

# Weekly Commentary

20 May 2013

## Easing off the fiscal brakes

**The economy is improving and so are the Government's books. This improvement has generated a bit of loose change, allowing the government to either increase spending, reduce revenue, or generate larger surpluses. In Budget 2013, the Government chose to stick to its "small government" instincts and deliver lower government levies from 2014/15. This pretty much amounts to a tax cut. All the while the focus remains on a return to surplus in 2014/15, followed by reductions in Government debt.**

In recent commentary we have described the opposing forces pushing and pulling the New Zealand economy. On the positive side are the Christchurch rebuild and the housing market. On the negative side are drought, the high currency, and fiscal austerity. The "tax cut" delivered last week effectively weakens the last of these negative forces. That bolsters our view that the positive forces are steadily overcoming the negative so far as New Zealand economic growth is concerned, and affirms our view that interest rates will need to rise in the years ahead.

While the Government remains on track to achieve surplus by 2015, it has deliberately sailed very close to the wind, forecasting a surplus of just \$75 million. The Government could have allowed the projected surplus to widen. Its choice not to implies a certain degree of confidence that it will reach its surplus goal.

Closer examination of the Treasury's economic forecasts leaves us feeling that this confidence is well-placed. We think Treasury's economic assumptions are conservative, particularly around household consumption. If our more bullish forecasts are closer to the mark, the Government's books will improve further over the next year, leaving it in the happy position of being able to deliver more spending lollies or tax cuts in election year (2014) – while still delivering on that promised surplus.

The Budget included a range of initiatives related to housing, the most important being a plan to reach accord with councils to create special zones in which housing consents can be issued in a streamlined fashion. We haven't seen the details yet, but our impression is that streamlining consents will slightly reduce the total cost of building new houses within the special zones. That may eventually have an effect on the price of houses in general – but the effect will probably be small and it will take decades to be felt. The most likely short-term effect may be an increase in the value of land within the slated special zones.

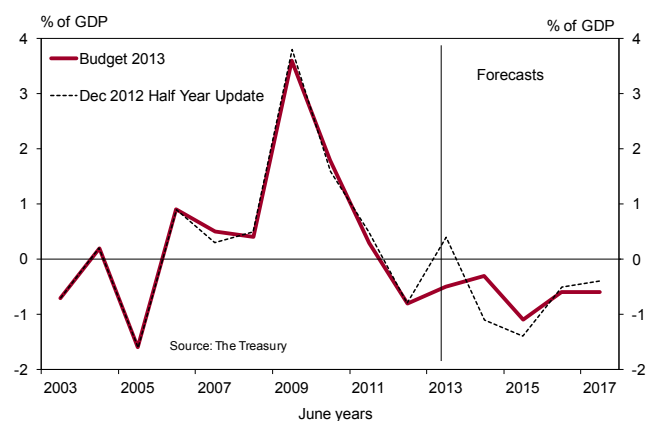
The Government also announced the signing of a memorandum of understanding (MOU) between the Minister of Finance and Governor of the Reserve Bank regarding the use of 'macro-prudential tools' – various measures designed to ensure the banking system resilience through cycles in asset prices and credit. The MOU was broadly as expected, retaining all of the four tools previously canvassed by the Reserve Bank. The Reserve Bank must consult with the Minister and Treasury before using the tools, which are strictly for the purpose of maintaining stability in the financial system.

With this administrative box ticked, we expect the Reserve Bank to begin implementing these tools in 2014. Again, as we explained in more detail last week, we don't expect these tools to have a significant impact on the cost of borrowing, nor the housing market itself.

Rebuilding Christchurch remains central to the Government's plans, and rightly so. Budget 2013 contributed a further \$2 billion or so to the Government's rebuild efforts.

The focus on the rebuild, however, means that funds are being diverting away from other productive areas of the economy. Much of the first instalment of the so-called Future Investment Fund (proceeds from asset sales) has been channelled into the rebuild plus the ongoing rescue of KiwiRail. This is in preference to the type of productivity enhancing investment in national infrastructure that we might have hoped for.

