

Australia & New Zealand weekly.

Week beginning 29 July 2019

- RBA to cut cash rate to 0.75% in October & to 0.50% in February – possible package to enhance the impact of the February cut.
- Australia: CPI, retail sales, dwelling approvals, home prices, trade prices, private credit.
- NZ: dwelling approvals, business confidence.
- China: NBS and Caixin PMI's.
- Europe: GDP, CPI, unemployment rate.
- US: FOMC policy meeting, payrolls, ECI.
- Central banks: BOJ and BOE policy meetings.
- Key economic & financial forecasts.

Information contained in this report current as at 26 July 2019.



RBA to cut cash rate to 0.75% in October & to 0.50% in February – possible package to enhance the impact of the February cut

We are bringing forward the timing of our forecast for the next cut in the overnight cash rate by the RBA from November to October.

By October, we expect that the path of the unemployment rate will be sufficiently contrary to the RBA's plans that they will have appropriate justification to ease policy a little earlier than we had previously expected.

We recognise that September is also likely to be a "live" meeting but expect the Board will wait for more data, such as the June quarter national accounts, before moving again.

We are also revising down our terminal rate forecast from the 0.75% we forecast on May 24 to 0.50%. We expect the move from 0.75% to 0.50% to occur in February next year.

Developments since our last forecast change on May 24

Since we announced the 0.75% target terminal rate on May 24 a number of factors have strengthened the case for an even lower terminal rate.

The AUD is providing less support than expected. At the time of our May 24 forecast, markets had not priced in the prospect of a 0.75% terminal rate by year's end. We expected that as markets moved in that direction the AUD would adjust accordingly. Markets have indeed moved to price in that move but the AUD has actually appreciated from USD0.692 to USD 0.702, partly due to the higher terms of trade and the prospect of a lower US federal funds rate.

We expect that the near term boost to demand from the higher terms of trade will be limited by a cautious response from both the private and public sectors.

Since May 24 we have also moved to forecast an easing cycle from the Federal Reserve. Lower rates globally are largely the result of the concern from the Federal Reserve and other central banks around world growth and deteriorating global trade.

Some data releases since May 24 have also highlighted downside risks for demand, wages and the labour market. In particular we have been surprised by the response of consumer sentiment to the rate cuts in June/July, having fallen by nearly 5%. Furthermore, our measure of unemployment expectations has also deteriorated markedly.

Our forecasts of inflation and unemployment emphasise the extent of the challenge faced by the RBA in boosting demand and wages and reaching their own targets. We expect that the RBA will eventually see only one more rate cut, in October, as being an insufficient response.

RBA's challenge around its forecasts

In its Statement on Monetary Policy (SMP), which will be released on August 9, the RBA is expected to lower its growth forecast for 2019 from 2.75% to 2.50% but retain its current forecast for growth in 2020 to be at trend 2.75%.

On inflation we expect that following the print of the June quarter Consumer Price Index on July 31 the Bank will have to lower its forecast for underlying inflation (trimmed mean) from 1.75% in 2019 to 1.50% and from 2.00% to 1.75% in 2020.

In the August SMP, forecasts for December 2021 will be released and the RBA's trimmed mean forecast is expected to lift to 2%. The RBA will be signalling an eventual return to the 2-3% target band although the journey will take a year longer.

The real difficulty will come with the unemployment rate where the actual for June has just printed 5.24% compared to the RBA's forecast of 5.0% in May. In May the RBA was only able to forecast that the unemployment rate would hold steady at 5.0% in both the remainder of 2019 and 2020. That was essentially because it was only prepared to forecast trend growth in 2019 and 2020. A fair rule of thumb is that the unemployment rate can only be credibly forecast to fall if growth is expected to be above trend.

Note that the forecasts in May assumed market pricing which at the time had discounted two 25 bp rate cuts by year's end. Accordingly the August forecasts cannot be significantly lifted as a result of the rate cuts that have already occurred. However, the cuts have come earlier than expected by the market at the time of the May forecasts and it is now discounting a further cut by year's end. Those factors provide some further market support for the RBA's August forecasts.

The unemployment forecast is going to challenge the RBA Governor given his stated desire to drive the unemployment rate down to 4.5%.

Westpac's own forecast for the unemployment rate by end 2019 is 5.4%. A range of our leading indicators – the Westpac Jobs Index and the Westpac Index of Unemployment Expectations – signal a continuation of the current slowdown in employment growth over the remainder of 2019 and into 2020.

With the unemployment rate holding or drifting higher there seems little justification to delay the cut to 0.75% to November. We expect an October move while recognising that September will be a "live" meeting.

This is a relatively minor adjustment to Westpac's forecast released on May 24, when we were the first in the market to forecast a cash rate below 1.0%.

At the time we signalled downside risks to that terminal rate but chose to stick with 0.75% partly due to uncertainty about the effectiveness of any cuts below 0.75%.

The response by the banks to the move in the cash rate to 0.75% will be an indicator to the RBA of the likely effectiveness of any further cuts.

An alternative approach to maximise the impact of a rate cut

However, there may be a way in which the RBA could ensure an effective response of a cut to 0.50%.

When the Bank of England cut the Bank Rate from 0.50% to 0.25% following the Brexit vote in June 2016, it supported the economy through a four pronged strategy. This was highlighted by the Bank Rate cut being accompanied by the Term Funding Scheme, a form of policy designed to "encourage banks to pass on cuts in Bank Rate to customers" (boost household demand). The Term Funding Scheme allowed banks (and building societies) to borrow from the Bank of England on a secured basis (subject to appropriate haircuts) at the new Bank Rate.

