

Weekly Commentary

29 March 2016



Spotlight on household spending

This week we take a closer look at the outlook for household spending, which was a key driver of economic growth over the past year. Looking across several gauges of household sector conditions, we expect that households' spending growth will pick up to a healthy 3.4% this year (up from 2.5% in 2015).

This is positive news for retailers. However, much of this growth is being underpinned by growth in the population and low prices. In addition, there are some downside risks.

Household spending accounts for around 60% of economic activity and over the past year it has been growing at a solid pace. This has meant that overall economic growth in New Zealand has remained firm despite challenging conditions in parts of the external sector and in rural regions.

With the economy continuing to face strong headwinds from offshore, conditions in externally focused parts of the economy are expected to remain subdued for some time. This raises questions about whether the recent strength in domestic demand can be sustained. With this in mind, the latest Westpac McDermott Miller consumer confidence survey provided some interesting food for thought.

New Zealand households have become increasingly nervous about where the economy is heading. The latest consumer confidence report revealed that the proportion of households expecting good economic times over the next five years has dropped to its lowest level since 1991. This follows a barrage of bad news in the early part of this year. Much of this was related to signs that conditions in the global economy have deteriorated, signalling tougher times ahead for many in the export sector. There's also been particularly worrying news for those in the dairying sector with continued declines in prices and Fonterra again revising down its forecast payout for this season.

But while households have become more nervous about the general economic outlook, they remain more upbeat about their personal economic situation. In fact, the proportion of households who expect to be better off financially in a year's time has actually picked up.

Importantly, households remain in the mood to spend, with spending on electronic cards chugging along at a healthy annual rate of 5% in the early part of the year. A growing proportion of households are reporting that they have increased their spending on entertainment and eating out. In addition, the number of households that think it's currently a good time to purchase a major household item has continued to climb.

Helping to support households' appetite for spending has been growth in their purchasing power. That may seem a little surprising given that nominal wage growth has lingered at low levels since the financial crisis. However, with consumer price inflation running at the lowest rate we've seen in well over a decade, the limited wage increases households have received have been stretching much further. For instance, over the coming year lower petrol prices will put around \$900m back into households pockets compared to 2015. Adjusting for changes in the cost of living, real wage growth is actually around a 15 year high.

Also boosting households' purchasing power have been low borrowing rates, which have made it very attractive for households to purchase larger items. Indeed, when asked what they would do with a cash windfall, households

Spotlight on household spending continued

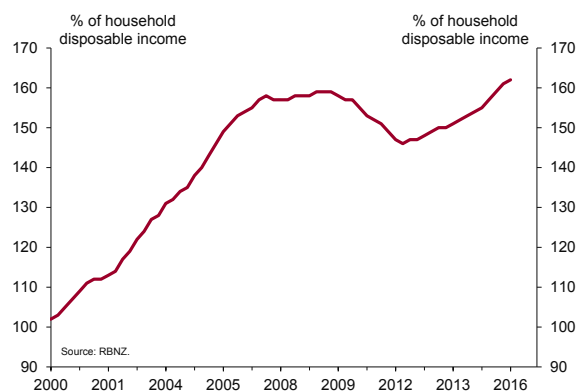
reported that they are much more likely to spend it than to pay down debt. In contrast, the proportion of households that indicated that they would use a cash windfall to pay down debt is only just above record lows.

Reinforcing the above factors has been continued strong growth in the economy's demand base, mainly as a result of record levels of net immigration. On an annual basis net immigration rose to 67,390 in February, and it now looks likely that it will surpass 70,000 by June. That would take population growth to its fastest pace since 1974.

For businesses, growth in the economy's demand base is resulting in more bodies in stores and is providing a buffer from the headwinds hitting the economy. However, for individual households, the economic environment will feel quite different. Indeed, per capita economic growth is not much above zero. Population growth is also boosting the supply side of the economy, limiting wage and inflation pressures. Consequently, the Reserve Bank is reducing the OCR at a time of reasonable GDP growth.

