Weekly Commentary

6 June 2017

Constructive

Construction has been a key driver of economic activity in recent years, and with a large pipeline of work planned it will be a key driver of growth and employment for years to come. However, there are questions about how quickly work will proceed. The building industry is facing growing constraints, particularly around the availability of skilled labour. We are also seeing costs rising. Such factors are likely to delay planned construction activity, especially in Auckland where demand is the strongest.

Construction and constraints

Much of the strength in the construction outlook relates to residential building, especially in Auckland. This follows strong population growth but relatively low home building in earlier years. This has led to a shortfall of more than 35,000 homes, with the vast majority of this shortfall centred on the Auckland region. Initiatives by central and local government have been introduced to deal with supply side pressure, including opening up land to build more houses. Further solutions have been proposed, including potential changes to laws like the Resource Management Act 1991, however such changes may not provide immediate relief from issues facing the market now.

We expect that home building will continue to rise over the coming year. However, over the past few months building consent issuance has been largely flat across the nation, especially in Auckland. In the year to April 2017 around 30,000 new homes were consented nationwide - a level that's remain largely unchanged since late 2016.

As discussed below, some of this levelling off in consent issuance is related to regulatory hurdles in Auckland. But we have also seen capacity pressures emerge in the industry, with many building firms highlighting difficulties finding skilled labour. This is despite building levels still being short of what is required to keep up with population growth. On top of this, costs and interest rates have been rising. These factors don't necessarily negate the need for building. However, they imply that the construction cycle may be protracted.

Around the country

New Zealand's strong construction outlook is heavily centred on Auckland. But despite a strong demand backdrop, consent issuance in the region has been relatively flat since mid-2016. Notably, this masking a change in the composition of building. While the number of standalone dwelling consents has eased, there's been a trend increase in multi-unit consents (such as apartments and townhouses). This potentially reflects increased activity from developers now that the Unitary Plan has cleared its legal hurdles. We expect this trend to continue over the coming months. Nevertheless, with only a bit over 10,000 new dwellings consented in Auckland over the past year, home building still remains lower than what's needed to keep up with surging population growth in the region. As a result, Auckland's housing shortfall is likely to get worse before it gets better.

Despite the existing housing shortfall, rising interest rates and tighter building restrictions has seen the Auckland housing market cooling-off. In fact, house prices in the region have been flat since late 2016. But with population growth remaining strong and capacity pressures in the

Constructive continued

building sector rising, the scope for a material decline in Auckland house prices seems limited. Housing affordability in our largest city is likely to remain stretched for some time.

Turning to Canterbury, we're continuing to see a shift in activity. Homebuilding in the region has pulled back now that the residential rebuild is past its peak. Non-residential construction in the region remains stronger, through the past few months have seen consent issuance in this space easing back also.

Outside of the main centres, we are seeing residential construction activity ramping up. The past year has seen strong gains in dwelling consent issuance in many regions including Northland, Nelson, the Manawatu and Otago.

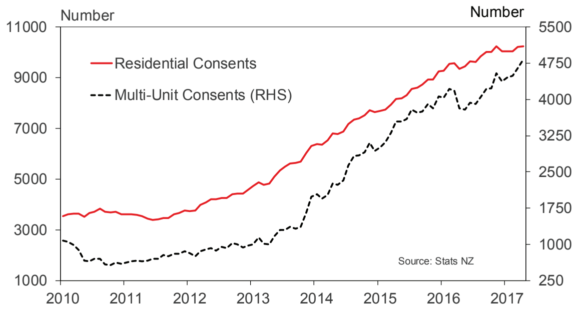
Non-residential

There is also a large amount of non-residential work planned, with more than $6.4bn of work consented over the past year. Much of this is related to infrastructure spending, including the building of new schools, hospitals and the addition of new faculty buildings at universities to service the needs of a growing population.

On top of this commercial construction is increasing especially in the main centres. This includes increased spending on office buildings and hotels (the latter reflecting the positive outlook for the tourism sector).

Non-residential building will receive a further boost over the coming year from increases in infrastructure spending, given the 2017 budget.

