

Weekly Commentary

11 April 2016



Dairy Scary

Although the New Zealand economy recorded solid growth in the latter half of 2015 on the shoulders of strong population growth, the outlook over the coming year is decidedly mixed. This was underscored last week by the quarterly NZIER Business Opinion survey which suggested firms are becoming more concerned about the impact of the dairy downturn beyond the agricultural sector. However, the survey did not signal any change to the inflation backdrop, as firms continue to struggle to see opportunities to lift prices.

The *Quarterly Survey of Business Opinion* offers one of the most timely and comprehensive reads on the New Zealand economy. So it is worth taking a close look at some of the details in the March survey.

The survey showed business confidence fell in the March quarter, descending well below the average of the last few years. On its own this result was not too surprising – other confidence measures have also tracked lower in the first few months of this year. But dig beneath the headlines, and it is not hard to find evidence that firms expect the conditions they face to become decidedly more challenging this year.

When asked about how their own firm's trading activity had fared over the last three months, businesses reported little change in activity relative to December. This was a bit more upbeat than we expected, and warranted a small upgrade of our Q1 GDP growth forecast to 0.6%.

But it was quite a different story when businesses were quizzed about how they expect their own activity to fare in the coming three months. This measure plunged to its lowest level since March 2011 (in the aftermath of the Canterbury earthquakes). The key influence on this change in sentiment is likely to be the dairy downturn, as firms assess what the hit to dairy farmers' incomes means for both the New Zealand economy and their own businesses.

It is worth noting that this survey does not cover the agriculture sector directly. Instead it is a reflection of how firms in the manufacturing, construction, retailing and service sectors see the agricultural sectors woes impacting their own operations.

Dairy farmers themselves actually received a sliver of good news at last week's GlobalDairyTrade auction. Dairy prices lifted 2.1%, largely unwinding the fall from the previous auction. And while any improvement in prices is likely to be welcomed by the embattled dairy sector, our view remains that prices are set to kick around near current low levels for some time yet. The conditions required to generate a sustained (albeit modest) lift in prices, namely slower growth in global supply and firmer demand, will not be in place until late 2016. We continue to forecast a \$4.60 milk price for next season.

We have had some interesting insights on the labour market in the last week. Solid economic activity over the last couple of years has supported strong employment growth. However, a feature of this employment growth has been that it has come without significant upward pressure on wages. This was a topic addressed in some detail this week in a speech by Reserve Bank Deputy Governor Geoff Bascand which waded into the often muddy waters of the New Zealand labour market.

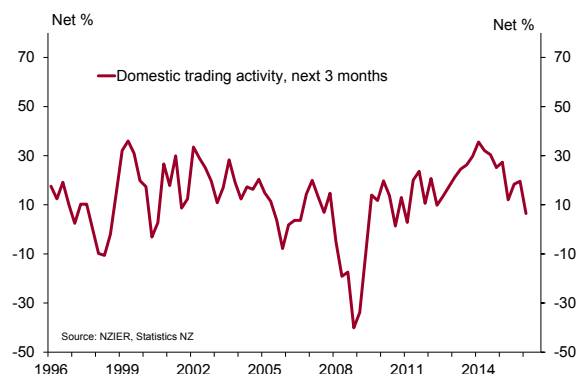
Dairy Scary continued

The speech attributed the lack of upward pressure on wages to strong growth the labour force via the combination of rapid population growth and increasing participation. This adds to the supply of labour, reducing the degree of stretch in the labour market and limiting the upward pressure on wages.

From the Reserve Bank's perspective, understanding the degree of stretch in the labour market is important for understanding overall inflation pressures in the economy. And the speech introduced another tool which helps the RBNZ do just this. The Labour Utilisation Complex Index (LUCI) is calculated by combining 17 labour market variables (official Statistics NZ labour data as well as surveys and data on the number of job seekers) into a summary measure of the labour market which then varies with the business cycle. When this index is above zero, it indicates a greater degree of labour market tightness than unusual, and when it is below zero a greater degree of labour market slack. A higher LUCI is associated with stronger wage growth. The index is currently sitting around zero, consistent with little pressure on wages either way.

