How risky is risky? The RBNZ can loosen lending restrictions. And they should ease this week.

"We keep LVR settings under regular review. The question we are assessing… is whether the same restrictions are needed in the current environment… we expect to gradually ease the policy in coming years." (Geoff Bascand, RBNZ)

- **We expect the RBNZ's LVR restrictions to be loosened, slightly. Credit growth into 2019 may lift a little as a result.**
- **The price of oil continues to fall. Households should expect a lower petrol price. And we expect a slight lift to household consumption.**
- **The UK's PM May has two weeks to sell an unsalable Brexit deal to torn UK politicians. The EU say the deal is as good as it gets.**

Here's our take on current events.

The most important event in the Kiwi calendar is the Financial Stability Report (FSR), Wednesday. The "temporary" measures that are the Loan-to-value Ratios (LVRs), are unlikely to remain temporary, but become permanent. The levels at which these measures become permanent will most likely be looser than the current settings. So, as an interim step between temporary and permanent, we expect the LVR restrictions to be loosened again. It was this time last year when the RBNZ loosened the LVRs just a little. And we expect a little more loosening this year. Risk in the system is being managed.

As they stand, "*Only 15 percent of new loans to owner-occupiers can have deposits of less than 20 percent. And, only 5 percent of loans to property investors can have deposits of less than 35 percent.*" We are likely to see a loosening of the speed limits, and potentially a lowering of the deposit percentages. A loosening in LVR restrictions would loosen the availability of credit, and add a little to credit growth next year. And a loosening is in line with the RBNZ's three criteria:

1. Evidence that house price and credit growth have fallen to around the rate of household income growth.
2. A low risk of housing market resurgence once LVR restrictions are eased.
3. Confidence that an easing in policy will not undermine the resilience of the financial system.

We argue all three criteria have now been met.

The need to guard against excessive leverage building in parts of the system remains. But credit quality has improved materially since 2016. We believe the 2nd and 3rd requirements are easy to argue, now that the housing market has cooled, with Auckland's lead.

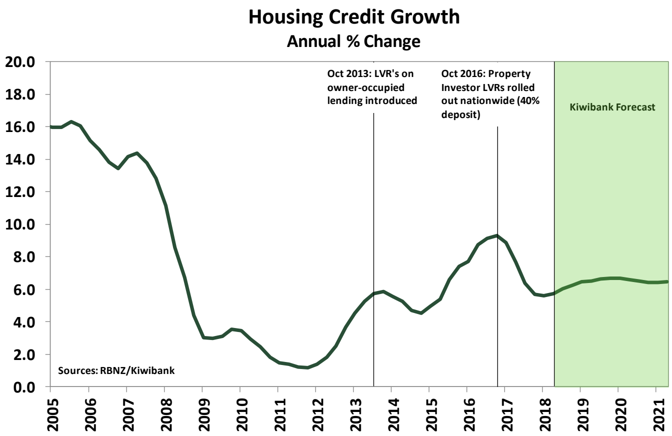
Offshore, there is a lot going on. UK politicians will spend the next two weeks bickering over a take it or leave it deal to withdraw from the EU. UK PM Theresa May has the seemingly impossible task of pulling together divided friends and foes over a deal the fails to appeal to either side. It's not hard enough for the Brexiteers and too hard for the Bremainers. No one is confident, and May's leadership may face a vote of no confidence.

Meanwhile, the price of oil keeps falling. The Saudi's keep pumping, and the US shale producers changed the game long ago. Iran is Iran, Russia is Russia, North Korea is China and geopolitical battles continue. The good news is lower oil prices mean lower petrol prices, unless you live in Auckland where prices go up quick but struggle to fall. Lower petrol prices, when they come through, will add to discretionary spending after a pretty tough quarter at the pump. Consumers will get a little gift into Christmas.

Financial markets are still choppy. Investors are getting hammered with a daily barrage of heated headlines. It is normal for markets to stumble admit tightening in monetary conditions. The US Fed are tightening, the ECB are posturing towards tightening, and the monstrous amount of money that was printed during QE is no longer the lifeblood of financial markets, everywhere.

Our chart of the week: the impact of LVRs.

The LVR restrictions have clearly worked, if not initially. They were difficult to implement, but clearly worth the effort. Our chart shows the LVRs reducing risk in the system. But now the market has cooled, and temporary measures need to be looked at. We prefer a loosening in the speed limit of 15% on owner-occupier loans with <20% deposit. Because the availability of credit should be extended to first home buyers in particular. A lifting in the speed limit to 25% would ease access to a difficult market, in our view. An easy argument to make politically. The deposit on investor lending could also be eased (again) to 30%, and the speed limit to be lifted a little without adding much fuel to the fire. Credit growth is subdued, and credit to investors has been reined in since 2016. A loosening in LVR restrictions would loosen the availability of credit, and add a little to credit growth next year. For more on property, see "[Property Insights: 3 Ps of Property](#)".

