

# Weekly Commentary

20 June 2016



## Weight of numbers

Over the last couple of years, New Zealand has been buffeted by the loss of two major sources of income growth. Dairy export prices have gone from very high to very low, and the level of quake-related building work has topped out. On the face of it, the economy appears to have coped well with these shocks, with GDP continuing to grow at a solid pace. But the underlying picture is less encouraging. Rapid population growth has flattered the total GDP growth figures, and spending has been supported by borrowing against rising house values.

March quarter GDP rose by 0.7%, slightly ahead of market expectations. The highlights were a sharp rise in construction work over the summer, strong growth in overseas tourist spending, and rising demand for services from a rapidly growing population. The main weak spot was in meat processing, though this was largely a timing issue. An accelerated cull in the second half of last year meant fewer animals to process than usual in early 2016.

For the year to March, GDP growth slowed to 2.4%. That compares to a peak rate of 3.7% at the end of 2014, and demonstrates that the dairy downturn and the fading growth pulse from the Christchurch rebuild have had a visible impact on the economy's momentum.

The slowdown in economic growth is even more apparent when you consider that population growth has surged in that same time. Strong net inward migration has lifted population growth to around 2% over the last year, compared to 1.6% in 2014. That means per-capita GDP growth has slowed from 2.1% in 2014 to just 0.4% today.

Strong population growth bolsters the rate of GDP growth, but it also adds to the economy's available capacity. So there is no chance that the GDP growth figures will have the Reserve Bank fretting about the risk of the economy overheating, or inflation approaching the 2% target midpoint more rapidly than expected. We think the GDP

figures support the case for a further OCR cut at the August *Monetary Policy Statement*.

Population growth aside, there have been a few developments that have helped the New Zealand economy absorb the blow from the dairy downturn. One is a strong rise in construction activity outside of Canterbury, particularly around Auckland where a substantial lift in homebuilding is needed. Another is the strong growth in overseas tourist numbers over the last two years.

A third factor is that rising house prices have left homeowners feeling more wealthy, and more willing to borrow and spend against their newfound wealth. Household credit growth rose to 7.9% in the year to April, its fastest pace since 2008, and household debt has risen to a new high of 163% of annual disposable income.

The shift towards debt accumulation was also apparent in last week's balance of payments figures. While the current account deficit narrowed slightly to 3.0% of GDP, the accumulated deficit still outstripped the weak pace of national income growth. New Zealand's international net debt position had been steadily improving since 2009, but that improvement now looks to be coming to an end.

Admittedly, the link between rising house values, borrowing and spending hasn't been as powerful over the past couple of years as it was in the previous decade. That may be

# Weight of numbers continued

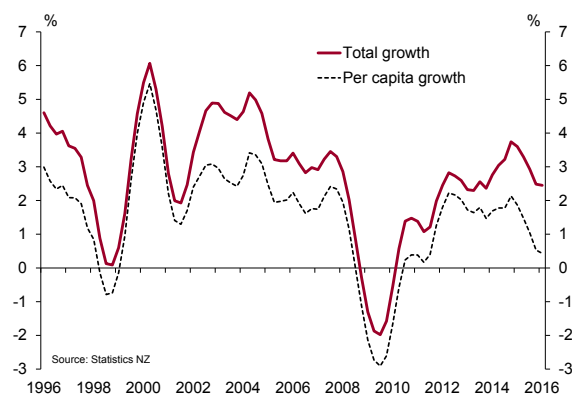
because there have been some restraining factors that weren't present before the financial crisis, in terms of both regulation and lenders' ease of access to overseas funding. Or it may be due to the – up until recently – skewed nature of the housing upturn. Auckland house prices were perhaps rising faster than homeowners could spend their newfound wealth, while in the rest of the country homeowners were experiencing little or no increase in property values.

That picture, though, has well and truly changed. House prices are now rising strongly across much of the country, in some cases overtaking the rate of growth in Auckland. (Canterbury is the major exception: houses are losing their scarcity premium as more and more houses are repaired or rebuilt.) It's possible that the borrow-and-spend dynamic strengthens from here, as it becomes a more nationwide phenomenon.

Debt accumulation isn't inherently a problem, especially if it's set against expectations of strong income growth in the future. That would have been a reasonable assumption a few years ago, when dairy export earnings were strong and the Christchurch rebuild was ramping up. But those sources of income growth have faded, and it's not clear what might come along to make up for them – especially since the economy still has to navigate the wind-down phase of the quake rebuild over the next few years.

