10 November 2014

Weekly Commentary

Rere Waterfall, Gisborne.

In this issue

Escaping the bind

Last week we released our latest quarterly Economic Overview. As always, it's a compact but comprehensive summary of our views on the New Zealand economy, available on our website at http://www.westpac.co.nz/wib/economic-updates/.

Three key developments have informed our latest thinking: the recent commodity price downturn, the intensifying housing shortage in the Auckland region, and the absence of inflation. Combined, they add up to continued solid, albeit uneven, economic growth, supported by a more muted hiking cycle from the RBNZ.

Sharply lower dairy and forestry prices are certainly going to make life difficult for some New Zealand regions and sectors over the next year. Compared to a 'normal' dairy payout in the low $6 range, the $4.80 payout we expect for this year's season represents a revenue loss of about $2.5bn for the industry. Add the hit to log exports and the likely flow-on effects to confidence and government revenues, and the impact on economic activity could plausibly exceed 0.5% of annual GDP.

But construction activity is going gangbusters, fuelled by the Canterbury rebuild, burgeoning construction activity elsewhere, and booming net immigration. Net immigration has continued to exceed even our bullish expectations, and we now expect the annual rate to reach an unprecedented 55,000 in the first half of next year. The resulting population growth has seen the Auckland housing squeeze get noticeably tighter, despite the increase in building we have already seen in the region. In recognition we have significantly upped our forecasts for Auckland residential construction – and even on that assumption Auckland's housing shortage is likely to get worse before it gets better.

On balance we expect economic growth to maintain a respectable 3.2% pace through next year, following 3.6% growth this year. Ordinarily, we would expect sustained growth at this rate to run into a wall of rising inflation and rising interest rates. But inflation has been largely missing in action.

Escaping the bind continued

The themes of solid growth but tame inflation were clearly illustrated by last week's labour market data. Businesses continued to hire at a rapid clip in the September quarter – employment rose 0.8%, to be up 3.2% for the year. The payrolls-based Quarterly Employment Survey sent a similar message, with filled jobs up 1% in the quarter and 3% over the year.

But the resulting drop in the unemployment rate, to 5.4%, was incremental. Surging population growth may be adding to housing pressures, but it is also boosting the pool of available labour, as is rising workforce participation among both older and younger workers. And wage inflation continued to be subdued, inching up to 1.9% (according to our preferred measure, the private sector, ordinary time Labour Cost Index) and sitting at just 1.7% if we include public sector workers.

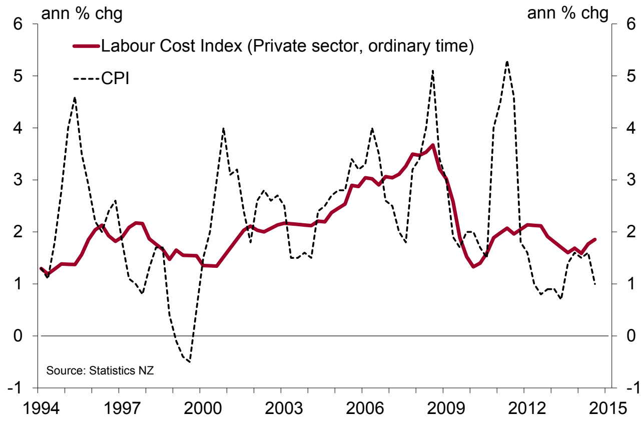
In part, low wage inflation is simply a reflection of low consumer price inflation, which means less need for cost-of-living adjustments. And some of the reasons for low inflation, such as the soft patch in the global economy, are likely to wane. But there's also the fundamental fact that the economy's capacity to meet demand has proven more elastic than we gave it credit for – thanks to the growing labour force, and an investment and efficiency drive by businesses over the last few years.

Our current OCR forecasts reflect this reality. While we do expect another tranche of OCR hikes starting in September next year, the peak is likely to be a tepid 4.75%. There simply isn't enough time left for inflation pressures to gather a serious head of steam before the Canterbury rebuild starts to wind down.

A key way in which this will give the economy more breathing space is by pushing out the day of reckoning for New Zealand's housing market. Fixed mortgage rates have already fallen sharply as markets have priced out further OCR rises, and could fall further in the near term. Along with strong population growth and an election result removing the risk around capital gains tax, that could well give the housing market a modest second wind.

