

Weekly Commentary

25 March 2013

Spanner in the works

The New Zealand economy sprang back into gear at the end of 2012, spurred on by the Canterbury rebuild hitting its straps. The rebuild is sharing the love across all sectors, with services in particular benefitting. By all accounts, activity has continued, even accelerated, into 2013. The drought, however, will cause the economy to tap the brakes mid-year. Risks are building in both directions, but we retain our view that the OCR needs to rise in the December quarter.

The New Zealand economy sprang back in to action much harder than expected with 1.5% GDP growth in the December 2012 quarter, beating even our top-of-the-range forecast of a 1.2% increase. There were gains across almost every industry, but particularly in the service sectors, highlighting the domestic (read construction-led) nature of this upturn. Strong growth at this juncture shouldn't come as a surprise – when you drop \$30 billion on a small island economy of course it's going to have an impact. Add low interest rates into the mix and the domestic economy is humming.

We have long expected the Canterbury rebuild to promote a high rate of GDP growth, inflation pressures, and eventually interest rate hikes. Last week's figures must surely dispel any lingering doubts in the market about the first phase of this process.

Meanwhile, the high currency and now drought are hammering the export sector. These factors are promoting all sorts of economic imbalances – last week, Statistics New Zealand revealed that the current account deficit widened from 4.7% to 5.0% of GDP in the December quarter.

The sharp jump in December quarter GDP was to some degree making up lost ground, after growth slowed to just 0.2% each in the June and September quarters. Quarterly growth rates from here on are more likely to be sub-1% – and drought will scoop a chunk out of this profile through the middle of this year. Our working assumption is that the drought will knock around 0.6 percentage points off GDP over the next couple of years. We have updated our economic forecasts, with the impact of drought most evident in Q2 where we revised quarterly growth from 0.9% to 0.4%.

Clearly, the drought is a major hit to farmers' incomes. We estimate the hit at upwards of \$600m in current dollars. This

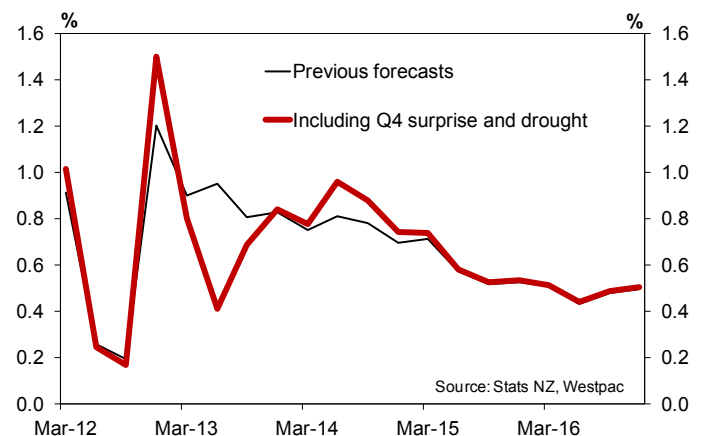
income hit will knock economic confidence; curtail spending, particularly in rural areas; while the food manufacturing industry will suffer too. Including the flow-on effects, we estimate the total impact will be in the vicinity of \$1.3 billion.

Also of note is that the Big Dry is putting upward pressure on world dairy prices. New Zealand is a major player in world dairy markets, and GlobalDairyTrade auction prices have risen 30% over the last three auctions to record levels.

We see room for prices to push higher. We have increased our forecasts of Fonterra's farmgate milk price for this season by 10c to \$5.65/kg, and for next season by 20c to \$5.90/kg (for a fully shared-up farmer this equates to \$6.10 and \$6.40 before retentions, respectively). If prices do push higher, there's scope for our farmgate milk price forecasts to increase further, particularly for next season. While this is cold comfort for the majority of dairy farmers, others, particularly in the South Island, will see their farm incomes rise.

