Weekly Commentary

12 June 2017

There and back again

We expect this week's GDP figures to show a more 'normal' pace of growth over the March quarter, as some of the temporary factors that held back growth in the December quarter unwind. We're forecasting a 0.8% increase in GDP, a little less than the 0.9% rise that the Reserve Bank expected in its most recent *Monetary Policy Statement,* but at the higher end of market forecasts. Meanwhile, the current account deficit is expected to widen as weak export volumes outweigh higher prices.

Q1 GDP, 15 June

We expect a 0.8% rise in the production measure of GDP for the March quarter, following a 0.4% rise in the December quarter. Growth in the December quarter was weighed down by two factors in particular: a pullback in milk production in response to low dairy prices, and a temporary shutdown of the Maari oil platform. Both of these factors have since unwound, and accordingly we expect strong contributions to growth from the agriculture and mining sectors.

Recent indicators have also pointed to strong gains in transport, retail, wholesaling and non-food manufacturing. This growth in the more domestically-oriented parts of the economy highlights the fact that 'people power' continues to account for a large share of the growth in GDP. New Zealand's population grew by more than 0.5% over the March quarter as net migration continued to power ahead at a record pace.

On the weaker side, food manufacturing was weighed down by lower meat production as dairy farmers have shifted back to rebuilding herds. Wood harvesting slowed for a second quarter despite a sustained run of very high exports prices for wood products. Real estate services are likely to have fallen as the loan-to-value restrictions introduced last July have continued to slow housing turnover.

The biggest weak spot for the March quarter was in the construction sector. In particular, there was a sharp drop in non-residential building, concentrated in Auckland. However, activity in this segment tends to be lumpy, and the pipeline of work remains strong. At the margin, poor weather may have also hindered the pace of activity (especially compared to the consistently dry December quarter). Residential building is running up against capacity constraints, particularly in Auckland, but the effect has been a slowing in the pace of growth rather than an outright decline.

It's worth noting that the Kaikoura earthquake last November does not appear to have weighed on GDP growth over the December quarter. If anything, it may have done the opposite – Stats NZ has noted that transport activity was up in the South Island, due to the need to take longer alternative routes, and civil construction (roading, earthmoving etc) was boosted over the quarter. So that suggests we're unlikely to see a quake-related rebound in activity in this or coming quarters.

The expenditure measure of GDP is considered to be less reliable on a quarterly basis, and the outlook for the March quarter is clouded by some large offsetting factors. We expect to see strong growth in private consumption, based on both the sharp rise in retail sales and a rise in spending by New Zealanders travelling overseas. Investment is shaping up as mixed, with lower construction but stronger investment in plant and machinery. Export volumes are shaping up to be quite weak for the second quarter in a row,

There and back again continued

though some of this is likely to be an issue of timing, with stocks building up ready to be shipped next quarter.

Q1 current account, 14 June

We expect the current account deficit to widen from 2.7% to 3.0% of GDP for the year to March, reversing the narrowing that we saw for December.

In seasonally adjusted terms, the goods trade deficit widened to more than $1bn, its weakest since 2008. While New Zealand's terms of trade reached a new high in the March quarter, trade volumes remained unfavourable. In particular, dairy export volumes fell sharply for the second straight quarter.

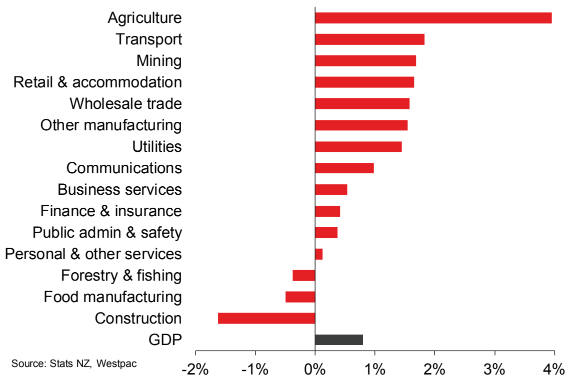
Dairy products tend to be shipped with a lag of about three months after production, so the weakness in exports reflects the slow start to the dairying season last year. Milk volumes have since recovered as farmgate milk prices have improved, so we expect a strong catch-up bounce in export volumes over the rest of this year.

