Weekly Commentary

11 March 2013

Building blocks

The New Zealand economy is gaining momentum. The rebuild effort in Christchurch is playing a key role in the rebound, but there is evidence of an improvement across a range of sectors. We will publish our December 2012 quarter GDP preview this week, but as it stands the risks to our forecast of 0.8% growth are to the upside. It also looks as though stronger growth has lasted into early 2013, which will be valuable in dealing with some of the challenges that New Zealand is likely to face this year, not least of which is the escalating drought across much of the country.

The building activity survey released last week showed a 1.8% increase in the December quarter, following a 9.8% rise in the September quarter. Residential building work was up just 0.7% nationwide, but non-residential work rose another 3% on top of a 13.5% increase in the previous quarter.

The survey demonstrated that post-quake reconstruction in the Canterbury region is well under way. By value (the regional breakdown is not deflated), building work in Canterbury rose by 4%, and is now 20% above the peak level reached in the last decade's property boom. Non-residential work in particular has picked up sharply in the region – although much of the CBD remains out of action as demolition continues, there are a lot of new buildings going up in the ring around the CBD.

As we detailed in our February 2013 *Economic Overview*, the total amount of rebuild work to date appears to be running broadly in line with our expectations, though with residential work picking up a little slower and non-residential work a bit faster than we assumed. We expect the rebuild to make a sizeable contribution to GDP growth over the next couple of years, with the level of activity peaking around 2015.

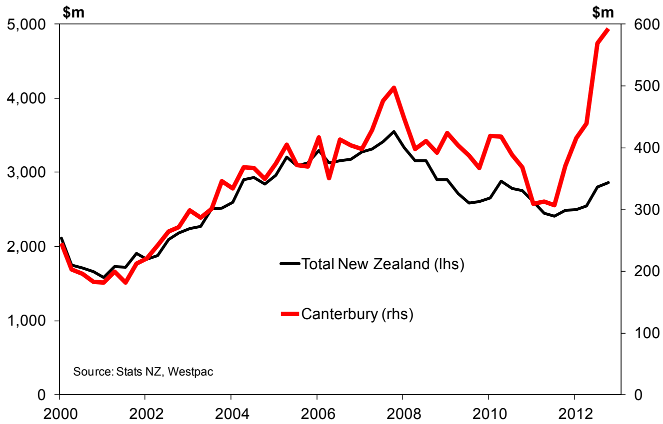
The pickup in construction is not entirely a Canterbury story. Activity in all of the major regions has lifted over the last year – particularly in the Auckland housing market, which has had the greatest legacy of under-building relative to population growth in recent years. Nevertheless, building activity nationwide is still closer to the trough than the peak of the last cycle. On the face of it there is a substantial amount of capacity in the industry to handle the Christchurch rebuild; mobilising those resources has been and will remain the challenge. There is already evidence of construction cost pressures in the Canterbury region, though they have yet to filter out to the rest of the country.

The building survey, along with other recent sectoral indicators (retail sales, wholesale trade and manufacturing) suggests that December quarter GDP will turn out much stronger than the 0.4% growth that the Reserve Bank assumed in its last *Monetary Policy Statement*. Thursday's *MPS* will acknowledge the stronger near-term growth picture and the impact of the Christchurch rebuild, although these will be partially offset by the dampening effects of government austerity and the high New Zealand dollar (with the trade-weighted index around 4% higher today than the RBNZ projected). On balance, that points to another "on hold" statement.

One issue that will get more attention this time is the housing market – although it's not as if the RBNZ shied away from this issue previously. The RBNZ upgraded its house price forecasts in the December *MPS*, and noted that a stronger housing market could lead to higher inflationary pressures, which "all else equal… could necessitate a higher OCR". The January OCR review commented that "the Bank does not want to see financial stability or inflation risks accentuated by housing demand getting too far ahead of supply." And more recently RBNZ Governor Wheeler described the housing market as "overheating", suggesting that what was regarded as an upside risk is now becoming the central view.

While there will undoubtedly be questions around 'macroprudential' tools, we don't think the *MPS* will go any way towards signalling their use. As we wrote in our recent bulletin "Tool time", the RBNZ has made it clear that that these new tools are aimed at preventing

Value of building work, s.a.



