

Weekly Commentary

22 April 2013

Goldilocks in the rain

New Zealand's combination of strong economic growth and low inflation prompted us to title our February *Quarterly Economic Overview* "A Goldilocks Moment." Recent data has more than borne out the idea of a "Goldilocks economy". Economic growth has turned out even stronger than expected, and there is no sign of letup. December quarter 2012 GDP growth was a whopping 1.5%. Earlier this month the *Quarterly Survey of Business Opinion* suggested the economy had grown by perhaps another 0.8% in the March quarter of 2013. And last week the ANZ consumer confidence index for April actually strengthened despite severe drought gripping most of the country.

Meanwhile the March quarter Consumer Price Index, released last week, confirmed the low level of inflation. Prices rose just 0.4% in the March quarter, and annual inflation remained steady at 0.9%. The domestically generated element of inflation is not insignificant - non-tradables inflation is running at a 2.4% annual pace. But the high exchange rate has kept a firm lid on prices for tradable goods and services, which are now 1.1% lower than a year ago.

The sharp fall in petrol prices over recent weeks, and the extreme weakness of the Japanese Yen (which will bring down prices for some imports) could cause annual inflation to fall to 0.7% in the June quarter, instead of rising as we were previously expecting. Our latest forecast suggest annual inflation will finish the year only a little above 1%, and will not reach the RBNZ's target of 2% until late-2014.

At this point the reader could be forgiven for asking why the Reserve Bank does not cut interest rates at next week's OCR review. The reason, of course, is that house prices are rising rapidly and the Canterbury rebuild is stoking economic growth. Both factors will, in time, provoke inflation pressures. Cutting the OCR now would leave the RBNZ poorly positioned to deal with a construction and housing boom that will last years.

So we expect the Reserve Bank will continue to sit on the fence at the OCR review on Wednesday this week. It will leave the OCR unchanged at 2.5% and reiterate the "on hold" outlook. We expect the final sentence of the press release will be repeated from the March *Monetary Policy Statement*:

"At this point we expect to keep the OCR unchanged through the end of the year."

The body of the RBNZ's press release will likely describe the opposing forces of strong growth versus low inflation while emphasizing the diametrically opposed risks that the Reserve Bank faces.

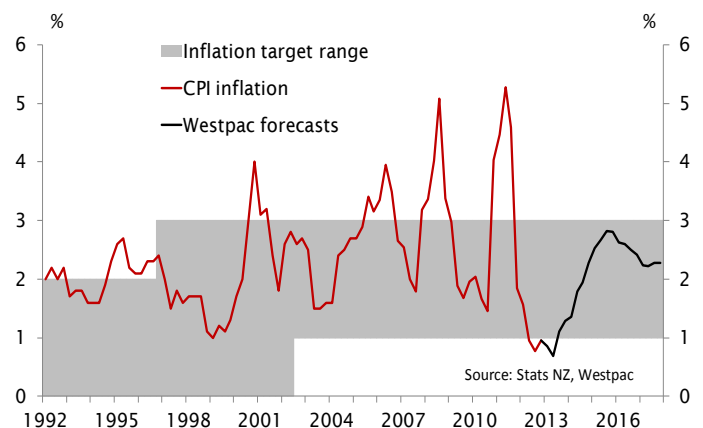
Discussion of the domestic economy will be bullish, and the risk that rising house prices could reignite a borrow-and-spend economy will be singled out for special mention. The drought will certainly be discussed, but so will the sharp rise in dairy export prices. And as always, the RBNZ will rail against the high exchange rate. Given that the Trade Weighted Index has risen to a new all-time high, the RBNZ might even invoke language associated with exchange rate intervention, such as labeling the New Zealand dollar "unjustified" and "exceptional" (these are two of the RBNZ's four criteria for intervention).

Rain, at long last

The most important economic development over the past week has been rain, which has fallen heavily in many regions of New Zealand. Forecasts of more rain over the week ahead suggest that the drought will fully break soon. However, North Island farmers still face a difficult winter ahead with stock in precarious condition and feed supplies low.

