

Weekly Commentary

8 May 2017



Work shift

Last week's labour market data showed that the jobs market continued to strengthen in the March quarter, though it's still not as tight as it was through much of the 2000s. This week, all eyes will be on the Reserve Bank when it releases its latest Monetary Policy Statement on Thursday. With inflation hitting the 2% target mid-point much sooner than expected, the RBNZ now faces a new challenge of keeping inflation on target. We expect the RBNZ to tone back its accommodative policy stance, but signal that the OCR will remain on hold at 1.75% for at least another year.

The March quarter labour market data was stronger than we and other forecasters had expected. Employment rose by a solid 1.2% - an increase of 29,000 - building on the 0.7% rise in the previous quarter. Strong employment growth saw the unemployment rate fall to 4.9%, reversing the rise seen at the end of 2016.

By sector, jobs growth has been particularly strong in construction, as well as retail, hospitality and professional services. That fits with the idea that much of New Zealand's economic growth is being driven by rapid growth in the population. By region, it's notable that the biggest drop in the unemployment rate has been in Auckland, the region that's had the strongest population growth. This suggests that people are coming to Auckland because that's where the work is. In contrast, we're now seeing a meaningful rise in unemployment in Canterbury, as the level of quake rebuild work continues to wind down.

Strong growth in the number of people available and willing to work has gone a long way to satisfy firms' demand for workers. While record levels of net immigration have provided a significant boost to the labour force, labour force participation has also risen to a record high - that's an area where New Zealand stands out favourably compared to peer countries, including Australia and the United States.

Wage growth remained relatively subdued, as expected,

with wages rising 1.5% over the past year. In part, that reflects the low inflation environment we've been in for the past few years, which means that households' purchasing power has still been expanding at a healthy pace. But subdued wage growth also reflects some remaining slack in the labour market, even though there are pockets of tightness in some areas, such as homebuilding.

There were further encouraging signs for the dairy sector from last week's GlobalDairyTrade auction, with dairy prices rising 3.6% in aggregate. That was the fourth consecutive gain, taking global prices back to the highest level since early February. While demand (especially from China) has been solid, dairy prices seem to be responding to concerns about New Zealand supply off the back of April's storms. But production for this season is largely done and dusted, and it's not clear that next season's production will be significantly impacted. European supply has also turned a corner in recent months and is expected to continue trending higher. But while rising global supply is expected to put downward pressure on global dairy prices later this year, recent gains bode well for next season's farmgate milk price, and have created upside risk to our forecast of \$6.10/kgMS.

Looking ahead, Thursday's *Monetary Policy Statement* will address a challenge that the RBNZ hasn't faced in many years: not how to return inflation to target, but how to

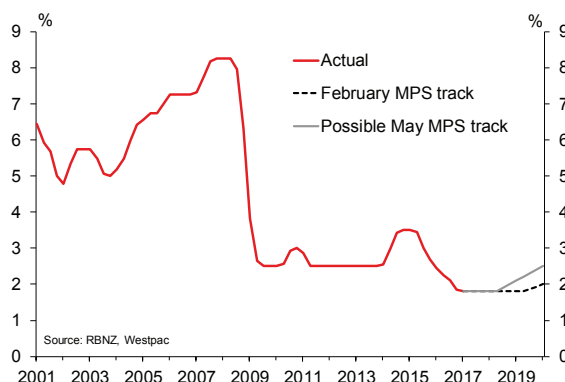
Work shift continued

keep it there.¹ Headline inflation has reached the 2% mark much sooner than expected, though partly due to some temporary factors (like weather-related spikes in food prices) that will wane over the coming year. Still, measures of underlying inflation have also been picking up for the last year or so, which suggests that at some point the RBNZ will need to move away from the very loose monetary policy settings of recent years.

Our view – one we think the RBNZ will share – is that inflation will hold around the 2% mark for the next year or so. The New Zealand dollar is about 4% lower than the RBNZ’s forecasts, which will add to its forecast for tradables inflation. But the economy doesn’t look at risk of overheating, with per-capita growth running at a modest pace of around 1% a year, and the unemployment rate still above most estimates of the ‘natural rate’. There are also headwinds to a further pickup in inflation over the coming years – most notably, a cooling in the housing market. That’s a double edged sword for the RBNZ, because while it may be pleased from a financial stability perspective, a slower housing market presents a real challenge for monetary policy. The RBNZ’s forecasts have long relied on strong household spending, supported by rising house prices, to drive economic growth and a lift in domestic inflation. House prices this year are running well shy of RBNZ’s forecasts, creating the risk that household spending disappoints.

