

Weekly Commentary

19 June 2017



Coming up short again

The New Zealand economy grew by 0.5% in the March quarter, which was softer than market and RBNZ forecasts. This is the second consecutive quarter that GDP has underwhelmed, following December quarter growth of 0.4%. Although this growth profile seems lacklustre, we expect this softness to be temporary. Looking ahead, we expect solid growth over the next few years but with a change in composition of the key drivers, as the growth phase we have experienced over the past few years matures.

The main drivers of growth in the March quarter were largely as expected. Agricultural production rose by 4.3%, underpinned by a 7.5% pickup in dairy production. This will pass through to firmer conditions rural regions in terms of improved spending and labour demand. In addition, the rebound in milk volumes also provided a lift to food manufacturing and is set to boost exports in the next quarter. In other areas, retail spending rose by 1.9% which was interesting given the recent evidence of the slowing housing market.

On the downside, the March quarter saw sharp declines in construction and transport services, both of which were down around 2%. We think these movements were largely transitory, so we're inclined to bump up our forecast for June quarter growth. The large pipeline of planned work nationwide will sustain the construction industry for many years, and the fact that employment in the sector rose strongly over the last two quarters doesn't suggest the sector is slowing. Similarly, on transport services, we expect that the decline will not be sustained, but we aren't as confident about the timing of a rebound.

Quarterly GDP is inherently volatile, and strongly influenced by short-term movements in particular sectors. But even if we smooth through the quarterly surprises, the broader picture remains that, outside of population growth, the economy is growing at a very muted pace. Indeed, per capita GDP growth has remained subdued for some time,

and is not expected to accelerate significantly at this point in the cycle.

While growth has been soft recently, we continue to expect that it will remain around 3% through this year and next. However, the drivers of growth are shifting. Over the past few years, growth has been strongly linked to gains in the housing market and the related increases in household spending. As discussed below, momentum in the housing market has now dissipated, especially in Auckland. Nevertheless, activity continues to be supported by strong population growth and ongoing construction activity. In addition, the outlook for the export sector has firmed, and fiscal policy is set to become more expansionary.

Housing market

The REINZ house price index showed that nationwide house price growth slowed to 5% in the year to May. This follows the tightening in loan-to-value restrictions last year, and the continued creep higher in mortgage rates.

However, there are some important regional differences. The slowdown has been centred on Auckland, where house prices have gone from flat to outright falling. This trend may seem surprising given the demand and supply pressures in the market. There is currently a shortage of around 37,000 homes in Auckland, compounded by land availability restrictions and rapid population growth.

Coming up short again continued

Our view is that much of the rise in Auckland property values over recent years was driven by the land component, which in turn reflects the value of the homes that could be built on that land in the future. It may be that the slow pace of building and rising construction costs are now undermining the perceived development value of land.

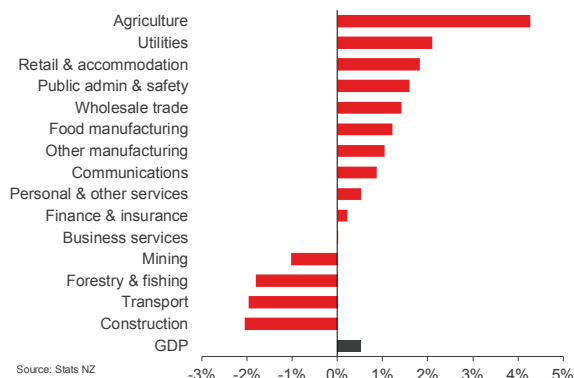
Outside Auckland, house prices rose by 11% over the past year. While still strong, that is down on the levels seen earlier in the year, and we expect a further moderation over the coming months.

Consumer spending typically has a strong link to house values in New Zealand, as housing makes up a large proportion of household wealth. Consumer spending has held up so far, rising 4.7% in the year to March. But as the housing market slowdown progresses, we expect spending growth to moderate to be more in line with income growth.

OCR preview

With GDP growth coming in significantly lower than the RBNZ's expected result, the market will be holding out for guidance from this Thursday's OCR statement. In its May *Monetary Policy Statement*, the RBNZ put a lot of emphasis on the softer than expected GDP growth over the second half of 2016. In its view, the softer starting point meant a slower return to full capacity and a more delayed pick-up in inflation pressures. The first quarter's GDP result, which once again fell significantly short of the RBNZ's forecast, will only reinforce the RBNZ's view that the need for interest rate hikes is a long way off.