Residential Building Consents

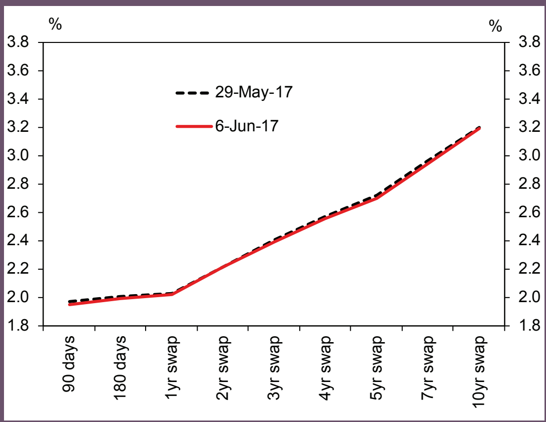


Fixed vs Floating for mortgages

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



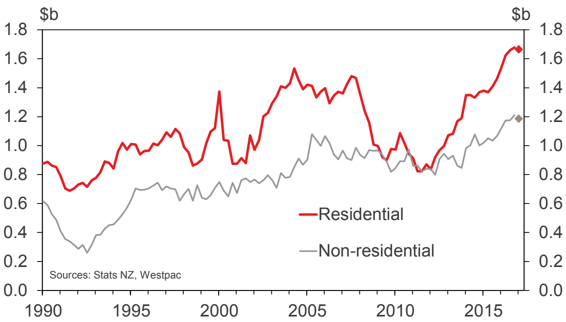
The week ahead

NZ Q1 building work put in place

June 6, Last: 1.9%, Westpac f/c: Flat, Mkt f/c: Flat

- The past year saw strong increases in both residential and non-residential construction. And with sustained strong population growth and a large pipeline of planned work, we expect construction activity will continue to expand through 2017. However, capacity constraints and rising costs are likely to provide some brake on the pace of growth.
- We expect the March quarter figures will show that growth in construction activity was broadly flat in the early part of the year. Dwelling consent issuance has levelled off since late mid-2016, particularly in Auckland. We're also seeing building levels in Canterbury easing back as residential repairs have been completed. On top of this, poor weather earlier in the year is likely to have hampered building activity.

NZ real building work put in place

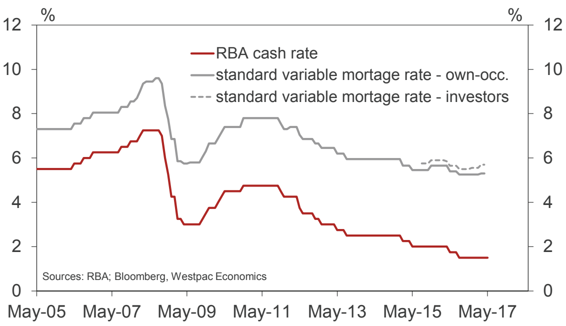


Aus RBA policy decision

Jun 6, 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 June. 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 & market pricing

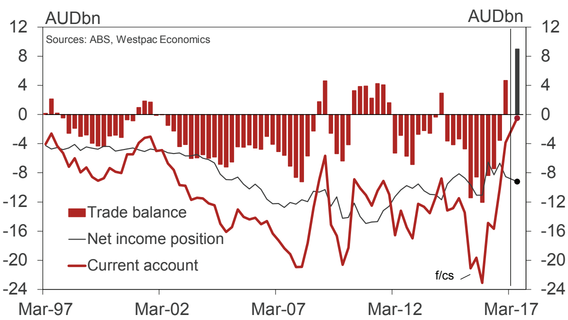


Aus Q1 current account balance, AUDbn

Jun 6, Last: –3.9, WBC f/c: –0.2
Mkt f/c: -0.5, Range: -3.1 to +0.5

- Australia's current account deficit shrunk to $3.9bn in December 2016, from $23.1bn in December 2015. That is the smallest deficit since March 1980, at only 0.8% of GDP. In March, the current account could potentially edge into surplus, for the first time since June 1975. Perhaps we are being cautious, but we expect it to fall a fraction short of that, forecasting a deficit of $0.2bn
- The trade surplus increased to $9.0bn in March, up from an originally reported $4.7bn in December. The improvement is entirely due to higher commodity prices, with the terms of trade increasing by an estimated 6%. The net income deficit widened from $6.7bn to $8.5bn in December. We expect the income deficit to widen further, to $9.2bn, as improved returns in the resource sector are in part paid to foreign investors.