We released a bulletin last week explaining the two important effects of this summer's drought. It will hit agricultural production

CPI inflation and forecasts





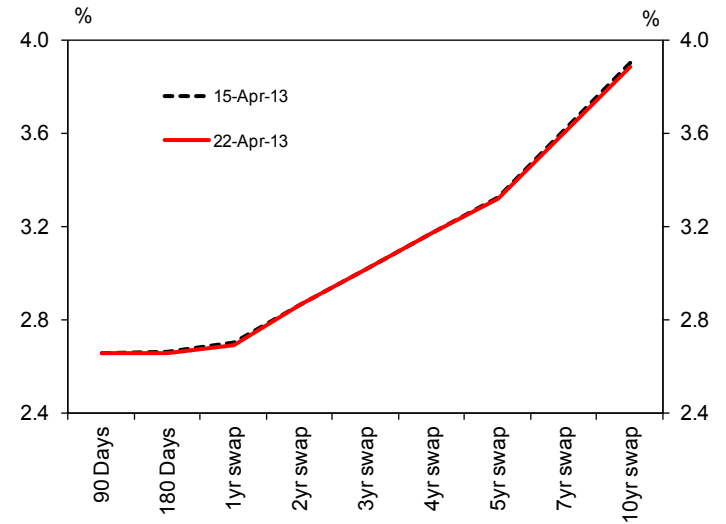
and downstream processing hard. We are bracing for low real GDP growth and a run of poor economic data relating to the June quarter of 2013 in particular. For farmers, the effects of the drought will linger for years.

The drought in New Zealand has also caused an extraordinary surge in dairy export prices, worth about a billion dollars to the New Zealand economy. Incredibly, it now looks as though the dairy sector as a whole will earn more revenue this season than we anticipated before the drought struck. The ability to earn more revenue by selling less product implies market power. Our bulletin argues that New Zealand has gradually cornered the fast growing Chinese whole milk powder market, which bodes well for the future of New Zealand's terms of trade.

But back in the here and now, the practical implication is that different farmers and different regions of New Zealand will have wildly divergent experiences this year. Those dairy farmers hardest hit by drought will lose more in production than they gain from higher milk prices. The meat sector (New Zealand's second biggest export) has experienced a drop in prices on top of drought, and will suffer accordingly. By contrast, those dairy farmers in regions that did receive rain or who have access to irrigation will benefit from a higher dairy payout.

Fixed vs floating for mortgages: At current mortgage rates we regard fixing as being better value than floating over the next few years. 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.

NZ interest rates



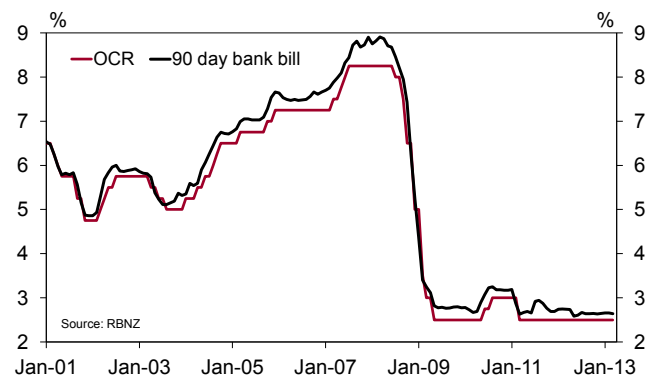
Key Data Previews

RBNZ Official Cash Rate

Apr 24, Last: 2.5%, WBC f/c: 2.5%, Mkt f/c: 2.5%

- The RBNZ has kept the OCR on hold for two years and expects to leave it unchanged “through the end of the year”.
- But the RBNZ is confronted by two diametrically opposed risks. The high exchange rate might suppress inflation even further. Or the buoyant housing market could renew the borrow-and-spend economy.
- The OCR review will sit on the fence, maintaining the on hold outlook while emphasising both risks.

NZ OCR and 90 Day Rate



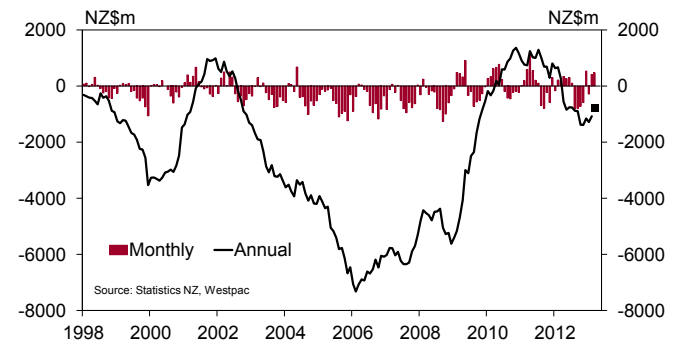


NZ Mar Merchandise Trade

Apr 26, Last: \$414m, WBC f/c: \$470m, Mkt f/c: \$470m

- We expect the early stages of the surge in world dairy prices to shine through in the March trade data. Note that this data will reflect prices set in late 2012 and early 2013, and volumes will pre-date the worst of the 2013 drought.
- A rebound in the volatile oil category should see seasonally-adjusted import values pick up in March. Overall, we expect the trade balance to show a small deficit on a seasonally-adjusted basis.
- On an annual basis, we expect the deficit to narrow a touch in March. 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



