# Weekly Commentary

19 December 2016

## It's a wrap

This is our final weekly commentary for 2016. And what a year it has been. The New Zealand economy has performed strongly. The unemployment rate has fallen to its lowest level since 2008, net immigration has hit new all-time highs, the OCR has been cut to an all-time low, house prices nationwide have continued to trek higher, the RBNZ has introduced further macroprudential policy tightening, and New Zealand has a new Prime Minister. And that's just at home. Abroad, after much umming and ahhing, the Fed has finally raised rates again, Britain has embarked on the path away from the EU, and the US has voted in favour of President Trump.

Looking ahead to 2017, there is no doubt that there will be more shocks and surprises in store. There are however, some more predictable themes we expect to emerge next year.

Front and centre after Prime Minister John Key's recent surprise resignation after eight years in office, is election uncertainty. New Zealanders will head to the polls some time before 18 November next year. And the nature of MMP means that anyone looking to form a government will probably have to rely on the support of more than one party. On the whole there's not a huge gap in the economic policies of the two major parties; both are relatively centrist. That said, views do differ in certain policy areas, including approaches to addressing housing affordability concerns. Immigration policy, superannuation and perhaps even monetary policy are other issues which may be up for debate during the election campaign.

New Zealand's housing market is another sector likely to remain under scrutiny in 2017. We estimate that annual house price inflation reached 14% this year. However, we're now forecasting a considerably slower pace of growth in 2017. Our forecast of 5% annual house price inflation next year comes after several years of double-digit gains. A key reason for this view is the outlook for interest rates. Although we expect the OCR to remain at its current level for the foreseeable future, around the world longer-term interest rates are heading higher. Markets have taken the view that a Trump presidency is likely to have inflationary consequences in the US on the back of a lift in spending. What's more, last week's well-anticipated decision by the Federal Reserve to hike rates was accompanied by a more hawkish set of forecasts than many had anticipated.

The upward pressure on global rates is also flowing through to upward pressure on rates locally. Longer-term mortgage rates have been moving higher and this could

## Happy holidays!

**This is the last Weekly Commentary for 2016. Weekly Commentary will resume on 16 January 2017.**

# It's a wrap continued

continue over the coming year. It is these rising interest rates which we think will ultimately provide the biggest headwind to the housing market in 2017. In contrast, we think the RBNZ's latest round of LVR restrictions will have an impact on the number of people able to participated in the housing market (and therefore impact sales volumes), but ultimately won't impact the prices people are willing to pay for property. The latest REINZ data for November tended to support this view. House sales were broadly flat in the month, while prices climbed 0.9% to be up almost 15% on a year ago.

Thirdly, there's the inflation picture. Annual inflation currently sits at 0.4% and has been below the bottom of the RBNZ's 1-3% target band for two years. But that looks set to change next year. We're forecasting annual inflation to rise to 1.2% in the December quarter. But looking further ahead, given that the appreciation of the NZ dollar in the early part of this year, it doesn't look like inflation is at risk of threatening the upper end of the RBNZ's target band any time soon. Consequently, we think the RBNZ will be comfortable remaining on hold over the course of 2017 (and beyond).

But before the focus shifts toward Christmas dinners, the weather forecast at the beach and resolutions for 2017, we can't forget that there's still a couple of important data releases to tick off next week before we officially wind up for the year. After being delayed by earthquake damage to its Wellington headquarters, Statistics New Zealand is scheduled to release September quarter GDP and Balance of Payments data on Thursday. We're expecting 0.8% GDP growth in the quarter – the fifth straight quarter where growth has been 0.8% or 0.9%. This would leave annual GDP growth steady at 3.6%. The biggest contributions to growth are likely to come from manufacturing, retail and business services, with agriculture (in particular a drop in milk production) likely to be a soft spot. But aside from the highs and lows, perhaps the most pleasing feature of the current run of growth is its relatively broad-based nature. While the growth impulse from construction is moderating (although activity in this sector remains at a high level), other sectors have strengthened to fill the gap.

