

Weekly Commentary

20 March 2017



Neither good nor bad

Last week we received GDP data for the December quarter, which showed that the New Zealand economy grew by only 0.4% in the final quarter of 2016. Smoothing through the quarterly volatility highlights an economy that continues to grow at a moderate pace, but doesn't look at risk of overheating. Against this backdrop, we expect the Reserve Bank to hold the OCR at 1.75% at Thursday's review and to maintain a neutral outlook for the policy rate.

The New Zealand economy hit a bit of a soft patch in late 2016. GDP rose only 0.4% in the December quarter – close to what we had forecast, but below what many were expecting, including the Reserve Bank. A downward revision to growth in the September quarter added to the soft tone of the GDP report.

While we certainly wouldn't gloss over the soft December outturn, at the same time we'd caution against taking too gloomy a view of it. Much of the drag on growth came from specific issues in the primary sector. Milk and meat production were hampered by poor spring weather conditions, forestry production pared back earlier strong gains, and oil output fell due to a temporary shutdown at one of the major fields in Taranaki. None of these things have much to do with the economy's productive capacity, and there's good reason to expect them to be firmly on the positive side of the growth ledger in the March quarter. Indeed, plentiful summer rainfall has resulted in very favourable pasture conditions, leading to a recovery in milk and meat production, while the Maari oil field came back on line in early January which should have led to a recovery in oil output.

But looking past these factors, the underlying picture of the economy is still a moderate one. Growth in calendar '16 came in at 3.1%, an improvement from 2015, but hardly a screaming result when population growth is running in

excess of 2%. As a result, annual growth in per-capita terms continue to linger at a subdued pace below 1%.

Looking ahead, we expect a moderate pace of growth to continue. Migration inflows and tourist arrivals hit record highs in January, meaning that "people power" will remain an important part of the growth story, boosting activity in services sectors in particular. At the same time, prospects in regional New Zealand have improved, with better dairy incomes beginning to hit farmers' pockets, although recent sharp declines in global dairy prices will keep farmers cautious about discretionary spending. On top of this, conditions for several other commodity producers, including beef and horticulture, have remained positive.

However, there are also factors that are expected to have a diminishing impulse on growth this year – notably, housing and construction. Higher interest rates and loan-to-value restrictions have taken their toll on the housing market, with the rate of house price inflation continuing to slow in February. And in Auckland and Christchurch we've seen prices flattening off. That's likely to have an impact on consumer spending, since housing is an important part of New Zealanders' wealth. On the homebuilding front, declines in dwelling consent issuance in late 2016 point to a softer trend in building in early 2017. This will hold back construction, although there is still a solid pipeline of non-residential and infrastructure work across the country.

Neither good nor bad continued

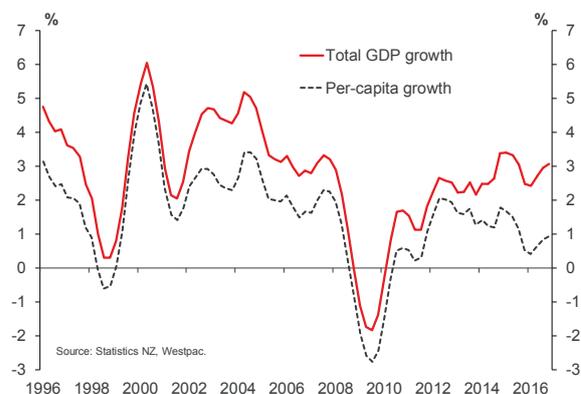
This week, the main local event is the Reserve Bank's OCR review on Thursday. In its February *Monetary Policy Statement*, the Reserve Bank left the OCR unchanged and pointedly moved away from an easing bias to a more neutral outlook for interest rates. We suspect the policy statement will be largely unchanged this time, retaining the message that "monetary policy will remain accommodative for a considerable period".

Indeed, the balance of economic news in recent weeks has been on the softer side, including the softer GDP outturn, the cooling housing market and declines in global dairy prices. This makes the case for an OCR increase look even more distant. The issue for the Reserve Bank is not that the economy is slowing, but that the Reserve Bank needs more than "average" growth to meet its inflation target. In the February *MPS*, growth was forecast to rise towards 4% this year, which is now looking increasingly stretched. The risk is that the economy simply doesn't have enough puff to generate the domestic price pressures that the Reserve Bank is hoping for.