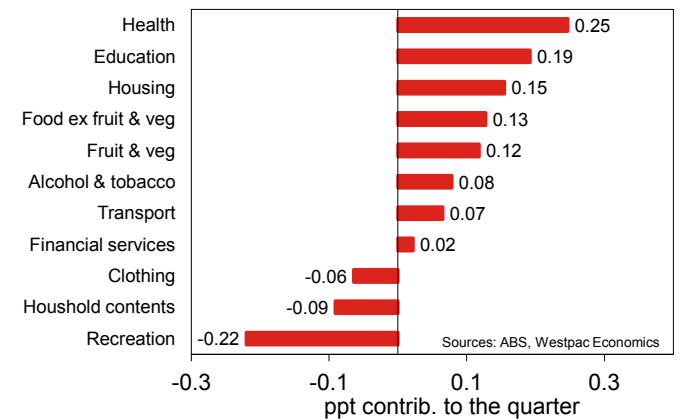
Aus Q1 CPI

Apr 24, Last: 0.2%, WBC f/c: 0.6%

Mkt f/c: 0.7%, Range: 0.4% to 0.9%

- In Q4, the CPI rose by 0.2%, leaving annual inflation at 2.2%yr, up from 2.0%yr in Q3. Annual core inflation moderated a touch to 2.3%yr. Q4 saw a strong rise in clothing & footwear and a more modest decline in food than expected; however, housing was surprisingly weak. All in all, price pressures were best described as modest and contained.
- The typical seasonal lift is expected in Q1, thanks to pharmaceuticals and education. A further boost is expected to come from fruit & vegetables as well as fuel. Falling airfares and audio, visual and computing equipment deflation will provide a partial offset. Overall, that leaves us with a 0.6% headline forecast (2.7%yr), and a 0.5% core expectation (2.4%yr).

Contributions to 0.6% qtr Q1 CPI Forecast



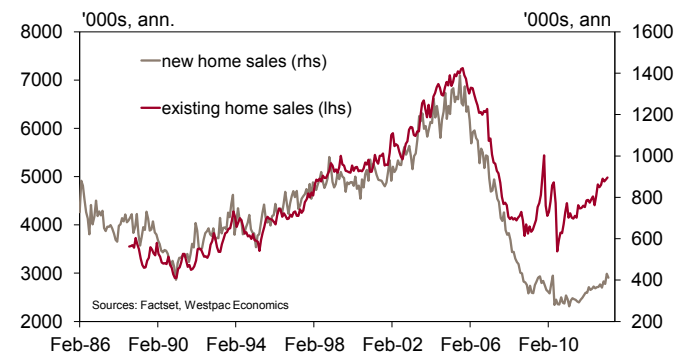
US Mar existing/new home sales

Apr 22, Existing: Last: 0.8%, WBC f/c: 1.0%

Apr 23, New: Last: -4.6%, WBC f/c: 0.0%

- New home sales fell 4.5% in Feb, but have been ratchetting higher since Aug last year, albeit in a volatile manner. Feb 2013 saw a gain of 12.3%yr, following a gain of 34%yr from the sales nadir (Feb 2011). Even so, those two years of recovery have only reversed 12% of the peak-to-trough plunge in sales since 2005. A lack of decent established homes for sale has helped the new-build market along. With single family house starts falling from their Feb post-recession high in Mar, and builder confidence slipping in Feb-Apr, we expect stalled Mar new sales before a resumption of the sales up-trend.
- Pending home sales fell slightly in Feb following Jan's 3.9% rise, so we expect a further modest rise in contract closures for existing home sales in Mar, but nothing spectacular.