However, very recent data, namely last week's *QSBO* survey, along with our own Westpac McDermott Miller Employment Confidence Survey, provide some hints that the labour market may be tightening. Firms reported that they were finding it a little more difficult to find skilled labour, and that they were more likely to see labour as a constraint on growth. Meanwhile households are reporting

QSBO domestic trading activity



they are more optimistic about future employment conditions than they were three months ago.

The labour market will continue to be an important consideration in monetary policy decisions going forward. Strong real wage growth and high levels of employment will likely continue to provide support to consumer spending this year. However, employment prospects are likely to deteriorate as GDP growth slows significantly over the course of 2017 and beyond, and the Canterbury rebuild winds down. Another reason we are considering the possibility that the OCR could go below 2% at that time.

Fixed vs Floating for mortgages

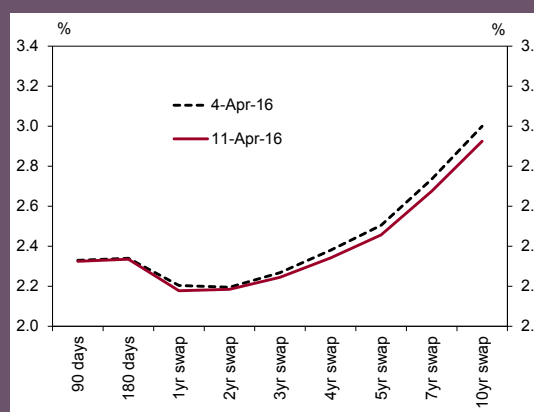
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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 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.

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



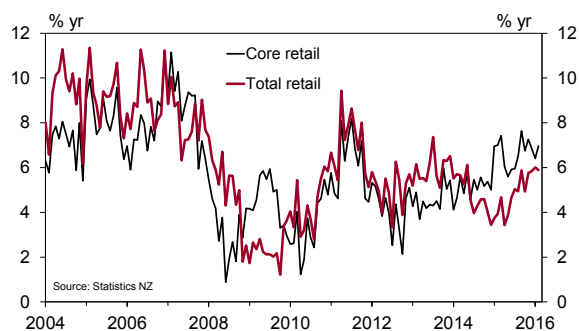
The week ahead

NZ Mar retail card spending

Apr 11, last: +0.7%, WBC: f/c -0.1%

- Overall retail spending was up 0.7% in February, with core spending (which excludes the volatile motor vehicle and fuel categories) up a very healthy 1.2%. Combined with earlier solid gains, that left the level of retail spending up 5.6% over the past year.
- We expect March's figures to reveal a modest easing back in spending. In part, this is because growing concern around conditions in the agricultural sector will put a bit of a dampener on confidence and spending. In addition, increases in petrol prices will limit households' spending on other goods and services.

Card transactions, annual % change

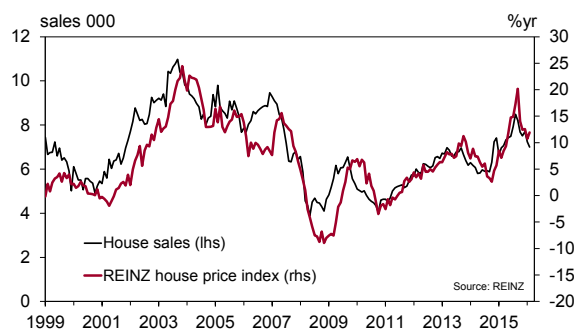


NZ Mar REINZ house prices and sales

Apr 11-14 (tbd), Sales last: -3.3%, Prices last: 1.6%

- The housing market has cooled since the batch of new regulations aimed at property investors came into force last October. House sales have fallen from their pre-regulation peaks, particularly in Auckland and the nearby regions.
- We may see some stabilisation in sales in March. Mortgage approvals have been strong in recent weeks, and anecdotally auction clearance rates have improved.
- Auckland house prices initially saw a sharp drop after the new regulations, but have risen since then, albeit at a much more sustainable pace than before. However, prices in the rest of the country have been gaining momentum, supported by low mortgage rates and a loosening of lending restrictions.