Balancing the negative factors, near-term inflation is looking stronger. Food prices in particular have risen sharply, but these can be volatile and some of the recent gains are likely to unwind. With inflation still tracking on the lower side of the 2% target, the Reserve Bank has plenty of time to make the judgement about whether recent price gains will persist. As a result, we expect the OCR to remain on hold for a prolonged period.

Also worth a mention is Wednesday morning's GlobalDairyTrade auction. Milk powder futures are tipping

Annual GDP growth



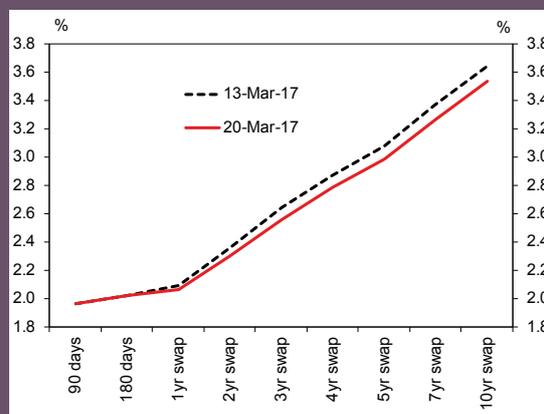
prices to fall a bit more after the sharp 12% decline in whole milk powder prices a fortnight earlier. Global dairy prices have come under increasing downward pressure this year, as better-than-expected production in New Zealand has resulted in more product coming on to the market, while milk collections in Europe are also on an improving trend. Despite the recent declines, prices are still around 35% higher than in mid-2016. And while prices might track a bit lower in the near term, fundamentals in dairy markets are better than they were a year ago with global supply still well shy of last year's peak. We expect global dairy prices to improve as we move through this year.

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 still have a chance to lock in at historically quite low levels.

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



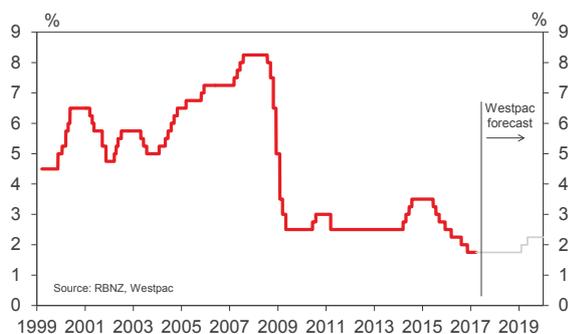
The week ahead

NZ RBNZ Mar OCR review

Mar 23, last: 1.75%, Westpac: 1.75%, Market: 1.75%

- We expect the Reserve Bank to hold the OCR at 1.75% and to maintain a neutral outlook for interest rates.
- While near-term inflation is looking a bit stronger, growth in activity has fallen short of the RBNZ's very optimistic forecasts. The slowdown in the housing market may have been a factor here.
- The risk is that the economy simply may not have enough puff to generate the sustained lift in inflation pressures that the RBNZ is looking for.

NZ Official Cash Rate



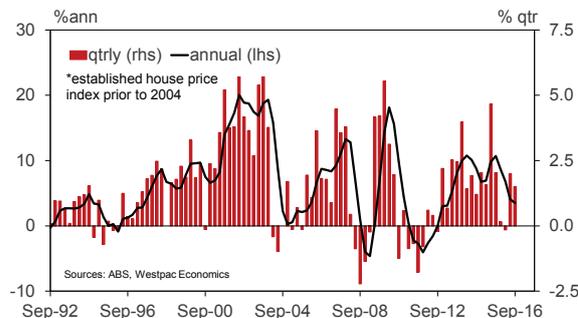
Aus Q4 residential property price index

Mar 21, Last: 1.5%, WBC f/c: 2.5%

Mkt f/c: 2.5%, Range: 1.6% to 4.1%

- Note that the ABS residential property price index is more dated than private sector measures but still gains attention due to its 'official' tag. For Q3, it showed a 1.5% lift with annual price growth slowing to 3.5%. In contrast, most private sector measures show a clear quickening in price growth in recent quarters.
- Private sector measures registered Q4 price moves ranging from 3.5%qtr, 6.7%yr (APM), 1.8%qtr, 3.0%yr (Residex), and 2.1%qtr, 9.9%yr (CoreLogic). The ABS measure tends to track the APM series. As such we expect the ABS to show a robust 2.5% gain in Q4 lifting annual growth back towards 6%. More timely data shows the price acceleration has carried into early 2017 with Sydney and Melbourne leading the way.

