



Weekly Commentary

24 June 2013

Two for the hawks, one for the doves

On balance, last week's developments were a clear positive for New Zealand interest rates, with a more hawkish US Fed and a stunning local consumer confidence report outweighing a GDP outturn that was a touch weaker than expected.

The news that overshadowed everything last week was the US Federal Reserve's signal that it could start 'tapering' its rate of asset purchases later this year, if the US economy continues to improve in line with its forecasts. In the resulting market rout, the NZ dollar has fallen more than 3% against the US dollar while wholesale interest rates have risen more than 10 basis points over the past week.

It remains to be seen whether 'tapering' will actually happen. Our own take on the US economy has long been significantly less optimistic than the Fed's (and to date, we have been a lot closer to the mark). If we're right this time, the Fed may yet not follow through with its game plan. Even if it embarks on tapering, it may well end up having to reverse course once the data disappoint (as Chairman Bernanke himself acknowledged).

But for now, the undeniable fact is that the Fed Chairman is, in his words, willing to 'ease the pressure on the accelerator' sooner rather than later. One very clear implication is that we could start to see more hawkish commentary from the RBNZ – a greater willingness to hike the OCR.

The RBNZ has been stuck between the rock of a rising housing market and the hard place of an overvalued exchange rate, which in turn has kept inflation uncomfortably low. That dilemma has forced it to keep the OCR on hold. Now that the announcement of tapering has sent the NZ dollar diving, one side of the dilemma has become less acute. That gives the RBNZ more wiggle room to raise interest rates in response to overheating domestic conditions. If so, we could see the RBNZ's projections for interest rate hikes move forward, to be more in line with of our own.

Last Monday's Westpac McDermott Miller consumer confidence survey received much less attention from markets, but arguably points the RBNZ in the same direction. For some time, the RBNZ has taken the view that the rising housing market would have only a modest impact on domestic spending. The latest survey makes that view much harder to maintain.

A couple of weeks ago we published an article explaining how the housing market and household spending are related.¹ In a nutshell,

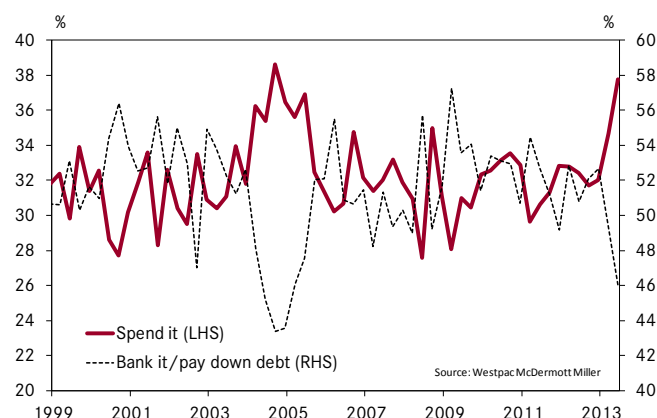
in a debt-fuelled housing upswing, buyers borrow more money, which ends up in sellers' pockets, who feel wealthier as a result. The economy as a whole ends up borrowing and spending more.

In the first few years after the 2008 recession, this channel from the housing market to spending was effectively blocked, as existing borrowers decided to ramp up the pace at which they were repaying debt, and households put more money in the bank. However, our view has been that the channel would reopen as the rate of debt repayment stabilised and people became less financially conservative.

But even we were stunned by how much attitudes had shifted in last Monday's consumer confidence survey. Two details stood out: over the past six months, the share of people saying they'd spend a windfall cash payment (rather than bank it or use it to pay down debt) has risen to levels last seen in 2004. And the share of people saying it's a good (as opposed to bad) time to buy a big-ticket item is the highest since 2005. This is exactly the kind of scenario in which a rising housing market is likely to spill over to the rest of the economy.

The latest GDP outturn was, by contrast, a negative for interest rates. After blowing everyone away with a 1.5% surge in the December quarter, New Zealand's economic growth fell short of expectations in March, growing just 0.3%. However, the surprise was fairly small (and upwards revisions to previous quarters left the annual rate of growth at 2.5%, as expected).

'What would you do with a \$10,000 windfall?'



¹ See 'Hair of the Dog', at <http://www.westpac.co.nz/wib/economic-updates/economic-research-and-strategy/> as part of our 'Deeper Insights' series.