While there are a range of factors supporting spending, there are some offsets. Two of the most important are the drag from lower commodity prices and the slowdown in the housing market. With regards to commodity prices, falls in the prices of some of our key exports (particularly for dairy products) are already weighing on incomes in rural communities. Our recent discussions in rural areas have highlighted that this has passed through to reductions in spending in associated industries, and it's likely that will be felt through the economy more widely. Also dampening spending has been a slowdown in Auckland house price

Household financial liabilities (incl. rental properties)



inflation following changes in taxation and investment policies last year. While markets in other parts of the country have picked up, the slowdown in Auckland has seen nationwide house price inflation slow. And with housing market activity closely associated with household spending, this is likely to have at least some dampening impact.

While spending appetites remain healthy, one area to keep an eye on is household debt levels. Following the financial crisis, we saw a period of balance sheet consolidation among households. But since 2012, households' financial liabilities have again been climbing. And by the end of 2015, they had reached 162% of households' annual disposable income (including debt on investment housing). That's higher than pre-financial crisis peaks, with much of this increase in debt secured on housing.

Fixed vs Floating for mortgages

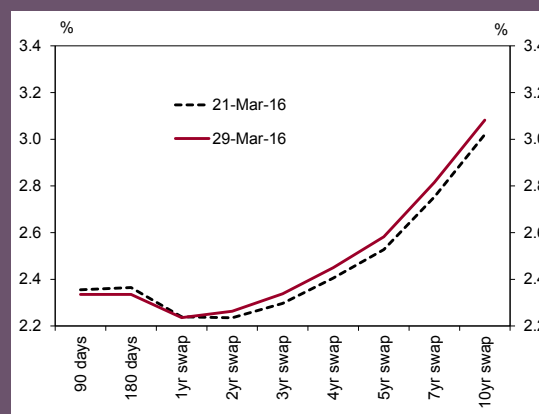
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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



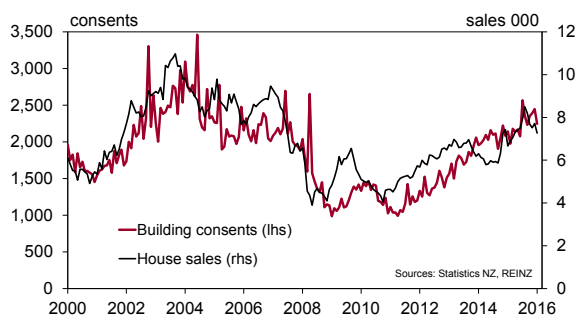
The week ahead

NZ Feb building consents

Mar 30, Last: -8.2%, Westpac f/c: 5.0%

- Seasonally-adjusted monthly residential building consents fell sharply in January. However, we expect a significant rebound in consents this month, undoing a fair portion of the slowdown last month.
- Canterbury residential consent numbers were especially weak in January, down 30%, and we expect some of that decline to unwind.
- Non-residential building consent values were also down quite sharply in January, and we again expect some upward correction in the trend.

NZ housing activity

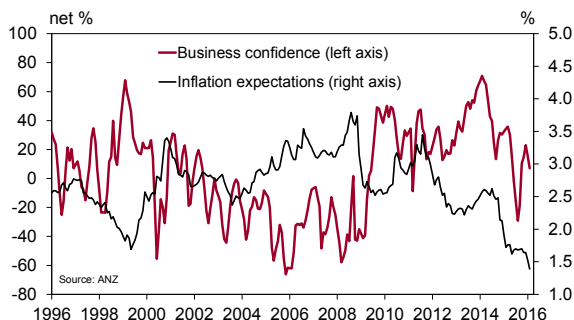


NZ Mar business confidence

Mar 31, Last: 7.1

- After a modest rebound at the end of 2015, business confidence fell sharply again in the early part of this year. The agricultural sector was particularly downbeat as a result of the fall in dairy prices, and the latest cut to the farmgate milk price in early March is likely to have soured sentiment further.
- The RBNZ's unexpected OCR cut came in the midst of the survey period. As such, its impact on confidence may be more apparent in the April survey.
- Expected inflation for the year ahead fell to a record low in the February survey. Falling inflation expectations have become a key concern for the RBNZ, although this measure tends to carry less weight due to its short time horizon.