The services balance remains strongly in surplus, but is likely to have narrowed compared to the record high seen in the December quarter. Spending by overseas tourists in New Zealand was up slightly, but this was outweighed by rising spending by New Zealanders overseas.

We expect the investment income deficit to widen, largely because the December quarter appears to have captured some windfall gains from New Zealanders' investments overseas. Earnings of foreign-owned companies in New Zealand appear to have been fairly steady for the quarter.

New Zealand's net overseas liabilities narrowed sharply in the December quarter, to just below 60% of GDP. This measure can be thrown around a lot by changing asset valuations, so we wouldn't be concerned if this gap widened again in the March quarter. There has been a marked trend improvement in this balance since 2009, to the point that New Zealand's balance is now much in line with Australia's.

Q1 GDP changes by sector

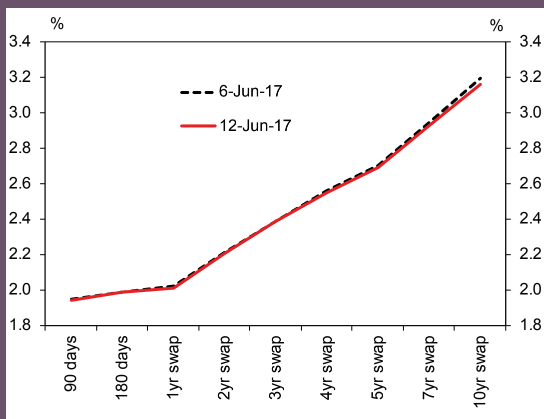


Fixed vs Floating for mortgages

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 May house prices and sales

Jun 12-16 (tbc), Sales last: -4.2%%, Prices last: 7.8%yr

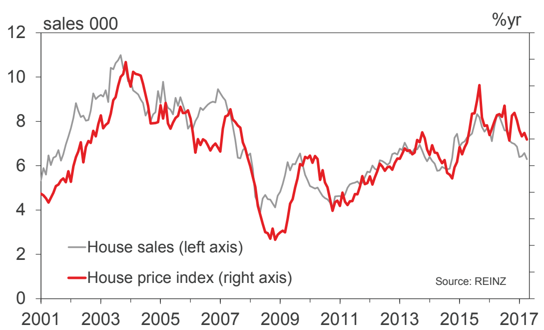
- The housing market has slowed significantly since mid-2016. The Reserve Bank lightened loan-to-value limits for property investors in July, and mortgage rates started to rise in November after two years of persistent declines.
- House sales are down more than 20% from their 2016 peaks, although there are signs that they are bottoming out. The drop in sales in April may have been due to the timing of public holidays that month.
- House prices are still up almost 8% on a year ago, but that annual rate hides a lot – prices were rising sharply up until August last year, but have flattened out in the past eight months, particularly in the previous hotspots such as Auckland, Hamilton and Tauranga.

May retail card spending

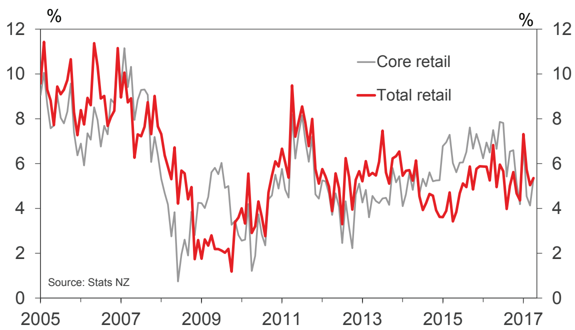
June 12, Last: +1.1%, Westpac f/c: –0.1%

- After a larger than expected gain last month, we expect spending will flatten off in May. In part, this is a normal easing after earlier gains in lumpy categories like durables. At the same time, the creep higher in borrowing rates and related slowdown in the housing market are likely to crimp spending. Falls in petrol prices over the month will also weigh on nominal spending levels.
- While the momentum in spending has moderated, we are still looking at a slowdown (rather than a sudden stop). Population growth is still strong and the country is enjoying a strong tourist season. We're also likely to see increasing regional differences in spending, with the housing market slowdown centred on Auckland, while many other regions are continuing to see gains.

