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Easter, but no surprise

Heading into the countdown to the RBNZ's OCR Review, last week delivered a downside surprise on inflation and another drop in dairy prices. However, this week we should get another instalment of ultra-strong net migration data.

Last week's Consumer Price Index revealed that inflation ticked down from 1.6% to 1.5% in the March quarter. This was well below the market median forecast of 1.7%, and came as a shock to markets that have become accustomed to New Zealand data that goes only upwards. Our own forecast was 1.6% and we saw the risks to the downside, so we were less surprised.

What really matters here is the Reserve Bank's take on the data. Back in the March *Monetary Policy Statement* the RBNZ signalled a front-loaded and extensive OCR hiking cycle on the basis that inflation pressures were building. Its interest rate forecast implies that it was planning to hike the OCR in April, June and July, on top of the hike already delivered in March.

But that was based on a forecast of inflation reaching 2% by June. It now looks more like inflation will be only 1.6% at that point. The question that naturally arises here is, will the RBNZ change its plan? As always, the answer lies in the detail.

The downside surprise on inflation, from the RBNZ's perspective, has been almost entirely on tradable items. Some of this will have been due to food prices, with recent monthly prints showing a smaller than usual rise in prices for this time of year. And some may have been due to the NZ dollar, which has been tracking higher than assumed over the last month or so. The RBNZ is likely to treat these kinds of inflation surprises as transitory, and therefore of diminished importance for monetary policy.

Non-tradables inflation – those items generally not subject to overseas competition – is tracking close to the RBNZ's expectations, and is trending higher. In particular, housing-related pricing pressures have picked up substantially. The price of building a new dwelling has risen 5.1% nationwide in the last year, and this trend is clearly spreading beyond quake-affected Canterbury. Prices for property maintenance, real estate fees and house insurance have also continued to rise.

Easter, but no surprise continued

The RBNZ will be quite concerned by the upward trend in non-tradables inflation, because it knows that non-tradables inflation is hard to suppress once it takes hold. In contrast, the RBNZ will get only a little solace from the fact that tradables inflation is currently low, because it knows that tradables inflation can turn on a dime. So we would suggest that the weak inflation data will be only a modest downside development in the Reserve Bank's deliberations ahead of this week's OCR Review.

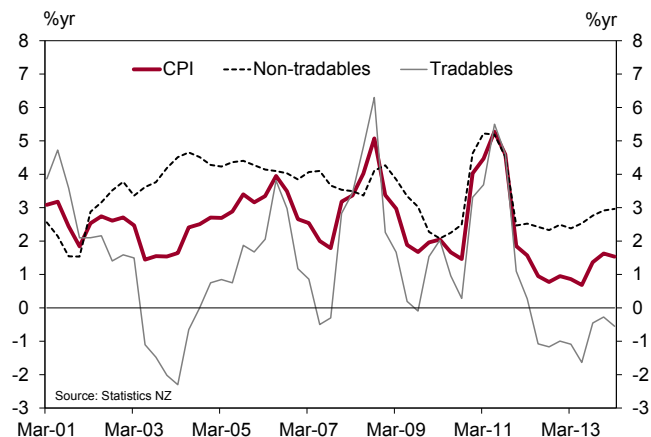
The other important development that the RBNZ will be considering for Thursday's Review will be the fact that the trade-weighted exchange rate is 2.5% higher than the March MPS forecast. This will be considered especially important in light of the fact that the terms of trade are deteriorating. Dairy auction prices have fallen 20% since early February, including a 2.6% fall in prices last week. (On its own, the drop in dairy prices isn't an unanticipated development - both the Reserve Bank and we have been expecting a drop in dairy prices for some time.)

The final consideration for the RBNZ will be net migration, which has in recent months dramatically exceeded its forecast, and has even exceeded our own bullish forecast. This week we anticipate data showing that net migration reached 31,000 in the year to March 2014 - and we think it is on its way to 40,000 per annum (or almost 1% of New Zealand's population).

Although strong net migration will be a partial offset, the balance of the developments and data surprises that the RBNZ has faced since it published the March *Monetary Policy Statement* clearly points towards less inflation pressure in the system. Six weeks ago the RBNZ indicated that it was considering 200 basis points of OCR increases over two years. Now it may be thinking more along the lines of 175 basis points.

The Reserve Bank will probably react by deliberately choosing slightly more cautious language when it describes the outlook for inflation and the OCR in the press release accompanying the OCR review.

CPI inflation



However, the downside developments have not been significant enough to kibosh the planned April hike - we, and the markets, still expect the RBNZ will lift the OCR to 3% on Thursday. Nor has the degree of downside surprise been enough to cancel the June OCR hike which we had pencilled in.

What is becoming more doubtful in our minds is the prospect of a July hike. Should the exchange rate remain high or the data weaken, then the June *Monetary Policy Statement* would be the natural opportunity for the RBNZ to deliver a final hike and signal a pause in the cycle.

