



Weekly Commentary

17 June 2013

Things left unsaid

On the face of it, last week's *Monetary Policy Statement* seemed to be a straightforward affair, with the RBNZ maintaining its stance on interest rates and making only minor changes to its economic forecasts. But we found it notable for what was left unstated around a couple of key matters.

The first matter was the near-absence of discussion about macroprudential tools – this was a straight-out assessment of monetary policy and inflation conditions. This is appropriate: macroprudential tools are aimed at the soundness of the financial system, and are not a substitute tool for monetary policy, although they do form part of the economic backdrop when assessing monetary conditions. While macroprudential tools will be increasingly discussed as their framework is finalised over coming months, for now no decisions have been made about their use, and the RBNZ has prepared its forecasts under the assumption of no changes to prudential policy.

The second notable absence in the RBNZ's assessment was the recent fall in the New Zealand dollar. Indeed, the market seems to have been caught out by the fact that the RBNZ *raised* its exchange rate projections relative to the March MPS. That was partly an accident of when the RBNZ finalised its forecasts (at the end of May, when the currency was still higher on a trade-weighted basis), although the more timely media statement didn't place much significance on the currency's decline either.

Furthermore, the RBNZ's alternative scenarios addressed the risk of an additional upside surprise on the exchange rate. In this instance, a 2% permanent increase in the trade-weighted index would equate to around 100 basis points of OCR cuts over the next year. The implication, though, is that the interest rate outlook would be just as sensitive in the other direction. And as it happens, the exchange rate is currently sitting about 4% below the RBNZ's central projection.

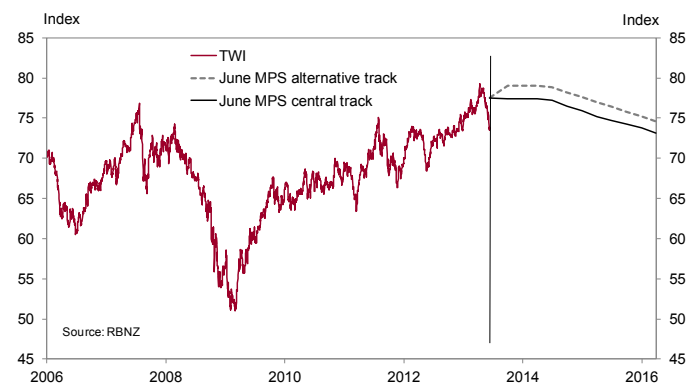
That said, the relationship not quite so straightforward. There are two conditions under which a lower exchange rate would significantly alter the RBNZ's stance. The first is that the move would have to be driven by a shift in investor attitudes, not a deterioration in New Zealand's economic fundamentals. We can safely tick that box – recent market movements have largely been driven by the expectation that the US central bank will scale back its bond-buying programme as the US economy improves.

The second condition is that it would have to be sustained, and there is simply no way to determine that right now. Our own view is that the NZ dollar will strengthen later this year, similar to the RBNZ's central view. But forecasting short-term exchange rate movements can be a humbling exercise. If the TWI is still lingering around current levels in six weeks' time, then it will form the base case for the July OCR review – and the RBNZ's tone would become accordingly more hawkish. Even more so if the TWI was still in the low 70s or lower when the September *MPS* rolls around.

Our view remains that OCR will remain at 2.5% for the rest of this year, before rising steadily from March 2014. While our forecasts differ from the RBNZ's in several respects, overall we see greater upside risks to inflation. We expect that the Canterbury rebuild will produce just as much inflation pressure as past building booms have done, and that rising house prices will provoke consumer spending in a similar fashion to past housing cycles.

Last week's economic data releases were all broadly in line with our understanding of the economy. Electronic card spending continues to grow steadily, the housing market remains very tight, and food prices are still flat to falling in annual terms. But there's one release that we'd like to single out: the PMI manufacturing survey rose to 59.2 in May, its highest level in almost nine years. That strength looks to be broad-based across subsectors and regions.

