



Nugget Point, Balclutha

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A look back

In 2013 New Zealand has cheered on the unbeaten All Blacks, once again become a nation of frustrated sailing fans, and suddenly taken an unprecedented interest in women's golf. Wellingtonians were reminded that they live on a fault line, Mr and Mr (or Mrs. and Mrs) can now be legally married, The Luminaries became a popular choice for holiday reading and the number of Kiwi's topped 4.5million. And as the year draws to a close it's an opportunity to pause and reflect on where the economy is today compared with where we thought we'd be a year ago.

The economy has accelerated markedly as we anticipated. It has built up a head of steam as cranes have replaced broken buildings on the Canterbury skyline, house prices have accelerated into uncharted territory and firms have increasingly had the confidence to translate a more optimistic outlook into investment and hiring decisions.

Of course one important event that was missing from our forecasts in December last year was the drought which gripped the country in late summer. The economy grew just 0.6% over the first half of the year. But thanks to excellent spring growing conditions, the agricultural sector and dairy production in particular has staged an impressive rebound.

Indeed the big lift in agricultural production is an important reason we're forecasting 1.4% GDP growth in the September quarter (released Thursday). Milk production alone is estimated to be up 35% in the quarter on a seasonally adjusted basis. But improvements are not just confined to the rural sector. Non-food manufacturing, construction, forestry and communication sectors (amongst others) are also expected to make significant positive contributions to GDP growth in the September quarter.

Complicating this week's GDP and balance of payments releases will be revisions to historical data. Stats NZ has signalled a range of improvements to the way it measures

Happy holidays!

This is the last Weekly Commentary for 2013.

Weekly Commentary will resume on 13 January 2014.



A look back continued

components of both GDP and the balance of payments. Broadly, these relate to improved measurement of quake related repair work, new ways of calculating activity in the communications sector, better methods for collecting information on overseas visitor spending in New Zealand and improved estimates of spending on low-value imports. The net effect of the revisions will be a higher level of GDP and a smaller current account deficit. In short, New Zealand's dearth of savings is not nearly as severe as official figures have made it look – something we have been talking about for some years.

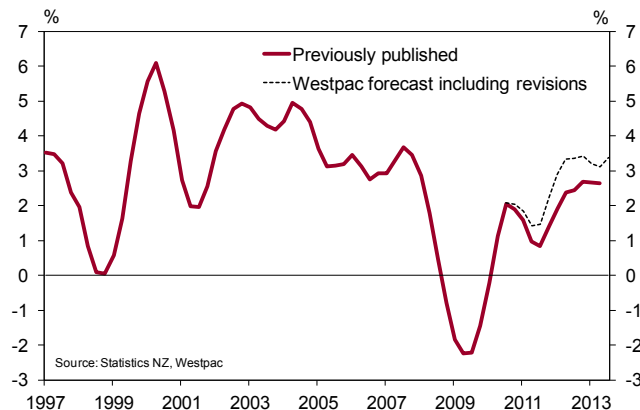
The record high terms of trade – thanks to exceptionally strong export commodity prices – was one of the bigger surprises of 2013. A year ago we were expecting commodity prices to improve, but not nearly as much as they have done. Dairy prices in particular have been the star performer but meat, logs and wool prices have all improved significantly in recent months despite a lacklustre global economy.

A consistent theme in our commentaries over the last year has been our view on the housing market. In particular we were adamant that low interest rates would fuel house price inflation in 2013. REINZ data last week showed house price inflation running at 9.6%yr in November.

We have been equally adamant that rising interest rates and LVR restrictions would see turnover in the housing market slow from around November with house price inflation starting to slow in 2014. In this regard, the 10% drop in sales since the LVR restrictions came into effect on the 1st of October has been right on cue. Turnover in the housing market gives a good lead on house price inflation. The drop in house sales bolsters our view that the rate of house price inflation will slow to 6.5% next year. And while LVR restrictions themselves weren't cemented into our forecasts at the start of the year, we have long warned of the RBNZ's desire to change the mix of monetary policy conditions through the use of macroprudential tools.

