

# Weekly Commentary

6 March 2017



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## People power

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Last week we received the first reading of business confidence for the year. After rounding out 2016 on a positive note, confidence has waned a bit, but overall, firms are still feeling upbeat about their own prospects. This bodes well for a solid pace of growth continuing this year.

With the economy now in its seventh year of sustained expansion, firms have largely used up their spare labour and capital resources. Against this, it's not surprising to see that firms are planning to take on new staff and increase investment. While this should help reinforce the expansion, that fact that it's no longer as easy to scale up activity will act as a bit of a handbrake on growth. It will also contribute to building inflation pressures, but as we outline later we expect the rise in CPI inflation to be gradual.

As it's been for some time, population remains an important part of the growth story, as New Zealand's positive economic backdrop, including solid growth in employment, makes us an attractive location for New Zealanders and non-New Zealanders alike. Last week's migration data for January showed this trend has a bit longer to run, with the annual inflow hitting a new record of 71,000 people.

Over the past year, low numbers of New Zealanders chose to leave, and the number returning home continued to climb. The net outflow of 1,700 in the year to January was the lowest since 1984, well down on levels of nearly 40,000 in 2012. With Australia's labour market remaining sluggish, crossing the ditch for work isn't as appealing as it once was. And while economic growth in Australia is expected to improve after a soft patch in 2016, prospects are expected to wane again next year, meaning any improvement in Australia's labour market might be short-lived.

At the same time, we've continued to see strong levels of arrivals of non-NZ citizens, especially from Europe, China

and other parts of Asia. A large chunk of these gains have been people arriving on work visas. While this has helped firms meet their staffing needs, the pressure that a rapidly rising population places on infrastructure and housing means that migration will likely be a hot topic ahead of September's election.

It's not just long-term migration boosting demand. Visitor arrivals have continued to surge, topping 3.5 million in the year to January. That's up 11% on a year earlier. The tourism sector is benefitting from increased demand for services globally and a growing middle class in China, with New Zealand's relative safety also adding to our appeal. There's been strong growth in arrivals from all regions, but standouts have been China, South East Asia and the United States – all boosted by the introduction of new air routes. The sheer growth in visitor numbers has delivered a significant boost to retail and services spending, even as the strengthening NZ dollar has dampened tourists' spending power. While the outlook for tourism remains positive, the pace of growth is expected to slow, especially given the tight supply of accommodation in tourist hotspots like Auckland and Queenstown.

But it's not all about people. A number of other factors are in play, including construction, which continues to grow strongly even as reconstruction in Canterbury in eases back. Building activity rose 1.9% in the December quarter, and over 14% in 2016 as a whole. Construction is expected to push higher this year, reflecting a large pipeline of building

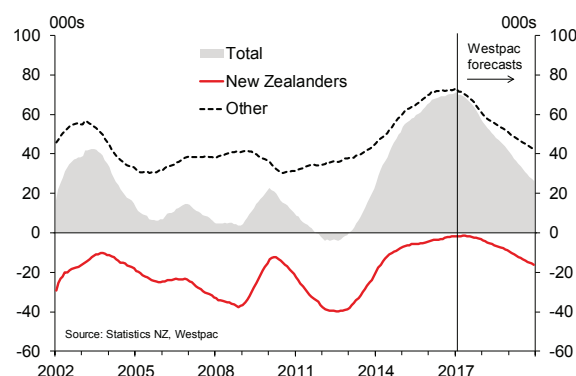
# People power continued

in Auckland, and planned infrastructure work nationwide. However, emerging capacity constraints will provide some brake on growth and see sustained pressure on costs.

And of course, the outlook for the dairy sector is now looking much better than it has for a couple of years, removing what had been a key drag on economic growth. We're forecasting a milk price this season of \$6.20/kgMS, a far cry from last season's \$3.90/kgMS. A pull-back in global supply has been the swing factor for global dairy prices, which are nearly 50% higher than mid-2016 despite easing back a bit this year. It's looking like prices might come under a bit more downward pressure in this week's GlobalDairyTrade auction, with Fonterra again revising up the volume of milk powder that it's selling on the auction platform following upside surprises to its summer milk collections.

