



Weekly Commentary

1 July 2013

Pivot points

Markets have spent the last week mulling over the US Federal Reserve's signal that it could start slowing its rate of asset purchases later this year, but with no real resolution. In fact, the New Zealand dollar and domestic interest rates are much where they were in the immediate wake of the Fed's statement.

In light of the recent market movements we have made some changes to our global financial forecasts, marking down the outlook for the NZ dollar in the near term and nudging long-term interest rates higher (our OCR forecast is unchanged). However, we don't believe that the turning point for exchange rates has arrived yet. Our view remains that the pace of recovery in the US will continue to disappoint, and as a result quantitative easing won't be 'tapered' as quickly or smoothly as the market is currently factoring in.

Nevertheless, now that the Fed has opened the door to tapering, the issue is not going to go away. So while we expect the US dollar to retrace some of its recent gains, it's unlikely to return all the way to the levels that we previously forecast. Similarly, we expect the NZD to climb back to 83 cents against the USD by year-end, but then edging down again to average 81c over 2014 (previously 83c).

If the currency's recent decline proves temporary, as we expect, then the implications for inflation and interest rates will be limited. Inflation will be higher in the near term of course, but not to a great degree, and it comes at a time when inflation is already at the low end of the RBNZ's target band. A sustained fall in the NZD would have more serious implications for monetary policy – but only time will tell if that's what we're facing.

The RBNZ certainly seems to be unmoved by the currency's recent decline – even intervening in May to buy back some of the NZ dollars that it sold in April. And a speech last week by Deputy Governor Spencer made it clear that the RBNZ is still fearful of driving the NZD higher again if it raised interest rates in response to the hot housing market.

That apparent dilemma has left the RBNZ "seriously considering the use of macro-prudential policy" – although having now declared the housing market "a real threat to future financial stability", it doesn't sound like there's anything more to consider. Restrictions on home loans with high loan-to-value ratios (LVRs) are now the macro-prudential tool of choice, as they would

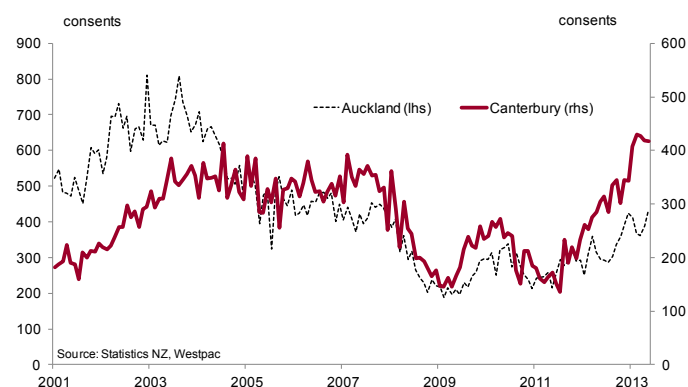
be relatively more effective at leaning against the housing market upturn (the other tools on offer are more focused on strengthening banks' balance sheets). There are a number of issues with implementation to be worked out, but the RBNZ is moving this process forward quickly and we suspect they will be ready to act within the next few months.

Our view is that macro-prudential tools such as LVR restrictions only address the symptoms of a hot housing market, not the underlying causes, whatever they may be (the RBNZ says that "limited housing supply is at the heart of the problem"; we put more emphasis on low interest rates). For that reason, we don't hold out much hope that they offer a solution to housing booms, nor that they can ever really be used in a cyclical manner. The track record of LVR restrictions overseas has generally been one of successive tightenings over the course of several years; instances of them being loosened are conspicuously rare.

The case for using macro-prudential tools rests in part on the RBNZ's view that "in the current low inflation environment, interest rate increases are not seen as an appropriate response" to the housing market. Yet that standpoint is being steadily eroded by recent data, which is starting to paint a picture of an economy that is really getting up a head of steam. Last week's releases alone give considerable pause for thought.