Fixed vs Floating for mortgages

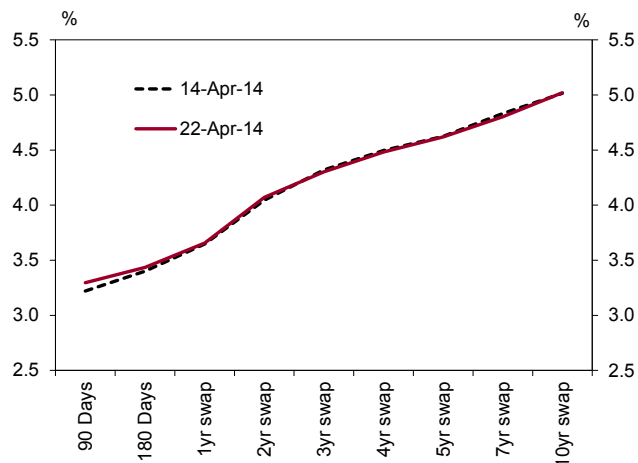
Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates, such as the six month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

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

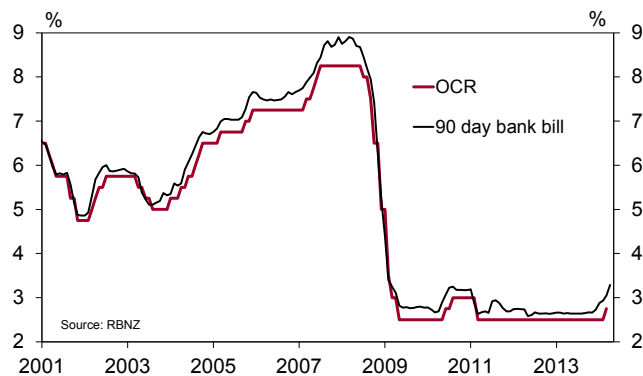


NZ RBNZ policy decision

Apr 24, Last: 2.75%, Westpac f/c: 3.0%, Mkt f.c: 3.0%

- We expect the Reserve Bank will increase the OCR to 3% on the day.
- The accompanying press release will reiterate that inflation pressures are building and so the OCR needs to rise. However, we expect that this OCR review will strike a more cautious tone than the March MPS, due to soft inflation data and the high exchange rate.
- The RBNZ is probably still on track to hike the OCR again in June, but question marks are starting to appear around the July hike that we have also pencilled in.

NZ OCR and 90 day rate

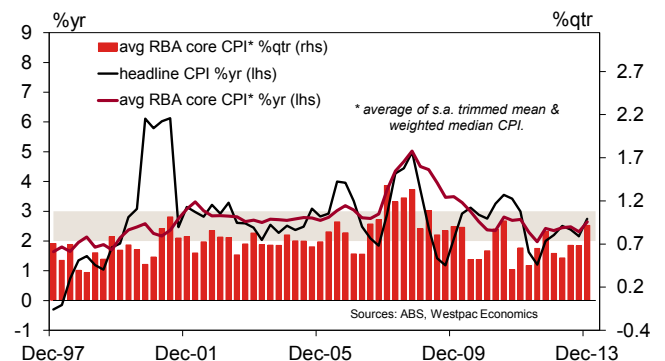


Aus Q1 CPI

**Apr 23, Last: x%, WBC f/c: 0.9%qtr
Mkt f/c: 0.8%, Range: 0.4% to 1.0%**

- The CPI rose 0.8% in Q4, well above the market expectation of a 0.5% rise and lifting the annual rate to 2.7%yr from 2.2%yr in Q3. The RBA core measures also surprised on the high side, with the average core inflation measure rising 0.9%qtr/2.6%yr. The biggest surprises seem to be due to a greater than expected pass-through from the weaker AUD.
- Exchange rate price effects are expected to feature again in Q1, amplified by a seasonal boost, tobacco excise and fuel price rises. Our Q1 headline CPI forecast is 0.9%qtr/3.2%yr. Core inflation, as measured by the average of the trimmed mean and weighted median, is expected to show a more muted rise of 0.7%qtr/2.8%yr. Please see our full Q1 CPI preview for more details.