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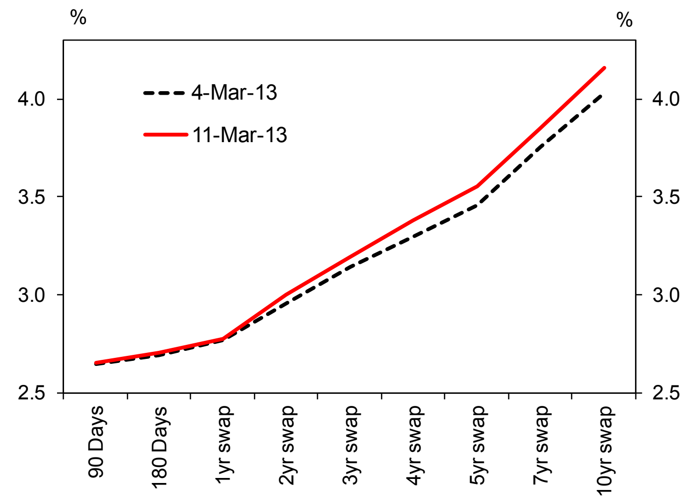
the build-up of risks in the financial system. They are not a substitute for the OCR as a monetary policy tool, although their use would have some impact on the economic and financial backdrop for monetary policy decisions. And as the RBNZ's consultation paper released on Monday shows, there is still a significant amount of work to be done on developing the framework for their use. Right now it's up to the market to provide the RBNZ with some guidance on these new tools, not the other way around.

Fixed vs floating for mortgages: Fixing is likely to prove better value than floating over the next few years. 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 better option if the RBNZ actually cut the OCR, and we regard that as fairly unlikely. Our view is that the OCR will stay on hold for now, and increase steadily from late 2013.

NZ interest rates



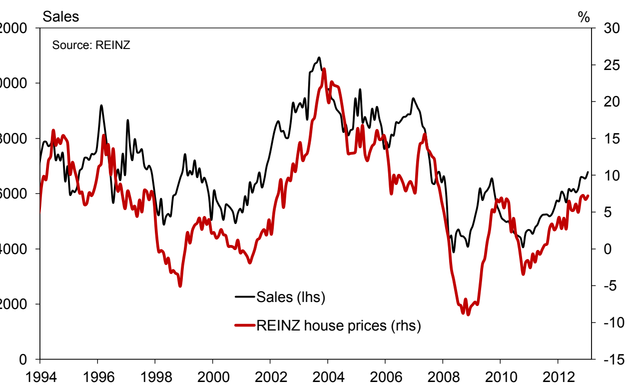
Key Data Previews

NZ Feb REINZ house prices and sales

Mar 11-15, Sales last: 3.5%, Prices last: 1.0%

- The expectation of low mortgage rates for an extended period continues to underpin the housing market. Sales rose 3.5% in January and the stratified price index was up 7.2% on a year earlier.
- Indicators for February remained positive. We estimate that mortgage approvals rose 6% s.a. to their highest in six years (though this measure includes refinancing activity). The largest agency in the Auckland region reported a 1.5% rise in sales.
- We expect house price inflation to accelerate further, from an estimated 6% pace in 2012 to 9% this year. Auckland and Christchurch continue to lead the way due to their respective supply shortages, but prices are now rising in all of the main centres.

