



Mt. Taranaki, Mt. Egmont National Park.

## In this issue

Fixed vs floating	2
The week ahead	3
Data calendar	4
New Zealand forecasts	5
International forecasts	6

## As good as it gets?

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Last week was the climax of the New Zealand quarterly data calendar, with March quarter GDP and current account data released. Both releases printed close to expectations and contained relatively little to surprise markets, confirming that the NZ economy is running along at a decent clip. But our view is that this may well be as good as it gets (on a quarterly basis at least), and we expect the pace of growth to moderate a little from here.

New Zealand's current account deficit narrowed to 2.8% of GDP in the March quarter. And there were encouraging signs in the detail of the release, which helped to reinforce the message that New Zealand's external finances have improved significantly since last decade.

The March quarter saw a further improvement in the goods balance, thanks to the turnaround in the performance of the agricultural sector following last year's drought. Since then, not only have agricultural export volumes improved, but export commodity prices (especially dairy prices) have been particularly strong. There was also a solid improvement in the services balance. Spending by tourists has risen significantly over the last year or so (despite ongoing strength in the NZD), after being hit hard during the global financial crisis. The strong performance of the New Zealand economy was also reflected in improving profits for offshore owned firms. Arithmetically, this is a negative for New Zealand's current account balance, but is another sign pointing to strength in the local economy.

In quarterly terms at least, this is likely to be as good as it gets for the current account balance for the near future (although in annual terms, the deficit could narrow a little further in the June quarter as a percent of GDP). The goods balance in particular is likely to deteriorate a bit under the weight of falling commodity prices. Yet over a medium-term horizon, we expect commodity prices to remain at elevated levels (relative to history) thanks to increased integration and trade with fast-growing Asian

# As good as it gets? continued

economies, especially China. Combined with a new, more cautious attitude by consumers toward their own spending, this should help the current around deficit to eventually settle around 4% of GDP – a significantly healthier level than the deficits of nearly 8% of GDP that were achieved in the 2000s.

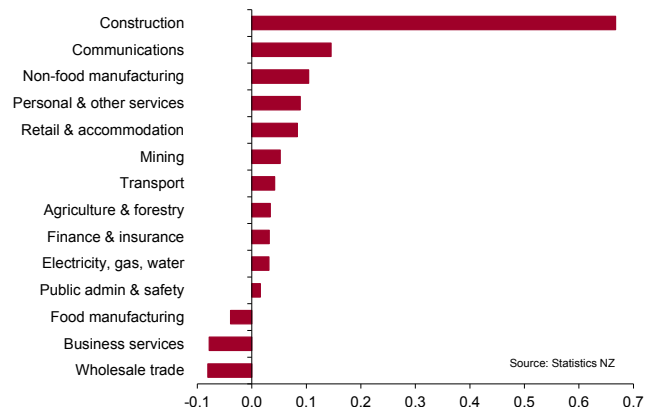
The 1% rise in GDP over the March quarter was a touch shy of forecasts, but certainly not by enough to challenge the key message relayed by the data – that the NZ economy is growing strongly, and certainly fast enough to continue to put upward pressure on inflation. As foreshadowed, the biggest contribution came from the construction sector. The 12.5% jump in construction activity accounted for around two-thirds of the increase in GDP over the quarter. Detail provided in earlier releases showed that while construction activity in Canterbury continues to lead the charge, there has been a solid lift in the regions well, most notably from Auckland. Aside from construction there were also smaller positive contributions from a wide range of other sectors.

Only three sectors failed to make a positive contribution to growth in the March quarter: food manufacturing, business services and wholesale trade. Of these, it is the contraction in the business services sector which is most significant (the other two can be quite lumpy from quarter to quarter). This is a reasonably diverse category and can arguably be regarded as something of a bellwether for the general economy. It recorded a second consecutive fall in the March quarter. Partly this reflects the slowing housing market. The sharp fall in turnover in the housing market (house sales are down 19% over the last eight months) has dented real estate and hiring services. But it is difficult to pinpoint a reason for the remainder of the weakness.