### Effect of fiscal policy on GDP





Other initiatives included top-ups for health and education, and general policy tinkering against the backdrop of what's still a conservative approach to spending. We agree that austerity is the right strategy to offset the impetus of the Canterbury rebuild. But we are not so convinced by the detailed policy initiatives. This Government wants to be seen as "doing something" without actually offering up much dosh. The end result is a little too much tinkering and not enough vision for our liking.

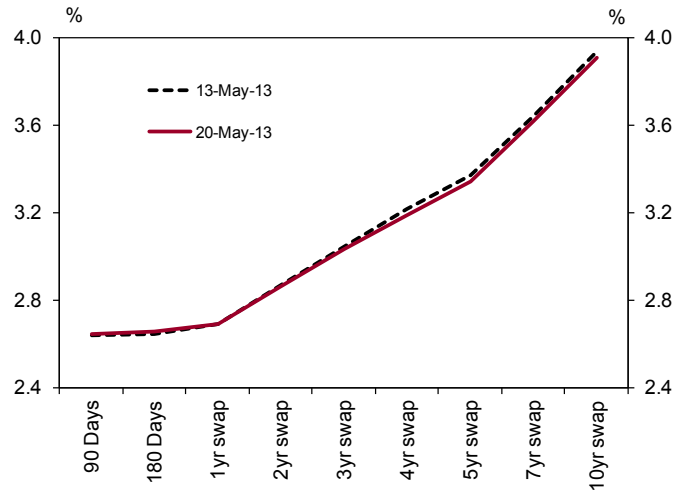
In other developments last week, world dairy prices continued a gradual descent from record highs in Wednesday night's GlobalDairyTrade auction as local drought concerns fade. However, prices were still the fourth highest on record.

We expect world dairy prices to descend further from their peak, but to remain at elevated levels by historical standards. World dairy supply remains tight. Coupled with strong Asian demand, particularly from China, these factors should see dairy prices higher on average over 2013 compared to 2012. These higher prices will aid the dairy sector's recovery from drought.

Overall, the Budget combined with other events last week further cemented our view that the pace of economic growth will accelerate over 2013 as the impacts of drought fade and the Christchurch rebuild charges ahead. Now we also know that the Government is doing less to spoil the party.

**Fixed vs floating for mortgages:** Fixed-term rates out to two years are currently well below floating rates, while three-year and longer fixed rates are only slightly higher. So staying on floating would only be the better option if the RBNZ actually cut the OCR – which we regard as unlikely. That said, there is little upward pressure on banks' funding costs, and fixed-rate 'specials' remain a feature of the mortgage market. Consequently, while we favour fixing over floating for the next couple of years, there's scope to time your entry to take advantage of further fixed-rate deals.

**NZ interest rates**



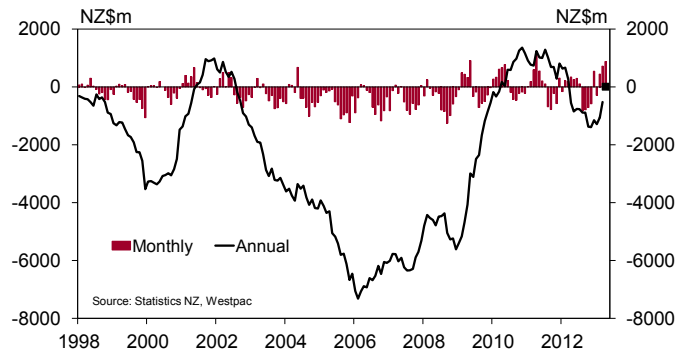
**Key Data Previews**

**NZ Apr merchandise trade**

May 24, Last: \$718m, WBC f/c: \$870m, Mkt f/c: \$480m

- We expect the early stages in the surge in world dairy prices to shine through in the April trade data. Note that this data will reflect prices set in early 2013, and volumes will pre-date the worst of the 2013 drought.
- On a seasonally-adjusted basis we expect the April trade balance to show a small surplus. Looking at the annual balance, we expect the deficit to narrow further in April - our forecasts actually suggest that it may tick narrowly back into surplus.
- Further out, the annual trade deficit may widen as imports increase in line with the Canterbury rebuild and strong domestic growth.