Business confidence rose strongly in June, reaching its highest levels since early 2010, when the economy was entering what was – at least initially – a rapid rebound out of recession. Investment

Housing consents, seasonally adjusted





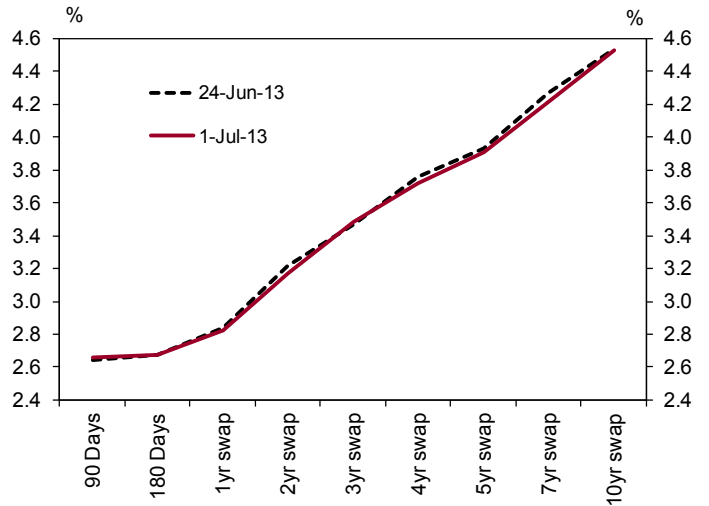
and employment intentions are now well above their long-run averages, hinting that the spare capacity in the economy is being soaked up. Business confidence has been high for some time; the more recent development of note is that pricing intentions are rising again – the rise in June leaves them above their long-term average and at their highest level in two years.

While confidence is strong across the board, the standout is not surprisingly the construction sector, with confidence at its highest since the first Canterbury earthquake (and the second-highest since 1994). That was backed up by May building consents, which rose further after a 21% spike in April. The early Easter seems to have distorted the figures a bit, but they suggest that the underlying trend was even stronger than we thought. The uptrend in consents has been strongest in Canterbury (although the pace seems to have stalled in the last few months) and in Auckland, with builders responding to supply shortages and higher prices in these regions.

Finally, net inward migration accelerated further in May, with the annual balance reaching 6,200 people. The turnaround in the last year has been largely about flows to and from Australia – fewer New Zealanders leaving, and more people (Kiwis and otherwise) coming across the Tasman. Of course this is yet another demand pressure on an already-hot housing market, but it also gives a clear sense of how job opportunities here relative to Australia have shifted over the last year.

Fixed vs floating for mortgages: We favour fixing over floating. Fixed-term rates out to two years are currently well below floating rates, while three-year and longer fixed rates are only slightly higher. Staying on floating would only be the lower-cost option if the RBNZ actually cut the OCR, which we regard as unlikely. In fact, we expect the floating mortgage rate to rise significantly over the 2014 to 2016 period. Wholesale interest rates have risen sharply in recent weeks. If sustained, this could translate into a hike in fixed mortgage rates in the near term.

NZ interest rates



Key Data Previews

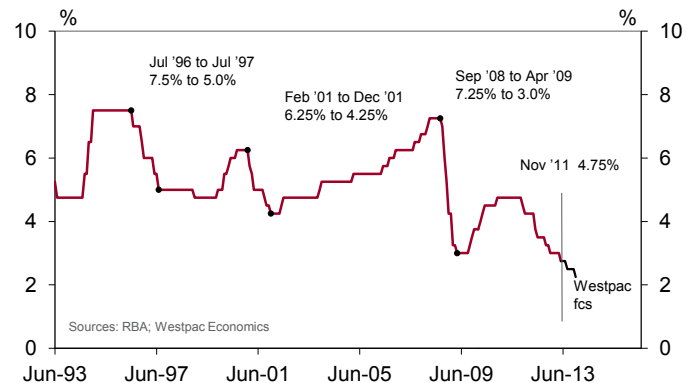
Aus RBA policy announcement

Jul 2, Last: 2.75%, WBC f/c: 2.75%

Mkt f/c: 2.75%, Range: 2.50% to 2.75%

- The minutes to the June monetary policy meeting again highlighted that the RBA maintains an easing bias. Inflation was not seen as a concern, with the focus clearly on activity. On business investment, the minutes downplayed the relatively sanguine forward view presented by the CAPEX survey. However, household spending was thought to be strong in Q1.
- The Q1 national accounts highlighted that the Australian economy is weaker than the RBA anticipated. Household consumption was particularly disappointing, with weaker services consumption offsetting stronger goods demand. Residential investment also disappointed, a decline in renovation work offsetting growth in new dwelling activity. The case for further easing has been made, but we favour an August move given the AUD's depreciation and Q2 CPI timing.