REINZ house price and sales

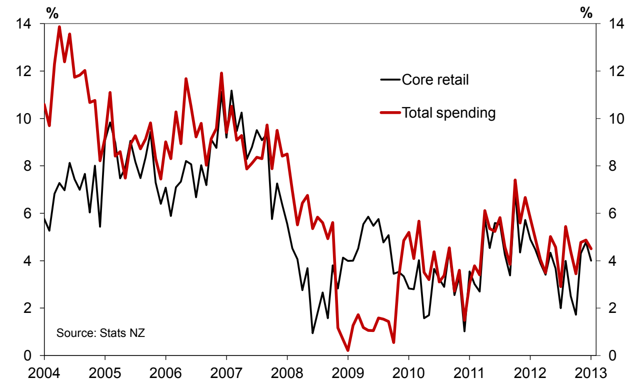


NZ Feb electronic card transactions

Mar 11, Last: 0.4%, WBC f/c: 0.5%, Mkt f/c: 0.5%

- Like many facets of the economy, consumer spending has regained its upward momentum after a soft patch in the September quarter.
- Paymark, the largest cards processor, reported a 0.9% rise in spending in February. Higher fuel prices for the month will have boosted the total. Nevertheless, this was reported as the strongest five-month run of gains since June 2007.
- Pressure on retail prices has generally been down in recent months due to the persistent strength of the NZ dollar. As a result, slow growth in nominal spending is still consistent with solid growth in real terms.

Card transactions, annual % change

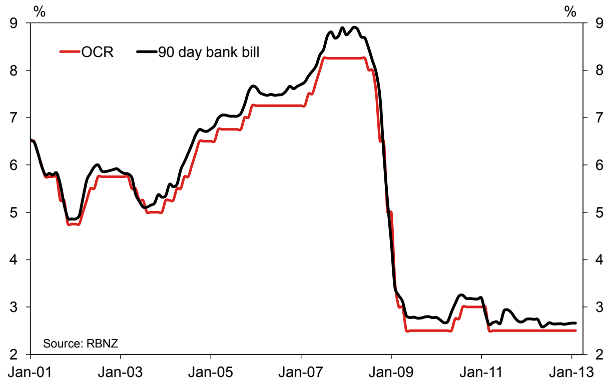


RBNZ Monetary Policy Statement

Mar 14, Last: 2.50%, WBC f/c: 2.50%, Mkt f/c: 2.50%

- We expect the RBNZ to repeat its simple "on hold" outlook for the OCR. Stronger than expected near-term activity has been partially offset by ongoing fiscal austerity and a stronger NZD. The emerging drought should also be noted as a downside risk.
- There could be another warning that ongoing house price inflation would provoke early OCR hikes.
- The RBNZ may repeat the basic message that macroprudential tools are about financial stability, and are not OCR replacements.

NZ OCR and 90 day rate

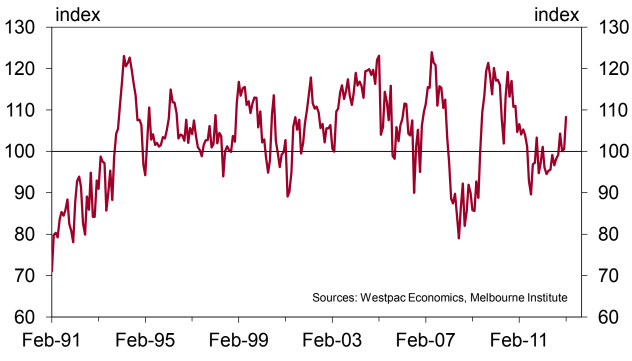


Aus Mar Westpac-MI Consumer Sentiment

Mar 13, Last: 108.3

- Consumer sentiment improved markedly in Feb with a 7.7% rise into solidly optimistic territory. This was the strongest reading since Dec 2010, the biggest monthly gain since Sep 2011 and the most promising sign yet that the lower level of interest rates may finally be starting to gain more traction with the consumer. Indeed, the Feb move came despite a mild disappointment on rates with the RBA opting to leave the cash rate on hold at its Feb meeting.
- The Mar survey is in the field from Mar 4 to 10. Factors that may influence sentiment include: the RBA's decision to leave rates on hold; a mixed batch of economic data but a continued positive run on the sharemarket (ASX up 2.8% since Feb survey and the Dow Jones hitting new highs).

Consumer sentiment



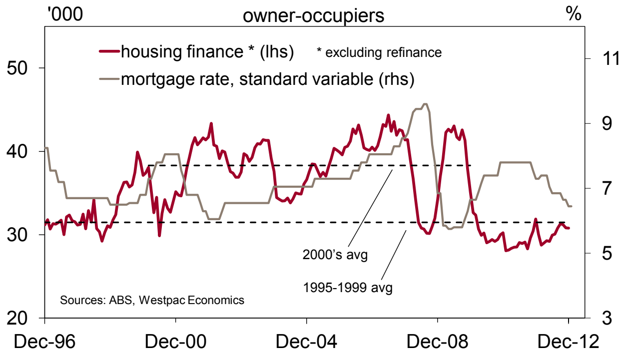
Aus Jan housing finance (no.)

