



Weekly Commentary

8 July 2013

Taking stock

After a very quiet New Zealand data week, we've decided to step back and review the three big themes of the past month – the increasingly strong tone of the New Zealand economic data, the fall in the NZ dollar, and the RBNZ's growing determination to proceed with loan-to-value ratio restrictions for new mortgages. Our conclusion is that they amount to a more hawkish RBNZ – but not to rate hikes this year.

New Zealand data over the past few months have varied from encouraging to stunning. Consumer and business confidence have risen to their highest levels in three years. The construction industry is going from strength to strength. But there are also signs that the upswing is spreading. Business confidence has lifted across industries. Within construction, building consent issuance in the undersupplied Auckland market has ramped up particularly strongly in the last few months. Consumer confidence outside Canterbury and Auckland has begun to catch up.

One clear upshot from the recent data is that the summer drought seems to be having rather less of an impact on the economy than we had been expecting. Notably, our latest Regional Economic Confidence survey showed particularly big rebounds in the rural North Island. To be sure, the drought will dampen the June quarter GDP figures – that's unavoidable with milk production down and meat production below normal. But the spillovers to other parts of the economy look remarkably limited. That suggests some upside risk to our 0.3% forecast for June quarter GDP. This week's NZIER quarterly business survey will give further guidance – with the proviso that the survey doesn't cover the farm sector, and will therefore overstate growth.

The second big theme is the major market reassessment of how soon the US Federal Reserve will start to 'taper' the rate of asset purchases, and the resulting fall in the NZ dollar. (As elsewhere, the other consequence for New Zealand has been higher longer-term wholesale interest rates, which has lifted fixed-term mortgage rates). We explained our take on this last week. In brief, while we're still sceptical that a decisive turning point for the US economy, or US monetary policy, has arrived, we have to acknowledge that the Fed has let the 'tapering' genie out of the bottle. Accordingly, we expect the NZ dollar to retrace some of its losses later this year, but not to go all the way back to what we were forecasting a month ago.

The combination of a surprisingly strong domestic economy and a lower exchange rate outlook would naturally point in the

direction of a Reserve Bank that's a little more willing to consider raising interest rates. The July OCR Review is probably too soon for a wholesale change in view. But if the exchange rate stays at recent low levels until the September *MPS* we may well hear more hawkish talk from the RBNZ.

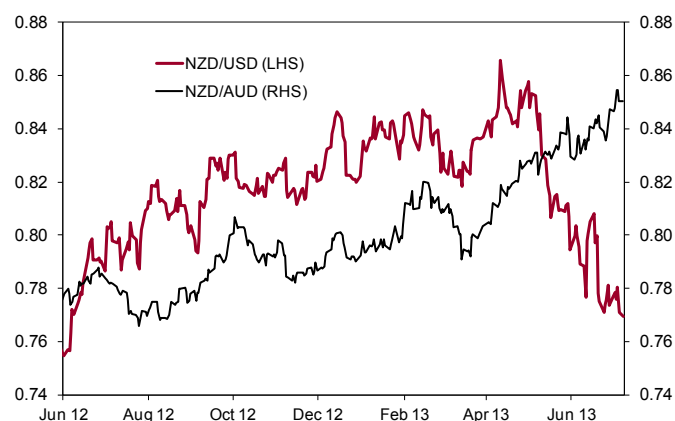
However, we have not gone so far as to change our view that the hiking cycle will start early next year, for a couple of reasons.

First, the RBNZ has made it clear that it still thinks the exchange rate is uncomfortably high. In its June *Monetary Policy Statement* (when the NZ dollar TWI was 73.5 compared to 74 now), it simply noted that 'despite having fallen ... the New Zealand dollar remains overvalued'. And in a recent speech, the RBNZ's Deputy Governor expressed continued concern that interest rate hikes could put unwanted pressure on the exchange rate.

Of course, the RBNZ's primary concern is the inflation outlook. But the RBNZ also seems to have developed the view that the persistent high *level* of the exchange rate (not just past changes) has helped dampen inflation, by compressing importers' and retailers' margins, and is likely to continue doing so.

It's also worth remembering that the economy is picking up from a point of weakness. Actual signs of inflation pressure remain patchy at best. Firms' surveyed pricing intentions have picked up recently, but only to around average levels. And according to the latest Employment Confidence survey jobs are still much harder to get than before 2009, while wage expectations remain subdued.

