

Lake Wanaka, New Zealand

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Variations on a theme

Last week the Reserve Bank increased the OCR a second time to 3.00%, as was unanimously expected by economists and financial markets. Also as expected, the accompanying press release acknowledged some of the less inflationary developments over the previous six weeks. However, the message remained firmly focused on the build-up of inflation pressures over the medium term, requiring higher interest rates over the next couple of years.

More so than it has done in recent times, the RBNZ re-used much of the language from its previous press release in the March *Monetary Policy Statement*. For us, that implies two things. First, it furthers the impression that the RBNZ has firmly set its intended course for monetary policy. Second, it means that any changes in wording were intentional, and are worthy of elaboration.

Of the downside surprises since the March *MPS*, the RBNZ gave the least credence to the softer than expected March quarter CPI figures, where annual inflation slowed to 1.5% against the RBNZ's forecast for a lift to 1.7%. The statement noted that headline inflation "is moderate" (compared to "has been moderate" in March), but that "inflationary pressures are increasing and are expected to continue doing so over the next two years." This serves to emphasise that the RBNZ is focused on future inflation on average over the medium term, not the latest blip in the headline figures.

The 20% drop in world dairy prices in the last couple of months was cited explicitly in the press release, although the RBNZ did not elaborate on the implications. We have long been expecting dairy prices to come off their highs as both domestic and global milk supply picks up, and we don't think that the RBNZ will have been too surprised by the fall in prices either.

The most substantial change in the RBNZ's language was around the exchange rate, with the New Zealand dollar trade-weighted index currently tracking about 2% higher

Variations on a theme continued

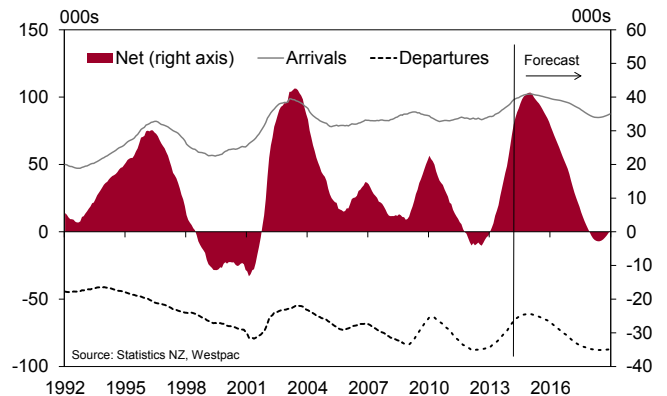
than the RBNZ had assumed in March. The crucial 'bias' part of the press release, regarding future changes in the OCR, started out as a repeat from March: "The speed and extent to which the OCR will be raised will depend on economic data and our continuing assessment of emerging inflationary pressures." However, the latest statement added the clause: "including the extent to which the high exchange rate leads to lower inflationary pressure."

The statement did also touch on some positive developments since the March MPS. The RBNZ has upgraded its estimate of GDP growth in the year to March from 3.3% to 3.5%, suggesting that it has effectively banked the upside surprise from December quarter GDP. Growing inflation pressures in the construction sector – apparent in the March quarter CPI – warranted a mention, and the RBNZ noted that "the increase in net immigration is adding to housing demand".

The statement would certainly have been coloured by the migration figures released the day before. The monthly net inflow accelerated further to 3,800 people in March, driven by both fewer departures and a growing influx of foreign immigrants and returning New Zealanders. The annual net inflow has now surpassed the 30,000 mark, and we expect it to peak at around 40,000 by the end of this year – equivalent to almost a 1% increase in the population. This is clearly stronger than the RBNZ was anticipating, although our modelling suggests that the scale of the 'surprise' is worth about 0.4% in terms of extra house price inflation – a fairly modest effect, and not enough to negate the impact of rising mortgage rates.

