

# Australia & New Zealand weekly.

## Week beginning 19 November 2018

- Mixed signals on housing but adjustment process likely to have further to run.
- Australia: RBA Governor Lowe speaks, RBA Minutes, Westpac-MI Leading Index.
- NZ: net migration.
- Europe: ECB minutes, EU Brexit Summit.
- UK: BOE Governor Carney speaks.
- US: Thanksgiving, durable goods orders, housing starts and building permits.
- Flash PMI's for Japan, Europe and the US.
- Key economic & financial forecasts.

Information contained in this report current as at 16 November 2018.

# Mixed signals on housing but adjustment process seems likely to have further to run

The Westpac Melbourne Institute Index of Consumer Sentiment rose 2.8% to 104.3 in November from 101.5 in October.

That was a surprisingly strong result. In particular, respondents are much more positive about their own finances. That is despite consistent reports around weakness in the housing markets in the major capitals and the sharp falls in the equity market through October. Low interest rates and their prospect of being sustained for some time are clearly supporting confidence. For example, the confidence of those respondents with a mortgage increased by 4.3%. However, on a more cautionary note, measures of spending intentions have been weaker.

Consumer views around housing were very interesting. Buyer sentiment improved sharply but price expectations fell to new lows.

The 'time to buy a dwelling' index posted a strong 11.8% surge to be up 16.7% on a year ago to the highest level since March 2015. Consumers in NSW showed a particularly strong gain with a 26% jump taking the state index to a five year high and suggesting the decline in Sydney house prices is starting to generate some interest from buyers. Because the NSW Index has been so low, this stunning improvement only restores the Index to just below its long term average. The other state, Victoria, where prices have recently shown significant weakness, improved only modestly with "Time to Buy" up only 3.3%.

Consumer expectations for house prices posted another fall in November. The Westpac Melbourne Institute Index of House Price Expectations fell 2.3% to 99 – on par with the weakest read we have ever seen on this index, when it was first compiled back in May 2009. The state detail continues to show particularly weak reads in NSW and Victoria, both hitting new lows in November with Victoria's index down 25% over the last three months alone. The house price corrections underway in Sydney and Melbourne now look to be firmly embedded in consumer expectations.

In this cycle, Sydney dwelling prices have already fallen by 8.7% while prices in Melbourne are down by 5.1%.

New lending for housing is also contracting. New lending for "upgraders" (owner occupiers excluding First Home Buyers) has fallen by 13.2% over the last year (October 2017 to September 2018) but more significantly has fallen by 10.7% in the two months to September.

New lending to investors peaked in December 2016 and has fallen by 25.9% in the year to September 2018 and 4% over the last two months.

These developments have largely reflected stretched affordability (on the demand side) in the two cities and tighter lending policies from the four major banks (on the supply side).

Households now expect house prices to continue to fall. The Westpac Melbourne Institute Index of House Price Expectations has fallen by 39% for NSW and 41.5% for Victoria over the last year. Both indexes moved from prints which indicated that optimists strongly outnumbered pessimists (134 for NSW and 144 for Victoria) to positions where pessimists outnumber optimists (82 for NSW and 84 for Victoria). Note that any read below 100 indicates a majority of pessimists.

Furthermore these current levels are the lowest we have registered since Westpac and the Melbourne Institute first started this question in the Consumer Sentiment survey in May 2009.

Westpac also calculates measures of housing affordability. These relate to the proportion of income required to accumulate a deposit and service a loan which is 75% of the median house price. These measures of affordability can vary around assumptions related to the time required to accumulate the deposit and whether the 75% is a reasonable assumption.

Based on the estimates being used we assess that affordability in both NSW and Victoria is more stretched than we saw in the previous periods which preceded falls in house prices – 2008/09 and 2010/11.

Peak to trough in those previous periods were falls of 6.4% (Sydney) and 8.7% (Melbourne) in 2008/2009 and 3.4% (Sydney) and 8.2% (Melbourne) in 2010/2012.

The restoration of affordability in those previous periods came through falls in interest rates and house prices while income growth also contributed. Wages growth was running at around 4% in both periods. That compares with current wages growth of 2.3%.