Mar 13, Last: –1.5%, WBC f/c: –0.5%

Mkt f/c: 0.5%, Range: –4.0% to 2.0%

- Housing finance to owner-occupiers fell 1.5% in Dec after a 0.7% fall in Nov. The Dec fall was driven by a sharp drop in refinancing with new lending (i.e. ex refinance) down just –0.1% in the month. However, most of the other detail was poor with approvals to first home buyers weak (–5.7%, with a surprisingly steep fall in NSW). This was offset by a solid pick-up in loans to 'upgraders' a decline in investor loans (–2.4% in value terms) suggests softening momentum overall.
- We expect Jan to show a slightly better result although the seasonal low means data is less reliable (unadjusted approvals fall 15-20% in Jan). State government policy changes behind some of the recent weakness should drop out of the picture from Jan but Dec's rate cut does not look to have impacted until Feb (moves usually takes 2-3 months to impact). Overall, approvals are forecast to decline 0.5%.

Owner-occupier finance and the rate cycle



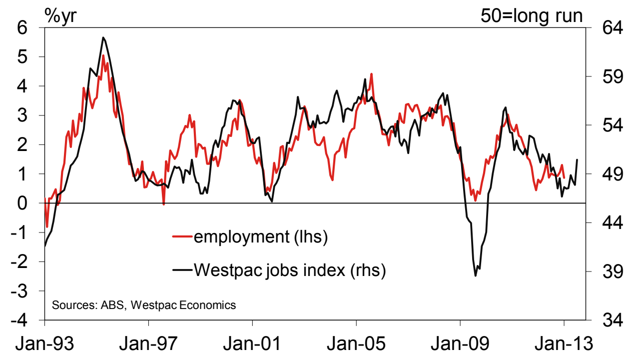
Aus Feb employment

Mar 14, Last: 10.4k, WBC f/c: 17k

Mkt f/c: 10k, Range: flat to 25k

- Total employment rose 10.4k in Jan, compared to the market median of +8k and Westpac's forecast of 18k. The total gain in the past year is 98.9k, a rise of 0.9%.
- Jan was a soft print with –9.8k full-time, +20.2k part-time, and a 0.2% fall in hours worked (up 1.2%yr). In the last three months, the Australian economy has lost 31.4k full-time jobs, while it has added 57.1k part-time jobs.
- Both job ads and business surveys are painting a more constructive picture for employment so far in 2013. This is not, however, why we are forecasting a positive Feb print. Our observations of the Labour Force Survey has revealed some statistical properties that suggests a smaller than usual print in Jan is more likely to be followed by positive print in Feb.

Business survey a bit more positive on jobs



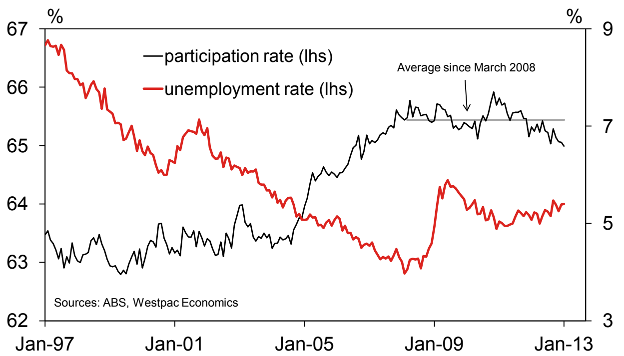
Aus Jan unemployment rate

Feb 14, Last: 5.4%, WBC f/c: 5.4%

Mkt f/c: 5.5%, Range: 5.4% to 5.6%

- The unemployment rate was flat at 5.4% (5.40% from 5.39% in Dec). The participation rate fell to 64.99% in Jan, with the fall due to declining male participation. Had the participation rate held closer to its average since March 2008, then the unemployment rate would now be around 6% rather than 5.4%.
- The state numbers revealed some interesting trends. Unemployment in NSW was flat at 5.1% while Vic saw a rise (to 6.1% from 5.6%). There was quite an improvement in Qld (down to 5.3% from 6.1%), so too in WA (down to 4.1% from 4.3%).
- Growth in the working age population has lifted again and with the participation rate holding steady at 65% we expect the unemployment rate to round down to 5.4% in Feb.