Q1 GDP changes by sector

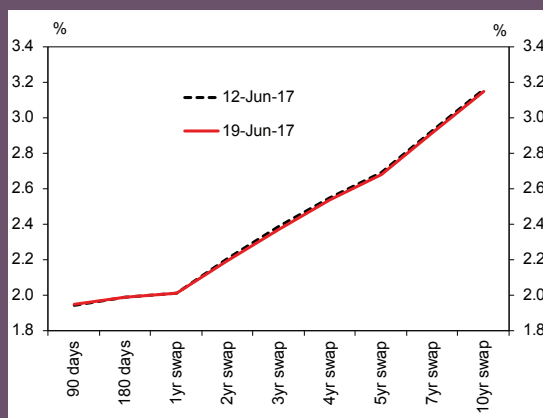


Fixed vs Floating for mortgages

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 Westpac McDermott Miller Consumer Conf.

Jun 19, Last: 111.9

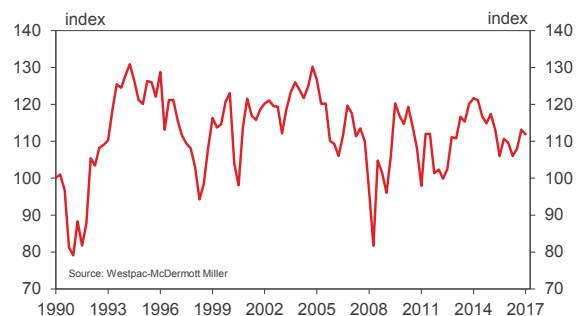
- The Westpac McDermott Miller Consumer Confidence survey edged back in the March quarter, falling 1.2 points. Given normal quarter-to-quarter volatility, and the soggy summer weather, that was a fairly small fall. And after gains in the previous two quarters, it still left confidence in the households sector at around average levels.

RBNZ OCR review

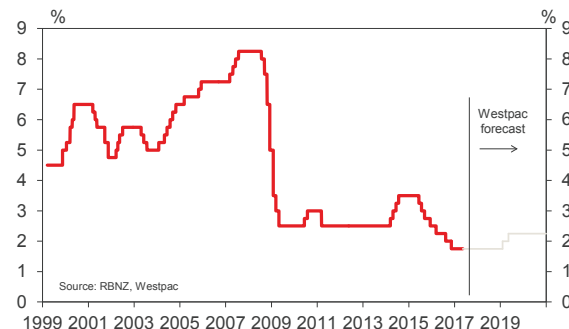
Jun 22, last: 1.75%, Westpac f/c: 1.75%, Market f/c: 1.75%

- We expect the Reserve Bank to hold the OCR at 1.75% and to maintain a neutral outlook for interest rates.
- In its May review the RBNZ regarded the recent jump in inflation as temporary, and noted that the softer than expected starting point for the economy would mean a more gradual lift in domestic inflation pressures. Recent developments will only bolster those views.
- There is a risk that next week's statement may emphasise the equal likelihood of rate cuts or hikes. That could rattle financial markets, which are largely focusing on rate hike scenarios.

Westpac-McDermott Miller consumer confidence



NZ Official Cash Rate

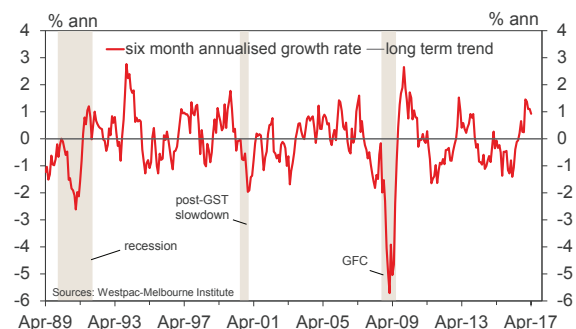


Aus May Westpac-MI Leading Index

Jun 21, Last: 0.92%

- The six month annualised growth rate in the Leading Index, a guide to the pace of economic activity three to nine months into the future, slipped from 1.11% in March to 0.92% in April. Despite the moderation, the index continues to point to above trend growth momentum.
- Components look to have been mixed in May. On the weak side: the ASX200 fell -3.4% vs 1% last month; the Westpac-MI Consumer Expectations Index was down -3.2% vs 0.5% last month; US industrial production was flat vs 1.1% last month; commodity prices fell -4.5% (in AUD terms) vs -2.9% last month; and the Westpac-MI Unemployment Expectations Index reversed last month's modest improvement. Against this, dwelling approvals rose 5.6% vs -13.4% last month and total hours worked posted a strong 1.9% gain.