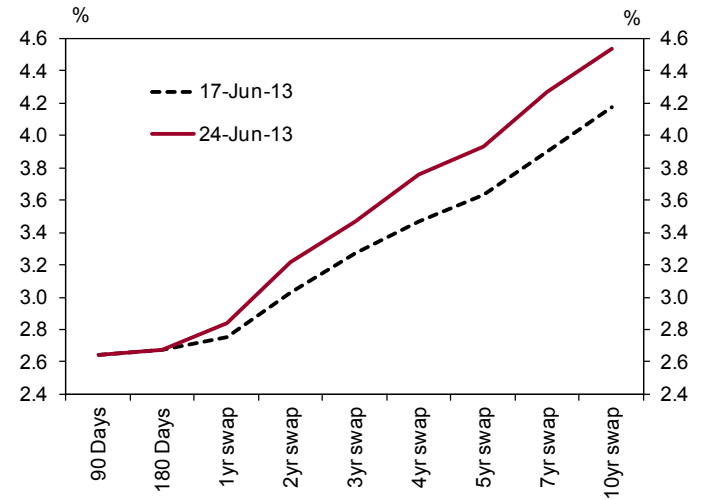


The details of the GDP report were much in line with the story we have been telling for a while. Construction-related activity is ramping up strongly, while the rest of the economy is growing more modestly. On top of a 5.5% gain in the construction sector, there was a 3.9% rise in professional services, which Statistics NZ partly attributed to demand for architectural and engineering services – notably, not just in Christchurch but in Auckland as well, the other centre with obvious signs of housing supply shortages.

It is fair to say that the economy’s momentum has cooled a little this year, in part thanks to the recent drought. Dairy production was down 6% in the quarter and sheep farming down 4%. Offsetting this, there was a boost to food manufacturing as sheep and cattle were sent to slaughter earlier than usual. That offset will disappear in the June quarter, so we expect another quarter of weak growth – just 0.3%. After that, the growing momentum in New Zealand’s domestic economy should shine through more clearly.

Fixed vs floating for mortgages: We favour fixing over floating. 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 lower-cost option if the RBNZ actually cut the OCR, which we regard as unlikely. In fact, we expect the floating mortgage rate to rise significantly over the 2014 to 2016 period. Wholesale interest rates rose sharply last week. If sustained, this could translate into a hike in fixed mortgage rates in the near term.

NZ interest rates



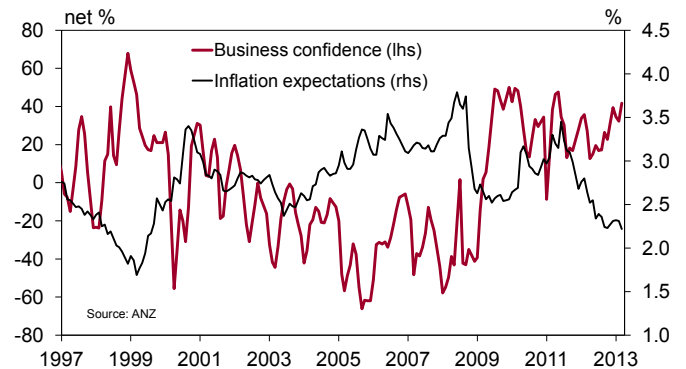
Key Data Previews

NZ Jun ANZ business confidence

Jun 27, Last: 41.8

- Business confidence rose to a two-year high in May, after small declines in March and April. The drought was a significant factor in those two months, but confidence remained surprisingly robust outside of the agricultural sector.
- We expect that confidence remained high in June, pointing to a solid underlying pace of growth over the quarter. However, with the drought likely to have its greatest impact on GDP in Q2 (with both dairy and meat production below normal), we expect growth of just 0.3%.
- Inflation expectations for the year ahead fell to a fresh 13-year low in May, following another low inflation print of 0.9% in Q1 (which we expect to ease further to 0.7% in Q2). A weaker NZ dollar will have some bearing on inflation pressures, but that’s probably too recent for this survey.