Residential property price index, ABS measure

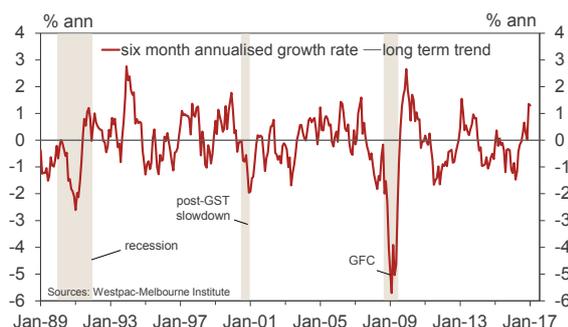


Aus Feb Westpac-MI Leading Index

Mar 22, Last: 1.30%

- The Westpac-Melbourne Institute Leading Index has surged strongly in recent months, spearheaded by a jump in commodity prices but with notable support from financial shifts reflecting improved market expectations for global growth. Domestically focussed components have been mixed. The Index growth rate held at 1.30% in Jan, a sharp turnaround on a year ago and near the most recent peak in early 2013. The Feb read will include updates on: the ASX200, up 1.6% vs -0.8% last month; the Westpac-MI Consumer Expectations Index, up 1.7% vs 1.8% last month; commodity prices, down -0.9% (in AUD terms) vs 3.1% last month; dwelling approvals, up 1.8% vs -2.5% last month; the yield spread, widened 2.7bps vs a 6.5bps narrowing last month; the Westpac-MI Unemployment Expectations Index, down -3.1% vs 3.1% last month; and total hours worked, -1.2% vs 0.6% last month.

