



# Weekly Commentary

10 June 2013

## Guns on safety, cannons moving in to place

**The Canterbury rebuild is off to the races, while the rest of the economy is not too far behind. Dropping \$40 billion on our second largest city is clearly having the growth impact we have long predicted. The next stage to come is spreading inflation pressures, but for now these look contained within Canterbury. This will allow the RBNZ to continue to keep its interest rates guns on safety this week. However, at the same time the RBNZ navy is moving its new LVR cannon into position.**

Nationwide building activity popped higher in the March 2013 quarter. Post-earthquake reconstruction in the Canterbury region is gathering a head of steam, while elsewhere activity, particularly in Auckland, is ticking along at a very respectable rate.

These figures back our long-held view that construction activity would boom – due to both the Canterbury quake rebuild and a legacy of under-building in some regions.

This quarter the quake rebuild was so large it dominated the data. Canterbury residential and commercial construction both posted gains north of 20% in the March quarter. In fact, there was more commercial construction in the March quarter in Canterbury than in the rest of the country combined.

As such, it would be easy to overlook strength elsewhere, but that would be folly. Residential construction rose 11% outside of Canterbury. In another era, this number would generate handshakes all around.

We've also long highlighted that construction booms are usually accompanied by construction cost inflation, which tends to filter out into generalised inflation over the course of several years. We await more data on this front, but we don't think the result will be any different this time. Overall, the building survey provided upside risk to our forecast of 0.8% growth in March quarter GDP, and as such leans in the direction of higher interest rates.

This brings us neatly to this week's *Monetary Policy Statement* (MPS). For some time now monetary policy has been in a bind. As outlined economic growth is picking up strongly on the back of the Canterbury rebuild, plus house prices are now rising quite rapidly. But for now inflation is very low, owing to the high currency. Hiking interest rates now could push the currency even higher, which would risk inflation dropping even lower.

So the RBNZ is stuck, and has been forced to keep the OCR on hold. Its interest rate forecasts have implied that the OCR will

remain on hold until at least mid-2014 before rising slowly. Recent statements have pointed out risks on both sides of that outlook.

Not much has changed since then. If anything, the economy is stronger than the RBNZ had factored in, while inflation remains in check. The exchange rate is high, but no more so than the RBNZ forecast back in March.

So far, so simple. But the plot thickens.

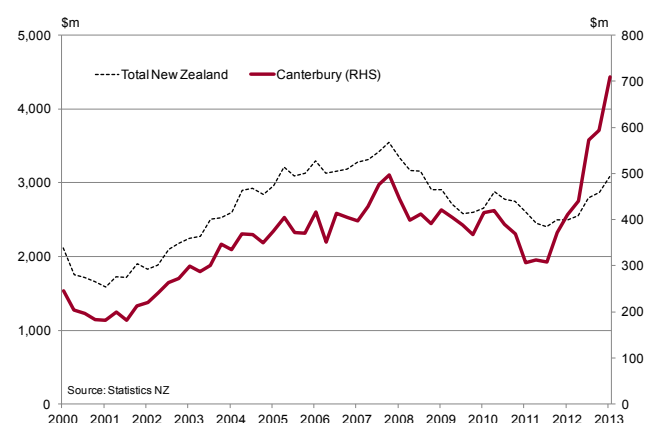
The most difficult aspect of the RBNZ's dilemma is that the longer interest rates stay low, the greater the probability of a boom-bust cycle in the housing market. This raises concerns around the safety of the financial system.

In a speech two weeks ago, Governor Wheeler talked up the possibility of restricting the proportion of new loans banks are allowed to make above a certain loan-to-value ratio (LVR). Mr Wheeler went on to make the case that these LVR speed limits might be a way of escaping from the monetary policy bind. The proposition was that LVR speed limits might curtail house price rises, thus cooling the economy.

Mr Wheeler even went so far as to propose that if house prices became "much less of a concern", the OCR could be reduced. However, the fact is, nobody really knows what LVR speed limits will do to the housing market or the economy.