RBA cash rate: easing cycles





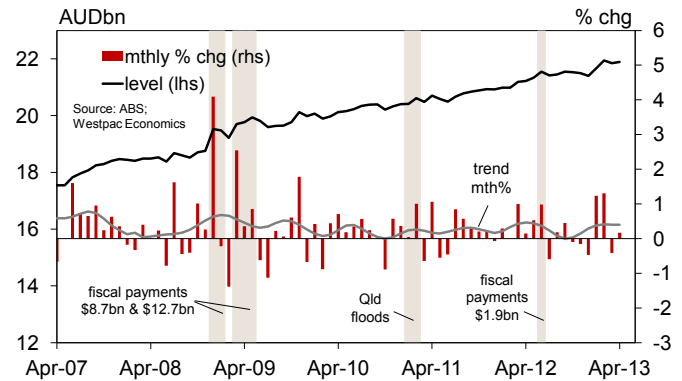
Aus May retail trade

Jul 3, Last: 0.2%, WBC f/c: 0.2%

Mkt f/c: 0.4%, Range: 0.0% to 1.0%

- After bursting out of the blocks in Jan-Feb, retail activity came to a standstill in Mar-Apr, with nominal sales slipping 0.2% over the two months. Consumer sentiment has shown a similar pattern, opening the year with a promising rally which faded badly in Mar-Apr. The Q1 national accounts also showed growth in total spending was much weaker than retail volumes.
- Sentiment fell heavily in May, with Budget concerns and rising job-loss fears triggering a 7% drop into pessimistic territory. Against this, the RBA delivered more relief for mortgagors with a 25bp rate cut while labour markets were relatively stable (although falling hours worked suggest wage incomes are still under pressure). Anecdotal reports point to soft rather than weak conditions. We expect retail sales to show a slight 0.2% gain for May, with downside risks on 'discretionary' items.

Monthly retail sales



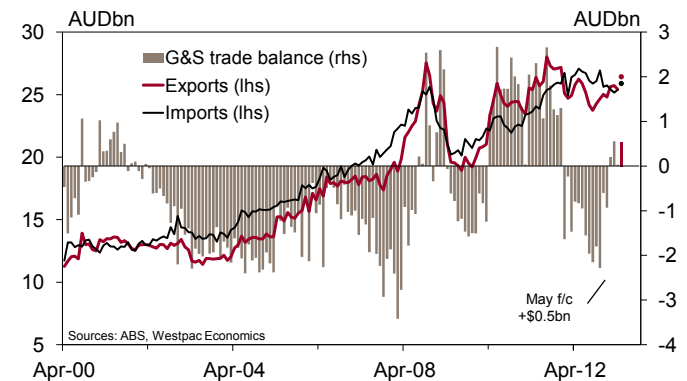
Aus May trade balance, AUDmn

Jul 3, Last: 28, WBC f/c: 500

Mkt f/c: 53, Range: -700 to 500

- Australia's trade balance is expected to improve in May. We anticipate a surplus of around \$500mn following a wafer-thin \$28mn surplus in April (subject to revision).
- Export earnings are forecast to rise by about 4%. Volumes are likely to be up, centred on iron ore, coal and rural goods. Commodity prices weakened in USD terms, but rose around 2% in AUD terms.
- The AUD moved sharply lower in May, falling 4.5% against the USD, and declining 4% on a TWI basis.
- Imports are forecast to rise by around 2%, suggesting a decline in volumes.

