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Humming along

New Zealand's powerful economic upswing appears to have rumbled on through the first quarter of 2014 – although there are some question marks in the detail. Last week the NZIER's *Quarterly Survey of Business Opinion* gave a rough indication of the state of economic activity in the March quarter, well in advance of Statistics New Zealand's official figures. Judging by the results of the survey, the economy is still humming along.

When asked about their own activity levels, a net 23% of firms reported better times over the last three months and a net 35% expected further improvement over the next quarter – both responses were more upbeat than last quarter. When questioned about the overall economy, a net 52% of firms expected business conditions in general to improve over the next six months, unchanged from a 20-year high reached for this question in the December survey.

This leaves us quite comfortable with our forecast of 1.1% GDP growth in the March quarter.

While the status of the overall economy is very clear, there are question marks around the housing market and consumer spending. Housing market turnover and house price inflation dropped sharply in the wake of the Reserve Bank's restrictions on mortgage lending, which were introduced in October last year. We have been looking for a short-term bounce in the market, as the initial shock of the mortgage restrictions wears off.

Last week's Real Estate Institute data, which relates to the month of March, suggested that market turnover has stabilised at a relatively low level, but hasn't improved. However, the situation with house prices is unclear.

The Real Estate Institute's House Price Index (HPI) rose 2.9% over February and March, and now stands 9.2% higher than a year ago. Normally the HPI is a trustworthy and timely indicator, but we are concerned that it may have been skewed by the RBNZ's

Humming along continued

mortgage restrictions, which have changed the composition of sales. Odd price lurches in individual regions raise further question marks about the veracity of this sudden lift in the HPI.

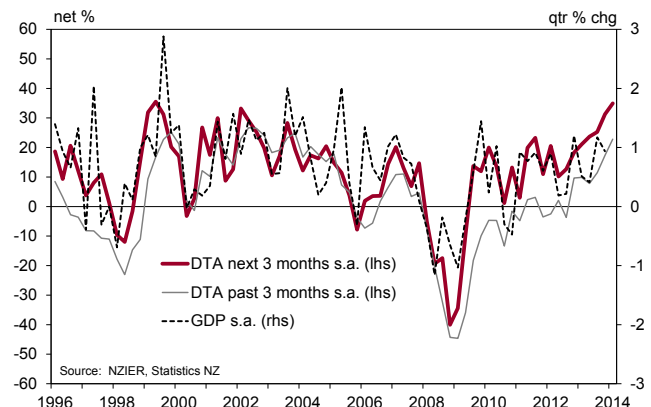
Quotable Value's (QV) monthly house price index is generally a more accurate measure of house prices, because it adjusts more comprehensively for the composition of sales. Last week the QV measure painted a very different picture, with house price inflation barely above zero since the start of 2014. However, the QV measure has itself been beset by technical issues relating to the measurement of house price inflation in Christchurch. And in any case, Quotable Value only records sales upon settlement, meaning the data is effectively two months behind the Real Estate Institute series. So the jury is out the question of house prices, pending further data.

In a similar vein, we are getting mixed signals from the retail sector. Consumer spending and the housing market are normally joined at the hip in New Zealand, so we would not have been surprised to see a bit of spending slowdown early this year. True to that idea, this week's electronic transactions data was flat in March, and on our travels around New Zealand there have been plenty of anecdotal reports of a slowdown in spending.

But the QSBO cast doubt on the idea that consumers are pulling their heads in, by registering a particularly strong lift in activity among retailers. A net 35% reported better results, the highest in 20 years. And of course, consumers remain supremely confident – the Westpac McDermott Miller Consumer Confidence Index is currently at its highest level since 2005.

Aside from these details, it does remain very clear that the overall economy is expanding rapidly. For some time our concern has been that buoyant activity would lead to inflationary pressures. The *Quarterly Survey of Business Opinion* bore these concerns out to some extent – firms reported a very sharp rise in pricing intentions, with a net 37% of firms intending to raise their prices in the next three months (the high point in the previous cycle was 46%).

QSBO - Domestic trading activity



But while pricing intentions soared, actual price increases reported by firms over the past three months were modest. Only a net 16% of firms raised their prices in the last quarter, the highest since December 2011 but still lower than at any point during the period of accelerating inflation in 2005-08.

