

# Weekly Commentary

18 February 2013

## Make hay while the sun shines

Last week we released our quarterly *Economic Overview*, titled "A Goldilocks moment?" In it we outlined how activity has picked up in the December quarter after a short, sharp slowdown in the September quarter. The Canterbury rebuild is hitting its straps, business and consumer confidence is improving, and the housing market is happily gaining ground.

At the same time, the high exchange rate is keeping inflation down, meaning that the RBNZ can keep interest rates low. It sounds like the best of all economic worlds, and for now it is a Goldilocks moment for the economy.

Unfortunately, it may not last. Low interest rates are stimulating the housing market. Also, price pressures from the accelerating Canterbury rebuild will eventually spillover into general inflation. And, when this happens, interest rates will have to rise in response. We think that interest rates will eventually rise much further than markets anticipate. And higher rates will hurt the housing market.

### Retail spending is back on track

The week's data aligned well with our story. Retail sales volumes rebounded 2.1% in the December quarter of 2012 after a 0.2% drop in the September quarter.

The high currency shone through, generating growth in durables sales volumes and price falls. In particular, the volume of department stores sales and electronic goods rose by 4.5% and 3.0% respectively; both categories recorded price falls. Similarly, the data showed that vehicle sales rose strongly over 2012.

### ...and 2013 is off to a good start.

Spending momentum has continued into 2013 as consumers find they are getting more bang for their buck. Total electronic card spending rose 0.4% in January and was up 4.5% on a year ago. Considering that retail prices have barely risen over the last year, this represents a significant increase in sales volumes. The retail dollar is going much further these days.

### The housing market continues to heat up...

The January round of housing data portrayed a housing market that has continued to heat up. The seasonally adjusted number of REINZ house sales was up 3.5% in January, and is 21% higher than a year ago.

House price inflation has continued to accelerate. The REINZ's House Price Index is now 7.2% higher than a year ago, while Quotable Value's index is 6.2% higher.

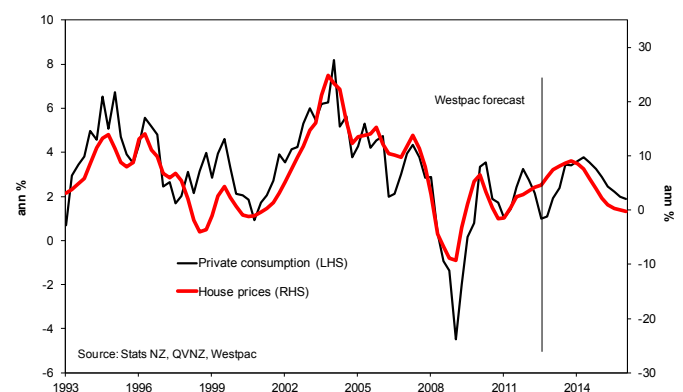
In addition, the market is becoming more buoyant across New Zealand, not just in Auckland and Canterbury. The volume of house sales has risen at least 10% over the past year in all regions of New Zealand, except Taranaki (last three months of sales compared to same period a year earlier).

### ...and confidence is building.

February consumer confidence continued its slow burn upwards, with the headline index reading rising around four points from December. The housing market and dollar shone through; confidence was highest in Auckland, and the number of consumers stating that it was a good time to buy a major household appliance rose significantly.

Sentiment in the manufacturing sector also perked up in January. We suspect that some of this high reading may be due to Canterbury rebuild activity spilling over into manufacturing activity; recent Reserve Bank research noted that a rise in construction activity has the largest impact on the manufacturing sector. However, we do caution against reading too much into one month's outturn in what is a volatile series.

### House price inflation and consumer spending





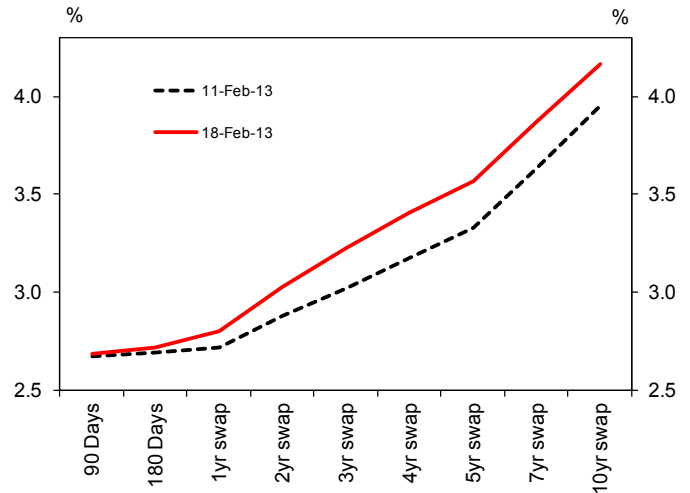
**However, food and petrol prices are rising.**