In the 2008/09 period the RBA cut the cash rate by 425 basis points from 7.25% to 3%; in the 2011/12 period it cut rates by 175 basis points from 4.75% to 3.00%. The challenge with this particular cycle is that the RBA appears to be absolutely committed to the next move in rates being up.

So in those previous periods affordability and demand were restored through a combination of income growth; substantial rate cuts; and price adjustments. In this current period the responsibility for a restoration of affordability will fall mainly to price adjustments.

The Consumer Sentiment Report indicated that the "Time to Buy a Dwelling" Index had lifted significantly in the weak NSW market.

That might imply that despite continuing stretched affordability, prospective buyers may be considering re-entering the market. That does seem surprising given the downbeat price expectations and stretched affordability.

However, as discussed, in this cycle there is another complication.

We have a different environment from the perspective of credit supply. Banks have tightened credit conditions such that when demand for credit recovers (as may be implied by the "Time to Buy" index for NSW) it may not be as simply accommodated as was the case in those previous periods.

This will complicate the usual adjustment process. Markets stabilise when prospective buyers feel encouraged to re-enter the market. Affordability returning to equilibrium and price expectations turning positive are generally the triggers for markets to recover. The "Time to Buy" index for NSW is sending an encouraging early signal but if prospective buyers are unable to secure adequate funding to enter the market, the move to the new equilibrium may be more extended.

In summary it is apparent that this cycle is quite different to the two previous down cycles for dwelling prices. Affordability is more stretched and sources of adjustment are more restricted. Furthermore, credit conditions indicate that a recovery in affordability and demand may not be accommodated through credit supply in the same way we saw in previous cycles.

**Bill Evans**, Chief Economist

# The week that was

Labour market data provided two contrasting perspectives on Australia's economy this week. Meanwhile, consumer sentiment strengthened, and business conditions remained above average.

Following last month's 5.0% unemployment rate, a level historically regarded as consistent with full employment, the [Australian labour force survey for October](#) was keenly awaited. It certainly did not disappoint, with the unemployment rate remaining at 5.0% despite a partial reversal of the 0.2ppt decline in participation seen in September. On a multi-market basis, it is employment not participation that is driving the unemployment downtrend. At October, annual employment growth stood at 2.5%yr, nearly a percentage point above population growth. Furthermore, those gains have largely been full-time in nature.

The above trend is favourable for household income growth, increasing aggregate hours worked across the economy and reducing slack. However, this tightening of the labour market is yet to stoke wages growth. In the September quarter, the [wage price index](#) rose just 0.6% (2.3%yr) and was weaker still for the private sector at 0.5% (2.1%yr). Arguably this disconnect between wages and employment growth is in part due to considerable underemployment (those working less hours than they would like to). That said, the current level of underutilisation is historically consistent with wages growth around 2.5%yr, not the 2.1%yr currently being seen in the private sector. Herein is evidence of other factors being at play, principally globalisation; technology; and a focus on efficiency amongst large corporates.

In terms of the outlook for wages, it is troublesome that the states of NSW and Vic, who have seen a more aggressive downtrend in unemployment and underemployment, are also yet to see a substantial lift in wages growth, respectively 2.2%yr and 2.5%yr at September.

The enduring disconnect between wages and employment arguably is a key reason why [family finance perceptions](#) continue to lag households' economic and labour market expectations; and now, even as family finance views are shifting to above long-run average levels, why 'time to buy a major household item' is at 18 month lows and spending intentions for Christmas are the weakest they have been since 2014. House price expectations, which are now on par with their lowest ever level back to mid-2009, are decidedly unfavorable for spending, as is the pressing cash-flow reality of high household debt. Weakness in consumer spending was also evident in the [NAB business survey](#) for October, particularly in NSW. That said,

while confidence is now below average in aggregate, conditions for businesses remain above average overall on the back of robust trading conditions and profitability.

Moving offshore, data released this week for China points to the investment trend having troughed. That said, the acceleration in activity will be slow in coming amid headwinds from ongoing structural change in the finance sector and, to a lesser extent, uncertainty associated with trade policy. On that front, murmurs of the US' being willing to compromise with China on trade bolstered markets overnight. President Trump will meet President Xi at the end of the month. The hope is that this conversation can turn the tide and stop any further intensification of tensions. This would only be a starting point for negotiations however. Many hurdles must be overcome for a lasting solution to be attained.