US Housing Sales



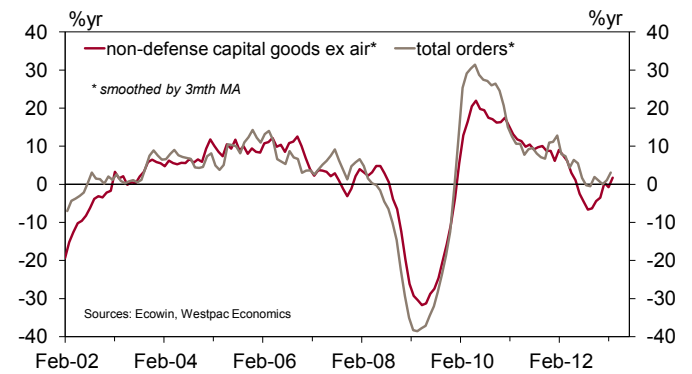


US Mar durable goods orders to fall

Apr 24, Last: 5.6%, WBC f/c: -3.0%

- Durable goods orders jumped 5.6% in Feb, reversing Jan's 3.8% decline. Aircraft were up 95% and autos gained 4%, but core capital goods fell 2.7% after a 12% rise in the previous four months. Even so, core orders were down 3.5%yr. Defence has been volatile lately, but was down 4.4%yr in Feb. Shipments rose 1%, but were up just 0.8% over the year.
- This subdued orders picture is masked by an apparently decent jump in the headline and some components in recent months; however, it is mostly swings in the seasonal factors not underlying growth driving the month-to-month profile.
- ISM factory orders fell 6.4pts in Mar. Boeing took just 39 orders, versus 179 in Feb. Auto sales slipped, but production rose. And business equipment output was flat last month. These signals point to a fall in total orders, even if core capital goods reverse some of their Feb drop.

US Durable Goods Orders

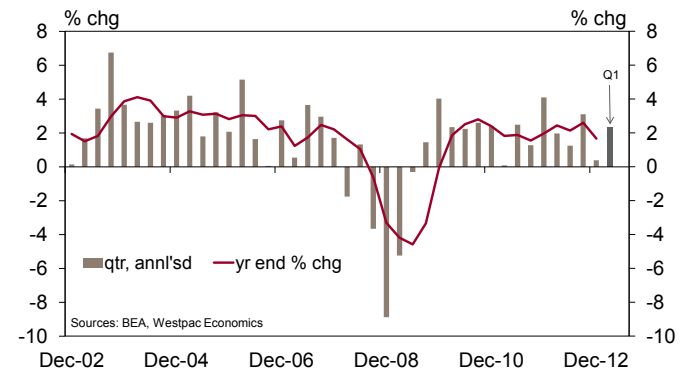


US Q1 GDP to grow at 2+% pace

Apr 26, GDP % annualised: Last: 0.4%, WBC f/c: 2.3%

- The private sector spending components were stronger in Q4, with personal consumption accelerating from 1.6% to 1.8% annualised, business investment from -1.8% to 13.2%, and housing from 13.5% to 17.6%. Along with a 0.3ppt add from net exports, these sectors added 3.3ppts to the growth bottom line.
- But a sharper than expected reversal of Q3's defence spending jump saw government spending subtract 1.4ppts from GDP, on top of a 1.5ppt drag from inventories. Hence the modest overall 0.4% growth in Q4.
- Q1 is likely to see a resumption of growth at or above 2% annualised, with a broadly similar breakdown to Q4, except for a modest addition from inventories, and slightly weaker growth in business investment.

