



Sunrise over Mt. Ruapehu crater.

## In this issue

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

## Clouds on the horizon?

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A significant concern for the economic outlook is whether the strength in household spending seen in early 2015 will be sustained. It's an issue that was highlighted by last week's Westpac McDermott-Miller consumer confidence index, which is a key leading indicator of household spending. Consumer confidence slipped back in June. And while it's still a bit above its long run average, confidence is now well down from its mid-2013 high. So how concerned should we be?

There are some clouds on the horizon for household spending. Dairy prices are down, and we expect this will flow through to lower income growth and employment. We've already seen this reflected in a particularly sharp drop in consumer confidence in rural regions.

On top of this, the inflation environment is starting to look less benign than it has been recently. Petrol prices are up, and the fall in the exchange rate will push up the prices for a range of imported goods. Consequently, over the coming year growth in real labour income (i.e. earnings adjusted for changes in purchasing power) is going to look more moderate than it has recently.

But despite the above headwinds, we remain positive about the outlook for household spending over 2015/16. We do expect that there will be some softening in spending growth over the coming months. But that follows strong growth of 4.4% in the year to March, and still leaves us with a firm outlook.

So what's supporting our expectations for firm growth in household spending? First of all is the level of interest rates. Borrowing rates are already at low levels. And with the RBNZ expected to cut the OCR further over the second half of the year (we're picking cuts in both July and September), interest rates are likely to remain under downwards pressure for some time.

# Clouds on the horizon? continued

Adding to the favourable outlook for household spending is the strength of the housing market. Housing market turn-over tends to be associated with increased spending on items such as home furnishings and renovation materials, spending on which is up by around 10% over the past year. There has also been a more general boost to household spending associated with gains in household wealth as a result of rising home prices, particularly in Auckland.

Surging population growth has also boosted household spending. Migration figures for the year to May revealed a record net inflow of just under 58,000 people. That's around 35% higher than the peak seen in the mid-2000s. In part this is due to strong arrivals of new migrants. But it also reflects that more New Zealanders are choosing to stay on shore, or to come back from overseas (particularly from Australia).

Finally, increasing numbers of New Zealanders have been entering employment, with numbers employed rising by a solid 3.2% over the past year.

We expect that the above factors will continue to provide a solid foundation for household spending through 2015/2016. But at the same time, we are conscious that spending growth has been uneven across the economy, and it's likely to remain so for some time. Over the past year spending growth has been heavily centred on Auckland and Canterbury, with these regions accounting for around 80% of the growth in nationwide spending. In part, this is because these regions have had stronger population growth than other regions. But even in per capita terms, spending in these regions has outpaced other parts of the economy.

In Canterbury, much of the strength in spending has been related to the boost to demand from reconstruction activity. However, looking forward it's likely that spending growth in Canterbury will start to moderate. In addition to the drag from lower dairy export incomes, we've been noting for some time that peak in the Canterbury rebuild is very close now. Indeed, residential building consents have fallen by around 20% in

the early part of 2015, and some parts of the non-residential rebuild are still proceeding very gradually. The resulting flow through to employment and population growth will dampen spending in Canterbury over the coming years.

In contrast, we expect that demand conditions in Auckland will be more enduring. Auckland has benefited from the strengthening in its housing market, as well as growth in employment associated with technological change and the related expansion of the service sector. We expect these conditions to continue for some time.

Importantly, Auckland's positive outlook isn't just a short-term cyclical phenomenon. Longer-term population estimates indicate that Auckland's population will grow by around 275,000 people over the coming decade, with growth expected to remain strong further ahead. This will account for more than half of nationwide population growth. In addition, Auckland is the main destination for people moving within New Zealand.

The longer term implications of such population trends are significant. They will have important impacts on a range of economic decisions, including where businesses choose to locate, regional house prices, and spending decisions by both central and local government.

These population trends will also have a pronounced and varied impact on tax bases in different regions. This is particularly important for smaller regional centres who may face the combination of lower population growth, and aging populations.

## The week ahead

Over the coming week we'll receive updates on a number of key economic indicators. Monday will see the release of the June quarter Westpac McDermott Miller Employment Confidence survey. On Tuesday we'll receive updates on building consent issuance and business confidence. Rounding out the week will be the results of the latest GlobalDairyTrade auction, due Thursday morning.

