



Sawcut Gorge, Isolated Hill Scenic Reserve, South Marlborough

In this issue

Fixed vs floating	2
The week ahead	3
Data calendar	5
New Zealand forecasts	6
International forecasts	7

The deepening divide

The divisions running through New Zealand's economy are deepening, with a second poor dairy season now looking likely, while Auckland's housing market pushes further into the stratosphere. However the overall economic outlook remains solid.

A further fall in global dairy prices last week has prompted us to revise down our expectations for Fonterra's season milk price. We've adopted Fonterra's \$4.70/kg forecast for this season, and now expect a milk price of \$5.70/kg for 2015/16, slightly below the average of about \$6 for the last decade.

The renewed weakness in global dairy prices has to some extent been due to New Zealand's own improving weather conditions. Fonterra's latest monthly production update has confirmed that conditions have improved for the dairy industry as a whole (the North Island has fared rather better than the South Island). Indeed, with only two relatively low-production months left in the current season, Fonterra's milk collection is now up 1.1% on 2013/14 – a much better outcome than was expected at the start of the year.

Even so, two consecutive seasons of a below-average farm gate milk price are clearly bad news for New Zealand's largest export industry. The repercussions for spending, agricultural lending, and farm prices are potentially a lot more severe than we have seen to date.

For now, though, conditions in the wider economy have proven remarkably resilient not just to deteriorating dairy prospects, but to the economic malaise in Australia and a NZD/AUD approaching parity. The NZIER's *Quarterly Survey of Business Opinion*, which doesn't cover the farm sector but includes manufacturing exporters, did show business confidence pulling back marginally in the March quarter. However, sentiment remains comfortably above average levels, as do firms' reported activity levels and expansion plans. With the pull-back in agricultural output looking progressively less severe, it all points to another strong quarter of GDP growth in the March quarter – probably higher than the 0.6% for the quarter that we currently have pencilled in.

The deepening divide continued

Meanwhile Auckland's house prices continue to run rampant. The latest Real Estate Institute data showed the Auckland house price index rising 4.6% in March alone and 17% over the past six months. By contrast, house price inflation has slowed considerably in Canterbury as repairs have progressed, and remains low to moderate in other parts of the country. Even so, the momentum in Auckland is so strong that our forecast for a 7.5% rise in nationwide house prices this year is now looking too low.

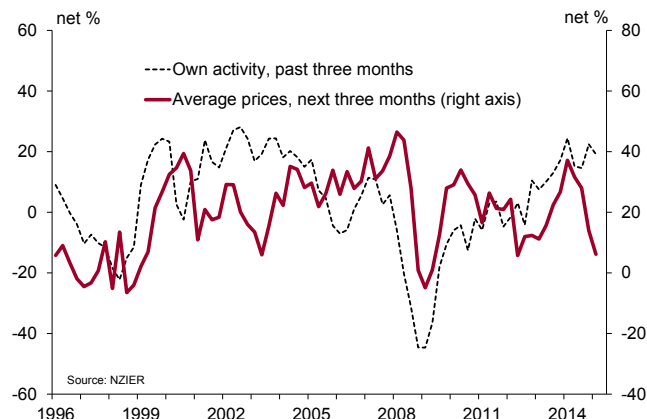
The Auckland housing market is also heating up as a political issue. Last week the Reserve Bank weighed in, calling for an all-of-government response to what it sees as a growing risk to financial stability from an overheated market in New Zealand's biggest city.

In his speech, Deputy Governor Spencer discussed three sets of policy options. One was around streamlining the building approval process and better urban planning – with pointed reference to the Government's proposed reforms to the Resource Management Act, which the recent bye-election in Northland has put in jeopardy. The second option was around tax. While the speech avoided explicit mention of capital gains tax, it made the point that leveraged property investors in New Zealand enjoy a tax advantage which in turn pushes up property prices. The third option was more macro-prudential action by the Reserve Bank itself, probably aimed at those same leveraged property investors.

We would agree with the Reserve Bank that progress along the first two dimensions would be very welcome. Indeed, we have been making similar points about the distortionary effects of New Zealand's tax system for a long time. However, action on option three looks far more likely, at least in the near term.