With annual growth now at 3.8%, the economy is growing much more quickly than the 2-3% pace we would regard as its potential. That means pressure on resources is building, and for the Reserve Bank, that's inflation pressure it is compelled to respond to by increasing interest rates.

Indeed, higher interest rates are one reason we expect to see the pace of growth gradually moderate over the remainder of this

Percentage point contribution to Q1 GDP growth



year and next. Already higher mortgage rates (combined with LVR restrictions) are proving a headwind for the housing market. And while consumer spending remains buoyant, the recent pace of growth has slowed from late last year. Add to this falling international dairy prices, a downgrade in the forecast payout to dairy farmers this season, and the ongoing battle of non-commodity exporters with the high NZD, and the pace of growth is likely to decline modestly over the next few years (we're forecasting annual GDP growth to slow to 3.5% by the end of this year, and 3.1% by the end of next). But a slowdown of this magnitude won't be enough to deter the Reserve Bank from the substantial interest rate tightening cycle it signalled most recently in the June *Monetary Policy Statement*.

Looking ahead to this week's data, of most interest will be the migration numbers for May, to be released today. Net migration has been exceptionally strong, in large part driven by fewer Kiwis departing across the Tasman. There appears to be little reason to expect a major change in this trend this month, with the Australian labour market remaining relatively weak. The Reserve Bank will also be watching with interest. Stronger migration was identified as an important upside risk to interest rates in the June *MPS*.

## Fixed vs Floating for mortgages

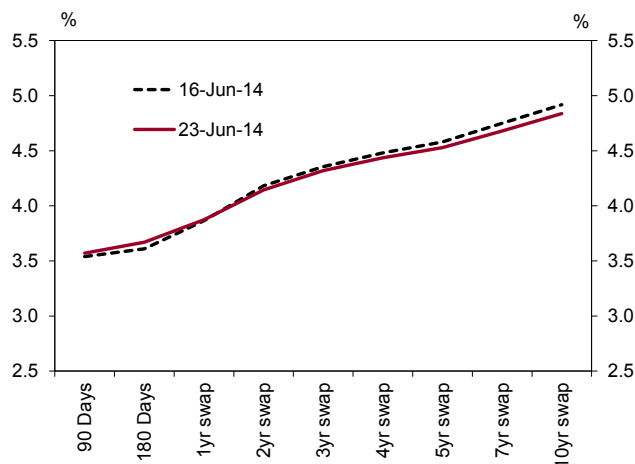
We believe that the current 2-3 year fixed-rate specials offer good value.

The standard fixed rates from around six months to three years appear to offer similar value, and are a fair reflection of where we think shorter-term rates are going to go over the next few years. However, there are a number of specials currently on offer, particularly for 2-3 year fixed terms, that are substantially below our expectation for short-term rates over those horizons. Fixed rates are more likely to rise than fall over the next few months, so for those who are looking to fix there is little to gain from waiting.

Fixing for four or five years may result in higher interest payments over the life of the loan than opting for shorter-term fixed rates. However, these longer-term fixed rates may still be preferred by those who are willing to pay for certainty.

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.

NZ interest rates

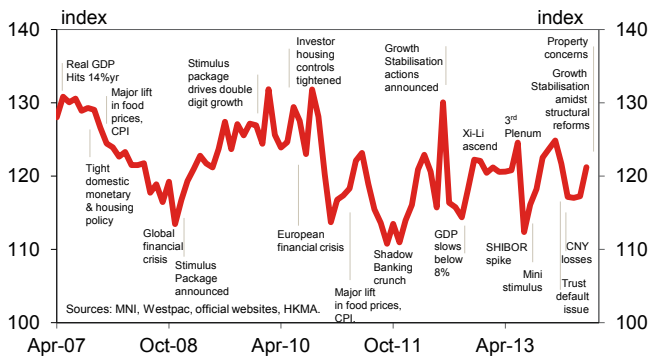


## China Westpac MNI Consumer Sentiment

June 25 Last: 121.2

- The headline index rose from 117.3 in April to 121.2 in May, a 3.4% change over the month and 0.4% over the year. The May outcome is 0.3% below the long run average. The survey indicates that the anxieties gnawing away at the Chinese consumer through the first four months of the year lessened considerably in May. The outlook for employment took a turn for the better, consistent with the improvement in responses regarding business conditions and family finances.
- Consumers' attitudes towards real estate were noticeably firmer in May, despite weak anecdotes on prices and excess supply. This indicated that households had taken note of the tentative shift in policy approach in April and early May. With the move towards growth support no longer tentative, the June outcome depends upon how much extrapolation consumers indulged in last time around.

