

Weekly Commentary

22 May 2017



People power

Recent developments have highlighted the strength in economic conditions through the first half of the year. We expect that economic growth will continue ticking along at around 3% per annum for the next few years. However, the drivers of growth will shift over time.

Rapid population growth and record tourist inflows have provided a powerful boost to demand in the economy over the past few years. And it looks like these factors will continue to support demand for some time yet.

Looking first at population growth, net migration did ease back a little in April with a monthly inflow of 5,800. However, that's still very strong, and the annual inflow of 71,900 people is just shy of the record high reached in March. Strength in net migration has seen our demand base continue to expand, with population growth rising to more than 2% per annum. That's some of the fastest growth we've seen since the 1970s, and a rapid pace for any developed economy. We expect net migration will remain firm for some time yet, though it does look like the annual inflow has reached a plateau.

Looking to the next couple of years, we expect net migration will start to ease off as the global economy improves and more New Zealanders start to look at moving offshore. Nevertheless, this eventual easing in migration looks like it will be quite gradual.

New Zealand's economic conditions remain relatively positive. In addition, recent policy changes in Australia - the main destination for New Zealanders travelling abroad - are likely to encourage more New Zealanders to stay onshore. These include levies on international workers in Australia and increases in tertiary education costs for New Zealanders studying across the ditch.

Turning to tourism, the past year saw a record 3.6 million international visitors. That's up 10% over the past year, with strong growth in visitor numbers from the Americas, Europe and Asia. This has added to demand in a range of sectors, with the boost to activity spread across the regions. We expect tourist flows will remain strong for some time, reflecting growing international appetites. Events like the Lions tour will reinforce the demand outlook.

The combination of strong population growth and strong tourist inflows have given spending in the economy a powerful shot in the arm. That was reflected in the latest retail trade figures, which showed that spending was up a solid 1.5% in the March quarter. Much of this was the result of a very large increase in motor vehicle sales. However, there were gains in most categories, with core spending up 1.2% over the quarter.

Strength in economic activity isn't just because of 'people power'. The outlook for rural incomes has also improved as prices for our key commodity exports have lifted. The largest gains have been for the prices of dairy exports, which are up around 60% since this time last year. In light of the continued gains in prices, we've bumped up our forecast for the 2017/18 dairy payout to \$6.50/ kgMS (from \$6.10/kgMS previously). That will be a step-up from the \$6/kgMS milk price expected for the season just finishing, and substantially higher than the \$3.90/kgMS payout last season. That will further shore up sentiment within the industry and support spending in dairy-intensive regions.

People power continued

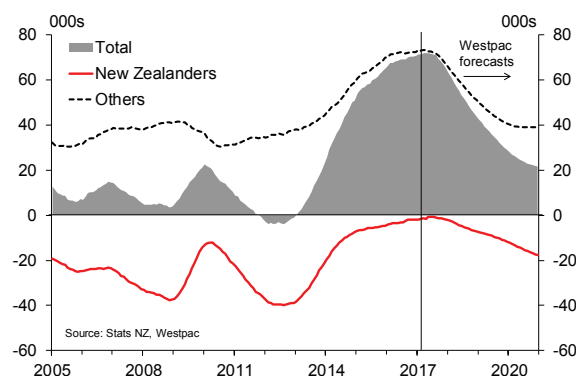
World prices for beef and lamb have also strengthened in recent months to be well up on a year ago. Higher prices reflect improved demand in key markets, but the biggest boost has been from constrained supply from New Zealand and Australia. As such, recent price gains are expected to unwind over the coming year as supply improves.

Putting the above factors together points to continued momentum in activity through mid-2017.

However, while there are a range of positives supporting economic activity, there are also some mounting headwinds. One of the most important that we've highlighted before is the rise in interest rates and related slowdown in the housing market. These developments will weigh on household spending as we go into the back half of 2017, and consequently will dampen GDP growth.

Nevertheless, GDP growth is expected to remain resilient over the next few years. In addition to firmness in export sectors, there is a large pipeline of construction work. And on top of this, the upcoming Budget is likely to signal a shift to more expansionary fiscal policy over the coming years, especially with the general election in September. The incumbent National-led government has already announced a sizeable increase in infrastructure spending, and has hinted that an adjustment in tax thresholds is on the cards. It's likely that we'll see additional new spending announced when the Budget is released on Thursday.