Westpac-MI Leading Index



Data calendar

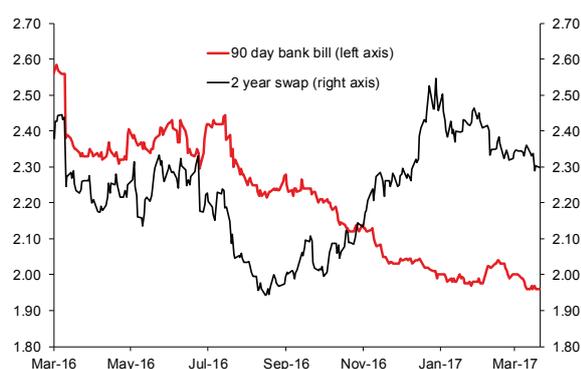
		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
NZ	Feb BusinessNZ PSI	59.5	-	-	Points to firm activity, with strength in sales and orders.
	Q1 Westpac-MM Consumer Confidence	113.1	-	-	Confidence firmed through the back half of 2016.
Aus	RBA Speech	-	-	-	Asst. Governor Ellis at ACT launch of Women in Economics Network.
UK	Mar Rightmove house prices	2.0%	-	-	Uncertainty and rising living costs weighing on prices, esp. in London.
US	Feb labour market conditions index	1.3	2.5	-	The Fed's composite measure of labour market conditions.
	Feb Chicago Fed activity index	-0.05	-	-	Indicative of trend growth.
	Fedspeak	-	-	-	Evans on economic conditions and monetary policy in NY.
Can	Jan wholesale trade	0.7%	-	-	Business sector conditions have firmed supported by domestic demand.
Tue 21					
NZ	Feb net migration	6460	-	6200	Expected to remain elevated; strong arrivals and low departures.
Aus	Q4 ABS residential property price index	1.5%	2.5%	2.5%	Very late but 'official' measure will frank gains seen in private measures.
	Minutes of March RBA Board Meeting	-	-	-	RBA on hold. Weak employ and concerns over sentiment v's housing.
UK	Feb CPI	-0.5%	0.4%	-	Lower pound pushing prices higher, especially food and fuel.
	Jan house price index, %yr	7.2%	-	-	Low rates and limited supply providing a floor.
	Feb public sector borrowing, €bn	-9.8	-	-	The debt position has been better than expected.
US	Q4 current account balance, \$bn	-113.0	-129.1	-	Very dated.
	Fedspeak	-	-	-	Dudley speaks at BOE event on Bank Ethics.
	Fedspeak	-	-	-	George speaking on the economy and the Fed in Washington.
Wed 22					
NZ	GlobalDairy Trade Auction	-6.3%	-	-	Milk powder futures point to a further fall in prices.
Aus	Feb Westpac-MI Leading Index	1.30%	-	-	Global factors driving above trend reads, commodity prices especially.
	RBA Speech	-	-	-	Deputy Governor Debelle at TradeTech FX Asia Conf. Singapore.
Eur	Jan current account, €bn	47.0	-	-	Euro critical to competitiveness.
US	Jan FHFA house prices	0.4%	0.4%	-	Prices have held up well so far...
	Feb existing home sales	3.3%	-1.9%	-	... but sales activity losing momentum.
	Fedspeak	-	-	-	Mester speaking at University of Richmond.
Thu 23					
NZ	RBNZ policy decision	1.75%	1.75%	1.75%	Firmer inflation but softer activity. RBNZ to maintain neutral stance.
Eur	Mar consumer confidence	-6.2	-5.9	-	Mood remains positive, thanks to domestic and external factors.
UK	Feb retail sales	-0.3%	0.4%	-	Rising prices have been eroding spending appetites.
US	Initial jobless claims	241k	-	-	Remains at very low levels.
	Feb new home sales	3.7%	0.9%	-	Likely to be impacted by higher interest rates and rates uncertainty.
	Mar Kansas City Fed index	14	-	-	Strong manufacturing conditions.
	Fedspeak	-	-	-	Chair Yellen delivering open. speech at Fed community dev. conf.
	Fedspeak	-	-	-	Kashkari speaking on education outcomes in Washington.
Fri 24					
NZ	Feb trade balance, \$m	-285	100	160	Imports to ease back as last month's spike in oil imports unwinds.
Eur	Mar Markit manufacturing PMI flash	55.4	55.2	-	Strong conditions...
	Mar Markit services PMI flash	55.5	55.3	-	... likely to persist.
Ger	Mar Markit manufacturing PMI flash	56.8	56.5	-	Germany in very strong position...
	Mar Markit services PMI flash	54.4	54.5	-	... given labour market and external demand.
US	Feb durable orders (provisional)	2.0%	1.2%	0.5%	FOMC more positive on investment; but growth still soft.
	Mar Markit manufacturing PMI (provis)	54.2	-	-	Optimism set to persist.
	Fedspeak	-	-	-	Evans Speaks at community development conference.
	Fedspeak	-	-	-	Kaplan speaks on economic outlook in Chicago.
	Fedspeak	-	-	-	Bullard to speak to Economic Club of Memphis.
Can	Feb CPI %yr	2.1%	-	-	Gas prices up, but core inflation well contained.
Sat 25					
Chn	PBOC speech	-	-	-	Zhou speaks on trade panel at Boao Forum.
Sun 26					
Chn	PBOC speech	-	-	-	Zhou speaks on monetary policy at Boao Forum.

New Zealand forecasts

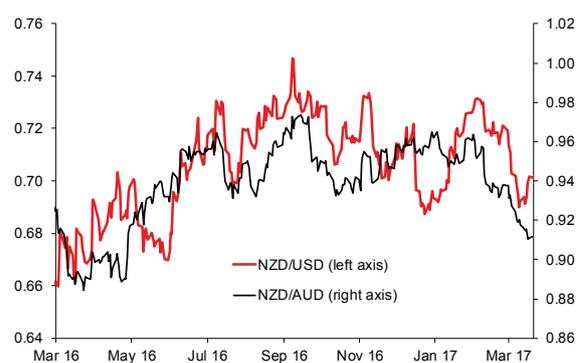
Economic Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2015	2016	2017f
GDP (Production) ann avg	3.4	2.4	3.1	3.4	2.5	3.1	3.2	3.4
Employment	3.2	2.0	5.3	2.1	1.4	5.8	2.3	1.5
Unemployment Rate % s.a.	5.4	5.2	4.7	4.4	4.9	5.2	4.4	4.2
CPI	0.3	0.4	1.8	1.5	0.1	1.3	1.6	2.1
Current Account Balance % of GDP	-3.5	-3.1	-2.7	-2.7	-3.4	-2.7	-2.6	-3.3

