

# Weekly Commentary

27 June 2016



## Comings and goings

Friday's Brexit vote came from left field for markets. While the risk that Britain would vote to leave the EU had been on the horizon, it wasn't until the votes starting being counted that that risk started to become a reality and markets really took fright. Meanwhile in New Zealand, net migration data hinted the tide might be about to turn on the migration front, and consumer confidence weakened as households became more pessimistic about the outlook for the New Zealand economy.

British voters went to the polls on Friday NZ time, in a referendum asking whether or not the UK should remain in the EU. In the end they voted 51.9% to 48.1% to leave. The result surprised market and, it seems, a significant proportion of the British public. In the immediate aftermath markets reacted sharply, sending the pound down to its lowest level in over 30 years, equity markets falling and interest rate markets reducing the chance of rate hikes/increasing the chance of cuts around the world.

While the referendum is not legally binding (exit from the EU still requires a Parliamentary vote) the current expectation is that Britain will kick off the exit process once a new Prime Minister is decided (current PM David Cameron resigned in the wake of the historic exit vote Friday NZ time). This is likely to be in the Northern Hemisphere spring.

Any eventual exit will, however, take time. Once triggered, the UK has two years to negotiate the exact details of exit and establish new agreements on the likes of trade. So we face a protracted period of uncertainty around business and trade arrangements in Europe.

New Zealand is likely to feel the impact of "Brexit" most immediately through our exposure to international financial markets. To date, the NZ dollar and NZ interest rates have fallen, and credit spreads have risen (which will push bank funding costs higher).

At a slightly longer horizon, uncertainty is likely to weigh on growth prospects for the UK economy. Combined

with the weaker pound against the New Zealand dollar, this could weigh on demand for New Zealand goods and services exports. The UK takes around 3% of New Zealand's merchandise exports, valued at around \$1.7bn and around 9% of service exports (mainly tourism, valued at around \$1.5bn).

Even further down the track, attention is likely to turn to the renegotiation of trade agreements with the UK. At this stage any potential impact remains very uncertain, although it's unlikely to be positive. It's difficult to envision New Zealand being able to negotiate considerably more favourable arrangements given the swing toward protectionism in recent times.

While it is very early days yet, in our view Brexit has upped the chances of an August rate cut from the RBNZ. Markets pricing has moved decidedly in favour of an OCR cut to 2% in August (and a chance of the OCR falling below this).

Before Brexit stole the headlines late in the week, New Zealand net migration and consumer confidence data were released. Over the last four years, net migration has turned from a net outflow of around 3,000 people to a record net inflow of almost 68,500 – 1.5% of New Zealand's population. But recent data shows signs that the annual net flow of migrants is close to peaking. Seasonally adjusted data for May, out last week, showed a net 5,500 more people arriving in New Zealand in the month on a Permanent and Long Term (PLT) basis (i.e. intending to live in New Zealand for a year or more). That's about flat

# Comings and goings continued

compared to April, but noticeably below the 6,000 per month numbers from late last year. What's more, the number of people arriving on student and work visas has started to decline in recent months. We expect net migration to continue falling as those who arrived in recent years on student and temporary work visas begin to depart.

It's also important to remember that about half of the increase in net migration is due to the choices of New Zealanders. And in particular the choices New Zealanders make about whether or not to move to Australia (and in some cases whether to move back). The biggest driver of this decision is relative employment prospects in the two countries. For some time now, New Zealand's labour market has provided better prospects than Australia's. But going forward, we expect the Australian labour market to once again appear more attractive than New Zealand, encouraging people to shift to Australia.

Combined, this is likely to see net migration slow from its current exceptionally high levels down to more normal levels of around 20,000 p.a. by 2019.

New Zealand's headline GDP growth has undoubtedly been bolstered by migration-driven population growth at present. A bigger population adds to demand for goods and services of all persuasions. This backdrop is leading to the current period of growth being interpreted quite differently by households and businesses. For firms, strong population growth has clear advantages. Restaurants will see more bookings, cinemas will sell more tickets, more people will be buying cars or doing their weekly shop at the supermarket – the list goes on. What's more, strong population growth has boosted labour force participation,

ensuring a growing pool of workers is available to work, in turn keeping a lid on wage and salary costs. This has helped business confidence remain elevated.

In contrast, individual households are likely to be finding things a lot tougher. Per capita GDP growth has been very weak, falling to close to 0.4% in annual terms in the March quarter. In other words while the size of the NZ economic "pie" has been increasing, individuals' slices of that pie have hardly grown at all.