NZ business confidence & inflation expectations



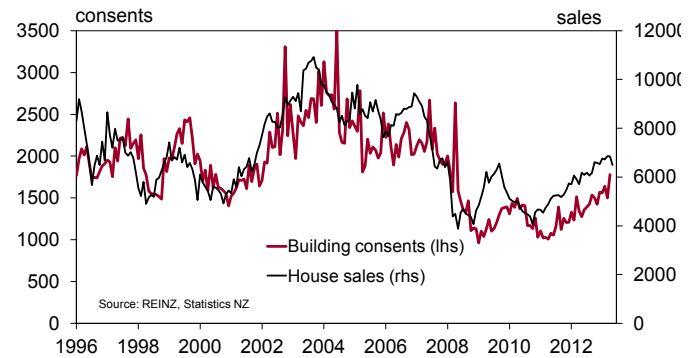


NZ May building consents

Jun 28, Last: +18.5%, WBC f/c: -7.0%

- Monthly consents have been thrown around by the earlier timing of Easter this year. An 8.3% fall in March (when there was one less working day than usual) was followed by an 18.5% jump in April (when there was an extra working day).
- A return to 'normal' implies that the level of consents must fall again in May; we expect a 4% drop in ex-apartment consents. Combined with an unusually high number of apartment consents in April that is unlikely to be repeated, and we estimate that total consents were 7% lower.
- Consents in the Canterbury region are now surging higher and should continue to lead the way, regardless of recent squabbling about the slow pace of approvals. The Auckland region has been of more concern to us, with the pace of consents slowing since the start of the year despite clear evidence of supply shortages and rapidly rising sale prices.

NZ housing activity

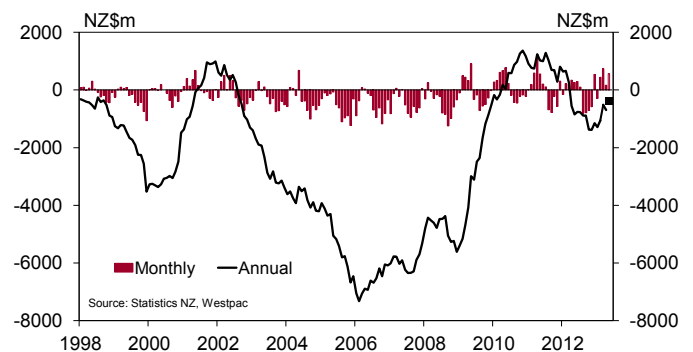


NZ May Merchandise Trade

Jun 27, Last: \$157m, WBC f/c: \$570m, Mkt f/c: \$376m

- We expect the surge in world dairy prices to shine through in the May trade data. Partially offsetting this increase, will be declining meat prices and volumes as the surge in stock slaughtering recedes.
- On a seasonally-adjusted basis we expect the May trade balance to be close to zero. Looking at the annual balance, we expect the deficit to narrow further in May.
- Further out, the annual trade deficit may widen as imports increase in line with the accelerating Canterbury rebuild and strengthening household demand.

NZ merchandise trade balance



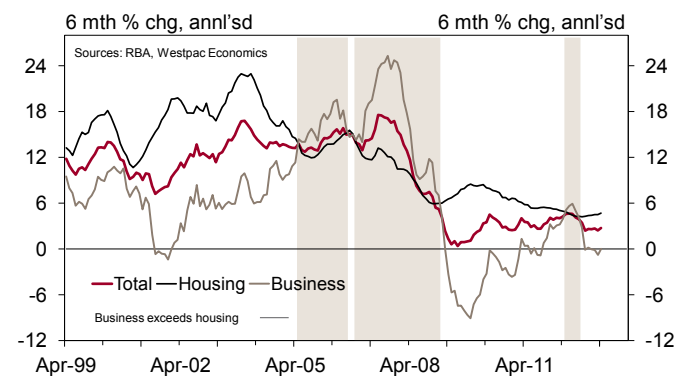
Aus May private sector credit

Jun 28, Last: 0.3%, WBC f/c: 0.2%

Mkt f/c: 0.3%, Range: 0.2% to 0.4%

- Credit to the private sector is expanding at a slow pace. Annual growth moderated to 3.1% in April from a high of 4.4% in June.
- Monthly credit growth was 0.3% in April, a slight uptick from a run of three consecutive gains of 0.2%. This lift was centred on a 0.2% rise in business, which has been broadly flat of late.
- Housing credit growth strengthened a touch in Q1, to 1.2%, from 1.1% in Q4. This reflects a modest improvement in new lending which is responding to lower interest rates although this is being offset by many existing mortgage holders taking advantage of lower rates to accelerate repayments.
- Business credit has stalled since mid 2012, following a 4.4% increase in the year to June 2012. We expect a broadly flat result in May.