In supporting the package, The Bank of England noted that:

"Evidence from a number of economies suggests that, as the level of interest rates set by the central bank becomes lower, the extent to which further cuts are passed on by commercial banks and building societies to other interest rates in the economy decreases, making monetary policy less effective... The potential difficulty, from a monetary policy

transmission perspective, arises when interest rates are close to zero because it is likely to be difficult for banks and building societies to reduce deposit rates much further. This constraint means that lenders may then face a choice between reducing the pass through of lower official rates to those they charge on loans — in particular rates on new loans — or a period of lower profitability, which, were it to persist, could reduce the supply of lending”.

(Bank of England Quarterly Bulletin, 2018 Q4)

Adopting a package of instruments, alongside a cut in the Bank Rate, ensured the effectiveness of the rate cut (in time, 24 bps of cuts in the variable mortgage rate followed the 25 bp cut in the Bank Rate) and avoided the confidence drag from adopting an “emergency measure” later on, such as a term lending program or asset purchase facility in isolation.

Banks found that the alternative costs of funding – wholesale and term retail funding – were considerably more expensive (around 70bps) than the drawdown costs of the program.

Important to choose a package best suited to the Australian Financial System

The point is that the combination of a rate cut and a financial package appears to have been quite effective in maximising the impact of the cut. The details of any domestic package, of course, would need to be best suited to the Australian financial system.

Alternatively, the market’s response to the move to 0.75% might be sufficiently encouraging for the RBA to make the cut to 0.50% without any supporting package.

At a public forum on July 23rd, I asked the RBA Assistant Governor (Financial Markets) Kent about prospects for other RBA policies to support demand in addition to rate cuts. He indicated that the RBA was unlikely to adopt unconventional policy measures, although he was clear that the RBA had considered a number of policies that had been implemented elsewhere in the world from the perspective of what would be most effective in the Australian financial system.

Consequently in the near term there seems little prospect of the RBA adopting a package of policies which would support the effectiveness of its interest rate policies.

Our forecast is that the RBA will cut the cash rate to 0.50% in February. It may be prepared to link the move with a package of other policies, most appropriate for the Australian financial system, that would result in an effective reduction in the mortgage and business interest rates to ensure effective pass through of the rate cut.

However, we emphasise that the rate cut we envisage in February is not conditional on an associated package of other policies.

Bill Evans, Chief Economist

The week that was

This week, there were two speakers from the RBA: first Assistant Governor (Financial Markets) Christopher Kent; then Governor Phillip Lowe. [The Assistant Governor's speech](#) was focused on the Committed Liquidity Facility, its role within the economy and recent changes the RBA has made. These remarks have no immediate significance for monetary policy and economic momentum. However, during Q&A, Assistant Governor Kent noted that the RBA was unlikely to adopt unconventional monetary policy measures, while making clear the RBA had considered a number of policies implemented elsewhere from the perspective of what would be most effective in Australia.

Arguably the RBA believe they are unlikely to deliver unconventional easing because they regard the outlook as "reasonable", and also believe they still have scope to support the economy through conventional means. This was highlighted in the [Governor's subsequent speech](#). Governor Lowe was constructive on the outlook, noting that the "foundations of the Australian economy remain strong" and that the "two recent reductions in the cash rate will support demand... [as will] recent tax cuts, higher commodity prices, [and] some stabilisation in the housing market. Further, "if demand growth is not sufficient, the Board is prepared to provide additional support by easing monetary policy further", while "other arms of public policy could also play a role".

Westpac continues to see greater risk to the outlook, believing that activity growth and inflation will disappoint the RBA's expectations. Recent data for the labour market and consumer sentiment have supported our economic view, so too the stickiness of the Australian dollar, which has failed to depreciate in response to the June/ July rate cuts.

As a result, [as highlighted by Chief Economist Bill Evans](#), we believe the case for a third cash rate cut to 0.75% will now be made by October (following two more labour market prints and June quarter GDP), and more importantly that there will be a need for a fourth cut to 0.50% come February 2020. In recent days, markets have quickly gravitated towards our view, pricing roughly an extra 7bps in the IB curve, seeing a third cut in October fully priced and a 0.59% expected cash rate at February 2020 - indicating the likelihood of a fourth cut.

To ensure the effectiveness of the cut to 0.50%, we also see the possibility of the RBA adopting a package of other measures to aid pass-through. [Chief Economist Bill Evans has outlined an example of this concept](#), using the experience of the Bank of England. However, we note that any unconventional easing undertaken by the RBA must suit Australian circumstances. It

is important to note that we do not believe this possibility for unconventional easing is in conflict with the remarks of Assistant Governor Kent. This is because we see such a course of action only eventuating after a material economic disappointment, and only to guarantee the effectiveness of conventional monetary policy, i.e the rate cut to 0.5%, not to move market rates lower in their own right. It is also important to emphasise that the rate cut we envisage in February is not conditional on an associated package of other policies being adopted.

For their own reasons, Westpac New Zealand economics have also updated their policy view this week, [now seeing a second rate cut from the RBNZ to 1.00%](#), most likely in November. In short, the New Zealand economy has disappointed of late, and there are concerns over business sentiment and its potential impact on investment and employment. This is in addition to global uncertainties and sector-specific weakness in forestry. Importantly, our New Zealand team continue to believe these cuts will prove effective and will see growth strengthen come 2020.

The [July ECB meeting](#) largely met expectations through indicating the deposit rate is very likely to be cut at their September 12 meeting and that other stimulus measures are on the table. While the July meeting does not involve updated projections, President Draghi noted the outlook is getting "worse and worse". The Governing Council note data continues "to point to somewhat slower growth in the second and third quarters of this year. This mainly reflects the ongoing weakness in international trade in an environment of prolonged global uncertainties, which are particularly affecting the euro area manufacturing sector."