In recent months the housing market has shown little momentum, possibly due to pre-election uncertainty. Hence we are looking forward to this week's October housing market data with interest. That said, though we think conditions for a post-election rebound are in place, they may not be leading to results just yet. While mortgage approvals and listings picked up noticeably in October, data from a major Auckland realtor suggest that this hasn't yet translated into a pickup in sales.

Wage growth and CPI inflation



Also of relevance to the housing market will be the Reserve Bank's half-yearly Financial Stability Review, out on Wednesday. The RBNZ has said it will take the opportunity to review the mortgage lending restrictions it put in place last year. We wouldn't be surprised if it set out a timetable for their removal, the only real question being at what pace.

On most relevant metrics the impact of the LVR restrictions has met or exceeded expectations. House price inflation has clearly moderated, despite resurgent migration. Housing credit is growing at its slowest pace since early 2013. The number of new high-LVR home loans written by banks remains safely below the Reserve Bank's stipulated speed limit, and on our estimates the high-LVR share of the total stock of mortgage loans is back to the post-recession lows seen in 2010. The only thing that might give the Reserve Bank pause is the drop in mortgage pricing over the past six months, and the risk that the housing market could reignite as a result.

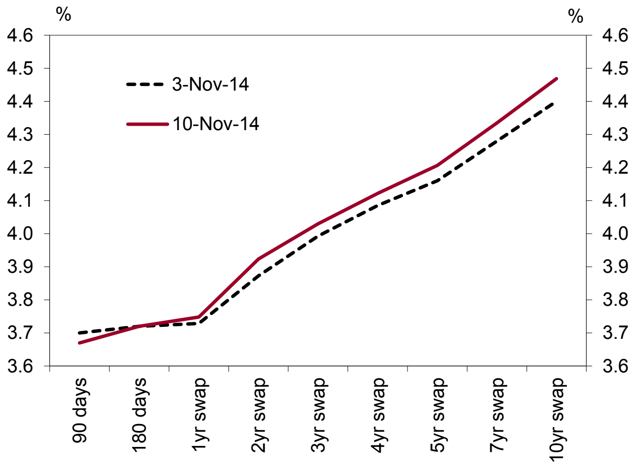
Fixed vs Floating for mortgages

Fixed mortgage rates have been falling recently, and may have further to fall in the weeks ahead. Those looking to fix their mortgage might find it is worth waiting a few weeks for better rates.

Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates, such as the six-month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

Among the standard fixed rates, the best deal for borrowers with a deposit of 20% or more is the two-year term, which offers substantial value relative to where we expect shorter-term rates to go over the next two years. There is little point in fixing for just one year, given that these rates are higher than the two-year rate in most cases. Four- and five-year rates seem rather high relative to where we think shorter-term rates are going to go over the coming four or five years, but they do offer stability.

NZ interest rates

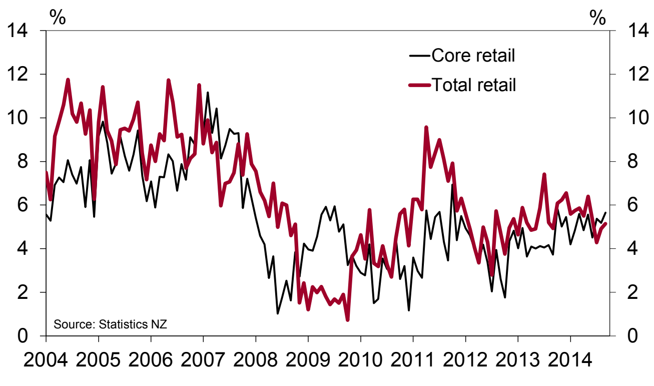


NZ Oct retail electronic card spending

Nov 11, last -0.1%, Westpac f/c: 0.9%

- Retail electronic card spending slowed unexpectedly sharply last month. With no obvious catalyst, we suspect a good part of this was monthly volatility, and expect a corresponding rebound in October.
- That said, the trend pace of growth in card spending does appear to have moderated in the course of the year, as consumer sentiment has come off the boil, the housing market has slowed, and low inflation has further dampened increases in dollar spending.