REINZ house prices and sales



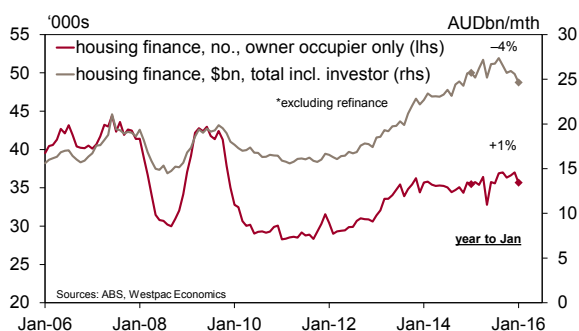
Aus Feb housing finance (no.)

Apr 11, Last: -3.9%, WBC f/c: 1.0%

Mkt f/c: 2.0%, Range: 1.0% to 3.0%

- The Jan housing finance approvals report was uniformly weak with owner occupier loans down 3.9%, the value of investor loans down 1.6%/mth and the total value of all loans down 3.4%/mth. It should be noted that housing data is much less reliable in January due to the Christmas holiday period.
- Industry figures suggest owner occupier approvals firmed a touch in Feb, albeit with a sharp pull-back in loans for the purchase of 'newly erected' dwellings (which despite the name includes 'off the plan' purchases of dwellings yet to be built). We expect Feb to show the owner occupier finance approvals up 1%. The more meaningful statistic though will continue to be the broader 'total value of loans' measure which includes investor loans. Some stabilisation here seems likely given the somewhat firmer start to 2016 for housing markets.

New finance approvals*



Aus Apr Westpac-MI Consumer Sentiment

Apr 13 Last: 99.1

- The **Westpac-Melbourne Institute Consumer Sentiment Index** slipped 2.2% in March to 99.1 from 101.3 in February. The Index is back to around its average reading over the last 6mths but has held on to most of the lift seen late last year.
- The April survey is in the field over the week ended April 9. Factors that may influence sentiment include: a further rise in the AUD (up 2¢ since the March survey to 75½¢ US); a mixed month for equity markets (up offshore but the local ASX down 2.8% vs March); but a firmer start to the year for the Sydney and Melbourne housing markets. Political developments may also be a factor in April with the PM indicating an early 'double dissolution' election is now likely in July.

Consumer Sentiment Index



The week ahead

Aus Mar employment change

Apr 14, Last: -0.3k, WBC f/c: 25k
Mkt f/c: 18.5k, Range: flat to 40k

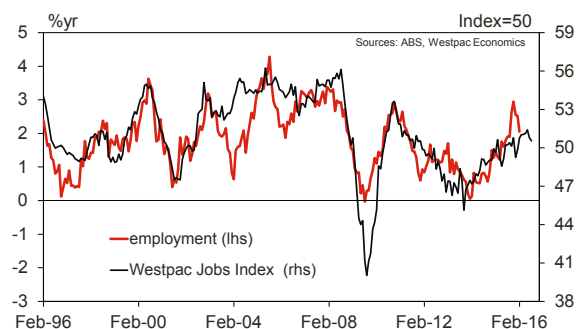
- In Feb, total employment rose just 0.3k compared to a market median of +12.5k and a range of -3k to +25k. Westpac's forecast was for +10k. That is an average of -2.2k per month over the last three months.
- Total employment has grown 239.4k (or 2.1%yr) in the year to Feb which is more in line with leading indicators. The pace peaked at 2.9% (340.2k) in Nov and the recent low was 1.6%yr (185.3k) in Jun 2015.
- The Feb Survey was the third soft monthly update and brought the annual growth pace in total employment more in line with our preferred leading indicators. Our forecast for a 25k rise in Mar will hold the annual pace at 2.0%yr.