Unemployment and participation rates

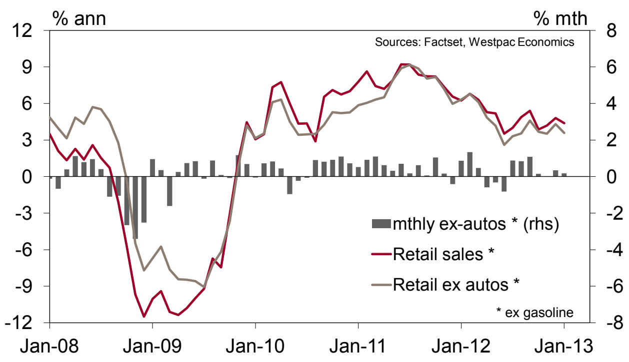


US Feb retail sales

Mar 13, Last: 0.1%, WBC 0.3%

- Retail sales rose 0.1% in Jan and core retail ex autos and gas rose 0.2%, a slower pace than the 0.8%/0.7% gains recorded in Nov and Dec. The detail showed close to flat sales growth in eight of the fourteen storetypes, sharp losses in personal care and miscellaneous and moderate gains in sporting goods, non-store, general merchandise and department store retailers.
- This reflected consolidation at the start of the new year after the late 2012 sales burst, in part supported by the Dec surge in income due to the pull-forward of bonus/dividend payments. Income growth has since fallen back again, constraining the potential for further sales upside.
- Auto sales were little changed in Feb but gasoline prices were up sharply. We expect headline retailing to rise 0.3% but that will be entirely due to gasoline with core retail likely to be flat.

US retail sales



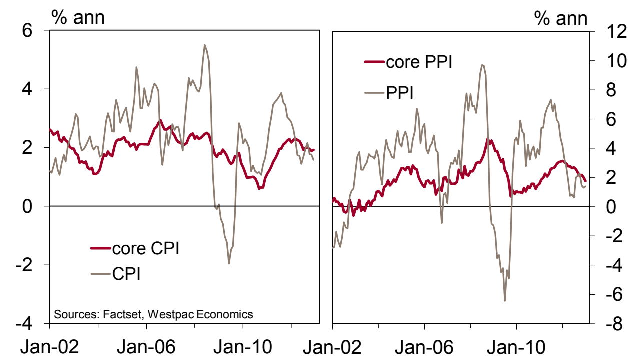
US Feb PPI and CPI

Mar 14, PPI Last: 0.2%, WBC f/c 0.5%

Mar 15, CPI Last: 0.0%, WBC f/c 0.5%

- The PPI rose 0.2% in Jan. Food prices rose 0.7%, energy was down 0.4% and core prices were also up 0.2%. Prescription drugs up 2.5% posted their usual Jan spike but flat clothing prices and falls of 0.8%/0.4% for autos/trucks constrained the overall PPI rise. Feb saw sharp gasoline price rises, though other energy was little changed, and farm prices fell. Autos are an upside risk. We expect a 0.5% headline and modest 0.2% core.
- The CPI was flat in Jan with energy down 1.7% and food prices flat although the core CPI rose 0.3% on apparel (0.8%) and rents (0.2%) after 0.1% gains for both in Dec. The headline annual pace slowed a tick to 1.6% yr but the core pace was steady at 1.9% yr. Gasoline prices jumped sharply in Feb and will lift the headline CPI but food prices should be constrained and Jan's core spike should settle back to a 0.1% rise.