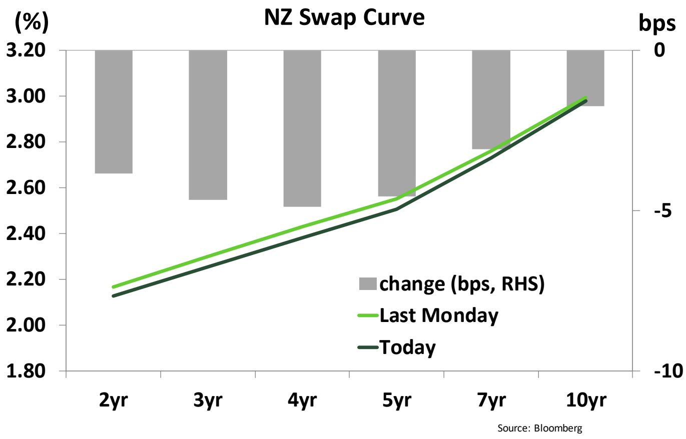


Financial Markets

On Monday morning, StatsNZ released the retail trade survey for the September quarter. Total retail trade volumes were unimpededly weak, with volumes flat over the quarter as opposed to the market expecting a respectable 1% qoq lift. What stood out in the survey was the jump in spending on petrol, as we saw petrol prices hit record levels in some parts of the country. This looks to have played a part in weak volumes as consumers have shifted spending away from some discretionary items. Spending volumes on food and beverage services were 3.3% qoq lower. This is an example of how sharp rises in energy prices are seen as a pay cut for energy-importing countries like NZ. However, the lacklustre spending in Q3 is likely to temporary. Fundamentals are strong for consumers. Petrol prices have already retreated in November as oil prices have slumped, mortgage rates are at all-time lows, the labour market is humming, and incomes are rising (in part due to fiscal policy).

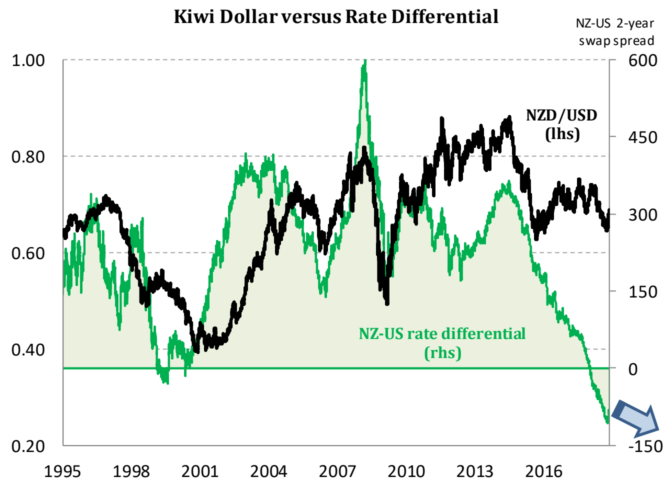
In the wonderful world of rates, the world is flat.

The flush out of stale longs has petered out and yields have moved lower in line with global moves. Short-end receiving has reappeared and support should come in around the previous range highs of 2.12%, giving a new range of 2.10-2.20% in the 2 year-swap. In short, the market is consolidating around current levels, and feels more balanced after being heavily received into the more balanced RBNZ meeting earlier this month. The curve has flattened recently, some on the back of new issuance flow and some given global fear-based moves (Brexit/US growth wobbling a little/lower oil prices) and the rest of relative value spreads looking wide vs Aussie. However, a delayed reaction function from the RBNZ should still see steepening via the mid curve given an anchored short end. After the FSR report this week we have to wait until 13 February 2019 MPS, and there will certainly be some volatility between times. The market continues to weight up a more dovish RBNZ vs more hawkish domestic data reads and is keeping positioning nimble (with a bias to receive short rates on spikes).



In the wonderful world of FX, the dollar dominates.