Fig 3: TWI, with projected scenarios



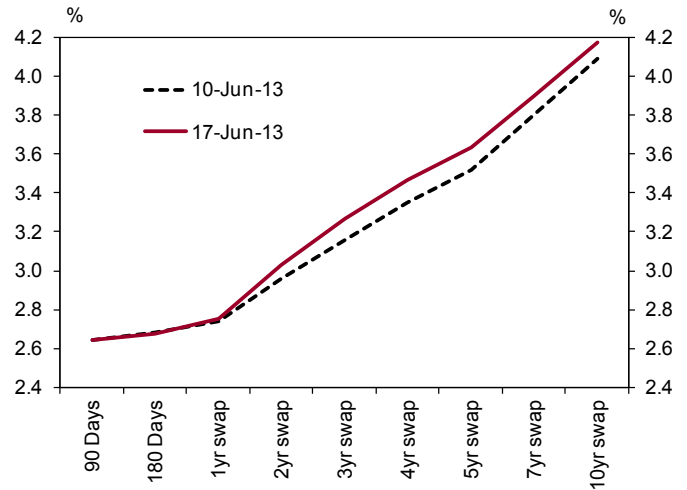


We don't want to make too much of the significance of this series – for instance, the March quarter manufacturing activity survey, which feeds directly into GDP, was quite disappointing to us compared to what the PMI survey implied over that period. But it does reinforce a point made by the RBNZ in a recent research article: the manufacturing sector on the whole is more exposed to domestic demand, and especially construction, than it is to export markets and the high NZ dollar. You only have to look at the equivalent manufacturing surveys in other countries (mostly weak, and dire in Australia's case) to realise that whatever is driving the upturn in manufacturing must be something NZ-specific. That something is a \$40bn earthquake rebuilding programme.

Post-quake reconstruction is likely to be the highlight of March quarter GDP, published this Thursday. We expect a modest 0.5% rise in GDP, following a storming 1.5% rise in the December 2012 quarter. Quite apart from the difficulty of repeating that feat, the March quarter figures will be held back by the impact of a short but severe drought, which cut milk production by 7%. Increased animal slaughter will be a positive for Q1 growth, but this is a timing issue that means the drought is likely to leave its biggest dent in the Q2 figures.

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



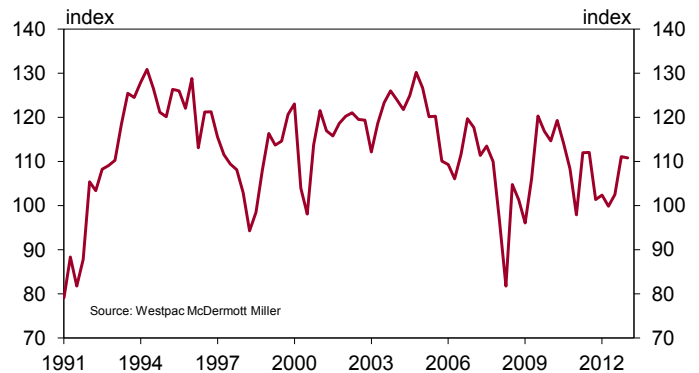
Key Data Previews

NZ Q2 Westpac-MM Consumer Confidence

Jun 17, Last: 110.8

- Consumer confidence was roughly unchanged in the March quarter after lifting out of the doldrums in late 2012.
- Consumer confidence is now back near its historical average. The details remain mixed. Most positively, the net percentage of households saying it is good time to buy a major household item rose for a fifth quarter in a row in March, to levels last seen during brief confidence bursts in mid-2010 and mid-2011. Households' perceptions of their own finances and their economic optimism remained relatively subdued.
- The Westpac McDermott Miller consumer confidence survey is a snapshot of sentiment at the start of the last month of the quarter, but asks households to think back over the past three months. The upcoming survey was taken over 1-10 June.