NZ business confidence and inflation expectations

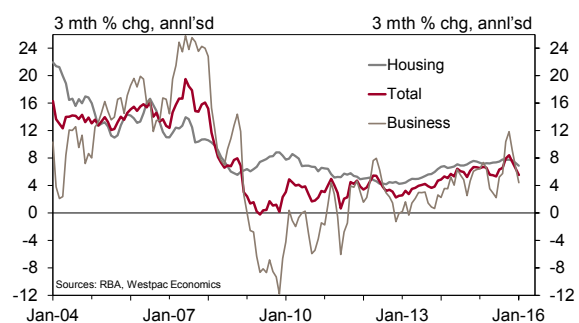


Aus Feb private sector credit

Mar 31, Last: 0.5%, WBC f/c: 0.4%, Mkt f/c: 0.5%, Range: 0.4% to 0.7%

- Credit to the private sector has lost a little momentum at the turn of the year as lending conditions have tightened. For February, we expect credit to grow by 0.4%, following gains of 0.4%, 0.5% and 0.5%. This contrasts to results of either 0.6% or 0.7% over the previous four months.
- Housing has cooled as lending conditions have tightened, including a rise in mortgage rates. In January, housing credit grew by 0.5%, 7.3%/yr, moderating from a 7.8% annualised pace over the three months to October.
- Business credit advanced by 0.9% per over the four months to October. These outcomes were inflated by valuation effects associated with a falling dollar. This has given way to gains of 0.5% and 0.6% over the past two months. Softer commercial finance of late points to the risk of a further moderation.

Credit momentum

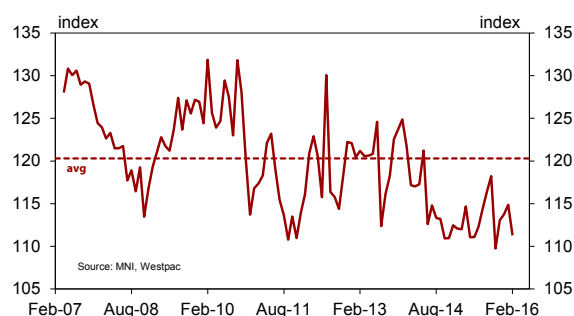


Chn Mar Westpac-MNI Consumer Sentiment

Mar 30, Last: 111.3

- The Westpac MNI China Consumer Sentiment Indicator fell 3.6pts to 111.3 in Feb, retracing most of the gains over Nov-Jan to be just 1.4% above the 9yr low recorded in Oct last year. This was a disappointing result after previous reads had been suggesting confidence was seeing a sustained improvement despite renewed turmoil in financial markets. Weak business conditions and elevated job-loss fears were again weighing on the consumer mood with a notable weakening in spending intentions and an uneven picture around real estate.
- The post Lunar New Year period has been more settled although the National People's Congress at the start of the month announced a lower growth target (6½-7%) and acknowledged 'downward pressure on the economy was growing'. With consumers the main driving force for growth at the moment, sentiment shifts are taking on more importance.

Westpac MNI China CSI



The week ahead

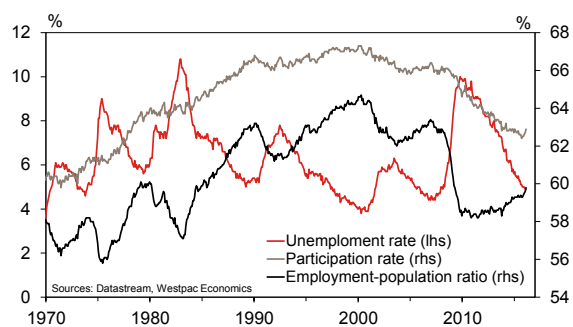
US Mar non farm payrolls & unemployment

Nonfarm payrolls Apr 1, Last: 242k, WBC 210k

Unemployment rate Apr 1, Last: 4.9%, WBC 4.9%

- Nonfarm payrolls surprised (again) to the upside in Feb, rising by 242k to leave the 3-mth average at 228k.
- Household employment was also strong in the month. On both measures, employment is up 1.9%yr, well head of growth in the labour force of 1.2%yr at Feb – despite a rise in participation.
- While the stronger USD and continued weakness in the energy sector is impacting activity and labour demand, sectors dependent on domestic demand continues to fare well. Come Mar, we expect another robust gain in jobs, circa 210k; and, while not our call, a 4.8% unemployment rate is a risk.

