

Weekly Commentary

3 April 2017



Down, but not out

In most of New Zealand's regions, confidence in economic conditions softened in early 2017. Many New Zealanders are also feeling less upbeat about their personal economic situation. However, the recent softening in confidence follows some solid gains over the past year, and still leaves us with a relatively healthy outlook for the New Zealand economy.

Each quarter Westpac and McDermott Miller survey the attitudes of more than 1,500 households across the country in relation to general economic conditions and their own personal financial situation. The results of the latest survey showed confidence in the outlook for most regions softened in March quarter. The survey also showed that New Zealanders have become a bit less upbeat about the health of the labour market.

However, it's important to put the recent softening in confidence in context. While confidence did ease in early 2017, this comes on the back of solid gains in late 2016. Residents in most regions are more confident than they were six months ago, and much more so than a year ago.

When we look at the broader economic backdrop, it isn't surprising that confidence remains healthy. At a national level, GDP growth picked up to 3.1% in 2016, generating jobs and encouraging more people into the labour force. And importantly for regional prospects, the drivers of growth have become increasingly broad based. After two lousy seasons, better dairy incomes are now hitting farmers' pockets, and conditions for other commodity producers, including beef and horticulture, have remained positive. Most regions are also benefitting from rising tourist numbers, a pick-up in population growth, and increasing house prices (that said, the pace of house price growth has slowed in some regions in recent months, with prices flattening off in the case of Auckland and Christchurch).

Looking at some of the results by region, Southland topped the leader board this quarter, for the first time since 2012. With one of the country's highest exposures to dairy, the improved outlook for dairy incomes has no doubt played a key role in boosting confidence. Other major dairying regions like the Waikato, Taranaki and Manawatu-Whanganui have also moved up the ranks over the past year. But as these regions have risen up the ranks, the Bay of Plenty has stumbled back into the middle of the pack this quarter, after dominating the number 1 spot for the past 18 months.

Auckland remains the least optimistic region in the country. Confidence in the region's economic outlook has been on a downward spiral for the past couple of years, and only a net 7% of residents expect the region's economy to improve over the year ahead. This relatively downbeat assessment for Auckland is despite what has actually been some pretty solid economic activity. Regional GDP figures for the year to March 2016 show that Auckland's GDP rose by 6%. And even when you account for the fact that the region has had the highest rate of population growth in the country, it was still the second fastest growing region that year. More recently, we've seen continued positive activity and solid employment growth in the region, with the construction and tourism sectors performing strongly.

Like many rapidly growing cities globally, Auckland has encountered 'growing pains', including poor housing affordability and transport woes, and such issues are likely

Down, but not out continued

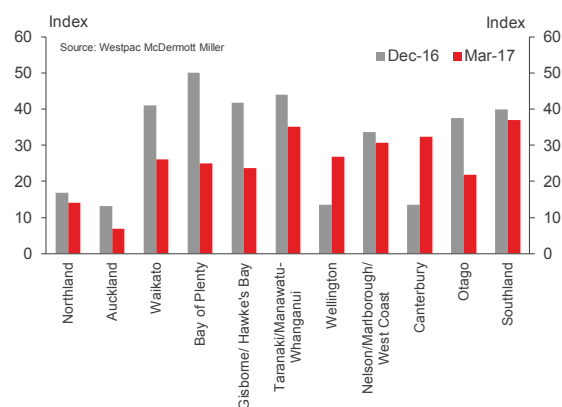
weighing on residents' views of the region's prospects. Nevertheless, the region's strong economy, as well as education and social opportunities are continuing to attract people.

One very positive development for Auckland was the sharp increase in dwelling consent issuance in February, including a strong rise in multi-unit consent numbers. Housing market tightness is one of the biggest challenges Auckland is wrestling with. But with the Unitary Plan having now cleared many of its legal hurdles, it appears developers are coming back into the market, and we expect home building to rise over the coming year. But for now, issuance in Auckland still remains below what's needed to keep up with surging population growth in the region, and housing market tightness is likely to remain a challenge for some time yet.

Looking at the other major centres, confidence was up in both Canterbury and Wellington. This follows declines last quarter that were related to earthquake induced disruption and uncertainty.

In Wellington, population growth and a strong tourism season are boosting demand. Together, these factors are supporting activity in many parts of the services sector, and are encouraging increased investment spending by businesses. However, the past few months have seen concerns about rising rents and housing affordability.