With no substantial change in the RBNZ's message, our expectations for the OCR this year are also unchanged. The RBNZ is clearly on track to deliver another 25 basis point hike in June, and we have pencilled in further hikes of 25 basis points each for July and December. However, we admit that the high exchange rate makes a fourth consecutive hike in July a close call. While we expect the June MPS to signal further rate hikes, there is a strong chance that the RBNZ uses its full set of forecasts to justify a slowing in the expected pace of tightening. In this scenario we would expect the next OCR hike to be delayed until September or October.

Net immigration to New Zealand



This week brings the usual month-end flurry of economic data. The merchandise trade balance for March (Tuesday) is expected to be another boomer, with dairy export prices remaining high and volumes back at pre-drought levels. While dairy prices at auction began to fall sharply in March, those prices related to delivery in April and beyond, so will start to show up in the trade figures over the next few months.

Building consents for March (Wednesday) are expected to continue their upward trend, notwithstanding the ongoing volatility in the apartment units component. Business confidence (also Wednesday) should also remain near cycle highs, though perhaps with a seasonal drop in the headline measure. With the upturn in activity now well established, we're increasingly looking to this survey for signs that capacity pressures and pricing power are re-emerging.

Finally, we get some detail on mortgage lending activity in March. The share of high-LVR lending, released on Tuesday, is likely to have remained well below the RBNZ's 10% cap. The aggregate credit figures on Wednesday could be of more interest – in particular, whether the shift from floating-rate to fixed-rate mortgages has accelerated since the first OCR hike.

Fixed vs Floating for mortgages

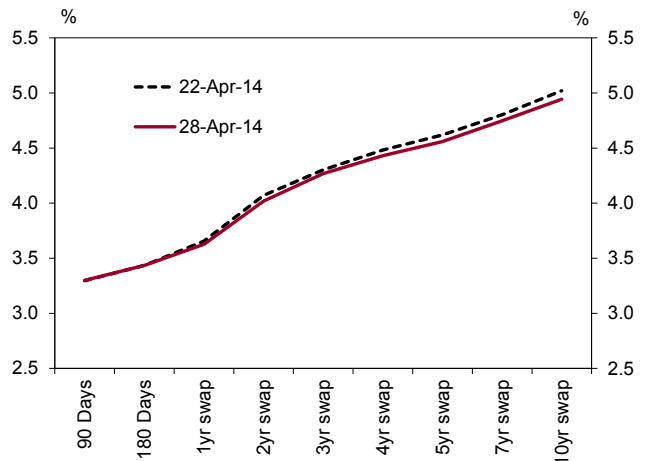
Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates, such as the six month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

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

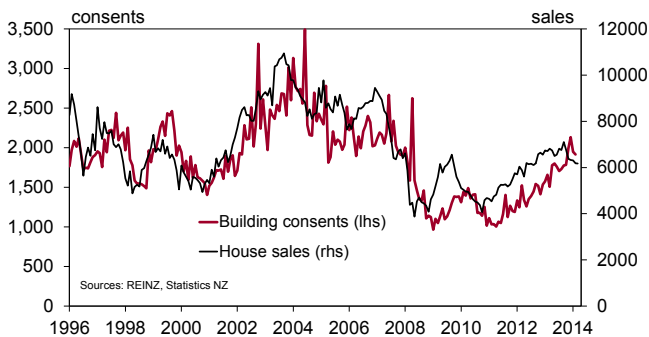


NZ Mar building consents

Apr 30, Last: -1.7%, Westpac f/c: 4.0%

- Single-dwelling consents rose to a six-year high in February, led by Auckland and Canterbury as the building industry continues to address those region's respective supply shortages. A drop in apartment unit consents (to a below-average 66) dragged down the total for the month.
- Our forecast of a 4% rise in March consents assumes a return to average levels for apartment units, along with a continued steady upturn in single dwellings. Falling house sales in recent months would ordinarily be a red flag for a drop in building activity. However, there are two factors which suggest that the wedge could persist: the necessity of the Christchurch rebuild, and the RBNZ's restrictions on high-LVR lending, which have dampened turnover but not the underlying demand for dwellings. The RBNZ's decision last December to exempt high-LVR construction loans should further support this wedge.