Still, we think that the borrow-and-spend dynamic can continue to support consumer spending growth for a while longer. As we've highlighted before, low interest rates are a common factor that can explain why house prices are rising

GDP, annual average % change



across almost the entire country, while rents are increasing only slowly. Last decade, a sharp lift in interest rates was the circuit-breaker for this dynamic, but that seems unlikely in the next year or so, with inflation persistently below the midpoint of the target band.

In light of the resurgence in house prices over the last few months, we've revised up our forecast to a 14% increase in nationwide house prices this year. That even includes an allowance for more restrictions on mortgage lending by the Reserve Bank at some point this year. Depending on the form that these take, they may slow the rate of house price growth for some time, but are unlikely to constitute a circuit-breaker.

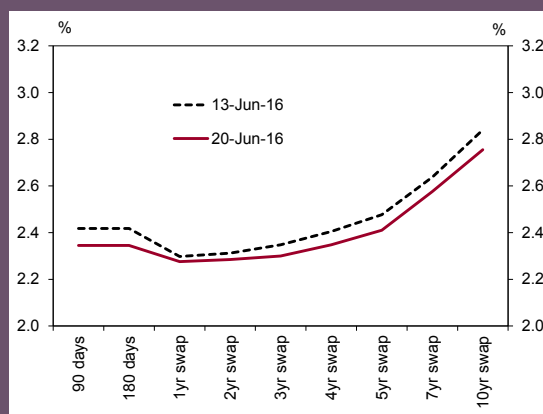
## Fixed vs Floating for mortgages

Fixed rates have fallen a long way recently, and are becoming a more attractive option for borrowers.

For borrowers with a deposit of 20% or more, the best value probably lies in the two-year rate or shorter terms. Four- and five-year rates seem high relative to where we think shorter-term rates are going to go over the next four or five years. That said, fixing for a longer term does offer the borrower greater 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



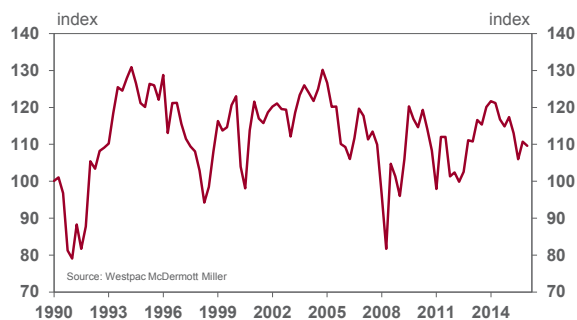
# The week ahead

## NZ Q2 Westpac-MM Consumer Confidence

June 20, Last: 109.6

- Consumer confidence nudged down in the early part of 2016 as households became increasingly worried about where the economy is heading over the next few years.
- However, while nervousness about the general economic outlook had increased, households remained more optimistic about their personal economic situation. As a result, they remain in the mood to spend.
- The June quarter survey was in the field over 1-12 June.

## Westpac-McDermott Miller consumer confidence

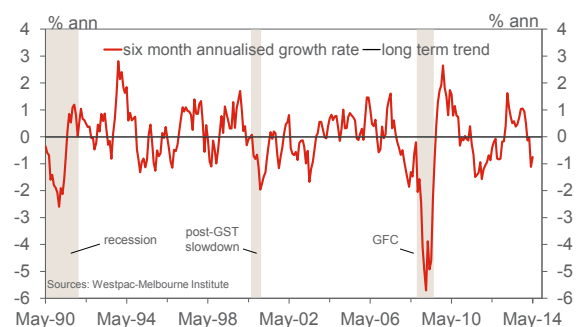


## Aus May Westpac-MI Leading Index

Jun 22, Last: -1.08%

- The six-month annualised growth rate in the Westpac-Melbourne Institute Leading Index rose from -1.51% in March to -1.08% in April. Despite the improvement, the Index remained firmly in negative territory for a 12th consecutive month, pointing to below-trend growth throughout 2016.
- The May reading will include more positive updates on: the ASX200, up a further 2.4% vs 3.3% last month; commodity prices, up 3.8% (in AUD terms) vs 0.1% last month; dwelling approvals, up 3% vs 2.9% last month; and total hours worked, up 1.7% vs -1.2% last month. On the other hand, it will also include softer reads on: the Westpac-MI Consumer Expectations Index, down -2.9% vs 11.6% last month; US industrial production, down -0.4% vs 0.6% last month; and a significant narrowing in the yield spread.