Aus Mar unemployment rate

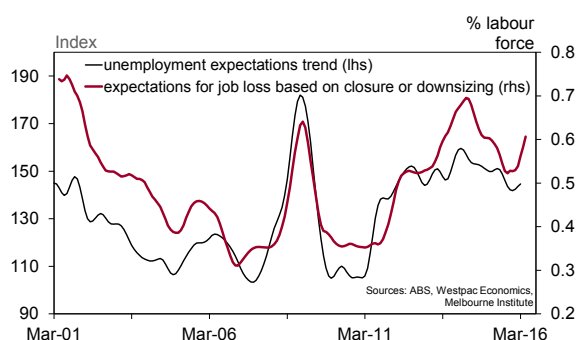
Apr 14, Last: 5.8%, WBC f/c: 6.0%
Mkt f/c: 5.9%, Range: 5.8% to 6.0%

- The big surprise in the Feb Survey was the drop in the participation rate from 65.14% to 64.90%. The largest sources of the drop by state were Qld (60.5% from 60.7%) and WA (60.5% from 61.1%). This, along with the very soft labour force prints in those states suggests there may have been some sample roll issues in the Feb survey.
- Westpac is expecting a bit of rebound in both employment and participation this month, in particular from Qld and WA. Our forecast for a 0.2ppt lift in the participation rate to 65.1% puts it back on a par with the Jan and Dec prints and effectively adds 58k to labour force. As such, our forecast for a robust 25k lift in employment is not enough to prevent the unemployment rate rising 0.2ppts to 6.0%.

Employment outpacing jobs index, a rare event



Unemployment expectations rising again



Chn Q1 GDP

Mar 15, Last: 6.8%yr, WBC 6.8%yr

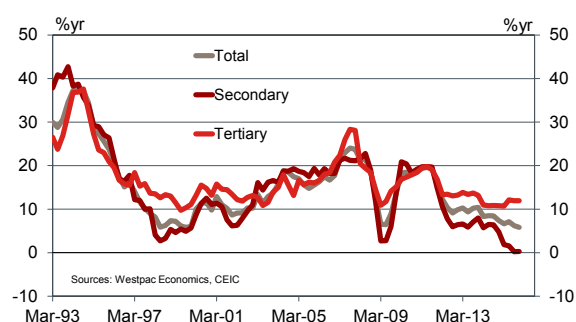
- Chinese real GDP surprised to the downside in Q4, rising 1.6% against the market's 1.8% expectation. Annual growth edged lower to 6.8%.
- As was the case throughout 2015, weakness in current momentum was more apparent in the nominal data, through the year growth slowing to a 5.8%yr pace in Q4, from 6.2%yr in Q3 and 7.1%yr in Q2. The deflator was weak in Q4, -1.0%yr.
- There remains a significant divergence between services sector activity (11.7%yr) and that of secondary industry (1.0%yr). This theme will persist in 2016.
- Come Q1, another soft quarterly outcome is anticipated - we expect a 1.4% gain. But the base effect should flatter annual growth, with it likely unchanged from Q4's 6.8%yr.

US Mar retail sales

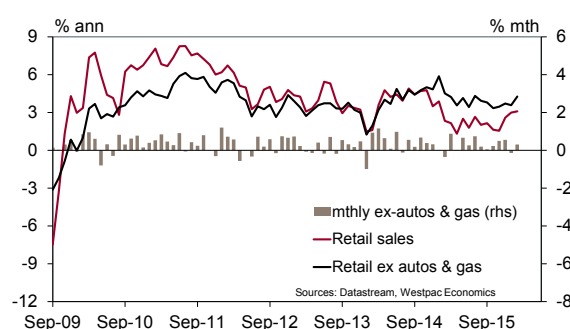
Mar 13, Last: -0.1%, WBC 0.2%

- Consumption data for the US has been a material disappointment in Q1.
- The headline outcomes have been particularly weak, a 0.1% fall in February following January's 0.4% decline, and leaving annual growth at 3.1%yr.
- Sure enough, this weakness has, in large part, been due to energy prices. However, recent core retail sales momentum is best regarded as flat, a 0.3% rise in February offsetting January's 0.1% decline, leaving annual growth at 4.3%yr.
- Come March, a little more momentum is expected, with gas likely to have a limited impact on the headline outcome. Auto's however are expected to partially offset some of the momentum in core sales; a still- modest headline result of around 0.2% is then the most likely outcome.