NZD/USD and NZD/AUD





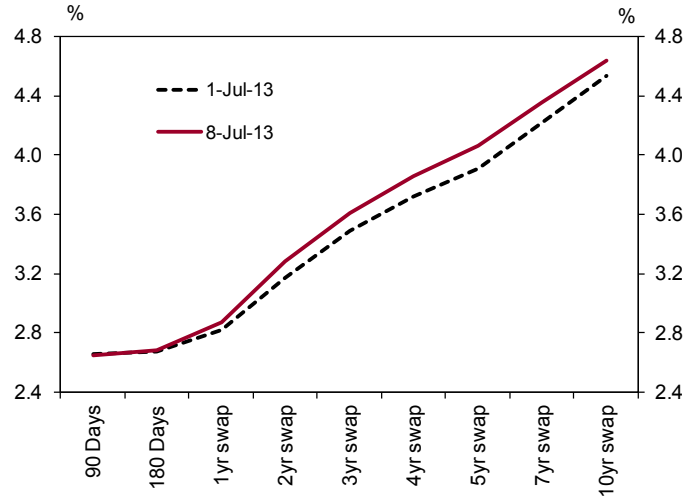
Lastly and most importantly, the RBNZ has left little doubt that until the inflation picture changes materially, restrictions on new home loans with high loan-to-value ratios (LVRs) will be its first port of call to cool the hot housing market. The consultation process on these restrictions closed last week, and given the sense of urgency we suspect the RBNZ will be ready to act within a few months. However, the RBNZ will also want to evaluate how the market responds to any LVR restrictions before it decides what to do next.

As we explained last week, our best judgement is that LVR restrictions will have some impact on the housing market and credit growth, but it will be limited. They would definitely hit first home buyers. But they wouldn't affect property investors (who are less leveraged to begin with). Indeed, by cutting out competing borrowers and buyers, and raising demand for rental accommodation in the process, they may draw more investors into the market.

That means LVR restrictions aren't a substitute for eventual OCR increases, but they may encourage the monetary policy department of the RBNZ to take a wait-and-see approach. In his speech, the Deputy Governor indicated that LVR restrictions would not be removed until one of: a hard landing for the housing market; the restrictions proving ineffective; or a persistent moderation in housing market pressures and household credit growth. What the RBNZ is really hoping for is the last of these, and only time will tell.

Fixed vs floating for mortgages: We favour fixing over floating. Fixed-term rates out to two years are currently below floating rates, while three-year and longer fixed rates are only slightly higher. Staying on floating would only be the lower-cost option if the RBNZ actually cut the OCR, which we regard as unlikely. In fact, we expect the floating mortgage rate to rise significantly over the 2014 to 2016 period. There may be value in fixing sooner rather than later. Wholesale interest rates have risen sharply in recent weeks, and fixed mortgage rates are already rising in response. We think fixed mortgage rates may rise further in the near term.

NZ interest rates



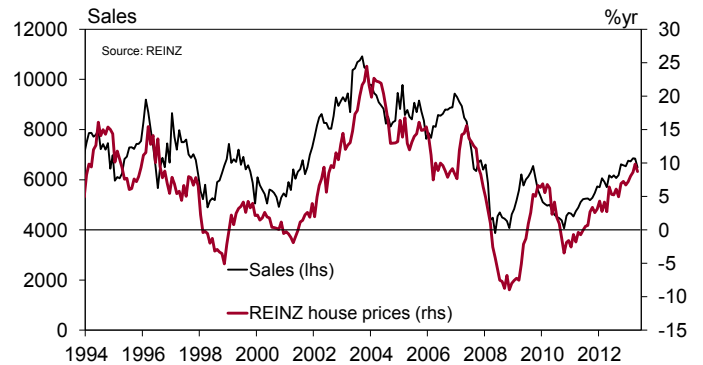
Key Data Previews

NZ Jun REINZ house prices and sales

Jul 8-12, Sales last: -5.2%, Prices last: 8.7%yr

- The rate of growth in house sales has clearly slowed since the start of the year; the 5% fall in May was the biggest monthly drop since late 2010. However, with available listings hitting new lows nationwide and prices still rising at a strong clip, there is little evidence that demand is cooling.
- Note that we've been through this before: in the previous housing cycle, sales started to decline from late 2003, while prices continued to rise (albeit at a slightly less frenetic pace) right up until mid-2007.
- The RBNZ's intention to restrict low-equity home loans in the near future could put a further handbrake on housing turnover. Overseas evidence suggests this may slow the rate of increase in house prices, but is unlikely to counteract the underlying appeal of low mortgage rates.