Credit momentum



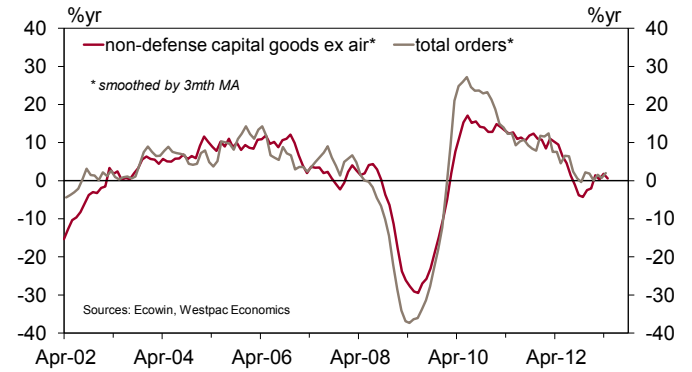


US May durable goods orders

Jun 2, Last: **-5.7%**, WBC f/c: **3.0%**

- Durable goods orders rose 3.5% in April following March's 5.9% drop, a bigger rebound than expected. The headline result was boosted by an 8.1% rebound in the volatile transport component (2% autos, 18% aircraft). The 'core' non-defence capital goods ex-aircraft component, a better indicator of plant and machinery investment, also exceeded expectations, posting a decent 1.2% gain; March was revised up to 0.9%.
- ISM factory orders fell 3.5pts to a contractionary 48.8 in May, their lowest since July. Boeing took 232 orders in May from 51 in Apr. Auto sales rose 2.4% and production was up 0.7% in May; business equipment output edged up 0.2% last month. These signals point to a headline gain in durable orders but outside of transport their should be weakness.
- We expect a 3% rise in durables, but core capital orders to be flat in the month.

US durable goods orders



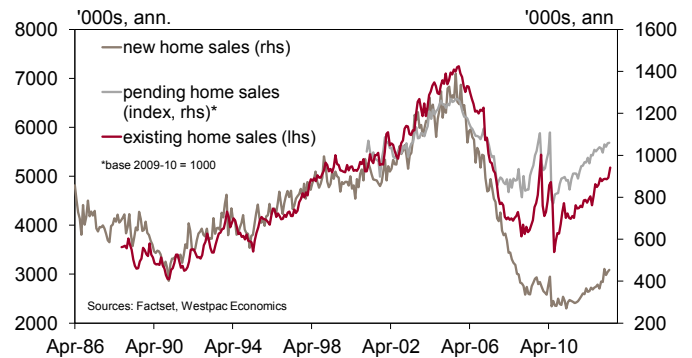
US May new/pending home sales

Jun 25, New: Last: **4.6%**, WBC f/c: **3.0%**

Jun 27, Pending: Last: **0.3%**, WBC f/c: **2.5%**

- Last year's run up in housing seemed to stall on a range of indicators including single family starts and new home sales, both of which have levelled off since the start of this year. However homebuilder sentiment has soared in recent months, so the new home sales uptrend should resume.
- Existing home sales, having apparently levelled off in April at just below their late 2012 peak sales pace, rose 4.2% in May, hitting a new cycle high. A caveat was that first time buyers accounted for an unusually low 28% of sales (usually 40%+) while cash buyers and investors remained over-represented relative to the norm. To the extent that recent sales strength is driven buy investor groups snapping up cheap homes, the new housing market may not benefit. Even so, pending home sales (measuring existing sales earlier in the transaction process, are due for some catch up in May.

US housing sales



US May PCE deflator, personal income & spending

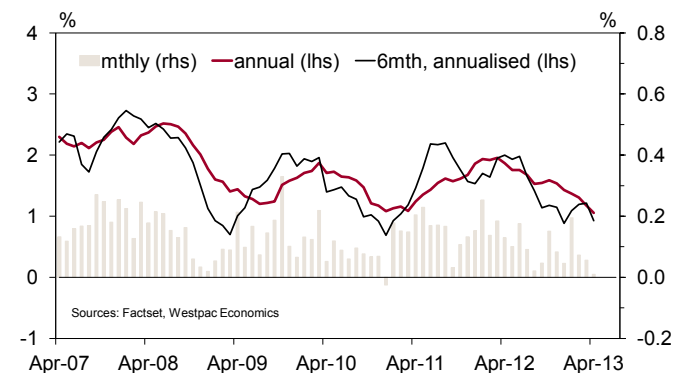
Jun 27, Core PCE deflator: Last: **0.0%**, WBC f/c: **0.1%**

Jun 27, Personal income: Last: **0.0%**, WBC f/c: **0.1%**

Jun 27, Personal spending: Last **-0.2%**, WBC f/c: **0.4%**

- Personal income was flat in Apr, with a 0.2% rise in hourly earnings being offset by a 0.1% fall in hours worked and little impact from other income sources. Hourly earnings were flat in May and hours worked rose just 0.1%, so personal income growth should be close to flat again.
- A 0.6% rise in retail sales, despite subdued income growth, suggests savings were run down last month. So the 0.2% fall in personal spending in April should have been reversed in May.
- The core CPI rose 0.2% in May after a 0.1% rise at the start of the current quarter. But different weight and rounding suggest a softer 0.1% rise in the core PCE deflator in May after no change in April.