Nominal Chinese GDP: total & by broad sector



US retail sales, momentum firms



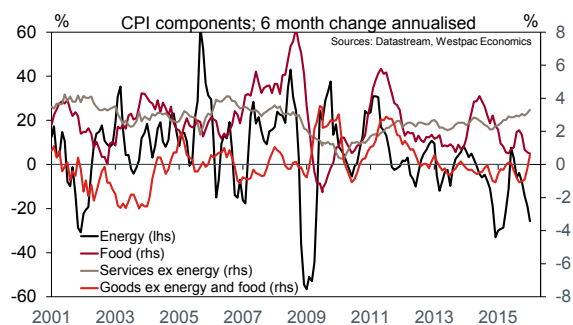
The week ahead

US Mar CPI

Mar 14, Last: -0.2%, WBC 0.2%

- Although the focus has remained on soft headline inflation, 1.0%yr at February, core inflation pressures have continued to build steadily in recent months.
- Ex food & energy, prices rose 0.3% in February, leaving annual growth at a robust 2.3%yr.
- Underlying this result is persistent strength in services inflation, brought about by robust rent increases as well as acceleration inflation for health and food & accommodation services.
- While we do not expect the pace of annual core inflation to continue to press ahead, it will remain above the FOMC's medium-term target for the foreseeable future. In March, both the headline and core CPI should rise by 0.2%, with energy and food prices broadly neutral.

