

Weekly Commentary

10 April 2017



Stand pat

The Quarterly Survey of Business Opinion showed that firms remain upbeat about how their own businesses are faring. The survey also reinforced that the inflation backdrop is evolving, with more firms now looking to raise prices. We view the increase in pricing intentions as consistent with a pick-up in inflation to moderate levels rather than a sustained over-shoot of the Reserve Bank's target, but will continue to monitor inflation trends closely

With official data released with a substantial lag, survey data can provide a timely heads up on how the economy is tracking. And last week's Quarterly Survey of Business Opinion (QSBO) suggests that the economy started the year on decent footing. Confidence in the general business situation eased a bit, but it's still much higher than a year earlier when low dairy prices appeared to be weighing heavily on broader economic confidence. And more importantly, firms' assessment of their own activity – which is the better indicator for economic growth – remained steady at well above average levels.

The survey results suggest that economic growth bounced back in early 2017, after the sluggish result of only 0.4% in the December quarter. Growth in December was largely held back by declines in primary production, including milk, meat and oil production (which wouldn't be expected to show up in the QSBO results). Plentiful summer rainfall has made for favourable pasture conditions in early 2017, and milk production has recovered strongly. And while a turnaround in meat processing hasn't been so clear-cut, it won't be the same drag on growth as it was in late 2016. We've pencilled in 0.9% for March quarter growth.

Abstracting from the quarterly volatility, the underlying pace of growth looks to be continuing at a moderate pace. We're forecasting growth in calendar '17 at a touch above 3% - respectable, but not strong when the population is growing around 2% per year. Nonetheless, with the

economy now in its seventh year of sustained expansion, firms have largely used up their spare labour and capital resources. But while constraints on production might act as a handbrake on growth from here (and lead to rising price pressure), it's encouraging to see firms continuing to look at bolstering their labour and capital stocks which will help them scale up activity.

Against this backdrop, the labour market looks set to strengthen further, and the unemployment rate is expected to push comfortably below 5% this year. Ongoing strength in labour demand has been highlighted by recent data on job ads, which continued to push higher in March to be up 18% from a year earlier. Notably, the strongest growth in job ads in recent months has been outside of the three main centres. That's consistent with improved economic conditions across regions off the back of factors such as the recovery in dairy sector incomes, and a broadening of population growth and house price gains across regions. However, one factor that could hold back firms' hiring plans is difficulty in finding suitable staff, with firms reporting that it hasn't been this difficult since 2007.

The QSBO reinforced that we're in an evolving inflation environment, with firms' pricing indicators rising to the highest levels since September 2014. However, the recent gains need to be put in context after a two-year stint when inflation lingered below 1%. Indeed, the net 14% of firms that raised prices last quarter looks consistent with annual

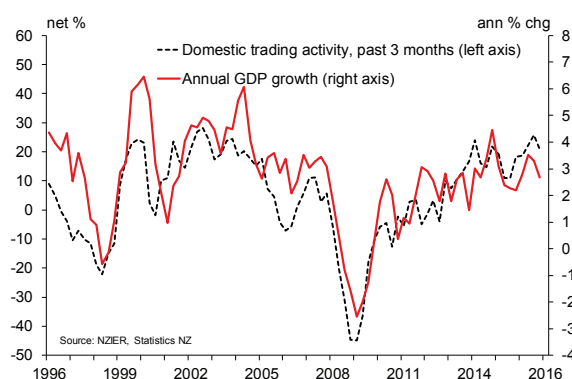
Stand pat continued

inflation jumping up near 2% in Q1 (our current forecast is 1.8%, but we're in the process of doing the final number crunching ahead of the release on 20 April). But we're sceptical that rise in inflation will be sustained. The QSBO highlighted that even though firms are pushing up against capacity constraints, there hasn't yet been a notable increase in cost pressures (both experienced and expected). In part, this reflects record levels of net migration, including a high-proportion of "work-ready" migrants, that have helped keep a lid on wage inflation. However, with the unemployment rate expected to decline, pressure on employers to raise wage rates will begin to grow.