The NZD remains bid…but only to a point. That point being the 200-day moving average (MDA) of just under $0.6900 which is providing solid resistance. A rally beyond $0.6900 will require something that jolts NZ's yield advantage in the NZD's favour. In the near-term that looks unlikely. Last week the positive trade dispute rumblings failed to generate much positive risk sentiment, coupled with that the NZD wobbled under the commodity story leaving only a weaker USD proving NZD support. The FSR this week is a point of interest, some form of loosening of LVRs feels likely but this is incremental stuff that is unlikely to push the NZD around too much – but nonetheless a supporting factor. The NZD/AUD has rallied, the Aussies weakening housing story and the royal commission bringing out AUD sellers. However, positioning and commodity divergence suggest the NZD/AUD should be lower. The NZD 200MDA of $0.6897 is providing strong resistance, with initial support lying at $0.6700 and then then the lower 100MDA of $0.6650 is solid support.



The Domestic Events that matter this week include:

Oct Merchandise Trade (Tuesday)

Monthly Deficit – Last: $1,560mn; Consensus: $850mn

As we move into the spring/summer period, agriculture production starts to lift, and monthly merchandise trade deficits shrink. This year, a mild spring has meant that diary production is well ahead on the same period last year. We will start to see this feed into a lift in the value of exports, although commodity prices have been fading this season and may partly offset higher volumes. On the import side, oil prices peaked at the start of October and could see the value of imports rise. The market is picking a deficit of $850mn in September, from $1,560mn in September. Looking at the annual trade deficit, this has generally widened over 2018.

Nov RBNZ Financial Stability Report (Wednesday)

In a speech a few weeks ago, Head of Financial Stability at the RBNZ, Geoff Bascand, hinted at the main themes of the November Financial Stability Report (FSR). The RBNZ looks likely to stick to the themes of recent FSRs. The financial system is sound, but its main vulnerabilities continue to be: the high level of indebtedness of Kiwi households and the dairy sector; and our reliance on offshore funding. However, what was jumped on in Bascand's speech were comments related to the debate going on behind the scenes at the Bank on whether the Loan-to-Value Ratio (LVR) restrictions currently in place should be slightly eased – which would be announced as part of the FSR. Bascand noted:

"*The question we are assessing is whether the same* [LVR] *restrictions are needed in the current environment where debt levels remain high but are not deteriorating, now that bank lending standards have tightened significantly and rapid growth in credit and house prices have stabilised. If these conditions continue, we expect to gradually ease the policy in coming years.*"

We believe that current conditions are congenial to looser LVRs. In addition, loosening LVR's would work with, not act against, the Bank's monetary policy objective. There is a dovish streak running through the Bank at present, which would be receptive to the loosening of LVRs. If the RBNZ does decide to loosen LVRs this month we would expect only modest adjustments akin to those delivered last November. Such as: shaving the investor LVR by 5% to allow lending to those with at least a 30% deposit (down from 35% currently); for owner-occupied borrowers, the speed limit on banks' lending to those with less than a 20% deposit could be raised slightly to 20% of new bank lending from 15% at present.

Nov ANZ Business Outlook Survey (Thursday)

Activity Outlook – Last: net 7.4%

Business confidence is again worth keeping an eye on, with the ANZ *Business Outlook* survey for November out on Thursday. Firms' outlook for their own activity held steady in October, with a net 7% of firms expecting an increase in activity in the coming months – this is a sub-par reading and not flash for future growth. The good run of local data of late would suggest that business confidence should be rosier than it is. So, we will be looking for improvement in ANZ's survey in November. Other forward indicators of activity, such as the BusinessNZ Performance of Manufacturing (PMI) and Services (PSI) indexes, which had recently followed confidence lower, rebounded in October. The PMI hit a reading of 53.5 in October, the highest reading since May; with production, employment and new orders posting decent gains in the month.

Nov ANZ-Roy Morgan Consumer Confidence Survey (Friday)

Last: 115.4; -1.9% mom

Consumer confidence slipped in October as measured by the ANZ-Roy Morgan survey, with headline confidence down 3 point to 115.4 and now clearly below the survey's average. It seems consumers are worried about the future, with the future conditions index falling further last month. However, a decent share of consumers still think is a good time to purchase a major household item. Looking at recent developments it's easy to see why. Petrol prices are falling fast from record highs, mortgage rates are at all-time lows, the labour market is humming, and incomes are rising (in part due to fiscal policy). The question is whether headline confidence will follow suit?

Oct Building Consents (Friday)

Last: -1.5% mom

Building consents data for October are due on Friday. Residential consents eased 1.5% mom in September and have been generally softened lately. Consents, particularly in Auckland, are at levels last seen during the early-to-mid-2000s mini-building boom. Capacity constraints seem to be capping consents from taking another leg higher. So while the construction sector is all hands to the pump, its contribution to GDP growth may diminish.