The detail on other potential stimulus measures is not clear cut, but the Council are clearly making preparations in the context of responding to the medium term inflation outlook disappointing. We continue to believe that a cut will be delivered in September, but now expect a broader stimulus package will also soon be introduced. This is in response to the particularly bad run of data over recent weeks, in particular the ECB Bank Lending survey. The new package is likely to include a tiered deposit rate to mitigate the pressure on banks and see asset purchases of sovereign bonds restarted. Our expectation is for the ECB to introduce a €30bn per month program in December lasting for a year, at this stage.

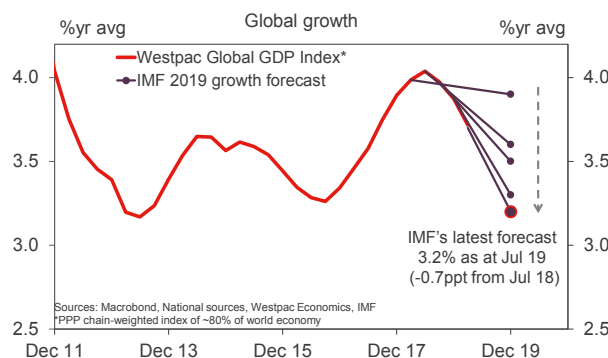
Ahead next week, for Australia we receive the [June quarter CPI report](#). And in the US, there is the all-important July FOMC meeting, which is expected to result in a 25bp rate cut.

Chart of the week: Global growth

On the broader global backdrop, this week saw [the IMF revise down their global growth view for 2019 and 2020](#) on weakness in emerging and developing markets. The scale of these revisions was immaterial, but they highlight that momentum continues to deteriorate and that risks remain skewed to the downside.

The latest flash Markit PMI data for Europe and the US also confirmed a further loss of momentum in manufacturing. Euro Zone manufacturing momentum is the worst it has been in seven years, and for the US, nearly ten.

IMF fourth consecutive forecast downgrade



New Zealand: week ahead & data wrap

How low can they go?

We now expect the RBNZ to reduce the OCR in August and November this year, with a risk of a more aggressive cutting profile.

We have revised our expectations for rate cuts from the RBNZ. Previously we expected that the RBNZ would cut the Official Cash Rate to 1.25% at its upcoming August policy decision and would then pause. At the time, softening global economic conditions were on our mind, as well as the related easing in global monetary policy and upwards pressure on the NZ dollar. While we did see the possibility of a further cut beyond that time, we expected that firming domestic activity on the back of lower borrowing rates would stay the RBNZ's hand.

While we still expect the RBNZ to cut the OCR in August, we now expect that they will follow this up with another cut in November. That would take the OCR to a new record low of 1%.

Underlying this change in our forecast are signs that the New Zealand economy has continued to soften. We estimate that annual GDP growth has slowed from a little over 3% through 2018 to around 2.7% in early 2019. And while that's far from recessionary, it's still a fairly modest rate of expansion given the continued rapid pace of population growth. In fact, in per capita terms, annual GDP growth has now fallen to 0.9% - its slowest pace in eight years.

Regular readers will know that we predicted the slowdown that has occurred since 2016. We've previously highlighted that the Canterbury rebuild would gradually wind down, net migration would slow, and the cooling housing market would dampen household spending. However, with interest rates at low levels and fiscal spending ramping up, we had expected to see a bit more momentum in economic activity through mid-2019. Instead, recent economic indicators point to quarterly GDP growth running at only around 0.5% - just barely above the rate of population growth:

- In the **household sector**, spending growth has been very sluggish through the first part of the year. That's in part due to ongoing softness in housing markets in some parts of the country. High petrol prices have also siphoned funds out of households' wallets, offsetting some of the increases in Government spending.
- We're also seeing headwinds in the **business sector**. While it's easy to dismiss low business confidence as a reaction to the political back drop, businesses are also highlighting tough trading conditions. That includes strong competition and sluggish demand growth. Businesses have also reported increases in both operating and compliance costs, but haven't been able to pass those increases through to output prices. That's squeezed profitability and has dampened plans for investment spending.

- This cooling in economic conditions now looks like it's passing through to the **labour market**. The official government series of job ads flatlined from November last year, and has actually fallen in the past couple of months. Our own count of job ads listed on TradeMe has fallen far more sharply. This is tentative data, so we're taking it with a grain of salt, but it suggests that unemployment could rise over the quarters ahead.
- In addition to a softening in domestic conditions, there are also some cracks appearing in the **export sector**. While some sectors like horticulture are still booming, dairy auction prices fell 8% over May and June, prompting us to lower our farmgate milk price forecast to \$6.90/kg (previously \$7.20). And over the past month, there has been a 25% drop in export log prices. Forestry accounts for only 9% of our merchandise exports, but it is disproportionately important for the economic cycle due to its impact on employment.

Topping all that off, the trade-weighted exchange rate has risen about 3% over the past month, and is now about 1.5% higher than the RBNZ was expecting.

Since its introduction earlier this year, the RBNZ's Monetary Policy Committee has been responsive to signs of softening in economic conditions. Going into the August policy decision, the above developments mean that they will be facing a softer picture for activity and the labour market than they had expected. That's in addition to the lingering softness in inflation. As a result, we expect that the MPC will cut the OCR in August and will signal that they may cut the cash rate further. We expect that the RBNZ's published forecasts will show the OCR dropping to 1.1%, implying a good chance (but not a certainty) of another cut.

Most likely, the RBNZ will follow this up with another cut in November, when the MPC has the benefit of the full quarterly analysis undertaken by Bank staff. However, there is a chance that they could act sooner, at the September OCR Review. A possible catalyst for an earlier OCR cut could be adverse news on the labour market. And if the RBNZ did cut in September due to rising unemployment, then there's a chance that they could go even further by cutting the OCR to 0.75% in November. However, at this stage we view earlier or more aggressive OCR cuts as a risk scenario - our central forecast is an OCR low of 1% delivered in November.

