

Weekly Commentary

3 July 2017



Building foundations

This week we take a deeper dive than usual into the building consents data. On the face of it, there are concerning signs that the pace of homebuilding may have flattened out, at a time when population growth requires a substantial lift in activity. But there are other aspects of the consent figures that paint a fuller picture.

Consents for new dwellings rose 7% in seasonally adjusted terms in May, after a 7.4% drop in April. The April figures may have been affected by the timing of the Easter and Anzac Day holidays this year. However, the rise in consents in May doesn't fully make up for this shortfall.

The fall in April and the rebound in May were both concentrated in Auckland, which in turn was driven by the trend in multiples (townhouses, terraced housing etc). The latter is the kind of housing that has been enabled more by the city's new Unitary Plan, so the growth in consents for multiples over recent months is an encouraging sign.

However, the pace of consents remains well short of what's needed to meet population growth. The annual total for dwelling consents in Auckland rose to 10,379 in May, a fresh high for the current cycle. But the growth in Auckland's population over the last year meant that another 15,000 homes were needed in that time.

What's more, the time to build means that Auckland's housing stock is growing even more slowly than the above figures suggest. At times the Auckland Council has provided data on the number of final inspections for newly-built homes, which is essentially the point at which they become habitable. These figures imply that the average time from consent to completion has stretched out to around 18 months. This will be partly due to capacity constraints in the homebuilding industry, and partly because apartments

(which take longer on average to complete) have made up a growing share of consents in recent years.

While the number of new homes consented is our best gauge of what's happening in the industry, it doesn't tell the complete story. The consents data also indicate that there is a substantial amount of work happening nationwide on additions and alterations to existing houses. At least some of this work will amount to an increase in the capacity of the housing stock.

Secondly, there is a fishhook to watch out for in the data for apartment consents. Apartment developments in Auckland have been particularly under the spotlight recently, with anecdotes of a number of projects being cancelled due to rising building costs or difficulties in securing funding. But the level of interest in new developments means that there is still a substantial amount of work going ahead.

Apartment buildings are often consented in stages, with the first consent covering the groundwork – site clearing, water connections, etc. The way that consents are recorded means that the cost of the groundwork is recorded in the first consent, but the number of planned dwellings is captured in a later consent. (For this reason, we'd caution against using the consents data to infer the average cost of building for apartments.)

Why is this relevant? In recent months we've seen a strong lift in the value of consents for groundwork in Auckland – at

Building foundations continued

least in terms of the ones that we can identify, given the aggregation of the data. For the last three months alone, we've identified over \$100m of consents with no dwellings recorded against them, well above any prior period. The implication is that a surge in the number of consented apartments could be on the way in the near future, as these developments reach their next stage.

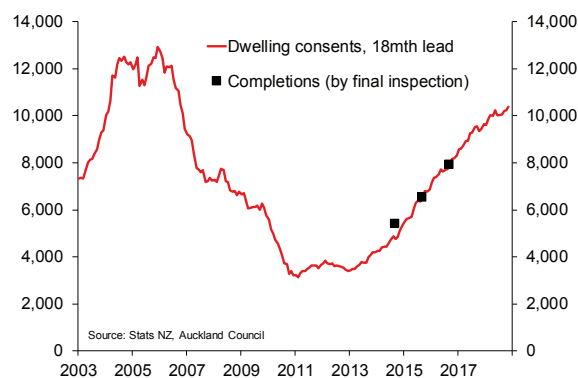
Homebuilding in Auckland tends to attract the greatest attention, due to the scale of the housing shortage that has accumulated over the years (we estimate a shortfall of around 35,000 homes, which will get worse before it gets better). But there is a substantial amount of work going on in the rest of the country too, especially in the rest of the North Island.

Wellington is the only other region where there is evidence of a growing housing shortage, albeit nowhere near to the same extent as Auckland. The number of dwelling consents appears to be trending higher in Wellington in response, although the numbers have been choppy from month to month, as consents for large apartment blocks tend to be much less frequent than in Auckland. Building consents have also been trending higher in high population growth areas such as the Waikato and Bay of Plenty.