Westpac MNI China CSI: an event map



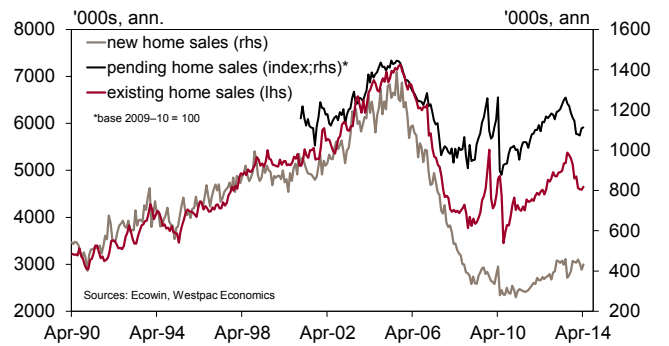
## US existing/new home sales in May

Jun 23, Existing: Last: 1.3%, WBC f/c: 2.2%

Jun 24, New: Last: 6.4%, WBC f/c: 1.5%

- Existing home sales fell 15% between July last year and March before recovering slightly in April. Pending home sales recovered nearly 4% in March-April, with most of that in March. Given the 1-2 months between signing and closure (EHS are recorded at closure), most of those sales would have closed by May; hence, we expect a 2.2% rise.
- New home sales recovered 6.4% in April after falling a revised 6.9% in March (from -14%). Even so, April's annualised sales pace of 433k was lower than during the harsh winter earlier this year and lower than most of 2013. Sales peaked around 450-459k on five occasions between Jan 2013 and Jan 2014. The recent up-tick in homebuilder confidence suggests that sales pace might be approached later this year, although not in May, especially given falling single family house starts.

US housing sales

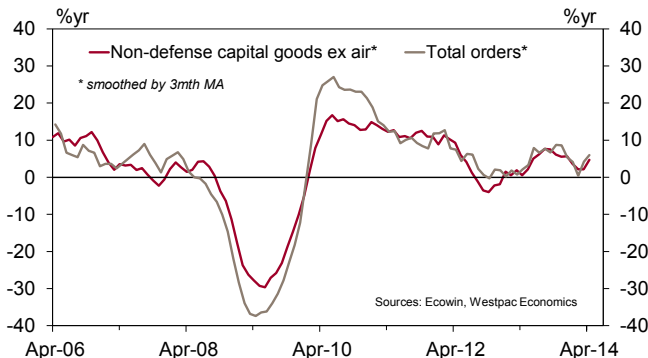


## US May durable goods orders: mostly firmer signals

Jun 25, Last: 0.6%, WBC f/c: 1.0%

- DGOs rose 0.6% in April, buoyed by a 39% increase in defence orders. Ex defence, orders fell 1.0%, with autos, civilian aircraft and core capital goods orders ex defence & aircraft all falling, the last by 1.2% after a cumulative gain of 4.8% in the previous two months.
- ISM factory orders rose to their high for the year so far at 56.9 in May, but are still well down from the 61-65 readings of Aug-Dec last year. Boeing orders rose from 70 to 99 in May, unlikely to be much of a rise after seasonal adjustment. Auto production and business equipment output were both up sharply in May. These signals suggest a positive headline, including a renewed gain in core capital goods orders in May.