## Fixed vs Floating for mortgages

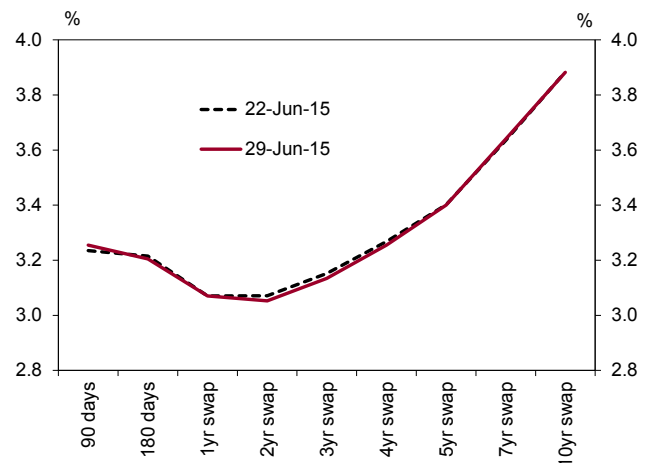
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

Longer-term fixed rates do offer the benefit of stability, but even those looking to fix may want to wait a while longer.

For borrowers with a deposit of deposit of 20% or more, the best value probably continues to lie in the two-year ahead and three-year ahead terms. Four- and five-year rates still seem high relative to where we think shorter-term rates are going to go over the next four or five years, though the gap has narrowed.

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

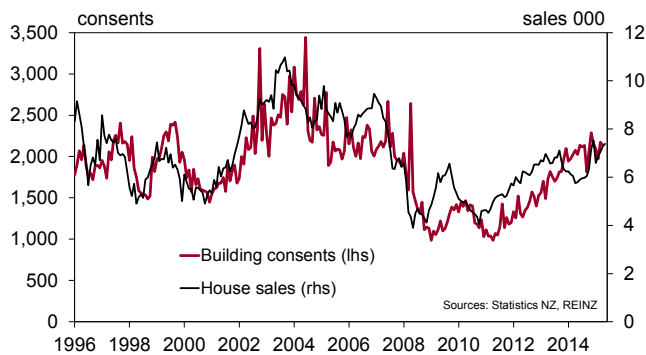


## NZ May building consents

Jun 30, Last: -1.7%, Westpac f/c: 0.0%

- The number of residential building consents fell 1.7% in April, an expected pullback after a 10% jump in March. We expect a flat outcome in May.
- The centre of activity has clearly shifted. The number of consents in Auckland has risen to its highest in nearly ten years, with a distinct shift towards multiples (apartments, townhouses etc). In contrast, the pace of new consents continued to slow in Canterbury, with the residential side of the quake rebuild now well advanced.
- However, with nationwide building consents flattening out over the last year, we suspect that the building industry is running up against capacity constraints at the current levels of activity.

NZ housing activity

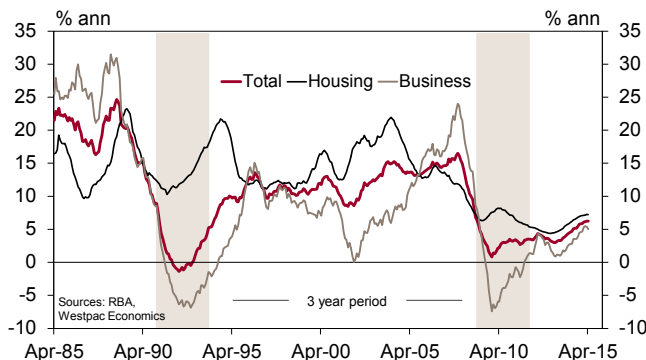


## Aus May private credit

Jun 30, Last: 0.3%, WBC f/c: 0.4% Mkt f/c: 0.5%, Range: 0.4% to 0.6%

- Credit to the private sector grew by 6.1% in the year to April, accelerating from a 4.6% increase over the previous year as lower interest rates had an impact.
- However, in the month of April itself, credit expanded by only 0.3%, the smallest gain since October 2013. The softer result was centred on a stalling of business, following a strong run over recent months. This weak month for business credit was a lagged response to an earlier cooling of business confidence.
- For May, credit is forecast to grow by 0.4%, a little firmer than the April result. New lending data suggests that business credit may perform better than the flat April outcome.
- Housing credit grew by 0.5% mth, 7.2% yr in April. A similar result is likely in May.