But it now seems obvious that the RBNZ would like to give LVR speed limits a crack before considering hikes to the OCR – the navy is readying to roll out the cannons before the end of the year.

### Value of building work s.a.





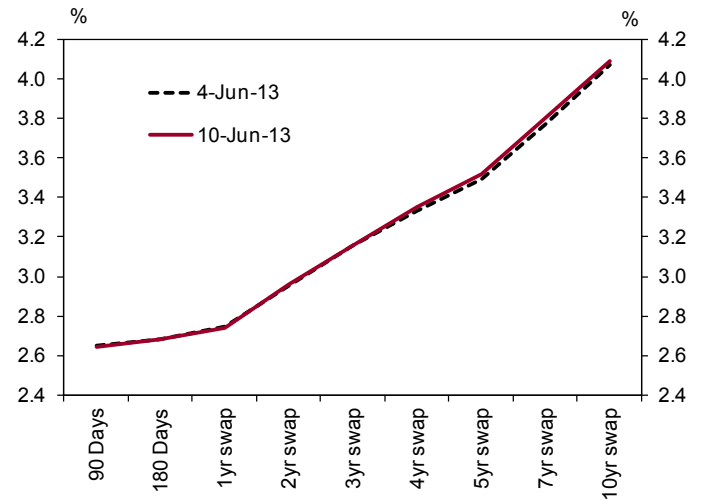
As for the interest rate guns – we expect the RBNZ will keep them on safety this week by repeating the “bottom line” from the April OCR review:

*“At this point, we expect to keep the OCR unchanged through the end of the year.”*

However, we reiterate our view that rates will need to move earlier than both the RBNZ and markets expect. We expect more inflation on two fronts: the Canterbury will suck in more resources and cause more inflation; in addition, we think rising house prices will lead to more household spending which in turn will generate additional inflation. With this in mind, we will explain the links between the housing market and household spending in a research bulletin this week. Our call remains for the first hike in the OCR in the March quarter of 2014.

**Fixed vs floating for mortgages:** Fixed-term rates out to two years are currently well below floating rates, while three-year and longer fixed rates are only slightly higher. So staying on floating would only be the better option if the RBNZ actually cut the OCR – which we regard as unlikely. That said, there is little upward pressure on banks’ funding costs, and fixed-rate ‘specials’ remain a feature of the mortgage market. Consequently, while we favour fixing over floating for the next couple of years, there’s scope to time your entry to take advantage of further fixed-rate deals.

**NZ interest rates**



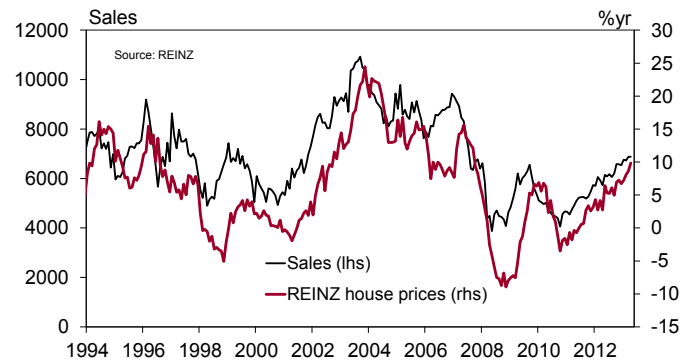
**Key Data Previews**

**NZ May REINZ house prices and sales**

Jun 10-14, Sales last: 0.2%, Prices last: 9.8%yr

- House sales and annual price growth both reached new cycle highs once again in April. While supply constraints are increasingly being fingered as a driver, particularly in Auckland, it’s clear that prices are rising across all of the main regions, led by the common factor of low interest rates.
- Supporting evidence suggests that the housing market remained very tight in May. Mortgage approvals rose slightly, while a major Auckland real estate agency reported a further rise in prices (and an all-time low for available listings).
- We expect nationwide house prices to rise 9.5% over this year and 7.5% next year. These numbers are similar to the RBNZ’s forecasts; where we differ is on the extent to which a stronger housing market will boost household spending and inflation pressures.