Energy prices stabilising; USD impact to lessen



Data calendar

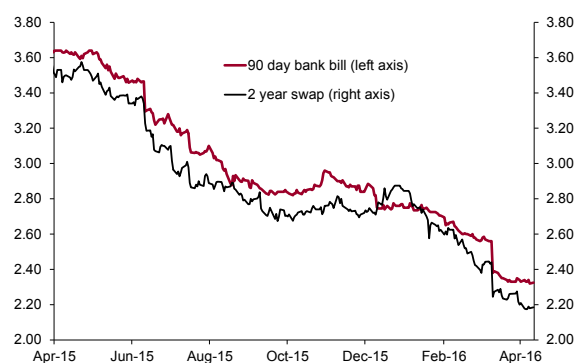
		Last	Market median	Westpac forecast	Risk/Comment
Mon 11					
NZ	Mar electronic card spending	0.7%	0.3%	-0.1%	Some pullback following firm gains earlier in the quarter.
	Mar REINZ house sales	-3.3%	-	-	Due this week. Sales may be stabilising after post-regulation drop.
	Mar REINZ house price	1.6%	-	-	House prices flattened out in Auckland, but strengthening elsewhere.
Aus	Feb housing finance	-3.9%	2.0%	1.0%	Headline is owner-occupier loans only. Investors driving current slowdown.
Chn	Mar CPI %yr	2.3%	2.4%	-	Price pressures remain benign...
	Mar PPI %yr	-4.9%	-4.6%	-	... commodity prices and secondary sector slack suppressing upstream.
US	Fedspeak	-	-	-	Dudley and Kaplan.
Tue 12					
Aus	Mar NAB business survey	8	-	-	In Feb, conditions partial rebound, 2pts to +8, an above avg level.
Ger	Mar CPI (final)	0.8%	0.8%	-	Despite historically low unemployment, inflation pulse weak.
UK	Mar CPI	0.2%	0.3%	-	Headline low, core firmer but upward pressure still very limited.
	Feb ONS house prices (% yr)	7.9%	-	-	Dated relative to other measures. Remains firm.
US	Mar NFIB small business optimism	92.9	93.8	-	Conditions mixed for small business, by region and sector.
	Mar import price index	-0.3%	1.0%	-	USD strength has had material impact; so too commodities.
	Mar monthly budget statement	-192.6	-88.5	-	Household income & capital gains supporting revenues.
	Fedspeak	-	-	-	Harker on outlook; Williams and Lacker also.
Wed 13					
NZ	Mar food price index	-0.6%	-	-0.5%	Food prices falling on an annual basis.
Aus	Apr Westpac-MI Consumer Sentiment	99.1	-	-	'Neutral' national read conceals wide range of sentiment across states.
Chn	Mar trade balance USDbn	32.59	33.40	-	Trade has been very weak; little improvement anticipated in Mar.
Eur	Feb industrial production	2.1%	-0.5%	-	A weaker EUR would be appreciated across the Continent.
US	Mar retail sales	-0.1%	0.1%	0.2%	Revisions to Q1 data to date have shown weaker momentum.
	Mar PPI	-0.2%	0.3%	-	Input cost inflation has lifted in recent months.
	Feb business inventories	0.1%	0.1%	-	Inventory outcomes for Q1 soft.
	Federal Reserve's Beige book	-	-	-	Conditions across the Fed regions.
Can	Mar Teranet house prices	0.6%	-	-	House price inflation remains moderate.
	Bank of Canada policy decision	0.50%	0.50%	0.50%	Activity continuing to rotate away from commodities.
Thu 14					
NZ	Mar BusinessNZ manufacturing PMI	56.0	-	-	Signs of nervousness have crept into the manufacturing sector.
Aus	Apr MI inflation expectations	3.4%	-	-	Down from a recent peak of 4.0%yr holding the trend at 3.6%yr.
	Mar employment	0.3k	-	25k	Three soft months averaging -2.2k so looking for modest rebound but ...
	Mar unemployment rate	5.8%	-	6.0%	... a lift in the part-rate back to the Jan level will see unemployment rise.
Eur	Mar CPI %yr	-0.2%	-0.1%	-	Core pressures contained at 1.0%yr.
UK	Bank of England policy decision	0.50%	0.50%	0.50%	BoE to remain on hold; global environment a key concern.
	Mar RICS house price balance	50%	-	-	Demand firm, rush to beat stamp duty increase boosting sales.
US	Initial jobless claims	267k	-	-	Claims historically low.
	Mar CPI	-0.2%	0.2%	0.2%	Marked distinction between headline and core inflation.
	Fedspeak	-	-	-	Powell before Senate Banking Committee; also Lockhart.
Can	New housing price index	0.1%	-	-	Has remained subdued.
Fri 15					
Aus	RBA Financial Stability Review	-	-	-	Half yearly update. Banking system remains sound.
Chn	Mar industrial production %yr	5.4%	5.9%	-	PMIs starting to show a little more momentum.
	Mar retail sales %yr	10.2%	10.4%	-	Chinese consumer remains wary of outlook.
	Mar fixed asset investment ytd %yr	10.2%	10.3%	-	Investment pipeline remains modest.
	Q1 GDP %yr	6.8%	6.7%	6.8%	Weakness more likely to show through in nominal data.
Eur	Feb trade balance €bn	21.2	-	-	A weaker EUR would be appreciated across the Continent.
UK	Feb construction output	-0.2%	-	-	Construction spending has been sluggish despite low rates.
US	Apr Fed Empire state index	0.6	2.0	-	Manufacturing conditions have firmed in recent months.
	Mar industrial production	-0.5%	-0.1%	-	Remains weak.
	Apr Uni. of Michigan sentiment	91	92	-	Uni. Of Michigan measure.
	Fedspeak	-	-	-	Evans speaks on economy and policy.

New Zealand forecasts

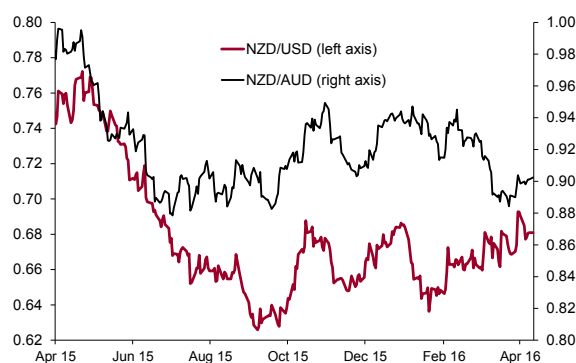
Economic Growth Forecasts	March years				Calendar years			
	% change	2014	2015	2016f	2017f	2014	2015	2016f
GDP (Production) ann avg	2.7	3.6	2.4	2.8	3.7	2.5	2.8	2.6
Employment	3.8	3.2	1.4	2.5	3.6	1.4	2.7	1.5
Unemployment Rate % s.a.	6.0	5.8	5.8	5.6	5.8	5.3	5.6	5.9
CPI	1.5	0.3	0.3	1.1	0.8	0.1	0.7	2.2
Current Account Balance % of GDP	-2.5	-3.4	-3.2	-3.4	-3.1	-3.1	-3.4	-3.7