Putting it all together, drought, higher dairy prices, and stronger GDP growth are roughly a wash so far as our OCR call is concerned. We retain our forecast for the OCR to first rise in the December quarter. What has changed is the balance of risks.

Westpac quarterly GDP forecasts





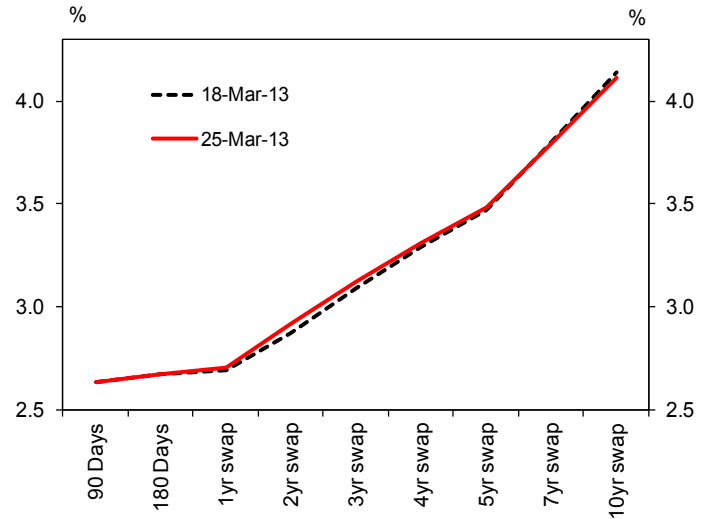
On the upside, Q4 GDP might signal the start of a period of very strong growth. Early indicators of March quarter growth have certainly been strong. The Quarterly Survey of Business Opinion, released on 9 April, will give a better guide as to how the economy fared in the March quarter.

There are two downside risks. First, inflation was surprisingly low last year. It could remain so in 2013. We will get a steer on the evolution of inflation when Q1 figures are released on 17 April.

The second downside risk is that the drought persists for longer than expected – and on that score, we'll be watching weather forecasts, when not looking expectantly out the window for rain.

Fixed vs floating for mortgages: At current mortgage rates we regard fixing as being 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. So staying on floating would only be the better option if the RBNZ actually cut the OCR – which we still regard as unlikely.

NZ interest rates



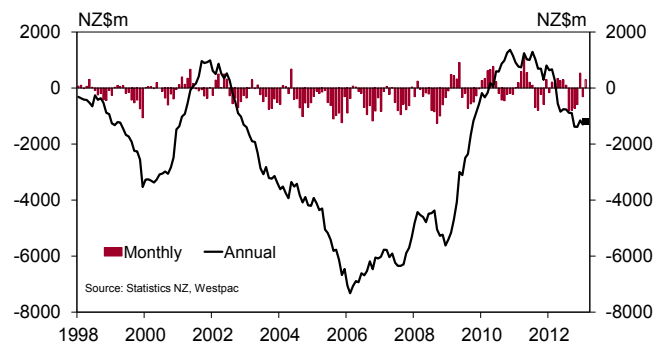
Key Data Previews

NZ Feb merchandise trade

Mar 26, Last: -\$305m, WBC f/c: +\$300m, Mkt f/c: -\$4m

- We expect earlier improvements in world dairy prices plus a rebound in volumes to shine through in the February trade data. Note that this data will reflect prices set in late 2012, and volumes will pre-date the recent drought.
- Surging vehicle imports, on the back of a weak yen and improving confidence, should see seasonally-adjusted import values pick up in February. Overall, we expect the trade balance to improve on a seasonally-adjusted basis.
- On an annual basis, we expect the deficit to narrow a touch in February. Further out, the annual trade deficit may widen as imports increase in line with the Canterbury rebuild and drought weighs on commodity exports.