NZ housing activity

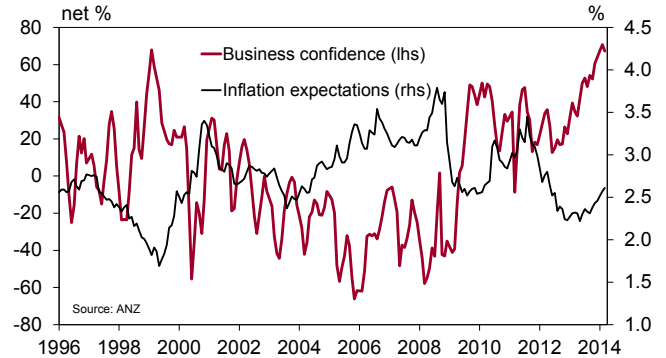


NZ Apr business confidence

Apr 30, Last: 67.3

- Business confidence remained near a two-decade high in March (arguably exceeding it, after seasonal adjustment). The data flow since then has generally remained positive, and the informal BNZ business confidence survey (taken in early April) was only slightly lower.
- With the upturn in activity now well established, we are increasingly focusing on indicators of inflation pressures. Firms clearly see a need to expand capacity, and pricing intentions are now above-average. However, the ability to act on those intentions remains muted, as demonstrated by the softer than expected March quarter CPI (published after the responses were received for the April business survey).

NZ business confidence and inflation expectations

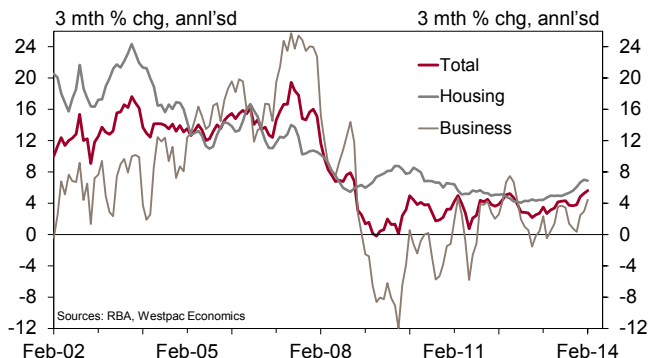


Aus Mar private credit

Apr 30 Last: 0.4%, WBC f/c: 0.4%
Mkt f/c: 0.4%, Range: 0.3% to 0.5%

- Credit has gained momentum as business credit advances.
- Monthly growth in total credit, which was steady at 0.3% through April to November 2013, strengthened to a 0.5%, a 0.4% and a 0.4% over the past three months. We anticipate a 0.4% print in March. This will lift annual growth to 4.5%, the strongest outcome since early 2009, when the GFC hit.
- Housing credit has strengthened, off a low base, as the sector responds to record low interest rates. Three month annualised growth in January was 6.9%, up from 4.4% a year earlier.
- With commercial finance advancing strongly in recent months business credit is moving higher, with prints of 0.5%, 0.2% and 0.4% over the past three months, following a flat period. There is the prospect of a further rise in March.