NZ consumer confidence



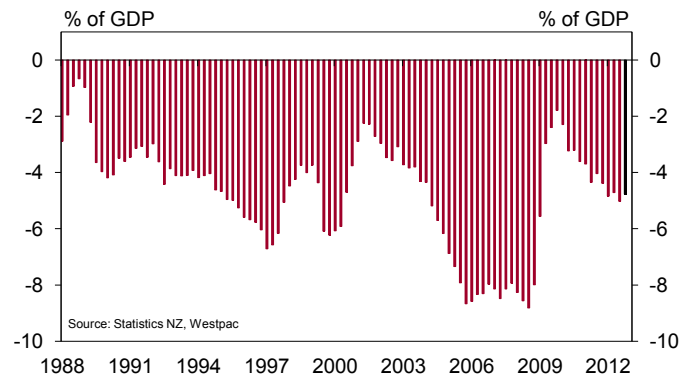


NZ Q1 current account balance

Jun 19, Last: -5.0%, WBC f/c: -4.8%, Mkt f/c: -4.8%

- We expect the annual current account deficit to narrow from 5.0% to 4.8% of GDP for the year to March owing mainly to a higher annual goods balance.
- Focusing on the March quarter, the seasonally adjusted goods balance increased as dairy export prices and volumes rose. We expect the investment income deficit to widen in Q1 as profits paid by foreign-owned NZ firms strengthened in line with the rest of the economy.
- We expect a volatile goods balance over 2013. The drought will hit export volumes, particularly in Q2, but increasing export (dairy) prices are likely to more than offset this by the end of the year. At the same time, imports are likely to increase as the Canterbury rebuild continues to ramp up. Stronger economic growth and higher interest rates from next year are likely to widen the investment income deficit.

NZ annual current account deficit

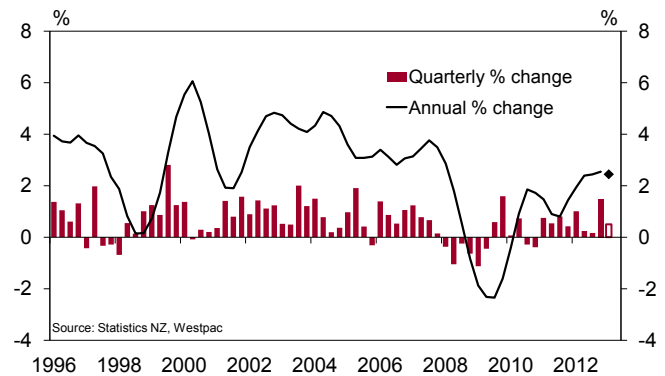


NZ Q1 GDP

Jun 20, Last: 1.5%, WBC f/c: 0.5%, Mkt: 0.5%

- Our pick for a modest 0.5% rise in March quarter GDP follows a storming 1.5% gain in Q4 2012. Aside from the fact that it would have been a big ask to repeat that effort, there was a short but sharp drought in early 2013 that will weigh on the growth figures for Q1, and probably more so for Q2.
- The construction sector will be the star performer, with the quake-hit Canterbury region recording a more than 20% rise in activity in the March quarter alone. Manufacturing was mixed, while the services sectors are likely to have recorded continued modest growth.
- Our forecast is at the middle of a fairly narrow range of market forecasts. Our main uncertainty is around the impact of the drought on the agriculture sector - bearing in mind that the initial estimate is often heavily revised over time.

