Weekly Commentary

21 November 2016

The shaky isles

In the wee hours of last Monday morning, New Zealand was rocked by another significant and damaging earthquake. Centred near Kaikoura in North Canterbury, the 7.8 magnitude quake was one of the largest ever recorded in New Zealand and was widely felt throughout the country. The earthquake has caused significant damage and destruction in the surrounding area, and tragically resulted in the loss of two lives.

With the effects of the devastating Canterbury earthquakes of six years ago still playing out, questions have begun to be asked about the economic impact of last week's events. At the outset we should note it is very early days. Every earthquake is different in how it plays out geologically, and that's true of economic impacts as well. Aftershocks continue to ripple through the region, and there is a significant chance that some of these will be big earthquakes in their own right. There are no firm estimates yet on the extent of the damage and likely costs of repair, although the Prime Minister has commented that the costs could be at least $2billion. To put this in context, the Canterbury quakes resulted in around $30bn of repairs and rebuilding.

A key difference between the latest earthquakes and the Canterbury events is that due to the regional location of last week's quake, much of the damage will be related to road and rail infrastructure. That said, there has been some damage and disruption in Wellington as well. The capital's CBD was effectively shut down for at least a day, some schools were temporarily closed, and structural damage has been discovered in a handful of buildings in the area. Overall, though, the location of the epicentre means there will be less economic disruption compared to the Christchurch earthquakes.

One aspect of the economy that will be significantly disrupted, however, is transport and logistics. With State Highway One now impassable near Kaikoura, and the main trunk railway line out of operation in the region, companies will be forced to use alternative routes to deliver goods. In some cases, coastal shipping will be used instead of transporting by road or rail, while in other cases, goods may have to be trucked via the West Coast rather than the more direct eastern route. This could mean additional expense and delays for firms and, ultimately, consumers.

The other industry severely impacted by damaged roads and infrastructure in the region will be tourism. Kaikoura is a popular stop for domestic and international tourists touring the country, well known in particular for whale-watching opportunities. But with roads now impassable, visitors could well opt to transverse the South Island via the west coast instead of the east. Already there are some reports of this occurring. Assuming that visitors aren't put off coming to New Zealand entirely by last week's events, this could mean displacement of activity rather than a decline on a nationwide basis.

In response the anticipated hit to local economic activity, the government has announced an aid package worth $7.5m for small businesses in the affected region. Firms will be able to get a subsidy of up to $500 per week, per full time employee, to help with wage costs. The initial scheme is for eight weeks, but could be extended. The government has also announced a $5.2m package for primary industries, mostly aimed at the repair of non-insurable assets such as tracks, on-farm bridges and water infrastructure.

The shaky isles continued

While the focus for now is on immediate relief for affected homes and businesses, eventually it will shift to recovery. And as we've learnt from the Canterbury earthquakes, repair and rebuilding following these disasters takes a long time and can suffer setbacks. The Canterbury rebuild is only around 60% completed six years after the first event. Similarly, recovery and repair following last week's events will be measured in months and years. In part, the timeframe and cost of the repair will be affected by choices the government makes about whether to rebuild existing infrastructure or implement new routes in light of the changed landscape.

Reconstruction work in the region will add to pressure in the already-stretched construction sector. The bulk of work is likely to be required on infrastructure, which requires a slightly different skillset to commercial and residential construction. Nonetheless, more activity is likely to translate to more demand for resources and upward pressure on costs in the construction sector.

The government is well-placed to handle the repair bill from the most recent earthquakes. The buoyant domestic economy means the tax take has been running well ahead of forecasts, while operational spending has been undershooting. Up to now, the government appeared to be in a strong position to deliver personal tax cuts or additional spending ahead of next year's election. While those still can't be ruled out, spending on the recovery effort in the North Canterbury region will take priority.

There has been little financial market reaction to the earthquakes. As things stand now, we think it's unlikely that the RBNZ will feel the need to cut the OCR in response to these events. Recall that the 2010 Darfield earthquake and the 2013 Seddon quakes did not prompt any discussion of OCR cuts, as it was considered that the initial disruptions would be followed by a boost to growth as repairs and rebuilding got underway. The 50 basis point OCR cut after the 2011 Christchurch earthquake was mainly a pre-emptive move to shore up confidence, given the massive scale of the shock.

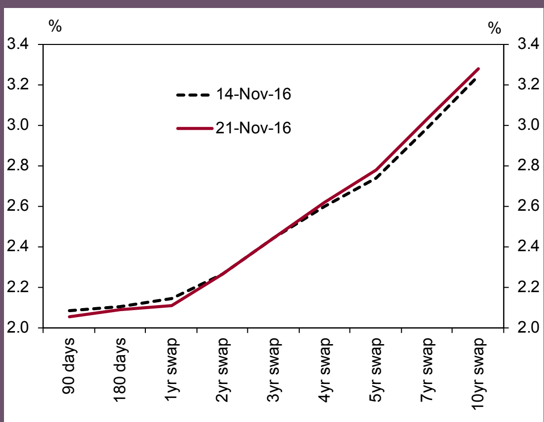
As it currently stands, the event calendar for the week ahead looks to be very light. Due to quake damage to its Wellington office, Statistics New Zealand has withdrawn its data release schedule until further notice.