This lower for longer outlook for the cash rate is supporting a 'risk on' environment in New Zealand. Investors' search for yield has resulted in weak deposit growth at banks, while share market prices have risen very sharply (particularly for dividend-paying stocks). We expect that this same search for yield will support a rise in house prices over the coming year, reinforcing our forecast for 7% house price inflation over the year ahead.

Round-up of local data released over the last week

Date	Release	Previous	Actual	Mkt f/c
Wed 24	Jun trade balance \$m	175	365	100

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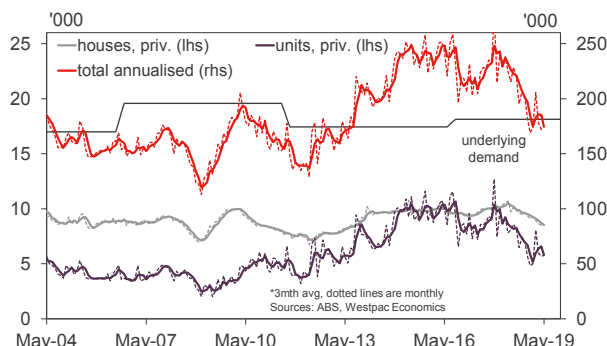
Data previews

Aus Jun dwelling approvals

Jul 30, Last: 0.7%, WBC f/c: -1.0%
Mkt f/c: 0.2%, Range: -3.0% to 2.0%

- Dwelling approvals have shown signs of levelling out in recent months after recording a 30% drop in 2018. Total approvals rose 0.7% in May but have been choppy month to month. The detail from the latest month suggests there is still residual weakness coming through, total approvals ex high rise down an estimated -0.8% for the latest month and still trending lower.
- We suspect the June update will again be a mixed bag. The headline is likely to show a dip as high rise approvals fall back from recent gains. However, the weakness in non high rise approvals should start to moderate going by construction-related finance approvals. On balance, we expect total approvals to be down about 1% in the month but with the mix a key point of interest.

Dwelling approvals



Aus Q2 CPI

Jul 31, Last: 0.0%, WBC f/c: 0.5%
Mkt f/c: 0.5%, Range: 0.3% to 0.8%

- Westpac is forecasting a 0.5% rise in the June quarter CPI lifting the annual pace to 1.5%yr from 1.3%yr
- The June quarter tends to be a seasonally soft quarter with the seasonally adjusted CPI forecast to rise 0.7%. The trimmed mean is forecast to rise 0.33%qtr/1.5%yr and the weighted median is forecast to rise 0.30%qtr/1.1%yr.
- In Q2 fresh fruit & vegetables will drag food prices down 0.4%qtr. Housing costs are down slightly due to falling utilities and soft dwellings & rents. There is a seasonal fall in pharmaceuticals, while car prices are set to fall again.
- Auto fuel has an 11% surge, alcohol & tobacco rise modestly while clothing & footwear also have a positive quarter. Health costs bump up as rising medical & hospital services more than offset falling pharmaceuticals while there is an unseasonal gain in domestic holiday travel.
- For more details see our [Australian Q2 CPI preview](#).

Contributions 2019Q2 CPI 0.5%qtr forecast

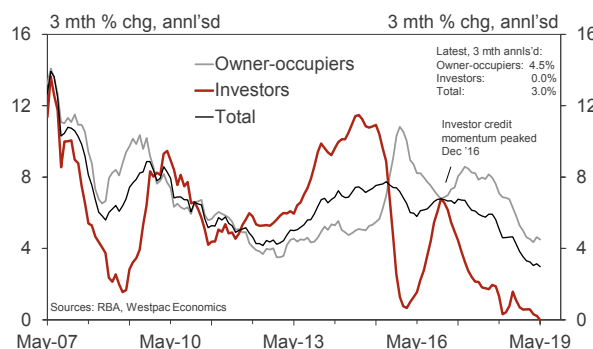


Aus Jun private credit

Jul 31, Last: 0.2%, WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: 0.2% to 0.8%

- Ahead of RBA rate cuts, private sector credit growth slowed to a sluggish pace as the housing sector weakened. Annual growth is 3.6% and the 3 month annualised pace is 2.4%.
- In April and May, credit grew by 0.2%, with housing increasing at a weak pace and business flat over the period.
- For June, we expect credit growth of 0.3%, supported by a return to growth in the business segment.
- Housing credit growth is weak at an historic low of 3.7%yr and 3.0% annualised for the 3 months to May. Another soft read is likely in June as new lending fell further last month. RBA rate cuts in June and July should see the emergence of some improvement.
- Business credit grew by 4.5% over the past year as investment trended higher. New lending to businesses spiked in May, emerging from the recent soft spot, pointing to a lift in credit.

Housing credit: weak ahead of RBA rate cuts



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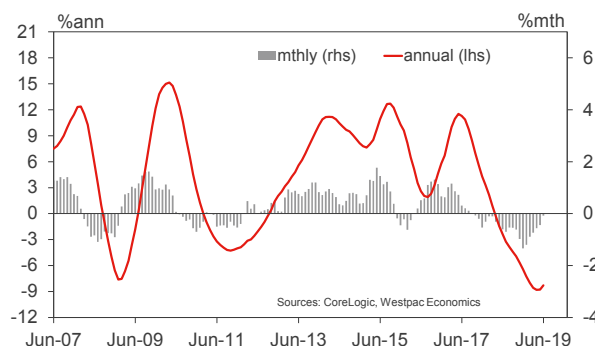
Data previews

Aus Aug CoreLogic home value index

Aug 1, Last: -0.1%, WBC f/c: flat

- The correction in Australian dwelling prices that began in late 2017 appears to have ended in mid-2019. The CoreLogic home value index dipped 0.1% in June to be down 8.0%yr – still weak but marking the first month to month improvement in the annual growth rate since its peak at +11.3%yr in mid 2017. Sydney and Melbourne both recorded their first monthly price gains since the correction began although prices continued to slip elsewhere.
- July has seen a further stabilisation. The daily index points to a flat outcome nationally, again with slight gains in Sydney and Melbourne but a mixed bag across the other capitals (a notable lift in Brisbane but slippage elsewhere). The picture is consistent with a continued improvement in auction markets and a clear lift in housing-related sentiment.