Production based GDP

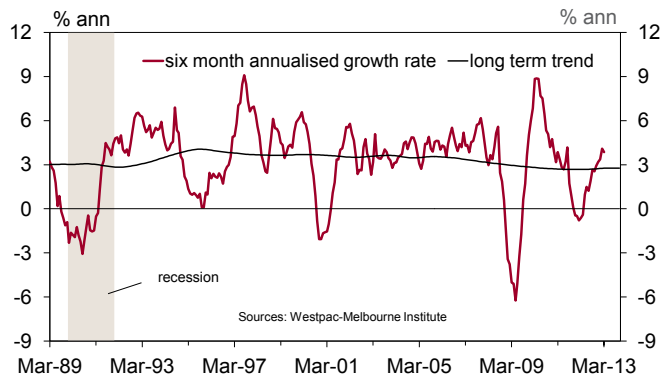


Aus Apr Westpac-MI Leading Index

Jun 19, Last: 3.9% annualised

- The annualised growth rate of the index, which indicates the likely pace of economic activity three to nine months into the future, slipped back a touch in Mar from 4.1%, to 3.9% but continued to point to above trend growth momentum (trend in the Index is 2.8%).
- The Apr release will see updated monthly data on: equities (ASX +3.8% vs -2.7% in Mar); money supply (+0.8% vs +0.5% in Mar); US industrial production (-0.5% vs +0.3% in Mar); and dwelling approvals (+9.1% vs -5.5% in Mar). It will also see the inclusion of updated quarterly data on: overtime worked (-11% vs +13% in Q4); manufacturing materials prices (flat vs +1.1% qtr in Q4); and on productivity and real corporate profits.

Westpac-MI Leading Index



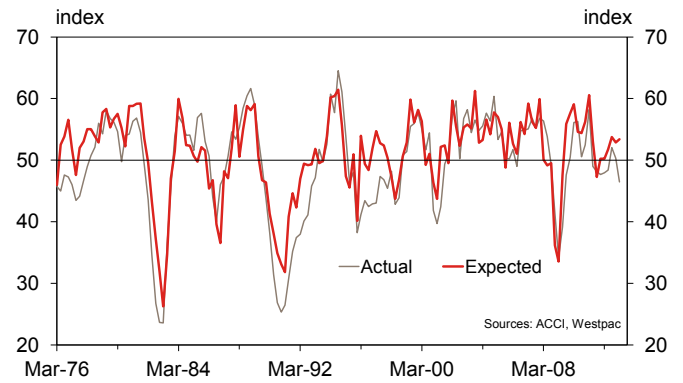


Aus Q2 Westpac-ACCI Survey of Industrial Trends

Jun 20, Last: 46.0

- The June quarter 2013 ACCI–Westpac Survey of Industrial Trends - the 207th report of this long running survey - will provide a timely update on current economic conditions and prospects. The survey was in the field from 9 May to 7 June.
- In the March quarter, the Westpac–ACCI Actual composite declined to 46.0, from 50.4. The Expected Composite was a touch stronger at 53.2, from 52.8. Broadly, the Survey depicted a sector under substantial pressure owing to the strength of the Australian dollar, and lacklustre domestic demand outside of mining – despite the material easing afforded by the RBA.
- Key for the June quarter release will be manufacturers' labour market and investment intentions. Growth in the Australian economy is decidedly sub-trend; with the peak in the mining investment boom drawing near, there is a real need for momentum in other sectors of the economy.

Westpac-ACCI composite indexes Actual & expected, sa

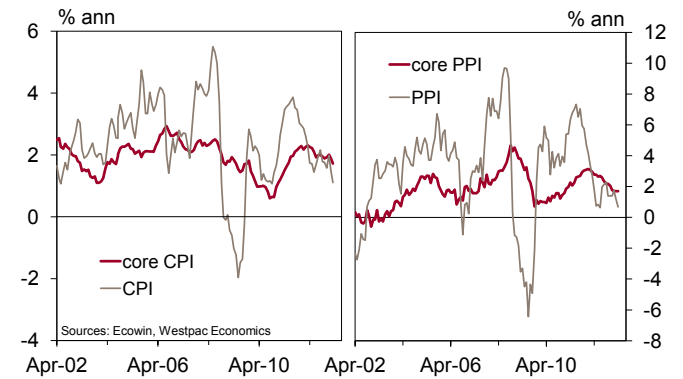


US May CPI

Jun 18, CPI: Last: -0.4%, WBC f/c: 0.2%

- The CPI posted a 0.4% contraction in April, the largest fall since the dark days of December 2008, while the fall in the annual rate to just 1.1% was to the lowest rate since June 2010. The drop in the headline was driven by a large fall in gasoline prices (-8.1%) aided by a mild rise in food prices (+0.2%). Clothing (-0.3%), air fares (-0.7%) and flat medical care held the core gain to 0.1%. The renewed softness in inflation underlines our concerns that the Fed remain well away from any 'tapering' in asset purchases over the next few months.
- Gasoline prices edged higher in May, and medical care and clothing prices pose upside risks (the latter after three monthly declines), but there is little else we can cite as driving upward price pressure. That should leave a subdued inflation picture intact, despite forecast above trend 0.2% rises in both the headline and core measures.