NZ merchandise trade balance



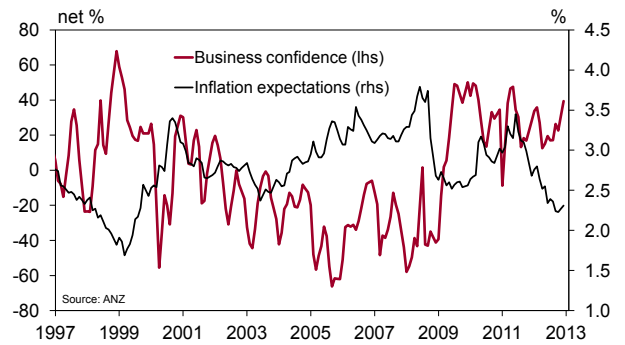


NZ Mar business confidence

Mar 27, Last: 39.4

- General business confidence rose sharply in the first survey of 2013, to its highest in 18 months. Indicators since then have generally been positive: the manufacturing and services PMIs both rose in February, house price growth accelerated, and card spending rose for a fifth straight month. The informal BNZ confidence survey rose further in early March.
- The encroaching drought over much of the country is the main downside risk to confidence this month. Interestingly, confidence in the agricultural sector rose in February even though dry conditions were apparent at that stage - higher dairy prices may have been an offset.
- The 1.5% surge in Q4 GDP reinforces that the NZ economy is in a 'Goldilocks moment' - improving growth but little in the way of inflation pressures. We don't think this will last, but for now the survey suggests that price pressures remain muted.

NZ business confidence and inflation expectations

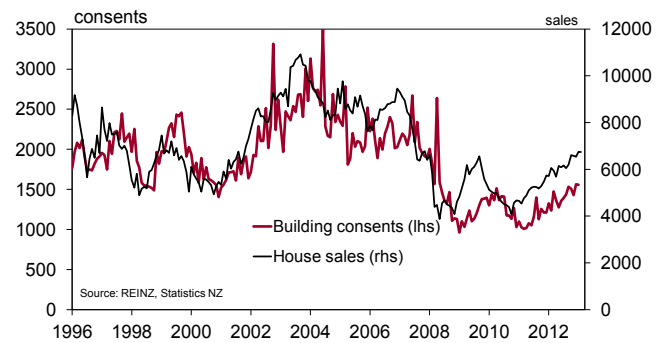


NZ Feb building consents

Mar 28, Last: -0.4%, WBC f/c: +3.0%, Mkt f/c: +3.0%

- The near-flat outcome in January consents masked some important details. Single-home consents shot up nearly 10% to a five-year high, while the lumpy apartments component fell from above-average to minimal. We suspect that single-home consents will ease back a little for February, offset by a normalisation in apartments.
- Growth is being led by Auckland and Christchurch, the two cities where there are obvious housing shortages (though for very different reasons). Rising prices in Auckland are starting to generate a supply response.
- Non-residential building consents have also picked up in the last year, led almost entirely by Canterbury. The strong growth in building activity over the second half of 2012 suggests that the lag from consent to construction has shortened.

NZ housing activity



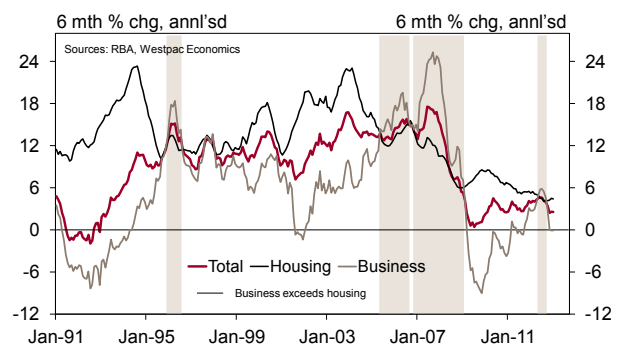
Aus Feb private credit

Mar 28, Last: 0.2%, WBC f/c: 0.2%

Mkt f/c: 0.3%, Range: 0.1% to 0.3%

- Credit growth lost momentum during the second half of 2012. Subdued growth has extended into early 2013.
- We expect credit to rise by 0.2% in February, a repeat of the January outcome and matching the average monthly pace over the second half of 2012.
- Housing credit growth is soft, at 0.4%, 4.4%yr in January. Lower interest rates will provide a modest boost to new lending during 2013 but timing distortions in the first home buyer segment have delayed this response.
- Business credit, which is volatile month to month, stalled over the last six months. A lack of confidence and mixed fundamentals, point to softness extending over the near-term.