For the US, data has been light but broadly supportive of the ongoing robust, non-inflationary uptrend in activity continuing, with the CPI benign in October (annual core inflation at 2.1%yr) as retail sales beat expectations (0.8%). Admittedly retail sales were bolstered by Hurricane season replacement spending in October and higher oil prices in the month, but underlying momentum remained robust. Chair Powell again showed confidence in the US economy and the outlook this week despite weakening residential investment and uncertainty over the lasting benefit of fiscal policy to growth. Recent market volatility is not a material concern, nor are global risks and trade tensions. But all are being watched closely. The move to hold a press conference after every FOMC meeting and to review "strategies, tools and communication practices" highlight a desire by Chair Powell and the Committee to be more nimble as this cycle matures.

For Europe (and the UK), Brexit has again been the focus. A brief respite from Brexit uncertainty was seen mid-week as the UK Cabinet rubber stamped a transition deal agreed by UK and European negotiators. But multiple ministerial resignations the day after consequently put Prime Minister May's position and the deal in jeopardy. It is not at all clear if the current deal will remain let alone what a replacement deal might look like. Of course the final deal, whatever its terms, then has to be passed by both the UK and EU parliaments. On the Italian budget, the Government has remained steadfast in not adjusting the proposal in response to disagreement from the European Commission. Whether the European Commission goes through with imposing infringement penalties will be of key interest in the weeks ahead.

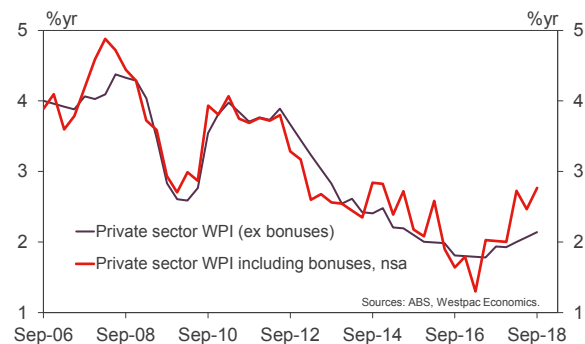
## Chart of the week: Australian wages including bonuses

It is worth noting that a cyclical indicator of wage momentum continues to look a bit more positive. Private sector wages including bonuses lift to 2.8%yr from 2.5%yr in Q2 and 2.7%yr in Q1. This is still above the wages and salaries only pace and the fastest pace in almost 4 years.

Bonus payments tend to be pro-cyclical so this could be seen as a positive leading indicator of a broader lift in wages sometime soon (variable components of remuneration are adjusted more frequently to changes in economic conditions than base wages).

But we note this is a very volatile series and at this stage it appears employers are adjusting variable compensation where they have to rather than lifting base wages and salaries.

## Salaries and bonuses



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# New Zealand: week ahead & data wrap

## Here we go

Falling mortgage rates have grabbed headlines this week, with some fixed-term mortgage rates now near the historic lows of 2016. This is what we predicted a few months ago. The next step is that the housing market will get a boost, albeit a temporary one. Indeed, October housing market data suggested that this lift may already be in train. The RBNZ is still likely to be fairly comfortable with activity in the housing market and will be contemplating loosening its LVR restrictions further. This could be announced as soon as the November *Financial Stability Report*, and will offer further support to house prices.

Fixed mortgage rates fell over the last few months on the back of lower wholesale rates following the Reserve Bank's more dovish tone. Competition amongst banks has pushed some fixed-term mortgage rates even lower this week in some cases to record lows.

Since August we have been predicting that lower mortgage rates would provide a temporary fillip to the housing market. Now signs of a bit more life in the housing market are coming through. October REINZ data showed a 9.3% jump in house sales in the month, leaving sales up 15.5% on a year ago. In reality, the true lift is likely to be even larger. REINZ house sales data tends to be revised upward over time, as sales data continues to trickle in from real estate agents after the data is first released.