The February MPS (and subsequent March OCR Review) concluded that “monetary policy will remain on hold for a considerable period”, and its interest rate projections suggested that the OCR could remain on hold at 1.75%

RBNZ OCR projection



until late 2019. With inflation picking up sooner than expected, that no longer seems like a tenable forecast. We expect the bottom line in this week’s statement to be more along the lines of: “Monetary policy will continue to be accommodative, to ensure that medium-term inflation remains near the 2 percent midpoint of the Reserve Bank’s target range.” We expect the RBNZ’s interest rate projections to be more consistent with an OCR hike by late 2018. This would probably be neutral for financial markets on the day: an earlier start than previously signalled, but stopping short of endorsing market pricing for a hike by March next year.

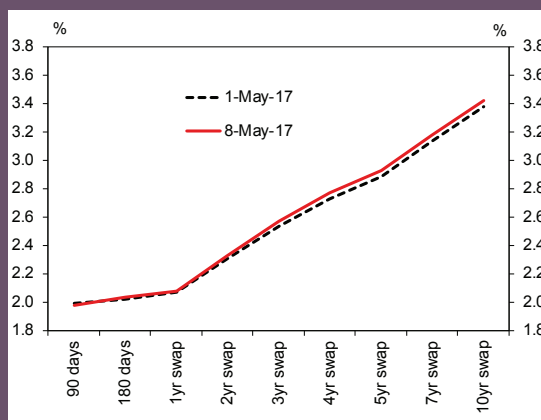
¹ Please see our full Monetary Policy Statement preview for more details <http://www.westpac.co.nz/assets/Business/Economic-Updates/2017/Bulletins-2017/MPS-Preview-May-2017.pdf>

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



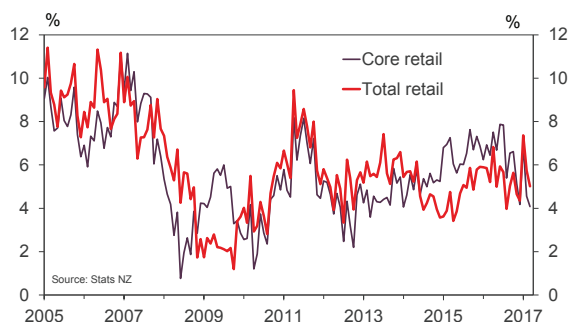
The week ahead

NZ Apr retail card spending

May 10, Last: -0.3%, Westpac f/c: 0.6% , Mkt f/c: 0.6%

- Retail spending pulled back in March. In part, this was due to reduced spending on petrol as prices declined over the month. However, core spending was also soft.
- A key area of weakness has been spending on durable items, which has fallen in five of the last six months. This is likely to be a symptom of the slowdown in the housing market following last year's tightening in lending standards and the rise in mortgage rates.
- We expect that the April figures will show modest growth in retail spending of 0.6%. With the housing market continuing to cool and borrowing rates pushing higher, momentum in household spending is expected to remain limited.

Card transactions, annual % change



NZ Apr REINZ house prices and sales

May 10 (tbc), Sales last: 1.7%, Prices last: 9.9%/yr

- House sales have slowed significantly in response to last year's tightening in lending restrictions on property investors and the rise in borrowing rates. However, there are signs that turnover has stabilised in the past couple of months.
- House price inflation has cooled substantially. In Auckland prices have been effectively flat since last August (though tightness in supply is limiting the downside for prices in Auckland). Previous hotspots such as Hamilton and Tauranga have also slowed. Prices are still rising at a moderate pace in many of the smaller regions.
- We expect that higher mortgage rates will further dampen house price growth this year.

REINZ house prices and sales



RBNZ Monetary Policy Statement

May 11, last: 1.75%, Westpac f/c: 1.75%, Mkt f/c: 1.75%

- We expect the Reserve Bank to hold the OCR at 1.75%, but with a stronger signal that the next move in interest rates will be up.
- Inflation is now close to the 2% target midpoint, though partly due to some temporary factors that are likely to fade over the next year. The challenge for the RBNZ now is to keep inflation on target over the medium term.
- The economy is growing steadily, but not at a pace that suggests the RBNZ needs to hit the brakes. And higher mortgage rates have already had a noticeable impact on house prices and consumer spending.