Australian dwelling prices

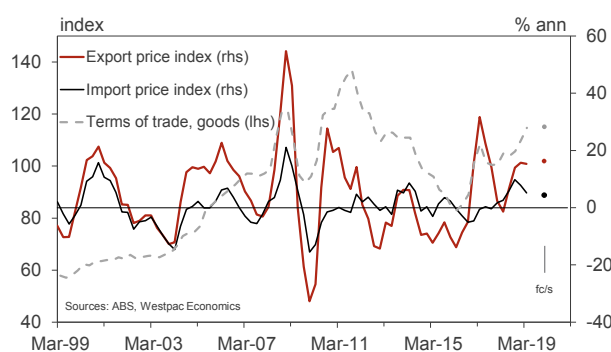


Aus Q2 import price index

**Aug 1, Last: -0.5%, WBC f/c: 2.4%
Mkt f/c: 1.8%, Range: 0.7% to 2.5%**

- The cost of imported goods increased over the past year as the Australian dollar weakened.
- In the March quarter, the import price index was 5.2% above the level of a year earlier, despite a 0.5% dip in the quarter. Over the year, the dollar fell by more than 5% on a TWI basis and declined by almost 10% against the US dollar.
- For June, import price index rose by a forecast 2.4% to be 4.4% above the level of a year ago.
- A lower currency and higher fuel prices combined to make imports more expensive in the June quarter. The dollar fell by 0.8% on a TWI basis and was 1.7% lower against the US dollar. Singapore gasoline prices moved sharply higher.

Import & export goods prices



Aus Q2 export price index

**Aug 1, Last: 4.5%, WBC f/c: 2.8%
Mkt f/c: 2.8%, Range: 2.3% to 4.0%**

- From early 2016, Australia's export prices have trended sharply higher, advancing on higher commodity prices.
- In the March quarter 2019, the export price index rose by 4.5%qtr, 15.3%yr.
- For the June quarter, the index is forecast to rise by 2.8%. This is largely on the back of a further spike in the price of iron ore following the supply disruptions in Brazil. The lower dollar also boosted export prices in the period.
- The terms of trade for goods, on these estimates, increased by around 0.5% in the quarter.
- As to prices for services, an update will be available with the release of the Balance of Payments on September 3.

Commodity prices & export price index



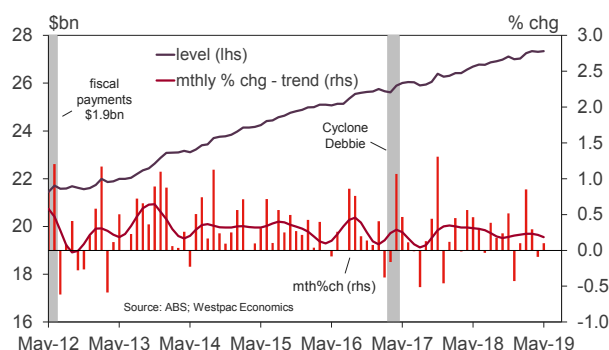
Data previews

Aus Jun retail trade

Aug 2, Last: 0.1%, WBC f/c: 0.1%
Mkt f/c: 0.3%, Range: 0.0% to 0.5%

- Retail sales edged up 0.1% in May, basically holding flat on a two month basis. Annual growth slowed to 2.4%yr, the weakest pace since the start of 2018 and well below the long run average of 4%. The sub-category and state detail was mixed: household goods and NSW notable weak spots but sales remain firm across other discretionary categories and in Vic, with a notable lift in the resource states.
- Conditions look to have again been soft in June. Consumer sentiment remained stuck around neutral, despite the RBA cutting rates 25bps in the month – the first easing since 2016. Wealth effect drags are also likely to still be operating. Retail responses to private sector business surveys were again very weak in June although some other partials based on card usage were a touch firmer. On balance we expect June to show another 0.1% sales gain.

Monthly retail sales

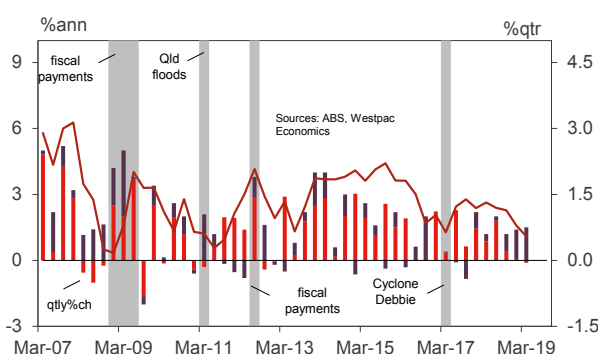


Aus Q2 real retail sales

Aug 2, Last: -0.1%, WBC f/c: 0.3%
Mkt f/c: 0.3%, Range: -0.1% to 0.5%

- Real retail sales dipped 0.1% in Q1, following a flat result in Q4. Annual growth slowed to 1.1%yr but with a cumulative gain of just 0.2% over the three quarters to March.
- Notably, some of the weakness in volumes through Q4 and Q1 reflected rising food prices, the deflator for basic food retail recorded a 2.5% gain over the six months.
- The 'price-volume' mix looks likely to be better for Q2. Nominal sales are tracking towards a 0.5% gain for the quarter – a touch softer than Q1's 0.7% rise. However, the Q2 CPI detail (out on July 31) is expected to show retail prices up 0.2% vs a 0.7% gain in Q1 with fresh food retracing some of the previous surge. That would see a slightly better outturn for volumes in Q2 with a 0.3% gain although annual growth will still slow to a very weak 0.5%yr. That would be the slowest pace since the GFC.