Credit momentum





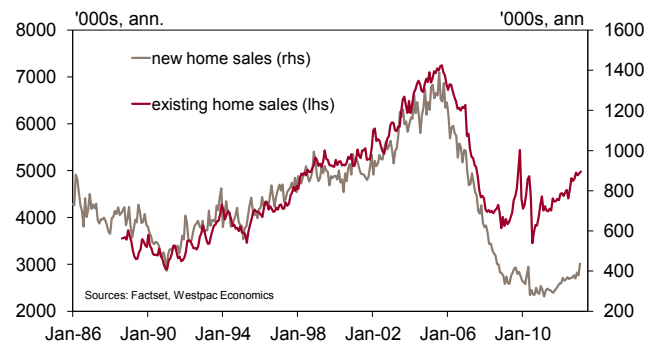
US Feb new/pending home sales

Mar 26, New: Last: 15.6%, WBC f/c: -5.5%

Mar 27, Pending: Last: 4.5%, WBC f/c: -1.0%

- New home sales surged 15.6% in Jan after an essentially flat quarter of sales in Q4 last year. That lifted sales to an annualised pace of 437k, up 60% from the sales low point in Feb 2011, which sounds impressive until you consider that recovery represents just 15% of the slump in sales between the 2005 peak and 2011 trough. With single family house starts at a post recession high in Feb but builder confidence slipping in Feb-Mar, we expect a pull-back in this volatile sales series but it should be modest and temporary.
- Pending home sales rose 4.5% in Jan and the Dec fall was revised from -4.3% to -1.9%. Lack of supply of decent homes is a constraining factor on sales (and helps explain the surge in new home sales) so we expect a modest pull-back in contract signings in Feb but a subsequent resumption of the up-trend.

US housing sales

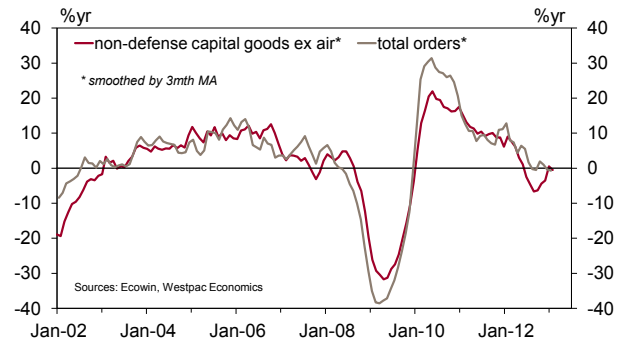


US Feb durable goods orders

Mar 26, Last: -4.9%, WBC f/c: 3.0%

- Durable goods orders fell 4.9% in Jan, mainly due to sharply lower Boeing orders (civilian aircraft fell 34%). Defence orders were down 70% having soared 107% in Jan, and auto orders were about flat for the second month running. A bright spot was the 7.2% jump in core capital goods orders, which have risen about 13% since the start of the fourth quarter. However this strength is taking time to show up in shipments of core durables which fell 1.1% in Jan and were about flat in Dec.
- ISM factory orders rose to a 22 month high in Jan. Boeing took just 2 orders in Jan but that jumped to 179 in Dec (Jan is typically a slow month but that was exceptional). Auto sales rose and production bounced in Feb and business equipment output rose just 2.5% last month. All this points to a decent bounce in orders even if core capital goods probably slipped a little after a steep rise in Jan.