REINZ house prices and sales



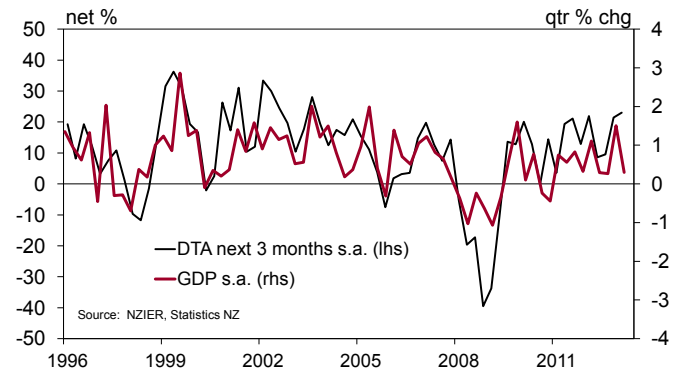


NZ Q2 NZIER business opinion

Jul 9, Last: 23

- Business sentiment improved further in the March quarter, with reported activity reaching its highest level in five years. There was also a sense that the upturn is becoming more broadbased, though construction remains the driving force.
- We suspect that, as in the March quarter, this survey will paint a positive picture of the underlying economy but will overstate the case for quarterly GDP growth - it does not directly cover the agricultural sector, where drought dragged down output in Q1 and probably even more so in Q2.
- The evidence on price pressures will be of particular interest. The monthly ANZ business confidence survey indicated that firms' pricing intentions are on the rise again, though not consistently - still very soft in retail, but rising for services and very strong in construction. The NZIER survey will give a fuller picture of where capacity constraints might be emerging.

QSBO domestic trading activity and GDP

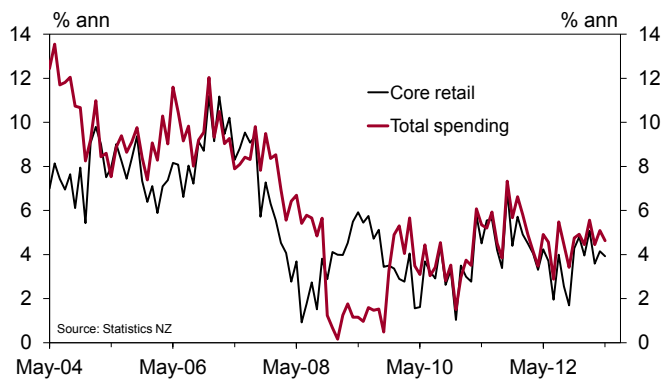


NZ Jun electronic card transactions

Jul 9, Last: 0.6%, WBC f/c: 0.7%

- The 0.6% rise in May card spending implied a slightly stronger underlying pace of growth than we thought, given that the starting point (April) appeared to have been overstated as a result of the earlier timing of Easter this year.
- Our forecast for June assumes a continuation of the recent pace of growth in the core retail sectors, along with a sharp lift in fuel spending. Petrol prices averaged 3.5% higher in June; volumes may have suffered as a result but the recent trend has been remarkably strong (up 14% in the last year).
- Card spending has been tracking at around 5% year-on-year growth in nominal terms, and probably more in real terms as the strong NZ dollar has depressed import prices. That started to change in May, but aside from fuel it could be some time before this becomes noticeable on retail shelves.