Quarterly retail volumes and prices

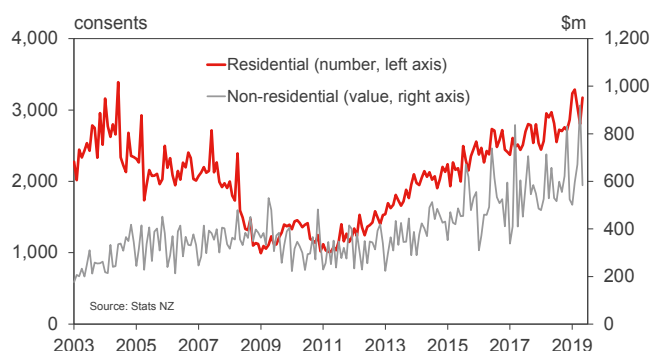


NZ Jun dwelling consents

Jul 30, Last: +13.2%, WBC f/c: -10%

- Residential dwelling consent issuance was much stronger than expected in May, rising by 13%. That was underpinned by a very large increase in consents for multi-unit dwellings like townhouses.
- We're forecasting a 10% pullback in consent numbers in June. That's due to an expected easing in consents for multi-unit dwellings which tend to be issued in lumps.
- Even with the anticipated pullback in the June month, annual consent issuance is expected to linger around multidecade highs. But while consent issuance is elevated and is expected to remain so for some time, it does appear to be flattening off. This likely portends a peak in the construction cycle over the year ahead.

NZ building consents



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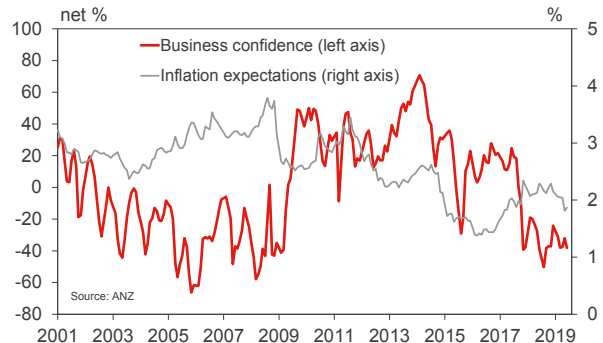
Data previews

NZ Jun ANZ Business confidence

Jul 31, Last -38.1

- Monthly business confidence fell in June, returning to the very low levels it reached in late-2017. Firms' impressions of their own business activity remain also fell a touch in June. And while these aren't as depressed as broader business confidence, they do remain weak.
- Firms are particularly concerned about margin squeeze as they are caught in the middle between rising prices and a limited ability to pass these increases onto their customers. Sluggish demand is also a concern. There is little reason to expect these dynamics changed significantly in July.
- We expect the sustained weakness in confidence to increasingly weigh on firms hiring and investment decisions this year.

NZ business confidence and inflation expectations

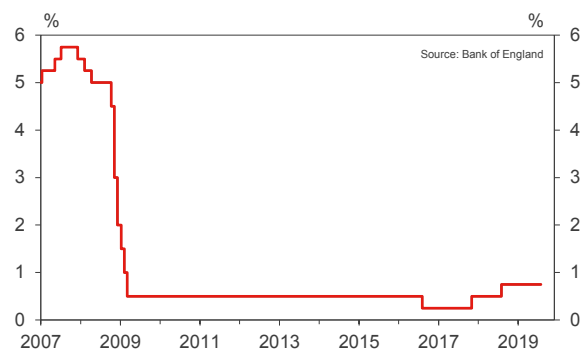


UK Bank of England Bank Rate Decision

Aug 1, Last: 0.75%, WBC f/c: 0.75%, Mkt: 0.75%

- At its June policy decision, the BOE left the bank rate on hold and maintained its very modest (and Brexit dependent) tightening bias.
- We expect that the Bank Rate will again be left on hold at the BOE's upcoming meeting.
- The key focus will be on the BOE's rhetoric in the accompanying statement. Up to now, the BOE's stance has assumed an orderly exit from the EU. However, the chances of such an outcome have continued to decline, especially following the change in Prime Minister. As result, we expect a softening in the BOE's rhetoric. That would also be consistent with the increased dovishness of comments from Carney and other MPC members.

Bank of England Bank Rate

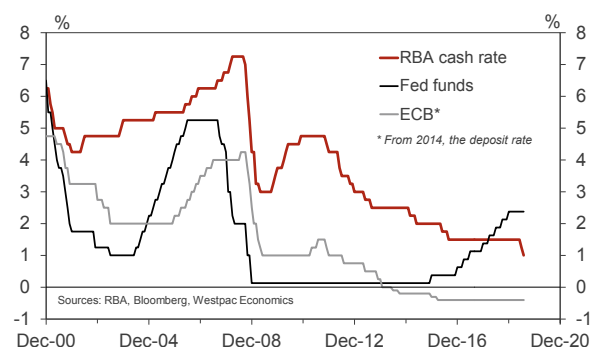


US Jul FOMC meeting

Jul 30-31, federal funds rate mid, last: 2.375%, WBC f/c: 2.125%

- Rate cut expectations for the FOMC have been running hot in recent months as market participants doubted the ability of the US economy to weather global and fiscal uncertainties.
- While some market participants continue to argue the case for a 50bp cut at the Jul meeting, we instead see a 25bp cut. Market pricing has converged on a similar view following recent comments by officials and after the announcement of a draft agreement on the debt ceiling and government spending to 2021.
- Looking ahead, we expect one further cut from the FOMC by year end, after which the Committee will be on hold. For the market's view of four cuts to mid-2020 (including Jul) to prove correct, the household sector will have to be hit by current and/or future uncertainties. If the status quo is maintained on trade and fiscal policy, this is unlikely.