US core PCE deflator





Key Data and Events

		Market Last	Westpac median	Westpac forecast	Risk/Comment
Mon 24					
NZ	May net migration	1,570	–	1,500	Departures come off sharply this year, while migrant arrivals have risen.
Ger	Jun Ifo business climate index	105.7	106.0	105.8	German economy just growing marginally on most indicators.
UK	Jun house prices %yr	1.1%	1.9%	–	Tentative date for Nationwide index due 24-28/6
US	May Chicago Fed national activity index	–0.53	–	–	Based on 80 or so data inputs, not a business survey.
	Jun Dallas Fed factory index	–10.5	–2.5	0.0	May weakness in district Fed surveys not repeated so far in June.
	Fedspeak	–	–	–	Fisher in London.
Tue 25					
UK	May mortgages no.	32.2k	–	–	BBA data covering about 70% of the market.
US	May durable goods orders	3.5%	3.0%	3.0%	Recent swings due aircraft; underlying story less soft; see text box.
	Apr house prices %yr	10.9%	10.6%	–	S&P-Case Shiller 20 city index.
	Jun Conf Board consumer confidence	76.2	75.2	72.5	Some pull-back likely after sharp gains earlier in Q2.
	Jun Richmond Fed factory index	–2	flat	1	Modest recovery after sentiment soured earlier in Q2.
	Apr house prices	1.3%	1.1%	–	FHFA index.
	May new home sales	–4.6%	2.2%	3.0%	2012 upswing stalled so far in 2013 but likely to resume. See text box.
Wed 26					
Eur	May money supply M3 %yr	3.2%	2.9%	–	Slowed from 3.9% peak in Oct 2012, LTRO paybacks a factor.
	Jun business climate indicator	–0.76	–0.72	–0.56	Business surveys have had a less weak bias, mostly, in June, and consumer confidence rose sharply.
	jun economic confidence	89.4	90.5	90.0	
Ger	Jul GfK consumer confidence	6.5	6.5	–	Surveyed early Jun but labelled Jul. Jun was highest since 2007.
UK	Jun CBI retail survey	–11	–	–	Reported sales index. May was much weaker than ONS retail figures.
US	Q1 GDP final	2.4% a	2.4%	2.3%	Economy barely expanded in late 2012, Q1 bounceback lacklustre.
Thu 27					
NZ	May merchandise trade balance	\$157m	\$427m	\$570m	Dairy prices surging.
	Jun ANZ business confidence	41.8	–	–	Confidence remains strong outside of the direct impact of drought.
Chn	May industrial profits %ytd	11.4%	–	–	Nominal activity has not improved in Q2, profit growth likely flatlining.
Ger	Jun unemployment ch	21k	flat	–	German joblessness risen in 11 of last 12 months.
	May retail sales	0.4%	0.5%	–	Tentative date.
UK	Q1 GDP final	0.3% a	0.3%	0.3%	More detail on modest rebound in growth.
	Q1 current account £bn	–14.0	–11.9	–	Deficit data volatile and often revised.
US	May core PCE deflator	flat	0.1%	0.1%	Core CPI was 0.2% in May but core PCE likely to round down to 0.1%.
	May personal income	flat	0.2%	0.1%	Hourly earnings flat in May, hours worked up just 0.1%.
	May personal spending	–0.2%	0.3%	0.4%	Retail sales up 0.6% suggest some savings rundown in May.
	Initial jobless claims w/e Jun 21	354k	350k	342k	Claims trending lower but latest week surprised to upside.
	May pending home sales	0.3%	1.0%	2.5%	Some catch up to latest existing home sales upswing likely soon.
	Jun Kansas City Fed factory index	2	4	0	Seven sub zero readings in Oct-Apr ended in May.
	Fedspeak	–	–	–	Powell and Lockhart.
Can	Apr average weekly earnings	3.1%	–	–	Uptrend since late 2011 now stabilised.
Fri 28					
NZ	May building consents	18.5%	3.9%	–7.0%	Returning to trend after early Easter distortions in Mar-Apr.
	May private sector credit %yr	4.1%	–	–	Housing growing steadily, business surged in April after a slow patch.
Aus	May private sector credit	0.3%	0.3%	0.2%	Housing inching higher, but still soft. Business trending sideways.
Ger	Jun CPI prelim %yr	1.5%	1.7%	–	Apr CPI at 1.2% yr lowest since late 2010, recent upside due to food.
UK	Jun GfK consumer confidence	–22	–21	–23	May spike to almost as high as during the 2011 Royal Wedding.
US	Jun Chicago PMI	58.7	55.0	52.0	May surge to highest since March 2012 unlikely to be sustained.
	Jun Milwaukee NAPM	40.67	–	–	Little watched.
	Jun UoM consumer sentiment final	82.7 a	83.0	81.0	Latest equity downswing unhelpful.
	Fedspeak	–	–	–	Lacker and Williams.
Can	Apr GDP	0.2%	flat	–	GDP rose every month in Q1, the first quarter of gains since Q3 2011.
	May industrial product prices	–0.8%	–	–	Apr saw first fall since Nov last year.