The speech offered no new information in this respect – the Reserve Bank is consulting to define a new regulatory asset class focused on property investors and 'reviewing some options' on macro-prudential policies it might apply to that group. Whatever form these eventually take, we remain of the view that they could be introduced later this year. That seems a realistic time-frame. LVR restrictions aimed at property

Businesses' reported activity and pricing intentions



investors, for example, wouldn't require a new tool to be developed, nor would they require banks to classify all their existing customers, just new ones.

One policy response to rising house prices that the Reserve Bank explicitly did not include in its list of options is raising the OCR. While the speech acknowledged that rising house prices might on their own suggest a tightening of interest rates, it also emphasized that this is simply not a viable option at the moment given the low inflation outlook.

On current inflation trends, that assessment is unlikely to change for quite some time. We expect headline annual inflation to come in at just 0.2% in today's Consumer Price Index release. While much of that weakness is due to the recent drop in petrol prices, there is also nothing to suggest that underlying inflation trends are picking up. The NZIER's QSBO was instructive in this regard – while business confidence was strong and the number of businesses complaining about lack of demand is at cyclical lows, the number expecting costs and prices to rise fell further from already low levels.

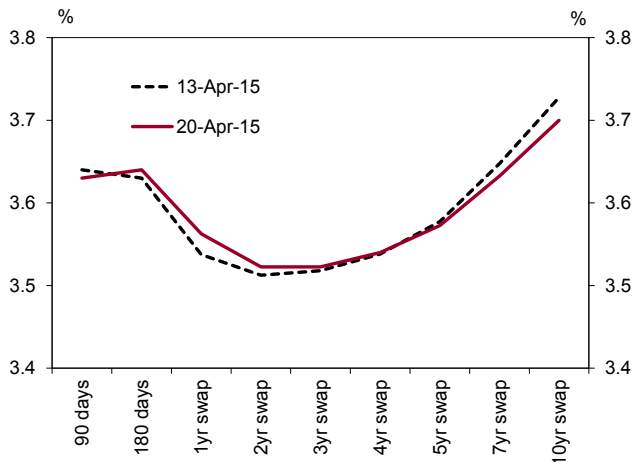
Fixed vs Floating for mortgages

Among the current standard fixed rates, the best value for borrowers with a deposit of 20% or more probably lies in the two-year and three-year terms. However, there is a possibility that fixed mortgage rates will fall even further over the weeks ahead. Waiting a while before fixing might offer even better value.

Four- and five-year rates still seem high relative to where we think shorter-term rates are going to go over the coming four or five years, though the gap has narrowed in recent weeks, and these longer-term rates do offer the benefit of stability.

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

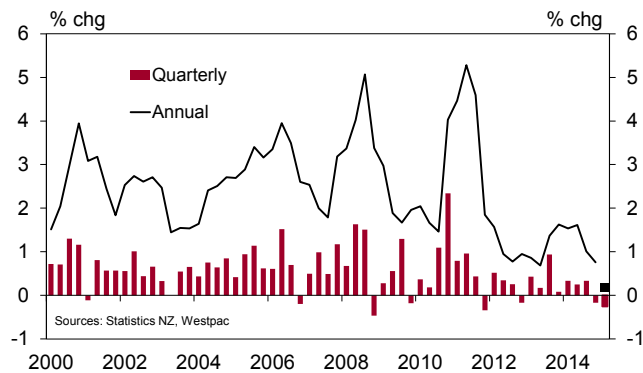


NZ Q1 CPI

Apr 20, Last: -0.2%, Westpac f/c: -0.3%, Mkt f/c: -0.2%

- We expect a 0.3% drop in the CPI over the March quarter, which would take annual inflation down from 0.8% to 0.2%. This would be the slowest pace since 1999, when annual inflation briefly dipped below zero.
- The sharp fall in fuel prices accounts for all of the expected slowdown in the annual inflation rate. However, underlying inflation pressures are likely to have remained subdued too, as a result of low wage growth and the still-high New Zealand dollar.
- The RBNZ will look through the direct impact of a one-off fall in fuel prices, but its concern is around the risk of consumers and business falling into a sustained low-inflation mindset.