US GDP Growth





Key Data and Events

		Market Last	Westpac median	forecast	Risk/Comment
Mon 22					
NZ	Net immigration, Mar (s.a.)	550	–	575	Departures to Australia have fallen sharply in the last two months.
Twn	Mar export orders %yr	–14.5%	1.9%	–	Predictable bounce post LNY, PMI new export orders improved.
Eur	Apr consumer confidence advance	–23.5	–24.0	–24.5	Confidence little changed in Q1, but likely to slip again soon.
US	Mar Chic Fed national activity index	0.44	–	–	Based on 80 or so data inputs, not a business survey.
	Mar existing home sales	0.8%	0.4%	1.0%	Pending sales fell slightly in Feb after sharp Jan gain. See text box.
Tue 23					
Chn	Apr HSBC flash manufacturing PMI	51.7	–	–	Orders/stocks improved, above 1, but March 'seasonally over-stated'.
Twn	Mar industrial production %yr	–11.45%	1.9%	–	Bouncing out of LNY trough; underlying momentum OK, not great.
Eur	Apr PMI factory adv	46.8	46.7	–	Q1 saw gap between French and German PMIs substantially widen.
	Apr PMI services adv	46.4	46.5	–	Composite PMI fact/ser was 46.5 in Mar.
UK	Apr CBI industrial trends survey	–15	–14	–	Total orders index.
	Mar PSNCR £bn	–1.5	–	–	Public sector net credit requirement. PSNB ex intv'ns £2.8bn in Feb.
US	Apr Richmond Fed factory index	3	–	–3	2013 early year gains less than in 2011 and 2012.
	Feb house prices	0.6%	0.7%	–	FHFA index.
	Mar new home sales	–4.6%	1.9%	0.0%	Feb decline likely, temporary pull-back in sales. See text box.
Can	Feb retail sales	1.0%	0.2%	–	Jan retail sales up 0.5% ex autos.
Wed 24					
NZ	RBNZ official cash rate	2.5%	2.5%	2.5%	The RBNZ will remain firmly on hold.
Aus	Q1 CPI	0.2%	0.7%	0.6%	Usual Q1 seasonal lift expected due to pharmaceuticals and education.
	RBA Deputy Governor Lowe	–	–	–	"The Journey of Financial Reform", Shanghai China
Ger	Apr Ifo business climate index	106.7	–	104.8	Loss of confidence to replicate mid 2012 slump?
UK	Apr CBI retail survey	0	–	–	Reported sales index.
	Mar mortgages no.	30.5k	–	–	BBA data covering about 70% of the market.
US	Feb durable goods orders	5.6%	–2.9%	–3.0%	Recent swings due to aircraft; underlying story soft. See text box.
Thu 25					
–	Anzac public holiday	–	–	–	Aus, NZ markets closed.
Kor	Q1 GDP %yr	1.5%	1.4%	–	Q4 was the trough. Net X plus offsetting negative inventory swing.
UK	Q1 GDP advance	–0.3%	0.1%	0.2%	Forecast rounds up to 0.2%; actually recovers only half of Q4's loss.
US	Initial jobless claims w/e 19/4	352k	351k	345k	Easter seasonality swings now over, leaving downtrend in place.
	Apr Kansas City Fed factory index	–5	–	0	Six sub-zero readings in Oct-Mar; weakest since 2009 recession.
Fri 26					
NZ	Mar merchandise trade	\$414m	–\$470m	\$470m	Dairy prices surging.
Jpn	Apr Markit/JMMA manufacturing PMI	50.4	–	–	March was first outcome > 50 since May-12. Leads are positive.
	Mar national CPI %yr	–0.7%	–0.8%	–	Ex ff and nrg –0.9%, ex ff –0.3%. 2% target is a distant surmise.
	Bank of Japan decision	0.1%	0.1%	0.1%	No moves expected, but medium term CPI forecasts of major import.
Sing	Mar industrial production %yr	–16.6%	–3.0%	–	Relatively sluggish vis-a-vis other regional exporters.
Eur	Mar money supply M3 %yr	3.1%	3.2%	–	Slowed from 3.9%yr peak in Oct 2012. Private loans down –0.9%yr.
US	Q1 GDP advance	0.4%	3.0%	2.3%	Economy barely expanded in late 2012, Q1 bounceback lacklustre.
	Apr UoM consumer sentiment final	72.3 a	73.5	73.0	Weekly confidence data suggest sentiment little changed thru Apr.
Sat 27					
Chn	Mar industrial profits %yr	17.2%	–	–	Margins have been rising, but soft March data may see that trend stall.