**REINZ house prices and sales**



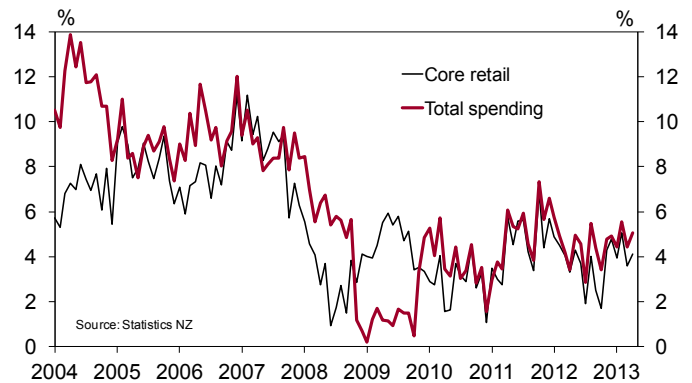


## NZ May electronic card transactions

Jun 12, Last: 1.1%, WBC f/c: 0.3%

- Card spending rebounded 1.1% in April, following a 0.9% drop in March. We suspect that the earlier timing of Easter this year meant that the level of spending in March was slightly understated, while April was slightly overstated. A return to normal levels in May implies a slightly depressed rate of growth for the month.
- That technical issue aside, we expect a continuation of the recent trend growth in card spending, supported by the growing momentum in the domestic economy and the strengthening housing market.
- Card spending has been tracking at around 5% year-on-year growth in nominal terms, and probably more in real terms as the strong NZ dollar has depressed import prices. That started to change in May, but aside from fuel prices it will be some time before this becomes noticeable on retail shelves.

## Card transactions, annual % change

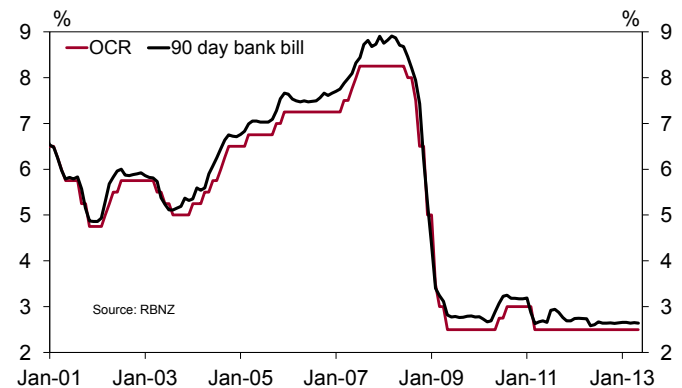


## RBNZ Monetary Policy Statement

Jun 13, Last 2.5%, Westpac: 2.5%, Market: 2.5%

- Monetary policy has been stuck between rising house prices and the high exchange rate for some time, leaving the RBNZ on hold.
- Lately the balance has shifted slightly in a positive direction. The economy is significantly stronger than the RBNZ expected, while the exchange rate and inflation have evolved in line with expectations.
- But the RBNZ now appears more open to restricting mortgage lending. These restrictions might curtail house price inflation, which would reduce the need for OCR hikes. We expect discussion of mortgage restrictions will take any hawkish gloss off the MPS, making for a neutral market reaction overall.