Financial Forecasts	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day bill	2.10	2.10	2.10	2.10	2.10	2.10
2 Year Swap	2.10	2.10	2.10	2.10	2.10	2.10
5 Year Swap	2.60	2.70	2.80	2.90	3.00	3.10
10 Year Bond	3.00	3.10	3.20	3.40	3.50	3.60
NZD/USD	0.64	0.62	0.61	0.62	0.62	0.62
NZD/AUD	0.89	0.89	0.88	0.88	0.86	0.85
NZD/JPY	76.2	75.6	75.0	77.0	77.3	77.5
NZD/EUR	0.59	0.57	0.57	0.58	0.58	0.57
NZD/GBP	0.46	0.44	0.44	0.45	0.45	0.43
TWI	69.3	67.8	67.2	68.0	67.8	67.3

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 11 April 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.25%	2.25%	2.50%
30 Days	2.26%	2.30%	2.51%
60 Days	2.31%	2.32%	2.55%
90 Days	2.33%	2.34%	2.58%
2 Year Swap	2.19%	2.26%	2.44%
5 Year Swap	2.46%	2.58%	2.71%

NZ foreign currency mid-rates as at Monday 11 April 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6809	0.6729	0.6796
NZD/EUR	0.5968	0.6009	0.6179
NZD/GBP	0.4822	0.4721	0.4778
NZD/JPY	73.59	76.29	77.46
NZD/AUD	0.9024	0.8919	0.9173
TWI	72.12	71.86	73.26

International forecasts

Economic Forecasts (Calendar Years)	2012	2013	2014	2015f	2016f	2017f
Australia						
Real GDP % yr	3.5	2.0	2.6	2.5	2.8	2.8
CPI inflation % annual	2.2	2.7	1.7	1.7	1.9	2.2
Unemployment %	5.3	5.8	6.2	5.8	5.9	5.7
Current Account % GDP	-4.4	-3.4	-3.0	-4.6	-4.5	-4.3
United States						
Real GDP %yr	2.2	1.5	2.4	2.4	2.4	2.1
Consumer Prices %yr	2.1	1.5	1.6	0.1	1.3	1.7
Unemployment Rate %	8.1	7.4	6.2	5.3	4.7	4.5
Current Account %GDP	-2.9	-2.3	-2.2	-2.3	-2.3	-2.3
Japan						
Real GDP %yr	1.7	1.6	-0.1	0.6	1.1	0.7
Euroland						
Real GDP %yr	-0.8	-0.3	0.9	1.5	1.3	1.3
United Kingdom						
Real GDP %yr	0.7	1.7	3.0	2.5	2.3	2.1
China						
Real GDP %yr	7.7	7.7	7.3	6.9	6.5	6.2
East Asia ex China						
Real GDP %yr	4.6	4.2	4.1	3.6	3.9	4.2
World						
Real GDP %yr	3.4	3.3	3.4	3.0	3.4	3.5

Forecasts finalised 11 Mar 2016

Interest Rate Forecasts	Latest	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
Australia						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.25	2.30	2.30	2.30	2.30	2.30
10 Year Bond	2.40	2.60	2.75	2.75	2.90	3.10
International						
Fed Funds	0.375	0.625	0.625	0.875	0.875	1.125
US 10 Year Bond	1.71	2.00	2.15	2.25	2.50	2.80
ECB Repo Rate	0.00	0.00	0.00	0.00	0.00	0.00

Exchange Rate Forecasts	Latest	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
AUD/USD	0.7536	0.72	0.70	0.69	0.70	0.72
USD/JPY	108.73	119	122	123	125	125
EUR/USD	1.1365	1.09	1.08	1.07	1.06	1.06
AUD/NZD	1.1103	1.13	1.13	1.13	1.14	1.17

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