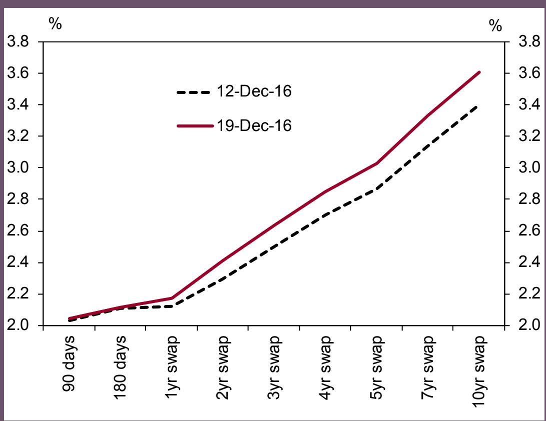
The current account deficit is expected to remain steady at 2.9% of GDP. The goods balance has been deteriorating on the back of weak dairy prices over the first half of the year, and is expected to deteriorate further in the September quarter due to rising oil prices. In contrast, trade in services is expected to remain firmly in surplus territory thanks to strength in the tourism sector, while the investment income balance is expected to narrow this quarter. A current account deficit around 2.9% is much smaller than recent peaks and unlikely to provoke much market reaction.

## Fixed vs Floating for mortgages

For borrowers with a deposit of 20% or more, the best value lies in the two-year rate or shorter terms. Three- to five-year rates seem high relative to where we think short-term rates are going to go over that time. That said, these rates are most likely to be pressured higher by global market trends, so borrowers who prefer the security of a longer term should lock it in now.

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 Dec business confidence

**Dec 19, Last: 20.5**

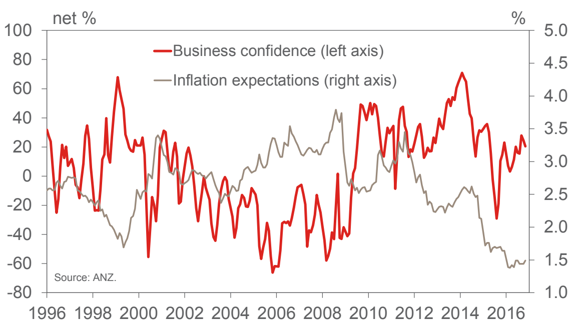
- Business confidence and firms' expectations of their own activity dipped further in November. But after a strong run higher through the middle of the year, the data still points to a continuation of solid growth heading into 2017.
- While construction firms remain the most upbeat (by far) about their own activity prospects, sentiment across sectors has perked up through the second half of this year.
- Pricing pressures look to have found a bottom. We'd expect to see the survey's two inflation metrics edge higher in coming months, as solid growth increases pressure on firms' capacity. That should eventually translate into higher consumer prices.

## NZ Oct building consents

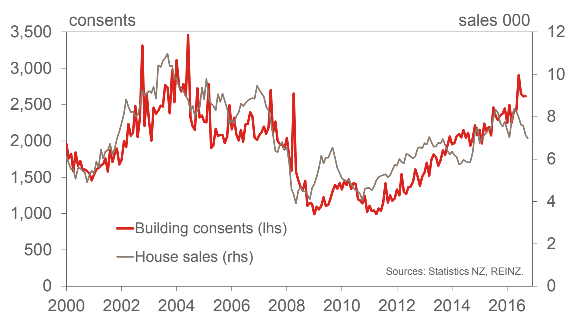
**19 Dec, Last: 0.2%, Westpac f/c: 3.0%**

- After strong growth in June, residential consents have been weak for three months, with two consecutive declines and near-zero growth in September.
- We expect to see growth return this month, with stronger readings for both Auckland and Canterbury after they both fell materially in September.
- Large swathes of the Auckland Unitary Plan became operative mid-November, so looking further out, we would expect to see stronger growth in Auckland residential consents.

### NZ housing activity




### NZ business confidence and inflation expectations




## NZ Q3 GDP

**Dec 22, Last 0.9%, Westpac f/c: 0.8%, Mkt f/c: 0.9%**

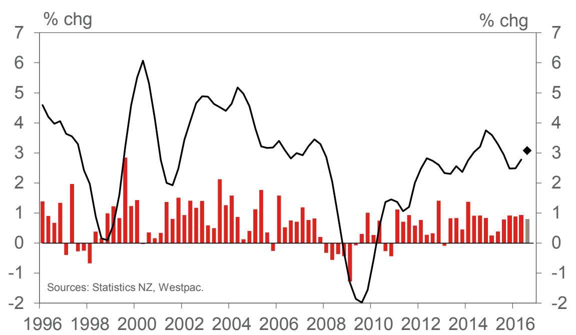
- The New Zealand economy is sailing smoothly into summer, with September quarter GDP expected to rise by a solid 0.8%. Following an impressive run-rate of 0.9% for the previous three quarters, this would hold annual growth steady at 3.6%.
- Familiar factors continue to underpin GDP growth, including strong population growth, surging tourist numbers, a large pipeline of building work, and low interest rates.
- By sector, growth in the quarter is looking relatively broad-based, with the largest contributions expected to come from manufacturing, retail and professional services. Agriculture is a notable exception, as a smaller dairy herd and poor weather dragged on milk production.