In Canterbury, dwelling consents have slowed over the last couple of years, as the housing stock has been returned to pre-earthquake levels. However, the number of consents has stabilised so far this year, at what could be considered 'business as usual' levels.

The demands on the construction sector extend beyond housing. Non-residential building is another category that

Auckland homebuilding, annual totals



tends to be lumpy from month to month, but the pipeline of consented work has grown strongly over the last year. This is worth noting because non-residential building work was a significant negative for March quarter GDP; we remain of the view that this was a blip in the timing of building work.

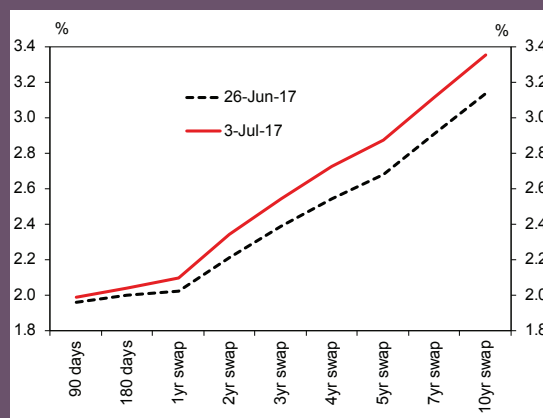
Finally, there also appears to be a large amount of infrastructure work in the pipeline, though it's harder to find information on how this is tracking. ('Building consents' generally cover anything with a roof, so they don't include things like roads, bridges, wastewater systems etc). The government significantly increased its allowance for capital spending in the latest Budget, to accommodate the growth in the population over recent years.

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



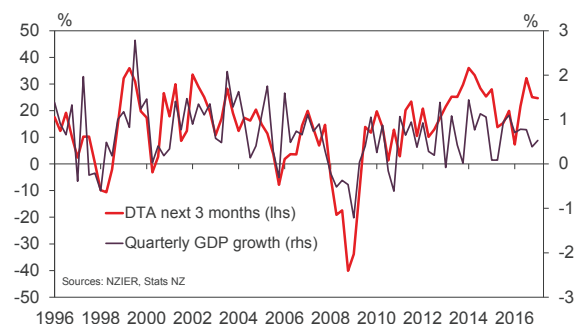
The week ahead

NZ Q2 Survey of Business Opinion

Jul 4, general situation last: +16

- The Quarterly Survey of Business Opinion provides a useful early lead on the strength of quarterly GDP. However, the survey has somewhat overstated the case in the last two quarters, as GDP was held back by temporary weather-related factors. We expect business sentiment to remain robust, consistent with a continuation of the underlying pace of GDP growth over the last few years.
- The inflation and capacity measures of the QSBO will be of particular interest. Headline inflation has risen substantially in a short period of time (though partly due to one-off factors), and the unemployment rate is at its equal-lowest since 2008. Pricing intentions and reported capacity utilisation have strengthened in recent surveys, but firms' ability to actually raise prices has been more constrained.