This suggests that March quarter inflation will remain relatively subdued when Statistics New Zealand reports the figures this week. We expect the consumer price index will lift 0.4% quarter on quarter, leaving annual inflation unchanged at 1.6%. The gradual upward march of inflation in most categories will continue, but a slower-than-usual rise in food prices will provide some offset. However, if those pricing intentions are followed up with actual price increases, the overall upward trend will soon reassert itself. We are currently picking 1.9% inflation for June.

Fixed vs Floating for mortgages

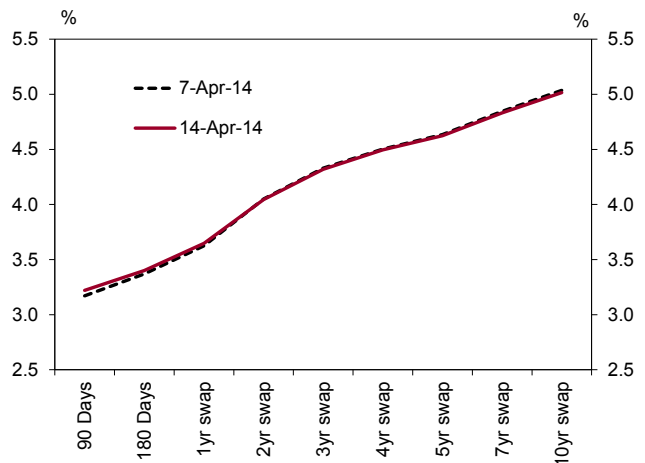
Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates, such as the six month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

For those who are looking to fix, there is little to gain from waiting. Fixed rates are more likely to rise than fall over the next few months.

Among the standard fixed rates, anything from six months to three years appears to offer similar value. Three-year rates are higher, but this is a fair reflection of where we think shorter-term rates are going to go over the next few years.

Fixing for four or five years may result in higher interest payments over the life of the loan than opting for shorter-term fixed rates. However, these longer-term fixed rates may still be preferred by those who are willing to pay for certainty.

NZ interest rates

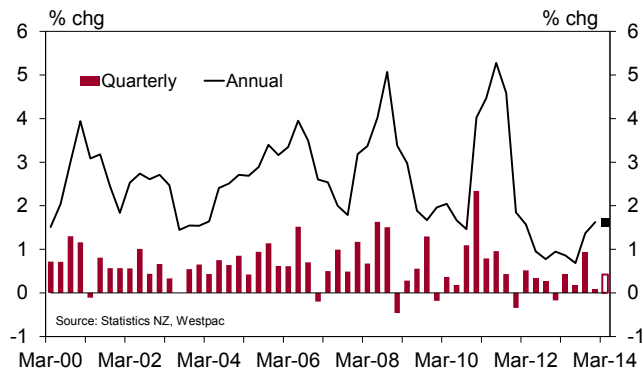


NZ Q1 CPI

Apr 16, Last: 0.1%, Westpac f/c: 0.4%, Mkt f/c: 0.5%

- We expect a 0.4% rise in the Consumer Price Index for the March quarter, leaving annual inflation unchanged at 1.6%.
- Prices are gradually accelerating across a broad range of categories as the economy heads towards full capacity, and the inflation-dampening effect of the New Zealand dollar fades.
- However, a slower increase in food prices in the year to March is expected to keep overall inflation in check.
- Inflation will continue to edge higher over the next couple of years. A short pause in that ascent, as we're anticipating, would have no real implications for monetary policy.