US price inflation

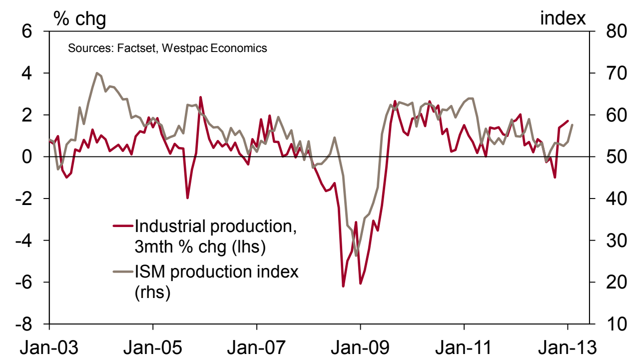


US Feb industrial production

Mar 15: Last: –0.1%, WBC f/c: 0.4%

- Industrial production fell 0.1% in Jan. Vehicle assemblies fell back from a new cycle high in the previous month, partly offset by a 3.5% bounce in utility output as colder weather set in. There was a sizeable upward revision to the post-Hurricane Sandy rebound in Nov-Dec.
- Jan core capital goods orders rose sharply, the ISM factory survey showed accelerating orders gains in Jan and Feb, and factory hours worked rose 0.6% in Feb. We expect manufacturing output was up 0.7% or more if autos bounce.
- The IP bottom line will be driven by the Fed's estimate of utility output. The weather was not as unseasonally cold in Feb as in Jan so utilities will probably be a drag on the IP bottom line.