US durable goods orders



US core PCE deflator and personal income/spending

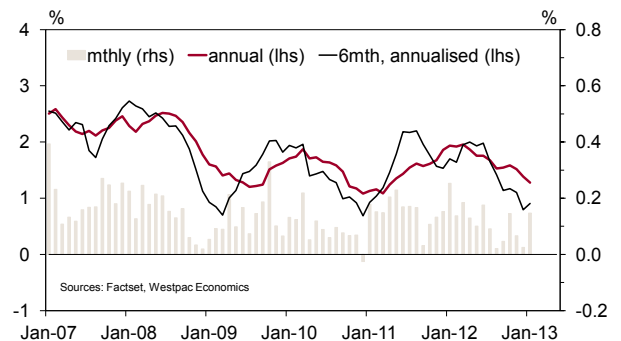
Mar 29, Core PCE deflator: Last: 0.1%, WBC f/c: 0.1%

Mar 29, Personal income: Last: -3.6%, WBC f/c: 0.6%

Mar 29, Personal spending: Last 0.2%, WBC f/c: 0.6%

- Personal income fell 3.6% in Jan, reversing the 2.6% spike in Dec caused by the early payment of bonuses and dividends; the payrolls tax rise also impacted on disposable income. Personal spending rose a subdued 0.2% after just 0.1% in Dec, so the income swings did not impact much on consumption. Meanwhile the core PCE deflator rose by just under 0.15% in Jan for a 1.3% yr annual pace, its slowest in nearly two years.
- The Feb income data should normalise but benefit from solid hours worked growth and a moderate rise in hourly earnings. Retail sales picked up smartly in Feb and that should be reflected in faster personal spending growth.
- The core CPI rose a cumulative 0.5% in Jan-Feb so there is some upside risk to our 0.1% forecast for the core PCE deflator in Feb.