REINZ house prices and sales



Card transactions, annual % change



NZ Q1 current account, % of GDP

Jun 14, Last: -2.7%, Westpac f/c: -3.0%, Mkt f/c: -2.7%

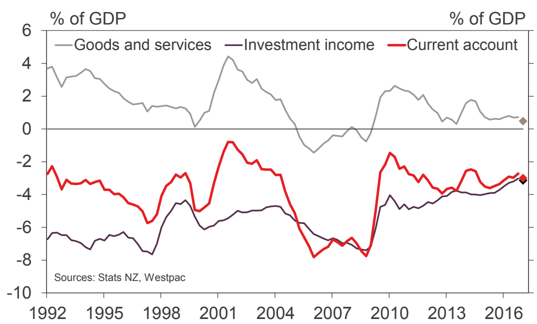
- The current account deficit is expected to widen for the March quarter. While New Zealand's terms of trade continued to rise strongly in the early part of this year, weak export volumes saw the goods trade deficit widen out to its largest since 2008.
- The weakness in export volumes, particularly for dairy products, appears to be a matter of the timing of export shipments. We expect a strong improvement in the trade balance over the rest of this year.
- We also expect a widening of the investment income deficit compared to the December quarter, which included some windfall gains to New Zealanders' investments offshore.

NZ Q1 GDP

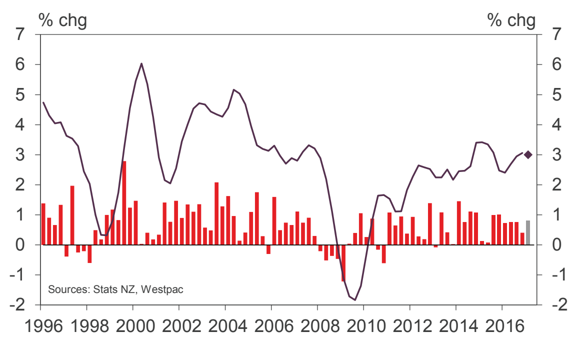
Jun 15, Last: 0.4%, Westpac f/c: 0.8%, Mkt f/c: 0.7%

- The New Zealand economy is expected to show a more 'normal' pace of growth over the March quarter after a subdued end to last year. We're forecasting a 0.8% increase in GDP, slightly ahead of the market median.
- December quarter GDP was held back by temporary declines in dairy production and oil and gas extraction, both of which have since rebounded.
- We also expect strong contributions from transport, retail and non-food manufacturing. The weakness in construction during the March quarter is likely to prove transitory, given the accumulated pipeline of building work.

Annual current account balance



Production-based GDP



The week ahead

Aus Jun Westpac-MI Consumer Sentiment

Jun 14 Last: 98.0

- The **Westpac-Melbourne Institute Consumer Sentiment Index** slipped from 99 in April to 98 in May. The survey was conducted following the Federal Budget with the muted move and additional questions indicating this had little or no impact on confidence. However, consumer views around family finances and housing were notably weaker.
- This month's survey was in the field June 5-11. With the RBA again leaving policy on hold, sentiment may be more impacted by reports of a dip in house prices in May and the soft Q1 GDP result, although the latter was not as weak as some feared, with Australia's expansion also hitting a new record for longevity. The global backdrop was again unsettled with terrorist attacks in the UK and more political drama in the US. Financial markets were mixed, the AUD up 1½¢ vs the USD but the ASX down 2.7%.

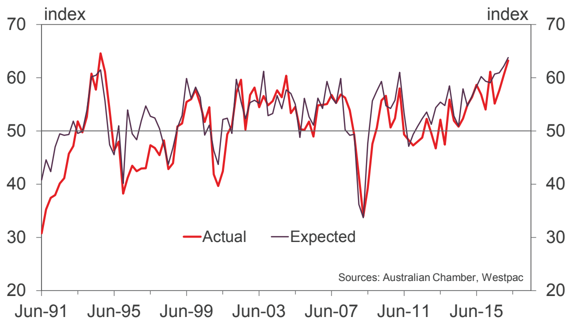
AusChamber-Westpac survey of Industrial Trends

Jun 15, Last: 63.0

- The Australian Chamber-Westpac survey of the manufacturing sector provides a timely update on conditions in the sector and insights into economy-wide trends. The Actual Composite tracks household demand, highlighting the key linkages between the consumer, home building and manufacturing. The Q2 survey was conducted post-Budget, during May and early June. In Q1, the Actual Composite rose to 63.0 from 60.5 in September, continuing the rebound from a dip in June to 55.0. Strength is centred on a lift in new orders and output as well as increased overtime and an emerging trend in employment. Manufacturing is benefitting from a recent rise in commercial construction, stronger world growth and the significant improvement in the competitiveness of exporters and import competing firms. However, weaker consumption constrained by low wage growth is a significant headwind.