In addition to this lift in sales, there was a drop in the average number of days taken to sell a house. This fell from 38.2 to 37.2 (seasonally adjusted), taking this measure to its lowest level since May. This adds further weight to our view that activity in the housing market has perked up.

House prices remained relatively subdued in October, up 0.4% in the month and 3.8% higher than a year ago. Scratching beneath the surface, it's clear that there has been a modest acceleration in house price growth recently with average growth over the last three months noticeably higher than the three months prior.

Much of the acceleration in both activity and prices is coming from Auckland and Canterbury. Yet even with the most recent improvement, annual house price growth in Auckland of -0.4% is much weaker than remainder of the country at 7.9%. It's even further behind current hotspots like Otago and Southland where annual house price inflation is running at 11.6% and 15.1% respectively.

Rising sales is a reliable sign that price inflation will soon accelerate. We remain of the view that quarterly house price growth will pick up noticeably in the first quarter of next year.

But we remain at pains to emphasise that the anticipated near-term boost to the housing market will be only a temporary shot in the arm. There appears to have been little direct impact from the foreign buyer ban in the October data. However, over a longer horizon, restrictions on foreign buyers combined with the extension of the Bright Line test is set to make housing a less attractive investment proposition. Next year, the changes to rules around the tax deductions for property investors are set to impact the market. In addition, the debate surrounding capital gains tax (or any other tax changes) is likely to intensify with the release of the Tax Working Group's final recommendations (slated for February 2019) and as the 2020 election draws closer. Combined with an eventual lift in mortgage rates and slowing population growth, we think this will see annual house price inflation slip into negative territory by mid-2020.

Short term gyrations aside, the slowdown in the housing market over the course of 2018 (unsurprisingly) coincided with a slowdown in credit growth. Mortgage lending grew 6% in the year to September, slightly slower than the 6.4% growth the year earlier, and a significant step down on the 9.1% growth in mortgage lending in the year to September 2016.

This slowdown in credit growth will be one factor considered by the RBNZ as it ponders whether the current LVR settings remain appropriate. In a speech this week titled "Financial Stability – risky, safe or just right?" Deputy Governor Geoff Bascand said "we expect to gradually ease the [LVR] policy in coming years." We think that the RBNZ could ease the LVRs at the November Financial Stability Review, due on the 28 November, as their concerns about financial stability have eased already.

It is not just that credit growth and house price inflation are lower than they were. Bank lending is also substantially less risky – the stock of loans with a loan-to-value ratio over 80% has fallen from 20.7% before the LVRs to 6.7% now. Furthermore, regulators in both New Zealand and Australia have prompted the banks to become more selective about who they will lend to. And the housing market is being regulated directly by the likes of the Bright Line Test and other tax changes. The Reserve Bank will probably conclude that there is now less need for LVRs to do so much of the work in ensuring financial stability.

Any changes to the LVR rules are likely to be incremental. Banks are currently restricted to a speed limit whereby 15% of new loans can be made at a loan-to-value ratio greater than 80%. That speed limit could be lifted to 20%. The effective LVR cap on investor lending could also increase, from 65% to 70%. If this occurs, it could add further momentum to the housing market. The last loosening of the LVR rules saw system-wide high LVR lending rise quite sharply, and coincided with a distinct lift in the housing market.

## Round up of local data released over the last week

Date	Release	Previous	Actual	Mkt f/c
Mon 12	Oct retail card spending	1.1%	0.1%	0.6%
Tue 13	Oct food prices	-0.1%	-0.6%	-
Wed 14	Oct REINZ house prices, %yr	4.0%	3.8%	-
	Oct REINZ house sales	-0.5%	9.3%	-
Fri 16	Oct BusinessNZ manufacturing PMI	51.9	53.5	-

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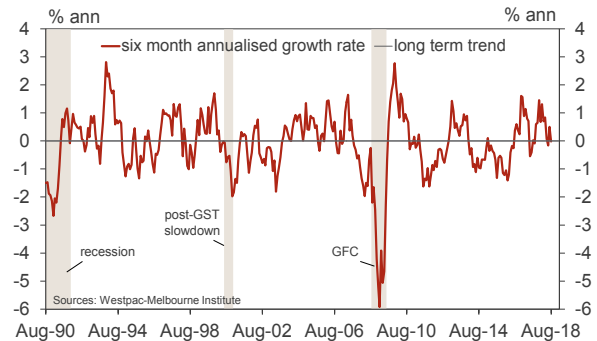
# Data previews