Card transactions, annual % change

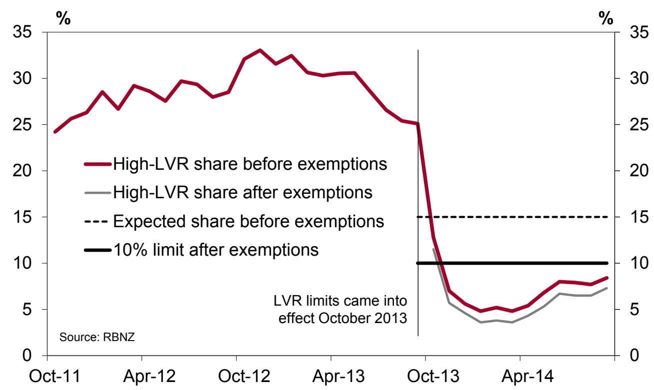


NZ RBNZ Financial Stability Report

Nov 12

- The RBNZ has been hinting for some time that it would review its ‘speed limit’ on high loan-to-value ratio (LVR) mortgage lending towards the end of this year. Back in May the RBNZ said: “Before removing the LVRs, we will want to be confident that the housing market is responding to interest rate increases, and that immigration pressures are not causing a resurgence of house price pressures.” We think those conditions have been comfortably met.
- The remaining questions are: (1) whether the RBNZ will give a firm or conditional timetable for removal, and (2) whether it will be loosened initially or removed all at once. We’re reluctant to guess at a date, but on the latter we suggest it would be prudent to at least retain some non-binding limit, to discourage a return to the previous habits that prompted the restriction in the first place.

New mortgage lending by loan-to-value ratio

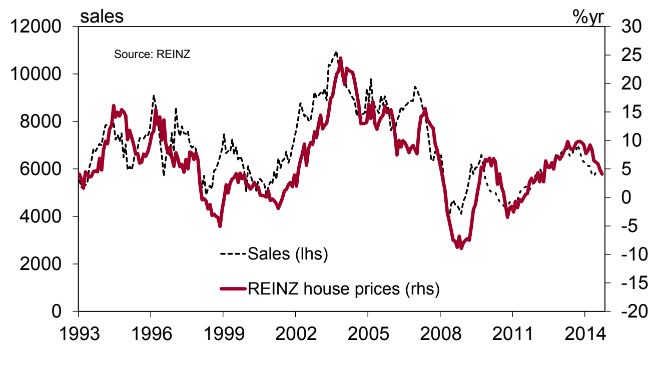


NZ Oct REINZ house prices and sales

Nov 14 (tbc), Sales last: -0.1%, Prices last: 4.1%yr

- The housing market was noticeably subdued ahead of the 22 September election, reflecting concerns that a change of government would bring a broader capital gains tax and the removal of ring-fencing for investment properties.
- Indicators for October suggest that both buyers and sellers were ready to spring into action again, with a substantial lift in both mortgage approvals and new listings. However, figures from Auckland’s largest realtor suggested that this hadn’t translated into a rise in sales yet.
- Annual house price growth is almost certain to slow further in October, given that this time last year buyers were scrambling to get in ahead of the RBNZ’s limit on high-LVR lending.

REINZ house prices and sales

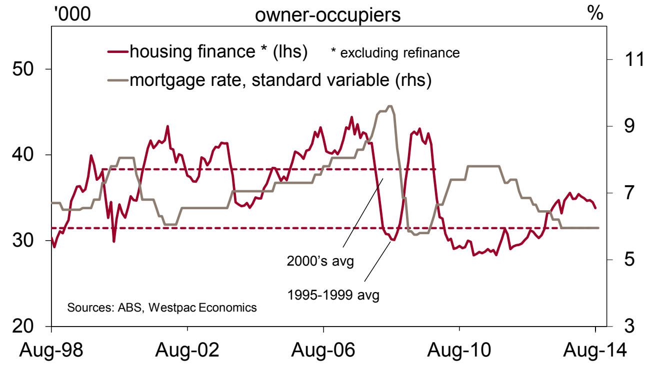


Aus Sep housing finance (no.)