## Westpac-MI Leading Index



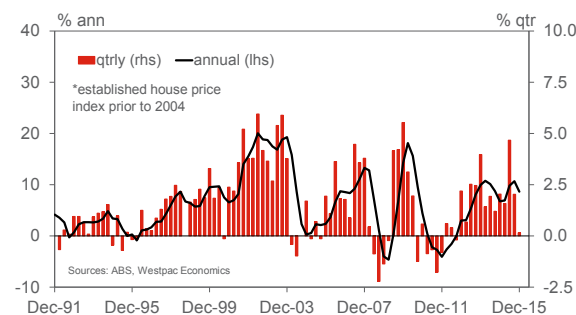
## Aus Q1 residential property price index

Jun 21, Last: 0.2%, WBC f/c: -1.0%

Mkt f/c: 0.8%, Range: -1.0% to 1.5%

- Note that the ABS residential property price index is considerably more dated than private sector measures, but it still gains attention due to its 'official' tag. For Q4, it showed a sharp slowdown, with prices up just 0.2%qtr nationally, taking annual price growth to 8.7% from 10.7% in Q3.
- Private sector measures registered Q1 price moves ranging from -1.3%qtr, 4.1%yr (REIA, houses only) to -1.1%qtr, 7.6%yr (Residex), -0.6%qtr, 5.8%yr (APM), and 1.6%qtr, 6.6%yr (CoreLogic RP Data). The ABS measure tends to track the APM series. As such, we expect it to show a 1%qtr fall, lowering annual growth to around 6%. More timely monthly updates show mixed results since Q1, with Residex pointing to more softness in Apr, but the CoreLogic RP Data measure showing a burst in Apr-May, which softened again in the first half of June.

## Residential property price index, ABS measure

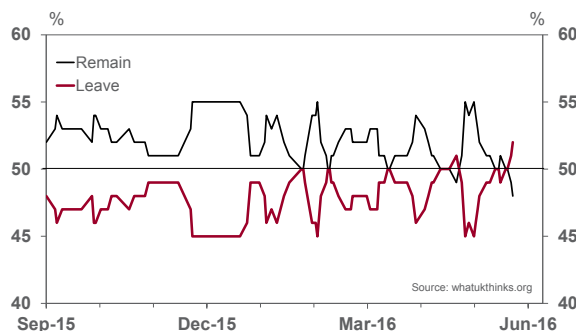


## UK referendum on EU membership

June 23

- The referendum on the UK's membership in the EU will take place on 23 June, with polls closing 10pm GMT. Early results are expected by late afternoon Friday 24 June, Australia and NZ time. Recent weeks have seen the 'leave' camp making up ground, with a number of polls indicating that it has pushed into the lead. However, questions surround the accuracy of polling, with phone polling (generally regarded as more reliable) signalling the 'stay' camp still has a narrow lead.
- Uncertainty ahead of the vote has dampened UK economic conditions and resulted in heightened nervousness in financial markets. Whatever the decision, further volatility is likely. In the event of a 'stay' result, a near term relief rally in Sterling and equities could be expected. Should the 'exit' camp prevail, increased risk aversion in financial markets is likely, followed by a period of subdued economic activity in the UK.