Card transactions

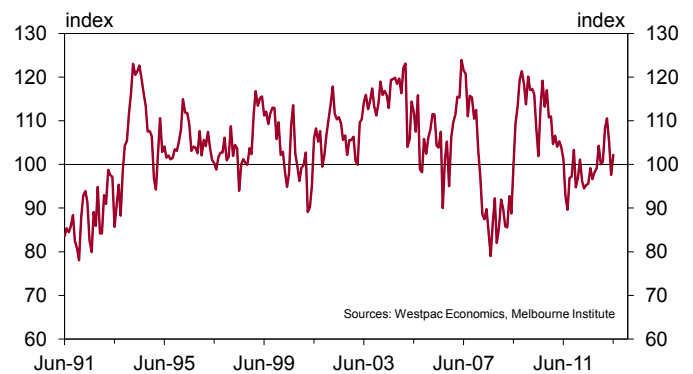


Aus Jul Westpac-MI Consumer Sentiment

Jul 10, Last: 102.2

- After falling sharply through Mar-Apr-May, consumer sentiment recovered some lost ground in Jun posting a 4.7% rise. That took the index level back over 100 indicating optimists once again outnumber pessimists, although the margin is slim with sentiment still 8.2% below its Feb peak.
- The Jul survey is in the field from Jul 1 to 7. It will capture reactions to: the RBA's decision to leave rates on hold at its Jul meeting; mixed economic data (lacklustre retail sales but more signs of a housing pick-up); another volatile month for the sharemarket, albeit with the ASX up 2% vs the previous survey; and a continued sharp slide in the AUD, falling a further 4¢ to US92.2¢ since the last survey. Political developments may feature as well, given heavy media coverage of the leadership change in the week prior to the survey.

Consumer Sentiment





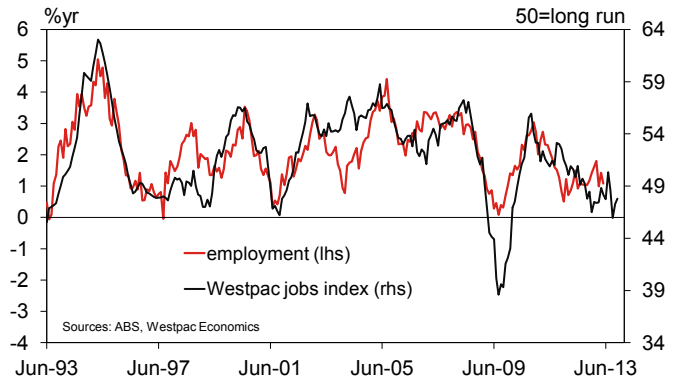
Aus Jun labour force - employment '000

Jul 11, Last: 1.1k, WBC f/c: -15k

Mkt f/c: flat, Range: -40k to 15k

- Total employment rose 1.1k in May, stronger than the market median (-10k) and Westpac's forecast (-20k).
- In May there was nothing much in the mix of jobs as full-time fell 5.3k and part-time rose 6.4k; but total hours worked fell 0.7% mth and the employment to population ratio declined to 61.6% from 61.7%. The May result was far from a robust read.
- Since the business surveys are still reporting soft demand for labour and the Westpac-MI unemployment expectations index is rising again, we suspect the next few months will report both soft employment and hours worked numbers.
- For June, we expect a -15k print. This will see annual growth edge up to 1.2% from 1.1%.

Employment has faded in the business surveys



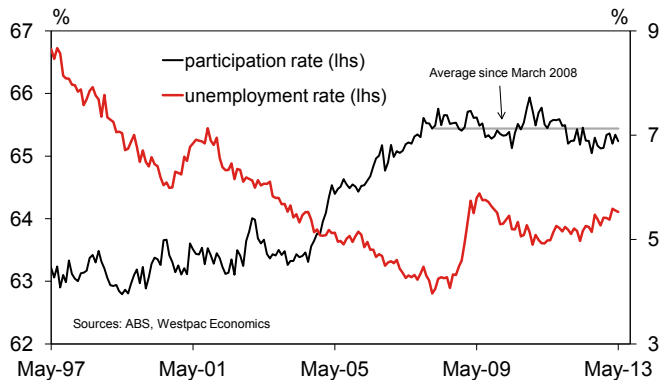
Aus Jun unemployment rate

Jul 11, Last: 5.5%, WBC f/c: 5.6%

Mkt f/c: 5.6%, Range: 5.7% to 5.5%

- At one decimal place, the unemployment rate dropped to 5.5% from 5.6% (revised from an originally reported 5.5%). But at two decimal places, you would have to describe it as a flat print as it was just a marginal fall to 5.53% from 5.56%.
- And this small fall in the unemployment rate was due to a decline in participation, from 65.34% to 65.24%, and the resulting decline in the labour force despite, solid gains in the working age population.
- If the participation rate holds at 65.2% then the -15k print in employment will be enough to lift the unemployment rate to 5.6%. In fact, given the recent volatility in this series there is an outside chance participation could rise this month even with a soft employment print.