November REINZ data bolsters our view that the housing market will prove weaker than the RBNZ forecast in its December MPS published last week. We also think the exchange rate could well prove stronger. On our forecasts both the US and Australian

Annual average GDP growth



economies will need more monetary stimulus than markets currently expect in the coming months, even as the start date for rate hikes in New Zealand draws closer. In contrast we think the economy and migration could both prove stronger than the Reserve Bank expects. On balance, we're taking the RBNZ at its word and are now expecting the first rate hike in March next year which is consistent with the published interest rate projections in its latest *Monetary Policy Statement*. But the risk is that a higher exchange rate and weaker housing market could cause the RBNZ to go weak at the knees and delay OCR hikes.

March 2014 is a later start date for the hiking cycle than we were tipping a year ago. An important reason for this is that the exchange rate has been stronger than expected and consequently inflation has been weaker. The more benign inflation outlook has allowed the RBNZ to keep interest rates low for longer – but not indefinitely.

As always, the New Zealand data calendar is chock-a-block at the end of the year. As well as GDP and Balance of Payments releases this week, we have our own consumer confidence survey, monthly business confidence, net migration data and another GlobalDairyTrade auction. We'll also fit in the Government's Half Year Fiscal Update on Tuesday.

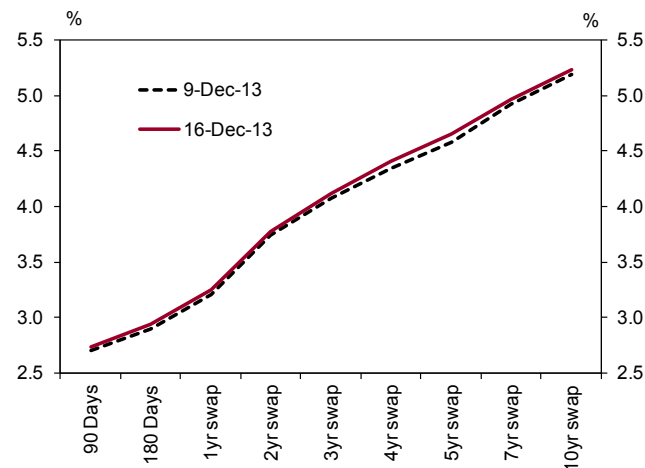
Fixed vs Floating for mortgages

From March 2012 until August 2013, we recommended fixed rates for mortgage customers. At the time, fixed rates were lower than or similar to floating rates. That offered a great opportunity to borrowers, given that we expected floating rates would rise substantially in coming years.

But fixed mortgage rates rose in mid-2013. On 2nd September 2013 we switched to an "indifferent" stance - fixed rates seemed a fair reflection of the expected increase in floating rates, and we could identify no term that was better value than another. We maintained that neutral stance until last week.

This week, we are switching to recommending fixed rates of one to three years for customers with lower than 80% loan to value ratios (LVRs). One-year rates are below floating for low-LVR borrowers. Three year rates are higher than floating, but are still very good value. Three year rates are too low to be a fair reflection of where we think short-term rates are heading. This opportunity to fix may not last long - wholesale interest rates are on the rise again, which could translate to higher fixed mortgage rates in the coming weeks.

NZ interest rates

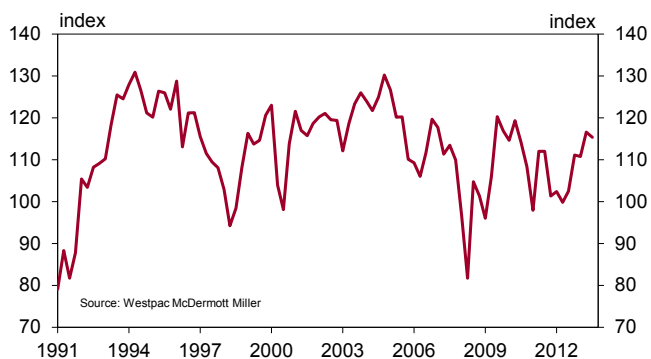


NZ Q4 Westpac-MM Consumer Confidence

Dec 16, Last: 115.4

- Consumer confidence eased slightly in the September survey, but it was still the second highest reading since mid-2010.
- On the positive side, there was an ongoing improvement in households' reported financial situation and an associated lift in reported discretionary spending, although both are still low by pre-recession standards.
- However, there were also signs of greater financial caution, with fewer people saying it is a good time to buy a major household item, and fewer saying they would spend a cash windfall. We noted a particularly large drop in willingness to buy a major household item in the Auckland region and, in general, urban areas fared worse than rural ones.
- The December survey was in the field over 1-10 December.