Contrary to the low inflation trend, data last week showed rising food and petrol prices. Food prices rose 1.9% in January. This rise, combined with 3 recent petrol price rises, makes it likely that inflation will rise above 1% in the March quarter.

Activity is picking up and inflation is low. In short, make hay while the sun shines!

**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**



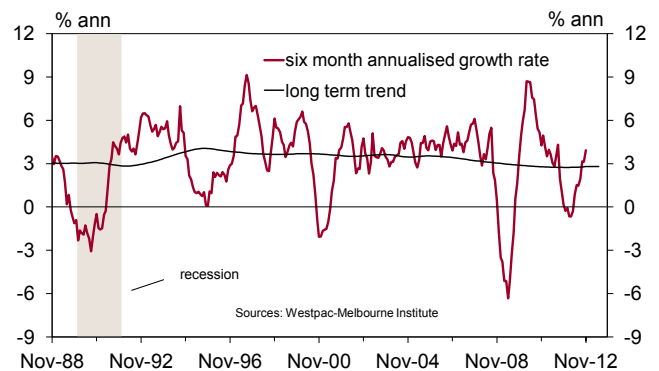
**Key Data Previews**

**Aus Dec Westpac-MI Leading Index**

Feb 20, Last: 3.9% annualised

- The **Westpac-Melbourne Institute Leading Index** showed a surprisingly buoyant growth signal in late 2012. The annualised growth rate of the index, which indicates the likely pace of economic activity three to nine months in the future, was 3.9% in November, comfortably above the long-run trend of 2.8% – Nov was the third above-trend month in a row.
- The Dec release will include updated monthly data on: equities (ASX +3.2% versus -0.4% in Nov); US industrial production (+0.3% versus +1% in Nov); money supply (+0.6% versus +0.2% in Nov); and dwelling approvals (-4.4% versus +3.4% in Nov).

**Westpac-MI Leading Index**





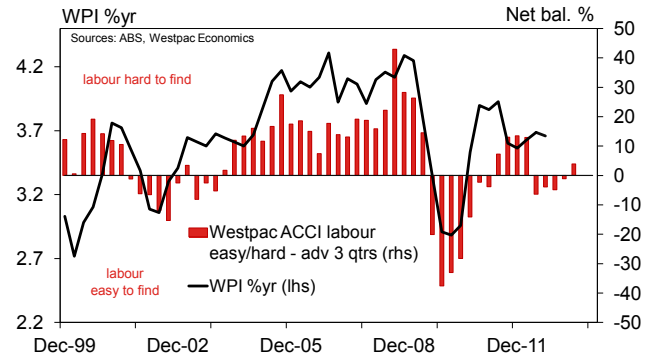
## Aus 2012 Q4 wage price index: %qtr

Feb 20, Last: 0.7%, WBC f/c: 0.9%

Mkt f/c: 0.8%, Range: 0.6% to 1.0%

- The September quarter Wage Price Index (WPI) printed at 0.7%qtr, below the market expectation of +0.8%qtr. That followed a reported 0.9%qtr rise in Q2, and a 0.8%qtr increase in Q1. In Q3, annual wage growth was flat at 3.7%yr.
- There was some moderation in private sector wages in Q3. The private sector WPI rose 0.8%qtr in Q3, compared to a 0.9%qtr rise in Q2 and Q1. This saw the annual rate moderate to 3.7%yr, from a downwardly revised 3.8%yr in Q2.
- The labour market continues to soften, moderating private-sector wage pressures. However, residual seasonality persists. An uptick in public wage inflation will also provide a very small boost to the headline outcome. For these reasons, we are forecasting a modest uptick in quarterly wage growth in Q4 to 0.9%.