NZ CPI inflation

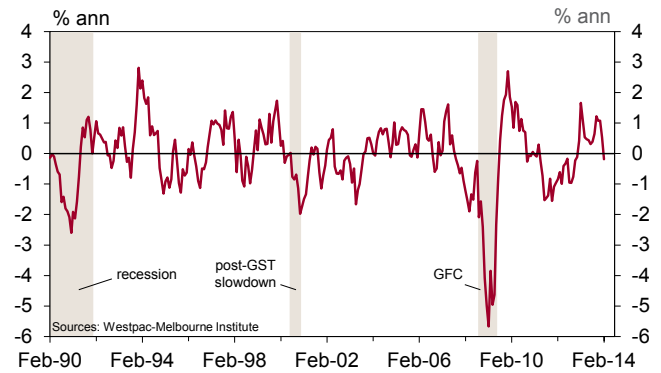


Aus Mar Westpac-MI Leading Index

Apr 16, Last: -0.19%

- The Leading Index showed a sharp loss of momentum in Feb, the growth rate swinging from 0.53% in Jan to -0.19% in Feb, the first sub-trend reading since 2012 (a positive reading is above trend, while a negative reading is below trend).
- Components have been mixed over the last month. Sentiment-based indicators improved off a weak base in Mar: the CSI Expectations Index up 2.7% and the Unemployment Expectations Index down 3.2% (recalling that higher readings indicate a poorer outlook for unemployment). Financial indicators were softer though, with commodity prices down 2.6%, the ASX dipping 0.2% and the yield gap narrowing (the spread between 10yr bonds and 90-day bills). The signal from labour markets was a little more positive though, with total hours worked up 0.5%.

Westpac-MI Leading Index

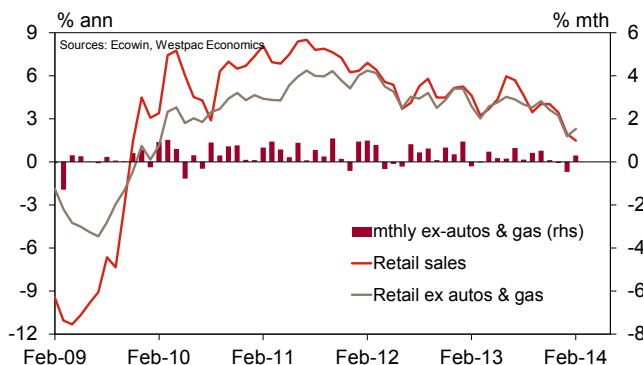


US Mar retail sales

Apr 14 Retail: Last: 0.3%, WBC f/c: 1.0%

- Retail sales rose 0.3% in Feb after 0.6%/0.3% falls in Jan-Dec. A downward revision to Jan reflected retailer returns for the last week of the month which was heavily disrupted by snow: core retail sales ex autos & gasoline were revised down 0.3ppts to -0.5%, but rose 0.3% in Feb. It will be some time before retail sales data are weather-impact free, with disruption stretching into early March (Feb could be revised lower) and deferred/delayed spending potentially boosting upcoming figures for several months, making underlying trends hard to discern.
- In March: gasoline prices rose; auto sales jumped 6%; retail jobs jumped 21k after falls in Jan-Feb. The stock market had recovered most of January's losses by early March and consumer confidence was rising, or holding on to recent gains. All bodes well for a solid retail bottom line, but core retailing might not pick up much given autos large gain.

US retail sales

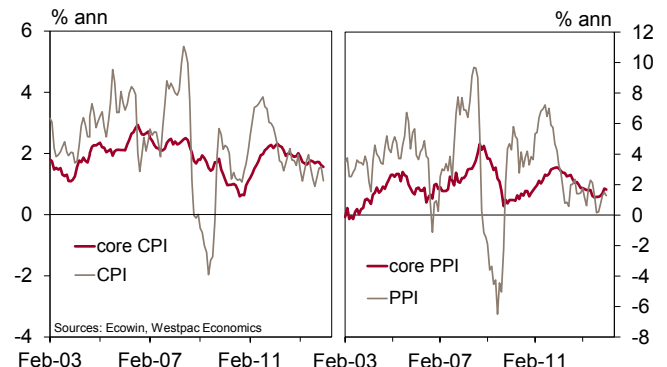


US Mar consumer price index

Apr 15, CPI: Last: 0.1%, WBC f/c: flat

- The CPI (headline/core) rose 0.1% in Feb, with food prices up 0.4% (weather disruption a factor), but lower-weighted energy prices down 0.5%. Rent was on trend at 0.2%, clothing fell 0.3% for a second month, and medical care kicked in again for the new year with 0.3% gains in Jan-Feb after flat prices in late 2013. New auto prices rose 0.1%, their first since Sep. The core annual rate at 1.6%yr was its lowest since mid 2011, but still well above the 0.6%yr low in October 2010, associated with deflation concerns at the time. The headline CPI at 1.1%yr was just above the 1.0%yr post-2009 recession low.
- Gasoline prices rose in March, some of which is seasonal so not captured in the headline CPI. Food prices probably fell as the weather cleared. Core pressures are minimal, averaging just over 0.1% per month, and the March headline could print flat. However, base effects will add at least 0.4ppts to headline annual CPI inflation in March-April.