NZ net migration, annual

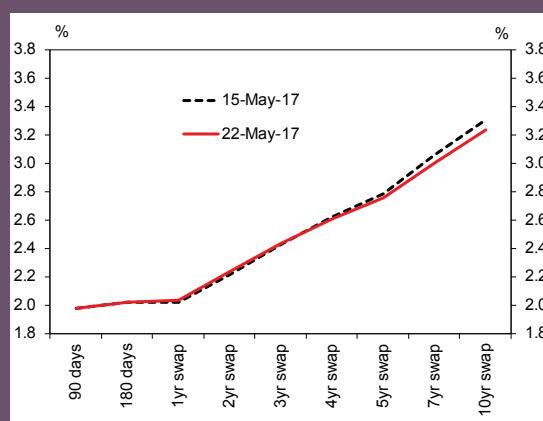


Fixed vs Floating for mortgages

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



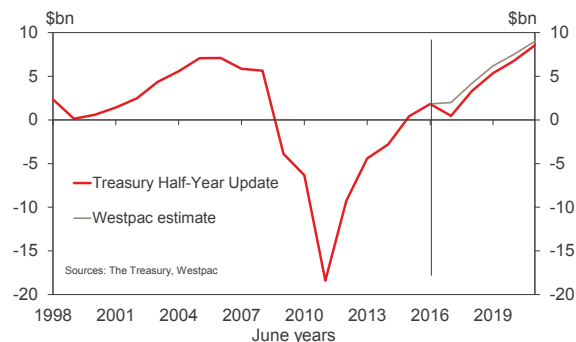
The week ahead

NZ Budget 2017

May 25

- The Half-Year Update in December forecast a narrower surplus of \$473m for the June 2017 year, after allowing for the costs of the Kaikoura earthquake. The fiscal accounts have been tracking much stronger than forecast since then, on both lower costs and higher tax revenue. We expect a full-year surplus of around \$2bn.
- The improving fiscal position leaves scope for additional spending commitments, particularly ahead of the election in September. Changes to income tax thresholds have also been mooted.
- Outside the operating balance, the Government has also announced a \$2bn increase in its capital spending allowance, in response to stronger than expected population growth.

Operating balance (excluding gains and losses)



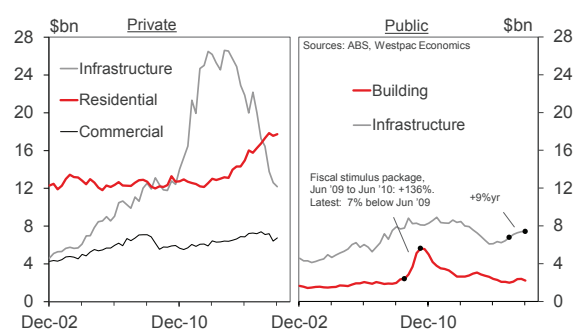
Aus Q1 construction work

May 24, Last: -0.2%, WBC f/c: -0.2%

Mkt f/c: -0.5%, Range: -2.0% to 0.7%

- Construction activity weakened over the past three years as the downturn in private infrastructure (centred on mining) outweighed gains elsewhere. In 2016, construction work fell by 7.8%, although the rate of decline moderated in Q4, to a fall of only 0.2%. For March 2017, we anticipate another small fall, of -0.2%, mindful that wet weather in the month of March was a constraint.
- Public works (20% of the total) should be a positive, led by transport projects, increasing by a forecast 3%.
- Private infrastructure (25% of the total) is expected to report a solid (but not rapid) fall, as work on gas projects winds down.
- Private building activity advances by a forecast 0.6%, with gains for both residential and non-residential.