Australia's trade position



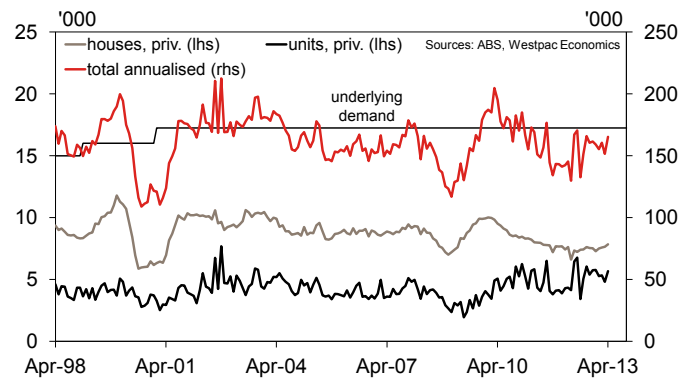
Aus May dwelling approvals

Jul 4, Last: 9.1%, WBC f/c: -1.0%

Mkt f/c: -1.0%, Range: -5.5% to 2.0%

- The housing construction recovery, which began early last year but seemed to lose its way in late 2012/early 2013, showed clearer signs of regaining momentum in Apr. Auction clearance rates surged, and dwelling approvals rose 9.1% to be up 27%yr. Some of that may have been embellished by an 'Easter timing effect' – the Mar timing this year may have contributed to the 5.5% drop in Mar and the subsequent Apr bounce. However, the broader picture from trend approvals and new loans points to a pick-up in momentum.
- We expect this trend to essentially consolidate in May. The signal from auction markets and construction-related finance approvals remains positive. Overall, we expect the aforementioned Easter effect and a shakier consumer sentiment backdrop to see headline approvals dip 1% in May, but this will leave a positive up-trend intact.

Dwelling approvals





US Jun ISM factory and non-manufacturing surveys

Jul 1, Factory: Last: 49.0, WBC f/c: 49.9

Jul 3, Non-man: Last: 53.7, WBC f/c: 53.4

- The orders/shipments detail in the May Philly (very weak) and NY Fed (mildly weak) factory surveys forewarned of the surprise dip to a post-2009 low of 49.0 in the May composite ISM and key sub components. In June, Philly shipments and orders bounced, but in NY, those same components plunged. These mixed results lead us to expect a less-contractionary 49.9 June outcome. Stronger Richmond/Dallas Fed survey detail suggest upside risks to our forecast.
- The ISM non-manufacturing index has averaged 53.4 so far in Q2, down from 55.2 in Q1. In 2011 and 2012, similar (albeit steeper) mid-year slumps occurred, and continued into Q3. Given the pattern seems to be repeating (the market turmoil post FOMC wouldn't have helped), we expect an outcome in line with the 53.4 average fo Q2 to date.

US ISMs



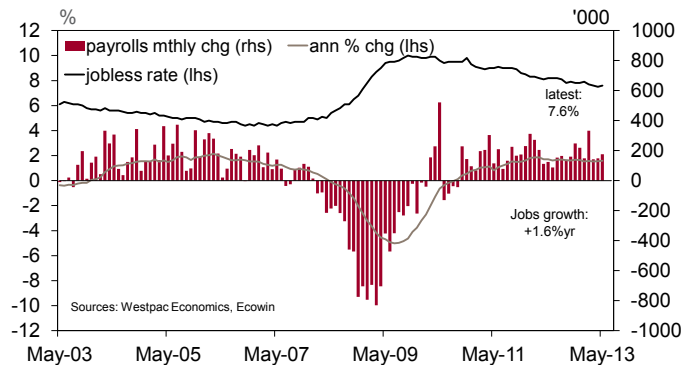
US Jun non-farm payrolls and jobless rate

Jul 5, Payrolls: Last: 175k, WBC f/c: 145k

Jul 5, Unemp rate: Last: 7.6%, WBC f/c: 7.5%

- In 2012, payroll employment growth weakened sharply from 262k in Q1 to 108k in Q2; in April/May this year, payrolls averaged 162k, down from 207k in Q1 2013. This mid-year weakness is observable across many indicators, and indeed in most years during the post-2009 recovery. Our 145k forecast for June is based on the assumption that the pattern holds this year. Some sequester impact and higher initial claims/layoffs in May are also factors that could weigh on payrolls.
- The separate household survey reported a 6k average job LOSS in Q1, but a 306k average gain in Q2 so far. This is because in April/May, job market participation reversed a 630k drop in Feb/Mar, leaving the jobless rate stalled at 7.5–7.6%. Our view is that a further fall in the jobless rate will be slower arriving in the jobs creation/layoff/participation outlook we envisage. The June jobless rate is forecast to round down to 7.5% again.