US price inflation

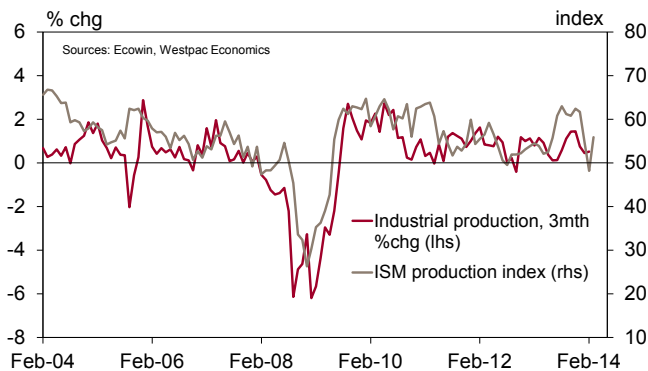


US Mar industrial production

Apr 16: Last: 0.6%, WBC f/c: 0.9%

- IP rose 0.6% in Feb, more than reversing Jan's 0.2% fall; although the manufacturing component's 0.8% rise, on the back of a 5% bounce in auto output and ongoing gains in machinery and electronics production, did not fully reverse January's 0.9% fall. Even so, the 0.8% rise was a decent outcome given the plunge in the ISM manufacturing's production index in Feb. Utilities recorded a 0.2% fall in Feb after surging 3.8% in Jan, when the weather turned especially cold; hence the slower IP (than manufacturing) bottom line gain.
- Factory hours worked posted a further 0.7% rise in March. Auto sales were up 6% after orders for autos rose 4% in Feb. The Core capital goods orders trend has turned negative in past six months. The Mar ISM factory survey showed orders and production partially recovering to 55-56, but are still well below their 60+ readings of late 2013. Even so, there is enough justification for a Mar IP forecast gain of almost 1.0%.

US industrial sector



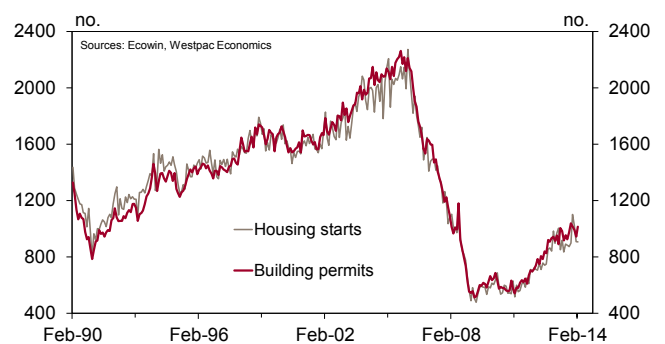
US Mar housing starts/permits

Apr 16, Housing starts: Last: -0.2%, WBC f/c: 4.0%

Apr 16, Housing permits: Last: 7.3%, WBC f/c: -4.0%

- Housing starts fell 0.2% in Feb and Jan's 16% fall was revised to an 11% decline. This was perplexing at first as it indicates that the snow disrupted months of Dec, Jan and Feb (whilst all recording declines in starts) saw higher levels of activity than in five of the six months prior to November's 22% spike (to an 1101k annualised sales pace). It seems odd that the worst winter in recent memory, when homebuilders' confidence tumbled by the most on record, would coincide with an upturn.
- But the riddle is solved by the singles/multiples split, which shows the former had reversed all of their November spike to be down 10.6%yr in Feb, while the latter were still running about 8% higher than in Oct, up 2.2%yr. Volatile multiples will drive the March headline as usual. It's a similar story for permits: in Feb, singles were -2%yr, multiples +22%yr.