In other news last week, it was an encouraging result in the GlobalDairyTrade auction, with prices overall rising 1.6%. After sharp declines in early March, global dairy prices look to have found a base. We've upgraded our forecast for this season's farmgate milk price from \$5.90/kgMS to \$6.00/kgMS – in line with Fonterra's latest forecast – and well above break-even for most farmers. We expect global dairy prices to track around current levels this year (albeit with usual volatility) as rising global supply limits the upside to prices and demand remains steady. For the 2017/18 season, a farmgate milk price in the low \$6's is our base case. See our *Fortnightly Agri Update* for more details on global dairy markets.¹

We released a bulletin last week looking at the varied housing market conditions in New Zealand's three main centres.² In Auckland, the issues of housing shortages and unaffordability are well known, with an estimated shortage of about 35,000 homes. To work off that shortage and meet

QSBO domestic trading activity and GDP growth



future demand, the city should be aiming to build 11,000 new homes on more, each year for the next decade. The current rate is about 8,000 homes completed in the last year, meaning the shortage will get worse before it gets better. Wellington is also developing a shortage of housing. It's not on the same scale as Auckland, and the pace of homebuilding has been rising. But no doubt this shortage has been a factor behind the resurgence in house prices and rents in the last couple of years. Finally, Christchurch is moving closer to restoring its housing stock in the wake of the 2010 and 2011 earthquakes. The pace of homebuilding has been slowing since 2015, and it will probably drop below normal levels for some time. House prices have flattened out, and rents have fallen over the last two years, now that homes are no longer scarce.

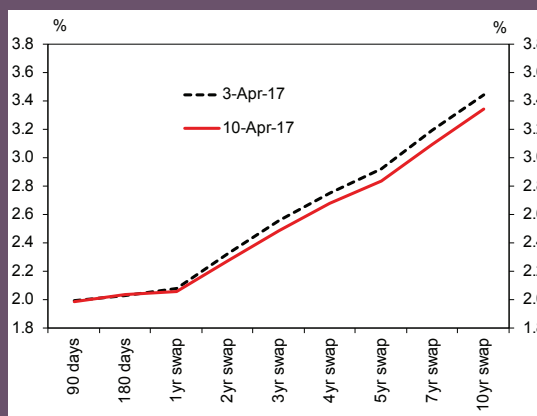
¹ <http://www.westpac.co.nz/assets/Business/Economic-Updates/2017/Fortnightly-Files-2017/NZ-Fortnightly-Agri-Update-5-April-2017.pdf>
² <http://www.westpac.co.nz/assets/Business/Economic-Updates/2017/Bulletins-2017/A-tale-of-three-cities-April-2017.pdf>

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 Mar REINZ house prices and sales

Apr 10-13 (tbc), Sales last: 0.4%, Prices last: 10.5%/yr

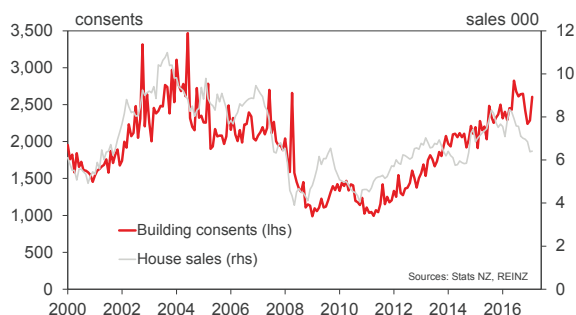
- House sales have slowed significantly since the latest round of loan-to-value ratio (LVR) restrictions on property investors, which were announced last July. However, there are signs that turnover has stabilised in the last couple of months.
- House prices have flattened out in previous hotspots such as Auckland, Hamilton and Tauranga. But prices have continued to rise strongly in some of the smaller regions which had remained subdued for years after the financial crisis.
- We expect that higher mortgage rates will lead to a more subdued performance for house price growth this year.

NZ Mar retail card spending

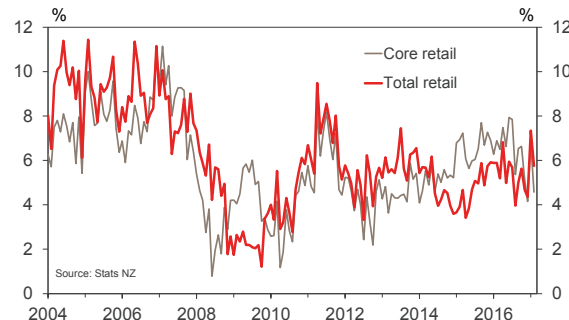
Apr 11, Last: -0.6%, Westpac f/c: 0.5%

- After some sharp swings in January and February, we expect a modest 0.5% increase in spending in March. Lower fuel prices and poor weather mid-month will provide a drag. However, such influences are being offset by factors such as strong population growth and tourist inflows.
- The one big cloud on the horizon are recent increases in interest rates. These have sapped some of the momentum out of the housing market (which, for better or worse, tends to be a big driver of spending in the New Zealand economy). But with interest rates still relatively low, and other supportive factors in play, we expect that spending will remain firm for some time yet.