NZ CPI inflation

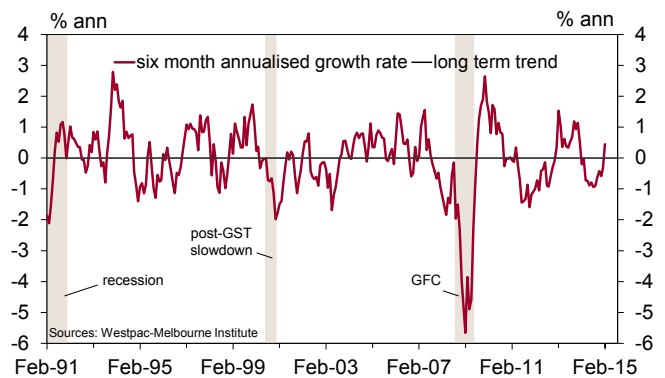


Aus Mar Westpac-MI Leading Index

Apr 22, Last: 0.49%

- The 6mth annualised growth rate of the Index, which indicates the likely pace of economic growth 3 to 9mths into the future, lifted from -0.32% in Jan to +0.45% in Feb, the first above trend reading since Jan 2014.
- The Mar update will include weaker reads on: the Westpac-MI Consumer Expectations Index and the Westpac-MI Unemployment Expectations Index, both of which deteriorated sharply in Apr (-5.7% and +8.5% respectively, the latter representing a higher, i.e. more pessimistic, outlook for unemployment); commodity prices (down 2.8% in Mar in AUD terms as prices fell but the currency held steady) dwelling approvals (down 2.7% in Feb but after a 7.9% surge in Mar); and US industrial production (down 0.6% in Mar). These are likely to more than outweigh positives from the ASX (+0.9% in Mar), the yield gap (+4bps) and hours worked (+0.3% in Mar).

Westpac-MI Leading Index



Aus Q1 CPI

Apr 22, Last: 0.2%, WBC f/c: 0.1%
Mkt f/c: 0.1%, Range: -0.1% to 0.5%

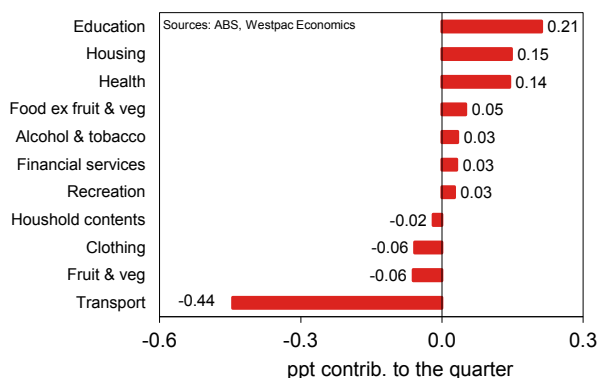
- The headline CPI rose 0.2% in Q4 with the annual rate easing back to 1.7% from 2.3%yr in Q3 and 3.0%yr in Q2. In the quarter, falling petrol and fresh fruit & vegetables more than offset the rise in tobacco and the unseasonally firm clothing & footwear and a stronger than expected rise in household contents.
- In Q4, the average of the core measures eased back to 2.2%yr from 2.5%yr in Q3 continuing the moderation in the pace of core inflation, taking it towards the bottom of the RBA's target band.
- Westpac is forecasting a meek 0.1%qtr rise (1.2%yr) in the headline CPI in the March quarter. The key factors for the very low headline CPI print are: the collapse in petrol prices through late Q4 and early Q1, falling fruit & vegetable prices and the usual post-Christmas discounting.

US Mar existing and new home sales

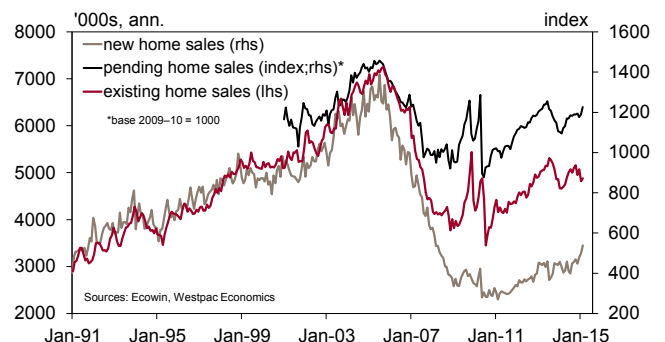
Apr 22, Existing: Last: 1.2, WBC f/c: 4.5%
Apr 23, New: Last: 7.8%, WBC f/c: -4.0%