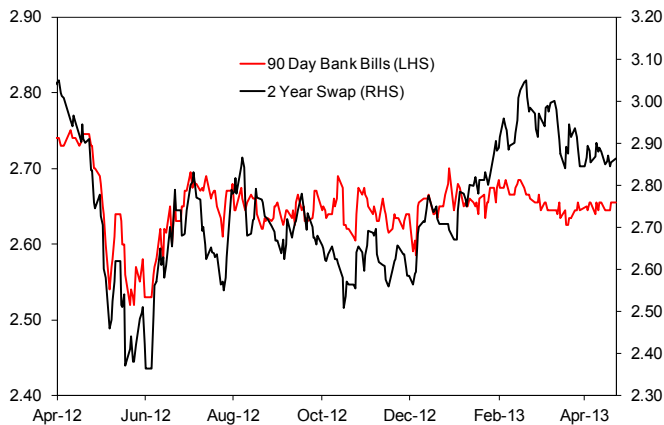


New Zealand Economic and Financial Forecasts

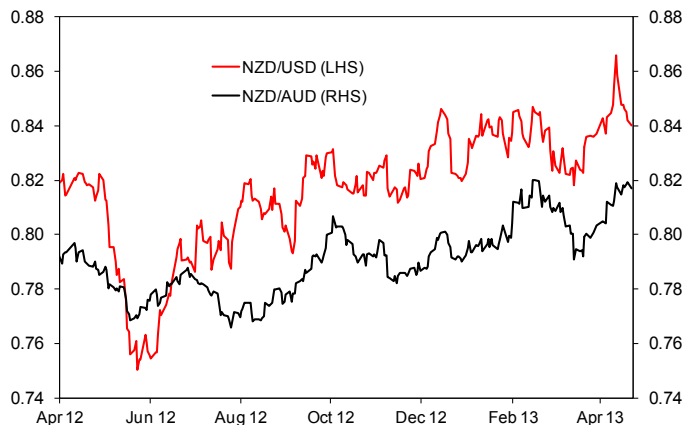
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	3.0	3.4	1.4	2.5	3.0	3.2
Employment	1.0	0.0	2.6	2.5	1.5	-1.4	3.7	2.6
Unemployment Rate % s.a.	6.7	7.0	6.1	5.1	6.4	6.9	6.3	5.3
CPI	1.6	0.9	1.4	2.5	1.8	0.9	1.3	2.3
Current Account Balance % of GDP	-4.4	-4.9	-5.0	-6.0	-4.0	-5.0	-4.8	-5.8

Financial Forecasts	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.50	2.50	2.75	3.25	3.50	3.75
90 Day bill	2.70	2.75	3.20	3.50	3.75	4.00
2 Year Swap	3.00	3.10	3.30	3.60	3.90	4.20
5 Year Swap	3.50	3.60	3.80	4.00	4.30	4.50
10 Year Bond	3.60	3.70	3.90	4.10	4.20	4.30
NZD/USD	0.85	0.85	0.85	0.84	0.83	0.82
NZD/AUD	0.82	0.83	0.84	0.85	0.86	0.85
NZD/JPY	81.6	80.8	79.1	77.3	74.7	72.2
NZD/EUR	0.65	0.66	0.68	0.69	0.70	0.70
NZD/GBP	0.56	0.56	0.56	0.56	0.56	0.54
TWI	78.1	78.5	79.1	79.0	78.7	77.9

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	2.64%	2.64%	2.64%
60 Days	2.64%	2.64%	2.64%
90 Days	2.66%	2.66%	2.64%
2 Year Swap	2.86%	2.85%	2.92%
5 Year Swap	3.32%	3.35%	3.49%

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

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8400	0.8413	0.8340
NZD/EUR	0.6427	0.6488	0.6435
NZD/GBP	0.5515	0.5497	0.5472
NZD/JPY	83.86	82.70	78.78
NZD/AUD	0.8172	0.8119	0.7990
TWI	77.71	77.68	76.45



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
Australia						
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	2.5	2.8
Unemployment %	5.6	5.2	5.2	5.3	5.9	5.8
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.8	-3.6
United States						
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	2.0	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	-3.1	-2.9	-2.9
Japan						
Real GDP %yr	-5.7	4.9	-0.4	1.9	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
Euroland						
Real GDP %yr	-4.4	1.9	1.5	-0.5	-0.5	-0.5
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
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	0.3	0.7	0.2
Consumer Prices %yr	2.2	3.2	4.0	2.7	2.3	1.8
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.4	-1.9	-3.8	-2.5	-1.5

Forecasts finalised 8 April 2013

Interest Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
Australia						
Cash	3.00	2.75	2.75	2.75	2.75	2.75
90 Day Bill	2.98	3.00	3.10	3.10	3.00	3.00
10 Year Bond	3.19	3.50	3.50	3.30	3.20	3.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.70	2.00	2.20	2.10	2.00	1.80
ECB Repo Rate	0.75	0.75	0.75	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
AUD/USD	1.0273	1.04	1.03	1.01	0.99	0.97
USD/JPY	99.81	96	95	93	92	90
EUR/USD	1.3068	1.30	1.28	1.25	1.22	1.19
AUD/NZD	1.2230	1.22	1.21	1.19	1.18	1.17

Westpac Economics Team Contact Details

Dominick Stephens , Chief Economist	Ph: (64-9) 336 5671	dominick_stephens@westpac.co.nz
Michael Gordon , Senior Economist	Ph: (64-9) 336 5670	michael_gordon@westpac.co.nz
Felix Delbrück , Senior Economist	Ph: (64-9) 336 5668	felix_delbruck@westpac.co.nz
Nathan Penny , Economist	Ph: (64-9) 336 5669	nathan_penny@westpac.co.nz

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