Headline & core in the upper half of the band



US Mar existing and new home sales

Apr 22, Existing: Last: -0.4%, WBC f/c: -0.5%

Apr 23, New: Last: -3.3%, WBC f/c: 2.0%

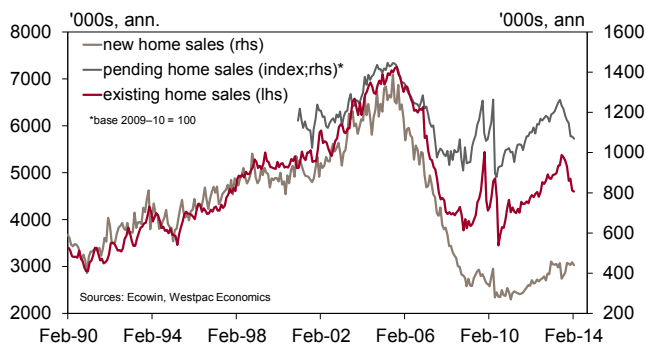
- Pending home sales' eight consecutive monthly declines between July and Feb took sales down 15%, some of which may be temporary due to the harsh winter. Existing home sales are down 14% from their mid 2013 peak so a further modest slip is in prospect in March.
- New home sales ran at a 452k annualised pace in Jan-Feb 2013 and a 448k pace in Jan-Feb 2014, little changed from 447k in Q4 2013. Last year started and finished on the same sales pace (after a mid-year dip) and this year has maintained that pace so far despite the weather. It's difficult to discern any snow effect here at all – indeed the 3% fall in Feb was similar to that recorded in Feb last year. We expect a partial rebound in March new home sales, with the housing market less upbeat heading into 2014 even aside from weather issues.

US Mar durable goods orders

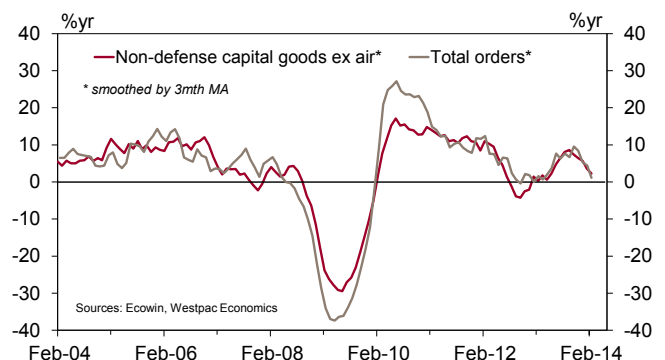
Apr 24, Last: 2.2%, WBC f/c: -0.5%

- Durable goods orders rose 2.2% in Feb on the back of a 14% rise in defence orders, a 3.6% recovery in autos (down 8.5% in Dec-Jan) and a 14% rise in civil aircraft after back to back 22% declines. Core capital goods orders fell 1.3% in Feb and have fallen in 4 of the past 6 months to be down 2% annualised in the Sep-Feb half year – in the 6 months to Aug 2013 core orders had risen 4%. This points to a significant loss of momentum in the business investment story at a time when the economy was reported to have accelerated.
- ISM factory orders had recovered just a third of their Jan plunge by Mar. Boeing orders were flat/weaker. Auto production slipped in March; business equipment output was up 0.5%. These signals suggest a sluggish headline. Any rise in core capital goods orders would likely be modest.