## NZ OCR and 90 day rate



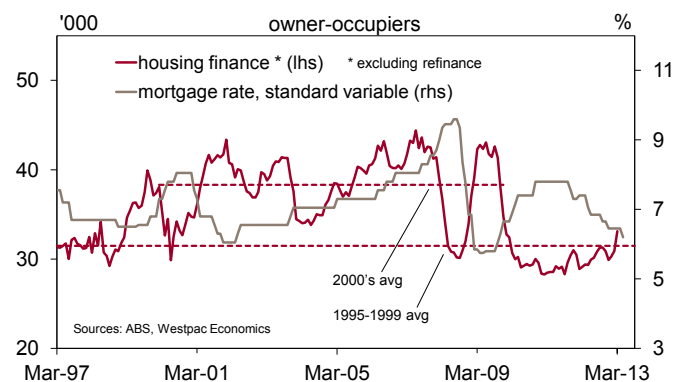
## Aus Apr housing finance (no.)

Jun 11, Last: 5.2%, WBC f/c: 2.0%

Mkt f/c: 2.0%, Range: -2.0% to 5.0%

- Housing finance to owner-occupiers posted a strong 5.2% gain in Mar after an indifferent 6mths in which last year's uptrend appeared to lose momentum. The Mar detail was mostly positive as well with lending ex refinance up 7.2% and a sharp jump in construction-related approvals, although loans to investors showed a more muted gain and first home buyer approvals remain at very low levels. The earlier timing of Easter this year may have been a factor although with other data this has tended to dampen Mar and boost Apr.
- Housing markets were on the up in Apr. Although consumer sentiment faltered, attitudes towards house purchase remained very positive and auction clearance rates were surging in Sydney and Melbourne. Overall we expect finance approvals to be up again, albeit with a milder 2.0% rise.

## Owner-occupier finance & the rate cycle



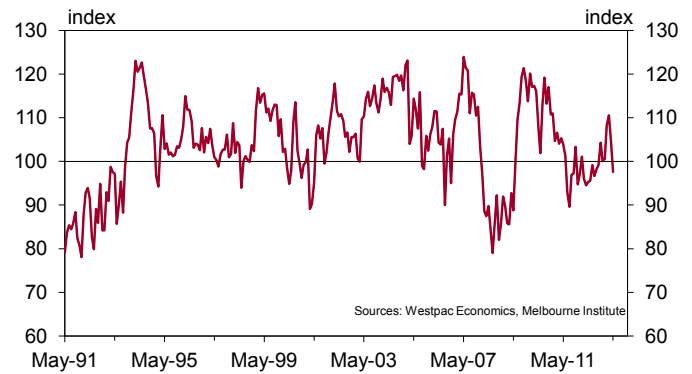


## Aus Jun Westpac-MI Consumer Sentiment

Jun 12, Last: 97.6

- Consumer sentiment dropped sharply in May, falling 7% back into pessimistic sub-100 territory for the first time since Oct last year. A badly received Budget and deepening concerns about the economic outlook, particularly across the mining states, more than offset any positive sentiment bump from the RBA's 25bp rate cut in May.
- The Jun survey is in the field from Jun 3 to 9. It will capture reactions to: the RBA's (widely anticipated) decision to leave rates on hold at its Jun meeting; disappointing economic data with the Q1 national accounts showing a smaller than expected rise in GDP and weak detail on domestic demand; mixed messages on the housing market (strong auction activity but more price slippage); a heavy fall in share prices (ASX down 8½% between the May and Jun surveys); and a further slide in the AUD, down 3c vs the USD to a 20mth low.