At the same time as we've seen the prices of our exports push higher, we've seen ongoing softness in import prices, which declined over 6% in the year to December. Price declines were widespread across goods, reflecting the strengthening New Zealand dollar and subdued global inflation. This highlights the ongoing challenge that the Reserve Bank faces in getting inflation back to its 2% target. While it's clear that consumer price inflation has passed its trough (last week's business survey showed further

Net migration, annual



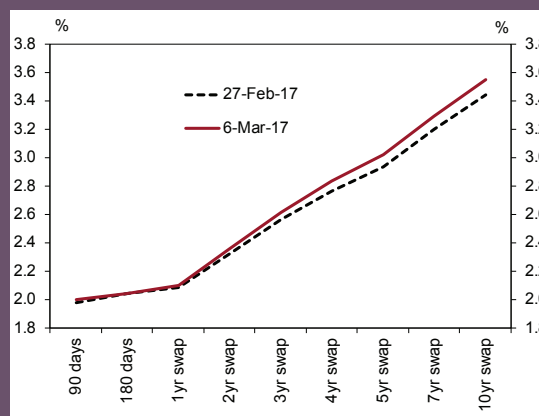
evidence of this, with one-year ahead inflation expectations rising to 1.7%), subdued imported inflation means that the Reserve Bank needs to generate a stronger pick-up in domestic inflation. As such, we expect the OCR to remain on hold for an extended period – a point reiterated in a speech by Reserve Bank Governor Wheeler last week. In particular, the Governor reinforced the neutral policy stance of the February Monetary Policy Statement, and highlighted balanced risks around the OCR.

## 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



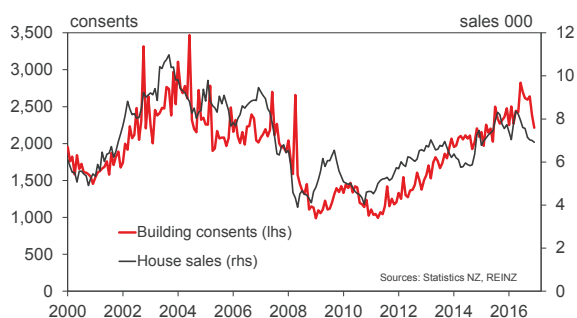
# The week ahead

## NZ Jan building consents

Mar 6, Last: -6.2%, Westpac f/c: 5.2%

- Dwelling consent issuance fell sharply in late-2016. In part this was due to a normal pull back following earlier strength. There were also disruptions associated with the Kaikoura earthquakes. But on top of those factors, there has been notable softness in consent issuance in Auckland. Issuance in Auckland has been easing back for several months and is currently at levels well below what is required to meet the needs of population growth.
- With teething issues around the Unitary Plan being worked out, and earthquake related disruptions fading, we expect to see consent issuance picking up again in January. Nevertheless, issuance in Auckland is expected to remain below the required levels.

## NZ housing activity



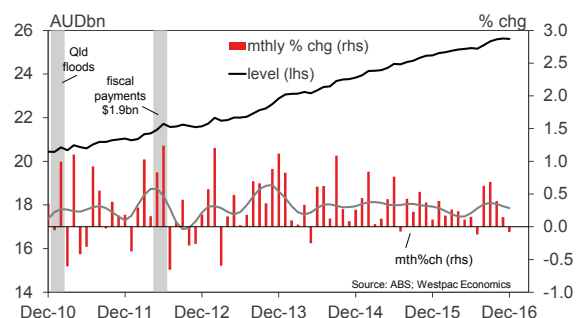
## Aus Jan retail trade

Mar 6, Last: -0.1%, WBC f/c: 0.2%

Mkt f/c: 0.4%, Range: 0.1% to 1.0%

- The December retail report showed a disappointingly soft finish for monthly sales to a quarter that had seen a solid gain for volumes. Monthly sales dipped 0.1% in Dec with annual growth edging down to 3%yr. Household goods retailers had a particularly weak finish, some of which may relate to the closure of Woolworths' Masters Home Improvement stores. Retail sales ex household goods recorded a decent 0.4% gain.
- The Jan month was likely another wobbly one for retailers. Consumer sentiment dipped back into 'cautiously pessimistic' territory in Dec-Jan. Both the NAB and AiG surveys also show retailers struggling compared to consumer service sectors. On balance we expect Jan to show a modest 0.2% gain, mainly as the drag from household goods retail dissipates. Risks are mainly to the downside.