Regional economic confidence



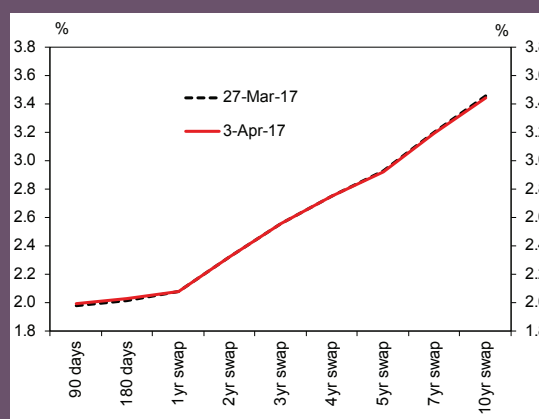
Canterbury's economy is continuing its transition though the rebuild process. Although growth has slowed, activity in the region remains at an elevated level. Recent months have seen the number of commercial buildings completed rise, and increasing numbers of businesses returning to the central city. On top of this, the drivers of activity are gradually shifting away from construction and towards areas like tourism and services. This has given the region a sense of vibrancy, with workers reporting improved job prospects and earnings.

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 terms. Three- to five-year rates seem high relative to where we think short-term rates are going to go over that time. That said, these rates are most likely to be pressured higher by global market trends, so borrowers who prefer the security of a longer term still have a chance to lock in at historically quite low levels.

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



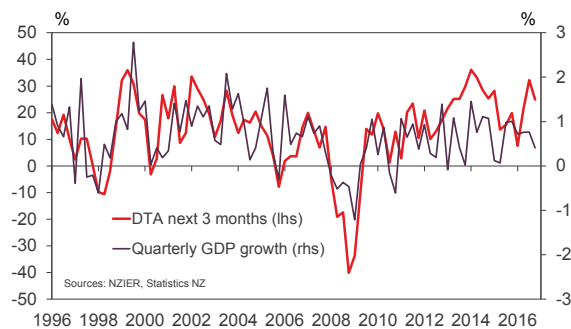
The week ahead

NZ Q1 Quarterly Survey of Business Opinion

Apr 4, Last: 26, General business situation

- The December quarter survey saw confidence ease a bit from September's strong result. But overall, firms across sectors reported solid results for the final quarter of 2016, and expected further gains in activity in early 2017 – consistent with a continuation of moderate economic growth.
- The survey's measures of costs and prices will be of particular interest. Last quarter firms' pricing intentions rose to the highest level in two years. While this is consistent with annual inflation past its trough, pricing indicators remained mixed across sectors. In particular, retailers' pricing intentions remained muted, potentially as the previous year's gain in the NZ dollar and soft global inflation kept a lid on imported inflation. We expect this will remain a feature of the inflation backdrop this year, limiting the rise in CPI inflation.

QSBO domestic trading activity and GDP



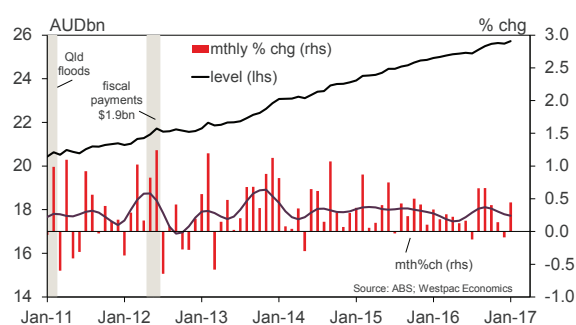
Aus Feb retail trade

Apr 3, Last: 0.4%, WBC f/c: 0.3%

Mkt f/c: 0.3%, Range: 0.1% to 0.7%

- Jan retail sales grew by 0.4%, the lift following a soft end to 2016 (essentially flat through Nov-Dec). The recent pattern has been driven by significant moves in 'household goods' retail where the closure of the Masters Home Improvement chain created a big drag on both prices and volumes late last year.
- Consumer sentiment slipped back into 'cautiously pessimistic' territory in Dec-Feb, the component detail showing a deterioration in family finances and pointing to a lift in risk aversion. Private sector business surveys have been more upbeat, although strength remains concentrated in consumer service sectors rather than retail. Overall we expect retail sales to post another sluggish 0.3% gain in Feb.