## Consumer Sentiment



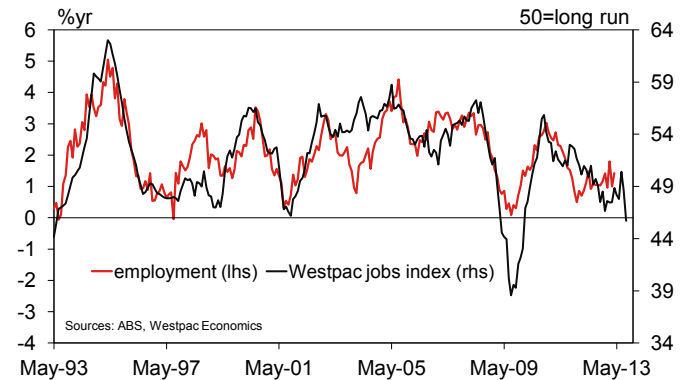
## Aus May employment

Jun 13, Last: 50.1k, WBC f/c: -20k

Mkt f/c: -10k, Range: -35k to 15k

- Employment rose 50.1k in Apr, much stronger than our forecast (15k) and the market median (11k). The detail was also upbeat with a big gain in full-time employment (34.5k) and a solid bump in total hours worked (0.7%*mth*).
- Nevertheless, the picture is soft through the year to Apr. Part-time employment continues to outperform (+2.0%*yr* or +68k); with full-time employment softer at 1.4%*yr* (+96.2k). Total hours worked is up 0.8%*yr*.
- We are not getting a lift from the usual cyclical industries: construction, transport/wholesaling and manufacturing which dominate male employment. With the leading indicators turning down again, we are looking for a statistical correction of -20k which will see the annual rate of employment growth ease to 1%*yr* from 1.4% in Apr. It was 1%*yr* in Mar.

## Employment has stalled in the business surveys



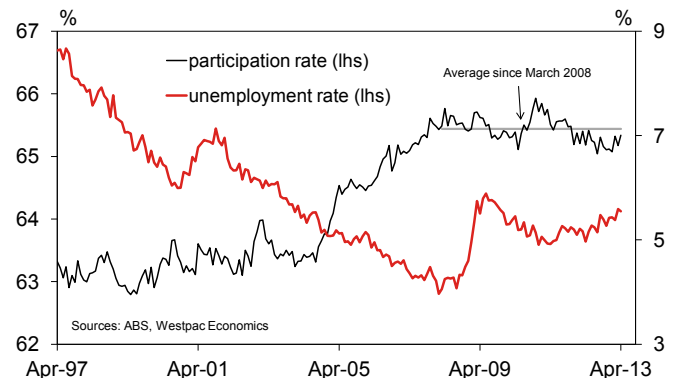
## Aus May unemployment rate

Jun 13, Last: 5.5%, WBC f/c: 5.6%

Mkt f/c: 5.6%, Range: 5.5% to 5.7%

- At one decimal place, the unemployment rate dropped to 5.5% in Apr from 5.6% in Mar. But at two decimal places, it was essentially flat, nudging down to 5.55%, from 5.59%. We think a flat (at best) to an upward trend (our core view) in the unemployment rate is the best way to describe the labour market.
- We also think the bump in the participation rate (65.3% from 65.2%), and associated bump in the labour force, will be unwound in May. To us, this volatility highlights that most of the recent volatility in the labour force is due to sample roll rather than labour market fundamentals.
- We are forecasting that a drop in the participation rate to 65.2% will limit the rise in unemployment to 5.6%.

## Unemployment and participation rates



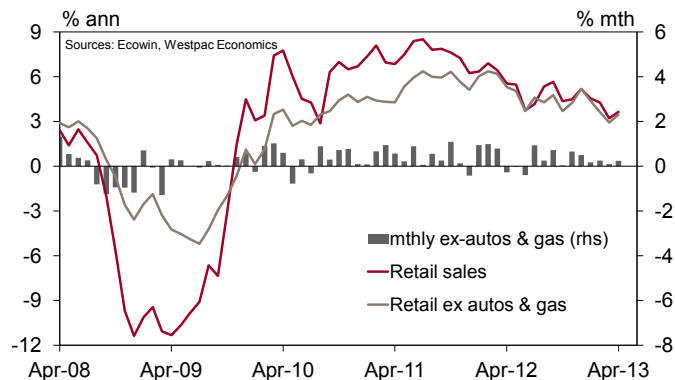


## US May retail sales

Jun 13, Last: 0.1%, WBC f/c: 0.3%

- Retail sales posted a soft 0.1% gain in April. A second straight negative print would have been recorded had it not been for an unexpected 1% rise in auto sales – a surprise given the 2% decline in industry unit sales reported in the month. The headline outcome was constrained by declining gasoline prices. Core retailing (ex autos and gas) posted a 0.6% gain, with most store types seeing gains.
- Despite the ongoing volatility associated with petrol prices and sporadic bursts of durables strength, retail sales growth has trended lower over the past year. Annual growth in total and core retail sales are now at their lowest level since mid to late 2010. Recent household income data has been poor and the household savings rate remains near its historic low. As such, there is little reason to expect a marked improvement in spending in the near term. For May, we forecast a 0.3% rise, in part due to stronger gas prices and auto sales.