Our forecasts:

Kiwi Economics Forecasts

	Quarter					
	Dec-17	Dec-18 (f)	Jun-19 (f)	Dec-19 (f)	Jun-20 (f)	Dec-20 (f)
GDP (Prodn, Real aapc)	2.9	3.0	3.4	3.1	2.9	3.0
CPI (% yoy)	1.9	1.9	2.1	2.1	2.1	2.0
Unemployment rate (%)	4.5	4.2	4.2	4.2	4.2	4.3
Wage Growth (pvt-sector LCI % yoy)	1.9	2.1	2.4	2.5	2.5	2.5
REINZ House Price Index (% yoy)	3.5	3.2	2.8	2.7	3.3	4.2
TWI (qtr average)	73.8	71.0	69.5	70.0	70.5	71.0
Official Cash Rate (%)	1.75	1.75	1.75	1.75	2.00	2.50
90-day bank bill rate (% quarter average)	1.88	2.00	2.00	2.05	2.30	2.75
2-year swap rate (% quarter average)	2.17	2.10	2.25	2.65	3.10	3.45

The International Events worthy of a mention include:

Australia: Private Capex. The most exciting release across the Tasman this week is September quarter private capital expenditure (Capex) on Thursday. Capex has not exactly set the house on fire in its recovery following the burst of Australia's mining bubble of several years ago. Mining investment has been the most volatile part of total Capex. The market is picking a modest 1.0% qoq rise in Capex following a 2.5% qoq fall in the second quarter.

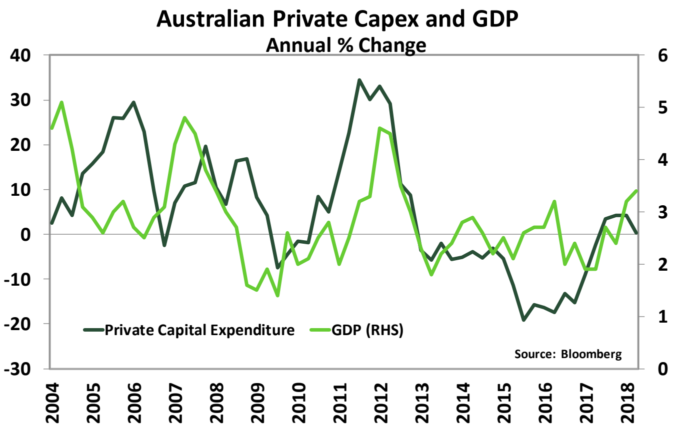
China: Manufacturing PMI. The official manufacturing PMI for November is one to watch in China this week. This metric is known for representing large state-owned manufacturers. In October the PMI surprisingly fell to 50.2, just a touch above 50 the margin between expanding and contracting activity. Economic activity has cooled in China over 2018, made worse by the ongoing US-China trade spat. Chinese authorities have moved in recent months to add stimulus to the system. The market does expect a slight lift in the manufacturing PMI to 50.3 in November.

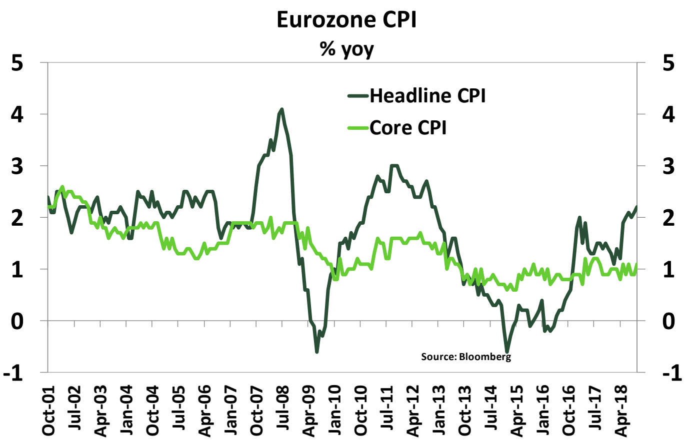
Japan: Industrial Production. Industrial production figures for October are due to be published on Friday. Production is expected to rebound in the month following disruption in September from a number of natural disasters. The market is picking a 1.2% mom jump after the 0.4% mom fall the month prior. Over the December quarter industrial production is likely to benefit from the recovery from natural disasters in addition to a weaker yen that should help exports of machinery.