Employment gains sees unemp' rate trend down



Data calendar

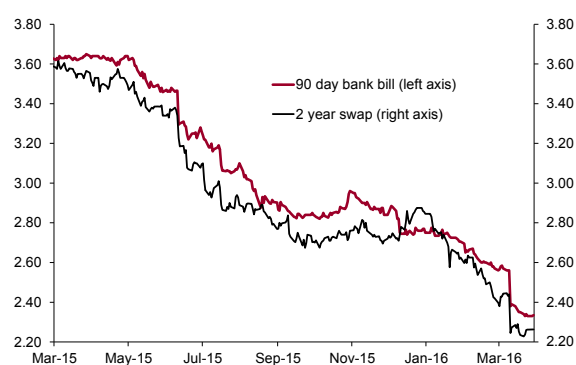
		Last	Market median	Westpac forecast	Risk/Comment
Tue 29					
Eur	Feb M3 money supply %yr	5.0%	4.9%	-	Credit figures also due.
US	Jan S&P/CS home price index	0.80%	0.70%	-	Annual price growth maintaining an annual pace above 5%.
	Mar consumer confidence index	92.2	94.0	-	Remains a little above average.
Wed 30					
NZ	Feb building permits	-8.2%	-	5.0%	Some recovery after last month's sharp pull back.
Chn	Mar Westpac-MNI Consumer Sentiment	111.3	-	-	Consumer now the main driver of growth in China.
Eur	Mar economic confidence	-9.7	-	-	The ECB will remain critical to mood...
	Mar business climate indicator	0.07	-	-	... amongst businesses..
	Mar consumer confidence	-8.8	-	-	... and households, with both sectors' spending critical to outlook.
Ger	Mar CPI	0.4%	0.7%	-	Despite historically low unemployment, inflation pressures absent.
US	Mar ADP employment change, '000	214	198	-	Employment growth remains strong,
	Fedspeak	-	-	-	Evans speaks on the economy and policy.
Thu 31					
NZ	Mar ANZBO business confidence	7.1	-	-	Fell sharply last month on global activity concerns.
Aus	Feb private sector credit	0.5%	0.5%	0.4%	Housing is slowing & expect more modest gain in business.
Chn	Q4 current account balance	\$84.3bn	-	-	Greater detail on trade and financial flows.
Eur	Mar CPI %yr	-0.2%	flat	-	Deflation/disinflation the focus in Europe.
UK	Mar GfK consumer sentiment	flat	-1	-	Brexit concerns and global conditions are weighing on confidence.
	Feb net mortgage lending £bn	3.7b	-	-	Low mortgage rates have been boosting demand.
	Feb mortgage approvals	74.6k	-	-	Has been increasing, supported by positive housing market trends.
	Q4 GDP	0.5%	0.5%	0.5%	Domestic demand offsetting the drag from external conditions.
US	Initial jobless claims	-	-	-	Claims at historically low level.
	Mar ISM Milwaukee	55.2	-	-	Several regional surveys point to improving manufacturing conditions.
	Mar Chicago PMI	47.6	49.8	-	Manufacturing weak across the US (and the world for that matter).
	Fedspeak	-	-	-	Dudley speaks on financial crises in Lexington.
Fri 1					
Aus	Mar AiG PMI	53.5	-	-	In Feb, up 2pts, highest level since Jul '10, on construction & lower AUD.
	Mar CoreLogic RP Data home value index	0.5%	-	0.2%	Price growth has stabilised after sharp slowdown in 2015 H2.
Chn	Mar manufacturing PMI	49.0	49.5	-	Disappointed in Feb...
	Mar non-manufacturing PMI	52.7	-	-	... with services also showing impact of external demand ...
	Mar Caixin China PMI	48.0	48.5	-	... new orders pointing to further declines, albeit not accelerating.
Eur	Mar Markit manufacturing PMI	51.4	-	-	Europe is also being impacted by same global forces.
	Feb unemployment rate	10.3%	10.3%	-	Improving ever so slowly.
Ger	Mar Markit manufacturing PMI	50.4	-	-	Weak demand for manufacturers globally limits new capex needs.
UK	Mar Markit manufacturing PMI	50.8	51.4	-	External headwinds are dampening manufacturing activity.
	Mar Nationwide house prices	0.3%	-	-	Price growth remains firm, supported by low interest rates.
US	Mar non-farm payrolls, '000	242	202	210	Yet to slow, as per business surveys.
	Mar unemployment rate	4.9%	4.9%	4.9%	Unemployment on the cusp of edging lower.
	Mar Markit manufacturing PMI	51.4	-	-	Markit measure more out of sync ...
	Mar ISM manufacturing	49.5	50.4	-	... with ISM, which is likely better read given USD and energy.
	Feb construction spending	1.5%	0.1%	-	Residential continues to support; non-res impacted by energy.
	Mar consumer sentiment (final)	90.0	90.5	-	Uni of Michigan measure.
	Mar domestic auto sales	13.74	13.90	-	Credit remains freely available.
	Fedspeak	-	-	-	Mester speaks in New York.