Credit mix: annual growth

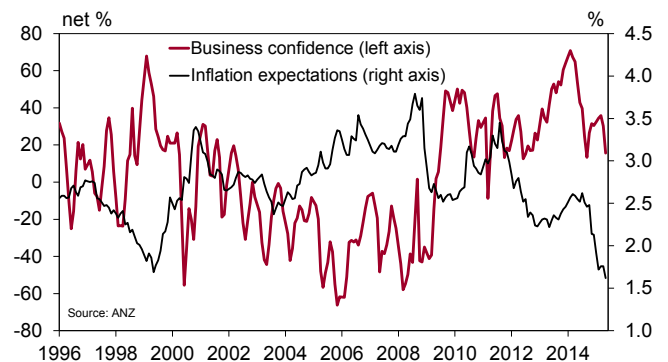


## NZ Jun ANZ Business Outlook survey

Jun 30, General business situation, last 15.7%

- While still healthy, business confidence has dropped back in recent months, with declines seen across all sectors.
- The domestic economy has lost some steam. We'll be watching to see if this has translated into a further decline in confidence in June, and if hiring and investment intentions have been affected.
- The survey's pricing gauges have fallen to low levels. But while inflation has been low, petrol prices have been climbing and the NZD is down. We'll be watching to see how these factors are affecting businesses' pricing intentions.

NZ business confidence and inflation expectations

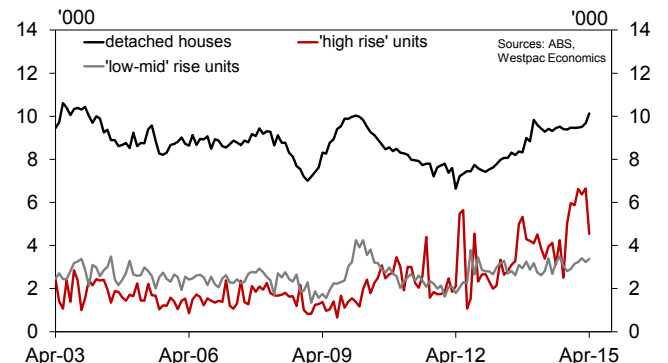


## Aus May dwelling approvals

Jul 1 Last: -4.4%, WBC f/c: -1.0% Mkt f/c: 1.3%, Range: -4.0% to 4.0%

- Dwelling approvals fell 4.4% in Apr led by a sharp pull back in high-rise approvals (from elevated levels after a surge over the previous 6 months) but with a significant offset from strong gains in other segments. Indeed, without this offset, monthly approvals could easily have fallen by 10% or more.
- The picture leading into the May number is quite mixed. Construction-related owner occupier finance approvals have softened notably since late last year, in line with a cooling off in buyer sentiment. Against this, policy settings remain stimulatory with investor activity strong and auctions and prices both showing continued strength, albeit concentrated in Sydney and Melbourne with softer conditions elsewhere. May's rate cut is unlikely to factor for a while yet, if at all. On balance we expect approvals to show a modest softening with a 1% dip in May. High-rise remains a wildcard.

Dwelling approvals: houses, low-mid, high rise

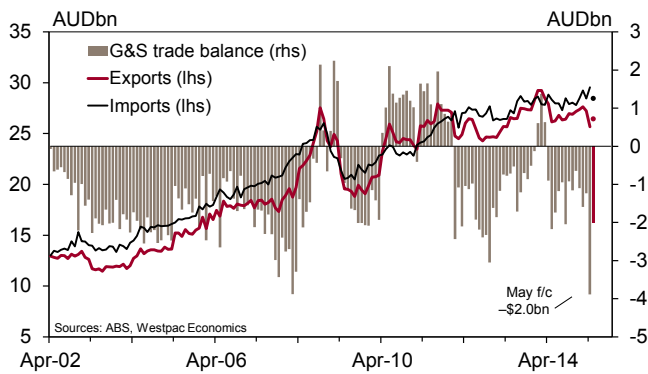


## Aus May trade balance, AUDbn

Jul 2, Last: -3.9, WBC f/c: -2.0 Mkt f/c: -2.25, Range: -3.7 to -1.0

- Australia's trade balance was in deficit for 13 consecutive months to April, with export earnings dented by falling global commodity prices.
- In April, the deficit blew-out to a record -\$3.9bn, from -\$1.2bn, as a further deterioration in export earnings, -5.7%, coincided with a jump in imports, 3.9%.
- For May, we expect a partial reversal, with a deficit of \$2.0bn.
- Imports fell a forecast 3.7%, with the ABS advising that goods imports declined by 4.6%.
- Exports rebounded by a forecast 3.0%. Iron ore prices bounced off their lows and coal shipments from NSW recovered following port closures due to the April storms.