NZ consumer confidence

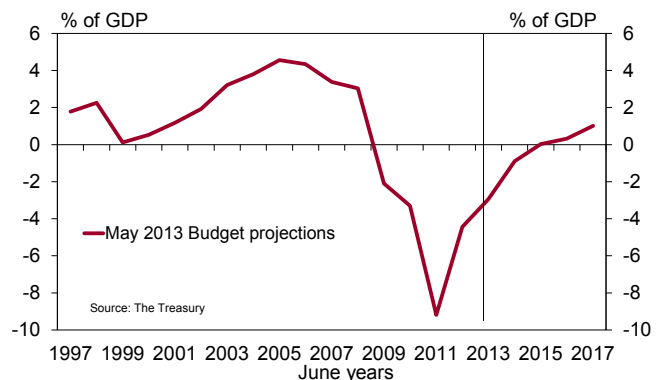


NZ Half Year Fiscal Update

Dec 17

- The Government provides an update of its economic forecasts as well as its revenue and expense projections in Tuesday's Half Year Fiscal Update and Budget Policy Statement.
- We expect that Treasury will have a more optimistic view of domestic economic activity than in the May Budget. This should be reflected in improved revenue forecasts in particular. In such an environment, the Government's goal of achieving an operating surplus in 2014/15 is unlikely to come under threat.
- Any major policy initiatives or new spending are likely to be saved up for an election year budget when the Government may be able to get more bang for its buck.

Operating balance (excluding gains and losses)

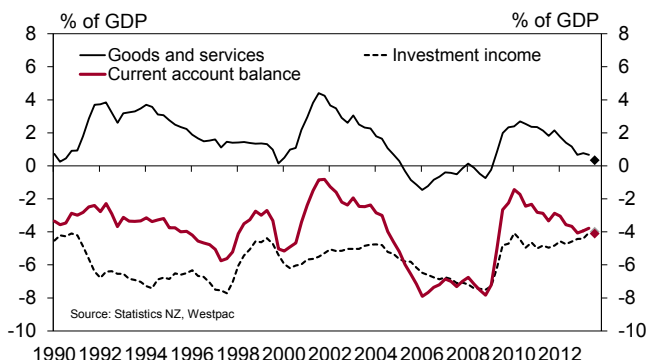


NZ Q3 current account balance

Dec 18, Last: -4.3%, WBC f/c: -4.1%, Mkt: -4.1%

- Revisions to the measurement of international trade have substantially narrowed the current account deficit going back to 1988. We estimate that the deficit for the year to June 2013 will be revised from 4.3% to 3.8% of GDP.
- From that improved starting point, we expect the deficit to widen to 4.1% of GDP for the year to September. Imports rose sharply in the September quarter, partly due to one-off items but also due to a jump in consumer goods and capital equipment.
- While export prices rose sharply, volumes remained depressed by the effects of the drought earlier this year. In the next few quarters, we expect a rebound in export volumes and sustained high prices to narrow the current account deficit again.

NZ annual current account balance

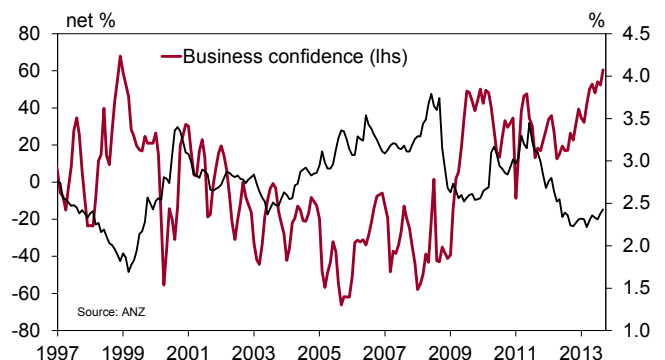


NZ Dec ANZ business confidence

Dec 18, Last: 60.5

- Business confidence rose to a new 14-year high in November, reinforcing the sense that the New Zealand economy's upswing is becoming firmly entrenched and wide-ranging.
- Monthly indicators have generally remained positive into year-end except for housing activity, where the new loan-to-value limits have clearly been a constraining factor. The informal BNZ business confidence survey rose even further into record territory in late November.
- The survey's indicators of inflation pressures are also starting to show signs of life, though they remain well below boom-time levels. Nevertheless, the RBNZ's strengthened commitment to anchoring inflation expectations to the 2% target midpoint means that these indicators will take on a growing importance.