Westpac-MI Leading Index



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 19					
NZ	Q2 Westpac-MM Consumer Confidence	111.9	-	-	Despite easing last quarter, confidence remains at firm levels.
	May BusinessNZ PSI	52.8	-	-	Expected to recover after last month's unexpected sharp decline.
Aus	RBA Governor speaking	-	-	-	Panel, Crawford Leadership Forum, Canberra 9.30 am AEST.
	May new vehicle sales	0.3%	-	3.0%	Strong month, weather a dampener in Apr?
Chn	May property prices	-	-	-	Will deceleration in tier-1 spread to tier-2 and 3?
UK	Jun Rightmove house prices	1.2%	-	-	Tight supply and low rates balanced against economic uncertainty.
US	Fedspeak	-	-	-	Dudley holds business roundtable discussion in Plattsburgh, NY.
Tue 20					
NZ	Jun ANZ consumer confidence	1.8%	-	-	Points to continued firmness in consumer activity.
Aus	RBA minutes	-	-	-	Firmly on hold - update on view on labour market and housing.
	Q1 house price index	4.1%	2.2%	0.5%	More timely measures suggest price growth started to slow in Q2.
Eur	Apr ECB current account, €bn	34.1	-	-	Remains in surplus but Euro appreciation will affect later months.
US	Q1 current account balance, \$bn	-112.4	-124.9	-	Expected to widen but data is dated.
	Fedspeak	-	-	-	Evans speaks on the economy and monetary policy at NYU.
	Fedspeak	-	-	-	VC Fischer and Rosengren at Amsterdam macroprudential conference.
Wed 21					
NZ	GlobalDairyTrade auction	0.6%	-	-	Dairy futures pointing to flat result, due to end of season volumes.
Aus	May Westpac-MI Leading Index	0.92%	-	-	Still comfortably above trend but losing a bit of altitude.
UK	May public sector borrowing £bn	9.6	-	-	The slowdown in growth will challenge public finances.
US	May existing home sales	-2.3%	-0.4%	-	Supply reportedly a big issue in existing market.
Thu 22					
NZ	RBNZ Official Cash Rate decision	1.75%	1.75%	1.75%	OCR to remain on hold, reflecting longer-term inflation outlook.
	May net migration	5780	-	5700	While still very strong, net inflows have levelled off.
US	Initial jobless claims	237k	-	-	At historic lows.
	Apr FHFA house prices	0.6%	-	-	Price momentum robust.
	May leading index	0.3%	0.4%	-	Trend growth continues.
	Jun Kansas City Fed index	8	-	-	Pointing to moderate growth, underperforming other measures.
	Fedspeak	-	-	-	Powell at Senate Banking Comm. hearing on economic growth.
Fri 23					
Eur	Jun Consumer confidence (advance)	-3.3	-3.0	-	To remain buoyant.
	Jun Markit manufacturing PMI (flash)	57.0	56.7	-	Momentum across the region in strong shape...
	Jun Markit services PMI (flash)	56.3	56.2	-	... across services as well as manufacturing...
Ger	Jun Markit manufacturing PMI (flash)	59.5	59.0	-	... led by German manufacturing...
	Jun Markit services PMI (flash)	55.4	55.4	-	... but services tracking at an even pace.
US	Jun Markit manufacturing PMI (flash)	52.7	53.0	-	Manufacturing index fell to eight month low...
	Jun Markit service PMI (flash)	53.6	-	-	... as services index rose to four month high.
	May new home sales	-11.4%	5.5%	-	Builders very optimistic on outlook.
	Fedspeak	-	-	-	Bullard speaks on the economy and policy in Nashville.
	Fedspeak	-	-	-	Mester at summit on Housing, Human Capital and Inequality.
	Fedspeak	-	-	-	Powell at symposium on central clearing and liquidity.