In part, this will reflect that some parts of the economy are feeling strong headwinds from low export earnings and this is weighing on household earnings. But that's not all that's going on. Our own Westpac McDermott Miller survey of consumer confidence, released last week, showed confidence falling below its long run average in the June quarter. There was a particularly marked deterioration in households' assessment of prospects for the economy over the next five years. That's a continuation of the trend that we've seen in this series in recent years. However, it looks like the June quarter result may have been exacerbated by a major newspaper running an exposé on household debt in the middle of the survey period. This may have been weighing on the mind of respondents when polled.

Strong population growth should help keep some spark in the consumer sector over the next year or so. But slowing population growth and falling confidence could weigh on household consumption at a longer horizon. In addition, the continued ramp up in household debt levels will also eventually act as a brake on spending. These are key reasons we expect growth to slow over the second half of the decade.

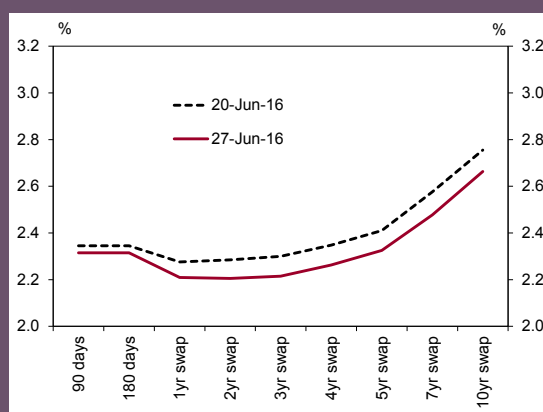
## Fixed vs Floating for mortgages

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



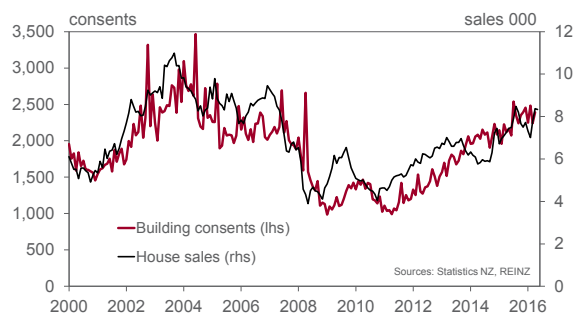
# The week ahead

## NZ May building consents

Jun 30, Last: 6.6%, Westpac f/c: 1.0%

- The timing of Easter explained much of the big swings in national residential consent activity over the last two months.
- We expect a small rise in building activity this month, although there are some signs that consent activity in Auckland may be slowing as we await the finalised Auckland Unitary Plan, which could allow more intensive development of some areas in the city.
- Canterbury residential consents last month were buoyed by a large number of retirement village units, so we expect numbers there to fall sharply this month.
- Strength in the Hamilton and Tauranga residential markets will likely continue in the latest data.

## NZ housing activity



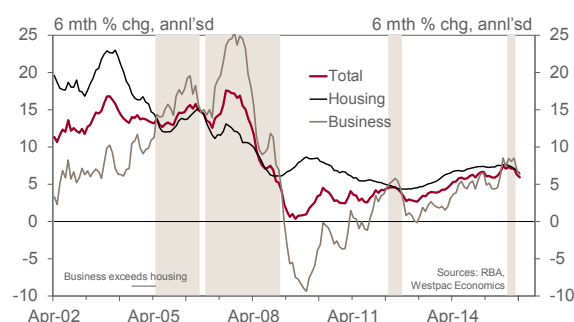
## Aus May private sector credit

Jun 30, Last: 0.5%, WBC f/c: 0.4%

Mkt f/c: 0.5%, Range: 0.4% to 0.7%

- Ahead of the RBA's May rate cut, credit to the private sector had lost a little momentum. Lending conditions had tightened somewhat and mortgage rates moved higher over the second half of 2015.
- In 2016 to date, monthly gains in credit have averaged 0.5%, moderating from 0.65% for the September quarter 2015. For May, we anticipate a 0.4% rise in total credit, a tick down on the 0.5% outcome for April.
- Housing credit growth has slowed. The April outcome was 0.45%, 7.0%yr, which the saw 3mth annualised pace moderate to 6.0%, down from 7.7% in October. Business credit, which rose 7.4% over the past year, is volatile month-to-month as commercial finance softens recently. Following a robust 0.8% gain in April we anticipated a more modest rise in May.