Credit momentum

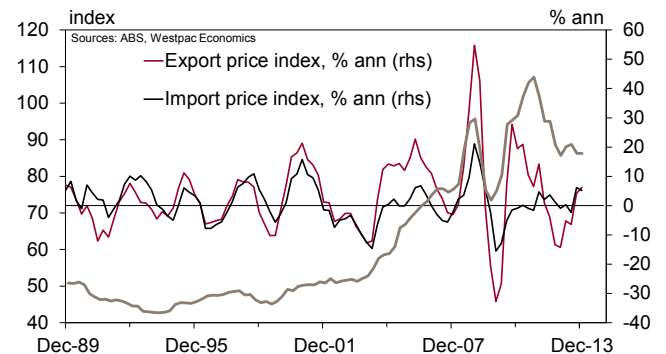


Aus Q1 import price index

May 1, Last: -0.6%, WBC f/c: 2.2%
Mkt f/c: 1.8%, Range: 0.0% to 3.9%

- Import goods prices are forecast to rise by 2.2% in Q1, lifting annual growth to around 7.5%. This follows a small decline in the import price index in Q4, down 0.6%.
- Fluctuations in the Aussie dollar are typically the key driver of quarter to quarter movements in import prices. In the March quarter the currency weakened 2.8% on a TWI basis, following a 0.7% rise in Q4, to be down 11.6% on a year ago.
- Global oil prices weakened a little, down 1.3% in USD terms, thereby partially offsetting the impact of a lower AUD.

Import & export price index



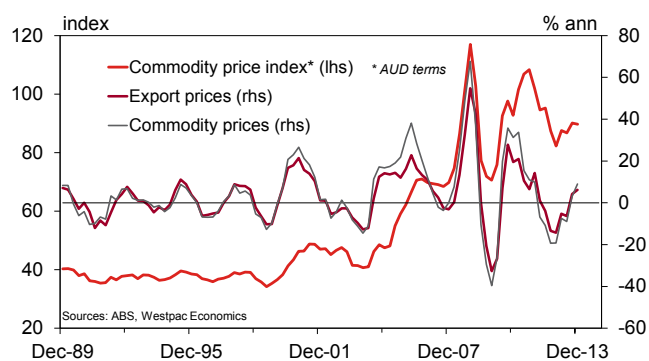
Aus Q1 export price index

May 1, Last: -0.5%, WBC f/c: 2.4%
Mkt f/c: 1.5%, Range: 0.0% to 2.4%

- The export goods price index is forecast to rise by 2.4% in Q1, which would see annual growth broadly steady at around 6.0%.
- Global commodity prices edged lower in Q1, down about 1% in USD terms.
- The dominant factor in the quarter was a weaker Aussie dollar, moving 3.4% lower against the USD. That placed upward pressure on export goods prices.
- The terms of trade for goods is broadly flat in Q1 on our forecasts, up 0.2%, to be around 1% lower than a year earlier.

(Note, the Balance of Payments estimates of export goods prices can differ from the export price index.)

Commodity prices and export price index

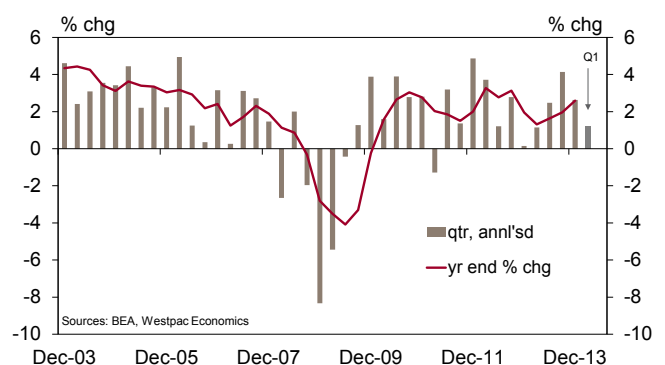


US Q1 GDP growth

April 30, GDP % annualised Last: 2.6%, WBC f/c: 1.2%

- Q4 GDP growth was first reported up 3.2% but has since been revised down to 2.6% annualised, slower than Q3's 4.1% pace. Household consumption of services was the fastest for some years and business investment growth picked up but housing was a drag, inventories neutral and net exports contributed 1ppt to the GDP bottom line.
- Only partly due to winter disruption, monthly data suggest personal consumption growth slowed sharply from 3.3% annualised in Q4. As we go to press we await capital goods shipments data but risks to our 2% growth forecast for equipment investment (from 11% in Q4) are to the downside.
- Destocking will have been a drag on Q1 growth and net exports may well be flat based on two months' data. Taken together we see Q1 GDP growth of 1.2% annualised