## Monthly retail sales

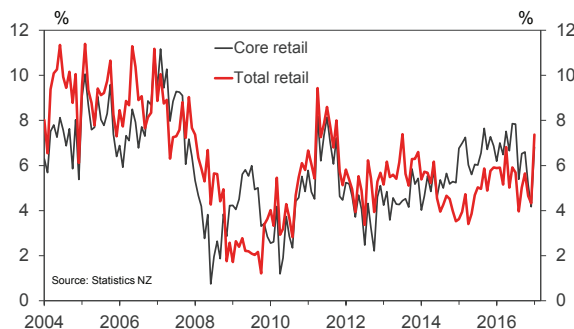


## NZ Feb retail card spending

Mar 6, Last: +2.7%, Westpac f/c: -0.4%

- After levelling off in late 2016, retail spending surged in January. Gains were widespread, with solid increases in spending on durables and consumables.
- Following the strong January result, we expect to see some moderation in spending in February and are forecasting a 0.4% decline over the month. Nevertheless, the outlook for retail spending over the coming year is very positive. Population growth remains strong, employment is up, and we continue to see strong tourist inflows.

## Card transactions, annual % change



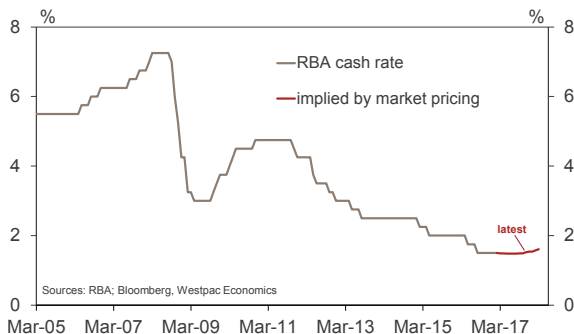
## Aus RBA policy decision

Mar 7, 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. Recent commentary has been more upbeat with global prospects improving and the Bank reaffirming its forecasts for 3% growth this year and next – a view that would have been supported by the Q4 GDP rebound.
- Labour markets and housing are the prime focus. On the former, conditions remain mixed with the weakness in household incomes in the Q4 national accounts likely to be of some concern. Against this, the latest resurgence in dwelling prices is clearly a limiting factor for further policy easing.
- While there is no chance of a rate move and an explicit 'bias' towards future policy is equally unlikely, there will be great interest in how these issues are handled in the Governor's decision statement.

## RBA cash rate & market pricing



# The week ahead

## Aus Jan housing finance (no.)

Mar 10, Last: 0.4%, WBC f/c: -1.0%

Mkt f/c: -1.0%, Range: -2.5% to 1.0%

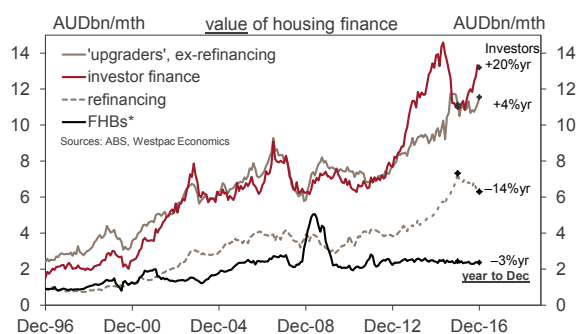
- Housing finance approvals to owner occupiers edged up 0.4% in Dec, up a solid 2.4% ex refi. The value of housing finance approvals to investors dipped 1% – a bit softer than might have been expected given the wider market's strong finish to 2016. Stepping back from monthly moves, finance approvals saw a resurgence over the second half of the year led by investor activity and aided by rate cuts in May and Aug.
- Industry data points to a small 1% dip in owner occupier loans in Jan. As always, Jan housing data should be treated with more than the usual caution due to volatility associated with seasonal adjustment over the summer period.