**NZ Merchandise trade balance**



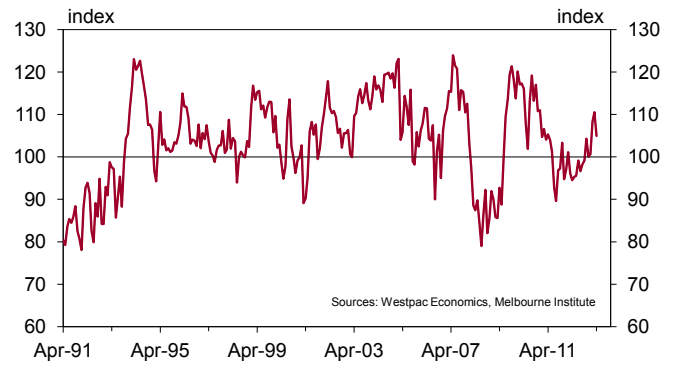


## Aus May Westpac-MI Consumer Sentiment

May 22, Last: 104.9

- Consumer sentiment suffered a significant setback in Apr, falling 5.1% after a promising 10.5% rally over the previous three months. Sentiment remained in optimistic territory but the fall highlights the fragility of the consumer mood given what the fairly mild negative events in the month (the Cyprus rescue, a minor decline in equities and speculation that the next move in rates might be up).
- As in previous years, the May survey has been delayed to capture reactions to the Federal Budget with fieldwork conducted between May 13 and 19. Aside from said Budget, sentiment is also likely to be influenced by: the RBA cutting the cash rate 25bps to a new record low at its May 7 meeting with expectations of more to come; a vigorous rebound in equity markets (ASX +6% since the Apr survey) but a sharp slide in the AUD (down 6.5c to well below parity vs USD).

## Consumer Sentiment



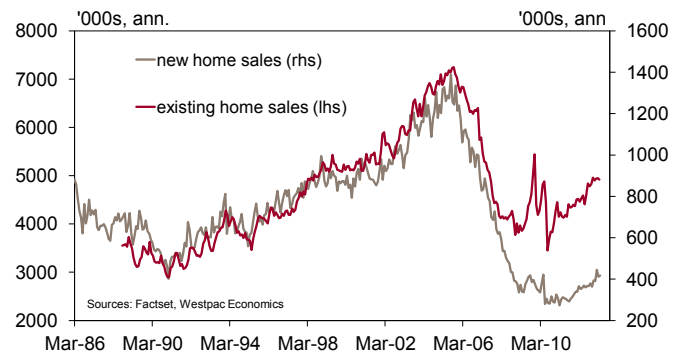
## US Apr existing and new home sales

May 22, Existing: Last: -0.6%, WBC f/c: 1.0%

May 23, New: Last: 1.5%, WBC f/c: 1.0%

- Existing home sales fell 0.6% in Mar to an annualised sales pace of 4.92mn, 0.8% below the 3yr high of 4.96mn in Nov last year. Excluding the late 2009 surge in sales ahead of the home-buyer tax credit expiry, Nov was the highest sales pace since mid 2007, but still 32% below the Sep 2005 sales peak of 7.25mn. Recent sales strength is believed to be in part driven by investor groups snapping up cheap homes which offer decent rental returns. Pending home sales rose 1.5% in March so existing sales likely resumed their upswing in April.
- New home sales rose 1.5% in Mar to an annualised sales pace of 417k, 6.3% below the 5yr high of 445k in Jan and 70% below the July 2005 sales peak of 1389k. The shortage of decent established homes available for sale suggests new home sales will keep rising.