QSBO domestic trading activity and GDP



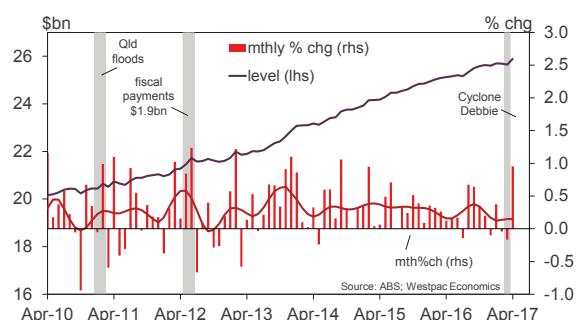
Aus May retail trade

Jul 4, Last: 1.0%, WBC f/c: 0.3%

Mkt f/c: 0.2%, Range: -0.3% to 0.6%

- Retail sales posted a strong 1% rise in Apr, as the effects of wet weather and Cyclone Debbie reversed. The result was the strongest monthly gain since Sep 2014. Note that some of the rebound likely reflects higher fresh fruit and vegetable prices post cyclone although non food retail was also up strongly (+0.8%/mth).
- Consumer sentiment remained soft through Apr-May with family finances under pressure and housing concerns to the fore but jobs security improving. Solid job gains through Mar-Apr-May point to a lift in total household income. Vehicle sales also posted a strong rise in May. On balance we expect retail sales to eke out a 0.3% gain - underperforming a slightly better improvement across the wider consumer sector.

Monthly retail sales



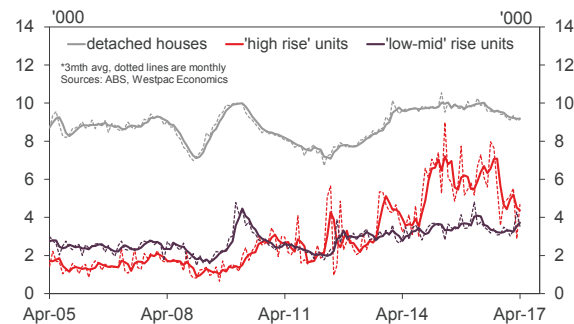
Aus May dwelling approvals

Jul 3, Last: 4.4%, WBC f/c: 1.0%

Mkt f/c: -1.3%, Range: -4.0% to 5.2%

- Dwelling approvals rebounded in April from what appeared to be a weather affected fall in March (down a steep 10.3%). Despite a choppy few months the broader picture is still of a high-rise driven slowdown with the composition pointing to dwelling construction entering a moderate but protracted downturn from late 2017.
- With weather disruptions dropping out of the picture, the May update should offer a cleaner read on the underlying cycle. Segment-wise, non-high rise approvals have shown signs of firming with construction-related finance approvals also pointing to a slight lift. High rise approvals have stabilised after the sharp pull-back late last year but may see another move lower in coming months. On balance we expect May to show a slight 1% gain in total approvals with main risks again around high-rise.

Dwelling approvals: houses, low-mid & high rise



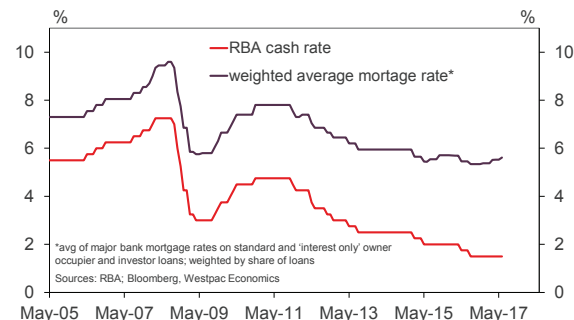
Aus RBA policy decision

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

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

- The Reserve Bank is widely expected to leave interest rates unchanged in July.
- Rates were last moved in 2016, with cuts in May and August. The Bank has highlighted the labour market and housing as key areas of concern. Developments for both will reinforce the 'on hold' decision. Labour market concerns will have eased with jobs growth surprising to the high side in both March and April, although movements in hours worked were less convincing. On housing, the RBA will keep a watching brief, monitoring the impact of recent macro-prudential measures.
- We continue to expect the RBA to remain on hold throughout 2017 and 2018.