Nov 10, Last: –0.9%, WBC f/c: –1.0%
Mkt f/c: –0.4%, Range: –3.0% to 2.7%

- The Aug report showed a continued softening in the number of owner-occupier finance approvals with NSW and WA leading the way. The slowdown in consistent with the weaker consumer sentiment reads on ‘time to buy a dwelling’ since late last year. Notably both the number of construction related approvals and the value of investor finance approvals (the latter excluded from the headline measure) remain firmer.
- Industry data suggests owner-occupier finance approvals continued to slip in Sep. We expect to see a further 1% decline in the number of owner-occupier approvals. The figures around investor activity will arguably be of more focus given the RBA’s recently voiced concerns. There are no reliable industry guides on this front. Firming auction clearance rates and prices may be a sign that this segment remains more active.

Owner-occupier finance & the rate cycle

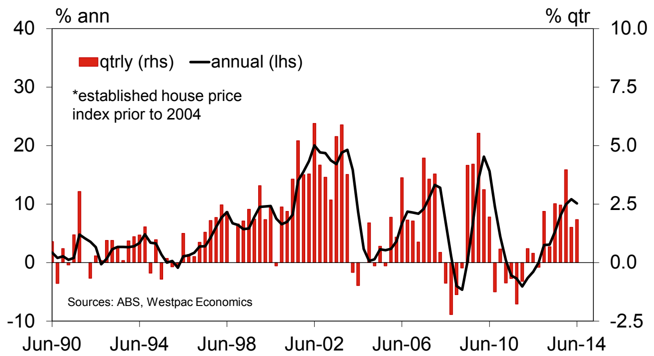


Aus Q3 residential property price index

Nov 11, Last: 1.8%, WBC f/c: 1.0%
Mkt f/c: 1.5%, Range: flat to 2.8%

- Australia's housing markets have seen a moderate slowdown in 2014 after a strong surged in the second half of 2013. The ABS residential property price index posted a solid 1.8% gain in Q2, up 10.1%yr, a touch firmer than Q1's 1.5% rise but maintaining the slower pace seen since Q4's 4% burst. Note that this measure now includes 'attached' dwellings (i.e. townhouses, terraces, units etc). Previously it covered only detached houses.
- Available private data on 'all dwelling' measures show gains of 0.8%qtr, 7.9%yr (APM), 2.0%qtr, 8.4%yr (Residex to Aug), and 2.8%qtr, 9.4%yr (RP Data-Rismark). The ABS measure tends to track the APM series more closely due to their similar construction. Accordingly we expect it to show a 1.0% gain, down a touch on the first half of 2014 and taking annual price growth back below 10%.

Residential property price index, ABS measure

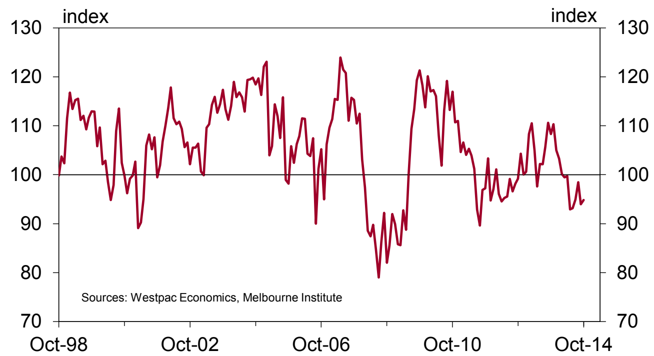


Aus Nov Westpac-MI Consumer Sentiment

Nov 12 Last: 94.8

- Consumer sentiment remained subdued in Oct with the **Westpac-Melbourne Institute Consumer Sentiment Index** in 'cautiously pessimistic' territory at 94.8 – the reading means pessimists outnumber optimists by 5.2%.
- The Nov survey is in the field in the week to Nov 9. With the RBA policy unchanged at its Nov meeting as expected, other developments will have more of a bearing. In particular, the ASX has rebounded 6% since the last survey, which was conducted in the midst of a sharp sell-off (ASX –7.3% between Sep and Oct surveys). Economic data has been mixed with stronger than expected retail sales but softer data on housing and jobs. The Budget-related concerns that have weighed on sentiment for much of the year may start to dissipate although this factor is very difficult to judge. The Nov sentiment read is particularly important for setting the tone heading into the critical Dec-Jan peak season for many retailers.