New Zealand forecasts

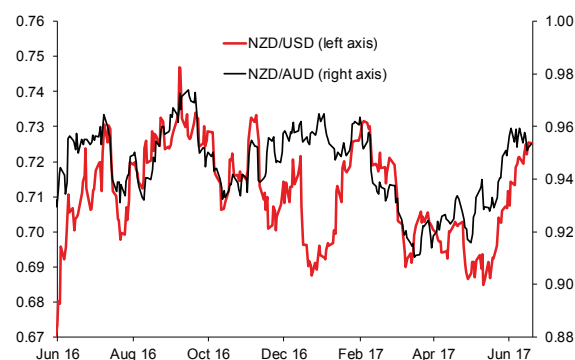
Economic Forecasts	2017				Calendar years			
	% change	Mar (a)	Jun	Sep	Dec	2015	2016	2017f
GDP (Production) ann avg	0.5	1.0	0.9	0.7	2.5	3.1	2.8	3.2
Employment	1.2	0.3	0.5	0.5	1.4	5.8	2.5	1.9
Unemployment Rate % s.a.	4.9	4.9	4.6	4.4	4.9	5.2	4.4	4.5
CPI	1.0	0.2	0.4	0.2	0.1	1.3	1.8	1.9
Current Account Balance % of GDP	-3.1	-3.1	-3.1	-3.2	-3.4	-2.8	-3.2	-3.3

Financial Forecasts	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-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	2.15
2 Year Swap	2.30	2.35	2.40	2.45	2.50	2.60
5 Year Swap	2.90	3.00	3.10	3.20	3.30	3.40
10 Year Bond	3.15	3.30	3.50	3.70	3.80	3.85
NZD/USD	0.71	0.70	0.69	0.67	0.66	0.65
NZD/AUD	0.96	0.96	0.96	0.97	0.97	0.97
NZD/JPY	79.5	79.8	78.7	77.1	76.6	76.1
NZD/EUR	0.65	0.65	0.66	0.65	0.65	0.64
NZD/GBP	0.56	0.56	0.56	0.54	0.54	0.54
TWI	77.8	77.5	77.1	75.9	75.4	74.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 19 June 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.86%	1.85%	1.87%
60 Days	1.89%	1.89%	1.92%
90 Days	1.95%	1.95%	1.98%
2 Year Swap	2.20%	2.21%	2.23%
5 Year Swap	2.68%	2.70%	2.76%

NZ foreign currency mid-rates as at Monday 19 June 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7253	0.7140	0.6925
NZD/EUR	0.6470	0.6342	0.6186
NZD/GBP	0.5681	0.5532	0.5331
NZD/JPY	80.45	78.87	76.87
NZD/AUD	0.9536	0.9535	0.9293
TWI	78.12	77.06	75.01

International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016	2017f	2018f
Australia						
Real GDP % yr	2.1	2.8	2.4	2.5	2.3	3.0
CPI inflation % annual	2.7	1.7	1.7	1.5	2.0	2.3
Unemployment %	5.8	6.2	5.8	5.7	5.7	6.2
Current Account % GDP	-3.4	-3.0	-4.7	-2.7	-1.7	-3.3
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	4.4	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	1.1	1.0
Euroland						
Real GDP %yr	-0.3	0.9	1.6	1.7	1.8	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 June 2017

Interest Rate Forecasts	Latest	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.72	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.41	2.75	2.85	3.05	3.20	3.35	3.30	3.15
International								
Fed Funds	1.125	1.375	1.375	1.625	1.625	1.875	1.875	1.875
US 10 Year Bond	2.17	2.55	2.65	2.90	3.10	3.30	3.30	3.15
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.30

Exchange Rate Forecasts	Latest	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
AUD/USD	0.7589	0.74	0.73	0.72	0.69	0.68	0.65	0.67
USD/JPY	111.11	112	114	114	115	116	116	118
EUR/USD	1.1144	1.10	1.08	1.05	1.03	1.02	1.01	1.00
AUD/NZD	1.0515	1.04	1.04	1.04	1.03	1.03	1.03	1.05

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