United States: Fed Speakers, GDP, FOMC Minutes, PCE Deflator. In a week devoid of top tier data, the focus is likely to be on speeches from Federal Reserve (Fed) officials, in particular Chair and vice Chair Jerome Powell and Richard Clarida respectively. Powell is due to speak Thursday morning NZT. Disappointing economic data since early October has put the debate around the terminal rate of the Fed's current hiking cycle back on the table. While the Fed is still expected to tighten further (with the next rate hike highly likely in December), the market is questioning if three hikes will be delivered next year. The second reading of Q3 GDP is out overnight Wednesday. There are expected to be a few minor revisions to GDP growth following the release of subsequent indicators. The market is expecting annualised quarterly growth will come in at 3.6% from the initial 3.5% previously published. The Fed is due to release the minutes of its November meeting Friday morning. Also part of the data calendar this week is the release of October personal spending and income data. Of interest is likely to be the release of the Fed's preferred inflation measure, the core PCE deflator. The core PCE deflator is expected to have edged 0.1%pts lower to 1.9% just below the Fed's 2% target where it had been for five consecutive months.

Eurozone: CPI Inflation, ECB President Speech. We have the advance reading of November CPI inflation for the Eurozone on Friday evening NZT. The plunge in global oil prices seen since the start of October is expected to weigh on transport prices and headline inflation. The market is predicting annual inflation will ease to 2% yoy from 2.1% in October. Core inflation, which excludes energy prices, is also expected to ease 0.1%pts to 1% yoy. European Central Bank (ECB) President Mario Draghi is scheduled to address the European Parliament's economic and monetary committee on Thursday. Growth has slowed in the Eurozone and is posing a challenge to the potential for policy tightening in 2019.

UK: BoE Financial Stability Report & Brexit Analysis. Like the RBNZ the Bank of England (BoE) is due to release its Financial Stability report this week. However, the release date has been brought forward because the BoE is due to send its analysis of the EU withdrawal agreement to the Treasury Select Committee on Thursday – using analysis from the FSR. The Bank has previously warned of the instability that a no deal Brexit would cause. And here we will see it laid bare.





Weekly Calendar

Date	Country	Economic Indicator	Previous	Forecast
Monday, 26 November 2018	**NZ**	Sep Qtr Retail Sales Volumes (% qoq)	1.1	1
	AU	RBA Speakers - Lowe, Kent	-	-
	JN	Nov Nikkei Manufacturing PMI	52.9	-
	GE	Nov IFO Expectations Index	99.8	99.2
	EZ	ECB Speakers - Praet, Nowotny, Coeure, Draghi	-	-
Tuesday, 27 November 2018	**NZ**	Oct Merchandise Trade (balance, $mn)	-1,560	-850
	UK	BoE Speaker - Carney	-	-
	EZ	ECB Speaker - Nouy	-	-
	US	Fed Speaker - Clarida	-	-
Wednesday, 28 November 2018	**NZ**	Nov RBNZ Financial Stability Report	-	-
	UK	Nov BoE Financial Stability Report	-	-
	EZ	ECB Speaker - Rehn	-	-
	US	Oct New Home Sales (% mom)	-5.5	4
		Sep Qtr GDP (Second Reading, % qoq Annualised)	3.5	3.6
		Nov Richmond Fed Manufacturing Index	15	16
		Fed Speakers - Bostic, Evans, George	-	-
Thursday, 29 November 2018	**NZ**	Nov ANZ Activity Outlook (Net % of Firms)	7.4	-
	AU	Sep Qtr Private Capital Expenditure (% qoq)	-2.5	1
	JN	Oct Retail Trade (% yoy)	2.1	2.6
		BoJ Speaker - Masai	-	-
	EZ	Nov Consumer Confidence	-3.9	-3.9
		ECB Speaker - Draghi	-	-
	US	Oct Core PCE Deflator (% yoy)	2.0	1.9
		Fed Speaker - Powell	-	-
Friday, 30 November 2018	**NZ**	Nov ANZ-RM Consumer Confidence (% mom)	-1.9	-
		Oct Building Permits (% mom)	-1.5	-
	CH	Nov Non-manufacturing PMI	53.9	53.8
		Nov Manufacturing PMI	50.2	50.2
	JN	Oct Jobless Rate (%)	2.3	2.3
		Oct Industrial Production (% mom)	-0.4	1.2
		Oct Industrial Production (% yoy, prelim)	-2.5	2.5
		Nov Consumer Confidence Index	43	43.2
	EZ	Oct Unemployment Rate (%)	8.1	8
		Nov CPI Estimate (% yoy)	2.2	2
		ECB Speaker - Coeure	-	-
	US	Nov FOMC Meeting Minutes	-	-
		Fed Speakers - Evans, Williams	-	-

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