NZ housing activity



Card transactions, annual % change



Aus Feb housing finance (no.)

Apr 10, Last: 0.5%, WBC f/c: -1.0%

Mkt f/c: 0.0%, Range: -1.4% to 2.0%

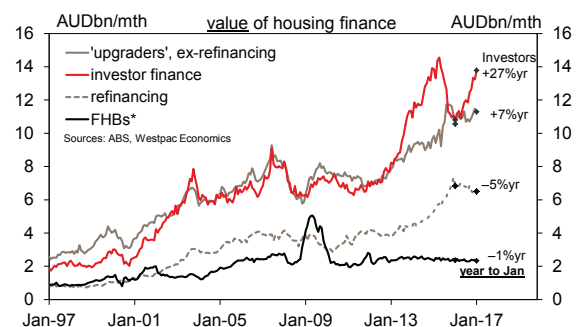
- January housing finance approvals came in slightly above expectations, with another strong rise in the value of investor lending. The total number of loans to owner occupiers lifted 0.5% versus expectations of a small decline. The value of investor loans surged 4.2% to be 27.5% higher over the year. Industry data suggests some softening in Feb - we expect owner occupier loans to record a 1% dip. The value of investor loans will again be of interest given they are tracking close to levels that could push annual growth in the stock of investor credit close to APRA's 10% 'speed limit'. This segment may still be strong in Feb though, with lenders' moves to increase investor loan rates only coming in March and APRA's harder line on macro prudential measures (10% guide should be met 'comfortably'; 'interest only' loans capped) announced in April.

Aus Apr Westpac-MI Consumer Sentiment

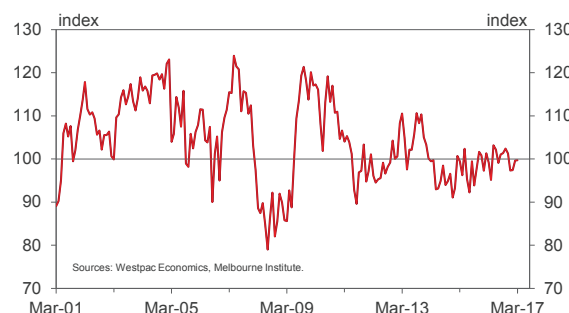
Apr 12 Last: 99.7

- The **Westpac-Melbourne Institute Consumer Sentiment Index** was essentially unchanged in March, holding just below the 'neutral' level of 100 - indicating pessimists slightly outnumber optimists. Sentiment has weakened since late last year on renewed concerns about the economy and a reported deterioration in family finances. This month's survey is in the field April 3-8. Factors that may influence confidence include: commercial bank increases in mortgage interest rates, particularly for investors and interest only loans - avg +3.3bps for standard owner occupier rate versus +24bps for standard investor rates and +23bps for interest only loans (both owner occupiers and investors); additional 'macro-prudential' measures from regulators aimed at containing risky mortgage lending; more signs of strong conditions in Sydney and Melbourne housing markets; but a patchy, uneven performance across the wider economy.