RBA cash rate & mortgage rates



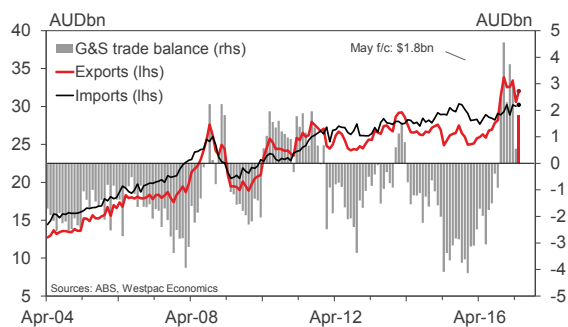
The week ahead

Aus May trade balance, AUDbn

Jul 6, Last: 0.6, WBC f/c: 1.8, Mkt f/c: 1.1, Range: -0.8 to 3.2

- Australia's trade balance, which has been comfortably in surplus, felt the impacts of Cyclone Debbie in April. For May, we expect the surplus to rebound partially, to \$1.8bn, up from \$0.6bn in April, but still short of the \$3.2bn in March.
- Export earnings are forecast to rise by 4.7%, +\$1.4bn, after an 8.3% slump. Coal shipments returned to normal, adding \$1.3bn (although that would still leave coal export earnings \$1.2bn below March due to lower prices). A jump in LNG shipments could add around \$0.7bn, but fully offsetting this is the impact of a 14% fall in the iron ore price. Imports are forecast to rise by 0.6%, \$0.2bn, as prices rise because of the weaker currency, down 1.6% on a TWI basis.
- *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



US June employment report

Jul 7, nonfarm payrolls, Last: 138k, WBC 190k

- The past three months nonfarm payroll outcomes have been disappointing for the market. The May outcome of 138k was below expectations and also came with 66k in downward revisions to March and April. That left the average for the three months to May at 121k, a material step down from 2016's 187k pace.
- However, this is not cause for concern. Given we are late in an expansion cycle and full employment has been achieved, employment growth should be expected to slow. A month-average pace in excess of 100k is a positive trend.
- Job growth tends to be volatile on a monthly basis; so, after a string of soft outcomes, we look for a bounce in June, circa 190k. From the household survey, having fallen to 4.3% in May, we expect the unemployment rate to edge back up to 4.4% in June as participation ticks higher.