US GDP growth

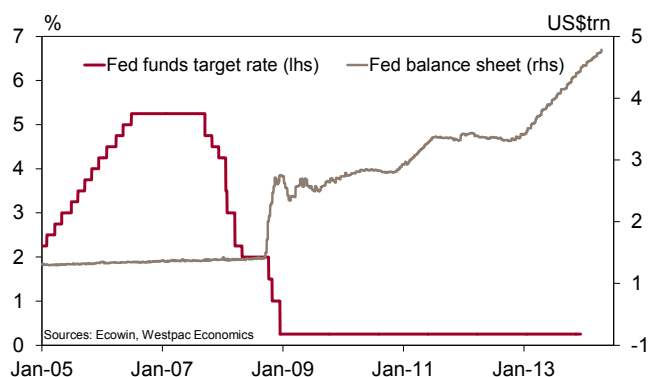


US FOMC

Apr 29-30, Asset Purchases \$bn Last: 55, WBC f/c 45

- The March FOMC came and went as expected, with a further \$10bn in tapering and a more malleable, qualitative forward guidance structure installed. The FOMC were a little more circumspect on current momentum, but remained resolute in their expectations over the outlook.
- Since then, FOMC communications have remained consistent with the thesis that, barring a material downside surprise on the economy, the tapering process will continue in measured steps in coming months, the next step being a further \$10bn.
- As is clearly apparent from the tone of available partial data, the likely outcome for Q1 GDP discussed above, and the absence of activity in the housing sector, underlying momentum is poor. That said, the FOMC preference is to continue tapering, then keep rates unchanged for as long as necessary.

Fed funds target rate and balance sheet

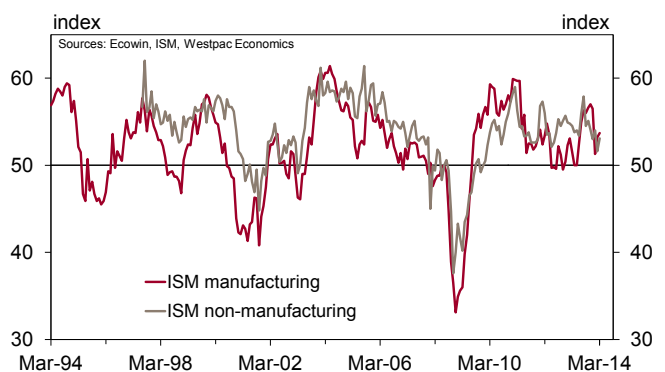


US Apr ISM factory survey

May 1, Manuf Last: 53.7, WBC f/c: 54.0

- The ISM factory survey rose from 53.2 to 53.7 in March, with production and orders higher but jobs slipping (jobs yet to post a rise in 2014). Production/orders remain well below the 60+ readings of H2 2013: the ISM suggests a lingering weather effect via excess inventory rundown (accumulated during the bad weather) is a factor at play.
- We suspect that there has been a genuine slowdown relative to where the economy was at in the second half of last year. The alternative Markit PMI which also surveys supply/purchasing managers edged slightly lower in April, but it unhelpfully has been contradicting the ISM story, despite both purporting to survey the same staff in the same industries. We expect to see a modestly higher 54.0 reading for the ISM, still well below the H2 2013 pace of expansion recorded half a year ago.