Construction work: divergent trends

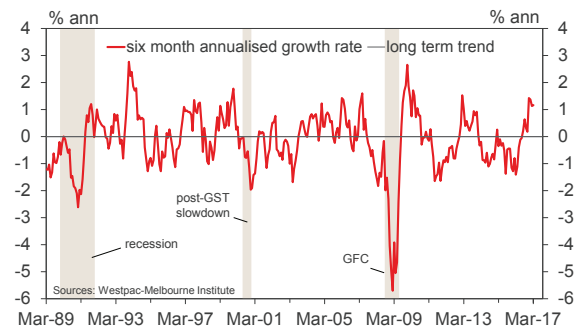


Aus Apr Westpac-MI Leading Index

May 24, Last: 1.17%

- The Leading Index continues to point to above trend growth momentum. The six month annualised growth rate in the Index, a guide to the pace of economic activity three to nine months into the future, rose from 1.14% in February to 1.17% in March.
- The Apr read will include positive updates on: the ASX200, up 1% vs 2.7% last month; the Westpac-MI Consumer Expectations Index, up 0.5% vs -2.2% last month; US industrial production, up 1% vs 0.4% last month; and the Westpac-MI Unemployment Expectations Index, down -3.4% vs 1.8% last month. This looks likely to be outweighed by negative updates on commodity prices (-2% in AUD terms); dwelling approvals (-13.4% vs +8.9% last month); and the yield spread, which narrowed 23bps vs a 5bp widening last month.

Westpac-MI Leading Index



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 22					
Aus	RBA Debelle speaks	-	-	-	'How I learned to stop worrying and love the basis' at BIS.
UK	May Rightmove house prices	1.1%	-	-	Uncertainty weighing on prices, esp. in London.
US	Apr Chicago Fed activity index	0.08	-	-	Growth remains stuck around trend.
	Fedspeak	-	-	-	Harker speaks on economic wellbeing to health professionals.
	Fedspeak	-	-	-	Kashkari gives brief welcoming remarks, followed by press brief.
Tue 23					
Eur	May Markit manufacturing PMI (flash)	56.7	56.5	-	External and domestic demand robust...
	May Markit services PMI (flash)	56.4	56.4	-	... giving broad-based support to industry.
Ger	May IFO business climate survey	112.9	113.1	-	Activity very strong; confidence also robust.
	May Markit manufacturing PMI (flash)	58.2	58.0	-	Very efficient industry and the benefit of the Euro...
	May Markit services PMI (flash)	55.4	55.5	-	... to see strong momentum sustained.
UK	Apr public sector borrowing £bn	4.4	-	-	Slower growth is hampering progress on public borrowing.
US	Apr new home sales	5.80%	-1.0%	-	Home builders very positive on buyer appetite.
	May Richmond Fed index	20	15	-	Held up better than expected last month; very positive.
	May Markit manufacturing PMI (flash)	52.8	53.4	-	Markit surveys have gone against the grain of late..
	May Markit service PMI (flash)	53.1	-	-	... signalling softer momentum than ISMs, etc.
	President Trump budget proposal	-	-	-	Cuts to education; housing; and welfare to fund lower taxes.
	Fedspeak	-	-	-	Brainard speaks on role of inclusion in strengthening economy.
	Fedspeak	-	-	-	Evans speaks privately on OTC derivatives, 58th Shanghai forum.
	Fedspeak	-	-	-	Kashkari holds media Q&A and later discusses home ownership.
	Fedspeak	-	-	-	Harker speaks on economic outlook at Harvard club of NY.
Wed 24					
NZ	Apr trade balance \$mn	332	233	310	Higher dairy prices support export receipts and trade balance.
Aus	Apr Westpac-MI Leading index	1.17%	-	-	Commodity price surge contributing about 1ppt to headline.
	Q1 construction work	-0.2%	-0.5%	-0.2%	Rate of decline moderating, gains in public works.
US	FOMC April minutes	-	-	-	Fed set to hike in June.
	Mar FHFA house prices	0.8%	-	-	Robust gains for prices continue.
	Apr existing home sales	4.4%	-0.7%	-	Low rates still providing benefit to sector.
	Fedspeak	-	-	-	Kaplan speaks at a C.D. Howe Institute Annual Directors' dinner.
	Fedspeak	-	-	-	Kashkari to participate in a "town hall" in Ashland, Wisconsin.
Can	Bank of Canada policy decision	0.5%	0.5%	-	Growth firming gradually, but inflation still muted.
Thu 25					
NZ	Budget 2017	-	-	-	FinMin likely to signal boosts to spending ahead of Sept election.
Eur	ECB Draghi speaks	-	-	-	ECB President Draghi speaks in Madrid.
UK	Q1 GDP	0.30%	-	0.30%	Softness in household spending a drag.
US	Apr wholesale inventories	0.20%	-	-	To remain a swing factor for GDP in 2017.
	Initial jobless claims	232k	-	-	Very low.
	May Kansas City Fed index	7	-	-	Exuberance receded in April; less +ve than other surveys.
	Apr goods trade bal. \$bn (advance)	-64.2	-64.0	-	Trade deficit slightly higher in 2017.
	Fedspeak	-	-	-	Brainard in a panel discussion on the global economy in D.C.
Fri 26					
US	Q1 GDP (second estimate)	1.7%	0.9%	1.0%	Q1 weak, but growth likely to bounce in Q2.
	Apr durable goods orders (prelim.)	0.9%	-1.8%	-1.0%	Underlying investment trend soft despite confidence.
	May Uni. of Michigan sentiment (pre.)	97.7	97.5	-	To be affected by uncertainty in Washington?
	Fedspeak	-	-	-	Bullard speaks on U.S. economy & monetary policy in Tokyo.
Sat 27					
Chn	Apr industrial profits %oyr	23.8%	-	-	Being aided by commodity prices.
Sun 28					
US	Fedspeak	-	-	-	Williams gives keynote on Asian banking & finance in Singapore.