US housing sales



US durable goods orders



Data calendar

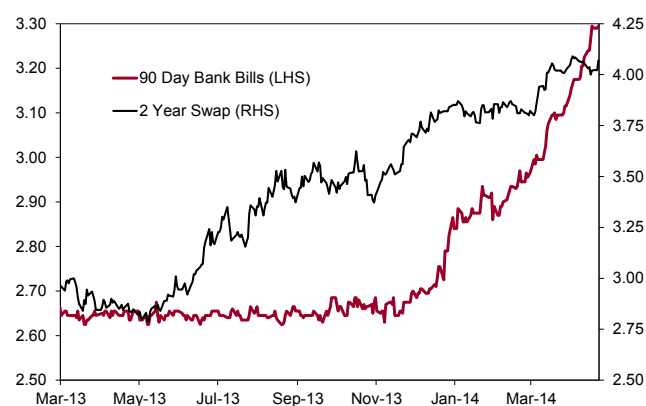
		Last	Market median	Westpac forecast	Risk/Comment
Tue 22					
Eur	Apr consumer confidence advance	-9.3	-9.0	-9.5	Confidence improved sharply in Q1, but may slip on Ukraine, deflation.
	Feb construction output	1.5%	-	-	Up 8.8% over year to Feb, although performances vary by country.
US	Apr Richmond Fed factory index	-7	-	-3	Richmond Fed dived on snow disruption in Feb but no Mar recovery.
	Feb house prices	0.5%	-	-	FHFA index.
	Mar existing home sales	-0.4%	-1.1%	-0.5%	Pending sales have not risen since June last year.
Can	Feb wholesale sales	0.8%	-	-	Jan saw partial recovery on computer/comms sales after Dec slide.
Wed 23					
NZ	Mar net migration	3470	-	3300	Net immigration running above 3000 a month.
Aus	Q1 CPI	0.8%	0.8%	0.9%	More price effects from lower AUD, amplified by seasonal boost ...
	Q1 average RBA core CPI	0.9%	0.7%	0.7%	... lifting headline to 3.2%yr but core inflation more contained at 2.8%yr.
Chn	Apr HSBC manufacturing PMI - flash	48.0	48.2	-	Orders-stocks ratio implies fall. +ive seasonality directional wildcard.
Eur	Apr PMI factory adv	53.0	53.1	52.7	March saw France improve on both PMIs, Germany slipping.
	Apr PMI services adv	52.2	52.5	52.0	Composite PMI fact/ser was 53.1 in Mar.
UK	BoE MPC minutes	-	-	-	April minutes usually defer to May when forecasts redone.
	Apr CBI industrial trends survey	6	7	-	Total orders index. Qtrly business optimism survey also published.
	Mar PSNCR £bn	-0.2	-	-	Public sector net credit requirement. PSNB ex intv'ns £9.3bn in Feb.
US	Apr Markit PMI factory	55.5	56.0	-	Unhelpfully tells different story to ISM surveying same industries.
	Mar new home sales	-3.3%	2.3%	2.0%	Weather impact minimal given usual volatility in series.
Can	Feb retail sales	1.3%	-	-	Jan retail sales rebound from weather-disrupted Dec
Thu 24					
NZ	RBNZ policy decision	2.75%	3.00%	3.00%	RBNZ likely to strike a slightly more cautious tone than in March.
Ger	Apr Ifo business climate index	110.7	110.5	110.5	Deteriorating expectations but improved current conditions lately.
UK	Apr CBI retail survey	13	-	-	Reported sales index.
US	Mar durable goods orders	2.2%	1.9%	1.0%	Recent gains due cars, planes; underlying story soft.
	Initial jobless claims w/e 19/4	-	-	-	Easter seasonality swings may be an issue.
	Apr Kansas City Fed factory index	10	-	5	At a 2 year high in March.
Fri 25					
Aus, NZ	ANZAC Day	-	-	-	Public holiday, markets closed.
UK	Mar retail sales incl autos	1.7%	-0.2%	-1.0%	Big monthly swings due weather disruption in part. Surveys weaker.
	Mar mortgages no.	47.5k	-	-	BBA data covering about 70% of the market.
US	Apr Market PMI services	55.3	-	-	This PMI tracks the ISM non-manufacturing sometimes.
	Apr UoM consumer sentiment final	82.6 a	83.0	82.0	Weekly confidence data suggest sentiment slipping in April.

New Zealand forecasts

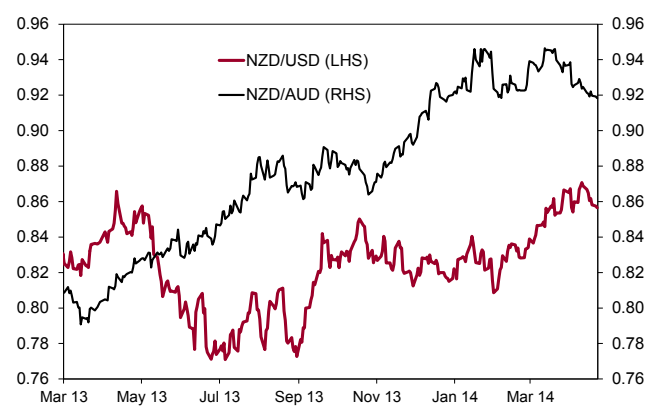
Economic Growth Forecasts	March years				Calendar years			
	2013	2014f	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.1	4.0	3.0	2.6	2.7	4.0	3.2
Employment	0.4	3.3	2.8	1.5	0.4	2.9	2.9	1.8
Unemployment Rate % s.a.	6.2	5.8	5.1	4.8	6.8	6.0	5.1	4.7
CPI	0.9	1.5	1.8	2.4	0.9	1.6	1.6	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 Tuesday 22 Apr 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.75%	2.75%	2.75%
30 Days	3.16%	3.00%	2.95%
60 Days	3.23%	3.09%	3.01%
90 Days	3.30%	3.17%	3.08%
2 Year Swap	4.07%	4.05%	4.02%
5 Year Swap	4.62%	4.64%	4.62%

NZ foreign currency mid-rates as at Tuesday 22 Apr 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8565	0.8582	0.8548
NZD/EUR	0.6209	0.6265	0.6196
NZD/GBP	0.5101	0.5177	0.5185
NZD/JPY	87.89	88.62	87.29
NZD/AUD	0.9183	0.9244	0.9406
TWI	79.67	80.18	79.98

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	2.67	2.55	2.55	2.55	2.55	2.65
10 Year Bond	3.98	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	2.63	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	0.9376	0.91	0.90	0.88	0.87	0.87
USD/JPY	102.07	104	103	102	103	104
EUR/USD	1.3836	1.36	1.34	1.30	1.28	1.28
AUD/NZD	1.0860	1.06	1.05	1.05	1.05	1.06

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