US core PCE deflator





Key Data and Events

		Market Westpac			Risk/Comment
		Last	median	forecast	
Mon 25					
Aus	Mar TD-MI inflation gauge	0.0%	-	-	Annual at 2.4%. Inflation remains well contained..
UK	Mar house prices %yr	-0.1%	-	-	Hometrack index
	Mar house prices %yr	0.0%	0.8%	-	Tentative date for Nationwide index due 25-29/3.
	Feb mortgages	32.3k	-	-	BBA data covering 70% of market.
US	Mar Dallas Fed factory index	2.2	-	3.0	2013 early year gains less than in 2011 and 2012.
	Feb Chicago Fed national activity index	-0.32	-	-	Based on 80 or so data inputs, not a business survey.
	Fed chair Bernanke	-	-	-	Speaking in London. Fed's Dudley in NY.
Tue 26					
NZ	Feb trade balance NZ\$m	-305	-4	300	Dairy prices on the up, but import values to rise over the year.
Aus	RBA Governor speaking	-	-	-	ASIC annual forum, Sydney, 3.45. Topic tba
UK	Mar CBI retail survey	8	-	-	Anecdotes that retailing results very poor this month.
US	Feb new home sales	15.6%	-2.8%	-5.5%	Modest and temporary pull-back in sales. See text box.
	Jan house prices %yr	6.8%	7.9%	-	S&P Case Shiller 20 city index.
	Feb durable goods orders	-4.9%	3.8%	3.0%	All indications point to a decent bounce; see text box.
	Mar Conf Brd consumer confidence	69.6	69.0	65.0	IBD-TIPP and UoM indices both weaker in Mar.
	Feb Richmond Fed factory index	6	-	3	2013 early year gains less than in 2011 and 2012.
Cyp	Bailout deadline	-	-	-	ECB to cease emergency funding of Cypriot banks if no deal reached.
Wed 27					
NZ	Mar ANZ business confidence	39.4	-	-	Momentum continued into early 2013, but drought a concern.
Aus	RBA financial stability review	-	-	-	Half year update. Commentary included in Minutes of March meeting.
Eur	Mar business climate indicator	-0.73	-	-0.85	Business outlook surveys have mostly kept improving despite Cyprus bailout failure late in month.
	Mar economic confidence	91.1	91.2	90.0	
UK	Q4 GDP 2nd revision	-0.3% a	-0.3% a	-	Focus now on Q1 and risk that economy is in triple dip recession.
	Q4 business investment revision	-1.2% a	-	-	Surveyed separately to national accounts capital formation data.
	Q4 current account deficit £bn	-12.8	-12.7	-	Q3 deficit narrowed from Q2 record but subject to extensive revision.
US	Feb pending home sales	4.5%	0.7%	-1.0%	Sales constrained by lack of quality homes for sale.
	Fedspeak	-	-	-	Rosengren, Koehlerakota.
Can	Feb CPI %yr	0.5%	0.8%	-	Annual CPI lowest since recession in Jan. BoC core rate 1.0% in Jan.
Thu 28					
NZ	Feb building consents	-0.4%	3.0%	3.0%	Construction ramping up in Auckland and Christchurch.
	Feb private sector credit %yr	3.5%	-	-	Housing lending has accelerated but business weak.
Aus	Feb private sector credit	0.2%	0.3%	0.2%	Subdued, housing soft & business flat.
Chn	Feb industrial profits %ytd	5.3%	-	-	Cycle turned in late Q3, margins widening again.
Eur	Feb money supply M3 %yr	3.5%	3.2%	-	Slowed from 3.9% yr peak in Oct 2012. Private loans down -0.9% yr.
UK	Mar GfK consumer confidence	-26	-27	-25	Verdict on the 2013 budget.
US	Q4 GDP 2nd revision, annls'd	0.1%	0.5%	0.3%	Economy barely expanded in late 2012.
	Initial jobless claims w/e 24/2	336k	338k	340k	Claims in downtrend so far this year.
	Mar Chicago PMI	56.8	56.3	55.0	Way down on 60 a yr ago and 70 two yrs ago.
	Mar Milwaukee NAPM	56.5	-	-	Little watched.
	Mar Kansas City Fed factory index	-10	-	0	Five sub zero readings in Oct-Feb, weakest since 2009 recession.
Can	Jan GDP	-0.2%	0.1%	-	GDP growth slowest in H2 2012 since recession last decade.
	Feb industrial product prices	0.0%	0.5%	-	Have only posted one rise (Sep) since April last year.
Fri 29					
-	Easter Friday	-	-	-	Aus, NZ, EU, UK Can markets closed.
Jpn	Mar Markit manufacturing PMI	48.5	-	-	Solid gain in store.
	Feb national CPI %yr	-0.3%	-0.7%	-	Ex ff at -0.2%yr, ex ff & nrg -1.0%yr. Tokyo headline at -0.9%yr in Feb.
	Feb industrial production %mth	0.3%	3.5%	-	METI projections bullish, but spread across front months is unreliable.
US	Feb core PCE deflator	0.1%	0.1%	0.1%	Core CPI was 0.3% but core PCE likely less.
	Feb personal income	-3.6%	0.9%	0.6%	Sharp Dec-Jan swings due to income pull-forward to beat Jan tax rises
	Feb personal spending	0.2%	0.6%	0.6%	but spending seemingly unaffected. Feb to normalise. See text box
	Mar UoM consumer sentiment final	71.8 a	72.9	73.5	Weekly confidence data suggests sentiment improved later in Mar.