New Zealand forecasts

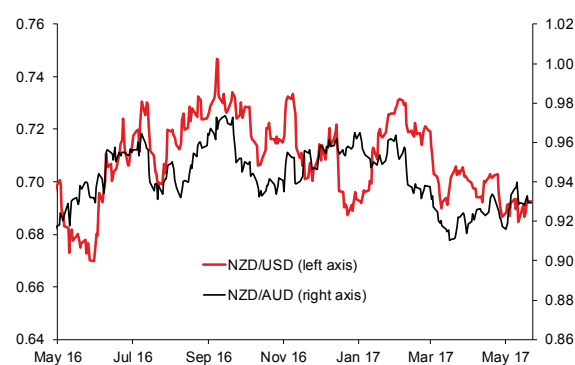
Economic Forecasts	March years				Calendar years				
	% change	2015	2016	2017f	2018f	2015	2016	2017f	2018f
GDP (Production) ann avg		3.4	2.4	3.1	3.3	2.5	3.1	3.2	3.4
Employment		3.2	2.0	5.7	1.9	1.4	5.8	2.7	1.8
Unemployment Rate % s.a.		5.4	5.2	4.9	4.5	4.9	5.2	4.4	4.4
CPI		0.3	0.4	2.2	1.5	0.1	1.3	2.0	2.1
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	2.50	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 22 May 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.87%	1.85%	1.83%
60 Days	1.92%	1.91%	1.89%
90 Days	1.98%	1.98%	1.95%
2 Year Swap	2.23%	2.33%	2.35%
5 Year Swap	2.76%	2.93%	2.90%

NZ foreign currency mid-rates as at Monday 22 May 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6925	0.6905	0.7047
NZD/EUR	0.6186	0.6272	0.6513
NZD/GBP	0.5331	0.5318	0.5493
NZD/JPY	76.87	77.98	77.86
NZD/AUD	0.9293	0.9321	0.9302
TWI	75.01	75.35	76.67

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	2.48	2.75	2.95	3.05	3.15	3.25	3.40	3.40
International								
Fed Funds	0.88	1.125	1.125	1.375	1.625	1.625	1.875	1.875
US 10 Year Bond	2.24	2.55	2.75	2.85	3.00	3.10	3.30	3.30
ECB Deposit Rate	0.00	-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	0.7425	0.73	0.73	0.73	0.72	0.69	0.68	0.65
USD/JPY	111.46	114	115	116	119	120	122	122
EUR/USD	1.1113	1.08	1.07	1.05	1.03	1.02	1.00	1.00
AUD/NZD	1.0784	1.07	1.07	1.07	1.07	1.05	1.05	1.03

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