Current account: f/c –$0.2bn in Q1

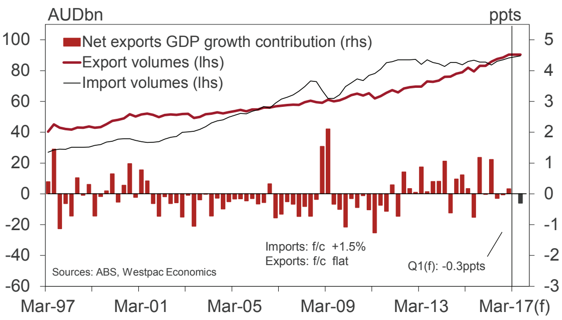


Aus Q1 net exports, ppts cont'n

Jun 6, Last: 0.2, WBC f/c: –0.3
Mkt f/c: -0.35, Range: -1.0 to +0.5

- Net exports have disappointed over the past year. For Q1, net exports are forecast to subtract 0.3ppts from growth, with the risks skewed towards a larger subtraction. The impact over the past year is also -0.3ppts, a sharp deterioration from +1.5ppts over the previous year. Export volumes appear to have stalled or even dipped in Q1, in part due to temporary disruptions. Annual growth slows to 5½% from 9%. We expect an improvement in coming quarters, as additional capacity in the gas sector comes on stream. Imports are now trending higher, up a forecast 1.5%qtr, 7%yr in Q1. By contrast, imports contracted by 2.7% over the previous year. The strength of imports suggests some improvement in domestic demand, with a notable lift in capital imports. The firmer currency is also a factor, boosting service imports.

Net exports: f/c -0.3ppts in Q1



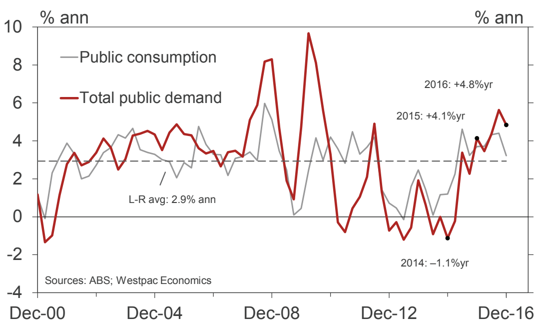
The week ahead

Aus Q1 public demand

Jun 6, Last: 1.3%, WBC f/c: 0.8%

- Public demand grew strongly in 2015 and 2016, +4.1%yr and +4.8%yr. This included strength in consumption (public servant numbers) and an upswing in investment as governments commit to new projects. Both the major states, NSW and Victoria, have benefitted from stronger revenue growth associated with the housing boom.
- For the March quarter, we anticipate a solid gain in public demand of 0.8%, coming on the back of a 1.3% quarter.
- Investment volatility is central to the quarterly profile. The 2016 year ended on a strong note, with investment jumping 7.5% in Q4. We expect a more modest 1% rise in Q1, underpinned by further gains in public works - with the construction survey reporting a 3% rise in the quarter.

Public demand: 2 years of above trend growth

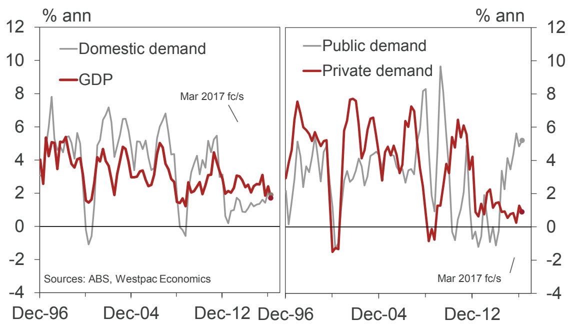


Aus Q1 GDP

Jun 7, Last: 1.1%qtr, 2.4%yr, WBC f/c: 0.4%qtr, 1.7%yr
Mkt f/c: 0.3%qtr, 1.6%yr Range: -0.3% to 0.7%

- Australia's economic output has been choppy of late. In Q3 2016, a 0.5% decline was recorded reflecting one-offs, including disruptions from weather and the Federal election. A broadly based strong rebound saw a 1.1% rise posted in Q4. For Q1 2017, we expect real GDP growth of 0.4%qtr, 1.7%yr. This is the slowest annual pace since Q3 2009.
- Weather disruptions are again at play, with home building down 4.5%qtr and exports stalling, such that net exports will subtract a forecast 0.3ppts in Q1. More fundamentally, consumer spending is sluggish, a f/c 0.5%qtr, 2.2%yr, constrained by weak wages growth
- Business investment most likely rose, a f/c 1%, as the mining investment drag wanes. Public demand is solid, boosted by an upswing in investment, centred on transport projects.