US price inflation



US May housing starts/permits/existing sales

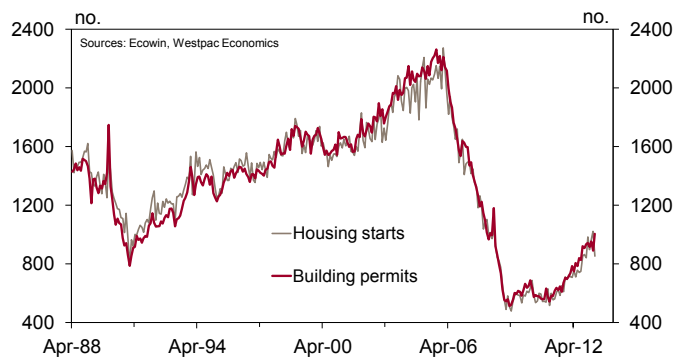
Jun 18, Housing starts: Last: -16.5%, WBC f/c: 8.0%

Jun 18, Housing permits: Last: 12.9%, WBC f/c: -4.0%

Jun 20, Existing home sales: Last: 0.6%, WBC f/c 0.4%

- Starts fell 17% in April due to the volatile multiples component, down 39% (and permits jumped 14% due to a 38% volatiles rise). Single-family home starts fell 2%, the second fall in a row to their lowest sales pace for 2013 so far. However singles permits rose 3% in April to a new cycle high of 617k, above single starts (610k) for the first month in 9, limiting further singles starts downside risk. We expect a small singles permits pull-back, flat singles starts, and the usual multiples-driven headlines.
- Indeed, last year's run up in housing has stalled on a range of indicators, not just single family starts: homebuilder sentiment, existing and even new home sales have levelled off since the start of this year. A modest pending home sales gain for April suggests a weak gain in existing home sales completions in May.

US housing starts & permits



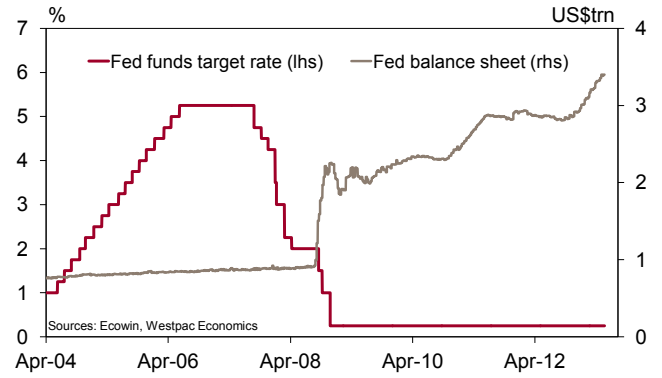


US FOMC meeting

Jun 19

- The May 1 FOMC issued a slightly more cautious assessment of the job market and more emphatic concern about fiscal policy than in the March statement. Also, the asset purchase outlook was expanded to include: "the Committee is prepared to increase or reduce the pace of its purchases to maintain appropriate policy accommodation as the outlook for the labour market or inflation changes." This attempt to make clear that policy may yet be eased further, seeking to prevent analysts/markets inferring that the next policy shift would only be towards a less accommodative stance, seems to have failed given the key theme of the past month has been the potential tapering of asset purchases! Fed chair Ben Bernanke we suspect privately shares our less optimistic view of the US economy so in his press conference he may seek to gently unwind tapering talk, that some of his regional Fed colleagues have openly encouraged of late.