## US housing sales

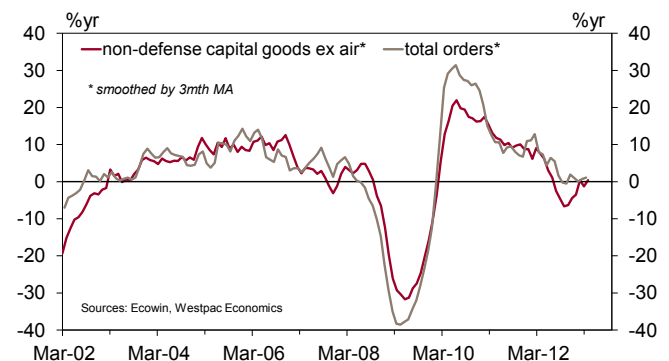


## US Apr durable goods orders

May 24, Last: -5.7%, WBC f/c: 1.0%

- Durable goods orders fell 5.7% in Mar, more than reversing their 4.3% Feb bounce. The fall was once again driven by the volatile aircraft component (down 48%), and defence (down 33%), both reversing steep gains in Feb. But core capital goods orders ex defence/aircraft were essentially stalled (up 0.2%) after falling 4.8% in Feb. Over the year, core orders were down 1.4% yr, indicative of underlying weakness.
- ISM factory orders recovered 0.9pts in Apr after falling 6.4pts in Mar. Boeing took 51 orders in Apr, up from 39 in Mar. Auto sales and production slipped in April, and business equipment output also declined.
- In sum, investment momentum is weak, and is likely to remain that way. We expect a 1.0% total orders gain and a flat result for core orders in April.

## US durable goods orders





**Key Data and Events**

		Market	Westpac	
		Last	median	forecast Risk/Comment
<b>Mon 20</b>				
<b>UK</b>	May Rightmove house prices	2.1%	–	– Signs of optimism seen of late, but annual growth negligible
<b>US</b>	Apr Chicago Fed national activity index	–0.23	–	– Index pointing to sub-trend growth.
	Fedspeak	–	–	– Evans.
<b>Tue 21</b>				
<b>NZ</b>	Apr net immigration (s.a.)	1220	–	1210 Departures are now well down on last year; migrant arrivals also up.
<b>NZ</b>	2-year-ahead inflation expectations	2.2%	–	– Could fall further, RBNZ wants 2%.
<b>Aus</b>	RBA meeting minutes	–	–	– Critical insight into Board deliberations.
	Secretary to Treasury Parkinson speaking	–	–	– Topic: "Budgeting in challenging times", Sydney, 12.30pm AEST Sydney.
<b>Ger</b>	Apr producer prices %yr	0.4%	0.0%	flat Upstream price pressures non existent.
<b>UK</b>	Apr CPI	0.3%	0.5%	0.4% Annual inflation still above target despite weak activity.
	Apr PPI %yr	1.3%	–	– Core output measure.
	Mar ONS house prices	1.9%	–	– Has decelerated from 3.3%, the fastest pace since late 2010.
<b>US</b>	Fedspeak	–	–	– Dudley.
<b>Wed 22</b>				
<b>Aus</b>	May Westpac–MI consumer sentiment	104.9	–	– Knocked lower in Apr. Sentiment positive but clearly fragile.
<b>Jpn</b>	BoJ decision ¥trn ann. base money chg	60-70	–	60-70 No change in current pace of annual base money expansion.
<b>EU</b>	Mar current account	12.1bn	–	– External demand remains crucial offset for weak domestic demand.
<b>UK</b>	Apr PSNCR	31.3bn	–	– Public sector net credit requirement. PSNB ex intv'ns £15.1bn in Mar.
	May CBI industrial trends survey	–25	–18	– Total orders index.
<b>US</b>	Apr existing home sales	–0.6%	1.4%	1.0% Have stalled in recent months, in part due to lack of supply.
	May FOMC meeting minutes	–	–	– Policy flexibility discussion of interest.
	Fedspeak	–	–	– Bernanke's testimony to Joint Economic Committee.
<b>Can</b>	Mar retail sales	0.8%	0.2%	– Ex autos saw 0.7% gain in Feb.
<b>Thu 23</b>				
<b>Aus</b>	May Westpac–MI unemploy. expect.	141.5	–	– Job-loss fears still extreme but consumers less fearful than Sep last year.
	May MI consumer inflation expectations	2.2%	–	– Has edged higher since Dec but coming from a 16yr low.
<b>Chn</b>	May HSBC flash manufacturing PMI	50.4	50.4	– April led lower by export orders, new orders/stocks ratio bodes ill.
<b>EU</b>	May PMI manufacturing	46.7	47.0	46.9 Conditions likely to remain weak; concerning for Q2 GDP 'growth'.
	May consumer confidence	–22.3	–22.0	–21.5 A material improvement highly unlikely in current climate.
<b>Ger</b>	May PMI manufacturing	48.1	48.4	48.3 Core activity stagnant; giving next to no support to region.
<b>UK</b>	Apr retail sales inc fuel	–0.7%	0.1%	0.0% March was weak, impacted by weather. But unlikely to bounce in Apr.
<b>US</b>	Initial jobless claims w/e 18 May	360k	346k	350k Firing to remain subdued; hiring the key concern for labour market.
	Apr new home sales	1.5%	1.9%	1.0% Revisions to history also due this week, tentative 23–24 May.
	May Kansas City Fed manf activity	–5	–	– Regional surveys have disappointed to date in May.
	Fedspeak	–	–	– Bullard.
<b>Fri 24</b>				
<b>NZ</b>	Mar merchandise trade, NZDmn	718	480	870 Dairy prices surging.
<b>Ger</b>	Q1 GDP, final	0.1%	0.1%	0.1% Germany underperformed in Q1 and looks likely to do the same in Q2.
	June GfK consumer confidence	6.2	6.2	6.2 Optimism currently in short supply amongst households...
	May IFO business climate	104.4	104.5	104.4 ... so too for businesses.
<b>UK</b>	Apr mortgages, no.	31.2k	–	– BBA data covering about 70% of the market.
<b>US</b>	Apr durable goods orders	–5.8%	1.7%	1.0% Tone of total and core orders series to remain soft; see preview.