Unemployment and participation rates



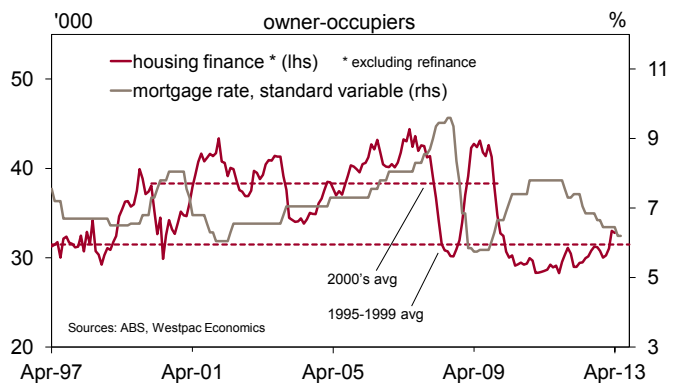
Aus May housing finance (no.)

Jul 12, Last: 0.8%, WBC f/c: 2.0%

Mkt f/c: 2.2%, Range: -0.5% to 3.0%

- The underwhelming recovery in housing finance approvals continued in April with a 0.8% rise following a 4.8% rise in March to be up 11.5% yr (ex refinance). A recovery is clearly underway but the strength of the upturn remains disappointing given the low level of interest rates.
- May should show more of the same. Auction markets showed a significant step-up in activity through Apr-May-Jun with house prices also firming, though more unevenly. The RBA's decision to cut the cash rate by another 25bps at its May 7 meeting may have helped sentiment although the full effect on finance approvals is likely to take a few months to appear. Overall we expect approvals to post a solid 2% gain in May.