## ECB Mar meeting

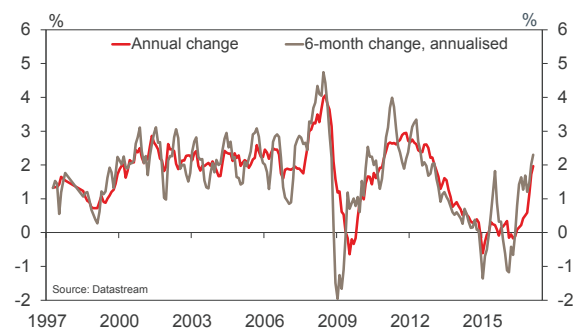
Mar 9, Last: -0.40%, WBC -0.40%

- Of late, the ECB has come under some pressure to signal an end to its alternative easing measures. This shift in sentiment arguably has as much to do with global financial market optimism as it does the jump in the headline inflation rate, from -0.2%yr a year ago to +2.0%yr at February 2017 – the ECB's medium-term target.
- While economic growth continues to run at a robust pace, 1.7%yr at December 2016, and the labour market has improved materially, overall risks to the inflation target are negligible. This is because substantial slack remains. At their March meeting, it is likely that President Draghi and the Governing Council will recognise the above positive developments, but their focus will remain on lingering slack – best represented by soft core inflation (0.9%yr) and high levels of unemployment outside of Germany. There remains a need for continued extraordinary support of the economy.

## Value of finance approvals by segment



## Euro headline inflation jumps on base effect

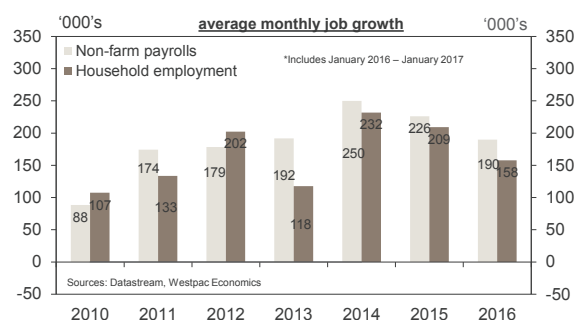


## US Feb nonfarm payrolls

Mar 10, Last: 227k, WBC 170k

- Nonfarm payrolls reported a strong 227k increase in January following three months where the average monthly gain was a more subdued 148k.
- Over the six months to January 2017, payrolls growth has averaged 183k per month. While a step down from the prior six month's 208k, it is still a strong result – particularly given full employment has been attained.
- A moderation in the pace of employment growth has been expected for some time, and there has been tentative evidence of one in the business survey detail – the ISM employment indexes have both eased back in recent months.
- Come February, we expect a slight moderation to 170k, albeit with downside risks. From the household survey, the unemployment rate is likely to round down to 4.7%.