Australian economic conditions

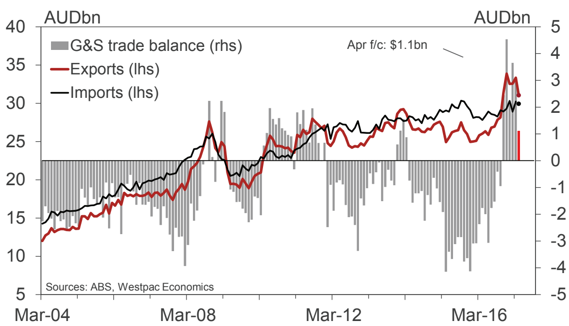


Aus Apr trade balance, AUDbn

Jun 8, Last: 3.1, WBC f/c: 1.1
Mkt f/c: 1.9, Range: 1.0 to 4.0

- Australia recorded a $3.1bn trade surplus in March, the 5th consecutive monthly surplus. Export earnings have been boosted of late by the jump in commodity prices. For April, we expect the surplus to narrow sharply, to $1.1bn.
- Export earnings fell by a forecast 7%, -$2.3bn. Coal earnings may drop by $1.5bn to $4.1bn on lower volumes (storm disruptions). Metal ores are expected to decline by $0.9bn, with the spot iron ore price retreating from US$87/t to $72.
- Imports are forecast to decline by 1%, -$0.3bn, centred on a correction in fuel imports, which jumped $0.5bn in March.
- *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

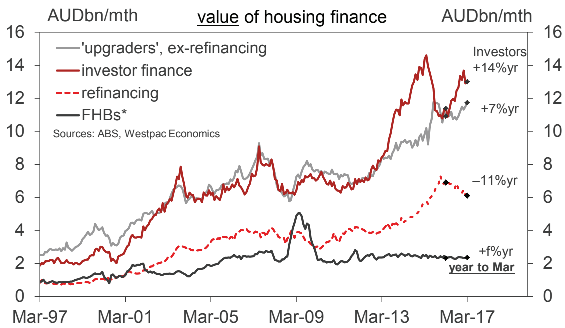


Aus Apr housing finance (no.)

Jun 9, Last: –0.5%, WBC f/c: –1.0%
Mkt f/c: -1.0%, Range: -2.0% to 1.5%

- The March housing finance approvals report was in line with expectations with both owner occupier and investor loan approvals holding about steady – the latter following a sharp –5.7% pullback in Feb.
- Approvals are likely to weaken from April as the 'macro prudential' tightening announced by APRA in late March combines with a notable deterioration in buyer sentiment. Finance approvals are likely to confirm the cooling already evident in auction markets and price measures. Industry data points to a slight decline in owner occupier approvals in the April month with the ABS measure expected to show a 1% dip. The real interest will be around investor loans, the segment more exposed to APRA's measures and associated increases in mortgage rates and lending criteria.

Value of finance approvals by segment



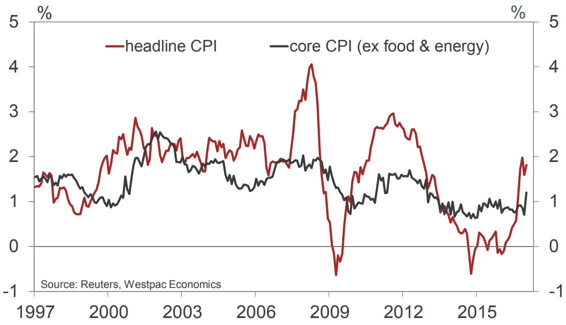
The week ahead

ECB June policy meeting

Jun 8, refi rate Last: 0.00%, WBC 0.00%

- 2017 has been a very positive period for the Euro Area. The six months to March saw annualised growth of 2.0%. Since that time, the PMIs have remained consistent with further robust growth. All the while, (still substantial) labour market slack continues to be reduced.
- It is not surprising then that market participants are expecting the June Governing Council meeting to signal a change in policy direction, specifically an end to asset purchases by year-end. The positive developments above notwithstanding, we believe the market is getting ahead of itself.
- We look for the ECB to further emphasise a reduction in downside risks, but to leave their options open regarding the stance of policy until core inflation tends toward the ECB's target.