US durable goods orders



## US May core PCE deflator & personal inc/spending

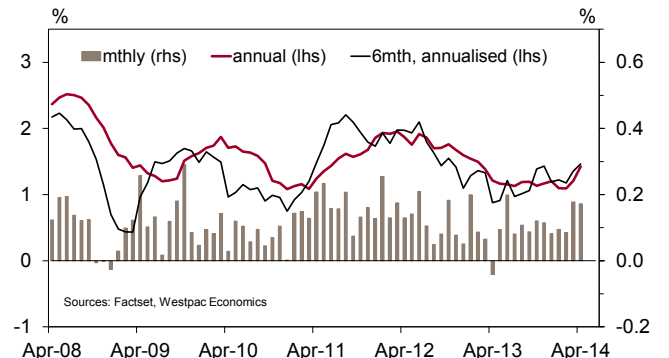
Jun 26, Core PCE deflator: Last: 0.2%, WBC f/c: 0.2%

Jun 26, Personal income: Last: 0.3%, WBC f/c: 0.4%

Jun 26, Personal spending: Last -0.1%, WBC f/c: 0.3%

- Personal spending fell 0.1% in April, mainly due to a 0.5% fall in durables spending; services fell slightly after strong gains through the winter, and spending on non-durables slowed to just 0.1%. Personal income rose 0.3%, slightly below the Q1 average of 0.4%; the core PCE deflator posted back to back 0.2% gains in March-April after eight months of 0.1% gains.
- Near stalled May retail sales outside of auto sales points to only a modest recovery in personal spending, though household services consumption retains the ability to surprise in either direction. Personal income growth will have picked up a little, with both hourly earnings and hours worked rising 0.2% in May.
- The core CPI was rounded up to 0.3% in May, but the core PCE deflator should print another 0.2%. Watch for back revisions.