Owner-occupier finance & the rate cycle





Key Data and Events

		Market Last	Westpac median	Westpac forecast	Risk/Comment
Mon 8					
Aus	Jun ANZ job ads	-2.4%	-	-	Ongoing weakness in ads has seen the annual rate fall to -20%yr.
Eur	Jul Sentix investor confidence	-11.6	-12.5	-10.0	ECB easing bias positive; Greek bailout, Portuguese politics negative
Ger	May industrial production	1.8%	-0.5%	-0.5%	Factory PMI sub 50; three monthly gains Feb-Apr unsustainable.
	May exports	1.7%	0.1%	-0.5%	If IP is down, exports are unlikely to rise further.
US	May consumer credit \$bn	11.1	13.0	-	Student and auto loans the main drivers in 2012 and so far this year.
Can	May building permits	10.5%	-	-	Up 4 months running already this year, latest rise led by multiples.
	Q2 BoC senior loan officer survey	-5.8	-	-	Credit availability relatively easy though not as loose as in 2011.
	Q2 business outlook survey	24	-	-	Future sales index.
Tue 9					
NZ	Q2 NZIER business opinion	23	-	-	Likely to be strong, but will overstate Q2 GDP as it excludes agriculture.
	Jun electronic card transactions	0.6%	-	0.7%	Fuel prices sharply higher in June; steady growth expected elsewhere.
Aus	Jun NAB business conditions	-4	-	-	June: conditions index +2pts to -4; confidence steady -1. Both below avg.
Chn	Jun consumer prices %yr	2.1%	2.5%	-	Swings in food, steady core, shelter plateauing.
	Jun producer prices %yr	-2.9%	-2.6%	-	Base effects becoming flattering.
UK	Jun BRC sales %yr	1.8%	-	-	Same store sales. May bounced after freezing Mar-Apr weather.
	Jun house prices net balance	5%	8%	-	RICS surveyors series.
	May industrial production	0.1%	0.2%	-0.4%	50+ PMI readings imply rising output outside oil/utility volatility
	May trade balance £bn	-8.2	-8.5	-	Exports down 1.4% and imports down 3.8% saw Apr deficit narrow.
US	Jun NFIB small business optimism	94.4	-	94.5	ISM surveys of big business pretty soft in June.
Can	Jun housing starts	13.8%	-5.1%	-	Permits upswing flowing through to starts.
Wed 10					
Aus	Jul Westpac-MI Consumer Sentiment	102.2	-	-	Financial volatility, job insecurity and politics may influence July read.
Chn	Jun trade balance USDbn	20.4	28.4	-	Small improvements in both X and M, seasonality does the rest.
	Jun foreign reserves USDbn	3443	3485	-	Tentative date. SAFE regs. and Bank activities implies little gain over Q1.
	Jun new loans RMBbn	667	800	-	Tentative date. First fortnight saw decent flows, irrespective of SHIBOR.
	Jun M2 money supply %yr	15.8%	15.2%	-	Tentative date. Capital inflows not what they were early in the year.
	Jun total credit RMBbn	1190	1400	-	Tentative date. Most interest in FX loans, bill financing and trusts.
US	May wholesale inventories	0.2%	0.3%	0.1%	Inventories expanded in Jan but kept tight since then.
	Jun 18-19 FOMC minutes	-	-	-	A range of views re tapering likely to be expressed.
	Fed Chairman Bernanke	-	-	-	Speaking in Boston on policy-making history
Thu 11					
NZ	Jun food price index	0.3%	-	1.4%	Seasonal jump in produce prices; annual inflation still near zero.
	Jun manufacturing PM	59.2	-	-	The nine-year high in May will be a challenge to match.
Aus	Jun employment, chg	1.1k	flat	-15k	Leading indicators pointing to a near term soft patch.
	Jun unemployment rate	5.5%	5.6%	5.6%	The die is being cast for the unemployment rate to rise through 6%.
	Jul Westpac-MI unemploy expectations	6.3%	-	-	Have risen almost 10% since Jan, households see a soft labour market.
	Jul inflation expectations %yr	2.1%	-	-	Median inflation expectations remain well anchored.
US	Jun import prices	-0.6%	0.0%	0.2%	Oil prices a little higher on avge than in May.
	Initial jobless claims w/e Jul 6	343k	335k	340k	Claims downtrend may have slowed or stalled.
	Jun federal budget \$bn	40.0	-	-	Impact of fiscal compromise/sequester to show up here.
Can	May new house prices	0.2%	-	-	Running around 2% yr annual pace since 2010.
Fri 12					
NZ	Jun REINZ house sales	-5.2%	-	-	No release date but usually available by the 12th. Low interest rates...
	Jun REINZ house price index %yr	8.7%	-	-	...and insufficient supply continue to drive prices higher.
Aus	May housing finance	0.8%	2.2%	2.0%	Uneven recovery. May rate cut boost more likely to show in Jun-Jul.
Eur	May industrial production	0.4%	-0.2%	-0.5%	Factory PMI sub 50; German IP data 8/7 will give an early clue.
US	Jun PPI	0.5%	0.5%	0.3%	Energy prices rising further.
	Jun PPI core	0.1%	0.1%	0.2%	Core trend now sub 0.2%, some upside risk from vehicle prices.
	Jul UoM consumer sentiment prelim	84.1	85.0	83.0	300 responses in prelim; IBD-TIPP weaker in Jul with 900 replies.
	Fedspeak	-	-	-	Plosser, Bullard and Williams
Can	Jun house prices %yr	2.0%	-	-	Teranet/National Bank index.