## Soft labour demand eases wage pressure



## US Jan housing starts/permits/sales

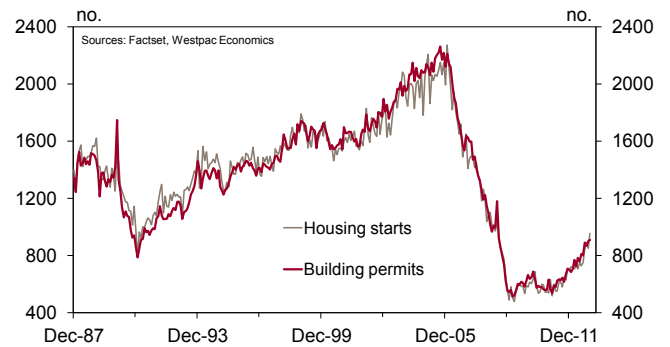
Feb 20, Housing starts: Last: 12.1%, WBC f/c: -5.0%

Feb 20, Housing permits: Last: 1.0%, WBC f/c: 4.0%

Feb 21, Existing home sales: Last -1.0%, WBC f/c: -1.0%

- Housing starts jumped 12% in Dec, with both single-home and multiples bouncing after Nov falls. But permits rose just 1%, and single-home permits have been running below starts for at least five months now, suggesting some risk of a pull-back in starts in early 2013. That said, to the extent that the housing upswing has legs (as rising homebuilder confidence suggests), permits may help close that gap themselves by posting bigger gains this year, as we are forecasting for Jan.
- Existing home sales fell 1% in Dec, in part due to a lack of supply (4.4mths stock, same as at market peak in 2005); that said, Dec's 4.94mn annualised sales pace is still the second-highest since Nov 2009. Pending home sales fell 4.3% in Dec, so Jan closings (measured by existing sales) may fall again.

## US housing starts and permits



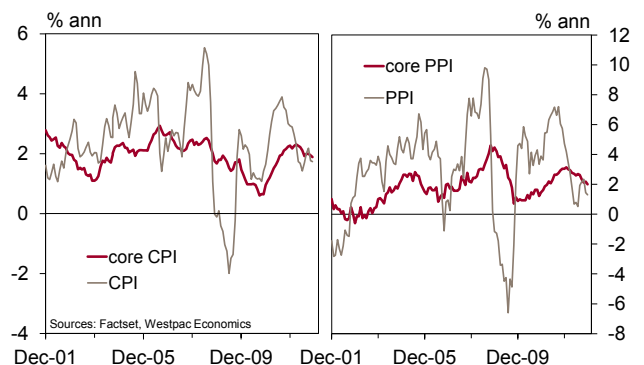
## US Jan producer and consumer price indices

Feb 20, PPI Last: -0.2%, WBC f/c 0.3%

Feb 21, CPI Last: 0.0%, WBC f/c 0.1%

- Seasonality issues distort many US data series. The PPI often spikes in Jan due to pharmaceutical price rises, but new seasonal factors will be published 15/2. Assuming these address the issue, we expect a 0.3% bounce in the PPI following monthly declines through Q4 (driven by energy, subdued core pressures, and in Dec, food). We expect a 0.4% core, a bounce in food, but lower energy prices.
- CPI revisions incorporating new seasonal factors will be published 19/2, but they are unlikely to substantially alter the recent subdued inflation picture – consistent with the modest PCE deflator. After a fall in Nov and a flat Dec, we expect the CPI to rise just 0.1% in Jan, with medical and clothing price gains likely after recent softness (risking a 0.2% core rate), food a little higher, but gasoline lower.