NZ business confidence and inflation expectations

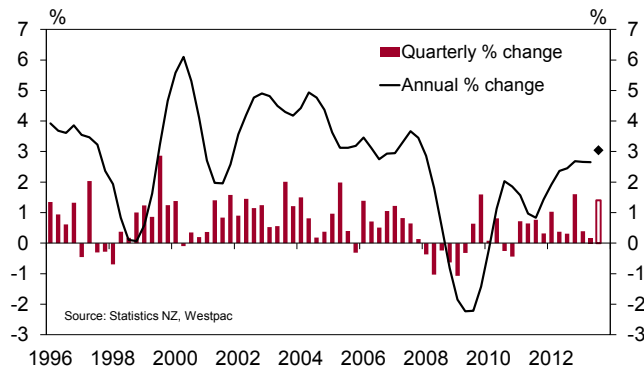


NZ Q3 GDP

Dec 19, Last: 0.2%, WBC f/c: 1.4%, Mkt: 1.1%

- GDP growth was subdued over the first half of this year as a short but intense drought hammered agricultural production. The fact that the economy did not slip into recession, as it often does during droughts, is a testament to the underlying strength of the economy.
- The rebound in agricultural output has been remarkably swift; we estimate that it added 0.6ppts to GDP growth in the September quarter, lifting our forecast for total growth to 1.4%.
- Aside from agriculture, indicators point to robust gains across a range of sectors including manufacturing, construction and personal services.
- Revisions to recent history are expected to lift annual growth above 3%, though the details remain uncertain.

Production based GDP (excluding revisions)

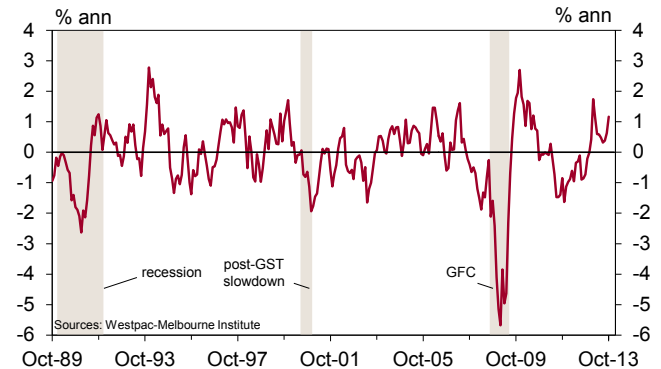


Aus Nov Westpac-MI Leading Index

Dec 18, Last: 1.2%

- The six month annualised deviation from trend growth rate of the Westpac Melbourne Institute Leading Index of Economic Activity rose to 1.2% in Oct from 0.6% in Sep. Note that Westpac and the Melbourne Institute introduced a redesigned Index last month that includes significant changes in the components that, amongst other things, means more timely updates are now available.
- Components have been mostly weaker in recent months: the ASX down 2% in Nov and a further 3.2% in Dec; the CSI Expectations Index down 2.4% and a further 5% in Dec; the Unemployment Expectations Index down 0.9% and 4.6% (rises indicate a deteriorating outlook); dwelling approvals down 1.8% in Oct following Sep's 16.9% spike; and hours worked down 0.7%. Against this, commodity prices rose 1.5% in AUD terms in Oct and the yield spread became more positive.