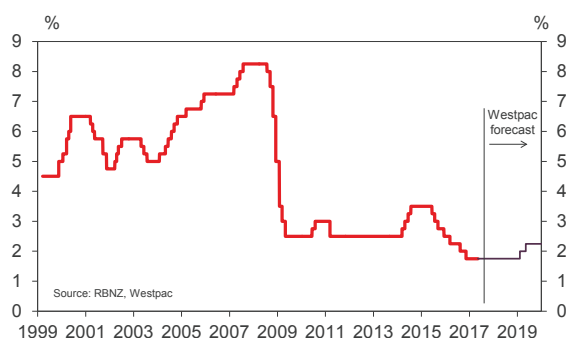
Aus Mar dwelling approvals

May 8 Last: 8.3%, WBC f/c: -1.5%

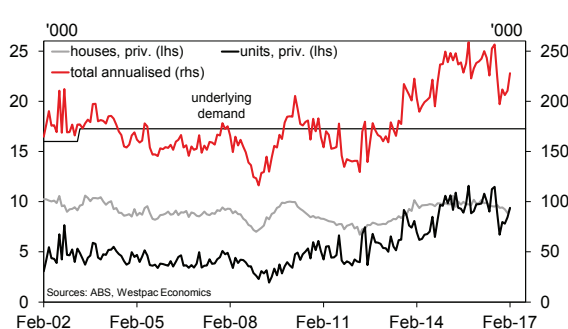
Mkt f/c: -4.0%, Range: -8.0% to 0%

- Dwelling approvals posted a stronger than expected 8.3% rise in Feb following a 2.2% gain in Jan. The state breakdown showed particularly strong rises in NSW and Qld, both of which saw a more pronounced weakening through the second half of 2016. Recent council mergers in NSW and changes to state government policies in Qld may have contributed to this volatility. Approvals declined across other states.
- We expect March approvals to drop back to levels consistent with an underlying slowdown. Although the bulk of the high rise drop now looks to have passed, approvals remain volatile month to month in this 'lumpy' segment. On balance we expect a 1.5% decline in total approvals in March, but given the Jan-Feb surge, a sharper pull back is possible.

NZ Official Cash Rate



Dwelling approvals



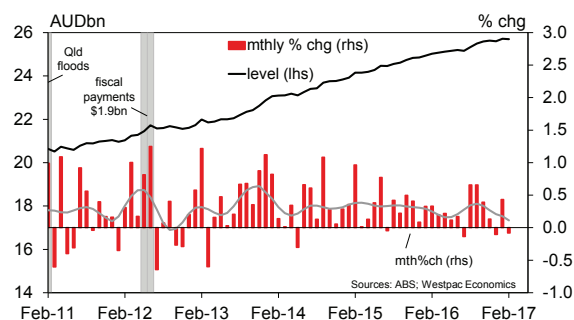
The week ahead

Aus Mar retail trade

May 9, Last: -0.1%, WBC f/c: 0.2%,
Mkt f/c: 0.3%, Range: 0.1% to 0.7%

- Retail sales came in weaker than expected in Feb with a 0.1% dip following a 0.4% gain in Jan. Annual growth slowed to 2.7%. Clothing was a notable weak spot, likely reflecting several chains entering liquidation at the start of the year. Weather may also have played a part - Feb was unusually hot for much of south eastern Australia.
- Weather conditions may factor again in March. The Met Bureau reported above average rainfall across most of Australia's eastern states with cyclone Debbie impacting Qld and parts of NSW. Consumer sentiment remained 'cautiously pessimistic' although consumer sector responses to private sector business surveys suggest a slight improvement. Price discounting remains a significant drag on nominal sales as well. Overall we expect retail sales to post a sluggish 0.2% gain in March.