Monthly retail sales



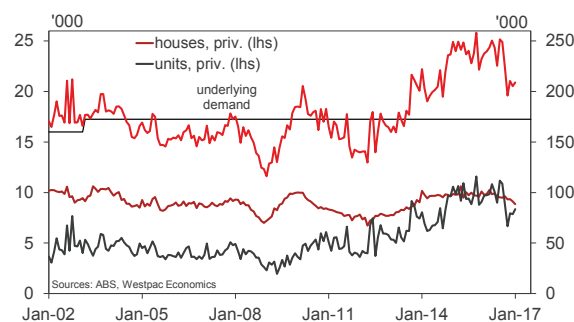
Aus Feb dwelling approvals

Apr 3 Last: 1.8%, WBC f/c: -1.0%

Mkt f/c: -1.5%, Range: -6.0% to 3.0%

- Dwelling approvals rose 1.8% in Jan retracing most of a downwardly revised 2.5% fall in Dec. However, Jan data is notoriously unreliable due to the summer low season with the detail showing weaker reads in components less susceptible to seasonal volatility issues. Stepping back, the picture is still of a marked slowdown since Aug last year. The main interest is around the mix of weakness across high rise and non high rise segments which will determine how much of the slowdown impacts construction activity in 2017 vs 2018 and beyond. The Feb update should provide a 'truer' read on conditions. The bulk of the high rise drop now looks to have passed but there is still likely to be some residual weakness coming through. We expect a 1% decline with risks looking a bit more evenly balanced than late last year.

Dwelling approvals



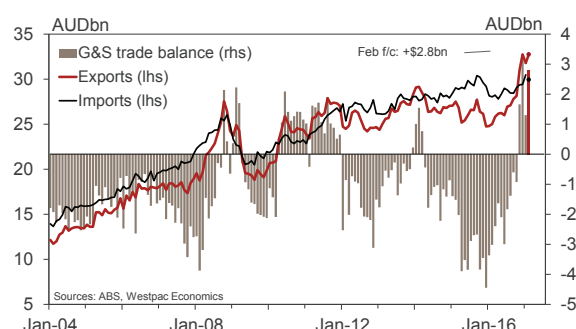
Aus Feb trade balance, AUDbn

Apr 4, Last: +1.3, WBC f/c: +2.8

Mkt f/c: +1.7, Range: +0.5 to +3.4

- Australia's trade account has moved well into surplus as a spike in commodity prices boosts export earnings. Although, in January the surplus narrowed from \$3.5bn to \$1.3bn, in part due to a surprise \$1.4bn spike in imports. In February, we expect a partial reversal to a \$2.8bn surplus.
- Export earnings rise a forecast 3.0%, almost \$1.0bn, largely due to a rise in iron ore (prices) and a rebound in gold.
- For imports, we've factored in a 1.8% fall, -\$550mn, on the judgement that part of the 4.7% jump in January was a pull-forward ahead of Lunar New Year disruptions.
- NOTE: Since January 2016, there is additional uncertainty around the import and trade forecast. The ABS no longer publishes customs goods imports ahead of the trade release.

Australia's trade balance



The week ahead

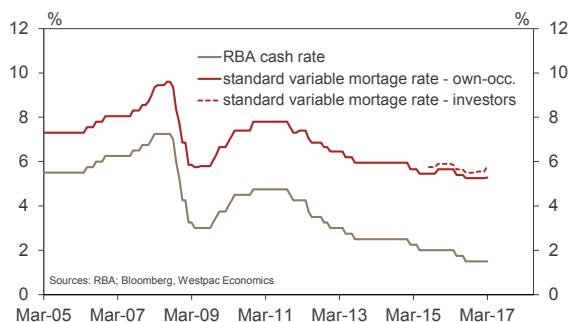
Aus RBA policy decision

Apr 4, Last: 1.50%, WBC f/c: 1.50%

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

- The RBA is firmly on hold. The minutes of the March Board meeting were less upbeat than previous assessments. Upside risks from global growth and commodity prices were downplayed, with the Bank again sounding cautious about labour market conditions and household incomes.
- However, concerns about “a build-up of risks associated with the housing market” effectively rule out further cuts. Recently announced 'macro prudential' measures should work to cool conditions but will take time to act. More generally the experience through 2015-16 – when rate cuts quickly reignited housing markets – will keep the Bank wary of moves down the track. Our expectation remains for rates to remain on hold throughout 2017 and 2018.