- Pending home sales' Feb rise of 3% took this measure of home sales pre final closure to its highest since Aug 2013, yet closures themselves in Feb were the lowest since April last year. Considerable catchup is due, with a 4.5% jump realistic with new home sales soaring so far this year. Note that revisions might play a role, but our 5.10mn annualised sales pace forecast for March would not as the data stand surpass the sales pace seen just 5-6 months earlier in fall '14.
- New home sales surged by 92k to 439k between Nov and Feb, a 3 month gain surpassed in recent times only by the 95k rise between Oct 2012 and Jan 2013. That earlier jump was followed by almost two years of stalled sales; with homebuilder confidence struggling so far in 2015, the near-term outlook for new home sales might be similarly unimpressive. We expect a 4.0% fall.

Contributions to 0.1%qtr 2015Q1 print



US housing sales

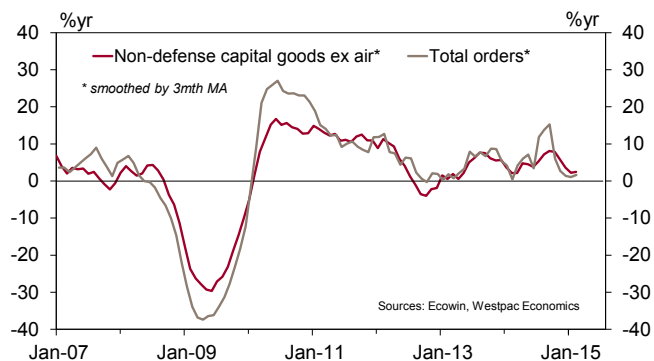


US Mar durable goods orders

Apr 24, Last: -1.4%, WBC f/c: 0.0%

- Durable goods orders fell 1.4% in Feb reflecting a further 0.5% fall in autos and a 9% fall in civil aircraft (after Jan's 122% surge). Defence orders were up 10% (their first rise since Oct) but core capital goods orders (down 1.4%) fell for the 6th month running by 1.4% in Feb; in the 3 months to Feb the annualised pace of decline was -8%, contrasting solid gains 6 months and longer ago. Part of the story is contracting investment in the energy sector as oil prices fell.
- ISM factory orders fell every month since Nov, to be down 11.2pts by March. Boeing orders almost halved in March; auto output/sales bounced in March; business equipment output rose 0.2%. These signals suggest both a sluggish headline and weak underlying story.