## US Price Inflation





**Key Data and Events**

Market Westpac  
Last median forecast Risk/Comment

		Market Westpac	Last	median	forecast	Risk/Comment
<b>Mon 18</b>						
<b>NZ</b>	Jan services PSI		51.5	–	–	One of many indicators that improved in late 2012.
<b>US</b>	Presidents' Day		–	–	–	Public holiday.
<b>UK</b>	Feb rightmove house prices %mth		0.2%	–	–	House prices up 2.4%yr according to rightmove.
<b>Tue 19</b>						
<b>Aus</b>	RBA Minutes, Feb Board meeting		–	–	–	Tone likely to be very similar to SoMP; CAPEX key for March.
<b>Eur</b>	Feb ZEW survey (Econ. Sentiment)		31.2	–	–	Sentiment has improved considerably; but will it be sustained.
<b>Ger</b>	Feb Zew Survey		7.1	7.5	–	Q4 saw German GDP decline; how will participants respond?
<b>Wed 20</b>						
<b>NZ</b>	Q4 Producer Price Index		–0.9%	–	–	Construction costs of interest during Canterbury rebuild.
<b>Aus</b>	Dec Westpac-MI Leading Index		3.9%	–	–	Surprisingly buoyant above-trend readings through Sep-Nov.
	Q4 Wage Price Index %qtr		0.7%	0.8%	0.9%	Soft labour market eases wage pressures but residual seasonality in Q4.
<b>US</b>	Jan housing starts %mth		12.1%	–3.4%	–5.0%	Starts have outperformed permits consistently for five months...
	Jan building permits %mth		1.0%	1.2%	4.0%	Will starts decline or permits rise to correct this disparity?
	Jan producer prices %mth		–0.2%	0.3%	0.3%	Bounce in food; lower energy. New seasonal factors and revisions.
	Jan Fed releases minutes from FOMC		–	–	–	Unlikely to differ in tone from meeting statement.
<b>Can</b>	Jan Teranet/National Bank HPI %mth		–0.4%	–	–	House prices up 3.1% over the year.
<b>Ger</b>	Jan producer prices %mth		–0.3%	0.3%	0.3%	Annual rate likely to decelerate from Dec's 1.5%.
	Jan CPI %mth		–0.5%	–0.5%	–0.5%	Final reading for January; up 1.7%yr.
<b>UK</b>	Bank of England minutes		–	–	–	Insight into goings on at the February meeting.
	Jan claimant count rate		4.8%	4.8%	4.8%	Another small decline in jobless likely, but rate to remain unchanged.
	Dec ILO unemployment rate		7.7%	7.7%	7.7%	3mth change in employment likely to accelerate, albeit modestly.
<b>Thu 21</b>						
<b>US</b>	Jan CPI %mth		0.0%	0.1%	0.1%	Inflation outlook is benign. New seasonal factors and revisions.
	Feb initial jobless claims		341k	360k	365k	Affected by weather in a number of states; volatility likely to persist.
	Feb Philadelphia Fed.		–5.8	1.0	0.5	Activity likely to improve, but level still soft.
	Jan existing home sales %mth		–1.0%	–0.8%	–1.0%	Pending sales fell in December; points to further pull back in closings.
	Jan leading indicators		0.5%	0.2%	0.3%	Likely to remain soft, with momentum largely absent of late.
<b>Eur</b>	Feb Euro-Zone consumer confidence		–23.9	–23.1	–	Consumer confidence remains weak amid recessionary conditions.
	Feb PMI manufacturing		47.9	48.4	48.2	Looks to be stabilising; services sector also likely to see small gain.
<b>UK</b>	Jan public finances (PSNCR)		1.3b	–	–	Ex interventions, 15.4bn in Dec; net borrowing came in at 13.2bn.
	Feb CBI trends selling prices		21	–	–	Retailers remain under pressure.
<b>Fri 22</b>						
<b>Aus</b>	RBA Gov. Stevens		–	–	–	Appearance before House of Reps. Economics Committee.
<b>Chn</b>	Jan 70 city house prices net % rising		66%	–	–	Clear disengagement from early 2012 trough & Q3 hiccup.