Labour market strong; job gains continuing



Data calendar

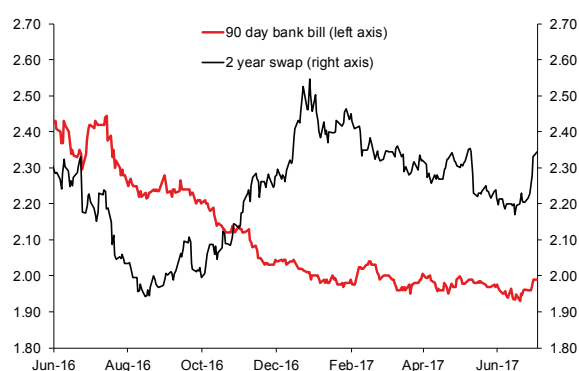
		Last	Market median	Westpac forecast	Risk/Comment
Mon 3					
Aus	May dwelling approvals	4.4%	-1.3%	1.0%	Should offer a cleaner read after weather-affected Apr-May.
	Jun MI inflation gauge %yr	2.8%	-	-	Currently the fastest annual pace since June 2014.
	Jun ANZ job ads	0.4%	-	-	Growth in job ads is holding around a 7% annual pace.
	Jun AiG PMI	54.8	-	-	Manuf'ng sector supported by construction & lower AUD.
	Jun CoreLogic home value index	-1.1%	-	1.5%	Daily index points to June price bounce but market still slowing.
Chn	Jun Caixin China PMI manufacturing	49.6	49.7	-	Surprised to the downside in May.
Eur	Jun Markit manufacturing PMI (final)	57.3	57.3	-	... flash indicating manufacturing maintaining a robust expansion.
	May unemployment rate	9.3%	9.3%	-	Labour market continues to improve.
UK	Jun Markit manufacturing PMI (final)	56.7	-	-	The lower pound is supporting manufacturing and investment.
US	Fedspeak	-	-	-	Bullard at BoE conference in London.
	Jun Markit manufacturing PMI (final)	52.1	-	-	Still pointing to solid growth...
	Jun ISM manufacturing	54.9	55.0	-	... though Markit continues to materially lag the ISM measure.
	May construction spending	-1.4%	0.3%	-	Underlying trend to remain uninspiring.
Tue 4					
NZ	Q2 QSBO business confidence	16.0	-	-	Inflation, capacity measures will be of particular interest.
Aus	May retail sales	1.0%	0.2%	0.3%	Weather-related rebound supported strong Apr gain.
	RBA policy decision	1.50%	1.50%	1.50%	Firmly on hold, labour and housing markets the focus.
US	Independence Day	-	-	-	Public holiday.
Wed 5					
NZ	GlobalDairyTrade auction	-0.8%	-	-	Futures point to a decline as global milk production picks up.
	Jun QV house price, %yr	9.7%	-	-	Monthly prices have flattened out and are declining in Auckland.
	Jun ANZ commodity prices	3.2%	-	1.0%	Further gains in meat and dairy prices in June.
Aus	Jun AiG PSI	51.5	-	-	Service sectors conditions mixed, index down 1.5pts in May.
Chn	Jun Caixin China PMI services	52.8	-	-	Employment growth becoming a concern.
Eur	Jun Markit services PMI (final)	54.7	54.7	-	Sentiment and activity strong as growth momentum solidifies.
	Retail sales	0.1%	0.3%	-	Expected to pick up with consumer sentiment at 2001 highs.
UK	May Markit services PMI (final)	53.8	-	-	Domestic activity facing headwinds from rising prices.
US	May factory orders	-0.2%	-0.4%	-	Another weak month expected given disappointing durables.
	FOMC June meeting minutes	-	-	-	Further detail on plans for normalisation? The risks?
Thu 6					
Aus	May trade balance, \$bn	0.6	1.1	1.8	Surplus, a partial rebound as coal shipments return to normal.
Eur	ECB policy meeting minutes	-	-	-	Greater clarity on ECB's forward guidance.
US	May trade balance US\$bn	-47.6	-47.0	-	Exports fell and imports rose in Apr.
	Jun ADP employment change	253k	178k	-	Has materially outperformed payrolls. Softer pulse likely.
	Initial jobless claims	244k	-	-	Very low.
	Jun Markit services PMI (final)	53.0	-	-	As for manufacturing...
	Jun ISM non-manufacturing	56.9	56.5	-	... Markit measure more subdued than ISM.
	Fedspeak	-	-	-	Powell on housing finance reform, Washington.
Fri 7					
Chn	Jun foreign reserves \$bn	3053.6	3069.0	-	Stable of late; limits on investment having an impact.
UK	Jun Halifax house prices	0.4%	-	-	Political uncertainty dampening housing market sentiment.
	May industrial production	0.2%	-	-	Lower pound and firm external demand supporting activity.
	May construction output	-1.6%	-	-	Infrastructure work rising, private spending flat.
	May trade balance, £m	-2050	-	-	Lower pound pushing up import costs.
US	Jun non-farm payrolls	138k	179k	190k	A bounce seems likely after recent soft outcomes.
	Jun unemployment rate	4.3%	4.3%	4.4%	4.3% feels too low; higher participation to edge u/e rate up.
	Fedspeak	-	-	-	Fischer on government policy and labour productivity.
	Fed mon. policy report to congress	-	-	-	Jul 2017 report ahead of Yellen's testimony to congress Jul 12th.
Sat 8					
Chn	Jun foreign direct investment %yr	-3.7%	-	-	Volatile in recent months. Tentative date - 8th to 18th.