Consumer Sentiment Index

Westpac-AusChamber Composite indexes. Actual & expected, sa



Aus May Labour Force employment '000

Jun 15, Last: 37.4k, WBC f/c: –5.0k
Mkt f/c: 10.0k, Range: -7.5k to 25.0k

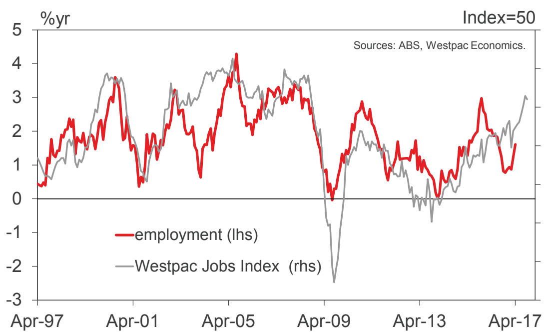
- Total employment increased by 37.4k in April, well above expectations (mkt median and Westpac +5k). The two month jobs gain is now 97.4k. Of course this employment spike, at a 5.0% annualised pace, exaggerates the underlying momentum in the labour market. Over the past year, employment grew by 1.6%, in line with population growth. Full-time fell by 11.6k in April, but that comes after a jump of 73.9k in March. Full-time employment is 1.0% higher over the past year, and part-time is up 3.0%.
- In 2014 the ABS adjusted the supplementary surveys conducted with the April labour force and since then there has been greater than usual uncertainty around the April/May surveys.
- We have tentatively pencilled in a -5k for May but the annual pace of employment growth is underperforming our Jobs Index.

Aus May Labour Force - unemployment %

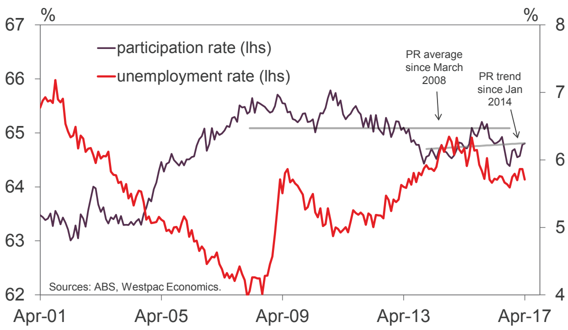
Jun 15, Last: 5.7% WBC f/c: 5.7%
Mkt f/c: 5.7%, Range: 5.6% to 5.8%

- In April the participation rate was steady at 64.8%, after rebounding over recent months, which resulted in a modest 18.3k gain in the labour force. This was somewhat surprising given the strength of the gain in total employment.
- As the gain in employment was greater than the gain in the labour force the unemployment rate printed at 5.71% in April, a moderation from 5.86% in March.
- Give that we see survey volatility as part of the reason for the May negative print for employment we are forecasting the participation rate to ease back to 64.7 from 64.8 which should see a modest 5k decline in the labour force. This decline in the labour force should be enough to hold the unemployment rate flat at 5.7%.