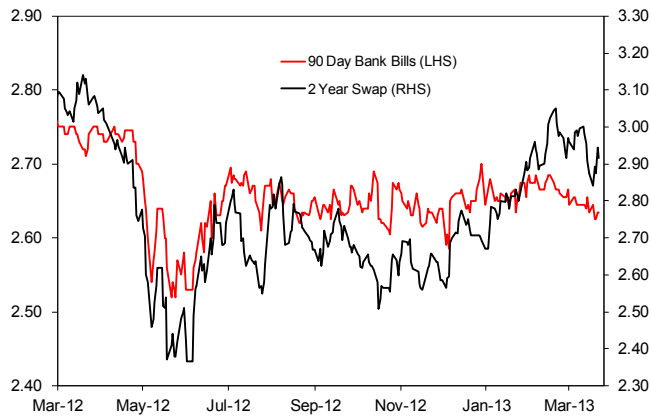


New Zealand Economic and Financial Forecasts

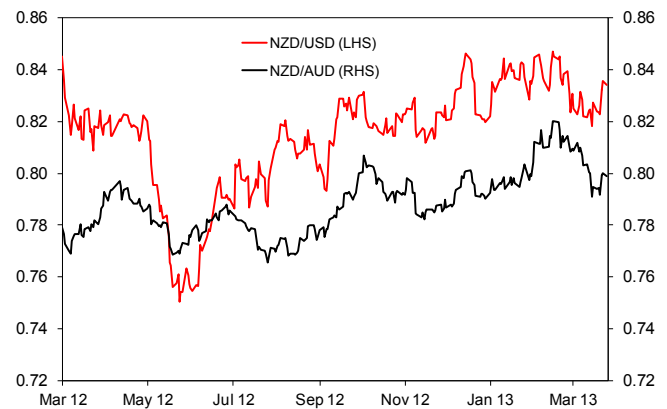
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012e	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	3.0	3.4	1.4	2.5	3.0	3.2
Employment	1.0	0.0	2.6	2.5	1.5	-1.4	3.7	2.6
Unemployment Rate % s.a.	6.7	7.0	6.1	5.1	6.4	6.9	6.3	5.3
CPI	1.6	1.1	1.9	2.3	1.8	0.9	2.0	2.3
Current Account Balance % of GDP	-4.4	-4.9	-5.0	-6.0	-4.0	-5.0	-4.8	-5.8

Financial Forecasts	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.50	2.50	2.75	3.25	3.50	3.75
90 Day bill	2.70	2.75	3.20	3.50	3.75	4.00
2 Year Swap	3.00	3.10	3.30	3.60	3.90	4.20
5 Year Swap	3.50	3.60	3.80	4.00	4.30	4.50
10 Year Bond	3.80	3.90	4.10	4.30	4.40	4.50
NZD/USD	0.85	0.85	0.85	0.84	0.83	0.82
NZD/AUD	0.82	0.83	0.84	0.85	0.86	0.85
NZD/JPY	78.2	77.4	75.7	73.9	71.4	68.9
NZD/EUR	0.63	0.64	0.66	0.67	0.67	0.68
NZD/GBP	0.54	0.55	0.55	0.55	0.54	0.53
TWI	76.9	77.3	77.8	77.7	77.3	76.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 25 March 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.64%	2.66%	2.67%
60 Days	2.64%	2.66%	2.67%
90 Days	2.64%	2.66%	2.66%
2 Year Swap	2.92%	3.00%	2.99%
5 Year Swap	3.49%	3.55%	3.56%

NZ foreign currency mid-rates as at Monday 25 March 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8340	0.8197	0.8362
NZD/EUR	0.6435	0.6311	0.6318
NZD/GBP	0.5472	0.5495	0.5528
NZD/JPY	78.777	78.637	78.870
NZD/AUD	0.7990	0.8028	0.8116
TWI	76.45	75.600	76.380



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	3.07	3.00	3.10	3.10	3.00	3.00
10 Year Bond	3.56	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	1.92	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	1.0425	1.04	1.03	1.01	0.99	0.97
USD/JPY	94.95	92	91	89	88	86
EUR/USD	1.2915	1.34	1.32	1.29	1.26	1.23
AUD/NZD	1.2530	1.22	1.21	1.19	1.18	1.17

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