Consumer Sentiment Index

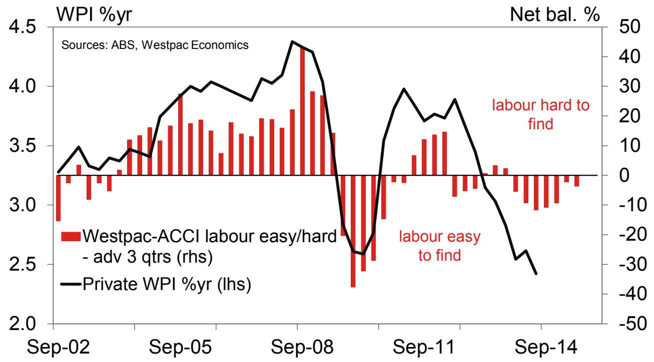


Aus Q3 wage price index

Nov 12 Last:0.6%, WBC f/c: 0.5%
Mkt f/c: 0.6%, Range: 0.5% to 0.8%

- The Q2 Wage Price Index came in below our and the market's expectations, printing at 0.6%. Annual growth eased a tick to 2.59% from 2.61%, a new record low for the series which dates back to Q3 1997.
- Following two strong quarters (0.9% in Q4 2013; and 0.8% in Q1 2014), public wages increased by a more modest 0.6% in Q2. Annual public sector wage growth slowed markedly to 2.8%yr, in line with the pace seen a year ago but well below Q2 2012's 3.3%yr result. Private sector wage growth was on par with that of the public sector in Q2 at 0.6% but annual growth is weaker at 2.4%yr (or 2.3%yr including bonuses).
- Ample slack remains in the labour market and the public sector is implementing wage restraint. The Sep quarter is set for another benign wages print.

Labour market still has ample slack

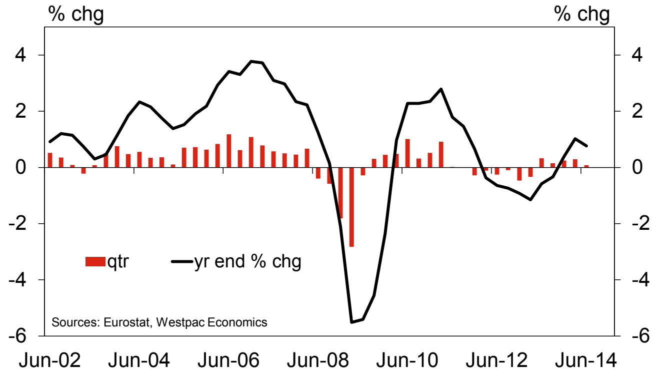


Eurozone GDP barely growing in Q3

Nov 14, Last: 0.0% *, WBC f/c: 0.1%

- Euroland GDP stalled in Q2 with Spanish growth of 0.6% and GDP bounces in Holland and Portugal offset by 0.2% falls in Germany (weather-related) and Italy (ongoing recession as GDP has contracted every quarter for 3 years; Q1 was rounded up to 0.0%). France remained on the sidelines, stalled right through H1 2014 (also contracting in Q2 before rounding).
- Spain has already reported 0.5% growth (and Belgium 0.2%)in Q3. Elsewhere, activity will have been tempered by falling business confidence and geopolitical tensions. Those factors have not by-passed Germany which "hardly expanded" in Q3 according to the Bundesbank (our forecast 0.1%); partial data suggest ongoing malaise in France and Italy (both forecast flat).
- Our Q3 Eurozone growth forecast is 0.1%; *Special note: GDP history has been revised following adoption of new national accounting standards. These show Q2 revised up to 0.1%.