New Zealand forecasts

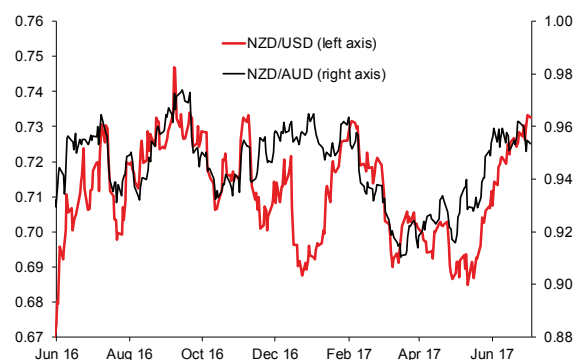
Economic Forecasts	2017				Calendar years			
	% change	Mar (a)	Jun	Sep	Dec	2015	2016	2017f
GDP (Production) ann avg	0.5	1.0	0.9	0.7	2.5	3.1	2.8	3.2
Employment	1.2	0.3	0.5	0.5	1.4	5.8	2.5	1.9
Unemployment Rate % s.a.	4.9	4.9	4.6	4.4	4.9	5.2	4.4	4.5
CPI	1.0	0.2	0.4	0.2	0.1	1.3	1.8	1.9
Current Account Balance % of GDP	-3.1	-3.1	-3.1	-3.2	-3.4	-2.8	-3.2	-3.3

Financial Forecasts	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-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	2.15
2 Year Swap	2.30	2.35	2.40	2.45	2.50	2.60
5 Year Swap	2.90	3.00	3.10	3.20	3.30	3.40
10 Year Bond	3.15	3.30	3.50	3.70	3.80	3.85
NZD/USD	0.71	0.70	0.69	0.67	0.66	0.64
NZD/AUD	0.96	0.96	0.96	0.97	0.97	0.98
NZD/JPY	79.5	79.8	78.7	77.1	76.6	74.9
NZD/EUR	0.65	0.65	0.66	0.65	0.65	0.63
NZD/GBP	0.56	0.56	0.56	0.54	0.54	0.53
TWI	77.8	77.5	77.1	75.9	75.4	74.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



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

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.86%	1.86%	1.85%
60 Days	1.92%	1.89%	1.89%
90 Days	1.99%	1.95%	1.95%
2 Year Swap	2.34%	2.20%	2.21%
5 Year Swap	2.88%	2.68%	2.70%

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

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7326	0.7253	0.7140
NZD/EUR	0.6409	0.6470	0.6342
NZD/GBP	0.5628	0.5681	0.5532
NZD/JPY	82.22	80.45	78.87
NZD/AUD	0.9536	0.9536	0.9535
TWI	78.59	78.12	77.06

International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016	2017f	2018f
Australia						
Real GDP % yr	2.1	2.8	2.4	2.5	2.3	3.0
CPI inflation % annual	2.7	1.7	1.7	1.5	2.0	2.3
Unemployment %	5.8	6.2	5.8	5.7	5.7	6.2
Current Account % GDP	-3.4	-3.0	-4.7	-2.7	-1.7	-3.3
United States						
Real GDP %yr	1.5	2.4	2.6	1.6	2.1	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	1.1	1.0
Euroland						
Real GDP %yr	-0.3	0.9	1.6	1.7	1.8	1.4
United Kingdom						
Real GDP %yr	2.2	2.9	2.2	2.0	1.8	1.6
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	3.3	3.5	3.5

Forecasts finalised 16 June 2017

Interest Rate Forecasts	Latest	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.71	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.59	2.75	2.85	3.05	3.20	3.35	3.30	3.15
International								
Fed Funds	1.125	1.375	1.375	1.625	1.625	1.875	1.875	1.875
US 10 Year Bond	2.28	2.55	2.65	2.90	3.10	3.30	3.30	3.15
ECB Deposit Rate	0.00	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30

Exchange Rate Forecasts	Latest	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
AUD/USD	0.7701	0.74	0.73	0.72	0.69	0.68	0.65	0.67
USD/JPY	111.82	112	114	114	115	116	116	118
EUR/USD	1.1442	1.10	1.08	1.05	1.03	1.02	1.01	1.00
AUD/NZD	1.0504	1.04	1.04	1.04	1.03	1.03	1.02	1.05

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