## Aus Oct Westpac-MI Leading Index

Nov 21, Last: **+0.21%**

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, lifted from  $-0.02\%$  in August to  $+0.21\%$  in September. Despite the lift back above trend, the Index growth rate continues to point to slowing momentum heading into year end, the pace slowing from an average  $0.89\%$  read over the seven months to April to  $0.13\%$  over the five months since.
- The index will include a very mixed range of component updates this month. On the negative side, the ASX200 fell sharply, down  $-6.1\%$  vs  $-1.8\%$  last month. However, other components mostly firmed, with the Westpac-MI Consumer Expectations Index up  $4.7\%$ ; commodity prices up  $3.7\%$  in AUD terms and dwelling approvals recovering some lost ground, up  $3.3\%$  vs  $-8.1\%$  in last month. Other components also look to have been mostly positive as well.

## Westpac-MI Leading Index



# Key data & event risk for the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 19</b>					
NZ	Oct BusinessNZ PSI	53.9	-	-	- Business have reported a slowdown since mid-2018.
Jpn	BOJ Governor Kuroda speaks	-	-	-	- At EuroPlus in Tokyo.
UK	Nov Rightmove house prices	1.0%	-	-	- Economic uncertainty continues to weigh on price growth.
US	Nov NAHB housing market index	68	67	-	- Builders remain positive, despite clear loss of momentum.
	Fedspeak	-	-	-	- Williams in moderated Q&A.
<b>Tue 20</b>					
Aus	RBA minutes	-	-	-	- Further colour on board members' views.
	RBA Governor Lowe speaks	-	-	-	- "Trust and Prosperity", CEDA dinner Melbourne 7:20 pm.
UK	BOE Gov Carney	-	-	-	- Testimony to Parliament on the Inflation Report.
US	Oct housing starts	-5.3%	2.0%	-	- Recent weakness likely beginning of clear downtrend...
	Oct building permits	1.7%	-0.8%	-	- ... with build-to-let activity leading the way.
<b>Wed 21</b>					
Aus	Oct Westpac-MI Leading Index	0.21%	-	-	- Momentum lifted in Sep but has slowed since start of year.
NZ	GlobalDairyTrade auction	-2.0%	-	-	- NZ milk production growth still strong, may weigh on prices
UK	Oct public sector net borrowing, £b	3.3	5.3	-	- Borrowing requirements have been surprising to the downside.
US	Oct durable goods orders	0.7%	-2.1%	-	- Underlying business investment trend moderate not strong.
	Initial jobless claims	216k	-	-	- Very low.
	Oct leading index	0.5%	0.1%	-	- Pointing to above trend but slowing growth.
	Nov Uni. of Mich sentiment final	98.3	98.3	-	- Well above average.
	Oct existing home sales	-3.4%	1.0%	-	- Partial reversal of Sep decline.
Can	Sep wholesale trade	-0.1%	-	-	- Rate increases have been weighing on spending.
<b>Thu 22</b>					
Jpn	Oct CPI %yr	1.2%	1.4%	-	- Core ex fresh food and energy stable at 0.4%yr.
Eur	Nov consumer confidence prelim.	-2.7	-3.0	-	- Sentiment eased back but still above average.
	ECB minutes	-	-	-	- Account of October meeting.
	ECB speak	-	-	-	- Weidmann, Knot and Visco speak in Florence.
US	Thanksgiving day	-	-	-	- Public holiday.
<b>Fri 23</b>					
NZ	Oct net migration	4640	4800	-	- The downtrend in annual migration is continuing.
Jpn	Nov Nikkei manuf' PMI flash	52.9	-	-	- Oct recovery to be maintained?
Eur	Nov Markit manuf' PMI flash	52.0	51.7	-	- Softened back to trend...
	Nov Markit services PMI flash	53.7	53.5	-	- ... but there were some one-offs in Q3.
Ger	Nov Markit manuf' PMI flash	52.2	52.0	-	- Will activity rebound...
	Nov Markit services PMI flash	54.7	54.4	-	- ... post adjustment to new emissions standards?
US	Nov Markit manuf' PMI flash	55.7	55.9	-	- Still pointing to robust momentum...
	Nov Markit services PMI flash	54.8	55.0	-	- ... across the economy.
Can	Oct CPI	-0.4%	-	-	- Signs core inflation is easing.
<b>Sun 25</b>					
Eur	EU summit	-	-	-	- Agreement to formalise Brexit terms?