Euro zone GDP growth

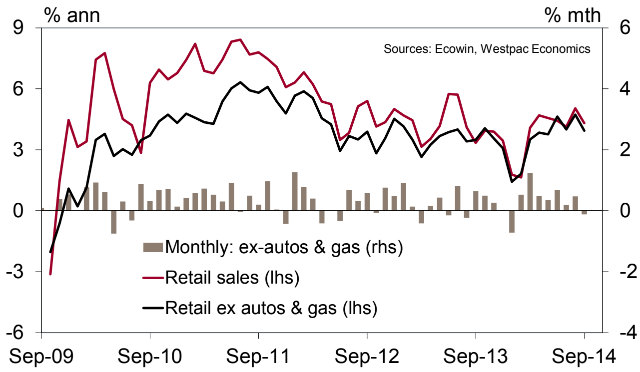


US Oct retail sales

Nov 14: Last: –0.3%, WBC f/c: 0.2%

- Retail sales fell 0.3% in September, with auto and gasoline sales both down 0.8%. But the surprise was a 0.1% fall in core retailing (ex autos/gas), the first since January this year (also for the first month in seven there was not an upward revision to core retailing in the prior month). In September, of the 12 storetypes outside of car dealers and servos, only four recorded sales gains, the strongest being electronics thanks to the Sep 19 launch of Apple's Iphone 6.
- This component may lead an upward revision to September sales as the latest report incorporates returns for the last week of the prior month. Our 0.4% core forecast for Oct (or a slightly lower outcome if Sep is revised higher) suggests some momentum in consumer spending resuming, despite patchy earnings growth. But auto sales stalled and gasoline prices fell further, weighing on the headline which we forecast at 0.2%.