Value of finance approvals by segment



Consumer Sentiment Index



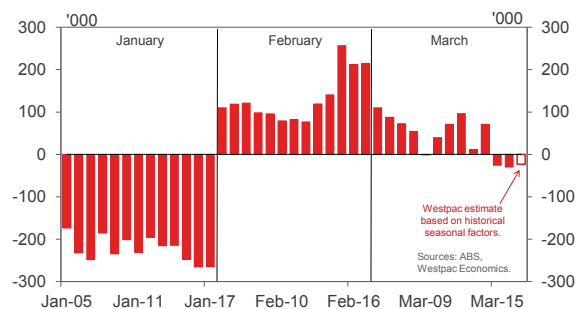
The week ahead

Aus Mar Labour Force Survey total employment

Apr 13, Last: -6.4k, WBC f/c: +20k
Mkt f/c: +20k, Range: +3.9k to +35k

- February's 6.4k fall in total employment was a softer than expected update on the labour market.
- The rise in full-time employment in February did not break the recent trend for a greater focus on part-time employment. In addition, weakening hours worked further emphasised that labour demand is weaker than the business surveys suggest (employment growth of +2%/yr).
- For February, sample rotation may explain some of the weakness, but not the soft prints of the last three months.
- March has an additional risk with seasonality. In the last two years it has shifted from being positive to negative. We have cautiously pencilled in +20k, holding the annual pace at 0.9%/yr.

Change in employment (in original terms)

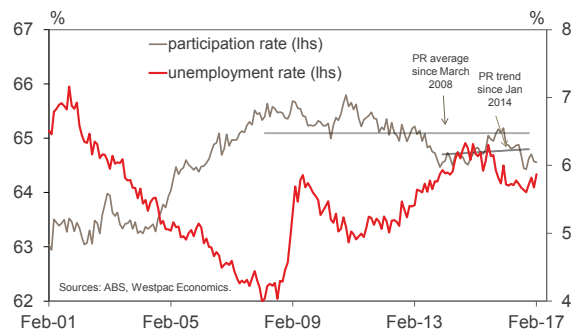


Aus Mar Labour Force Survey unemployment

Apr 13, Last: 5.9%, WBC f/c: 5.9%
Mkt f/c: 5.9%, Range: 5.7% to 6.0%

- In February, a negative employment print combined with a flat participation rate, driving a 19.5k lift in the labour force, saw the unemployment rate jump from 5.7% to 5.9%.
- The February survey also provided an update on underemployment, highlighting an increasing share of employees who are willing and able to work more hours than they currently do. In particular, the growth in female employment and participation has been associated with a rise in female underemployment. Youth unemployment continues to rise as does youth underemployment, suggesting that Australia's youth are being left behind by the jobs market.
- If participation is flat in March, a 20k rise in employment will be enough to hold the unemployment rate flat at 5.9%.

Unemployment and participation rates



US March CPI

Apr 14, Last: 0.1%, WBC 0.1%

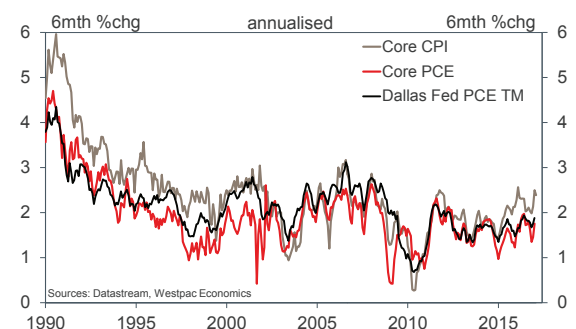
- The past two months have seen particularly strong CPI inflation outcomes in the US, with annual headline inflation coming in at 2.5%/yr in January then 2.7%/yr in February. Driving this outcome has been persistent strength in energy prices, now up more than 15%/yr.
- Abstracting from energy and food price dynamics, inflation has been more subdued and stable; but, at 2.2%/yr, core inflation is still above the FOMC's 2.0%/yr medium-term target.
- In coming months, we expect headline CPI inflation will moderate back towards a 2.0%/yr pace. In the month of March in particular, energy and food will be a drag. The headline CPI is therefore only expected to edge higher despite a 0.2% gain for core prices. The market forecast of a flat headline print for the month highlights that risks lay to the downside.