RBA cash rate & market pricing



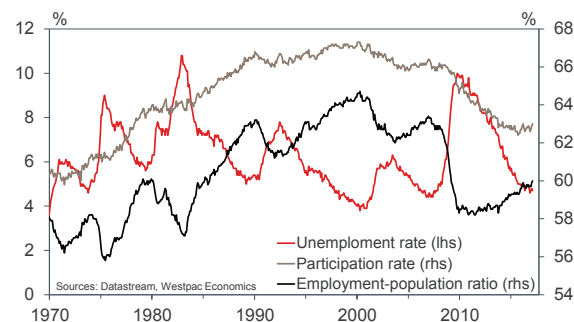
US March employment report

Apr 7, nonfarm payrolls Last: 235k, WBC 180k

Apr 7, unemployment rate Last: 4.7%, WBC 4.7%

- The labour market started 2017 on a particularly strong note, with a 235k gain in nonfarm payrolls in February following January's 238k rise (previously 227k). That is a material step up in the pace of job creation versus 2016 – a 187k average. The household survey also points to a strong labour market: the unemployment rate edging back down to 4.7%; and the employment to population ratio trended higher to 60%.
- Wages remain the one component that are not showing outright strength. However, solid gains continue.
- Come March, another robust jobs gain is expected, albeit back around 180k. With full employment reached, jobs growth should slow through 2017 to a pace more consistent with maintaining an unchanged unemployment rate – circa 4.7%.