US payrolls

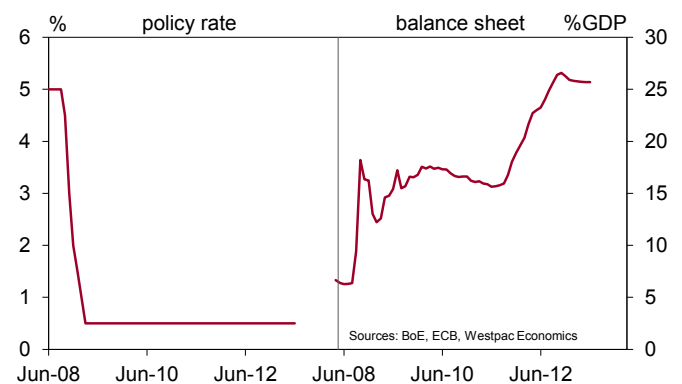


Bank of England: Mark Carney's first MPC

Jul 4, BoE asset purchase plan: Last: £375bn, WBC f/c: £375bn

- Out-going Governor King (and 2 others) argued for further QE at his last five meetings, but the subsequent minutes show they were out-voted each time 6:3. Improved May PMI data for factories, builders and services (expanding together for the first month since last Oct), and solid May retail data (if sustained), could raise expectations that Q2 might better Q1's lacklustre 0.3% growth rate (when consumption rose just 0.1%, public spending was flat, and investment fell for the second quarter running). Also, the May CPI jumped back from 2.4% to 2.7%yr, and mortgage lending picked up.
- Those factors might be enough for the committee to be less inclined to argue for further QE, but we won't see the minutes until July 17. Were Carney to maintain King's stance, he would instantly be classed as a dove. We doubt he will, but that doesn't mean he has no other policy tools that he may subsequently reveal if our forecast for 2014 GDP growth to slow, not quicken, relative to 2013 looks like materialising.

Bank of England



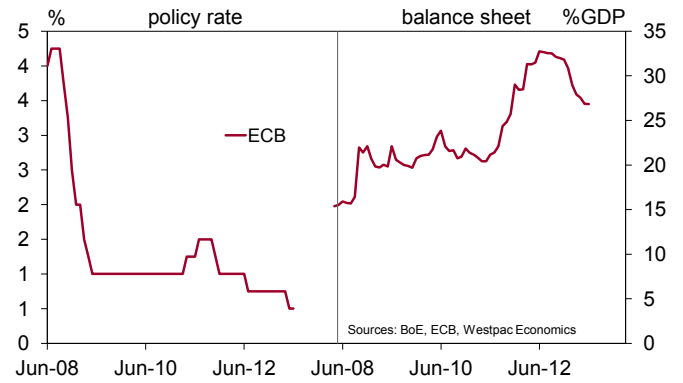


European Central Bank: nothing yet

Jul 4, ECB repo rate: Last: 0.5%, WBC f/c: 0.5%

- Since the last ECB Council meeting, June surveys showed the composite PMI at its least contractionary level since Q1 12; also, consumer confidence has now completely reversed its H2 2012 slump.
- However, while Cyprus' request for a bailout rework was knocked back by its EU partners, the problem won't go away; this is also true of Greece, which has failed to satisfy the IMF's fiscal commitments, risking another withheld bailout tranche. Higher peripheral bond yields also risk delayed Irish/Portuguese bailout exits as timetabled: late 2013 for Ireland and mid 2014 for Portugal.
- No new ECB policy measures are expected in July, but exit from accommodation is "distant" (said Draghi in late June). With the sovereign debt crisis looking to be back on a fast simmer, Super Mario might have a much busier second half of the year relative to the first, just as he did in 2011 and 2012!