## NZ Q3 current account (% of GDP)

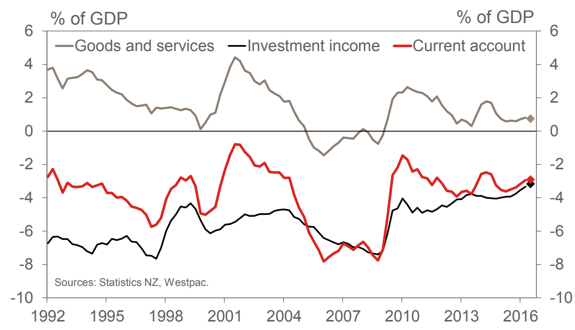
**Dec 22, Last: -2.9%, Westpac f/c: -2.9%, Mkt f/c: -3.0%**

- While the 10% fall in the terms of trade since mid-2014 has seen the goods trade balance move firmly into deficit, services continue to provide a strong offsetting force. The annual services surplus remains robust at around 1.7% of GDP, as tourism spending bolsters export receipts.
- Meanwhile, the investment income deficit is weighing on the current account much less than in the past. This reflects a number of factors, including low interest rates effect on interest payments on NZ's overseas debt as well as an increase in national savings.
- The current account deficit is expected to narrow over the next year as the 56% rise in global dairy prices since July translates into higher export receipts.

### Production-based GDP




### Annual current account balance



# The week ahead

### Aus 2016/17 Federal budget, mid-yr update, $bn

**Dec 19, Prelim: –37.1, WBC f/c: –40, Mkt f/c: –37, Range: –40 to –32**

- Since the May 2016 Budget: the broader economy has deteriorate materially (real output, employment and wages growth); against that commodity prices have spiked temporarily.
- For 2016/17, real GDP growth will be marked down by 1ppt to 1.5%, while nominal GDP is marked up by 1ppt to 5.25%.
- The budget deficit deteriorates by $3bn in 2016/17, widening to a $6bn deterioration in 2019/20, as broad based weakness outweighs the boost from higher commodity prices (we note the potential for the coal industry to carry forward tax losses).
- The Budget projected a return to surplus in 2020/21, to around $4bn to $5bn. On our figuring, the return to surplus in 2020/21 hangs in the balance given a $6bn deterioration in 2019/20.

### Aus Nov Westpac–MI Leading Index

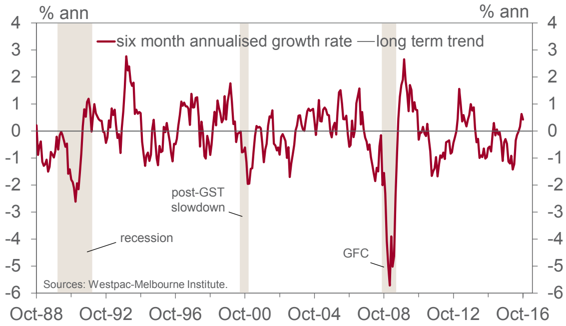
**Dec 21, Last: 0.43%**

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index slipped from +0.63% in September to +0.43% in October. Despite the retracement, this was the third consecutive above trend result after fifteen months of persistent below trend reads.
- Latest component updates have been a mix of weak and strong. Those based on 'real' activity have mostly been weak, dwelling approvals down particularly sharply (-12.6% vs -9.3% last month), US industrial production, and total hours worked down. Against this, those based on 'financial' indicators have been positive, commodity prices continued to surge (up 10.2% in AUD terms following a 6.7% gain last month), the ASX200 has firmed (up 2.3% vs -2.2% last month) and the yield spread has widened on higher global bond rates (a growth positive signal). These positives have carried into December as well.