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



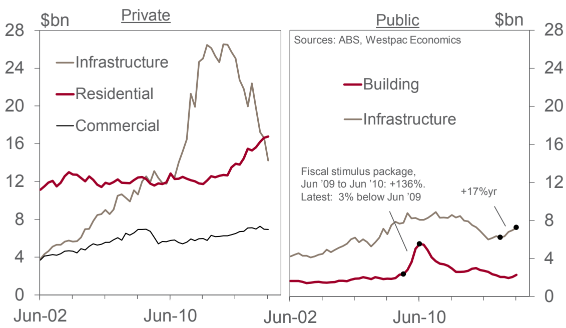
The week ahead

Aus Q3 construction work

Nov 23, Last: –3.7%, WBC f/c: –1.5%
Mkt f/c: –1.6%, Range: –3.5% to 5.2%

- Construction activity has been trending lower since 2012 as work on mining projects is completed. Total work fell in each of the past three years: –1%, –8% and –4%.
- For Q3, we expect construction activity to decline by 1.5%, bringing the year to date fall to 5.4%. Although, we anticipate a strengthening of activity ex private infrastructure, +1.3%qtr, to be 16% above the level of two years ago.
- Private construction activity falls by –2.8%qtr, –13%yr, with infrastructure down –8%qtr, –34%yr. New home building activity, having surged 32% over 2014 and 2015, is likely to make a more modest gain, f/c +1%.
- Public activity is expected to advance for a 5th consecutive quarter, +3.5%qr, +18%yr, led higher by infrastructure.

Construction work: divergent trends

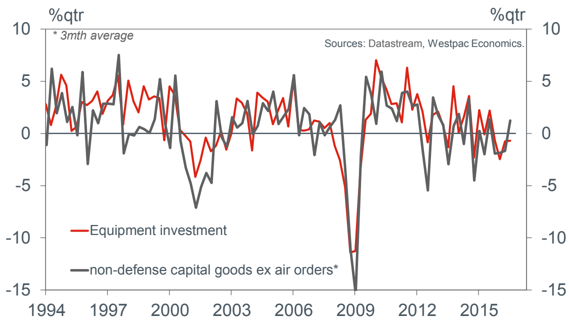


US Oct durable goods orders

Nov 23, Last: –0.3%, WBC: f/c +1.5%

- Weakness in business investment has become an entrenched theme in the US economy over the past two years. Growth in total business investment has slowed from a peak pace near 8%yr in Q3 2014 to –1.2%yr at Q3 2016. The deterioration has been broad based across structures and equipment.
- In recent months, durable goods orders and shipments have remained weak, implying that (at least for equipment spending), the absence of investment is set to persist. The average change in core orders (ex defence and aircraft) through Q3 was a gain of just 0.2% per month – though that is a modest improvement from Q2's –0.4%.
- Come October, we look for a near flat but positive core outcome around 0.3%. Headline orders are however likely to show a little more momentum, +1.5%, on aircraft demand.