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# Economic & financial forecasts

## Interest rate forecasts

	Latest (16 Nov)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day BBSW	1.94	1.98	1.93	1.91	1.90	1.90	1.85	1.83
3 Year Swap	2.19	2.20	2.20	2.25	2.25	2.30	2.35	2.50
10 Year Bond	2.68	2.70	2.80	2.80	2.90	2.80	2.70	2.60
10 Year Spread to US (bps)	-43	-55	-60	-70	-70	-50	-40	-40
<b>International</b>								
Fed Funds	2.125	2.375	2.625	2.875	3.125	3.125	3.125	3.125
US 10 Year Bond	3.11	3.25	3.40	3.50	3.60	3.30	3.10	3.00
US Fed balance sheet USDtrn	4.15	3.98	3.87	3.74	3.65	3.56	3.40	3.27
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.30	-0.20	0.00	0.20
<b>New Zealand</b>								
Cash	1.75	1.75	1.75	1.75	1.75	1.75	2.00	2.25
90 day bill	2.00	1.90	1.90	1.90	1.95	2.00	2.20	2.60
2 year swap	2.18	2.10	2.20	2.30	2.45	2.60	2.90	3.05
10 Year Bond	2.71	2.70	2.90	3.10	3.25	3.35	3.45	3.50
10 Year spread to US	-40	-55	-50	-40	-35	5	35	50

## Exchange rate forecasts

	Latest (16 Nov)	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Jun-20	Dec-20
AUD/USD	0.7266	0.72	0.71	0.70	0.68	0.70	0.74	0.74
NZD/USD	0.6822	0.66	0.64	0.63	0.61	0.62	0.65	0.67
USD/JPY	113.40	114	114	115	114	112	109	106
EUR/USD	1.1336	1.13	1.11	1.10	1.09	1.10	1.16	1.22
AUD/NZD	1.0651	1.09	1.11	1.11	1.11	1.13	1.14	1.11

## Australian economic growth forecasts

	2018				2019		Calendar years			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	2017	2018f	2019f	2020f
GDP % qtr, yr avg	1.1	0.9	0.7(f)	0.6	0.7	0.6	2.2	3.3	2.7	2.8
% yr	3.2	3.4	3.4(f)	3.3	2.9	2.6	2.4	3.3	2.7	3.0
Unemployment rate qtr avg, yr end	5.5	5.4	5.2	5.1	5.2	5.3	5.5	5.1	5.0	4.8
CPI % qtr	0.4	0.4	0.4	0.7	0.3	0.3	-	-	-	-
% yr	1.9	2.1	1.9	2.0	1.9	1.9	1.9	2.0	1.7	1.7
CPI underlying % qtr	0.5	0.4	0.3	0.5	0.5	0.5	-	-	-	-
% yr	2.0	1.8	1.7	1.8	1.8	1.9	1.9	1.8	1.9	2.1

## New Zealand economic growth forecasts

	2018				2019		Calendar years			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	2017	2018f	2019f	2020f
GDP % qtr	0.5	1.0	0.7(f)	0.7	0.7	0.8	-	-	-	-
Annual avg change	2.7	2.7	2.8(f)	2.8	3.0	3.0	2.8	2.8	3.1	2.9
Unemployment rate	4.4	4.4	3.9	4.3	4.4	4.3	4.5	4.3	4.2	4.0
CPI % qtr	0.5	0.4	0.9	0.5	0.4	0.2	-	-	-	-
Annual change	1.1	1.5	1.9	2.3	2.2	2.0	1.6	2.3	1.4	1.8

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