### Key fiscal numbers, $bn

| | '16/17 | '17/18 | '18/19 | '19/20 |
|---|---|---|---|---|
| **Budget** | | | | |
| Cash balance, underlying | –37.1 | –26.1 | –15.4 | –6.0 |
| % of GDP | –2.2 | –1.4 | –0.8 | –0.3 |
| Net public debt | 326 | 347 | 356 | 355 |
| % of GDP | 18.9 | 19.2 | 18.8 | 17.8 |
| **MYEFO*** | | | | |
| Change in cash balance | -3.0 | -4.0 | -5.0 | -6.0 |
| Cash balance, underlying | -40.1 | -30.1 | -20.4 | -12.0 |
| % of GDP | -2.3 | -1.7 | -1.1 | -0.6 |
| Net public debt | 340 | 365 | 379 | 384 |
| % of GDP | 19.5 | 20.2 | 20.2 | 19.5 |

### Westpac-MI Leading Index



# Data calendar

| | | Last | Market median | Westpac forecast | Risk/Comment |
|---|---|---|---|---|---|
| **Mon 19** | | | | | |
| **NZ** | Nov BusinessNZ PSI | 56.3 | – | – | Despite easing recently, service sector conditions remain firm. |
| | Oct building permits | 0.2% | – | 3.0% | A lift expected after softness in recent months. |
| | Dec ANZ business confidence | 20.5 | – | – | Has eased recently, but still points to firm growth. |
| **Aus** | Federal budget, mid-year update, AUDbn | –37.1(p) | –37 | –40 | 2016/17 budget deficit to be hit by broader economy weakness. |
| **Chn** | Nov property prices | – | – | – | Price gains continue to broaden across tier-2 and tier-3 cities. |
| **Ger** | IFO business climate | 110.4 | – | – | Current conditions strong, particularly for construction. |
| **US** | Dec Markit services PMI (provisional) | 54.6 | – | – | Continues to point to solid growth in services. |
| | Fed Chair Yellen | – | – | – | Address at University of Baltimore commencement. |
| **Tue 20** | | | | | |
| **NZ** | Nov food prices | –0.8% | – | –0.2% | Annual food price growth now turning slightly positive. |
| **Aus** | RBA minutes | – | – | – | Labour market the focus for 2017. |
| **Eur** | Oct current account, €bn | 25.3 | – | – | Exporters will be hoping Euro downtrend continues. |
| **Can** | Oct wholesale trade | –1.2% | – | – | Machinery and equipment sales have been a drag. |
| **Wed 21** | | | | | |
| **NZ** | GlobalDairyTrade auction | 3.5% | – | – | Futures point to another small gain. |
| | Nov net migration | 6240 | – | 6000 | Annual migration set to remain near record highs. |
| | Nov trade balance, $m | –846 | –500 | –540 | Improving dairy exports and absence of plane imports to narrow deficit. |
| **Aus** | Nov Westpac–MI Leading Index | 0.43% | – | – | Components divided in Nov: 'real' negatives vs financial positives. |
| **Eur** | Dec European Commission consumer conf. | –6.1 | – | – | Holding up at elevated level. |
| **UK** | Nov public sector net borrowing, £b | 4.3 | 11.5 | – | Debt reduction targets have been pushed out post-Brexit. |
| **US** | Nov existing homes sales | 2.0% | –1.1% | – | First glimpse at impact of election on housing market. |
| **Thu 22** | | | | | |
| **NZ** | Q3 GDP | 0.9% | 0.9% | 0.8% | Broad-based growth, led by manufacturing, retail and prof. services. |
| | Q3 current account (% of GDP) | –2.9 | –3.0% | –2.9% | Strong services and benign income deficit supporting current account. |
| **UK** | Dec GfK consumer confidence | –8 | –7 | – | While still firm, confidence has been pulling back. |
| **US** | Nov Chicago Fed national activity index | –0.08 | – | – | Points to only moderate growth. |
| | Q3 GDP (annualised, final) | 3.2% | 3.3% | 3.3% | Revisions expected to be minor in third and final estimate. |
| | Nov durable goods orders (provisional) | 4.6% | –4.7% | – | Reversal of transport-led gain expected in Nov; core trend weak. |
| | Initial jobless claims | 254k | – | – | Claims lingering at low levels heading into the holiday period. |
| | Oct FHFA house price index | 0.6% | 0.3% | – | House price growth continues at healthy pace. |
| | Nov personal income | 0.6% | 0.3% | 0.4% | Wages growth has solid momentum, but is struggling to accelerate. |
| | Nov personal spending | 0.3% | 0.4% | 0.4% | Services surprised to downside in Oct; and retail disappointed in Nov. |
| | Nov PCE deflator | 0.2% | 0.2% | 0.2% | Underlying price pressures near 2.0%yr target. |
| | Dec Kansas City Fed manf. Activity | 1 | – | – | Has picked up, but still points to moderate growth in manufacturing. |
| **Can** | Nov CPI | 0.2% | –0.1% | – | Inflation has picked up as the earlier drag from oil prices fades. |
| **Fri 23** | | | | | |
| **UK** | Q3 GDP (final) | 0.5% | 0.5% | 0.5% | Trade and household spending have supported growth. |
| **US** | Nov new home sales | –1.9% | 2.1% | – | First glimpse at impact of election on housing market. |
| | Dec Michigan consumer confidence (final) | 98.0 | 98.0 | – | Election brought about a jump in confidence which has been sustained. |
| **Can** | Oct GDP | 0.3% | – | – | Growth has been picking up following wildfires. |