Jobs Index continues to firm



Unemployment and participation rates



The week ahead

UK Mar Bank of England policy decision

June 15, Last: 0.25%, WBC f/c: 0.25%

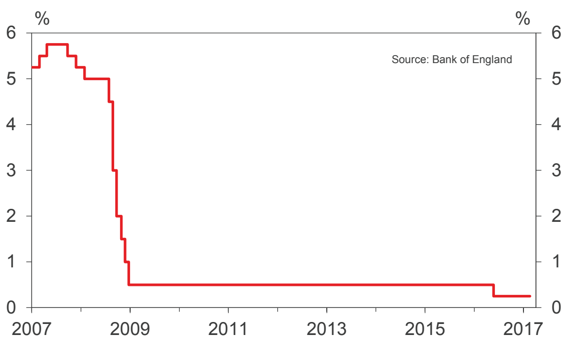
- We expect the MPC will keep the Bank Rate on hold again in June, and that it will leave the asset purchase program unchanged. We also expect the MPC to reiterate that policy could respond in either direction depending on the evolution of economic conditions. However, the accompanying statement is likely to highlight the increased downside risk for the economy.
- The economy has avoided a sharp slowdown thus far. However, conditions in the household sector have softened. In addition, the risks for medium term activity as Brexit looms are to the downside, especially in terms of investment decisions and businesses spending. The less–than–decisive June election result will also add to uncertainty around the outlook. These conditions will see the BOE keeping rates low for some time.

FOMC June policy meeting

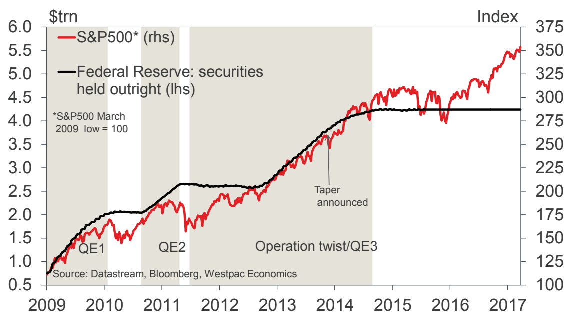
Jun 13-14, fed funds rate Last: 0.875%, WBC 1.125%

- 2017 has seen an acceleration in the pace of interest rate normalisation in the US. Following two years where the Committee struggled to achieve one rate hike, they are targeting three in 2016, with the second universally expected at this meeting.
- A strong labour market and robust confidence are the prime supports for policy normalisation. Core inflation is yet to accelerate to the FOMC's 2.0%yr target, but is anticipated to occur given full employment has been attained and economic growth continues near trend.
- The focus for the press conference will be to see if any further guidance on the timing and pace of balance sheet normalisation is offered. A decision before end-2017 is anticipated.

Bank of England Bank Rate



Monetary policy and risk assets



US May retail sales

Jun 14, Last: 0.4%, WBC 0.2%

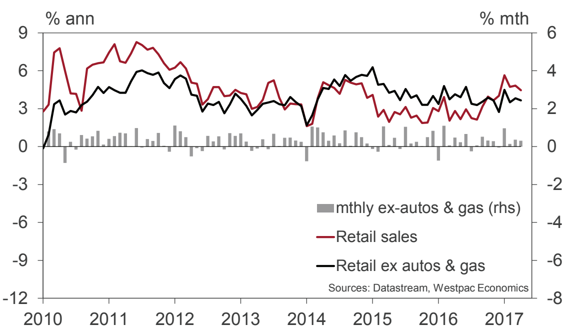
- US retail sales have been disappointing over the past six months, having failed to accelerate. Despite a 1.0% surge in January, over the past six months growth has averaged a modest 0.3%. This comes at a time when the labour market is at full employment and consumer confidence is elevated.
- In recent months, auto sales have surprised to the downside. This suggests pent-up demand for durables (which has aided spending post-GFC) may be coming to an end. There have also been numerous anecdotes of tighter credit standards in this market after a substantial rise in auto debt.
- We look for a 0.2% headline gain, as autos continue to weigh, and a 0.3% rise in core sales.

US May CPI

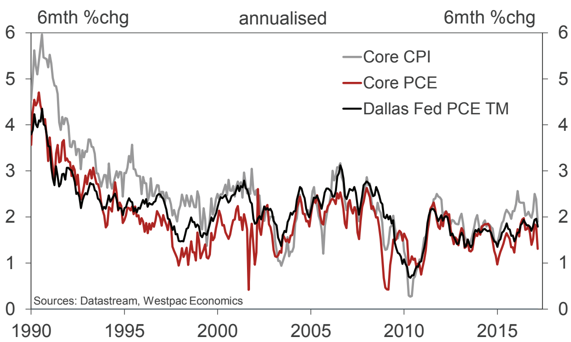
Jun 14, Last: 0.2%, WBC 0.1%

- US CPI inflation surged to a peak of 2.8%yr in February as energy prices declines reversed and core inflation pressures remained robust – most notably rents and health costs. However, since that time, the heat has come out of headline inflation, and it has begun to fall back to the FOMC's 2.0%yr target, printing at 2.2%yr in April. Core inflation is more modest at 1.9%yr.
- Come May, we expect a further narrowing of the gap between headline and core inflation, as the headline measure falls back to 2.0%yr. In the month, a 0.1% gain for prices is anticipated, a negative contribution from energy offsetting half of the anticipated 0.2% rise in core prices. In the remainder of 2017, headline and core CPI inflation should settle at or a little below the FOMC's targe