Inflation's energy surge tops out



Data calendar

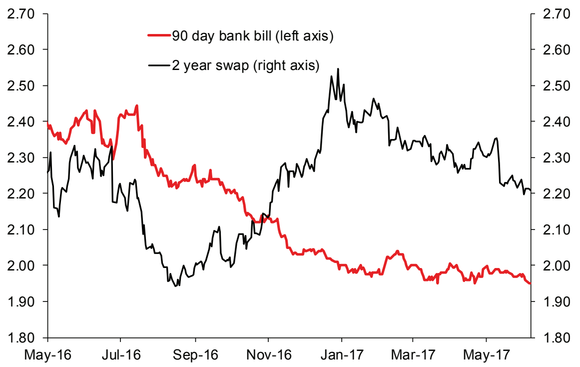
		Last	Market median	Westpac forecast	Risk/Comment
Tue 6					
NZ	Q1 building work put in place	1.9%	0.0%	0.0%	Building activity levelled off in early 2017, long term outlook positive.
	May ANZ commodity price index	–0.2%	–	–	Dairy prices strengthened in May.
Aus	Q1 current account balance, AUDbn	–3.9	–0.5	–0.2	Nearing a current a/c surplus, on higher commodity prices.
	Q1 real net exports, ppts cont'n	0.2	–0.35	–0.3	Exports flat, imports up 1.5%qtr, 7%yr.
	Q1 public demand	1.3%	–	0.8%	Public demand growth boosted by investment upswing.
	RBA policy decision	1.50%	1.50%	1.50%	On hold. Labour market, strong housing & growth momentum key focus.
Eur	May Markit services PMI (final)	56.2	56.2	–	Across the Continent.
	Jun Sentix investor confidence	27.4	27.2	–	Very strong sentiment.
US	Apr JOLTS job openings	5743	–	–	Hires; fires; quits; and job openings.
Wed 7					
NZ	GlobalDairyTrade auction	3.2%	–	–	Dairy futures point to a flat result.
	Q1 manufacturing activity	–1.8%	–	–	Rebound in milk collections will lift food manufacturing.
Aus	Q1 GDP	1.1%	0.3%	0.4%	Weather disruptions (housing, exports), sluggish consumer spending.
	Q1 GDP growth, %yr	2.4%	1.6%	1.7%	Slowest annual pace since 2009 Q3.
Eur	Q1 GDP, third estimate	0.5%	0.5%	–	Past six month has seen strong growth.
UK	May Halifax house prices	–0.1%	–	–	Low supply and interest rates limiting the slowdown in price growth.
Chn	May foreign reserves, $bn	3029.5	–	–	Stable of late.
US	Apr consumer credit, $bn	16.4	15.0	–	Lenders shifting capital from autos to students.
Thu 8					
Aus	Apr trade balance, AUDbn	3.1	1.9	1.1	Surplus narrows. Exports –7%, weaker iron ore & coal.
Eur	ECB policy decision, refi rate	0.0%	0.0%	0.0%	Draghi has headed off expectations of a hawkish policy shift.
UK	General election	–	–	–	The Conservatives' lead has been eroded in recent weeks.
	May RICS house price balance	22%	–	–	Housing market conditions have cooled.
Chn	May trade balance USD $bn	38.3	–	–	Exports and imports both missed in April.
	May foreign direct investment %yr	–4.3%	–	–	Set to remain weak, with private investment subdued.
US	Initial jobless claims	248k	–	–	Very low.
Fri 9					
Aus	Apr housing finance	–0.5%	–1.0%	–1.0%	Finance moving lower, tighter lending conditions impacting.
Chn	May CPI %yr	1.2%	1.4%	–	Accelerated in April, but remained weak overall.
	May PPI %yr	6.4%	5.4%	–	Industrial prices to drag on PPI growth in comng months.
UK	Apr industrial production	–0.5%	0.6%	–	The boost to exports from the lower pound appears to be waning.
	Apr construction output	–0.7%	0.0%	–	Home building has lost some momentum.
	Apr trade balance, £bn	–4.9	–3.4	–	Rising import costs are eroding the trade balance.
US	Apr wholesale inventories (final)	–0.3%	–0.1%	–	To remain a source of material volatility.
Sat 10					
Chn	May M2 money supply %yr	10.5%	10.4%	–	Tentative date.
	May new loans, CNYbn	1100.0	–	–	Tentative date.
	May aggregate financing, CNYbn	1394.2	–	–	Tentative date.