US retail sales



Data calendar

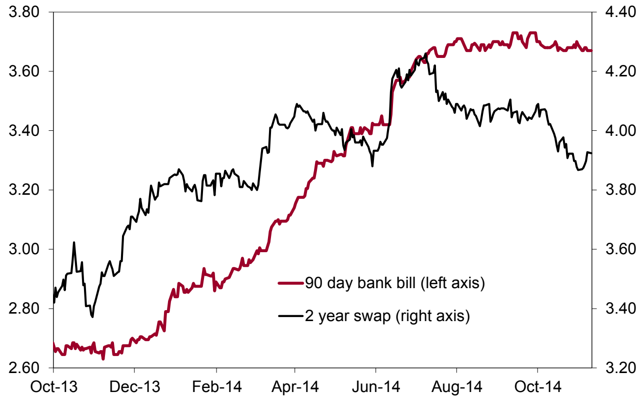
		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
Aus	Sep housing finance	–0.9%	–0.4%	–1.0%	Owner-occupier demand clearly cooling. Focus will be on Investor loans.
Chn	Oct PPI %yr	-1.8%	-2.0%	–	Raw materials and capital goods in decline, food, clothing up a touch.
	Oct CPI %yr	1.6%	1.6%	–	Shelter receding, lower transport fuel, non-food lowest since early 2010.
	Oct new loans RMBbn	620	857	–	Tentative date: Last two Octobers have been in the low 500s.
	Oct total credit RMB	880	1052	–	Tentative date: Consensus implies approximate 2% gain on a year ago.
	Oct money supply M2 %yr	12.9%	12.9%	–	Tentative date: FX reserves declined in Q3, onus on PBOC to offset.
US	Oct labour market conditions index	–	–	–	Fed's new composite indicator for assessing slack in the job market.
Can	Oct housing starts	0.5%	–	–	Residential permits decline a near-term constraint.
Tue 11					
NZ	Oct retail electronic card spending	–0.1%	–	0.9%	Expect monthly rebound within a slower trend.
Aus	Oct NAB business survey (conditions)	1	–	–	In Sep, both conditions & confidence down 2pts to LR average levels.
	Q3 residential property price index	1.8%	1.5%	1.0%	Price growth has moderated in 2014, back below 10%yr.
UK	Oct BRC retail sales %yr	–2.1%	–	–	Same store sales.
US	Oct NFIB small business optimism	95.3	95.0	94.9	Some tendency to track ISM services which was lower in Sep-Oct.
Wed 12					
NZ	RBNZ Financial Stability Report	–	–	–	Possible announcement on the loosening/removal of LVR limits.
Aus	Nov Westpac–MI Consumer Sentiment	94.8	–	–	Key reading to set the tone heading into Dec-Jan peak season for retail.
	Nov Westpac–MI unemploy expectations	–3.9%	–	–	Fallen close to 5% since Feb but remain at historically elevated level.
	Q3 wage cost index	0.6%	0.6%	0.5%	Ample slack in the labour market will keep wage inflation contained.
Eur	Sep industrial production	–1.8%	0.5%	0.5%	Factory PMI turned up in Oct but any Sep IP bounce might be modest.
UK	Oct jobless claims change	–19k	–25k	–20k	Claimant count falling less rapidly as GDP growth moderates.
	Q3 employment change	46k	162k	146k	Employment growth picking up from mid year slowdown.
	BoE inflation report	–	–	–	Guidance unlikely to suggest increased urgency re 2015 tightening.
US	Sep wholesale inventories	0.7%	0.2%	0.0%	Lower gasoline prices to weigh on total.
	Fedspeak	–	–	–	Kockerlakota; Plosser in London.
Can	Oct house prices %yr	5.4%	–	–	Teranet/National Bank measure
Thu 13					
NZ	Oct manufacturing PMI	58.1	–	–	Strong gains in recent months, perhaps aided by lower NZD/AUD.
	Oct food price index	–0.8%	–	–0.9%	Produce prices were unusually subdued over winter.
Aus	Nov MI consumer inflation expectations	3.4%	–	–	Expectations remain well anchored below LR avg of 4.5%.
	RBA Assistant Governor Economic	–	–	–	Dr Kent speaking, "The business cycle", ABE, Sydney, 12:30.
Chn	Oct fixed investment %ytd	16.1%	16.0%	–	Real estate, heavy industry in decline, infra & utilities imperfect offset.
	Oct retail sales %yr	11.6%	11.6%	–	Consumer sentiment weak, purchasing plans subdued despite iphone.
	Oct industrial production %yr	8.0%	8.0%	–	Sep bounce possibly over-stated; proxies point to a lesser pace.
UK	Oct RICS house price balance	30%	25%	–	UK housing market coming off the boil on range off measures.
US	Initial jobless claims w/e 8/11	278k	–	270k	Running at lowest trend pace so far this century.
	Sep JOLTS	–	–	–	Job openings and labour turnover.
	Oct monthly budget statement, $bn	–111.7	–	–	Budget position improved from last year.
Can	Sep new house prices %yr	1.5%	1.5%	–	Broadly steady pace of gain this year, below established price gains.
Fri 14					
NZ	Oct REINZ house sales	–0.1%	–	–	Due this week. Expect a post-election bounce in coming months.
	Oct REINZ house price index	4.1%	–	–	House price growth likely to remain subdued.
Eur	Oct CPI final %yr	0.4% a	0.4%	0.4%	Uptick from 0.3% largely due to Italian education and utility prices.
	Q3 GDP advance	0.0%	0.1%	0.1%	Spain the new engine room of European growth! See text box.
Ger	Q3 GDP advance	–0.2%	0.1%	0.1%	Q3 partials pretty dire. Some risk of technical recession.
UK	Sep construction output	–3.9%	4.0%	–	Construction PMI in upswing suggesting Aug fall erratic.
US	Oct import prices	–0.5%	–1.8%	–1.5%	Oil prices down sharply during month, and USD stronger.
	Oct retail sales	–0.3%	0.2%	0.3%	iphone sales boost in Sep-Oct but drag from autos, gasoline prices.
	Sep business inventories	0.2%	0.3%	0.1%	Inventories were drag on Q3 GDP growth.
	Nov UoM consumer sentiment prelim	86.9	87.5	88.5	Lower gasoline prices; also politics and equities influence.
	Q3 mortgage default/foreclosures	6.0%	–	–	Continued unwind from post-recession peak in 2010 (defaults).
	Fedspeak	–	–	–	Bullard.
Can	Sep manufacturing sales	–3.3%	1.1%	–	Aug fall due autos after July surge.
Sat 15					
Aus	G20 Summit	–	–	–	G20 Leaders' Summit, Brisbane, 15-16 November

New Zealand forecasts

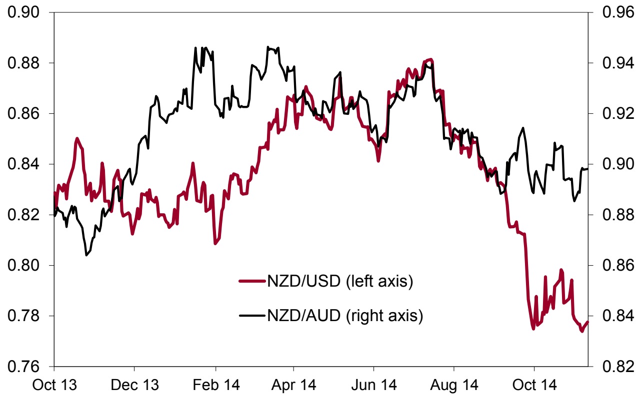
Economic Growth Forecasts	March years				Calendar years			
% change	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
GDP (Production) ann avg	2.3	3.2	3.5	3.1	2.8	3.6	3.2	2.9
Employment	0.4	3.8	2.8	2.6	2.9	3.0	2.7	2.0
Unemployment Rate % s.a.	6.2	5.9	5.2	4.8	6.0	5.4	4.9	4.5
CPI	0.9	1.5	1.3	2.2	1.6	1.0	2.2	2.4
Current Account Balance % of GDP	-3.8	-2.7	-4.6	-5.8	-3.3	-3.4	-5.9	-5.0