US housing starts & permits



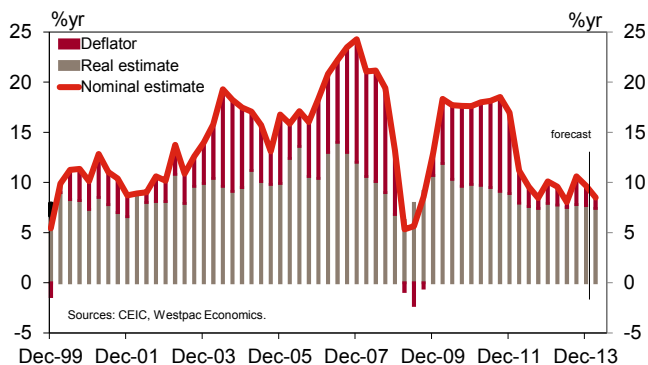
China Q1 real GDP

Apr 16, Last: 7.7%, WBC f/c: 7.4%

Mkt f/c 7.3%, Range: 6.8% to 7.7%.

- The NBS estimated that China concluded 2013 growing at a real rate of 7.7%yr, with a seasonally adjusted Q4 change of 1.8%. Our forecasts for Q1 are a 0.3ppt decline in both the y/y rate and the quarterly estimate. Tactically, we think that an outcome in the 7¼% to 7½% range would accomplish the two key tasks of 1) producing a credible growth estimate and 2) maintaining the perception that the trajectory of growth is broadly consistent with the annual target of 7½%.
- We anticipate that the decline in nominal activity will be more substantial, from 9.7%yr in Q4 to a forecast 8.5%yr, with the deflator expected to decline from 1.98% to 1.1%yr.
- The level of net exports is down both qtr/qtr and yr/yr, implying a subtraction from growth. Net exports added 1.1ppt to the 2013Q1 growth rate.