## US retail sales

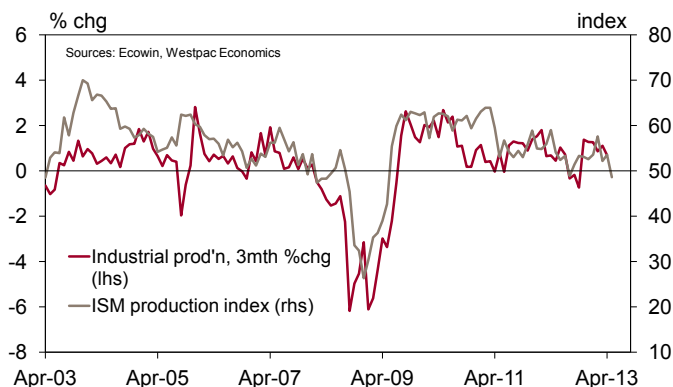


## US May industrial production

Jun 14, Last: -0.5%, WBC f/c: -0.1%

- Industrial production was much weaker than expected in April, declining by 0.5% against a -0.1% expectation. Capacity utilisation also fell from 78.3% to 77.8%. The decline in production in April was the result of weaker activity in the manufacturing sector, partly offset by an increase in mining output.
- The ISM manufacturing print for May points to a further decline in production in May. Not only did the headline index fall to a sub-50 level for the first time since last November, but the detail was also soft. Specifically, the production and new orders sub indexes both fell below 50.
- Stronger residential investment is a plus. But more broadly, the absence of robust strength in domestic end demand is a key concern for the US manufacturing sector, as is the recent appreciation of the US dollar. In May, we look for a -0.1% fall.

