esp. on durables hospitality.
<b>US</b>	Initial jobless claims	214k	-	-	Very, very low levels.
	Jul Philly Fed index	19.9	20.0	-	Remains positive.
	Jun leading index	0.2%	0.5%	-	Pointing to above-trend growth.
	Auto import tariff hearing	-	-	-	Public hearing from 19-20.
	Fedspeak	-	-	-	Quarles' pre-recorded speech on alternative ref. rates.
<b>Fri 20</b>					
<b>NZ</b>	June net migration	5090	-	5070	Arrivals easing back and departures rising.
<b>UK</b>	Jun public sector borrowing, £bn	3.4	3.5	-	Lift in tax revenue means borrowing lower than anticipated.
<b>US</b>	Fedspeak	-	-	-	Bullard speaks on the economy and policy in Kentucky.

# 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

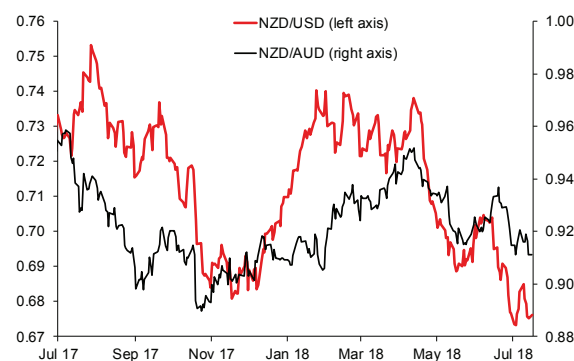
<sup>1</sup> Annual average % change

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	2.70	2.85	3.00	3.15	3.25	3.30
10 Year Bond	2.90	3.15	3.30	3.35	3.40	3.45
NZD/USD	0.68	0.67	0.65	0.65	0.64	0.65
NZD/AUD	0.92	0.91	0.90	0.90	0.91	0.93
NZD/JPY	76.2	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	73.4	72.7	71.2	70.9	70.1	70.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 16 July 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.86%	1.90%	1.90%
60 Days	1.90%	1.94%	1.94%
90 Days	1.95%	1.99%	2.01%
2 Year Swap	2.16%	2.15%	2.24%
5 Year Swap	2.55%	2.54%	2.66%

NZ foreign currency mid-rates as at 16 July 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6763	0.6782	0.7028
NZD/EUR	0.5785	0.5813	0.5967
NZD/GBP	0.5114	0.5139	0.5239
NZD/JPY	75.88	75.08	76.77
NZD/AUD	0.9113	0.9166	0.9259
TWI	72.76	72.68	73.88

# International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
<b>Australia</b>						
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	1.8	1.8
Unemployment %	6.2	5.8	5.7	5.4	5.5	5.6
Current Account % GDP	-3.0	-4.7	-3.1	-2.5	-2.8	-4.0
<b>United States</b>						
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
<b>Japan</b>						
Real GDP %yr	0.4	1.4	0.9	1.7	1.2	1.0
<b>Euro zone</b>						
Real GDP %yr	1.3	2.1	1.8	2.3	2.1	1.6
<b>United Kingdom</b>						
Real GDP %yr	3.1	2.3	1.9	1.8	1.2	1.5
<b>China</b>						
Real GDP %yr	7.3	6.9	6.7	6.9	6.3	6.1
<b>East Asia ex China</b>						
Real GDP %yr	4.2	3.8	3.9	4.5	4.3	4.3
<b>World</b>						
Real GDP %yr	3.6	3.5	3.2	3.8	3.8	3.7

Forecasts finalised 6 July 2018

Interest Rate Forecasts	Latest	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
<b>Australia</b>								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	2.02	2.04	2.02	1.95	1.95	1.90	1.90	1.85
10 Year Bond	2.64	2.75	3.05	3.20	3.10	3.10	3.00	3.00
<b>International</b>								
Fed Funds	1.875	2.125	2.125	2.375	2.625	2.625	2.625	2.625
US 10 Year Bond	2.85	3.00	3.35	3.50	3.50	3.40	3.20	3.10
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-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	0.7417	0.74	0.74	0.72	0.72	0.70	0.70	0.72
USD/JPY	112.63	111	112	114	113	112	110	109
EUR/USD	1.1664	1.17	1.16	1.15	1.16	1.18	1.20	1.21
AUD/NZD	1.0948	1.09	1.10	1.11	1.11	1.09	1.08	1.09

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