ECB





Key Data and Events

		Market Last	Westpac median	forecast	Risk/Comment
Mon 1					
Aus	Jun AiG PMI	43.8	–	–	Avg of 42.1 in 2013, to date. Suggests manufacturing sector contracting.
	Jun RP Data–Rismark home price index	–1.2%	–	1.6%	Daily version of index shows Apr–May fall reversed in Jun (3mth ch: –0.1%)
	Jun TD–MI inflation gauge	0.2%	–	–	2.2%yr in June. Inflation benign.
Chn	Jun manufacturing PMI	50.8	50.1	–	New orders/stocks ratio points to weaker outcome, but still > 50.
	Jun HSBC manufacturing PMI	49.2	48.3	–	Poor May detail points to deterioration. But are X/O excessively weak?
Eur	Jun PMI factory final	48.7 a	48.7	48.5	Fall in Ger PMI factory adv might extend elsewhere post FOMC.
	Jun CPI flash %yr	1.4%	1.6%	1.6%	Ger Jun CPI due 28/6 is expected to rise. Euro May core was 1.2%.
	May unemployment rate %	12.2%	12.3%	12.3%	Steady German jobless rate no longer offsets rises elsewhere.
UK	Jun house prices %yr	0.4%	–	–	Hometrack index
	Jun house prices %yr	0.4%	–	–	Tentative date for Halifax index due sometime this week.
	Jun factory PMI	51.3	51.0	50.0	Risks to downside from Fed tapering, European/China concerns.
	May net mortgage lending £bn	0.9	0.9	1.2	BoE/Treasury FLS credited with modest rise in household loan
	May net consumer credit £bn	0.5	0.7	–	outstandings, though demand for credit remains weak.
US	May M4 money supply ex IOFCs %yr	2.8%	–	–	Down from 7.9%yr in Aug, partly a function of BoE APP suspension.
	May construction spending	0.4%	0.6%	0.4%	Weak single-family starts in March to May constraining residential.
	Jun ISM factory	49.0	50.5	49.9	Mixed Jun regional detail: NY Fed weak; Philly Fed strong; see text box.
Tue 2					
NZ	Jun ANZ commodity price index	–1.6%	–	–	Dairy to lead descent from April's record peak
Aus	RBA policy decision	2.75%	2.75%	2.75%	Rate cut debate 'live'; Q2 CPI timing and AUD fall favours Aug over Jul.
Eur	May PPI %yr	–0.2%	0.1%	–0.2%	German PPI rose slightly in May, but still no price pressure from industry.
UK	Jun PMI construction	50.8	51.4	50.4	First rise above 50 in May since October last year.
US	Jun ISM New York	54.4	–	–	Down 3.9pts in May, but still above March low for year so far of 51.2.
	May factory goods orders	1.0%	2.0%	2.0%	Durables known up 3.6% in May. Non-durables softer due to fuel prices.
	Jul IBD-TIPP economic optimism	49.0	49.1	44.0	Survey will capture equities plunge post FOMC, unlike June CB index.
	Jun auto sales mn annualised	15.2	15.3	–	Sales in uptrend, but below Nov storm replacement spike to 15.5mn.
Wed 3					
Aus	May retail trade	0.2%	0.4%	0.2%	Sales to remain soft amid sharp fall in sentiment.
	May trade balance, AUDbn	0.03	0.05	0.5	Exports +4% (vols up, iron ore). Imports +2% (vols down). See textbox.
	RBA Governor Stevens speaking	–	–	–	Topic TBA, 12.55 pm AEST, Brisbane.
Chn	Jun non–manufacturing PMI	54.3	–	–	Looks overly high versus PBoC survey, general state of the economy.
	Jun HSBC services PMI	50.8	–	–	Underwhelming growth backdrop and anxieties from SHIBOR issue.
Eur	Jun PMI services final	48.6 a	48.6	48.4	Sub-50 since Aug 2011. France/Germany differential still very wide.
	Jun PMI composite final	48.9 a	–	48.7	Post-FOMC peripheral yields, falling stocks potential concerns.
	May retail sales	–0.5%	0.1%	–	German –0.4% retail sales decline revised to 0.4% gain in April.
UK	Jun BRC shop price index %yr	–0.1%	–	–	May was lowest reading since 2009 recession.
	Jun PMI services	54.9	55.0	51.0	Likely some hit given bank capital shortfall, market turmoil post FOMC.
US	Jun ADP private payrolls	135k	160k	140k	Q2 running much slower in Apr–May (avg 124k) vs Q1 (avg 176k).
	Initial jobless claims, w/e 22/6	346k	345k	340k	Downtrend in claims appears to have stalled.
	Jun ISM non-manufacturing	53.7	54.2	53.7	Some constraint from rising rates, falling equities likely.
	Jun corporate layoffs %yr	–41.2%	–	–	Challenger series.
	May trade balance \$bn	–40.3	–40.2	–41.0	Exports fully recovered Mar fall in Apr, but imports did not.
Can	May trade balance C\$bn	–0.6	–0.7	–	Exports down 0.2% in Apr, imports up 1.2%.
Thu 4					
Aus	May dwelling approvals	9.1%	–1.0%	–1.0%	Consolidation likely after big May gain (exaggerated by Easter timing?).
	RBA Deputy Governor Lowe speaking	–	–	–	Topic TBA, 12.30 pm AEST, Sydney.
Eur	ECB policy decision	0.5%	0.5%	0.5%	Draghi will note less-weak surveys, but peripheral yields have risen.
UK	BoE policy decision, asset purchases £bn	375	375	375	Mark Carney's first meeting as Governor. See text box.
US	Independence Day holiday	–	–	–	Markets closed.
Fri 5					
Ger	May factory orders	–2.3%	1.2%	1.0%	Volatile series, but any bounce will likely not offset April fall.
US	Jun non-farm payrolls ch'	175k	165k	145k	Early-year boost (avge 207k in Q1) has faded somewhat in Q2 so far
	Jun jobless rate	7.6%	7.5%	7.5%	(avg 162k). Higher participation stalling jobless rate improvement.
Can	Jun employment ch'	95k	–12.5k	10k	May jump restored jobs uptrend after weak Q1.
	Jun IVEY PMI	63.1	–	54.0	Will June continue see-saw pattern of 2013 to date?