US durable goods underlying trend weak



Data calendar

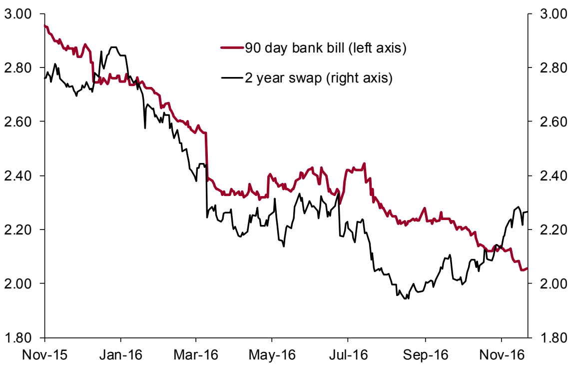
		Last	Market median	Westpac forecast	Risk/Comment
Mon 21					
Aus	RBA Head of Domestic Markets	–	–		Chris Aylmer, Securitisation Forum, Sydney, 10:25
Eur	ECB President Draghi	–	–	–	Presenting the ECB's annual reporting to the European parliament.
US	Oct Chicago Fed activity index	–0.14	–	–	Growth at trend.
Can	Sep wholesale trade	0.8%	–	–	Recent gains driven by the agricultural sector.
Tue 22					
Aus	RBA Assistant Governor Economic	–	–		Chris Kent, Australia's Economic Transition, State by State, 18:45.
Eur	Nov consumer confidence	–8.0	7.8	–	Broadly stable in recent months.
UK	Oct public sector borrowing £bn	10.1	6.7		Debt reduction target will be reassessed in the wake of the referendum.
US	Nov Richmond Fed index	–4	0	–	Mixed conditions across key manufacturing regions.
Wed 23					
Aus	Q3 construction work	–3.7%	–1.6%	–1.5%	Decline continues, led lower by mining infrastructure downturn.
Eur	Nov Markit manufacturing PMI (provisional)	53.5	53.2	–	Growth continues at solid pace...
	Nov Markit services PMI (provisional)	52.8	52.8	–	... albeit with material divergences between nations and sectors.
Ger	Nov Markit manufacturing PMI	55.0	54.7	–	A more positive tone has been apparent in...
	Nov Markit services PMI	54.2	54.0	–	... German surveys of late. Domestic & external demand supportive.
US	Oct durable goods orders	–0.3%	1.1%	1.5%	Core sales remain very weak; little interest in investment.
	Initial jobless claims	235k	–		At historically low level.
	Sep FHFA house prices	0.7%	0.5%	–	Price growth still robust.
	Nov Markit manufacturing PMI	53.4	53.5	–	Impact of USD will be key theme in coming months.
	Oct new home sales	3.1%	–0.9%	–1.5%	Sales have lost momentum; higher rates casts doubt over outlook.
	Nov Uni. of Michigan sentiment	91.6	91.6	–	Inflation expectations will be keenly watched in coming months.
	FOMC minutes	–	–	–	Inside word on Committee's views on policy/outlook.
Thu 24					
Ger	Nov IFO business climate survey	110.5	110.5	–	Expectations continue to lag current conditions.
US	Thanksgiving	–	–	–	Public holiday. Black Friday sales a test of consumer mood.
Fri 25					
UK	Q3 GDP	0.5%	–	0.5%	Growth has remained resilient since the referendum.
US	Oct wholesale inventories	0.1%	0.3%	–	Inventories unlikely to see material run higher.
	Nov Markt service PMI	54.8	54.8	–	Service sector in good shape; implication of election results?

New Zealand forecasts

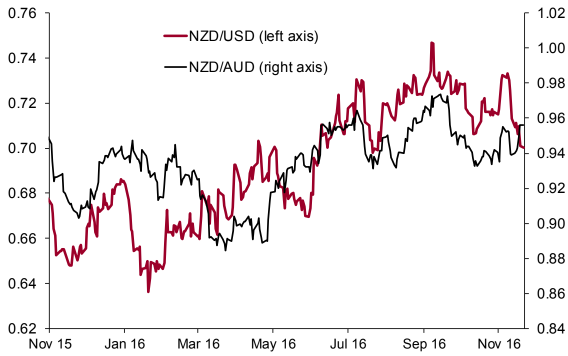
Economic Forecasts	March years				Calendar years			
% change	2015	2016	2017f	2018f	2014	2015	2016f	2017f
GDP (Production) ann avg	3.6	2.5	3.5	2.9	3.8	2.5	3.4	3.1
Employment	3.2	2.0	3.9	1.6	3.6	1.4	4.7	2.0
Unemployment Rate % s.a.	5.4	5.2	5.0	4.5	5.5	5.0	5.1	4.6
CPI	0.3	0.4	1.2	1.6	0.8	0.1	1.0	1.5
Current Account Balance % of GDP	-3.5	-3.1	-3.3	-3.8	-3.2	-3.4	-3.1	-3.9

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	0.73	0.73	0.71	0.70	0.68	0.66
NZD/AUD	0.95	0.96	0.96	0.96	0.94	0.94
NZD/JPY	77.4	78.4	78.1	77.0	76.2	75.2
NZD/EUR	0.67	0.68	0.68	0.67	0.67	0.65
NZD/GBP	0.59	0.59	0.58	0.57	0.56	0.55
TWI	78.9	79.2	78.6	78.1	76.7	75.4

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 21 November 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	2.00%	2.00%
30 Days	1.94%	2.08%	2.13%
60 Days	2.00%	2.11%	2.13%
90 Days	2.06%	2.13%	2.13%
2 Year Swap	2.27%	2.21%	2.08%
5 Year Swap	2.78%	2.51%	2.31%

NZ foreign currency mid-rates as at Monday 21 November 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7004	0.7323	0.7130
NZD/EUR	0.6605	0.6589	0.6557
NZD/GBP	0.5675	0.5850	0.5835
NZD/JPY	77.70	75.74	74.31
NZD/AUD	0.9560	0.9543	0.9382
TWI	77.45	78.58	77.03

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	1.76	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.73	2.65	2.70	2.75	2.80	2.90	2.95	3.00
International								
Fed Funds	0.375	0.625	0.625	0.875	0.875	1.125	1.125	1.375
US 10 Year Bond	2.33	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	0.7394	0.77	0.76	0.74	0.73	0.72	0.72	0.70
USD/JPY	110.61	106	108	110	110	112	114	116
EUR/USD	1.0603	1.09	1.07	1.05	1.04	1.02	1.01	1.00
AUD/NZD	1.0537	1.07	1.07	1.07	1.09	1.11	1.09	1.09

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