US core PCE deflator



# Data calendar

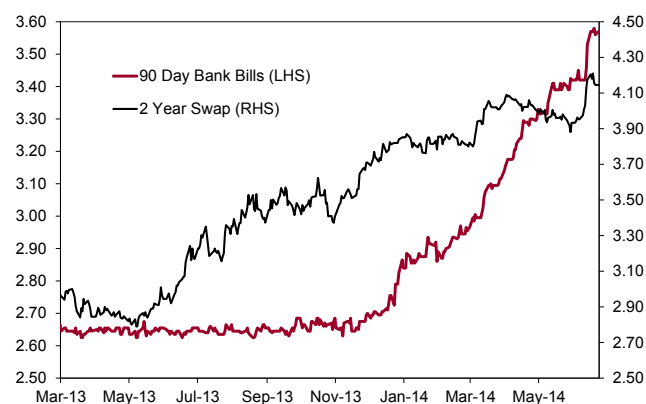
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 23</b>					
<b>NZ</b>	Net immigration, May (s.a.)	4,080	–	3,800	Strong immigration trend is being closely watched by RBNZ.
<b>Chn</b>	Jun HSBC manufacturing PMI - flash	49.4	49.7	–	Details favourable, despite downward revision b/w flash & final.
<b>Eur</b>	Jun factory PMI advance	52.2	52.0	52.1	Other Jun surveys have been mixed, with expectations lowered in
	Jun factory PMI services	53.2	53.3	53.2	some, but ECB policy action should be well-regarded.
<b>UK</b>	Jun house prices %yr	11.1%	–	–	Tentative date for Nationwide index due 23-30/6
	Jun house prices %yr	6.1%	–	–	Tentative date for Hometrack index due 23-27/6
<b>US</b>	May Chicago Fed national activity index	–0.32	–	–	Based on 80 or so data inputs, not a business survey.
	Jun factory PMI	56.4	–	–	Markit PMI has painted different picture of factory sector to ISM.
	May existing home sales	1.3%	1.7%	2.2%	Pending home sales suggest modest gain.
<b>Tue 24</b>					
<b>Ger</b>	Jun Ifo business climate index	110.4	–	105.8	Economy can't sustain Q1 growth pace in Q2 says Buba.
<b>UK</b>	May mortgages no.	42.2k	–	–	BBA data covering about 70% of the market.
<b>US</b>	Apr house prices %yr	12.4%	11.7%	–	S&P Case Shiller 20 city index.
	Apr house prices	0.7%	0.6%	–	FHFA index.
	Jun Conf Brd consumer confidence	83.0	83.5	84.0	Weekly data suggests gain.
	Jun Richmond Fed factory index	7	6	8	Lost altitude since late last year, in contrast to NY, Philly indices.
	May new home sales	6.4%	1.6%	1.5%	Slight upswing resumed.
	Fedspeak	–	–	–	Plosser
<b>Wed 25</b>					
<b>Chn</b>	Jun Westpac–MNI consumer sentiment	121.2	–	–	More easing now in the pipeline, and firmer official data in May.
<b>Ger</b>	Jul GfK consumer confidence	8.5	–	–	Surveyed early Jun, but labelled Jul. Apr-Jun was highest since 2007.
<b>UK</b>	Jun CBI retail survey	–16	–	–	Reported sales. Recent Easter-related volatility also in ONS data.
<b>US</b>	Q1 GDP final	–1.0% a	–1.8%	–2.3%	Economy went backwards rapidly in Q1.
	May durable goods orders	0.6%	–0.3%	1.0%	Underlying story less soft.
	Jun PMI services	58.1	–	–	Better tracking with ISM services than with factory index.
<b>Thu 26</b>					
<b>US</b>	May core PCE deflator	0.2%	0.3%	0.2%	Core CPI was 0.3% in May but core PCE likely to round down to 0.2%.
	May personal income	0.3%	0.4%	0.4%	Hourly earnings and hours worked rise 0.2% in May.
	May personal spending	–0.1%	0.4%	0.3%	Near stalled May retail sales outside of auto sales.
	Initial jobless claims w/e Jun 21	312k	–	310k	Claims downtrend stabilised again.
	Jun Kansas City Fed factory index	10	–	5	Steady climb since late last year.
	Fedspeak	–	–	–	Bullard and Lacker.
<b>Can</b>	Apr average weekly earnings	3.1%	–	–	Uptrend since late 2013 now well underway.
<b>Fri 27</b>					
<b>NZ</b>	May Merchandise Trade \$m	–	–	760	Solid surplus likely despite some moderation in key export prices.
<b>Chn</b>	May industrial profits %ytd	10.0%	–	–	A modest firming outside of the mining and metals smelting place.
<b>Eur</b>	Jun business climate indicator	0.37	–	0.40	Other Jun surveys have been mixed, with expectations lowered in
	Jun economic confidence	102.7	–	103.0	some, but ECB policy action should be well-regarded.
<b>Ger</b>	Jun CPI prelim %yr	0.6%	–	–	EU harmonised measure.
	May retail sales	–1.5%	–	–	Tentative date.
<b>UK</b>	Q1 GDP final	0.8% a	–	0.8%	More detail on above trend growth.
	Q1 current account £bn	–22.4	–	–	Deficit data volatile and often revised.
	Jun GfK consumer confidence	0	0	–	Confidence has roared higher over past year, in line with house prices.
<b>US</b>	Jun UoM consumer sentiment final	81.2 a	82.0	81.0	Weekly data suggest gain.
<b>Can</b>	May industrial product prices	–0.2%	–	–	Apr saw first fall since Oct last year.

# New Zealand forecasts

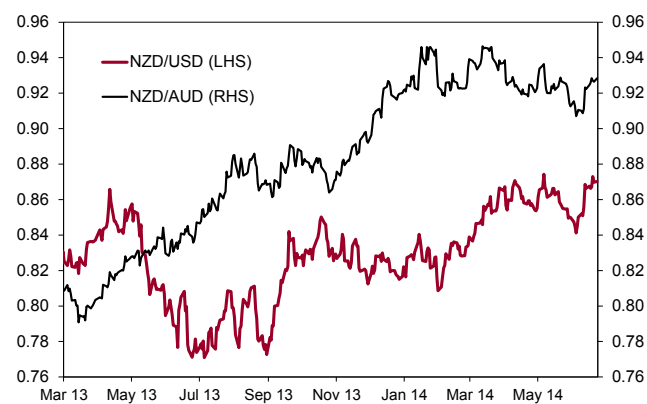
Economic Growth Forecasts	March years				Calendar years			
	2013	2014e	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.3	3.7	3.1	2.5	2.9	3.8	3.2
Employment	0.4	3.8	2.5	2.0	0.4	2.9	2.9	2.4
Unemployment Rate % s.a.	6.2	6.0	5.3	4.9	6.8	6.0	5.5	4.9
CPI	0.9	1.5	1.9	2.6	0.9	1.6	1.7	2.6
Current Account Balance % of GDP	-3.9	-2.8	-4.0	-4.4	-4.1	-3.4	-3.0	-4.6