## Credit momentum

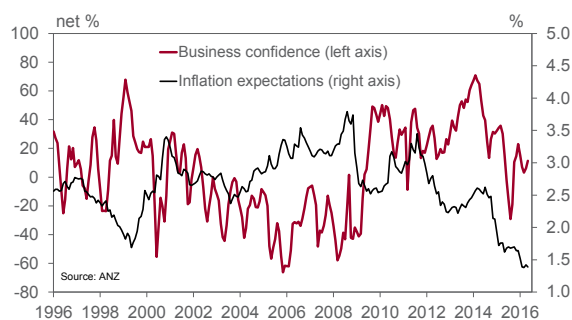


## NZ May business confidence

Jun 30, Last: 11.3

- May's business confidence survey painted a familiar picture of moderate growth but limited pressure on prices. General sentiment rose across all of the major industries. Not surprisingly, agriculture remained the most downbeat, while construction and services were the most optimistic.
- Recently we've seen consumer confidence pull back in response to concerns about debt and housing affordability. It will be interesting to see if such concerns have also affected business confidence, especially in the retail sector.
- We'll also be keeping a close eye on the survey's inflation gauges. Inflation expectations are still a key concern for the RBNZ. And with recent developments pointing to a firming in actual inflation, we'll be watching to see if price setting behaviour by businesses has responded.

## NZ business confidence and inflation expectations



## Chn Jun Westpac-MNI Consumer Sentiment

Jun 29, Last: 114.2

- The Westpac MNI China Consumer Sentiment Indicator fell 3.1% to 114.2 in May from 117.8 in April. Chinese consumers appear less convinced about prospects for improvement in the year ahead with family finances still under pressure and the hoped for business recovery continuing to disappoint.
- The June survey - in the field in the first half of the month - follows another period of relative calm for markets but with a mixed tone on the Chinese economy with continued weakness in the industrial sector but a housing upturn strengthening, but still very uneven across geographies.

## Westpac MNI China CSI



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# The week ahead

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## May US personal consumption and income

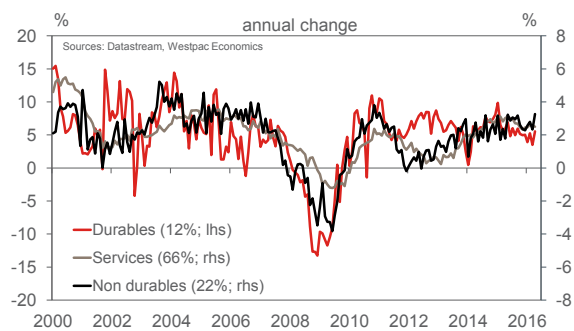
Jun 29, personal income Last: 0.4%, WBC 0.3%

Jun 29, personal consumption Last: 1.0%, WBC 0.4%

Jun 29, PCE deflator Last: 0.3%, WBC 0.2%

- Personal income growth has, by and large, become more resilient in 2016, with three 0.4% gains and one 0.1% result reported to April. This trend is expected to continue in May, with another solid 0.4% outcome.
- After a weak Q1, consumer spending bounced back in April, rising 1.0%. This was partly due to higher gasoline prices but also gains for autos and core spending. Retail sales data points to a subsequent moderation to around 0.4% in May. Services spending (not included in retail sales) should be supportive.
- The US inflation story remains one of convergence, with headline inflation slowly tending back to the core rate. At April, annual headline inflation was 1.1%/yr, while core stood at 1.6%/yr. In May, a 0.2% gain is expected for both measures.