Fed funds target rate and balance sheet





Key Data and Events

		Market Last	Westpac median	Westpac forecast	Risk/Comment
Mon 17					
NZ	Q2 Westpac-MM consumer confidence	110.8	-	-	Held steady in March after lifting strongly in December.
Aus	May new vehicle sales	-1.6%	-	0.5%	After a bumper 2012, sales down every month in 2013 so far (-4.4%ytd).
	May Performance of Services Index	56.1	-	-	Markedly stronger over the last three months.
Eur	Apr trade balance, €bn	18.7	-	-	External demand key to outlook for region.
UK	Jun house prices, %yr	2.5%	-	-	Rightmove measure; rose 2.1% in May.
US	Jun Empire manufacturing survey	-1.4	0.0	-	NY manufacturing activity remains weak.
Tue 18					
Aus	RBA meeting minutes	-	-	-	Should give more detail than the June decision's super-brief Gov's statmt.
Chn	May 70 city dwelling prices % net bal	94.3%	-	-	Expect a migration from "up" to "unchanged" to lower net balance.
Eur	Jun ZEW survey	27.6	-	-	Economic data poor but relatively stable; equities weak.
UK	May CPI	0.2%	0.1%	0.1%	Annual headline inflation stands at 2.4%yr; core inflation 2.1%yr.
	Apr ONS house prices	2.7%	-	-	Dated relative to private measures.
US	Jun NAHB housing index	44	45	-	Momentum in housing market looks to be slowing.
	May CPI	-0.4%	0.2%	0.2%	Gasoline prices have stopped falling; core pressures benign, see text box.
	May housing starts	-16.5%	11.4%	8.0%	Sharp April fall centred on a 39% drop in volatile multiples component.
	May building permits	12.9%	-2.7%	-4.0%	Small pull-back after April jump, on a 38% rise in multiples. See text box.
Wed 19					
NZ	Q1 current account % of GDP, annual	-5.0%	-4.8%	-4.8%	Expect a volatile balance over 2013.
Aus	Apr Westpac-MI Leading Index	3.9%	-	-	Wavered in Mar? But still pointing to momentum comfortably above trend.
Eur	Apr construction output, %yr	-7.9%	-	-	Lack of credit supply a big concern for sector, amongst many others.
UK	Bank of England minutes	-	-	-	Insight into thoughts of Committee ahead of Carney's arrival.
	May retail sales incl. fuel	-1.3%	0.5%	0.4%	Annual headline and core sales pace weak at 0.5% & 0.2% respectively.
US	FOMC meeting	-	-	-	Updated economic projections due; see text box.
Thu 20					
NZ	Q1 GDP	1.5%	0.5%	0.5%	Construction rampant, agri weak, modest growth elsewhere.
Aus	Q2 Westpac-ACCI Survey of Industrial Trends	46.0	-	-	Timely read on conditions in the manufacturing sector.
	Q2 RBA Bulletin	-	-	-	A treasure trove of economic analysis.
Chn	Jun HSBC flash manufacturing PMI	49.2	-	-	Export orders declining. Details imply another weak print.
Eur	Jun PMI manufacturing	48.3	48.4	48.4	Has shown signs of improvement, but sector still contracting.
	Jun PMI services	47.2	47.5	47.4	Persistent lack of demand for services unlikely to improve much.
Ger	May producer prices	-0.2%	0.0%	0.0%	Producer prices broadly flat over year.
	Jun PMI manufacturing	49.4	49.9	49.9	Nearing expansionary territory; so is the services sector.
UK	Jun CBI industrial trends survey	-20	-14	-	Total orders series; selling price series also due.
US	Initial jobless claims	334k	340k	342k	Claims look to have stabilised near multi-year low.
	Jun Philadelphia Fed index	-5.2	-1.0	-	Little in the way of momentum in US manufacturing.
	May existing home sales	0.6%	0.6%	0.4%	Little changed in 2013 following gains of late 2012.
	May leading indicators	0.2%	0.6%	0.5%	Modest underlying macro trend apparent, despite hype.
Fri 21					
Eur	Jun consumer confidence	-21.9	-21.5	-21.7	Not much for consumers to be optimistic about.
UK	May PSNCR, £bn	-10.8	-	-	Public sector net credit requirement. PSNB ex intv'ns £6.3bn in Apr.
Can	May CPI	-0.2%	0.4%	-	Inflationary pressures unthreatening.
	Apr retail sales	0.0%	0.2%	-	A lack of momentum apparent, particularly for ex auto sales.