New Zealand forecasts

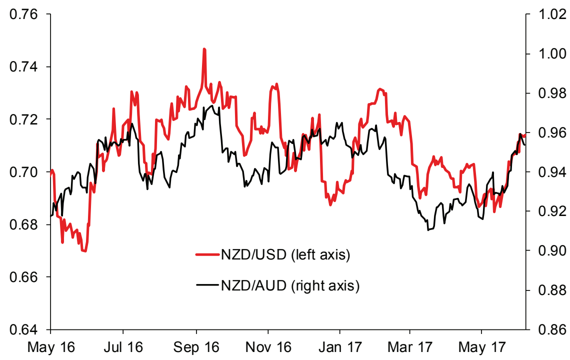
Economic Forecasts	March years				Calendar years			
% change	2015	2016	2017f	2018f	2015	2016	2017f	2018f
GDP (Production) ann avg	3.4	2.4	3.0	3.0	2.5	3.1	2.9	3.1
Employment	3.2	2.0	5.7	1.9	1.4	5.8	2.7	1.8
Unemployment Rate % s.a.	5.4	5.2	4.9	4.5	4.9	5.2	4.4	4.4
CPI	0.3	0.4	2.2	1.3	0.1	1.3	1.8	1.8
Current Account Balance % of GDP	-3.5	-3.1	-2.7	-2.3	-3.4	-2.7	-2.4	-2.8

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	2.60	2.70	2.80	2.90
5 Year Swap	3.10	3.20	3.30	3.40	3.50	3.55
10 Year Bond	3.30	3.50	3.60	3.70	3.80	3.90
NZD/USD	0.68	0.68	0.68	0.67	0.66	0.65
NZD/AUD	0.93	0.93	0.93	0.93	0.96	0.96
NZD/JPY	75.5	76.2	77.5	77.7	77.2	76.7
NZD/EUR	0.65	0.65	0.66	0.66	0.65	0.65
NZD/GBP	0.56	0.57	0.57	0.57	0.56	0.55
TWI	75.2	75.6	76.2	75.7	75.8	75.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Tuesday 6 June 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.87%	1.85%
60 Days	1.89%	1.92%	1.91%
90 Days	1.95%	1.98%	1.98%
2 Year Swap	2.21%	2.23%	2.33%
5 Year Swap	2.70%	2.76%	2.93%

NZ foreign currency mid-rates as at Tuesday 6 June 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7140	0.6925	0.6905
NZD/EUR	0.6342	0.6186	0.6272
NZD/GBP	0.5532	0.5331	0.5318
NZD/JPY	78.87	76.87	77.98
NZD/AUD	0.9535	0.9293	0.9321
TWI	77.06	75.01	75.35

International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016	2017f	2018f
Australia						
Real GDP % yr	2.1	2.8	2.4	2.5	2.5	2.7
CPI inflation % annual	2.7	1.7	1.7	1.5	2.1	2.2
Unemployment %	5.8	6.2	5.8	5.7	6.0	6.2
Current Account % GDP	-3.4	-3.0	-4.7	-2.7	-0.5	-2.5
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	4.5	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	1.7	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 May 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	1.73	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.50	2.75	2.95	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	2.28	2.55	2.75	2.85	3.00	3.10	3.30	3.30
ECB Deposit Rate	−0.40	−0.40	−0.40	−0.40	−0.30	−0.30	−0.20	−0.20

Exchange Rate Forecasts	Latest	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
AUD/USD	0.7390	0.73	0.73	0.73	0.72	0.69	0.68	0.65
USD/JPY	111.64	114	115	116	119	120	122	122
EUR/USD	1.1220	1.08	1.07	1.05	1.03	1.02	1.00	1.00
AUD/NZD	1.0445	1.07	1.07	1.07	1.07	1.05	1.05	1.03

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