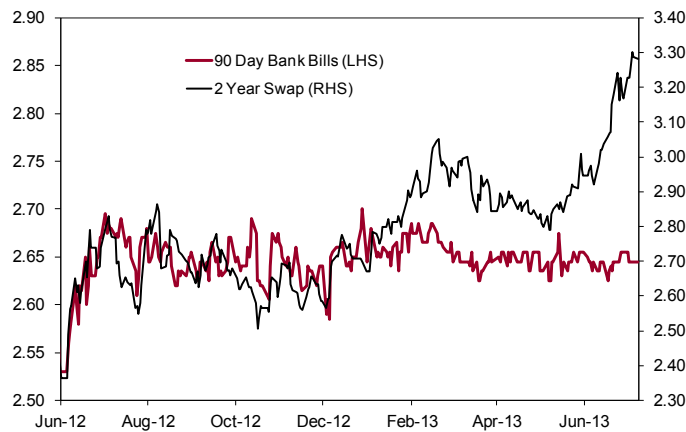


New Zealand Economic and Financial Forecasts

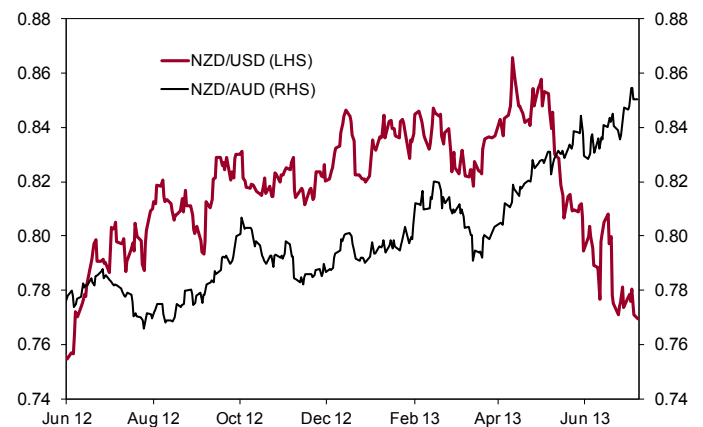
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	2.6	3.7	1.4	2.7	2.4	3.6
Employment	1.0	0.4	2.4	2.8	1.5	-1.4	3.3	3.2
Unemployment Rate % s.a.	6.7	6.2	5.8	5.0	6.3	6.8	6.2	5.1
CPI	1.6	0.9	1.5	2.3	1.8	0.9	1.5	2.0
Current Account Balance % of GDP	-4.4	-4.8	-4.3	-5.4	-4.0	-5.0	-4.2	-5.1

Financial Forecasts	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14
Cash	2.50	2.50	2.75	3.00	3.25	3.50
90 Day bill	2.70	2.75	3.00	3.25	3.50	3.75
2 Year Swap	3.20	3.20	3.40	3.60	3.80	4.00
5 Year Swap	3.90	3.80	3.90	4.00	4.20	4.40
10 Year Bond	4.10	3.90	3.90	4.00	4.10	4.20
NZD/USD	0.80	0.83	0.83	0.81	0.80	0.80
NZD/AUD	0.85	0.86	0.87	0.87	0.87	0.86
NZD/JPY	80.0	82.2	81.3	78.6	76.8	76.0
NZD/EUR	0.61	0.62	0.64	0.64	0.64	0.63
NZD/GBP	0.52	0.52	0.53	0.51	0.51	0.49
TWI	75.3	77.1	77.9	76.7	76.2	75.4

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 8 July 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.65%	2.65%	2.64%
60 Days	2.65%	2.65%	2.64%
90 Days	2.65%	2.65%	2.65%
2 Year Swap	3.28%	3.22%	2.96%
5 Year Swap	4.07%	3.93%	3.52%

NZ foreign currency mid-rates as at Monday 8 July 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7693	0.7736	0.7827
NZD/EUR	0.6004	0.5908	0.5933
NZD/GBP	0.5168	0.5029	0.5038
NZD/JPY	77.87	75.76	76.60
NZD/AUD	0.8501	0.8400	0.8330
TWI	73.87	73.06	73.39



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	2.3	2.6
Unemployment %	5.6	5.2	5.2	5.4	6.1	6.0
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.4	-2.6
United States						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.6	1.6
Consumer Prices %yr	-0.3	1.6	3.1	2.1	1.6	1.8
Unemployment Rate %	9.3	9.6	8.9	8.1	7.7	7.6
Current Account %GDP	-2.7	-3.0	-3.0	-2.8	-2.8	-2.9
Japan						
Real GDP %yr	-5.7	4.9	-0.5	1.9	1.7	2.2
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	-0.9	-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
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	0.2	0.5	0.4
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 5 July 2013

Interest Rate Forecasts	Latest	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
Australia						
Cash	2.75	2.50	2.25	2.00	2.00	2.00
90 Day Bill	2.83	2.55	2.30	2.10	2.10	2.10
10 Year Bond	3.79	3.60	3.40	3.30	3.20	3.10
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.50	2.40	2.20	2.10	2.00	2.00
ECB Repo Rate	0.50	0.50	0.50	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Sep 13	Dec 13	Mar 14	Jun 14	Sep 14
AUD/USD	0.9140	0.94	0.97	0.95	0.93	0.92
USD/JPY	100.15	100	99	98	97	96
EUR/USD	1.2914	1.32	1.33	1.30	1.27	1.25
AUD/NZD	1.1674	1.18	1.17	1.14	1.15	1.15

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