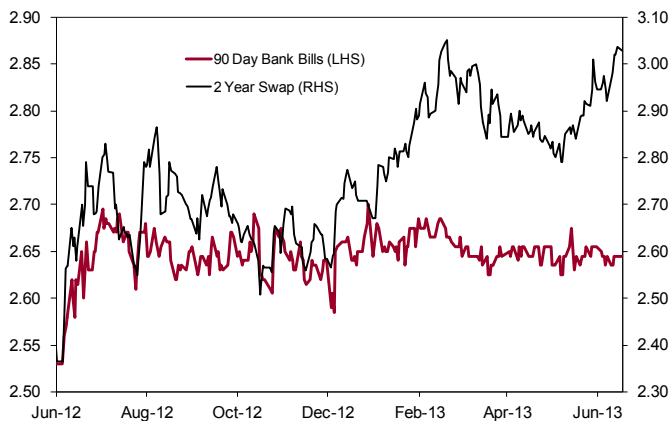


New Zealand Economic and Financial Forecasts

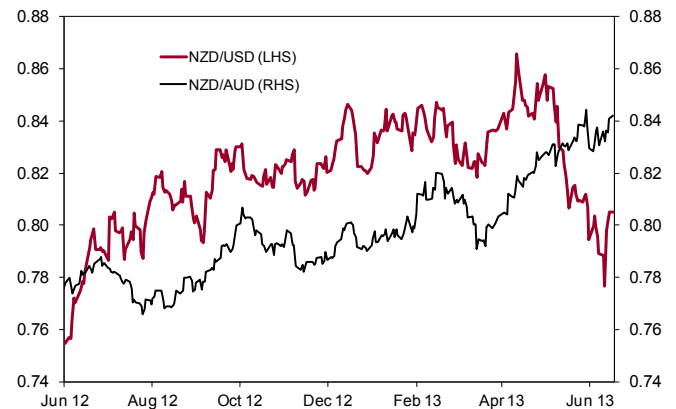
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.4	2.7	3.7	1.4	2.5	2.6	3.6
Employment	1.0	0.4	2.4	2.8	1.5	-1.4	3.2	3.2
Unemployment Rate % s.a.	6.7	6.2	5.7	4.8	6.3	6.8	6.1	5.0
CPI	1.6	0.9	1.4	2.5	1.8	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	3.00	3.10	3.30	3.50	3.70	3.90
5 Year Swap	3.60	3.70	3.80	3.90	4.00	4.10
10 Year Bond	3.65	3.70	3.75	3.80	3.85	3.90
NZD/USD	0.82	0.83	0.84	0.84	0.83	0.81
NZD/AUD	0.84	0.86	0.88	0.88	0.86	0.86
NZD/JPY	82.2	82.2	82.3	81.5	79.7	77.0
NZD/EUR	0.62	0.63	0.65	0.65	0.64	0.64
NZD/GBP	0.52	0.53	0.53	0.52	0.50	0.49
TWI	76.4	77.5	78.6	78.4	77.2	76.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 17 June 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.64%	2.64%	2.63%
60 Days	2.65%	2.65%	2.64%
90 Days	2.65%	2.65%	2.65%
2 Year Swap	3.03%	2.96%	2.86%
5 Year Swap	3.63%	3.50%	3.34%

NZ foreign currency mid-rates as at Monday 17 June 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8052	0.8088	0.8100
NZD/EUR	0.6033	0.6184	0.6306
NZD/GBP	0.5120	0.5278	0.5332
NZD/JPY	75.83	80.50	82.91
NZD/AUD	0.8419	0.8279	0.8303
TWI	74.49	75.61	76.47



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 10 May 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	2.82	2.55	2.30	2.10	2.10	2.10
10 Year Bond	3.37	3.20	3.20	3.10	2.90	3.10
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.15	2.00	2.00	1.90	1.80	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	0.9595	0.98	0.97	0.96	0.96	0.96
USD/JPY	94.65	100	99	98	97	96
EUR/USD	1.3369	1.33	1.31	1.30	1.30	1.30
AUD/NZD	1.1910	1.19	1.17	1.14	1.14	1.16

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