Westpac-MI Leading Index

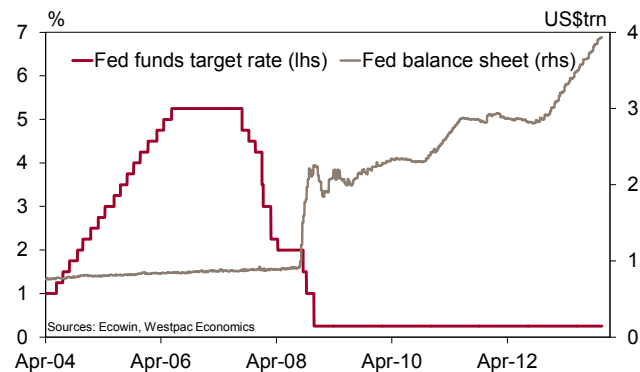


US FOMC policy decision

Dec 17-18

- The pick-up in 3-month average payrolls growth from immediately before the September 'no taper' decision to now (146k to 193k) and the 7% unemployment rate in November has seen market expectations of a near-term taper firm once again. This is despite the current pace of payrolls growth being little changed from 2012, and the lower unemployment rate being driven by declining participation, not job growth.
- To us, the absence of a material pick-up in job growth, weak domestic final demand and the US' slew of structural concerns all point to the best policy response in December (and indeed 2014) being no taper. Should the Fed surprise us with a near-term initial taper, on our base case for growth, the process would grind to a halt in 2014 and indeed may need to be reversed. Watch out for any additional commentary on forward guidance and interest on excess reserves.

Fed funds target rate and balance sheet



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 16					
NZ	Q4 Westpac-MM consumer confidence	115.4	–	–	Consumer confidence close to 3-year high in September.
	Nov Performance of Services Index	58.2	–	–	Persistently strong over the course of this year.
Eur	Dec PMI factory advance	51.6	51.8	–	German recovery being offset by ongoing French contraction in both manufacturing and services.
	Dec PMI services advance	51.2	51.4	–	
	Oct exports	0.2%	–	–	Back-to-back gains in Aug and Sep.
UK	Dec house prices, %yr	4.0%	–	–	Rightmove index of asking prices - last boost from BoE/Treasury FFL.
US	Dec Empire manufacturing survey	-2.2	5.0	8	Noisy index may over-compensate for Nov dip below 0.
	Nov industrial production	-0.1%	0.6%	0.4%	ISM survey strong; hours worked in factories up 0.2%.
	Oct TIC data \$bn	-66	–	–	Net long term flows; Q3 saw first net inflow since start of year.
	Q3 productivity revisions	1.9% a	–	–	Will be revised higher, as growth was.
Can	Nov existing home sales	-3.2%	–	–	Little history to this series.
Tue 17					
NZ	Half-Year Fiscal and Economic Update	–	–	–	To reflect stronger domestic economy.
Aus	RBA meeting minutes	–	–	–	Dec meeting statement almost identical to Nov.
	RBA Asst Gov Debelle speaking	–	–	–	Australasian Finance and Banking Conference, Sydney 11.15am AEDT.
	Mid year budget update	–	–	–	Report expected to be released today. See preview note from Friday.
	Nov new motor vehicle sales	-0.7%	–	2.5%	Industry figures show sales improved in Dec but still down 1.4%yr.
Eur	Q3 labour costs %yr	0.9%	–	–	In downtrend since 2011.
	Nov CPI final %yr	0.9% a	–	–	Core rate was 1.0%yr in flash report.
Ger	Dec ZEW survey of analyst expectat.	54.6	–	50.0	Sentix showing some signs of peaking.
UK	Nov PPI %yr	0.9%	1.0%	–	Core output measure.
	Nov CPI %yr	2.2%	2.2%	–	Core inflation sitting below 2% target at 1.7%.
	Oct ONS house prices	3.8%	–	–	Dated relative to private measures, but accelerating.
	Dec CBI industrial trends survey	11	11	–	Total orders series.
US	Dec NAHB housing index	55	54	53	Momentum in housing market looks to be slowing.