## US job creation remains strong



# Data calendar

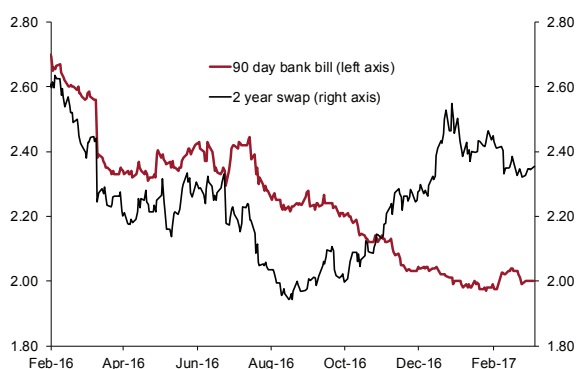
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 6</b>					
<b>NZ</b>	Jan building consents	-7.2%	-	5.0%	A recovery after earlier softness and quake disruptions.
<b>Aus</b>	Feb MI inflation gauge	2.0% <sub>6yr</sub>	-	-	Inflation is moving higher in the Gauge but yet to see it in the CPI.
	Jan retail sales	-0.1%	0.4%	0.2%	Retailers struggling again despite improved volumes in Q4.
	Feb ANZ job ads	4.0%	-	-	Annual pace has picked up to 7% <sub>6yr</sub> but still well off late 2015 highs.
<b>Eur</b>	Mar Sentix investor confidence	17.4	18.5	-	Global market sentiment extremely strong.
<b>US</b>	Jan factory orders	1.3%	1.0%	-	Core durable orders fell 0.4% in preliminary Jan estimate.
	Fedspeak	-	-	-	Kashkari at NABE conference.
<b>Tue 7</b>					
<b>Aus</b>	RBA policy decision	1.50%	1.50%	1.50%	Firmly on hold.
<b>Chn</b>	Feb foreign reserves \$bn	2998.2	2960.5	-	Past \$3trn threshold; participants watching rate of decline closely.
<b>Eur</b>	Q4 GDP (final)	0.4%	0.4%	-	Annual growth a solid 1.7% <sub>6yr</sub> .
<b>UK</b>	Feb Halifax house prices	-0.9%	0.4%	-	Price growth has slowed; low rates and tight supply providing a floor.
<b>US</b>	Jan trade balance US\$bn	-44.3	-46.5	-	Exports and imports both reported a solid gain in December.
	Jan consumer credit	14.16	19.00	-	Auto loans and consumer credit continues to push ahead.
<b>Can</b>	Feb Ivey PMI	57.2	-	-	Strong, but employment has deteriorated in past two months.
<b>Wed 8</b>					
<b>NZ</b>	GlobalDairyTrade auction	-3.2%	-	-	Futures pointing to a further decline in prices.
	Q4 Survey of manufacturing	2.1%	-	-	Growth in volumes ex. meat and dairy likely to soften after a strong run.
<b>Chn</b>	Feb trade balance USDbn	51.34	26.40	-	Strong imports following CNY holidays expected.
	Feb foreign direct investment % <sub>6yr</sub>	-9.2%	-	-	Tentative date, 8-18 March.
<b>Ger</b>	Jan industrial production	-3.0%	2.7%	-	Bounce expected in Jan; relatively unchanged from year ago.
<b>US</b>	Feb ADP employment change	246k	185k	-	Employment growth likely to moderate in February.
	Jan wholesale inventories (final)	2.6%	-	-	Justification to increase inventories limited for most firms.
<b>Thu 9</b>					
<b>Chn</b>	Feb CPI % <sub>6yr</sub>	2.5%	1.7%	-	Another food price induced downward shock anticipated in Feb.
	Feb PPI % <sub>6yr</sub>	6.9%	7.5%	-	Commodity prices have driven sharp rise in upstream prices.
<b>Eur</b>	ECB policy decision	-0.4%	-0.4%	-0.4%	On hold through 2017, bar unforeseen shock to economy.
	European Council	-	-	-	EU politicians discuss the economy, migration and security, 09-10.
<b>UK</b>	Feb RICS house price balance	25%	-	-	Buyer interest has waned.
<b>US</b>	Feb import price index	0.4%	0.1%	-	USD gains to keep tradeable price pressures contained.
	Initial jobless claims	223k	-	-	Continues to make new historic lows.
<b>Can</b>	Jan new housing price index	0.1%	-	-	Annual pace of growth at solid 3.0% <sub>6yr</sub> .
<b>Fri 10</b>					
<b>NZ</b>	Feb retail card spending	2.7%	-0.4%	-0.4%	A moderation after last months large gain. Underlying pace still firm.
<b>Aus</b>	Jan housing finance	0.4%	-1.0	-1.0%	A slight fall but Jan housing data generally unreliable.
<b>Chn</b>	Feb M2 money supply % <sub>6yr</sub>	11.3%	11.4%	-	Tentative date, 10-15 March.
	Feb new loans, CNYbn	2030.0	910.0	-	Tentative date, 10-15 March.
	Feb aggregate financing, CNYbn	3737.7	1450.0	-	Tentative date, 10-15 March.
<b>Ger</b>	Jan trade balance €bn	18.7	14.1	-	Germany remains in strong position.
<b>UK</b>	Jan industrial production	4.3%	-	-	The lower GBP has been a boon for manufacturers and exporters...
	Jan trade balance £bn	3.3	-3.3	-	... but import costs are rising, especially for food and fuel.
<b>US</b>	Feb non-farm payrolls	227k	180k	170k	Employment growth to slowly moderate through 2017.
	Feb unemployment rate	4.8%	4.7%	4.7%	On stable participation, unemp rate should edge lower.
	Feb monthly budget statement	51.3	-151.0	-	Deficit under control (for now) thanks to economy's gains.

# New Zealand forecasts

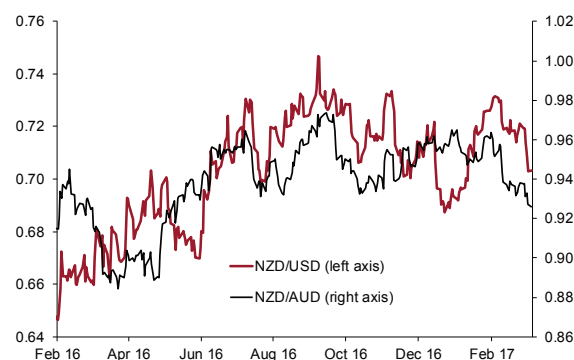
Economic Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2014	2015	2016f
GDP (Production) ann avg	3.4	2.4	3.5	3.6	3.4	2.5	3.3	3.6
Employment	3.2	2.0	5.3	2.1	3.6	1.4	5.8	2.3
Unemployment Rate % s.a.	5.4	5.2	4.8	4.4	5.5	4.9	5.2	4.4
CPI	0.3	0.4	1.7	1.5	0.8	0.1	1.3	1.5
Current Account Balance % of GDP	-3.5	-3.1	-2.8	-2.7	-3.2	-3.4	-2.8	-2.7