## Brexit polling



# Data calendar

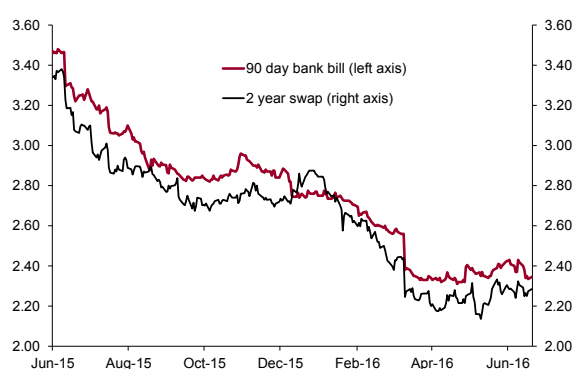
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 20</b>					
<b>NZ</b>	Q2 Westpac MM consumer confidence	109.6	-	-	Confidence edged back a little in March.
	May BusinessNZ PSI	57.7	-	-	Service sector conditions have been firm.
<b>UK</b>	Jun Rightmove house prices	0.4%	-	-	House price gains have eased off, expected to remain modest in June.
<b>Can</b>	Apr wholesale trade	-1.0%	-	-	Has fallen sharply, with vehicle sales a significant drag.
<b>US</b>	Fedspeak	-	-	-	Kashkari gives prepared remarks on 'Too big to fail'.
<b>Tue 21</b>					
<b>Aus</b>	RBA minutes	-	-	-	Assumes more importance given lack of guidance in June Gov's statement.
	RBA Assistant Governor Fin Markets	-	-	-	DeBelle on liquidity in domestic fixed income markets.
	Q1 residential property price index	0.2%	-	-1.0%	'Official' measure ancient history vs private data but may cause a stir.
<b>Eur</b>	Jun ZEW survey of expectations	16.8	-	-	Investors hopeful but hesitant.
<b>UK</b>	May public sector borrowing, £b	6.6	-	-	The UK government faces an uphill battle to achieve its surplus aims.
<b>US</b>	Fed Chair Yellen	-	-	-	Testimony on monetary policy to Senate banking panel.
<b>Wed 22</b>					
<b>NZ</b>	May net migration	5520	-	5250	While still strong, the peak in monthly migration flows has passed.
<b>Aus</b>	May Westpac-MI Leading Index	-1.08%	-	-	Components mixed in May but 6mth growth rate should improve.
<b>Eur</b>	Jun consumer confidence	-0.7	-0.7	-	Confidence has wavered of late.
<b>US</b>	Apr FHFA house price index	0.7%	-	-	Prices up 6.1% over the year.
	May existing home sales	1.7%	1.8%	2.0%	Abstracting from volatility, flat trend apparent.
	Fed Chair Yellen	-	-	-	Speaking in front of House Financial Services panel.
	Fedspeak	-	-	-	Powell makes introductory remarks at panel in New York.
<b>Thu 23</b>					
<b>Aus</b>	RBA Assistant Governor Fin Markets	-	-	-	Remarks on economy.
<b>Eur</b>	Jun Markit manufacturing PMI	51.5	51.4	-	Growth in Q1 surprised to the upside...
	Jun Markit services PMI	53.3	53.2	-	... but momentum likely to moderate through mid-2016.
<b>Ger</b>	Jun Markit manufacturing PMI	52.1	52.0	-	Unlikely to see much of a change in conditions...
	Jun Markit services PMI	55.2	55.0	-	... in either sector in June.
<b>UK</b>	Referendum on EU membership	-	-	-	Polling closes 10pm GMT, results expected late Friday in AU/NZ.
<b>US</b>	May Chicago Fed national activity index	0.1	-	-	Points to growth around trend.
	Initial jobless claims	277k	-	-	Remains at historically low levels.
	Jun Markit manufacturing PMI	50.7	50.3	-	Flash estimate, USD clearly weighing on manufacturing sector.
	May new home sales	16.6%	-8.7%	-10.0%	Pullback expected in May, but uptrend to remain intact.
	May leading index	0.6%	-	-	Points to growth around trend.
	Jun Kansas City Fed manuf activity	-5	-	-	Regional surveys lifting after recent falls.
<b>Fri 24</b>					
<b>Ger</b>	Jun IFO business climate	107.7	107.4	-	Current conditions healthy; confidence less so.
<b>US</b>	Fedspeak	-	-	-	Kaplan Speaks in New York.
	May durable goods orders	3.4%	-0.8%	flat	Can only characterise investment as weak.
	Jun Uni of Mich consumer sentiment (final)	94.3	94.1	-	Sentiment above average.