## Durables demand has softened; services robust



# Data calendar

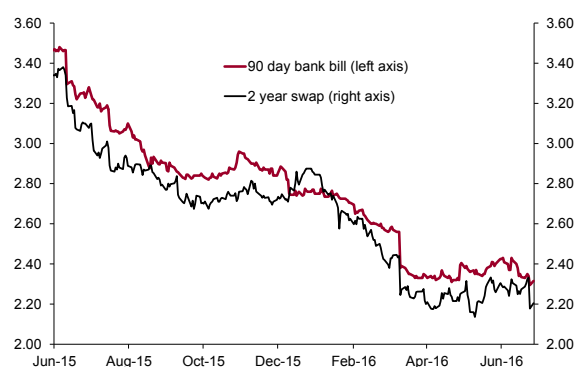
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 27</b>					
<b>NZ</b>	May trade balance, \$mn	292	164	70	Rising oil price to lift import bill.
<b>Chn</b>	May industrial profits %yr	4.2%	-	-	Soft external and domestic demand crimp profits.
<b>Eur</b>	May M3 money supply %yr	4.6%	-	-	Credit data also due.
<b>US</b>	Jun Markit services PMI (provisional)	51.3	51.9	-	USD also impacts services; but domestic demand supportive.
	Jun Dallas Fed manufacturing activity	-20.8	-14.5	-	Regional surveys have been rebounding.
<b>Tue 28</b>					
<b>US</b>	Q1 GDP (annualised, final)	0.8%	1.0%	1.0%	Third estimate; small upward revision likely.
	Mar S&P/C-S 20 city house prices	0.9%	0.5%	-	Annual growth robust at 5.5%/yr.
	Jun consumer confidence index	92.6	93.1	-	Conference board measure.
	Jun Richmond Fed manufacturing index	-1	2	-	Earlier gains have reversed; points to modest activity.
<b>Wed 29</b>					
<b>Chn</b>	Jun Westpac-MNI China Consumer Sent.	114.2	-	-	Eased back in May after Q1 mini-rally. Still below long run avg of 119.8.
<b>Eur</b>	May economic confidence	104.7	104.7	-	Confidence critical to activity outlook.
	May consumer confidence (final)	-7.0	-7.3	-	Remains above average.
	May business climate indicator	0.26	-	-	Current conditions robust; but confidence lacking.
<b>Ger</b>	Jun CPI (flash) %yr	0.0%	0.3%	-	Some momentum beginning to be seen in Germany.
<b>UK</b>	May net mortgage lending, £bn	0.3	-	-	Rebound expected after last month's stamp duty related decline.
	Mortgage approvals	66.3k	-	-	Has levelled off in recent months.
	Jun Nationwide house prices	0.2%	-	-	House price growth has levelled off, expected to remain modest.
<b>US</b>	May personal income	0.4%	0.3%	0.3%	Incomes are receiving greater support from wages.
	May personal spending	1.0%	0.3%	0.4%	Spending likely to see moderate gain in May after May bounce...
	May PCE deflator	0.3%	0.2%	0.2%	Annual headline inflation tending (slowly) to core rate.
	Fed Chair Yellen	-	-	-	Participates in panel at ECB conference.
	Fedspeak	-	-	-	Powell speaks in Chicago.
	May pending home sales	5.1%	-1.0%	-	Momentum has slowed; lead for existing home sales.
<b>Thu 30</b>					
<b>NZ</b>	May building permits	6.6%	-	1.0%	Modest growth expected as last month's bump in Canterbury falls out.
	Jun business confidence	11.3	-	-	Points to moderate growth, but limited pressure on prices.
<b>Aus</b>	May private sector credit	0.5%	0.5%	0.4%	Housing credit has slowed, business volatile month to month.
<b>Chn</b>	Q1 current account balance	48.1	-	-	Dated data, but provides a fuller picture of external flows.
<b>Eur</b>	Jun CPI (flash) %yr	-0.1%	flat	-	ECB's hoped-for inflaion uptrend still yet to materialise.
<b>UK</b>	May GfK consumer confidence	-1	-	-	Brexit uncertainty could weigh on confidence.
	GDP (final)	0.4%	-	0.4%	Production and construction drags, Brexit uncertainty dampening capex.
<b>US</b>	Initial jobless claims	259k	-	-	Claims remain at historically low levels.
	Jun Chicago PMI	49.3	50.5	-	Points to subdued manufacturing conditions.
	Fedspeak	-	-	-	Bullard speaks in London.
<b>Fri 1</b>					
<b>Aus</b>	Jun AiG PMI	51.0	-	-	Manufacturing index > 50, boosted by housing upswing & lower AUD.
	Jun CoreLogic RP Data home value index	1.6%	-	0.3%	Surprising burst in Apr-May looks to have eased in June.
<b>Chn</b>	Jun manufacturing PMI	50.1	-	-	The official NBS measure; outlook remains poor.
	Jun non-manufacturing PMI	53.1	-	-	Services stronger than manufacturing, but well below average.
	Jun Caixin China PMI	49.2	-	-	Has a greater focus on large exporters, so weaker at present.
<b>Eur</b>	Jun Markit manufacturing PMI (final)	52.6	52.6	-	Soft global growth the sector's prime concern.
	May unemployment rate	10.2%	10.1%	-	Very (Very) slow progress.
<b>Ger</b>	Jun Markit manufacturing PMI (final)	54.4	-	-	Supported by domestic demand, in Germany and across Euro Area.
<b>UK</b>	Jun Markit manufacturing PMI	50.1	-	-	Manufacturing activity has weakened in the face of soft global demand.
<b>US</b>	Jun Markit manufacturing PMI (final)	51.4	-	-	USD continues to weigh on sector.
	Jun ISM manufacturing	51.3	51.5	-	ISM and Markit measures telling same story.
	May construction spending	-1.8%	0.7%	-	Investment set to remain weak.
<b>Sat 2</b>					
<b>Aus</b>	Federal Election	-	-	-	Bookies favour government return, polls say it is too close to call.