Financial Forecasts	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	2.00	2.00	2.00	2.00	2.00	2.00
2 Year Swap	2.50	2.50	2.50	2.50	2.60	2.70
5 Year Swap	3.15	3.20	3.30	3.35	3.45	3.60
10 Year Bond	3.45	3.50	3.60	3.65	3.75	4.00
NZD/USD	0.69	0.68	0.67	0.66	0.64	0.63
NZD/AUD	0.91	0.91	0.91	0.91	0.92	0.93
NZD/JPY	81.4	80.2	80.4	80.3	79.7	79.4
NZD/EUR	0.66	0.66	0.66	0.66	0.65	0.64
NZD/GBP	0.57	0.57	0.56	0.56	0.54	0.53
TWI	76.3	75.8	75.5	75.0	74.2	73.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 20 March 2017

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.83%	1.85%	1.85%
60 Days	1.90%	1.93%	1.94%
90 Days	1.96%	2.00%	2.03%
2 Year Swap	2.30%	2.36%	2.34%
5 Year Swap	2.98%	3.02%	3.01%

NZ foreign currency mid-rates as at Monday 20 March 2017

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7012	0.7033	0.7192
NZD/EUR	0.6533	0.6632	0.6779
NZD/GBP	0.5660	0.5722	0.5793
NZD/JPY	79.00	80.10	81.16
NZD/AUD	0.9116	0.9261	0.9375
TWI	76.44	77.14	78.52

International forecasts

Economic Forecasts (Calendar Years)	2013	2014	2015	2016	2017f	2018f
Australia						
Real GDP % yr	2.1	2.8	2.4	2.5	2.6	2.8
CPI inflation % annual	2.7	1.7	1.7	1.5	2.0	1.9
Unemployment %	5.8	6.2	5.8	5.7	5.9	6.0
Current Account % GDP	-3.4	-3.0	-4.7	-2.7	-0.6	-2.5
United States						
Real GDP %yr	1.5	2.4	2.6	1.6	2.2	2.4
Consumer Prices %yr	1.5	1.6	0.1	1.3	2.1	1.8
Unemployment Rate %	7.4	6.2	5.3	4.9	4.4	4.4
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.7	-2.8
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	1.7	1.5	1.3
United Kingdom						
Real GDP %yr	2.2	2.9	2.2	2.0	1.9	1.5
China						
Real GDP %yr	7.7	7.3	6.9	6.7	6.6	6.0
East Asia ex China						
Real GDP %yr	4.2	4.1	3.7	3.7	3.8	3.8
World						
Real GDP %yr	3.3	3.4	3.1	3.2	3.5	3.5

Forecasts finalised 20 March 2017

Interest Rate Forecasts	Latest	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.79	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.86	2.95	3.00	3.05	3.15	3.25	3.40	3.40
International								
Fed Funds	0.875	0.875	1.125	1.125	1.375	1.375	1.625	1.625
US 10 Year Bond	2.53	2.65	2.75	2.85	3.00	3.10	3.30	3.30
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40

Exchange Rate Forecasts	Latest	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
AUD/USD	0.7675	0.76	0.75	0.74	0.72	0.70	0.68	0.66
USD/JPY	113.44	118	118	120	122	124	126	128
EUR/USD	1.0773	1.05	1.03	1.01	1.00	0.99	0.98	0.96
AUD/NZD	1.0988	1.10	1.10	1.10	1.09	1.09	1.08	1.06

Contact the Westpac economics team

Michael Gordon, Acting Chief Economist +64 9 336 5670

Satish Ranchhod, Senior Economist +64 9 336 5668

Sarah Drought, Economist +64 9 336 5696

Any questions email: economics@westpac.co.nz

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