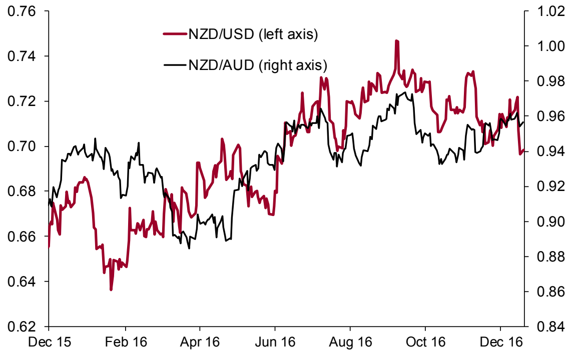
# New Zealand forecasts

| Economic Forecasts | March years | | | | Calendar years | | | |
|---|---|---|---|---|---|---|---|---|
| % change | 2015 | 2016 | 2017f | 2018f | 2014 | 2015 | 2016f | 2017f |
| GDP (Production) ann avg | 3.6 | 2.5 | 3.5 | 3.2 | 3.8 | 2.5 | 3.4 | 3.2 |
| Employment | 3.2 | 2.0 | 4.8 | 2.2 | 3.6 | 1.4 | 5.8 | 2.0 |
| Unemployment Rate % s.a. | 5.4 | 5.2 | 5.0 | 4.3 | 5.5 | 5.0 | 4.8 | 4.5 |
| CPI | 0.3 | 0.4 | 1.3 | 1.2 | 0.8 | 0.1 | 1.2 | 1.1 |
| Current Account Balance % of GDP | -3.5 | -3.1 | -2.9 | -2.8 | -3.2 | -3.4 | -2.9 | -2.8 |

| Financial Forecasts | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 |
|---|---|---|---|---|---|---|
| **Cash** | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 | 1.75 |
| **90 Day bill** | 2.10 | 2.10 | 2.10 | 2.10 | 2.10 | 2.10 |
| **2 Year Swap** | 2.30 | 2.40 | 2.50 | 2.50 | 2.50 | 2.50 |
| **5 Year Swap** | 2.70 | 2.80 | 2.90 | 3.00 | 3.00 | 3.00 |
| **10 Year Bond** | 3.00 | 3.10 | 3.20 | 3.25 | 3.30 | 3.25 |
| **NZD/USD** | 0.72 | 0.72 | 0.71 | 0.70 | 0.68 | 0.66 |
| **NZD/AUD** | 0.94 | 0.95 | 0.96 | 0.96 | 0.94 | 0.94 |
| **NZD/JPY** | 76.3 | 77.8 | 78.1 | 77.0 | 76.2 | 75.2 |
| **NZD/EUR** | 0.66 | 0.67 | 0.68 | 0.67 | 0.67 | 0.65 |
| **NZD/GBP** | 0.58 | 0.59 | 0.58 | 0.57 | 0.56 | 0.55 |
| **TWI** | 77.9 | 78.6 | 78.6 | 78.0 | 76.7 | 75.3 |

2 Year Swap and 90 Day Bank Bills


NZD/USD and NZD/AUD




NZ interest rates as at market open on Monday 19 December 2016

| Interest Rates | Current | Two weeks ago | One month ago |
|---|---|---|---|
| **Cash** | 1.75% | 1.75% | 1.75% |
| **30 Days** | 1.88% | 1.91% | 1.94% |
| **60 Days** | 1.98% | 1.98% | 2.00% |
| **90 Days** | 2.05% | 2.04% | 2.06% |
| **2 Year Swap** | 2.41% | 2.30% | 2.27% |
| **5 Year Swap** | 3.03% | 2.83% | 2.78% |