Chinese GDP: real & nominal estimates



Data calendar

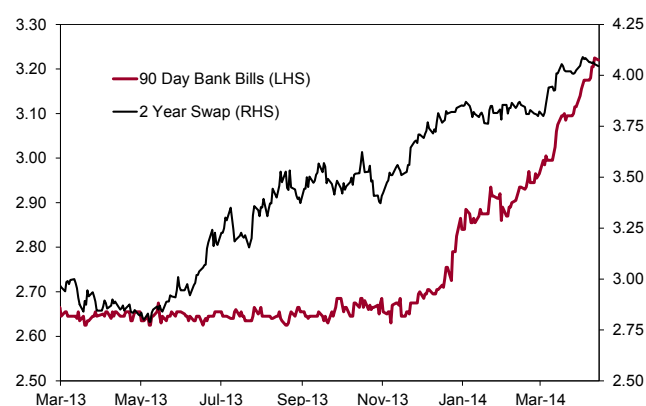
		Last	Market median	Westpac forecast	Risk/Comment
Mon 14					
NZ	Mar Performance of Services Index	53.1	–	–	Feb drop may have been due to seasonal adjustment difficulties.
Eur	Feb industrial production	–0.1%	–	0.2%	German IP (ex construction) rose 0.5% in Feb, French IP up just 0.1%
US	Mar retail sales	0.3%	0.8%	1.0%	Auto sales up 6.5%; gasoline prices higher.
	Mar retail sales ex autos & gas	0.3%	0.4%	0.4%	Some potential for Feb upward revision after heavy snow disruption.
	Feb business inventories	0.4%	0.5%	0.6%	Some unintended stockbuilding during harsh winter.
Can	Mar house prices %yr	5.0%	–	–	Teranet/National Bank index.
Tue 15					
Aus	RBA April meeting minutes	–	–	–	Unlikely to stray too far from message conveyed in statement.
	RBA Assist. Gov DeBelle	–	–	–	"The Australian Bond Market", 12:30 AEST, Canberra
Eur	Feb trade balance €bn sa	14.1	–	–	Surplus peaked a year ago at €16bn.
Ger	Apr ZEW analysts' expectations	46.6	–	42.0	Fell from 55 above yr ago level in Dec, to 2 below in Mar.
UK	Mar BRC sales %yr	–1.0%	–	–	Sharp decline due to Feb flooding and late Easter this year.
	Mar PPI %yr	1.1%	0.9%	–	Core output measure.
	Feb ONS house prices %yr	6.8%	–	–	Feb saw fastest pace of gain since late 2010.
	Mar CPI %yr	1.7%	1.7%	1.5%	BRC shop price index points to further deceleration, as does GBP gain
US	Mar CPI	0.1%	0.1%	0.0%	Gasoline prices higher in Mar but food prices down and core
	Mar CPI core	0.1%	0.1%	0.1%	price pressures minimal. See text box.
	Apr NAHB housing market index	47	50	49	Plunged in Feb and failed to recover much in Mar.
	Apr NY Fed factory survey	5.6	8.0	3.5	Seasonal issue often causes mid year slump, starting in Apr or May.
	Feb TIC data, \$bn	7.3	–	–	Net long-term TIC flows.
	Fedspeak	–	–	–	Fed Chair Yellen, Plosser, Lockhart & Rosengren.
Can	Feb manufacturing sales	1.5%	1.0%	–	Fast sales growth in Jan, with steel offsetting weaker autos.
	Mar existing home sales	0.3%	–	–	Feb saw first rise since Sep last year.
Wed 16					
NZ	GlobalDairyTrade auction	–8.9%	–	–	Prices down 20% from peaks in recent auctions.
	Q1 consumer prices	0.1%	0.5%	0.4%	Annual inflation holding steady at 1.6%.
Aus	Mar Westpac–MI Leading index	–0.19	–	–	Saw a sharp loss of momentum in Feb to first sub-trend read since '12.
Chn	Mar fixed investment %ytd	17.9%	18.0%	–	Utilities should bounce, heavy industry to stay under pressure.
	Mar retail sales %yr	11.8%	12.2%	–	Sentiment was weak through Q1, but was Jan-Feb fall overdone?
	Mar industrial production %yr	8.6%	9.0%	–	Heavy industry had excess inventory in Jan-Feb, output to be hindered.
	Q1 GDP %yr	7.7%	7.3%	7.4%	Soft domestic demand, narrow net X = weak nominal, but lower IPD.
Eur	Mar CPI final %yr	0.5% a	–	0.4%	Downward revision given latest CPI data for France, Greece & Holland.
UK	Mar unemployment ch'	–35k	–30k	–30k	Benefit claimants. Jobs up as economy growing above trend pace.
US	Mar housing starts	–0.2%	6.7%	4.0%	Starts pace for (single family dwellings) had been running ahead of
	Mar building permits	7.3%	–0.6%	–4.0%	permits until the harsh winter. See text box.
	Mar industrial production	0.6%	0.5%	0.9%	Factory hours rose by 0.7%. See text box.
	Fed beige book	–	–	–	Prepared ahead of the next FOMC meeting at the end of the month.
	Fedspeak	–	–	–	Bullard and Rosengren.
Can	Bank of Canada rate decision	1.0%	1.0%	1.0%	Policy firmly on hold, but next move eventually up.
Thu 17					
Aus	NAB business survey	–	–	–	Quarterly report provides additional detail on conditions.
Eur	Feb current a/c balance sa €bn	25.3	–	–	In surplus since late 2011, Jan was a new record.
Ger	Mar producer prices %yr	–0.9%	–	–1.1%	Euro appreciation in March to drive further PPI decline.
US	Initial jobless claims w/e 12/4	300k	315k	310k	Easter seasonality swings might come into play.
	Apr Philadelphia Fed factory survey	9.0	9.5	3.0	Seasonal mid-year slump in 2011, 2012 less obvious in 2013.
Can	Mar CPI %yr	1.1%	1.4%	–	BoC core rate was 1.2%yr in Feb.
Fri 18					
Chn	Mar new dwelling prices %net bal	80.0%	–	–	Pressure more pronounced in secondary market (42.9%).

New Zealand forecasts

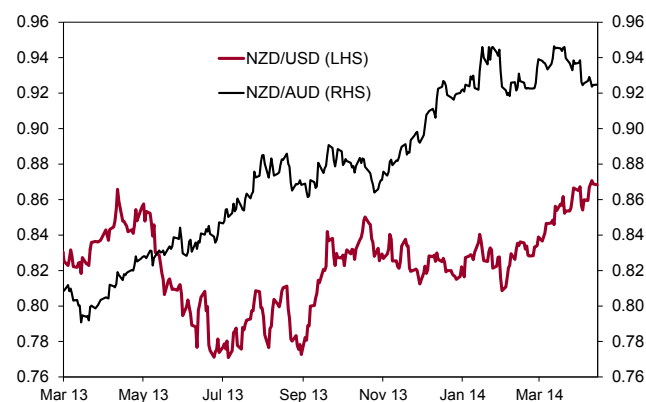
Economic Growth Forecasts	March years				Calendar years			
	2013	2014f	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.1	4.0	3.0	2.6	2.7	4.0	3.2
Employment	0.4	3.3	2.8	1.5	0.4	2.9	2.9	1.8
Unemployment Rate % s.a.	6.2	5.8	5.1	4.8	6.8	6.0	5.1	4.7
CPI	0.9	1.6	1.8	2.4	0.9	1.6	1.8	2.2
Current Account Balance % of GDP	-3.9	-3.1	-4.9	-5.2	-4.1	-3.4	-4.1	-5.3