## US industrial sector





**Key Data and Events**

		Market Last	Westpac median	Westpac forecast	Risk/Comment
<b>Mon 10</b>					
<b>NZ</b>	May REINZ house sales	0.2%	-	-	Due this week. Low interest rates are the common denominator...
	May REINZ house price index %yr	9.8%	-	-	...with prices now rising across all of the main regions.
	Q1 real manufacturing sales	1.5%	-	-	Drought slowed dairy production, partly offset by higher slaughter.
<b>Aus</b>	Queen's Birthday public holiday	-	-	-	Markets closed.
<b>Eur</b>	Jun Sentix investor confidence	-15.6	-10.3	-	Economy contracting at slower rate, but outlook remains grim.
<b>Tue 11</b>					
<b>Aus</b>	Apr housing finance approvals	5.2%	2.0%	2.0%	Housing recovery regained momentum in Mar-Apr.
	May NAB business confidence	-2	-	-	Survey weak in April. Conditions +1pt to -6. Confidence -3.6pts to -2.
<b>UK</b>	May RICS house price balance	1%	3%	-	Optimism creeping into UK housing market.
	Apr industrial production	0.7%	flat	-	Manufacturing jumped in Mar, but still down -1.4%yr.
<b>US</b>	May small business optimism	92.1	-	-	Confidence waning with stock market; activity sub-par.
	Apr wholesale inventories	0.4%	0.2%	0.2%	Inventories continue to accrue amid soft but positive end demand growth.
<b>Wed 12</b>					
<b>NZ</b>	May electronic card transactions	1.1%	-	0.3%	Recent uptrend reflects domestic recovery, housing strength.
<b>Aus</b>	Jun Westpac-MI Consumer Sentiment	97.6	-	-	Dropped sharply from 104.9 in May, back to pessimistic sub-100 levels.
<b>Eur</b>	Apr industrial production	1.0%	-0.2%	-0.3%	PMIs continue to point to further decline in output.
<b>Ger</b>	May CPI	0.3%	0.3%	0.3%	Even in core, inflation not a pressing issue, 1.5%yr in flash estimate.
<b>UK</b>	May jobless claims change	-7.3k	-6.5k	-	Claimant count unemployment expected to be unchanged at 4.5%.
	May employment change	-43k	-10k	-	ILO unemployment rate seen unchanged at 7.8%.
<b>US</b>	May monthly budget statement, \$bn	-110	-	-	Budget position has improved on higher revenue; needs to persist.
<b>Can</b>	May house prices	0.2%	-	-	Teranet measure; prices up 2.0%yr in Apr.
<b>Thu 13</b>					
<b>NZ</b>	RBNZ Monetary Policy Statement	2.50%	2.50%	2.50%	Recent data hawkish, countered by possibility of mortgage restrictions.
<b>Aus</b>	May employment, ch	50.1k	-10k	-20k	Statistical correction to a more realistic annual pace of 1%yr.
	May unemployment rate %	5.5%	5.6%	5.6%	A fall in participation will contain the rise in the unemployment rate.
	Jun Westpac-MI unemp. expectations	5.4%	-	-	The early indicators suggest the labour market continues to soften.
	Jun MI inflation expectations, %yr	2.3%	-	-	Have lifted from the low but still quite benign.
<b>US</b>	May retail sales	0.1%	0.4%	0.3%	Gasoline and autos should support; core demand remains soft.
	Initial jobless claims	346k	-	345k	Look to have settled after May volatility.
	Apr business inventories	flat	0.3%	0.3%	Inventories continue to accrue amid soft but positive end demand growth.
<b>Fri 14</b>					
<b>NZ</b>	May food price index	0.2%	-	0.3%	Seasonal uptick in produce prices; annual inflation still near zero.
	May manufacturing PMI	54.5	-	-	Stronger recently as Chch rebuild trumps high NZD, Aus slowdown.
<b>Eur</b>	May CPI	-0.1%	0.1%	0.1%	Inflation pressures are not a concern; activity very much is.
<b>UK</b>	Apr construction output, %yr	-7.4%	-	-	Construction sector remains in poor condition.
<b>US</b>	May producer prices	-0.7%	0.1%	0.1%	Upstream price pressure non existent; headline up 0.6%yr in Apr.
	Q1 current account, \$bn	-110.4	-112.4	-111.0	Annual revisions also due.
	May industrial production	-0.5%	0.2%	-0.1%	ISM manufacturing points to further weakness ahead.
	Uni of Mich. consumer confidence	84.5	84.5	82.0	Equity market weakness to weigh?