Employed share of population rising



Data calendar

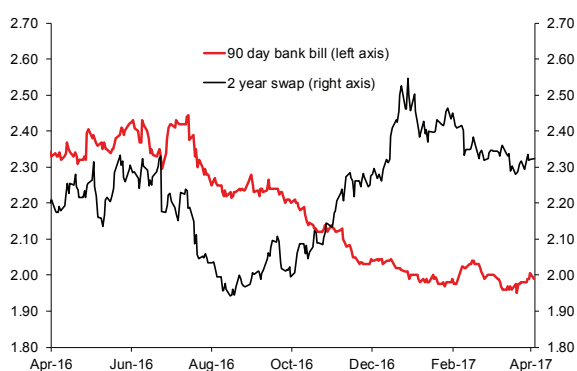
		Last	Market median	Westpac forecast	Risk/Comment
Mon 3					
Aus	Mar AiG PMI	59.3	-	-	Feb survey was very positive.
	Mar CoreLogic home value index	1.4%	-	1.4%	Annual growth nudging 12% on this measure.
	Mar MI inflation gauge %yr	2.1%	-	-	Inflation pressures to remain modest.
	Feb retail sales	0.4%	0.3%	0.3%	Consumer sentiment softened in Q1, incomes under more pressure?
	Feb dwelling approvals	1.8%	-1.5%	-1.0%	Most of high rise pull-back looks to have passed.
	Mar ANZ job ads	-0.7%	-	-	Feb dip followed surge in Jan, +3.9%.
Chn	Mar Caixin China PMI	51.7	51.7	-	Official measure reported another robust month in Mar.
Eur	Mar Markit manufacturing PMI (final)	56.2	56.2	-	Points to robust conditions for manufacturers.
	Feb unemployment rate	9.6%	9.5%	-	Slowly edging lower.
Ger	Mar Markit manufacturing PMI (final)	58.3	58.3	-	In a very strong position given EUR and domestic conditions.
UK	Mar Markit manufacturing PMI (final)	54.6	55.0	-	The lower pound has supported manufacturing and exporting.
US	Mar Markit manufacturing PMI (final)	53.4	-	-	Continues to point to robust momentum.
	Mar ISM manufacturing	57.7	57.0	-	Likely to remain strong for now.
	Feb construction spending	-1.0%	1.2%	-	Investment set to remain subdued; partly owing to energy sector.
	Fedspeak	-	-	-	Dudley on household debt; Harker on Fintech; and Lacker.
Tue 4					
NZ	Q1 QSBO business confidence	26	-	-	Confidence eased in Q4, still solid. Pricing intentions up from lows.
Aus	Feb trade balance, AUDbn	1.3	1.7	2.8	Surplus reduced from \$3.5bn to \$1.3bn in Jan - expect partial reversal.
	RBA policy announcement	1.50%	1.50%	1.50%	Firmly on hold as macro-prud. measures target housing risks.
	RBA speak	-	-	-	Governor Lowe gives remarks at the RBA Board dinner.
US	Feb trade balance US\$bn	-48.5	-46.5	-	Jan's deficit a 5yr high.
	Feb durable goods orders (final)	1.7%	-	-	Underlying growth still very subdued.
	Fedspeak	-	-	-	Fed's Tarullo speaks at Princeton University.
Wed 5					
NZ	GlobalDairyTrade auction	1.7%	-	-	Stabilised last auction. Futures point to another stable result.
	Mar QVNZ house prices, %yr	13.5%	-	-	Prices flattening out in Auckland, still rising in many other regions.
	Mar ANZ commodity prices	0.4%	-	-	This year's pullback in dairy prices expected to weigh on index.
Aus	Mar AiG PSI	49.0	-	-	Sharp pull-back in Feb but has been a poor indicator in recent years.
	RBA speak	-	-	-	RBA's Heath at a Bloomberg Panel Participation.
Eur	Mar Markit services PMI	56.5	56.5	-	Improvement in domestic conditions aiding services...
Ger	Mar Markit services PMI	55.6	55.6	-	... across the continent.
UK	Mar Markit services PMI	53.3	53.5	-	Has lost some ground. Growing concern about domestic demand.
US	Mar ADP employment change	298k	180k	-	Very strong in recent months; a correction due?
	Mar Markit service PMI	52.9	-	-	Much weaker than the ISM variant...
	Mar ISM non-manufacturing	57.6	57.0	-	... which is pointing to strong growth.
	Mar FOMC meeting minutes	-	-	-	Further detail to glean on rates and balance sheet outlook.
Thu 6					
Aus	RBA speak	-	-	-	RBA's DeBelle Speaks on 'Recent Trends in Australian Capital Flows'.
Chn	Mar Caixin China PMI services	52.6	-	-	NBS measure saw a robust gain in Mar.
US	Initial jobless claims	258k	-	-	Historically low.
	Fedspeak	-	-	-	Williams Speaks on a Panel in Frankfurt.
Fri 7					
Chn	Mar foreign reserves \$bn	3005	3015	-	Stable of late, but likely to see further declines through 2017.
Ger	Feb industrial production	2.8%	-0.3%	-	A slight pullback expected after Jan surge.
	Feb trade balance €bn	14.9	17.4	-	Competitiveness strong thanks to EUR.
UK	Mar Halifax house prices	0.1%	-	-	Limited supply is helping to offset softer demand.
	Feb trade balance €bn	-1966	-1900	-	Rising import prices, offsetting the improved export outlook.
	Feb industrial production	-0.4%	-0.1%	-	Production firm supported by lower pound, but costs rising.
	Feb construction output	-0.4%	-0.4%	-	Investment likely to be impacted by Brexit in 2017 and beyond.
US	Mar non-farm payrolls	235k	174k	180k	Slower growth expected in Mar; but forecast still for strong growth.
	Mar unemployment rate	4.7%	4.7%	4.7%	At full employment.
	Feb wholesale inventories	0.4%	-	-	Fickle despite optimism over outlook.
	Feb consumer credit \$bn	8.79	11.00	-	Auto and student loans continue to drive headline.
Can	Mar Ivey PMI	55.0	-	-	Firmer petroleum and chemical sales, softness in areas like transport.
Sat 8					
Aus	Westpac turns 200	-	-	-	Supporting Australia since 1817.
Chn	Mar foreign direct investment %yr	9.2%	-	-	Tentative date - 08/04 to 18/04.