# New Zealand forecasts

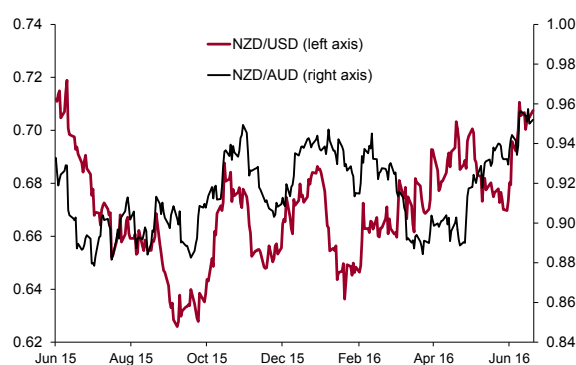
Economic Growth Forecasts	March years				Calendar years			
	% change	2014	2015	2016f	2017f	2014	2015	2016f
GDP (Production) ann avg	2.7	3.6	2.4	2.9	3.7	2.5	2.9	2.7
Employment	3.8	3.2	2.0	2.5	3.6	1.4	2.9	2.4
Unemployment Rate % s.a.	6.0	5.8	5.7	5.4	5.8	5.4	5.7	5.0
CPI	1.5	0.3	0.4	1.6	0.8	0.1	1.3	2.1
Current Account Balance % of GDP	-2.5	-3.4	-3.0	-3.7	-3.1	-3.2	-3.3	-3.9

Financial Forecasts	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
Cash	2.25	2.00	2.00	2.00	2.00	2.00
90 Day bill	2.40	2.20	2.20	2.20	2.20	2.20
2 Year Swap	2.30	2.20	2.20	2.30	2.30	2.30
5 Year Swap	2.50	2.50	2.60	2.70	2.80	2.80
10 Year Bond	2.60	2.70	2.80	2.90	3.00	3.10
NZD/USD	0.70	0.68	0.65	0.63	0.62	0.62
NZD/AUD	0.96	0.94	0.93	0.93	0.91	0.90
NZD/JPY	77.0	76.2	74.8	73.7	74.4	74.4
NZD/EUR	0.61	0.62	0.60	0.59	0.58	0.58
NZD/GBP	0.50	0.49	0.47	0.46	0.45	0.44
TWI	75.1	74.2	71.9	70.7	69.8	69.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 20 June 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.25%	2.25%	2.25%
30 Days	2.31%	2.28%	2.27%
60 Days	2.33%	2.36%	2.31%
90 Days	2.35%	2.39%	2.38%
2 Year Swap	2.29%	2.26%	2.29%
5 Year Swap	2.41%	2.43%	2.51%

NZ foreign currency mid-rates as at Monday 20 June 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7075	0.6923	0.6766
NZD/EUR	0.6244	0.6096	0.6038
NZD/GBP	0.4894	0.4793	0.4666
NZD/JPY	74.09	74.47	74.55
NZD/AUD	0.9520	0.9398	0.9369
TWI	75.44	74.02	73.06

# International forecasts

Economic Forecasts (Calendar Years)	2012	2013	2014	2015f	2016f	2017f
<b>Australia</b>						
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	1.7	2.1
Unemployment %	5.3	5.8	6.2	5.8	5.6	5.5
Current Account % GDP	-4.4	-3.4	-3.0	-4.6	-4.4	-4.5
<b>United States</b>						
Real GDP %yr	2.2	1.5	2.4	2.4	2.0	2.1
Consumer Prices %yr	2.1	1.5	1.6	0.1	1.1	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
<b>Japan</b>						
Real GDP %yr	1.7	1.4	0.0	0.5	0.7	0.7
<b>Euroland</b>						
Real GDP %yr	-0.9	-0.3	0.9	1.6	1.4	1.3
<b>United Kingdom</b>						
Real GDP %yr	1.2	2.2	2.9	2.2	1.9	2.1
<b>China</b>						
Real GDP %yr	7.7	7.7	7.3	6.9	6.5	6.2
<b>East Asia ex China</b>						
Real GDP %yr	4.6	4.2	4.1	3.7	3.9	4.1
<b>World</b>						
Real GDP %yr	3.5	3.3	3.4	3.1	3.3	3.5

Forecasts finalised 13 May 2016

Interest Rate Forecasts	Latest	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
<b>Australia</b>						
Cash	1.75	1.50	1.50	1.50	1.50	1.50
90 Day Bill	2.00	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.09	2.25	2.35	2.40	2.50	2.80
<b>International</b>						
Fed Funds	0.375	0.625	0.625	0.875	0.875	1.125
US 10 Year Bond	1.60	1.90	2.00	2.10	2.25	2.50
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40

Exchange Rate Forecasts	Latest	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17
AUD/USD	0.7392	0.72	0.70	0.68	0.68	0.69
USD/JPY	104.38	107	110	113	115	117
EUR/USD	1.1251	1.10	1.08	1.06	1.06	1.08
AUD/NZD	1.0487	1.06	1.08	1.08	1.10	1.11

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