Financial Forecasts	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-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	2.40	2.50	2.50	2.50	2.50	2.60
5 Year Swap	3.00	3.15	3.20	3.30	3.35	3.45
10 Year Bond	3.30	3.45	3.50	3.60	3.65	3.75
NZD/USD	0.71	0.70	0.68	0.67	0.66	0.65
NZD/AUD	0.93	0.92	0.91	0.91	0.92	0.93
NZD/JPY	82.4	82.6	80.7	80.4	80.5	80.6
NZD/EUR	0.68	0.68	0.68	0.67	0.66	0.66
NZD/GBP	0.58	0.57	0.56	0.55	0.55	0.54
TWI	78.1	77.5	76.4	75.5	75.1	75.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 6 March 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.85%	1.83%
60 Days	1.93%	1.94%	1.92%
90 Days	2.00%	2.03%	1.98%
2 Year Swap	2.36%	2.34%	2.39%
5 Year Swap	3.02%	3.01%	3.03%

NZ foreign currency mid-rates as at Monday 6 March 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7033	0.7192	0.7318
NZD/EUR	0.6632	0.6779	0.6810
NZD/GBP	0.5722	0.5793	0.5870
NZD/JPY	80.10	81.16	81.83
NZD/AUD	0.9261	0.9375	0.9558
TWI	77.14	78.52	79.64



# International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016f	2017f	2018f
<b>Australia</b>						
Real GDP % yr	2.1	2.8	2.4	2.2	2.1	2.8
CPI inflation % annual	2.7	1.7	1.7	1.5	1.9	1.9
Unemployment %	5.8	6.2	5.8	5.7	5.6	5.8
Current Account % GDP	-3.4	-3.0	-4.8	-2.9	-1.2	-2.5
<b>United States</b>						
Real GDP %yr	1.5	2.4	2.6	1.6	2.2	2.4
Consumer Prices %yr	1.5	1.6	0.1	1.2	1.7	1.7
Unemployment Rate %	7.4	6.2	5.3	4.9	4.6	4.5
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.7	-2.8
<b>Japan</b>						
Real GDP %yr	1.4	0.0	0.5	0.6	0.6	0.7
<b>Euroland</b>						
Real GDP %yr	-0.3	0.9	1.6	1.6	1.5	1.3
<b>United Kingdom</b>						
Real GDP %yr	2.2	2.9	2.2	2.0	1.9	1.5
<b>China</b>						
Real GDP %yr	7.7	7.3	6.9	6.7	6.6	6.0
<b>East Asia ex China</b>						
Real GDP %yr	4.2	4.1	3.7	3.7	3.8	3.8
<b>World</b>						
Real GDP %yr	3.3	3.4	3.1	3.2	3.5	3.5

Forecasts finalised 17 February 2017

Interest Rate Forecasts	Latest	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
<b>Australia</b>								
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	2.80	2.95	2.95	3.00	3.05	3.15	3.25	3.40
<b>International</b>								
Fed Funds	0.625	0.625	0.875	0.875	1.125	1.125	1.375	1.375
US 10 Year Bond	2.48	2.55	2.65	2.75	2.85	3.00	3.10	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	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
AUD/USD	0.7576	0.76	0.76	0.75	0.74	0.72	0.70	0.68
USD/JPY	114.38	116	118	118	120	122	124	126
EUR/USD	1.0508	1.05	1.03	1.01	1.00	1.00	0.99	0.98
AUD/NZD	1.0728	1.07	1.09	1.10	1.10	1.11	1.06	1.05

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# Contact the Westpac economics team

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**Michael Gordon**, Acting Chief Economist +64 9 336 5670

**Satish Ranchhod**, Senior Economist +64 9 336 5668

**Sarah Drought**, Economist +64 9 336 5696

**Any questions email:** [economics@westpac.co.nz](mailto:economics@westpac.co.nz)

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