New Zealand forecasts

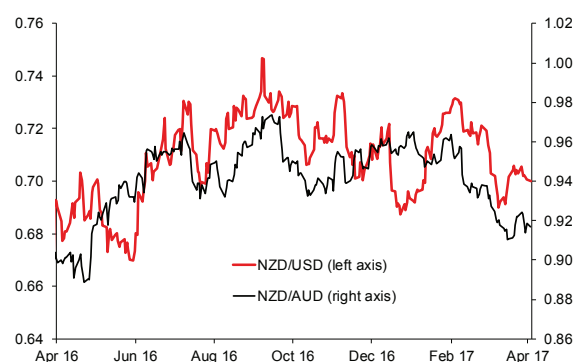
Economic Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2015	2016	2017f
GDP (Production) ann avg	3.4	2.4	3.1	3.4	2.5	3.1	3.2	3.4
Employment	3.2	2.0	5.3	2.1	1.4	5.8	2.3	1.5
Unemployment Rate % s.a.	5.4	5.2	4.7	4.4	4.9	5.2	4.4	4.2
CPI	0.3	0.4	1.8	1.5	0.1	1.3	1.6	2.1
Current Account Balance % of GDP	-3.5	-3.1	-2.7	-2.7	-3.4	-2.7	-2.6	-3.3

Financial Forecasts	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	2.00	2.00	2.00	2.00	2.00	2.00
2 Year Swap	2.50	2.50	2.50	2.50	2.60	2.70
5 Year Swap	3.15	3.20	3.30	3.35	3.45	3.60
10 Year Bond	3.45	3.50	3.60	3.65	3.75	4.00
NZD/USD	0.69	0.68	0.67	0.66	0.64	0.63
NZD/AUD	0.91	0.91	0.91	0.91	0.92	0.93
NZD/JPY	81.4	80.2	80.4	80.3	79.7	79.4
NZD/EUR	0.66	0.66	0.66	0.66	0.65	0.64
NZD/GBP	0.57	0.57	0.56	0.56	0.54	0.53
TWI	76.3	75.8	75.5	75.0	74.2	73.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 3 April 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.90%	1.83%	1.85%
60 Days	1.94%	1.90%	1.93%
90 Days	1.99%	1.96%	2.00%
2 Year Swap	2.32%	2.30%	2.36%
5 Year Swap	2.92%	2.98%	3.02%

NZ foreign currency mid-rates as at Monday 3 April 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7000	0.7012	0.7033
NZD/EUR	0.6565	0.6533	0.6632
NZD/GBP	0.5578	0.5660	0.5722
NZD/JPY	77.99	79.00	80.10
NZD/AUD	0.9170	0.9116	0.9261
TWI	76.22	76.44	77.14

International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016	2017f	2018f
Australia						
Real GDP % yr	2.1	2.8	2.4	2.5	2.6	2.8
CPI inflation % annual	2.7	1.7	1.7	1.5	2.0	1.9
Unemployment %	5.8	6.2	5.8	5.7	5.9	6.0
Current Account % GDP	-3.4	-3.0	-4.7	-2.7	-0.6	-2.5
United States						
Real GDP %yr	1.5	2.4	2.6	1.6	2.2	2.4
Consumer Prices %yr	1.5	1.6	0.1	1.3	2.1	1.8
Unemployment Rate %	7.4	6.2	5.3	4.9	4.4	4.4
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.7	-2.8
Japan						
Real GDP %yr	1.4	0.0	0.5	0.6	0.6	0.7
Euroland						
Real GDP %yr	-0.3	0.9	1.6	1.7	1.5	1.3
United Kingdom						
Real GDP %yr	2.2	2.9	2.2	2.0	1.9	1.5
China						
Real GDP %yr	7.7	7.3	6.9	6.7	6.6	6.0
East Asia ex China						
Real GDP %yr	4.2	4.1	3.7	3.7	3.8	3.8
World						
Real GDP %yr	3.3	3.4	3.1	3.2	3.5	3.5

Forecasts finalised 20 March 2017

Interest Rate Forecasts	Latest	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.79	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.70	2.95	3.00	3.05	3.15	3.25	3.40	3.40
International								
Fed Funds	0.875	1.125	1.125	1.375	1.625	1.625	1.875	1.875
US 10 Year Bond	2.41	2.65	2.75	2.85	3.00	3.10	3.30	3.30
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40

Exchange Rate Forecasts	Latest	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
AUD/USD	0.7644	0.76	0.75	0.74	0.72	0.70	0.68	0.66
USD/JPY	112.11	118	118	120	122	124	126	128
EUR/USD	1.0675	1.05	1.03	1.01	1.00	0.99	0.98	0.96
AUD/NZD	1.0942	1.10	1.10	1.10	1.09	1.09	1.08	1.06

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