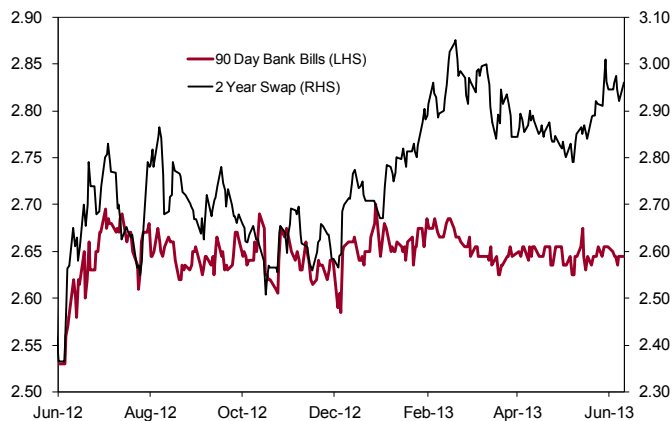


## New Zealand Economic and Financial Forecasts

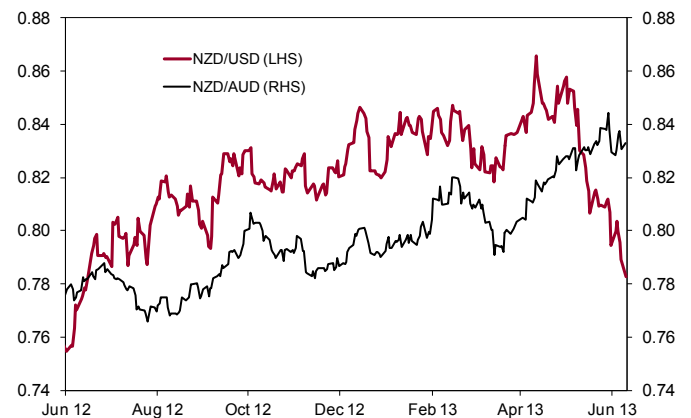
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	2.9	3.7	1.4	2.5	2.8	3.6
Employment	1.0	0.4	2.4	2.8	1.5	-1.4	3.2	3.2
Unemployment Rate % s.a.	6.7	6.2	5.7	4.8	6.3	6.8	6.1	5.0
CPI	1.6	0.9	1.4	2.5	1.8	0.9	1.3	2.3
Current Account Balance % of GDP	-4.4	-4.9	-4.6	-5.6	-4.0	-5.0	-4.5	-5.3

Financial Forecasts	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.50	2.50	2.50	2.75	3.00	3.25
90 Day bill	2.65	2.70	2.75	3.00	3.25	3.50
2 Year Swap	2.90	3.00	3.10	3.30	3.50	3.70
5 Year Swap	3.40	3.45	3.50	3.60	3.70	3.85
10 Year Bond	3.30	3.40	3.45	3.50	3.55	3.60
NZD/USD	0.82	0.84	0.85	0.85	0.84	0.83
NZD/AUD	0.84	0.84	0.86	0.88	0.88	0.86
NZD/JPY	82.0	83.2	83.3	82.5	80.6	78.9
NZD/EUR	0.63	0.64	0.66	0.68	0.68	0.67
NZD/GBP	0.54	0.54	0.54	0.55	0.54	0.52
TWI	76.8	77.9	79.2	80.2	79.4	78.2

### 2 Year Swap and 90 Day Bank Bills



### NZD/USD and NZD/AUD



### NZ interest rates as at market open on Monday 10 June 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.64%	2.64%	2.64%
60 Days	2.64%	2.65%	2.64%
90 Days	2.65%	2.66%	2.64%
2 Year Swap	2.96%	2.92%	2.87%
5 Year Swap	3.52%	3.44%	3.37%

### NZ foreign currency mid-rates as at Monday 10 June 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7827	0.8103	0.8288
NZD/EUR	0.5933	0.6265	0.6393
NZD/GBP	0.5038	0.5354	0.5397
NZD/JPY	76.60	81.94	84.46
NZD/AUD	0.8330	0.8403	0.8284
TWI	73.39	76.43	77.52



## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
<b>Australia</b>						
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
<b>United States</b>						
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
<b>Japan</b>						
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
<b>Euroland</b>						
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
<b>United Kingdom</b>						
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 10 May 2013

Interest Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
<b>Australia</b>						
Cash	2.75	2.75	2.50	2.25	2.00	2.00
90 Day Bill	2.78	2.55	2.55	2.30	2.10	2.10
10 Year Bond	3.26	3.20	3.40	3.25	3.10	2.85
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.06	2.00	2.20	2.10	2.00	1.80
ECB Repo Rate	0.50	0.50	0.50	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
AUD/USD	0.9504	0.98	1.00	0.99	0.97	0.96
USD/JPY	96.76	100	99	98	97	96
EUR/USD	1.3253	1.30	1.31	1.29	1.25	1.24
AUD/NZD	1.1920	1.20	1.19	1.16	1.14	1.14



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