Retail sales solid but not (yet) strong



Core inflation a little below target



Data calendar

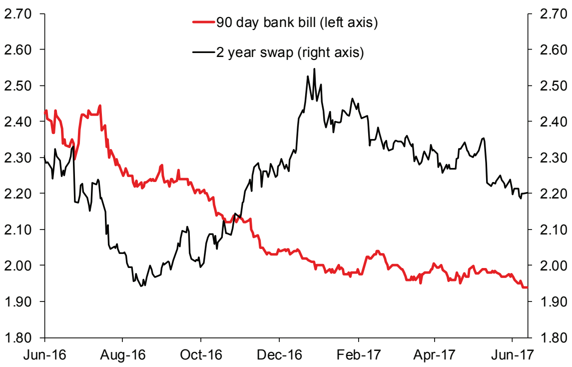
		Last	Market median	Westpac forecast	Risk/Comment
Mon 12					
NZ	May retail card spending	1.1%	–0.1%	–0.1%	Modest pullback after last month's strong gain.
	May REINZ house sales	–4.2%	–	–	Due this week. Turnover has slowed after LVR tightening last July.
	May REINZ house price index, %yr	7.8%	–	–	Annual growth to slow further as prices flatten out.
Aus	Queen's birthday public holiday	–	–	–	Markets closed.
	RBA Deputy Governor Guy Debelle	–	–	–	Global FX Code of Conduct launch, Hong Kong, 6:30pm AEST.
US	May monthly budget statement $bn	–52.5	–91.5	–	Budget benefitting from employment g'th and capital gains.
Tue 13				–	
Aus	May NAB business survey conditions	14	–	–	+2pts to +14, an historically high level, potential for some pull-back.
UK	May CPI	0.5%	0.2%	–	The lower pound is pushing inflation higher.
	Apr house price index, %yr	4.1%	–	–	Uncertainty is continuing to weigh on house prices.
Eur	Jun ZEW survey of expectations	35.1	–	–	Investors very optimistic on growth in Euro Area.
US	May NFIB small business optimism	104.5	105.0	–	Small businesses remain positive on outlook.
	May PPI %yr	2.5%	2.3%	–	Price pressures remain muted down and upstream.
Wed 14					
NZ	May food prices	–0.8%	–	–	Wet weather spike in vege prices will unwind in coming months.
	Q1 current account balance, % of GDP	–2.7%	–2.8%	–3.0%	Weak export volumes, will rebound later this year.
Aus	Jun Westpac–MI Consumer Sentiment	98.0	–	–	Weaker views on family finances a key area of concern.
Chn	May retail sales %yr	10.7%	10.7%	–	Job indicators from PMIs point to softer job/wage gains.
	May fixed asset investment ytd %yr	8.9%	8.8%	–	Private sector investment remains soft.
	May industrial production YTD %yr	6.7%	6.6%	–	PMIs near enough to average levels; robust g'th continues.
UK	Apr ILO unemployment rate	4.6%	4.6%	–	Labour market has been resilient following last year's referendum.
Eur	Apr industrial production	–0.1%	0.5%	–	PMIs indicate robust momentum continuing across region.
US	May CPI %yr	2.2%	2.0%	–	Headline inflation tending to target absent energy pressures.
	May retail sales (advance)	0.4%	0.1%	–	Auto sales have been weighing on retail spending in 2017.
	Apr business inventories	0.2%	–0.1%	–	Remain volatile.
	FOMC policy decision, midpoint	0.875%	1.125%	1.125%	June a near certainty; balance sheet discussion front and centre.
Thu 15					
NZ	Q1 GDP	0.4%	0.7%	0.8%	Rebound in dairy and mining output, soft construction.
Aus	Jun MI inflation expectations	4.0%	–	–	Closely watching to see what the spike in power bills will do.
	May employment	37.4k	10.0k	–5.0k	We suspect issues with seasonality will drive a small decline.
	May unemployment rate	5.7%	5.7%	5.7%	A decline in participation will result in a flat unemployment rate.
	Q2 AusChamber–Westpac bus. survey	–	–	–	Survey of manufacturing firms.
	RBA Deputy Governor Guy Debelle	–	–	–	Speaks at a Reuters event, Sydney, 5.40pm.
Eur	Apr trade balance €bn	23.1	–	–	ECB will be hoping EUR uptrend reverses, given X'pt hopes.
UK	May retail sales	2.3%	–0.7%	–	Rising prices weighing on demand.
	BOE bank rate decision	0.25%	0.25%	0.25%	Inflation rising, but growing concern around domestic activity.
US	May import price index	0.5%	–0.1%	–	Firming of import prices likely in months ahead given USD fall.
	Jun Fed Empire state index	–1.0	5.0	–	Manufacturing strong, though regions showing mixed results.
	Initial jobless claims	245k	–	–	At historically low level.
	Jun Phily Fed index	38.8	25.0	–	Very strong level, set to pull back.
	May industrial production	1.0%	0.1%	–	Hard data hasn't shown as much strength as surveys.
	Jun NAHB housing market index	70	70	–	Home builders very positive on outlook.
Fri 16					
NZ	May BusinessNZ manufacturing PMI	56.8	–	–	Business sector conditions remain healthy.
Eur	May CPI %yr (final)	1.9%	1.4%	–	Underlying inflation trend still very soft in Europe.
US	May housing starts	–2.6%	4.3%	–	Starts activity looks to be plateauing…
	May building permits	–2.5%	1.8%	–	… as does permits, but level to be maintained.
	Jun Uni. of Michigan sentiment (prel.)	97.1	97.1	–	Consumers positive thanks to labour market.
	Fedspeak	–	–	–	Kaplan speaks to Park Cities Rotary Club in Dallas.