	Nov CPI	-0.1%	0.1%	0.1%	Gasoline prices bottoming; core pressures benign with occasional component spikes quickly reversed.
	Nov CPI core	0.1%	0.1%	0.1%	
	Q3 current account deficit \$bn	98.9	101.0	–	Trade deficit a little wider in Q3.
Can	Oct manufacturing sales	0.6%	-0.3%	–	Sep rise led by autos.
Wed 18					
NZ	GlobalDairyTrade auction	3.9%	–	–	Can prices be sustained at these levels?
	Q3 current account % of GDP	-4.3%	-4.1%	-4.1%	Deficit widened in Q3, against a revised starting point.
	ANZ business confidence	60.5	–	–	Indicators of price pressures becoming more important.
Aus	RBA Governor Stevens testimony	–	–	–	House of Reps' Standing Committee on Economics, Canberra 9.30am AEDT.
	Nov Westpac-IMI Leading Index	1.2%	–	–	Revamped index, now more timely.
Chn	Nov new property prices %net bal	–	–	–	Early signs that renewed controls in tier 1 cities taking effect.
Eur	Oct construction output, %yr	-0.2%	–	–	Lack of credit supply still a concern for sector.
Ger	Dec Ifo business climate index	109.3	–	109.0	Sharp Nov rise may have been premature.
UK	Bank of England minutes	–	–	–	Has ongoing upswing in UK data altered risks around Nov forecasts?
	Nov unemployment ch	-42k	-35k	–	Claimant count measure.
US	Nov housing starts	–	–	–	3 months' data to be released.
	Nov building permits	6.7%	-4.7%	–	but multiples distort the headline picture.
	FOMC decision APP per mth \$bn	85	85	85	Tapering case not yet made. See text box.
Can	Oct wholesale trade	0.2%	0.3%	–	Has not posted fall since June.
Thu 19					
Aus	Dec RBA Bulletin	–	–	–	A handy compendium of economic research.
NZ	Q3 GDP	0.2%	1.1%	1.4%	Post-drought rebound on top of broad-based upturn.
UK	Nov retail sales incl. fuel	-0.7%	0.2%	–	Retailing less impressive aspect of UK upswing.
US	Initial jobless claims w/e 13/12	368k	355k	350k	Claims bounce following holiday seasonal issues.
	Dec Philadelphia Fed index	6.5	10	6.0	Sub-10 readings consistent with modest growth view.
	Nov existing home sales	-3.2%	-1.4%	-2.0%	Pending sales down 5 months running; mortgage rates higher.
	Nov leading indicators	0.2%	0.7%	–	Has not posted a decline since Mar.
Fri 20					
NZ	Net immigration, November (s.a.)	3,000	–	2,900	Annual migration to head above 20,000 by year end.
Eur	Dec consumer confidence adv	-15.4	–	-15.0	Confidence upswing stalled in Nov.
Ger	Nov PPI %yr	-0.7%	–	–	Deflation in Germany limited to industrial sector.
	Jan GfK consumer confidence	7.4	–	–	Surveyed early Dec despite Jan label.
UK	Nov PSNCR, £bn	-16.8	–	–	Public sector net credit requirement. PSNB ex intv'ns £8.1bn in Oct.
	Dec GfK consumer confidence	-12	-11	–	Upswing in sentiment stalled?
	Q3 GDP final	0.8% a	0.8%	0.8%	Q4 now in focus, looking even stronger than Q3.
	Q3 current account deficit GBPbn	-13.0	-14.0	–	Prone to revision and volatility.
US	Q3 GDP final	3.6% a	3.5%	3.5%	Payback for surge in Q3 GDP could be fall in Q4.
	Dec Kansas City Fed factory index	7	–	–	Has not posted fall since June.
Can	Nov CPI %yr	0.7%	1.0%	–	BoC core rate 1.2% yr in Oct.
	Oct retail sales	1.0%	0.2%	–	Sep retail sales boosted by autos