US industrial sector



Key Data and Events

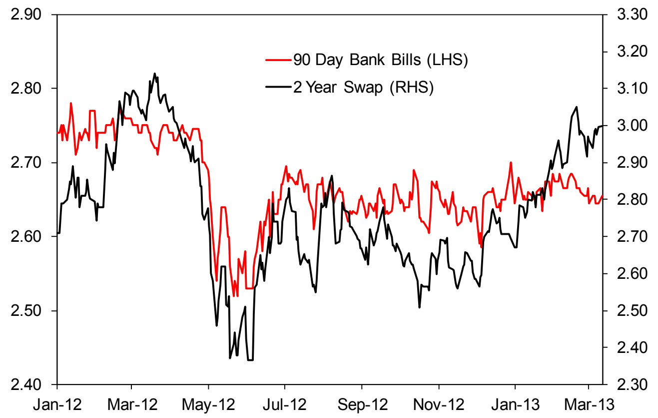
		Last	Market median	Westpac forecast	Risk/Comment
Mon 11					
NZ	Feb REINZ house sales %mth	3.5%	–	–	Due this week. Low interest rates remain the bottom line ...
	Feb REINZ house price index	1.0%	–	–	... with prices expected to accelerate further this year.
	Feb electronic card transactions	0.4%	0.5%	0.5%	Trending up again after a September quarter soft patch.
Jpn	Jan machinery orders %mth	2.8%	–1.7%	–	Foreign orders rising again, domestic likewise.
Ger	Jan exports %mth	0.3%	–	0.3%	If IP is expanding again, exports should be too.
	Q4 labour costs %yr	3.3%	–	–	Accelerating since earlier in 2012.
Tue 12					
Aus	Feb NAB business survey	–2	–	–	Jan: conditions +2pts to –2, confidence +1pt to +3. Both below avg.
UK	Feb house prices net %	–4	–	–	RICS surveyors neutral on house prices in Dec, more bearish in Jan.
	Jan industrial production %mth	1.1%	0.3%	0.2%	Dec IP jump followed sluggish 4 months but Feb PMI a worry.
	Jan trade balance £bn	–8.9	–9.0	–	Exports up 3% and imports up 1% saw deficit narrow in Dec.
US	Feb NFIB small business optimism	88.9	–	87.0	Feb survey cut off was day before sequester deadline.
	Feb federal budget $bn	–223	–220	–	Impact of fiscal compromise to show up here.
Wed 13					
NZ	Feb food price index %mth	1.9%	–	–0.2%	Seasonal dip in fresh produce prices; annual inflation near zero.
Aus	Mar Westpac–MI consumer sentiment	108.3	–	–	Will Feb's promising rise be sustained?
	Jan housing finance approvals %mth	–1.5%	0.5%	–0.5%	Dec fall driven by refinancing, lending flat, Dec rate cut yet to impact.
Eur	Jan industrial production %mth	0.7%	0.2%	0.0%	German IP due, but PMI suggests modest rise; French PMI weaker
US	Feb advance retail sales %mth	0.1%	0.5%	0.3%	Auto sales flat, gasoline prices higher. See text box
	Feb retail sales ex auto, gas %mth	0.2%	0.1%	0.0%	Core retailing constrained by incomes growth, some tax rises.
	Feb import prices %mth	0.6%	0.5%	0.1%	Oil prices may be a touch lower on avg than in Jan; US$ higher.
	Dec business inventories %mth	0.1%	0.3%	0.2%	Inventories being kept tight.
Thu 14					
NZ	RBNZ Monetary Policy Statement	2.50%	2.50%	2.50%	On hold but with growing concerns about housing strength.
Aus	Feb employment chg	10.4k	10k	17k	There has been a more constructive tone in the leading indicators.
	Feb unemployment rate %	5.4%	5.5%	5.4%	Our forecast rounds down to 5.4% so risks lie to the upside.
	Mar Westpac–MI unemploy. expect.	0.1%	–	–	Broadly flat in Feb the index is down almost 6% in the last 6 months.
	Mar MI inflation expectations %yr	2.2%	–	–	Has lifted off the low of 1.8%yr but still a very benign print.
	RBA Assistant Governor Kent speaking	–	–	–	To Australian Institute of Builders, Sydney 6pm AEDT.
US	Feb PPI %mth	0.2%	0.6%	0.5%	Gasoline price rises, other energy little changed, farm prices fell.
	Feb PPI core %mth	0.2%	0.1%	0.2%	Autos an upside risk.
	Q4 current account balance $bn	–107.5	–112.8	–113.0	Trade deficit widened in Q4, but other components can be fickle.
	Initial jobless claims w/e 10/3	340k	–	350k	Week prior to payrolls survey week.
	Fed releases CCAR	–	–	–	Details whether banks to pay dividends or build up capital.
Can	Q4 capacity utilisation rate %	80.9	–	80.9	Sluggish growth barely impacting on capacity use.
	Jan new house prices %yr	2.3%	–	–	Little impact of housing slowdown in new build prices yet.
Fri 15					
NZ	Feb manufacturing PMI	55.2	–	–	Strong Jan reading caught the market's attention, but it's volatile.
Eur	Feb core CPI %yr	1.3%	1.4%	–	Lowest since mid 2011. Feb flash headline CPI was 1.8%.
	Q4 labour costs %qtr	2.0%	–	–	Edging higher through 2012 but lower than in most of 2011.
	Q4 employment %qtr	–0.2%	–	–0.4%	Employment began to fall just before the current recession began.
US	Feb CPI %mth	flat	0.4%	0.5%	Gasoline prices jumped sharply in Feb but food prices constrained
	Feb CPI core %mth	0.3%	0.2%	0.1%	Jan's core spike should settle back to a 0.1% rise.
	Mar NY Fed factory survey	10.0	8.0	2.0	Sequester worries?
	Feb industrial production %mth	–0.1%	0.3%	0.4%	Factory output likely higher but utilities lower. See text box.
	Mar UoM consumer sentiment prelim	77.6	78.0	73.5	300 responses in prelim; IBD-TIPP down sharply with 900 replies.
	Jan TIC data, $bn	64.2	–	–	Net long term TIC flows.
	Fedspeak	–	–	–	Fisher on 'too big to fail'.
Can	Feb existing home sales %mth	1.3%	–	–	New data series, Jan saw only second rise in sales in eight months.