Financial Forecasts	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Cash	3.50	3.50	3.50	3.75	4.00	4.25
90 Day bill	3.70	3.70	3.75	4.00	4.25	4.50
2 Year Swap	3.80	3.90	4.10	4.50	4.70	4.80
5 Year Swap	4.10	4.20	4.40	4.70	4.90	5.00
10 Year Bond	3.90	4.00	4.20	4.50	4.70	4.80
NZD/USD	0.77	0.77	0.78	0.79	0.80	0.81
NZD/AUD	0.88	0.86	0.85	0.85	0.85	0.85
NZD/JPY	89.3	90.1	91.3	94.0	96.8	98.8
NZD/EUR	0.62	0.61	0.61	0.61	0.62	0.62
NZD/GBP	0.49	0.47	0.47	0.47	0.46	0.46
TWI	76.2	75.3	75.7	76.4	77.2	77.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 10 November 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.64%	3.65%	3.64%
60 Days	3.66%	3.67%	3.66%
90 Days	3.67%	3.68%	3.68%
2 Year Swap	3.92%	3.92%	4.02%
5 Year Swap	4.21%	4.20%	4.28%

NZ foreign currency mid-rates as at Monday 10 November 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7776	0.7894	0.7821
NZD/EUR	0.6231	0.6212	0.6190
NZD/GBP	0.4895	0.4895	0.4864
NZD/JPY	88.91	85.04	84.08
NZD/AUD	0.8981	0.8967	0.8992
TWI	76.89	76.68	76.27

International forecasts

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014f	2015f	2016f
Australia						
Real GDP % yr	2.6	3.6	2.3	3.2	3.2	3.5
CPI inflation % annual	3.0	2.2	2.7	1.8	2.5	2.7
Unemployment %	5.2	5.3	5.8	6.3	5.9	5.2
Current Account % GDP	-2.8	-4.4	-3.3	-3.1	-2.4	-1.2
United States						
Real GDP %yr	1.6	2.3	2.2	2.2	2.5	3.2
Consumer Prices %yr	3.1	2.1	1.5	1.8	1.8	2.0
Unemployment Rate %	8.9	8.1	7.4	6.3	5.7	5.2
Current Account %GDP	-2.9	-2.9	-2.4	-2.3	-2.2	-2.2
Japan						
Real GDP %yr	-0.3	1.5	1.5	1.0	1.4	1.6
Euroland						
Real GDP %yr	1.6	-0.6	-0.4	0.7	0.9	1.0
United Kingdom						
Real GDP %yr	1.1	0.3	1.7	3.0	2.5	2.7
China						
Real GDP %yr	9.3	7.7	7.7	7.4	7.5	7.8
East Asia ex China						
Real GDP %yr	4.5	4.5	4.3	4.1	5.1	5.7
World						
Real GDP %yr	4.1	3.4	3.3	2.9	3.7	4.5
Forecasts finalised 7 November 2014						

Interest Rate Forecasts	Latest	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Australia						
Cash	2.50	2.50	2.50	2.50	2.75	3.00
90 Day Bill	2.76	2.65	2.55	2.65	3.00	3.25
10 Year Bond	3.33	3.50	3.70	4.00	4.50	4.60
International						
Fed Funds	0.125	0.125	0.125	0.125	0.250	0.500
US 10 Year Bond	2.38	2.50	2.60	2.80	3.20	3.30
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
AUD/USD	0.8570	0.88	0.88	0.90	0.91	0.92
USD/JPY	115.10	116	117	117	119	121
EUR/USD	1.2380	1.23	1.23	1.24	1.25	1.26
AUD/NZD	1.1140	1.14	1.14	1.15	1.15	1.15

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