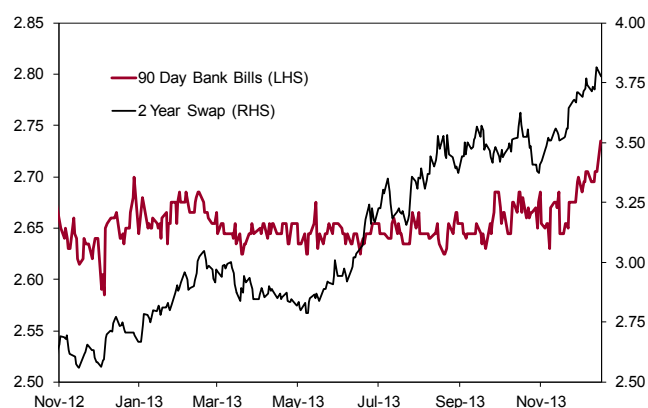


New Zealand forecasts

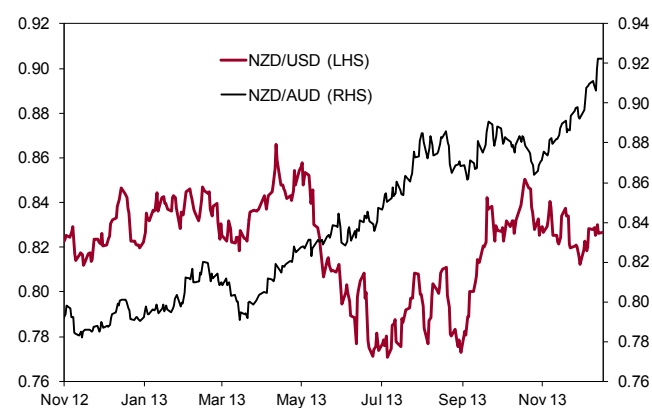
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.7	3.0	3.7	1.4	2.7	2.9	3.7
Employment	0.9	0.4	3.0	2.6	1.6	0.4	2.4	2.8
Unemployment Rate % s.a.	6.8	6.2	5.7	5.1	6.3	6.7	6.0	5.1
CPI	1.6	0.9	1.3	2.2	1.8	0.9	1.5	1.9
Current Account Balance % of GDP	-3.8	-4.5	-4.2	-5.0	-3.6	-4.7	-4.3	-4.5

Financial Forecasts	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Cash	2.75	3.00	3.25	3.50	3.75	4.00
90 Day bill	3.00	3.25	3.50	3.75	4.00	4.25
2 Year Swap	3.80	4.00	4.20	4.40	4.60	4.80
5 Year Swap	4.60	4.70	4.80	4.90	5.00	5.10
10 Year Bond	4.75	4.80	4.85	4.90	4.95	5.00
NZD/USD	0.85	0.84	0.83	0.81	0.80	0.79
NZD/AUD	0.92	0.93	0.92	0.92	0.92	0.91
NZD/JPY	81.6	79.8	78.0	75.3	75.2	73.8
NZD/EUR	0.63	0.65	0.64	0.64	0.63	0.63
NZD/GBP	0.52	0.52	0.51	0.50	0.48	0.47
TWI	79.3	79.2	78.2	77.0	76.4	75.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 16 Dec 2013

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.50%	2.50%
30 Days	2.68%	2.68%	2.65%
60 Days	2.70%	2.70%	2.65%
90 Days	2.74%	2.71%	2.64%
2 Year Swap	3.78%	3.69%	3.51%
5 Year Swap	4.65%	4.53%	4.41%

NZ foreign currency mid-rates as at Monday 16 Dec 2013

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8265	0.8140	0.8348
NZD/EUR	0.6019	0.5990	0.6187
NZD/GBP	0.5072	0.4971	0.5178
NZD/JPY	85.31	83.40	83.74
NZD/AUD	0.9225	0.8913	0.8902
TWI	77.85	76.52	77.92

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
Australia						
Real GDP % yr	1.5	2.3	2.6	3.6	2.4	2.6
CPI inflation % annual	2.1	2.8	3.0	2.2	2.3	2.5
Unemployment %	5.6	5.2	5.2	5.3	5.8	6.4
Current Account % GDP	-4.7	-3.5	-2.8	-4.1	-3.1	-3.8
United States						
Real GDP %yr	-2.8	2.5	1.8	2.8	1.6	1.6
Consumer Prices %yr	-0.3	1.6	3.1	2.1	1.5	1.7
Unemployment Rate %	9.3	9.6	8.9	8.1	7.5	7.1
Current Account %GDP	-2.7	-3.0	-2.9	-2.7	-2.5	-2.5
Japan						
Real GDP %yr	-5.5	4.7	-0.6	2.0	1.7	1.6
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	1.5	-0.6	-0.5	-0.1
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	-5.2	1.7	1.1	0.2	1.1	0.9
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 8 November 2013

Interest Rate Forecasts	Latest	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
Australia						
Cash	2.50	2.25	2.00	2.00	2.00	2.00
90 Day Bill	2.59	2.35	2.10	2.10	2.10	2.10
10 Year Bond	4.32	4.00	3.60	3.80	4.00	4.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.86	2.60	2.40	2.80	3.00	2.90
ECB Repo Rate	0.25	0.25	0.25	0.25	0.25	0.50

Exchange Rate Forecasts	Latest	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
AUD/USD	0.8960	0.92	0.90	0.90	0.88	0.87
USD/JPY	103.26	96	95	94	93	94
EUR/USD	1.3731	1.34	1.30	1.30	1.27	1.26
AUD/NZD	1.0841	1.08	1.07	1.08	1.07	1.09

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Disclaimer continued

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