Monthly retail sales

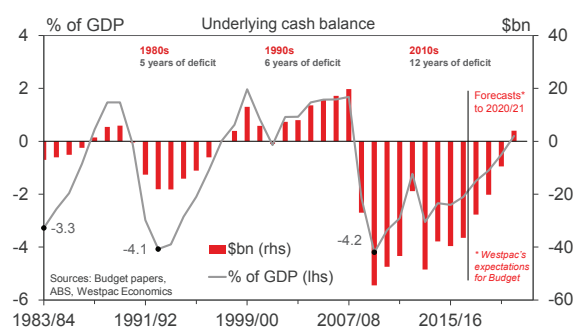


Aus 2017 Federal budget, AUDbn

May 9, Last: -36.5, WBC f/c: -27.7
Mkt f/c: -28.0, Range: -38.0 to -23.0

- The existing profile for the underlying cash balance, with a return to surplus in 2020/21, is to be largely confirmed. For 2017/18, we expect a deficit of \$27.7bn (-1.5% of GDP), a \$1bn upgrade on MYEFO due to a more favourable near term economic outlook - nominal GDP growth for 2017/18 to be upgraded by 0.5% to 4.25%.
- New spending initiatives (eg. schools) and the jettisoning of the 'zombie' savings measures (those stuck in the Senate) are to be funded by offsetting new savings. Major infrastructure projects are to be a focus. This will boost debt levels but with funding likely to be 'off balance sheet' their is minimal impact on the deficit.
- Net debt peaks at around 19.2% of GDP in 2018/19 (up from 19.0% in MYEFO).

Budget deficit 2017/18: -\$27.7bn, -1.5% of GDP*

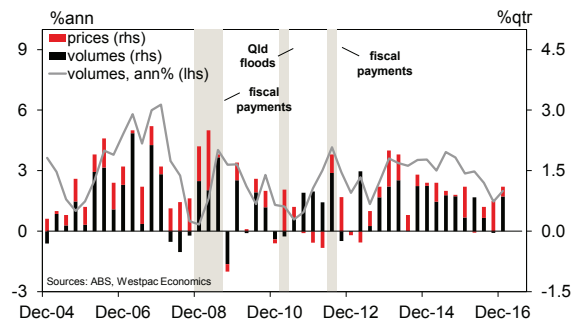


Aus Q1 real retail sales

May 9, Last: 0.9%, WBC f/c: 0.5%
Mkt f/c: 0.5%, Range: 0.0% to 0.8%

- Real retail sales posted a solid bounce in Q4 - up 0.9% following a flat Q3. We expect a more moderate 0.5% gain for Q1. Nominal sales are expected to finish up 0.4% vs 1.1% in Q4. However, the CPI detail suggests retail prices were weak, declining about 0.1% in the quarter vs a 0.2% rise in Q4. Food prices alone were down 0.2% in Q1 with discounting also evident in many other retail-related categories.
- Note that the retail survey remains a problematic indicator for the wider spending measures in the national accounts. Although the Q4 rise happened to be in line, the flat result in Q3 was well below the mark. The average deviation between quarterly growth in real retail sales and total consumer spending has been ½ppt over the last 5yrs.

Quarterly retail volumes and prices

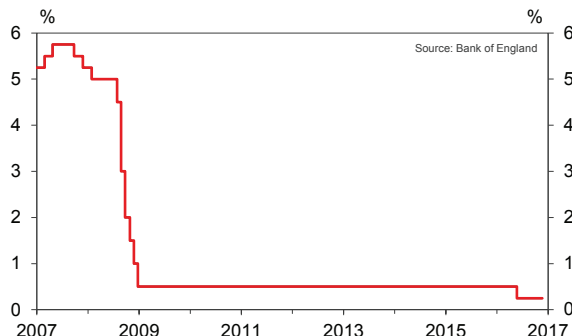


UK May Bank of England policy decision

May 11, Last: 0.25%, WBC f/c: 0.25%

- The BOE has been balancing concerns about the medium-term downside risks for the economy against the lift in inflation. Until recently, it appeared that balance of economic developments was tilting in favour of the MPC adopting a more hawkish stance. However, the latest GDP figures suggest that the pick-up in inflation has started to erode strength of spending in the economy (though this is still a moderation in activity, rather than a sharp slowdown as was feared following the referendum).
- We expect the MPC will keep the Bank Rate on hold again in May, with longer term downside risks for activity remaining key concerns. The BOE is likely to reiterate its earlier neutral policy stance.