US durable goods orders



Data calendar

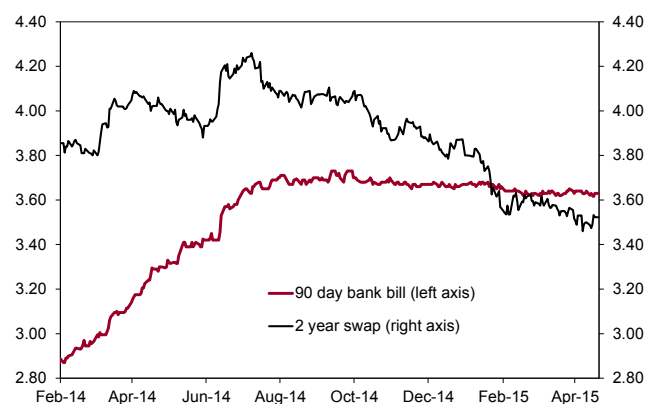
		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
NZ	Q1 CPI	-0.2%	-0.2%	-0.3%	Sharp fall in fuel prices; underlying inflation positive but subdued.
	Mar Performance of Services Index	55.6	-	-	Business confidence surveys suggest ongoing strength in services.
Eur	Feb construction output	1.9%	-1.6%	-	Favourable weather impact in Jan lifted annual growth to 3.0% yr.
Ger	Mar PPI %yr	-2.1%	-	-	Deflating at fastest pace in 5 years.
US	Mar Chicago Fed national activity index	-0.11	-	-	Based on 80 or so data inputs, not a business survey.
Tue 21					
Aus	RBA, Minutes of April Board meeting	-	-	-	Looking for any additional hints around likelihood of a May cut.
	RBA Governor Stevens speaking	-	-	-	Topic TBA, to Aus-US association lunch in New York 2.30 am AEST.
Chn	Apr MNI business indicator	52.2	55.0	-	First read on Q2 momentum - Q1 best forgotten on most counts.
Ger	Apr ZEW analysts' expectations	54.8	-	55.2	Have risen every month since November.
Can	Feb wholesale sales	-3.1%	-	-	Jan plunge reflected plummeting auto sales
	2015 Budget	-	-	-	Presented by Fin Min Oliver.
Wed 22					
Aus	Mar Westpac-MI Leading Index	0.49%	-	-	Feb was first positive read in a year but Mar data mostly weaker.
	Q1 CPI	0.2%	0.1%	0.1	A late surge in petrol prices only reduced, not reversed, the drag on CPI.
	Q1 avg. RBA core CPI	0.7%	0.55%	0.4%	Ex housing 0.1%qtr, seasonally adjusted 0.2%qtr, trimmed mean 0.5%qtr.
Eur	Apr consumer confidence advance	-3.7	-2.0	-3.0	Confidence at multi-year highs since Feb.
UK	BoE MPC minutes	-	-	-	April minutes usually defer to May when forecasts redone.
US	Feb house prices	0.3%	0.6%	-	FHFA index.
	Mar existing home sales	1.2%	2.7%	4.5%	Pending sales point to closings rising further in spring.
Thu 23					
NZ	Mar net immigration	4,820	-	4,800	Monthly migration flows hovering at high levels.
Aus	Q1 NAB business survey	-	-	-	Includes information around capex expectations.
Chn	Apr HSBC manufacturing PMI - flash	49.6	49.4	-	Residual seasonality hit Mar - consensus may have the direction wrong.
Eur	Apr PMI factory adv	52.2	52.5	52.5	March saw Germany improve on both PMIs, France stalled/slipping.
	Apr PMI services adv	54.2	54.4	54.5	Composite PMI fact/ser was 54.0 in Mar.
UK	Mar PSNCR £bn	0.0	-	-	Public sector net credit requirement. PSNB ex intv'ns £6.9bn in Feb.
	Mar retail sales incl autos	0.7%	0.6%	-1.0%	Almost stalled in early 2015; March to benefit from earlier Easter.
US	Initial jobless claims w/e 19/4	294k	-	286k	Approaching lows for the century so far.
	Mar new home sales	7.8%	-5.7%	-4.0%	Can recent sales surge be maintained?
	Apr Kansas City Fed factory index	-4	-	-2	At a 2 year low in March. For of the 5 regional Fed surveys are sub zero.
	Apr Markit PMI factory prelim	55.7	56.0	-	Unhelpfully tells different story to ISM surveying same industries.
Fri 24					
Chn	Mar industrial profits %yr	-	-	-	Weak nominal GDP a heavy downward weight on profits.
Eur	Eurozone summit, Riga	-	-	-	Finance ministers and central bankers to discuss Greek bailout.
Ger	Apr Ifo business climate index	107.9	108.2	108.2	Expectations rising faster than current conditions lately.
US	Mar durable goods orders	-1.4%	0.6%	0.0%	Aircraft to weigh on headline; core capital goods orders to extend
	Mar capital goods orders ex def/air	-1.1%	0.3%	-0.5%	6 month decline to Feb.