New Zealand Economic and Financial Forecasts

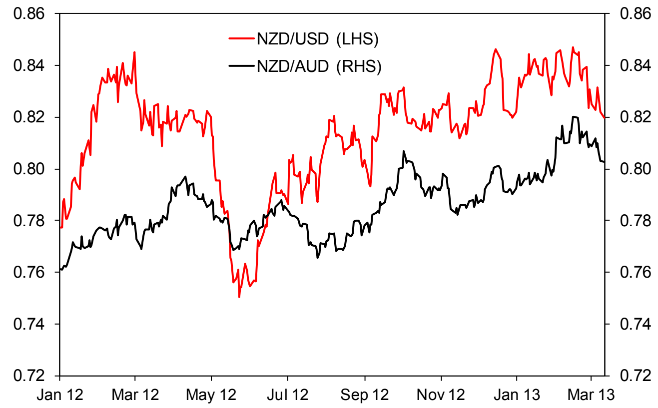
Economic Growth Forecasts	March years				Calendar years			
% change	2012	2013f	2014f	2015f	2011	2012e	2013f	2014f
GDP (Production) ann avg	1.9	2.2	3.3	3.1	1.5	2.4	3.0	3.2
Employment	1.0	0.1	2.8	2.5	1.5	-1.4	4.1	2.6
Unemployment Rate % s.a.	6.7	6.8	5.8	4.8	6.4	6.9	6.0	5.0
CPI	1.6	1.1	1.9	2.3	1.8	0.9	2.0	2.3
Current Account Balance % of GDP	-4.4	-4.9	-5.0	-6.3	-4.0	-5.0	-4.8	-6.1

Financial Forecasts	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.50	2.50	2.50	2.75	3.25	3.50
90 Day bill	2.70	2.70	2.75	3.20	3.50	3.75
2 Year Swap	2.90	3.00	3.10	3.30	3.60	3.90
5 Year Swap	3.40	3.50	3.60	3.80	4.00	4.30
10 Year Bond	3.70	3.80	3.90	4.10	4.30	4.40
NZD/USD	0.83	0.86	0.86	0.86	0.85	0.83
NZD/AUD	0.81	0.83	0.83	0.85	0.86	0.86
NZD/JPY	78.9	79.1	78.3	76.5	74.8	71.4
NZD/EUR	0.63	0.64	0.65	0.67	0.67	0.67
NZD/GBP	0.54	0.55	0.55	0.55	0.56	0.54
TWI	76.3	77.8	78.2	78.7	78.6	77.3

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 11 March 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.66%	2.67%	2.66%
60 Days	2.66%	2.67%	2.68%
90 Days	2.66%	2.66%	2.67%
2 Year Swap	3.00%	2.99%	2.90%
5 Year Swap	3.55%	3.56%	3.37%

NZ foreign currency mid-rates as at Monday 11 March 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8197	0.8362	0.8356
NZD/EUR	0.6311	0.6318	0.6261
NZD/GBP	0.5495	0.5528	0.5290
NZD/JPY	78.637	78.870	77.494
NZD/AUD	0.8028	0.8116	0.8109
TWI	75.600	76.380	75.890

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012e	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	2.5	2.8
Unemployment %	5.6	5.2	5.2	5.3	6.1	6.1
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-3.0	-3.8
United States						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.6	1.5
Consumer Prices %yr	-0.3	1.6	3.1	2.1	2.1	2.0
Unemployment Rate %	9.3	9.6	8.9	8.1	7.8	7.8
Current Account %GDP	-2.7	-3.0	-3.1	-3.0	-2.9	-2.9
Japan						
Real GDP %yr	-5.7	4.9	-0.4	1.9	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	1.9	1.5	-0.5	-0.5	-0.5
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.4
Unemployment Rate %	9.5	10.0	10.1	11.7	12.0	12.5
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	2.7	2.3	1.8
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.4	-1.9	-3.8	-2.0	-1.5

Forecasts finalised 8 March 2013

Interest Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
Australia						
Cash	3.00	2.75	2.75	2.75	2.75	2.75
90 Day Bill	2.98	3.00	3.10	3.10	3.00	3.00
10 Year Bond	3.40	3.50	3.50	3.30	3.20	3.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.94	2.10	2.20	2.10	2.00	1.80
ECB Repo Rate	0.75	0.75	0.75	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
AUD/USD	1.0269	1.04	1.03	1.01	0.99	0.97
USD/JPY	94.86	92	91	89	88	86
EUR/USD	1.3105	1.34	1.32	1.29	1.26	1.23
AUD/NZD	1.2396	1.21	1.20	1.17	1.16	1.17

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