Financial Forecasts	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Cash	3.25	3.50	3.75	4.00	4.00	4.25
90 Day bill	3.50	3.75	4.00	4.20	4.30	4.50
2 Year Swap	4.10	4.30	4.50	4.65	4.80	5.00
5 Year Swap	4.70	4.80	4.90	5.05	5.20	5.35
10 Year Bond	4.80	5.00	5.10	5.20	5.30	5.40
NZD/USD	0.86	0.86	0.84	0.83	0.82	0.83
NZD/AUD	0.95	0.96	0.95	0.95	0.94	0.93
NZD/JPY	89.4	88.6	85.7	85.5	85.3	86.6
NZD/EUR	0.63	0.63	0.64	0.64	0.63	0.63
NZD/GBP	0.50	0.51	0.50	0.49	0.47	0.45
TWI	80.5	80.9	80.0	79.6	78.6	78.4

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 14 Apr 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.75%	2.75%	2.75%
30 Days	3.05%	2.97%	2.94%
60 Days	3.13%	3.05%	3.01%
90 Days	3.22%	3.12%	3.06%
2 Year Swap	4.05%	4.03%	4.04%
5 Year Swap	4.63%	4.61%	4.57%

NZ foreign currency mid-rates as at Monday 14 Apr 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8683	0.8663	0.8530
NZD/EUR	0.6274	0.6294	0.6139
NZD/GBP	0.5195	0.5202	0.5128
NZD/JPY	88.23	89.16	86.39
NZD/AUD	0.9248	0.9373	0.9483
TWI	80.47	80.82	79.67

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013	2014f	2015f
Australia						
Real GDP % yr	2.2	2.6	3.6	2.4	2.7	3.0
CPI inflation % annual	2.8	3.0	2.2	2.7	2.4	2.5
Unemployment %	5.2	5.2	5.3	5.8	6.5	6.3
Current Account % GDP	-3.5	-2.8	-4.1	-2.9	-3.1	-2.0
United States						
Real GDP %yr	2.5	1.8	2.8	1.9	2.2	2.5
Consumer Prices %yr	1.6	3.1	2.1	1.5	1.5	1.5
Unemployment Rate %	9.6	8.9	8.1	7.4	6.8	6.2
Current Account %GDP	-3.0	-2.9	-2.7	-2.3	-2.4	-2.3
Japan						
Real GDP %yr	4.9	-0.3	1.5	1.6	1.5	1.3
Euroland						
Real GDP %yr	1.9	1.6	-0.6	-0.4	0.8	0.8
United Kingdom						
Real GDP %yr	1.6	1.2	0.2	1.7	2.6	2.1
China						
Real GDP %yr	10.4	9.3	7.7	7.7	7.3	7.6
East Asia ex China						
Real GDP %yr	7.8	4.3	3.9	4.0	4.0	5.0
World						
Real GDP %yr	5.2	3.9	3.2	2.9	3.2	3.8
Forecasts finalised 4 April 2014						

Interest Rate Forecasts	Latest	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Australia						
Cash	2.50	2.50	2.50	2.50	2.50	2.50
90 Day Bill	2.69	2.55	2.55	2.55	2.55	2.65
10 Year Bond	4.01	3.90	3.70	4.00	4.20	4.50
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.65	2.60	2.50	2.80	3.00	3.20
ECB Repo Rate	0.25	0.25	0.25	0.25	0.25	0.25

Exchange Rate Forecasts	Latest	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
AUD/USD	0.9375	0.91	0.90	0.88	0.87	0.87
USD/JPY	101.62	104	103	102	103	104
EUR/USD	1.3894	1.36	1.34	1.30	1.28	1.28
AUD/NZD	1.0849	1.06	1.05	1.05	1.05	1.06

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Disclaimer continued

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