US March retail sales

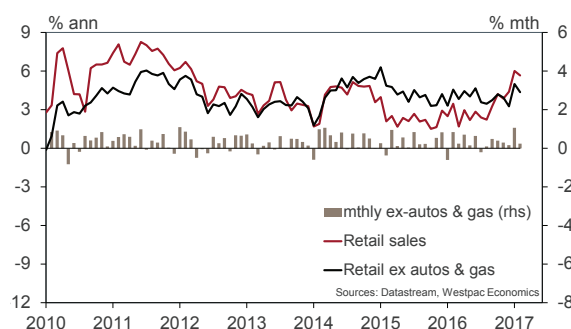
Apr 14, Last: 0.1%, WBC 0.1%

- In the US, confidence has recently reached multi-decade highs following President Trump's election and jobs growth continues at pace. Nonetheless, spending data has been decidedly mixed.
- Having ended 2016 on a strong note with a 1.0% gain in December, total sales growth slowed to 0.6% in January then just 0.1% in February. Core sales have also shown considerable volatility, with soft 0.2% gains in December and February split by January's 1.1% jump.
- The slowdown in headline sales growth in 2017 has principally come as a result of a deterioration in auto sales which could be (at least partly) the result of higher interest rates. Along with weaker gas sales, another soft outcome for autos is expected to limit the rise in total sales to 0.1%. Risks are skewed to the downside in March.

Core inflation to remain near target



Retail sales solid but questions remain



Data calendar

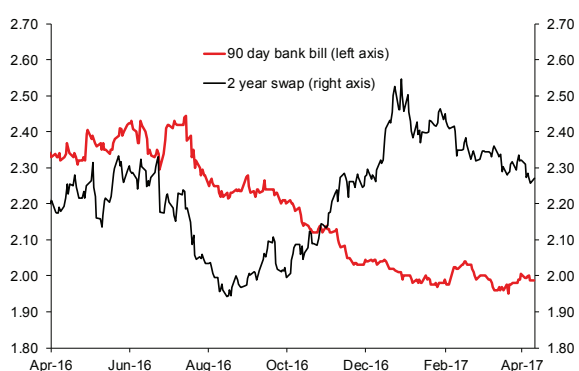
		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
NZ	Mar REINZ house sales	0.4%	-	-	Due this week. Sales may be stabilising after LVR restrictions.
	Mar REINZ house prices %yr	10.5%	-	-	Prices have flattened out in Auckland, still rising elsewhere.
Aus	Feb housing finance	0.5%	-	-1.0%	Headline own-occ only, industry figures point to a softer month.
	Feb value of investor finance	4.2%	-	-	Focus of RBA's risk concerns. Rate rises, APRA moves impact from Apr.
Chn	Mar M2 money supply %yr	11.1%	11.1%	-	Tentative date – 10/04 to 15/04.
	Mar new loans, CNYbn	1170	1200	-	Tentative date – 10/04 to 15/04.
	Mar aggregate financing, CNYbn	1148	1500	-	Tentative date – 10/04 to 15/04.
Eur	Apr Sentix investor confidence	20.7	20.2	-	Still riding high.
US	Mar labor market conditions index	1.3	-	-	Broad composite measure of conditions – strong.
	Fedspeak	-	-	-	Bullard speaks on the economy and policy in Melbourne.
	Fed Chair Yellen speaking	-	-	-	Speaking at Uni of Michigan, including Q&A.
Tue 11					
NZ	Mar retail card spending	-0.6%	-	0.5%	Population growth and tourism continue to boost demand.
Aus	Mar NAB business survey	9	-	-	Business conditions & confidence above long-run average.
Eur	Feb industrial production	0.9%	0.1%	-	Manufacturing sector in very good shape.
	Apr ZEW survey of expectations	25.6	-	-	Very positive on outlook.
UK	Mar CPI	0.7%	0.2%	-	Lower pound boosting core as well as food and fuel prices.
	Feb house price index	6.2%	-	-	Low supply is offsetting softer demand.
US	Mar NFIB small business optimism	105.3	104.8	-	Very strong in recent months, following lead of big business.
	Feb JOLTS job openings	5626	-	-	Hires; fires; quits; and vacancy detail.
	Fedspeak	-	-	-	Kashkari participates in Q&A in Minneapolis.
Wed 12					
Aus	Apr Westpac-MI Consumer Sentiment	99.7	-	-	Mortgage rate increases, housing concerns to impact?
Chn	Mar CPI %yr	0.8%	1.0%	-	Consumer prices very modest, impacted by food in recent months.
	Mar PPI %yr	7.8%	7.5%	-	Commodity prices have seen PPI surge over past year.
UK	Feb ILO unemployment rate	4.7%	4.7%	-	With GDP growth still firm, unemployment should remain low.
US	Mar import price index	0.2%	-0.2%	-	Robust gains seen over prior 3 months, commodities key.
	Mar monthly budget statement USDbn	-108.0	-	-	Outlook for federal deficit very uncertain.
Can	Mar Teranet / National Bank house prices	1.0%	-	-	Strength centred on Toronto.
	Bank of Canada rate decision	0.5%	0.5%	0.5%	BOC on hold. Activity firming, but inflation and wage growth soft.
Thu 13					
NZ	Mar BusinessNZ PMI	55.2	-	-	While down from earlier highs, business conditions remain firm.
	UniMar food price index	0.2%	-	0.0%	Weather-related jump in produce prices may persist into March.
Aus	Apr MI inflation expectations	4.0%	-	-	The trend continues to drift higher but is still below long-run average.
	RBA Financial Stability Review	-	-	-	Macroprudential policy and housing the focus.
	Mar employment	-6.4k	20k	20k	Pace of employment is now below 1%/yr even though leading indicators suggest it should be >2%/yr. A modest lift will hold unemployment flat.
	Mar unemployment rate	5.9%	5.9%	5.9%	
Chn	Mar trade balance USDbn	-9.15	11.75	-	Feb saw first deficit in 3 years owing to LNY seasonality; will revert.
Ger	Mar CPI (final)	0.1%	0.1%	-	Tight economy and energy supporting robust inflation.
US	Mar PPI	0.3%	0.0%	-	Depends on commodity prices; limited pass through to CPI.
	Initial jobless claims	234k	-	-	Claims remain at historically low levels.
	Apr Uni. of Michigan sentiment	96.9	97.0	-	Confidence looks resilient.
Can	Feb new housing price index	0.1%	-	-	Brisk sales in Toronto, more moderate elsewhere.
Fri 14					
Aus/NZ	Public Holiday – Good Friday	-	-	-	Markets closed.
US	Mar CPI	0.1%	0.0%	0.1%	CPI expected to moderate to 2% or a little below through 2017.
	Mar retail sales	0.1%	0.0%	0.1%	Solid, but questions remain over ongoing momentum.
	Feb business inventories	0.3%	0.3%	-	Will remain volatile in 2017, impacting growth.