FOMC to deliver insurance cuts



Data previews

US Jul employment report

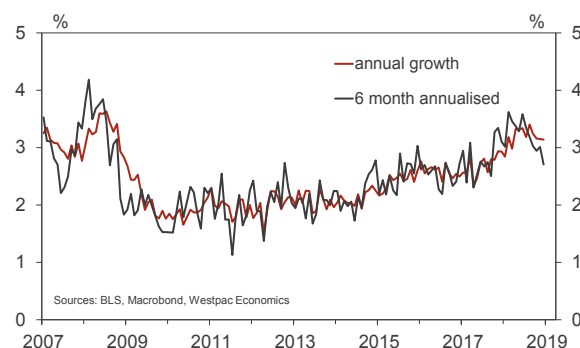
Aug 2, nonfarm payrolls, Last: 224k, WBC f/c: 180k

Aug 2, unemployment rate, Last: 3.7%, WBC f/c: 3.7%

Aug 2, hourly earnings, Last 0.2%, WBC f/c: 0.3%

- Following the weak May outcome, nonfarm payrolls came storming back in Jun, rising 224k. Despite a 11k downward revision to Apr and May, the 3-month average pace is strong at 171k. We expect Jul will deliver a similar gain circa 180k, thanks to continued strength in the services sector.
- Turning to the unemployment rate, a sustaining of Jun's 3.7% level is expected, although it is possible it will edge down to 3.6% instead, as the market expects. Participation, as always, will be key here.
- Hourly earnings has slowed materially since Feb. The recent outcomes seem too weak given job and activity data, and so we expect a stronger 0.3% gain in Jul. Note that the Q2 ECI is also due 31 Jul, providing a contrast to hourly earnings.

Hourly earnings has weakened materially



Key data & event risk for the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
UK	Jun net mortgage lending £bn	3.1	3.5	-	Softness in the housing market has dampened credit growth.
	Jul Nationwide house prices	0.1%	0.2%	-	Due this week. Brexit uncertainty still weighing on prices.
US	Jul Dallas Fed index	-12.1	-5	-	Regional surveys highly volatile at present.
Tue 30					
Aus	Jun dwelling approvals	0.7%	0.2%	-1.0%	High rise/non high rise mix will be of most interest.
NZ	Jun building permits	13.2%	-	-10.0%	Expected to fall back after May's lump of multi-unit consents.
Jpn	BOJ policy meeting	-0.1%	-0.1%	-	Forecast update to be a focus.
Eur	Jul economic confidence	103.3	103.0	-	Business confidence continuing to soften...
	Jul business climate indicator	0.17	0.15	-	... across a number of survey measures.
US	Jun personal income	0.5%	0.3%	-	Wage growth looks to be coming under pressure...
	Jun personal spending	0.4%	0.3%	-	... though recent growth in spending has been strong.
	Jun core PCE %yr	1.6%	1.7%	-	Underlying inflation tending to 2.0%yr.
	May S&P/CS home price index	0.0%	0.2%	-	House price growth has moderated, but still solid.
	Jun pending home sales	1.1%	0.4%	-	Existing sales remain soft. Supply the main issue.
	Jul consumer confidence index	121.5	125.0	-	Consumer mood remains buoyant.
Wed 31					
Aus	Q2 CPI	0.0%	0.5%	0.5%	Headline increase largely driven by fuel...
	Q2 CPI %yr	1.3%	1.5%	1.5%	... seeing the annual pace lift to 1.5%...
	Q2 core CPI - trimmed mean	0.3%	0.4%	0.3%	... while core pressures remain subdued...
	Q2 core CPI, %yr	1.6%	1.5%	1.5%	... for further detail see Australian Q2 CPI preview .
	Jun private credit	0.2%	0.3%	0.3%	Soft read but off lows, business up on a spike in new lending.
NZ	Jul ANZ business confidence	8.0%	-	-	Pressure on margins and soft demand weighing on sentiment.
Chn	Jul manufacturing PMI	49.4	49.6	-	Manufacturing under considerable pressure...
	Jul non-manufacturing PMI	54.2	54.0	-	... while services rely on consumer and modest investment.
Eur	Jun unemployment rate	7.5%	7.5%	-	Has continued to trend down on domestic demand despite...
	Q2 GDP	0.4%	0.2%	0.2%	... external sectors still weighing on output...
	Jul core CPI %yr	1.2%	1.1%	-	... and uncertainty around outlook holding down prices.
UK	Jul GfK consumer sentiment	-12	-13	-	Political uncertainty likely to weigh on confidence.
US	Jul ADP employment change	102k	150k	-	Jun was a very poor lead for payrolls. Likely to strengthen.
	Q2 employment cost index	0.7%	0.7%	0.7%	More stable but softer than hourly earnings.
	Jul Chicago PMI	49.7	51.8	-	Modest growth continuing.
	FOMC policy decision, midpoint	2.375%	2.125%	2.125%	Cut expected. Press conference guidance the focus.
Thu 01					
Aus	Jul AiG PMI	49.4	-	-	Manuf'g -3.3pts in June. Mixed of late on housing weakness.
	Jul CoreLogic home value index	-0.1%	-	flat	Housing market looks to have stabilised around mid-year.
	Q2 import price index	-0.5%	1.8%	2.4%	Imports costs up on lower dollar, higher fuel prices.
	Q2 export price index	4.5%	2.8%	2.8%	Export prices led higher by iron ore & up on the lower AUD.
Jpn	Jul Nikkei manufacturing PMI final	49.6	-	-	Remains soft with...
Chn	Jul Caixin China PMI	49.4	49.7	-	... manufacturers under considerable pressure...
Eur	Jul Markit manufacturing PMI final	46.4	-	-	... especially in Europe...
UK	Jul Markit manufacturing PMI	48.0	48.0	-	... with the UK also subdued.
	BoE policy decision	0.75%	0.75%	0.75%	Likely to see a dovish tilt in the BOE's rhetoric.
US	Initial jobless claims	206k	-	-	Very low.
	Jul Markit manufacturing PMI final	50.0	-	-	Conditions for manufacturers continue to deteriorate...
	Jul ISM manufacturing	51.7	52.0	-	... as trade uncertainty persists, and USD remains strong.
	Jun construction spending	-0.8%	0.5%	-	Non-residential business investment weak and at risk.
Fri 02					
Aus	Q2 PPI	0.4%	-	-	Rising fuel costs should boost the headline number.
	Jun retail sales	0.1%	0.3%	0.1%	Conditions remain very weak for retail although food price ...
	Q2 real retail sales	-0.1%	0.3%	0.3%	... decline gives slightly better vol-price mix for Q2 vs Q1.
NZ	Jul ANZ consumer confidence	122.6	-	-	Households spending has softened through mid-2019.
Eur	Jun retail sales %yr	1.3%	-	-	Consumption has remained resilient.
US	Jul non-farm payrolls	224k	160k	180k	Services sector continuing to provide robust support.
	Jul unemployment rate	3.7%	3.7%	3.7%	Unemployment rate to remain broadly stable ahead.
	Jul average hourly earnings %yr	3.1%	3.2%	3.2%	Recent outcomes look too weak to persist.
	Jun factory orders	-0.7%	0.6%	-	Durables provided an upside surprise in Jun.
	Jun trade balance US\$bn	-55.5	-54.2	-	Pull-forward has ended.