Bank of England Bank Rate



Data calendar

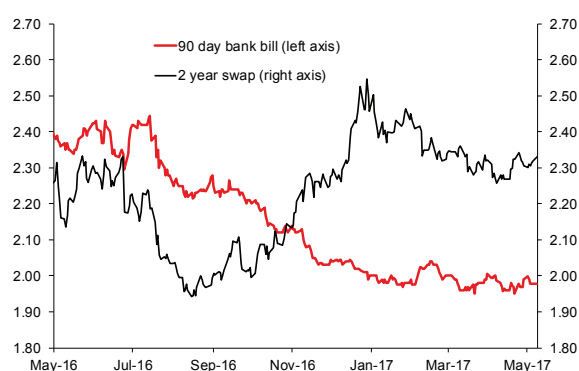
		Last	Market median	Westpac forecast	Risk/Comment
Mon 8					
Aus	Mar dwelling approvals	8.3%	-4.0%	-1.5%	Underlying slowdown to 'reassert' after Jan-Feb pop.
	Apr ANZ job ads	0.3%	-	-	The six month pace is running at a healthy 7.3% annualised.
	Apr NAB business survey, conditions	14	-	-	Up 5pts to a strong +14, supported by lower rates & lower A\$.
Chn	Apr trade balance USDbn	23.92	35.85	-	Volatile at beginning of year, with clear LNY effect.
	Q1 current account balance	11.8	-	-	Dated, but offers considerable detail on trade and investment.
	Apr foreign direct investment %yr	6.7%	-	-	Continuing at moderate pace. Outflow has been halted.
Eur	May Sentix investor confidence	23.9	24.7	-	Investors very positive on outlook.
UK	Apr Halifax house prices	3.8%	3.6%	-	Uncertainty weighing on prices.
US	Apr labor market conditions index	0.4	-	-	Full employment with wages growth beginning to emerge.
	Fedspeak	-	-	-	Bullard speaks on panel on interest rate policy.
	Fedspeak	-	-	-	Mester speaks on role of the Fed and the economic outlook.
Tue 9					
Aus	Mar retail sales	-0.1%	0.3%	0.2%	Store closures, discounting, weather conditions impacting?
	Q1 real retail sales	0.9%	0.5%	0.5%	Q4 bounce looks to have moderated in Q1.
	Federal budget, 2017/18 balance, \$bn	-36.5	-28.0	-27.7	A \$1bn upgrade on MYEFO on improved economic conditions.
US	Apr NFIB small business optimism	104.7	104.8	-	Sustainability of optimism an open question.
	Mar JOLTS job openings	5743	-	-	Hires; fires; quits; and job openings.
	Mar wholesale inventories (final)	-0.1%	-	-	To continue to add volatility to growth.
	Fedspeak	-	-	-	Kashkari at Minnesota High Tech Conference.
	Fedspeak	-	-	-	Rosengren speaks at risk management in real estate conference.
	Fedspeak	-	-	-	Kaplan speaks at an investment summit.
Wed 10					
NZ	Apr retail card spending	-0.3%	0.6%	0.6%	Modest growth expected, housing slowdown a drag on spending.
	Apr REINZ house sales	1.7%	-	-	Sales have fallen as interest rates have risen...
	Apr REINZ house sales %yr	9.9%	-	-	...with price growth expected to slow over remainder of 2017.
Chn	Apr CPI %yr	0.9%	1.1%	-	Well below target and set to remain there.
	Apr PPI %yr	7.6%	6.7%	-	Fuelled by commodity prices.
	Apr M2 money supply %yr	10.6%	10.8%	-	Credit growth started the year on a strong footing...
	Apr new loans, CNYbn	1020.0	800.0	-	... but is likely to slow...
	Apr aggregate financing, CNYbn	2118.9	1105.0	-	... as authorities keep a keen eye on sector.
Eur	Draghi speaks	-	-	-	Speaks in Dutch Parliament.
US	Apr import price index	-0.2%	0.2%	-	Has little in the way of implications for consumer inflation.
	Apr monthly budget statement, \$b	-172.6	-	-	Tax receipts have surprised to the downside.
	Fedspeak	-	-	-	Rosengren speaks on economy at Vermont Business Group.
Thu 11					
NZ	RBNZ policy decision	1.75%	1.75%	1.75%	Inflation back around 2%, policy support needed to keep it there.
	Apr food price index	-0.3%	-	-	April flooding wiped out some vegetable crops.
UK	Apr RICS house price balance	-1.0%	-	-	Brexit uncertainty weighing on prices, especially in London.
	Mar industrial production	-0.7%	-	-	The lower GBP is major tailwind for manufacturing and exports.
	Mar construction output	-1.7%	-	-	Momentum has eased, Brexit uncertainty to weigh on spending.
	Mar trade balance, £m	-3663	-	-	Exports have been receiving a boost from the lower GBP.
	BOE bank rate decision & inflation report	0.250%	-	0.250%	Activity resilient to date, but concerns momentum is fading.
US	Apr PPI	-0.1%	0.2%	-	Fall in services & goods producer inflation expected to reverse.
	Initial jobless claims	238k	-	-	At historically low level.
	Fedspeak	-	-	-	Dudley speaks on globalisation in Mumbai.
Can	Mar new housing price index	0.4%	-	-	Strength centred on Toronto.
Fri 12					
NZ	Apr manufacturing PMI	57.8	-	-	Business sector conditions remain positive.
Eur	Mar industrial production	-0.3%	0.4%	-	Rebound from soft patch last month. PMI's are elevated.
Ger	Apr CPI %yr (final)	0.0%	0.0%	-	Preliminary showed a jump associated with Easter holidays.
	Q1 GDP (preliminary)	0.4%	0.7%	-	Domestic demand edging up while exports gain momentum.
US	Apr CPI	-0.3%	0.2%	0.2%	Inflation to tend to 2.0%yr target.
	Apr retail sales	-0.2%	0.6%	1.0%	Durables to bounce?
	May Uni. of Michigan sentiment	97.0	97.0	-	Still very strong.
	Mar business inventories	0.3%	0.2%	-	To continue to add volatility to growth.
	Fedspeak	-	-	-	Evans Speaks on monetary policy and the economy in Dublin.
	Fedspeak	-	-	-	Harker speaks on the economic outlook in Philadelphia.
Can	Apr Teranet house prices	0.9%	-	-	Strong house price growth continues.