Financial Forecasts	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Cash	3.25	3.50	3.75	4.25	4.25	4.50
90 Day bill	3.40	3.70	4.00	4.30	4.45	4.60
2 Year Swap	4.20	4.40	4.60	4.80	4.90	5.00
5 Year Swap	4.60	4.80	5.00	5.10	5.20	5.30
10 Year Bond	4.50	4.60	4.80	4.90	5.00	5.05
NZD/USD	0.86	0.86	0.85	0.84	0.84	0.84
NZD/AUD	0.93	0.94	0.94	0.93	0.91	0.90
NZD/JPY	87.7	86.4	85.0	84.8	85.7	86.5
NZD/EUR	0.63	0.63	0.64	0.64	0.63	0.63
NZD/GBP	0.51	0.51	0.52	0.51	0.51	0.51
TWI	79.9	79.9	79.9	78.9	78.3	78.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 23 June 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.25%	3.00%	3.00%
30 Days	3.42%	3.03%	3.27%
60 Days	3.49%	3.11%	3.34%
90 Days	3.57%	3.42%	3.41%
2 Year Swap	4.15%	3.95%	3.96%
5 Year Swap	4.53%	4.41%	4.40%

NZ foreign currency mid-rates as at Monday 23 June 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8702	0.8501	0.8542
NZD/EUR	0.6403	0.6231	0.6270
NZD/GBP	0.5114	0.5058	0.5074
NZD/JPY	88.85	87.13	87.10
NZD/AUD	0.9284	0.9103	0.9249
TWI	80.98	79.25	79.79



## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013	2014f	2015f
<b>Australia</b>						
Real GDP % yr	2.2	2.6	3.6	2.4	3.2	3.0
CPI inflation % annual	2.8	3.0	2.2	2.7	2.5	2.6
Unemployment %	5.2	5.2	5.3	5.8	6.2	5.9
Current Account % GDP	-3.5	-2.8	-4.1	-3.2	-2.5	-2.0
<b>United States</b>						
Real GDP %yr	2.5	1.8	2.8	1.9	1.7	2.6
Consumer Prices %yr	1.6	3.1	2.1	1.5	1.6	1.6
Unemployment Rate %	9.6	8.9	8.1	7.4	6.5	5.9
Current Account %GDP	-3.0	-2.9	-2.7	-2.3	-2.3	-2.3
<b>Japan</b>						
Real GDP %yr	4.9	-0.3	1.5	1.5	1.3	1.3
<b>Euroland</b>						
Real GDP %yr	2.0	1.6	-0.6	-0.4	0.8	1.0
<b>United Kingdom</b>						
Real GDP %yr	1.7	1.1	0.3	1.8	2.6	2.1
<b>China</b>						
Real GDP %yr	10.4	9.3	7.7	7.7	7.2	7.6
<b>East Asia ex China</b>						
Real GDP %yr	7.8	4.4	4.0	4.0	4.2	5.0
<b>World</b>						
Real GDP %yr	5.2	3.9	3.2	3.0	3.1	3.7
Forecasts finalised 6 June 2014						

Interest Rate Forecasts	Latest	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
<b>Australia</b>						
Cash	2.50	2.50	2.50	2.50	2.50	2.50
90 Day Bill	2.70	2.60	2.55	2.55	2.55	2.65
10 Year Bond	3.67	3.90	4.00	4.10	4.30	4.50
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.61	2.60	2.70	2.80	3.00	3.20
ECB Repo Rate	0.15	0.15	0.15	0.15	0.15	0.15

Exchange Rate Forecasts	Latest	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
AUD/USD	0.9410	0.92	0.91	0.90	0.90	0.92
USD/JPY	101.85	102	101	100	101	102
EUR/USD	1.3624	1.36	1.35	1.32	1.32	1.33
AUD/NZD	1.0793	1.07	1.06	1.06	1.07	1.10



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