New Zealand forecasts

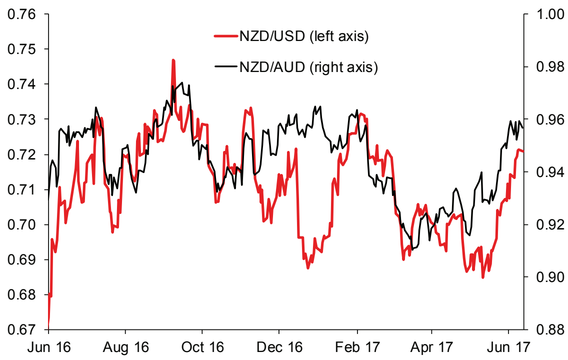
Economic Forecasts	March years				Calendar years			
% change	2015	2016	2017f	2018f	2015	2016	2017f	2018f
GDP (Production) ann avg	3.4	2.4	3.0	3.0	2.5	3.1	2.9	3.1
Employment	3.2	2.0	5.7	1.9	1.4	5.8	2.7	1.8
Unemployment Rate % s.a.	5.4	5.2	4.9	4.5	4.9	5.2	4.4	4.4
CPI	0.3	0.4	2.2	1.3	0.1	1.3	1.8	1.8
Current 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 Monday 12 June 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.85%	1.87%	1.88%
60 Days	1.89%	1.91%	1.93%
90 Days	1.94%	1.97%	1.98%
2 Year Swap	2.20%	2.22%	2.21%
5 Year Swap	2.69%	2.72%	2.79%

NZ foreign currency mid-rates as at Monday 12 June 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7209	0.7051	0.6860
NZD/EUR	0.6430	0.6312	0.6273
NZD/GBP	0.5668	0.5508	0.5322
NZD/JPY	79.52	78.46	77.63
NZD/AUD	0.9568	0.9479	0.9279
TWI	77.79	76.55	74.93

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	2.40	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	2.19	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	0.7538	0.73	0.73	0.73	0.72	0.69	0.68	0.65
USD/JPY	110.13	114	115	116	119	120	122	122
EUR/USD	1.1205	1.08	1.07	1.05	1.03	1.02	1.00	1.00
AUD/NZD	1.0452	1.07	1.07	1.07	1.07	1.05	1.05	1.03

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