NZ foreign currency mid-rates as at Monday 19 December 2016

| Exchange Rates | Current | Two weeks ago | One month ago |
|---|---|---|---|
| **NZD/USD** | 0.6982 | 0.7137 | 0.7004 |
| **NZD/EUR** | 0.6691 | 0.6699 | 0.6605 |
| **NZD/GBP** | 0.5595 | 0.5612 | 0.5675 |
| **NZD/JPY** | 82.37 | 80.93 | 77.70 |
| **NZD/AUD** | 0.9566 | 0.9577 | 0.9560 |
| **TWI** | 77.91 | 78.56 | 77.45 |

# International forecasts

| Economic Forecasts (Calendar Years) | 2013 | 2014 | 2015 | 2016f | 2017f | 2018f |
|---|---|---|---|---|---|---|
| **Australia** | | | | | | |
| Real GDP % yr | 2.0 | 2.7 | 2.4 | 2.9 | 3.0 | 2.8 |
| CPI inflation % annual | 2.7 | 1.7 | 1.7 | 1.6 | 1.8 | 2.5 |
| Unemployment % | 5.8 | 6.2 | 5.8 | 5.5 | 5.5 | 5.4 |
| Current Account % GDP | -3.4 | -3.0 | -4.7 | -2.9 | -2.6 | -2.5 |
| **United States** | | | | | | |
| Real GDP %yr | 1.5 | 2.4 | 2.6 | 1.5 | 2.1 | 2.1 |
| Consumer Prices %yr | 1.5 | 1.6 | 0.1 | 1.2 | 1.7 | 1.7 |
| Unemployment Rate % | 7.4 | 6.2 | 5.3 | 4.9 | 4.6 | 4.5 |
| Current Account %GDP | -2.3 | -2.3 | -2.6 | -2.7 | -3.0 | -3.1 |
| **Japan** | | | | | | |
| Real GDP %yr | 1.4 | 0.0 | 0.5 | 0.6 | 0.6 | 0.7 |
| **Euroland** | | | | | | |
| Real GDP %yr | -0.3 | 0.9 | 1.6 | 1.6 | 1.2 | 1.3 |
| **United Kingdom** | | | | | | |
| Real GDP %yr | 2.2 | 2.9 | 2.2 | 2.1 | 1.6 | 1.4 |
| **China** | | | | | | |
| Real GDP %yr | 7.7 | 7.3 | 6.9 | 6.7 | 6.5 | 6.0 |
| **East Asia ex China** | | | | | | |
| Real GDP %yr | 4.2 | 4.1 | 3.7 | 3.7 | 3.9 | 3.8 |
| **World** | | | | | | |
| Real GDP %yr | 3.3 | 3.4 | 3.1 | 3.3 | 3.5 | 3.4 |
| Forecasts finalised 11 November 2016 | | | | | | |

| Interest Rate Forecasts | Latest | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 |
|---|---|---|---|---|---|---|---|---|
| **Australia** | | | | | | | | |
| Cash | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 | 1.50 |
| 90 Day Bill | 1.77 | 1.80 | 1.80 | 1.80 | 1.80 | 1.80 | 1.80 | 1.80 |
| 10 Year Bond | 2.92 | 2.95 | 3.05 | 3.15 | 3.25 | 3.40 | 3.50 | 3.65 |
| **International** | | | | | | | | |
| Fed Funds | 0.375 | 0.625 | 0.625 | 0.875 | 0.875 | 1.125 | 1.125 | 1.375 |
| US 10 Year Bond | 2.43 | 2.25 | 2.30 | 2.35 | 2.40 | 2.50 | 2.55 | 2.60 |
| ECB Deposit Rate | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 | -0.40 |

| Exchange Rate Forecasts | Latest | Dec-16 | Mar-17 | Jun-17 | Sep-17 | Dec-17 | Mar-18 | Jun-18 |
|---|---|---|---|---|---|---|---|---|
| AUD/USD | 0.7358 | 0.74 | 0.74 | 0.73 | 0.72 | 0.70 | 0.70 | 0.68 |
| USD/JPY | 118.19 | 116 | 118 | 118 | 120 | 122 | 124 | 124 |
| EUR/USD | 1.0418 | 1.05 | 1.03 | 1.01 | 1.00 | 1.00 | 0.99 | 0.98 |
| AUD/NZD | 1.0453 | 1.04 | 1.04 | 1.04 | 1.04 | 1.04 | 1.06 | 1.06 |

# Contact the Westpac economics team

**Michael Gordon,** Acting Chief Economist +64 9 336 5670

**Satish Ranchhod,** Senior Economist +64 9 336 5668

**Anne Boniface,** Senior Economist +64 9 336 5669

**Sarah Drought,** Economist +64 9 336 5696

**Any questions email:** economics@westpac.co.nz

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