Australia's trade position

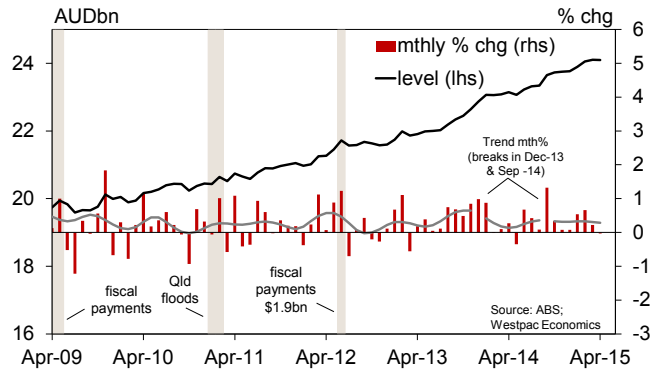


## Aus May retail trade

Jul 3, Last: flat, WBC f/c: 0.5% Mkt f/c: 0.5%, Range: 0.1% to 0.7%

- Retail sales disappointed in Apr with no change month on month and few redeeming features in the detail. The RBA's Feb rate cut would have cushioned soft income growth but looks to have done little to spur additional retail spending.
- Conditions should be better in May. Consumer sentiment posted a solid bounce post Budget and post the RBA's May rate cut. With labour markets improving a little, rising house prices generating solid wealth gains and tourism-related spending a more positive factor for retail that should see some lift in sales. Private business surveys suggest retailers have seen an improvement. However, against these positive signs is the restraint evident in the lacklustre response to the Feb rate cut and the fact that the May sentiment bounce proved to be short-lived. Overall, we expect sales to post a decent 0.5% gain in the month but there are risks to both sides.