New Zealand forecasts

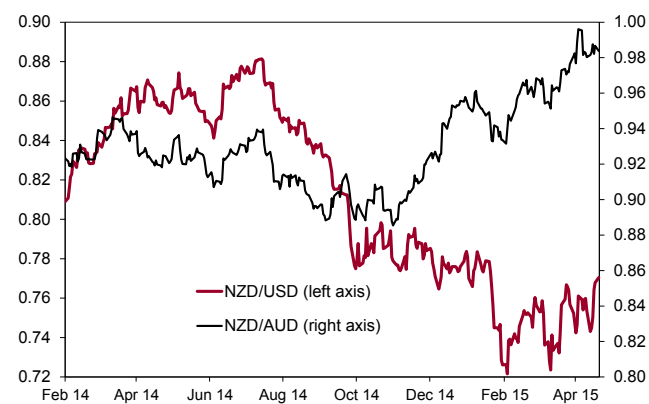
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
% change								
GDP (Production) ann avg	2.2	2.5	3.3	3.0	2.3	3.3	3.0	3.4
Employment	0.2	3.8	3.0	3.0	2.9	3.6	2.7	2.3
Unemployment Rate % s.a.	6.3	6.1	5.9	5.1	6.1	5.7	5.2	4.9
CPI	0.9	1.5	0.2	0.9	1.6	0.8	0.3	1.7
Current Account Balance % of GDP	-3.7	-2.6	-4.1	-4.7	-3.3	-3.3	-4.8	-4.4

Financial Forecasts	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Cash	3.50	3.50	3.50	3.50	3.50	3.75
90 Day bill	3.70	3.70	3.70	3.75	3.75	4.00
2 Year Swap	3.40	3.50	3.60	3.70	3.90	4.00
5 Year Swap	3.50	3.60	3.70	3.80	4.00	4.20
10 Year Bond	3.20	3.30	3.40	3.50	3.70	4.00
NZD/USD	0.74	0.72	0.71	0.71	0.71	0.72
NZD/AUD	0.99	0.99	0.99	0.99	0.99	1.00
NZD/JPY	88.8	87.8	88.2	88.0	88.8	90.7
NZD/EUR	0.70	0.70	0.70	0.70	0.70	0.71
NZD/GBP	0.51	0.50	0.50	0.49	0.48	0.48
TWI	79.8	78.9	78.6	78.4	78.4	79.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 20 April 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.62%	3.63%	3.63%
60 Days	3.62%	3.64%	3.62%
90 Days	3.63%	3.64%	3.62%
2 Year Swap	3.52%	3.49%	3.55%
5 Year Swap	3.57%	3.56%	3.62%

NZ foreign currency mid-rates as at Monday 20 April 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7705	0.7552	0.7565
NZD/EUR	0.7121	0.6903	0.6977
NZD/GBP	0.5151	0.5073	0.5054
NZD/JPY	91.68	90.23	90.68
NZD/AUD	0.9838	0.9935	0.9721
TWI	80.10	78.87	79.19



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014	2015f	2016f
Australia						
Real GDP % yr	2.7	3.6	2.1	2.7	2.2	3.0
CPI inflation % annual	3.0	2.2	2.7	1.7	2.3	2.4
Unemployment %	5.2	5.3	5.8	6.2	6.7	6.4
Current Account % GDP	-2.8	-4.4	-3.3	-2.8	-3.3	-2.9
United States						
Real GDP %yr	1.6	2.3	2.2	2.4	2.6	3.2
Consumer Prices %yr	3.1	2.1	1.5	1.6	1.0	2.1
Unemployment Rate %	8.9	8.1	7.4	6.2	5.3	5.0
Current Account %GDP	-2.9	-2.9	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	-0.4	1.7	1.6	-0.1	1.0	1.7
Euroland						
Real GDP %yr	1.6	-0.6	-0.4	0.8	1.1	1.1
United Kingdom						
Real GDP %yr	1.1	0.3	1.7	2.6	2.5	2.7
China						
Real GDP %yr	9.3	7.7	7.7	7.4	7.1	7.3
East Asia ex China						
Real GDP %yr	4.5	4.5	4.3	4.1	4.8	5.1
World						
Real GDP %yr	4.1	3.4	3.3	3.2	3.5	4.1
Forecasts finalised 10 April 2015						

Interest Rate Forecasts	Latest	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
Australia						
Cash	2.25	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.28	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.35	2.45	2.60	2.60	2.80	3.00
International						
Fed Funds	0.125	0.125	0.375	0.625	0.875	1.125
US 10 Year Bond	1.89	2.10	2.30	2.50	2.70	3.00
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
AUD/USD	0.7780	0.75	0.73	0.72	0.72	0.72
USD/JPY	119.0	120	122	124	124	125
EUR/USD	1.0780	1.06	1.03	1.02	1.02	1.02
AUD/NZD	1.0150	1.01	1.01	1.02	1.01	1.01

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