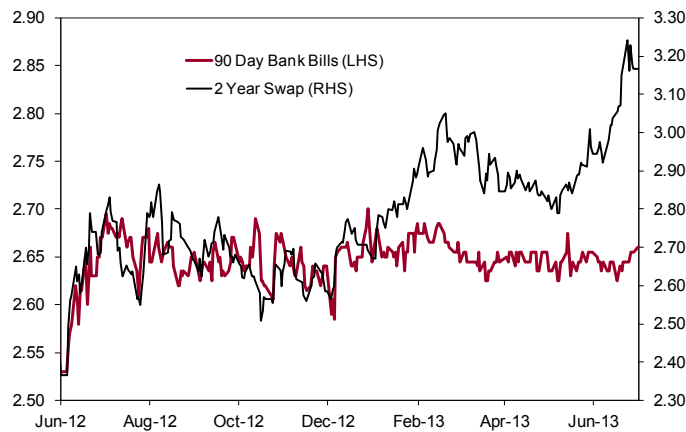


New Zealand Economic and Financial Forecasts

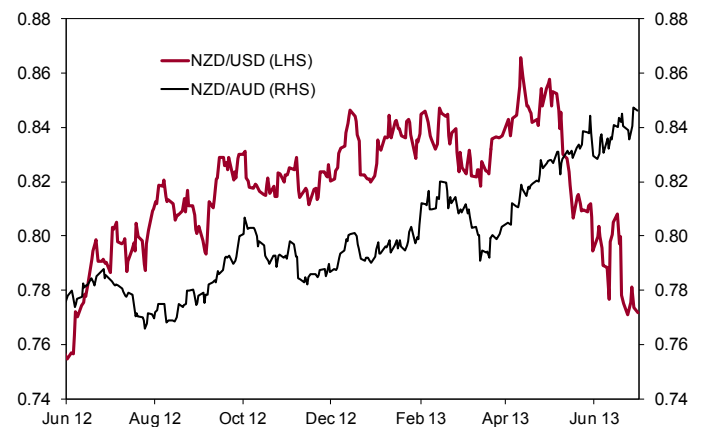
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	2.6	3.7	1.4	2.7	2.4	3.6
Employment	1.0	0.4	2.4	2.8	1.5	-1.4	3.2	3.2
Unemployment Rate % s.a.	6.7	6.2	5.7	4.8	6.3	6.8	6.1	5.0
CPI	1.6	0.9	1.4	2.5	1.8	0.9	1.3	2.3
Current Account Balance % of GDP	-4.4	-4.8	-4.9	-6.0	-4.0	-5.0	-4.6	-5.7