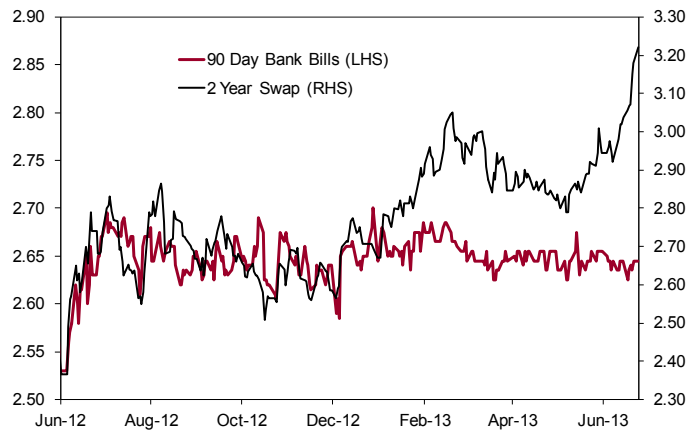


New Zealand Economic and Financial Forecasts

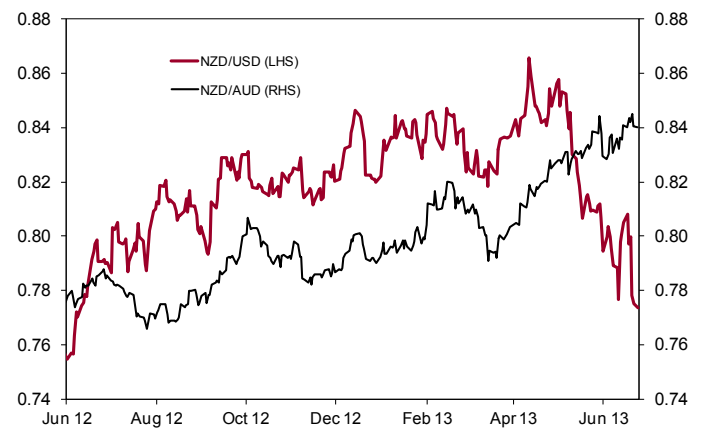
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	2.6	3.7	1.4	2.7	2.4	3.6
Employment	1.0	0.4	2.4	2.8	1.5	-1.4	3.2	3.2
Unemployment Rate % s.a.	6.7	6.2	5.7	4.8	6.3	6.8	6.1	5.0
CPI	1.6	0.9	1.4	2.5	1.8	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 24 June 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.65%	2.64%	2.64%
60 Days	2.65%	2.64%	2.65%
90 Days	2.65%	2.65%	2.66%
2 Year Swap	3.22%	2.96%	2.92%
5 Year Swap	3.93%	3.52%	3.44%

NZ foreign currency mid-rates as at Monday 24 June 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7736	0.7827	0.8103
NZD/EUR	0.5908	0.5933	0.6265
NZD/GBP	0.5029	0.5038	0.5354
NZD/JPY	75.76	76.60	81.94
NZD/AUD	0.8400	0.8330	0.8403
TWI	73.06	73.39	76.43



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 11 June 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	3.76	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	2.53	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	0.9211	0.98	0.97	0.96	0.96	0.96
USD/JPY	97.93	100	99	98	97	96
EUR/USD	1.3100	1.33	1.31	1.30	1.30	1.30
AUD/NZD	1.1913	1.19	1.17	1.14	1.14	1.16

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