New Zealand forecasts

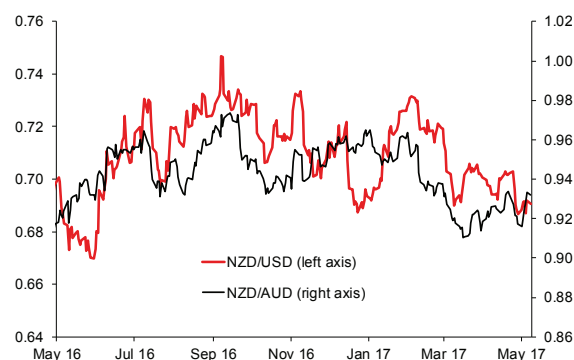
Economic Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2015	2016	2017f
GDP (Production) ann avg	3.4	2.4	3.1	3.3	2.5	3.1	3.2	3.4
Employment	3.2	2.0	5.3	2.1	1.4	5.8	2.3	1.5
Unemployment Rate % s.a.	5.4	5.2	4.9	4.7	4.9	5.2	4.7	4.7
CPI	0.3	0.4	2.0	1.5	0.1	1.3	1.8	2.1
Current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

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	2.40	2.40	2.40	2.50	2.60	2.70
5 Year Swap	3.00	3.10	3.15	3.25	3.35	3.50
10 Year Bond	3.30	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	76.2	75.8	75.4	74.9	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 8 May 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.83%	1.88%
60 Days	1.91%	1.89%	1.93%
90 Days	1.98%	1.95%	1.99%
2 Year Swap	2.33%	2.35%	2.27%
5 Year Swap	2.93%	2.90%	2.83%

NZ foreign currency mid-rates as at Monday 8 May 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6905	0.7047	0.6936
NZD/EUR	0.6272	0.6513	0.6552
NZD/GBP	0.5318	0.5493	0.5601
NZD/JPY	77.98	77.86	77.02
NZD/AUD	0.9321	0.9302	0.9268
TWI	75.35	76.67	76.03

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	2.2	2.1
Unemployment %	5.8	6.2	5.8	5.7	6.3	6.2
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	4.5	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	0.8	1.0
Euroland						
Real GDP %yr	-0.3	0.9	1.6	1.7	1.6	1.2
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	3.3	3.5	3.5

Forecasts finalised 13 April 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	1.74	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.66	2.85	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	2.35	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	-0.40	-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	0.7376	0.76	0.75	0.74	0.72	0.70	0.68	0.66
USD/JPY	112.25	111	112	114	116	117	118	118
EUR/USD	1.0985	1.05	1.04	1.03	1.02	1.01	1.00	0.99
AUD/NZD	1.0733	1.10	1.10	1.10	1.09	1.09	1.08	1.06

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