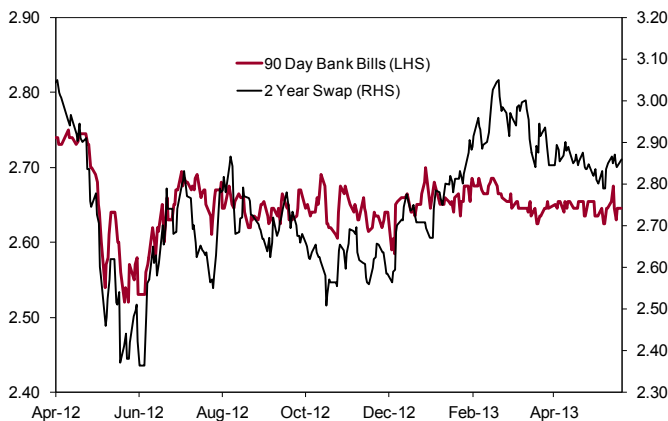


## New Zealand Economic and Financial Forecasts

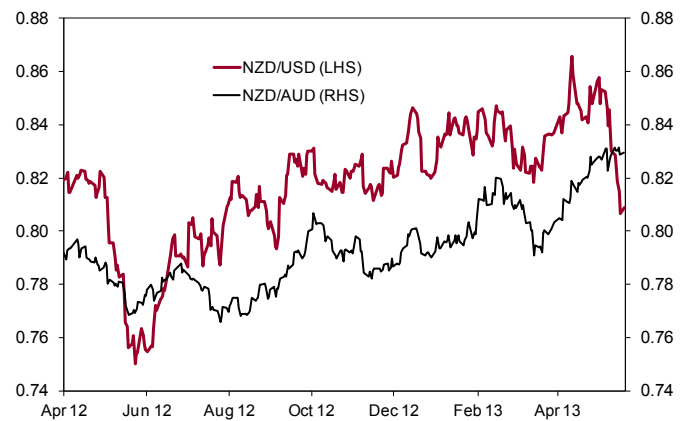
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	2.9	3.7	1.4	2.5	2.8	3.6
Employment	1.0	0.4	2.4	2.8	1.5	-1.4	3.2	3.2
Unemployment Rate % s.a.	6.7	6.2	5.7	4.8	6.3	6.8	6.1	5.0
CPI	1.6	0.9	1.4	2.5	1.8	0.9	1.3	2.3
Current Account Balance % of GDP	-4.4	-4.9	-4.6	-5.6	-4.0	-5.0	-4.5	-5.3