# New Zealand forecasts

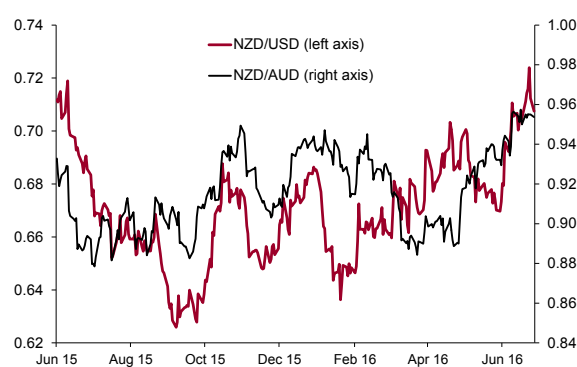
Economic Growth Forecasts	March years				Calendar years				
	% change	2014	2015	2016f	2017f	2014	2015	2016f	2017f
GDP (Production) ann avg		2.7	3.6	2.4	2.9	3.7	2.5	2.9	2.7
Employment		3.8	3.2	2.0	2.5	3.6	1.4	2.9	2.4
Unemployment Rate % s.a.		6.0	5.8	5.7	5.4	5.8	5.4	5.7	5.0
CPI		1.5	0.3	0.4	1.6	0.8	0.1	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	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day bill	2.20	2.20	2.20	2.20	2.20	2.20
2 Year Swap	2.20	2.20	2.30	2.30	2.30	2.30
5 Year Swap	2.50	2.60	2.70	2.80	2.80	2.80
10 Year Bond	2.60	2.70	2.80	2.90	3.00	3.10
NZD/USD	0.68	0.65	0.63	0.62	0.62	0.62
NZD/AUD	0.94	0.93	0.93	0.91	0.90	0.89
NZD/JPY	72.8	71.5	71.2	71.3	72.5	73.2
NZD/EUR	0.62	0.60	0.59	0.58	0.58	0.57
NZD/GBP	0.49	0.47	0.46	0.45	0.44	0.42
TWI	73.7	71.5	70.4	69.4	68.9	68.3

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 27 June 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.25%	2.25%	2.25%
30 Days	2.31%	2.31%	2.25%
60 Days	2.33%	2.35%	2.33%
90 Days	2.32%	2.42%	2.40%
2 Year Swap	2.21%	2.31%	2.27%
5 Year Swap	2.33%	2.48%	2.47%

NZ foreign currency mid-rates as at Monday 27 June 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7074	0.7053	0.6693
NZD/EUR	0.6421	0.6269	0.6022
NZD/GBP	0.5267	0.4943	0.4582
NZD/JPY	71.82	75.36	73.90
NZD/AUD	0.9537	0.9562	0.9323
TWI	75.92	75.55	72.42

# International forecasts

Economic Forecasts (Calendar Years)	2012	2013	2014	2015f	2016f	2017f
<b>Australia</b>						
Real GDP % yr	3.5	2.0	2.7	2.5	3.0	3.0
CPI inflation % annual	2.2	2.7	1.7	1.7	1.9	1.7
Unemployment %	5.3	5.8	6.2	5.8	5.6	5.4
Current Account % GDP	-4.4	-3.4	-3.0	-4.8	-4.7	-4.7
<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	4.9	4.7
Current Account %GDP	-2.9	-2.3	-2.3	-2.4	-2.4	-2.4
<b>Japan</b>						
Real GDP %yr	1.7	1.4	0.0	0.5	0.7	0.5
<b>Euroland</b>						
Real GDP %yr	-0.9	-0.3	0.9	1.6	1.6	1.4
<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	3.8	4.1
<b>World</b>						
Real GDP %yr	3.5	3.3	3.4	3.1	3.3	3.5

Forecasts finalised 17 June 2016

Interest Rate Forecasts	Latest	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
<b>Australia</b>						
Cash	1.75	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.94	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.03	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	1.48	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	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
AUD/USD	0.7330	0.72	0.70	0.68	0.68	0.69
USD/JPY	101.55	107	110	113	115	117
EUR/USD	1.0960	1.10	1.08	1.06	1.06	1.08
AUD/NZD	1.0470	1.06	1.08	1.08	1.10	1.11

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