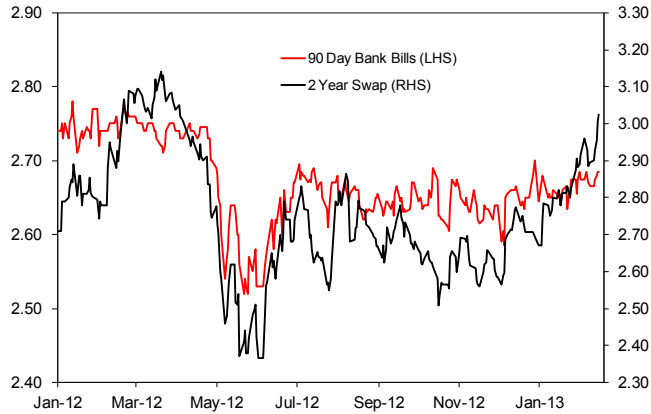


## New Zealand Economic and Financial Forecasts

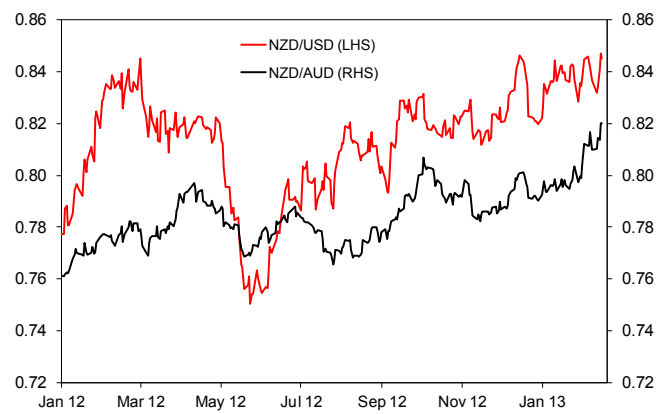
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012e	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.2	3.3	3.1	1.5	2.4	3.0	3.2
Employment	1.0	0.1	2.8	2.5	1.5	-1.4	4.1	2.6
Unemployment Rate % s.a.	6.7	6.8	5.8	4.8	6.4	6.9	6.0	5.0
CPI	1.6	1.1	1.9	2.3	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	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-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	0.85	0.86	0.87	0.87	0.85	0.83
NZD/AUD	0.80	0.80	0.83	0.84	0.84	0.84
NZD/JPY	77.4	76.5	75.7	73.6	70.6	67.2
NZD/EUR	0.63	0.63	0.66	0.67	0.68	0.67
NZD/GBP	0.54	0.53	0.54	0.54	0.53	0.51
TWI	76.4	76.4	78.0	78.2	77.5	76.0

**2 Year Swap and 90 Day Bank Bills**



**NZD/USD and NZD/AUD**



**NZ interest rates as at market open on Monday 18 February 2013**

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.66%	2.67%	2.67%
60 Days	2.67%	2.68%	2.67%
90 Days	2.69%	2.68%	2.66%
2 Year Swap	3.03%	2.91%	2.81%
5 Year Swap	3.56%	3.38%	3.25%

**NZ foreign currency mid-rates as at Monday 18 February 2013**

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8441	0.8466	0.8370
NZD/EUR	0.6323	0.6206	0.6288
NZD/GBP	0.5444	0.5394	0.5279
NZD/JPY	79.098	78.549	75.391
NZD/AUD	0.8197	0.8139	0.7962
TWI	76.890	76.270	75.340



## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012e	2013f	2014f
<b>Australia</b>						
Real GDP % yr	1.4	2.5	2.4	3.5	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.3	2.8
Unemployment %	5.6	5.2	5.2	5.3	6.0	6.2
Current Account % GDP	-4.2	-2.9	-2.3	-3.8	-3.3	-4.0
<b>United States</b>						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.6	1.5
Consumer Prices %yr	-0.3	1.6	3.1	2.0	2.0	2.0
Unemployment Rate %	9.3	9.6	8.9	8.1	8.0	7.9
Current Account %GDP	-2.7	-3.0	-3.1	-3.3	-3.5	-3.5
<b>Japan</b>						
Real GDP %yr	-5.7	4.9	-0.4	2.1	1.4	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	1.9	1.5	-0.5	-0.4	-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
<b>United Kingdom</b>						
Real GDP %yr	-4.0	1.8	0.9	0.0	0.7	0.2
Consumer Prices %yr	2.2	3.2	4.0	2.7	1.8	1.5
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 11 February 2013

Interest Rate Forecasts	Latest	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14
<b>Australia</b>						
Cash	3.00	2.75	2.75	2.75	2.75	2.75
90 Day Bill	2.90	2.85	3.00	3.10	3.10	3.00
10 Year Bond	3.55	3.25	3.60	3.50	3.30	3.10
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.00	1.85	2.20	2.30	2.10	2.00
ECB Repo Rate	0.75	0.75	0.75	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14
AUD/USD	1.0370	1.06	1.07	1.05	1.03	1.01
USD/JPY	92.55	91	89	87	85	83
EUR/USD	1.3363	1.34	1.36	1.32	1.29	1.25
AUD/NZD	1.2175	1.25	1.24	1.21	1.18	1.19

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