Monthly retail sales



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 29</b>					
<b>NZ</b>	Q2 Westpac-MM employment confidence	108.5	–	–	Unemployment has increased and wage inflation has been low.
<b>Eur</b>	Jun EC industrial confidence	–3.0	–3.0	–	Flash manuf PMI lifted, but IFO lost a little ground.
	Jun EC services confidence	7.8	8.0	–	Greek ructions suggest some downside risks - confidence 'aint activity.
	Jun EC consumer confidence - final	–5.6	–5.6	–	Unchanged from prior in advance print.
<b>UK</b>	May mortgage approvals	68.1k	68.6k	–	Edging higher again after the 2014H2 lull.
<b>Tue 30</b>					
<b>NZ</b>	May Building permits	–1.7%	–	0%	Quake rebuild peaking, but Auckland's upturn still on track.
	Jun ANZ business confidence	15.7	–	–	Confidence has been softening.
	Apr Private sector credit %yr	5.8%	–	–	Housing lending has accelerated in recent months.
<b>Aus</b>	May private sector credit	0.3%	0.5%	0.4%	April rise of 0.3%, incl. flat business, was smallest gain since Oct '13.
	RBA Governor Stevens speaks in London	–	–	–	18:40 AEST, 09:40 BST, at the OMFIF, London. Topic tba.
<b>Eur</b>	May unemployment rate	11.1%	11.1%	–	Now two years removed from the peak of 12.1%.
	Jun CPI headline %yr	0.9%	0.8%	–	Rose 0.3ppts in May, with energy –4.8%yr from –5.8% prior.
	Jun CPI core %yr	0.3%	0.2%	–	Still weighed down by the lagged impact of the protracted recession.
<b>UK</b>	Jun GfK consumer confidence	1	2	–	Consumers responding to the modest lift in housing, credit conditions.
	Q1 GDP %qtr - final	0.3%	0.4%	–	Year-ended to lift from 2.4% to 2.5%.
<b>US</b>	May pending home sales	3.4%	1.0%	–	Consensus view would be a strong follow up to the April outcome.
	Jun Dallas Fed manufacturing activity	–20.8	–16	–	Energy cycle not supportive and tech also rolling over in recent months.
	Apr S&P/CS 20-city house prices %yr	5.0%	5.2%	–	A key area where Yellen argues that headwinds are receding.
	Jun MNI-ISM Chicago PMI	46.2	50.0	–	Now called the 'business barometer'. The best of the regional surveys.
	Jun Conf Board consumer confidence	95.4	96.8	–	Has a strong labour market flavour.
<b>Wed 1</b>					
<b>Aus</b>	May dwelling approvals	–4.4%	1.3%	–1.0%	Big high-rise drop in Apr partially offset by strong rises in houses.
	Jun CoreLogic RP Data home value index	–0.9%	–	1.0%	May's dip mostly seasonal, Jun bounce also supported by rate cut.
	Jun AiG PMI	52.3	–	–	Manufacturing index up 4.3ppts in May, to be in expansionary zone.
<b>Chn</b>	Jun HSBC manufacturing PMI - final	49.6	49.6	–	Flash surprised modestly to the upside, details were OK too.
<b>UK</b>	Jun Markit PMI manufacturing	52.0	52.4	–	Modest uplift consistent with the move in flash measures on Continent.
<b>Eur</b>	Jun Markit PMI manufacturing - final	52.5	52.5	–	Entire eurozone PMI galaxy surprised on upside in June flash estimates.
	Jun Markit PMI services - final	54.4	54.4	–	" "
	Jun Markit PMI composite - final	54.1	54.1	–	" "
<b>US</b>	Jun ADP employment change	201k	210k	–	Less volatile than NFP in recent times.
	Jun ISM manufacturing	52.8	53.5	–	Down from the heights on \$US-export link, mining crunch, modest capex.
<b>Thu 2</b>					
<b>NZ</b>	Jun QV house prices (yoy)	9%	–	–	Auckland house prices rampant.
	GlobalDairyTrade auction	–1.3%	–	–	Still awaiting signs of stabilisation in world dairy prices.
	Jun ANZ Commodity prices	–4.7%	–	–3.0%	Further decline in dairy prices in May-June.
<b>Aus</b>	May trade balance, AUDbn	–3.9	–2.25	–2.0	Deficit –1.2 in Mar, –3.9 in April. F/c –2.0 in May, X +3%, M –3.7%.
<b>UK</b>	Jun nationwide house prices %yr nsa	4.6%	4.7%	–	Edging higher again, in line with the firmer mortgage approvals flow.
<b>UK</b>	Jun Markit-CIPS PMI construction	55.9	56.5	–	Down from the 60+ heights of mid 2014, but still in robust territory.
<b>US</b>	Jun nonfarm payrolls - change	280k	227k	235k	A modest rebound thru Q2 points to solid employment as qtr closed.
	Jun unemployment rate	5.5%	5.4%	5.4%	Standard 0.1ppt drop when NFP prints in solid, not spectacular territory.
	Jun initial jobless claims	271k	–	–	Grinding lower as 'cumulative improvement' in labour market continues.
	Jun ISM New York	54.0	–	–	Outlook measure fell steeply in May.
	May factory orders	–0.4%	–0.5%	–	Incorporates known decline in headline durables, led by aircraft.
<b>Fri 3</b>					
<b>Aus</b>	May retail trade	flat	0.5%	0.5%	Sentiment bounce and business surveys suggest some improvement.
<b>US</b>	Independence Day observed	–	–	–	Public holiday, markets closed.