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Economic & financial forecasts

Interest rate forecasts

	Latest (26 Jul)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
Cash	1.00	1.00	0.75	0.50	0.50	0.50	0.50
90 Day BBSW	1.04	1.00	0.85	0.70	0.70	0.70	0.70
3 Year Swap	0.91	0.90	0.85	0.80	0.80	0.85	0.90
10 Year Bond	1.23	1.20	1.20	1.10	1.10	1.10	1.10
10 Year Spread to US (bps)	-84	-80	-80	-90	-90	-90	-90
International							
Fed Funds	2.375	2.125	1.875	1.875	1.875	1.875	1.875
US 10 Year Bond	2.07	2.00	2.00	2.00	2.00	2.00	2.00
US Fed balance sheet USDtrn	3.80	3.80	3.80	3.80	3.80	3.82	3.84
ECB Deposit Rate	-0.40	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50
New Zealand							
Cash	1.50	1.25	1.00	1.00	1.00	1.00	1.00
90 day bill	1.50	1.30	1.15	1.15	1.15	1.15	1.15
2 year swap	1.27	1.25	1.20	1.20	1.25	1.30	1.40
10 Year Bond	1.51	1.45	1.45	1.45	1.50	1.55	1.65
10 Year spread to US	-56	-55	-55	-55	-50	-45	-35

Exchange rate forecasts

	Latest (26 Jul)	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
AUD/USD	0.6944	0.68	0.68	0.66	0.66	0.67	0.67
NZD/USD	0.6655	0.65	0.65	0.65	0.66	0.66	0.66
USD/JPY	108.63	106	105	107	108	109	110
EUR/USD	1.1149	1.14	1.14	1.13	1.13	1.12	1.12
GBP/USD	1.2447	1.26	1.25	1.26	1.27	1.29	1.30
AUD/NZD	1.0434	1.05	1.04	1.02	1.01	1.01	1.01

Australian economic growth forecasts

	2018			2019				Calendar years			
	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	2017	2018	2019f	2020f
GDP % qtr	0.9	0.3	0.2	0.4	0.5	0.6	0.7	-	-	-	-
% yr end	3.1	2.8	2.4	1.8	1.4	1.7	2.2	2.4	2.4	2.2	2.5
Unemployment rate qtr avg, yr end	5.4	5.2	5.0	5.0	5.2	5.3	5.4	5.5	5.0	5.4	5.6
CPI % qtr	0.4	0.4	0.5	0.0	0.5	0.5	0.6	-	-	-	-
% yr end	2.1	1.9	1.8	1.3	1.5	1.6	1.7	1.9	1.8	1.7	1.6
CPI trimmed mean %yr	0.5	0.4	0.5	0.3	0.3	0.3	0.5	-	-	-	-
% yr end	1.7	1.7	1.8	1.6	1.5	1.4	1.4	1.8	1.8	1.4	1.9

New Zealand economic growth forecasts

	2018		2019				Calendar years				
	Q2	Q3	Q4	Q1	Q2f	Q3f	Q4f	2017	2018	2019f	2020f
GDP % qtr	0.9	0.4	0.6	0.6	0.4	0.6	0.8	-	-	-	-
Annual avg change	3.2	3.1	2.9	2.7	2.4	2.3	2.3	3.1	2.9	2.3	3.0
Unemployment rate %	4.4	4.0	4.3	4.2	4.3	4.3	4.2	4.5	4.3	4.2	3.9
CPI % qtr	0.4	0.9	0.1	0.1	0.6	0.7	0.3	-	-	-	-
Annual change	1.5	1.9	1.9	1.5	1.7	1.5	1.7	1.6	1.9	1.7	1.9

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