Financial Forecasts	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.50	2.50	2.50	2.75	3.00	3.25
90 Day bill	2.65	2.70	2.75	3.00	3.25	3.50
2 Year Swap	2.90	3.00	3.10	3.30	3.50	3.70
5 Year Swap	3.40	3.45	3.50	3.60	3.70	3.85
10 Year Bond	3.30	3.40	3.45	3.50	3.55	3.60
NZD/USD	0.83	0.84	0.85	0.85	0.84	0.83
NZD/AUD	0.82	0.84	0.86	0.88	0.88	0.86
NZD/JPY	81.3	81.5	81.6	80.8	79.0	77.2
NZD/EUR	0.64	0.66	0.67	0.69	0.69	0.68
NZD/GBP	0.55	0.56	0.56	0.57	0.55	0.53
TWI	77.0	78.4	79.5	80.4	79.7	78.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 15 April 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.63%	2.64%	2.64%
60 Days	2.64%	2.64%	2.64%
90 Days	2.65%	2.64%	2.66%
2 Year Swap	2.86%	2.84%	2.86%
5 Year Swap	3.34%	3.28%	3.32%

NZ foreign currency mid-rates as at Monday 15 April 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8100	0.8533	0.8400
NZD/EUR	0.6306	0.6508	0.6427
NZD/GBP	0.5332	0.5483	0.5515
NZD/JPY	82.91	84.64	83.86
NZD/AUD	0.8303	0.8284	0.8172
TWI	76.47	78.67	77.71



## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
<b>Australia</b>						
Real GDP % yr	1.4	2.5	2.4	3.6	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.0	2.8
Unemployment %	5.6	5.2	5.2	5.4	6.2	6.0
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.6	-3.3
<b>United States</b>						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.7	1.6
Consumer Prices %yr	-0.3	1.6	3.1	2.1	1.9	2.0
Unemployment Rate %	9.3	9.6	8.9	8.1	7.7	7.7
Current Account %GDP	-2.7	-3.0	-3.1	-3.0	-3.1	-3.2
<b>Japan</b>						
Real GDP %yr	-5.7	4.9	-0.4	2.0	1.3	1.9
Consumer Prices %yr	-1.3	-0.7	-0.3	0.0	-0.2	0.1
Unemployment Rate %	5.2	5.1	4.5	4.3	4.3	4.3
Current Account %GDP	2.8	3.6	2.0	2.1	2.0	2.0
<b>Euroland</b>						
Real GDP %yr	-4.4	2.0	1.4	-0.6	-0.8	-0.6
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.2
Unemployment Rate %	9.5	10.0	10.1	11.7	12.4	13.0
Current Account %GDP	-0.2	-0.1	0.0	0.9	1.0	1.0
<b>United Kingdom</b>						
Real GDP %yr	-4.0	1.8	0.9	0.2	0.7	0.2
Consumer Prices %yr	2.2	3.2	4.0	2.8	2.3	1.8
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.5	-1.9	-3.8	-2.5	-1.5

Forecasts finalised 10 May 2013

Interest Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
<b>Australia</b>						
Cash	2.75	2.50	2.50	2.25	2.00	2.00
90 Day Bill	2.79	2.55	2.55	2.30	2.10	2.10
10 Year Bond	3.17	3.20	3.40	3.25	3.10	2.85
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.88	2.00	2.20	2.10	2.00	1.80
ECB Repo Rate	0.50	0.50	0.50	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
AUD/USD	0.9749	1.01	1.00	0.99	0.97	0.96
USD/JPY	102.46	98	97	96	95	94
EUR/USD	1.2855	1.30	1.28	1.26	1.23	1.22
AUD/NZD	1.2024	1.22	1.19	1.16	1.14	1.14

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