Financial Forecasts	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Cash	2.50	2.50	2.75	3.00	3.25	3.50
90 Day bill	2.70	2.75	3.00	3.25	3.50	3.75
2 Year Swap	3.20	3.20	3.40	3.60	3.80	4.00
5 Year Swap	3.80	3.80	3.90	4.00	4.20	4.40
10 Year Bond	3.80	3.80	3.90	4.00	4.10	4.20
NZD/USD	0.80	0.83	0.83	0.81	0.80	0.81
NZD/AUD	0.85	0.86	0.87	0.87	0.87	0.87
NZD/JPY	80.0	82.2	81.3	78.6	76.8	77.0
NZD/EUR	0.60	0.62	0.63	0.63	0.63	0.63
NZD/GBP	0.51	0.51	0.52	0.51	0.49	0.48
TWI	75.1	76.9	77.7	76.5	75.9	76.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 1 July 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.66%	2.64%	2.64%
60 Days	2.66%	2.65%	2.65%
90 Days	2.66%	2.65%	2.65%
2 Year Swap	3.17%	3.03%	2.96%
5 Year Swap	3.91%	3.63%	3.50%

NZ foreign currency mid-rates as at Monday 1 July 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7716	0.8052	0.8088
NZD/EUR	0.5927	0.6033	0.6184
NZD/GBP	0.5074	0.5120	0.5278
NZD/JPY	76.558	75.83	80.50
NZD/AUD	0.8463	0.8419	0.8279
TWI	73.34	74.49	75.61



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
Australia						
Real GDP % yr	1.4	2.5	2.4	3.6	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.0	2.8
Unemployment %	5.6	5.2	5.2	5.4	6.2	6.0
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.6	-3.3
United States						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.7	1.6
Consumer Prices %yr	-0.3	1.6	3.1	2.1	1.9	2.0
Unemployment Rate %	9.3	9.6	8.9	8.1	7.7	7.7
Current Account %GDP	-2.7	-3.0	-3.1	-3.0	-3.1	-3.2
Japan						
Real GDP %yr	-5.7	4.9	-0.4	2.0	1.3	1.9
Consumer Prices %yr	-1.3	-0.7	-0.3	0.0	-0.2	0.1
Unemployment Rate %	5.2	5.1	4.5	4.3	4.3	4.3
Current Account %GDP	2.8	3.6	2.0	2.1	2.0	2.0
Euroland						
Real GDP %yr	-4.4	2.0	1.4	-0.6	-0.8	-0.6
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.2
Unemployment Rate %	9.5	10.0	10.1	11.7	12.4	13.0
Current Account %GDP	-0.2	-0.1	0.0	0.9	1.0	1.0
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	0.2	0.7	0.2
Consumer Prices %yr	2.2	3.2	4.0	2.8	2.3	1.8
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.5	-1.9	-3.8	-2.5	-1.5

Forecasts finalised 11 June 2013

Interest Rate Forecasts	Latest	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
Australia						
Cash	2.75	2.50	2.25	2.00	2.00	2.00
90 Day Bill	2.79	2.55	2.30	2.10	2.10	2.10
10 Year Bond	3.76	3.60	3.40	3.30	3.20	3.10
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.49	2.40	2.20	2.10	2.00	2.00
ECB Repo Rate	0.50	0.50	0.50	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
AUD/USD	0.9130	0.94	0.97	0.95	0.93	0.92
USD/JPY	99.23	100	99	98	97	96
EUR/USD	1.3013	1.33	1.34	1.31	1.28	1.26
AUD/NZD	1.1806	1.18	1.17	1.14	1.15	1.15

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