New Zealand forecasts

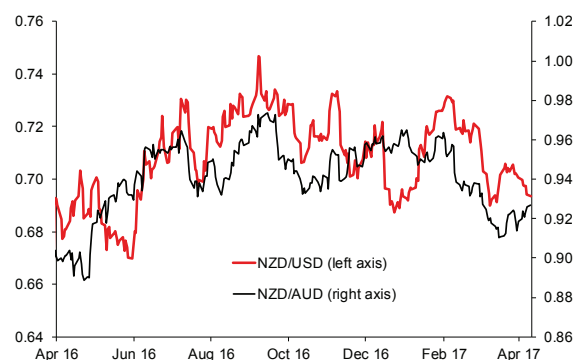
Economic Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2015	2016	2017f
GDP (Production) ann avg	3.4	2.4	3.1	3.4	2.5	3.1	3.2	3.4
Employment	3.2	2.0	5.3	2.1	1.4	5.8	2.3	1.5
Unemployment Rate % s.a.	5.4	5.2	4.7	4.4	4.9	5.2	4.4	4.2
CPI	0.3	0.4	1.8	1.5	0.1	1.3	1.6	2.1
Current 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 10 April 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.88%	1.83%	1.84%
60 Days	1.93%	1.90%	1.90%
90 Days	1.99%	1.98%	1.96%
2 Year Swap	2.27%	2.32%	2.36%
5 Year Swap	2.83%	2.93%	3.08%

NZ foreign currency mid-rates as at Monday 10 April 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6936	0.7009	0.6934
NZD/EUR	0.6552	0.6469	0.6492
NZD/GBP	0.5601	0.5617	0.5699
NZD/JPY	77.02	77.64	79.51
NZD/AUD	0.9268	0.9204	0.9192
TWI	76.03	76.33	76.13

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	1.78	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.54	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	2.31	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	0.7532	0.76	0.75	0.74	0.72	0.70	0.68	0.66
USD/JPY	110.54	118	118	120	122	124	126	128
EUR/USD	1.0643	1.05	1.03	1.01	1.00	0.99	0.98	0.96
AUD/NZD	1.0803	1.10	1.10	1.10	1.09	1.09	1.08	1.06

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