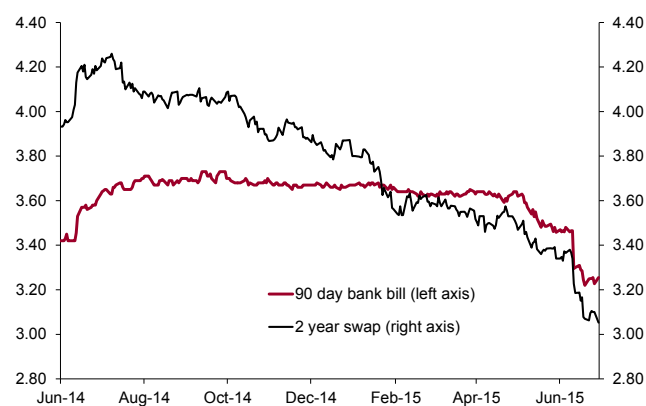


# New Zealand forecasts

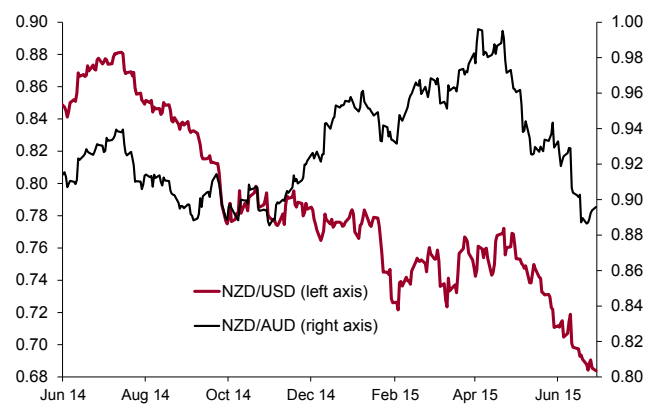
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.4	3.3	2.2	3.3	2.4	3.1
Employment	3.8	3.2	3.0	2.3	2.9	3.6	2.8	3.0
Unemployment Rate % s.a.	6.0	5.8	4.9	4.4	6.1	5.8	5.2	4.3
CPI	1.5	0.1	1.8	1.9	1.6	0.8	0.9	2.2
Current Account Balance % of GDP	-2.6	-3.2	-4.6	-4.3	-3.3	-3.3	-3.8	-4.4

Financial Forecasts	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Cash	3.25	2.75	2.75	2.75	2.75	2.75
90 Day bill	3.20	2.85	2.85	2.85	2.85	2.85
2 Year Swap	3.00	2.90	2.90	2.90	3.00	3.10
5 Year Swap	3.40	3.30	3.30	3.40	3.50	3.60
10 Year Bond	3.50	3.40	3.50	3.60	3.70	3.80
NZD/USD	0.69	0.65	0.64	0.64	0.65	0.65
NZD/AUD	0.88	0.89	0.89	0.89	0.90	0.89
NZD/JPY	84.2	80.6	80.6	80.6	82.6	83.2
NZD/EUR	0.63	0.62	0.62	0.62	0.63	0.63
NZD/GBP	0.46	0.45	0.45	0.44	0.44	0.43
TWI	73.2	71.0	70.5	70.4	71.5	71.3

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 29 June 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.25%	3.25%	3.50%
30 Days	3.34%	3.35%	3.54%
60 Days	3.31%	3.33%	3.51%
90 Days	3.26%	3.30%	3.48%
2 Year Swap	3.05%	3.21%	3.35%
5 Year Swap	3.40%	3.58%	3.60%

NZ foreign currency mid-rates as at Monday 29 June 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6838	0.6990	0.7088
NZD/EUR	0.6210	0.6231	0.6487
NZD/GBP	0.4358	0.4495	0.4662
NZD/JPY	83.88	86.15	88.47
NZD/AUD	0.8958	0.9026	0.9316
TWI	71.71	72.98	74.57

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014	2015f	2016f
<b>Australia</b>						
Real GDP % yr	2.7	3.6	2.1	2.7	2.4	3.0
CPI inflation % annual	3.0	2.2	2.7	1.7	2.5	2.5
Unemployment %	5.2	5.3	5.8	6.2	6.5	6.3
Current Account % GDP	-2.8	-4.4	-3.3	-2.8	-3.4	-3.4
<b>United States</b>						
Real GDP %yr	1.6	2.3	2.2	2.4	2.0	3.2
Consumer Prices %yr	3.1	2.1	1.5	1.6	0.1	2.0
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	-2.5	-2.5
<b>Japan</b>						
Real GDP %yr	-0.5	1.8	1.6	-0.1	1.3	1.8
<b>Euroland</b>						
Real GDP %yr	1.6	-0.8	-0.4	0.8	1.4	1.2
<b>United Kingdom</b>						
Real GDP %yr	1.6	0.7	1.7	2.6	2.5	2.7
<b>China</b>						
Real GDP %yr	9.3	7.8	7.8	7.4	7.0	7.0
<b>East Asia ex China</b>						
Real GDP %yr	4.4	4.5	4.3	4.1	4.4	5.0
<b>World</b>						
Real GDP %yr	4.2	3.4	3.4	3.4	3.2	4.0
Forecasts finalised 10 June 2015						

Interest Rate Forecasts	Latest	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
<b>Australia</b>						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.16	2.20	2.20	2.20	2.20	2.20
10 Year Bond	3.06	3.05	3.00	3.10	3.25	3.40
<b>International</b>						
Fed Funds	0.125	0.125	0.375	0.625	0.875	1.125
US 10 Year Bond	2.40	2.50	2.60	2.80	3.00	3.20
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	0.7720	0.77	0.73	0.72	0.72	0.72
USD/JPY	123.40	124	126	128	128	129
EUR/USD	1.1180	1.12	1.08	1.07	1.07	1.07
AUD/NZD	1.1200	1.12	1.12	1.13	1.13	1.11

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## Disclaimer continued

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