New Zealand forecasts

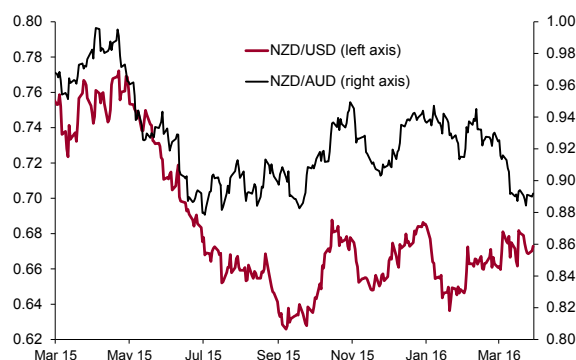
Economic Growth Forecasts	March years				Calendar years			
	% change	2014	2015	2016f	2017f	2014	2015	2016f
GDP (Production) ann avg	2.7	3.6	2.4	3.0	3.7	2.5	2.8	2.9
Employment	3.8	3.2	1.3	2.8	3.6	1.4	2.8	1.7
Unemployment Rate % s.a.	6.0	5.8	5.8	5.2	5.8	5.3	5.3	5.2
CPI	1.5	0.3	0.3	1.1	0.8	0.1	0.7	2.2
Current Account Balance % of GDP	-2.5	-3.4	-3.2	-3.3	-3.1	-3.1	-3.3	-3.6

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	2.80	2.90	3.00	3.10	3.10
10 Year Bond	3.00	3.10	3.30	3.50	3.60	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 Tuesday 29 March 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.25%	2.50%	2.50%
30 Days	2.30%	2.51%	2.52%
60 Days	2.32%	2.55%	2.55%
90 Days	2.34%	2.58%	2.58%
2 Year Swap	2.26%	2.44%	2.44%
5 Year Swap	2.58%	2.71%	2.68%

NZ foreign currency mid-rates as at Tuesday 29 March 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6729	0.6796	0.6639
NZD/EUR	0.6009	0.6179	0.6077
NZD/GBP	0.4721	0.4778	0.4784
NZD/JPY	76.29	77.46	75.62
NZD/AUD	0.8919	0.9173	0.9299
TWI	71.86	73.26	72.69

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	2.30	2.30	2.30	2.30	2.30	2.30
10 Year Bond	2.58	2.70	2.80	3.05	3.05	3.30
International						
Fed Funds	0.375	0.625	0.625	0.875	0.875	1.125
US 10 Year Bond	1.89	2.20	2.30	2.50	2.75	3.00
ECB Repo 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	0.7498	0.72	0.70	0.69	0.70	0.72
USD/JPY	112.83	119	122	123	125	125
EUR/USD	1.1173	1.09	1.08	1.07	1.06	1.06
AUD/NZD	1.1197	1.13	1.13	1.13	1.14	1.17

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