US ISMs

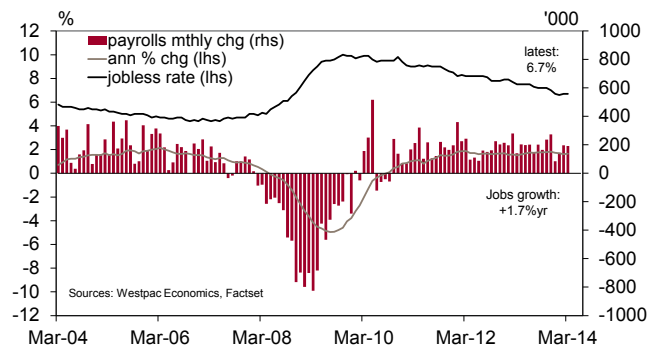


US non-farm payrolls in April

May 2 Last: 192k, WBC f/c: 190k

- Non-farm payrolls rose 192k in March, and the usual upward revisions added a further 37k jobs to Jan - Feb, such that March was 5k down on Feb's gain. Even so, payrolls averaged just 178k in Q1, down from 198k in Q4 last year; Q1 was the second weakest quarter for jobs growth in the last year and a half.
- Initial jobless claims in the week prior to the payrolls survey were down almost 20k vs a month earlier. However on our forecasts the economy slowed sharply in Q1 2014, which would tend to weigh against the prospects that payrolls growth would continue to accelerate into early Q2. Growth of 1.1% annualised in Q1 2013 drove payrolls gains averaging 200k in Q2 last year. Bearing in mind the tendency for upward revisions to the prior two months, we doubt the April report could deliver much more than 190k jobs in the first estimate for the month.

US payrolls



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 28					
Eur	EU Spring economic forecasts	1.2%	–	–	2014 GDP. Westpac expects growth ~1%. Q1 GDP due mid May.
Ger	Mar retail sales	1.3%	–	–	Back to back 1+% gains in Jan-Feb; last seen 2008! Tentative date.
UK	Apr house prices %yr	5.7%	–	–	Hometrack index.
	Apr house prices %yr	9.5%	–	–	Tentative date for Nationwide index due 28/4-2/5.
US	Mar pending home sales	-0.8%	0.6%	2.0%	Sales down 15% since mid 2013, but some post snow bounce likely.
	Apr Dallas Fed factory index	4.9	–	3.0	Latest six mths little volatility within 0-5 of 28 pt range previous 6 mths.
Tue 29					
NZ	Mar merchandise trade balance \$m	818	–	1200	Another chunky trade surplus expected in March.
Eur	Apr business climate indicator	0.39	–	0.50	PMI surveys stronger in April.
	Apr economic confidence	102.4	–	102.7	Consumer confidence higher in advance report.
	Mar money supply M3 %yr	1.3%	–	–	Focus on lending to households and corporates, down 2% yr.
Ger	May GfK consumer confidence	8.5	–	–	Surveyed early Apr but labelled May. Highest since 2007 in Mar-Apr.
	Apr CPI prelim %yr	1.0%	–	1.2%	Late Easter to push up CPI temporarily from near 4 year low.
UK	Q1 GDP advance	0.7%	–	0.9%	Fastest quarterly growth rate in 4 years despite flooding.
US	Feb house prices %yr	13.2%	12.9%	–	S&P Case Shiller 20 city index.
	Apr Conf Brd consumer confidence	82.3	83.2	84.0	Weekly data suggest confidence firmed later in April.
Wed 30					
NZ	Mar building consents	-1.7%	–	4.0%	Led by respective housing shortages in Christchurch and Auckland.
	Apr ANZ business confidence	67.3	–	–	Surveyed pricing intentions rising, though actual inflation remains low.
	Mar private sector credit %yr	4.7%	–	–	Mortgage credit growth has slowed modestly.
Aus	Mar private sector credit	0.4%	0.4%	0.4%	Lift in momentum to extend into March, as business credit advances.
Eur	Apr CPI flash %yr	0.5%	–	0.7%	Up-tick due to late Easter; likely to reverse in May. Mar core 0.7% yr.
Ger	Apr unemployment ch	-12k	–	–	German joblessness fallen 73k in last 4 months.
UK	Apr GfK consumer confidence	-5	–	-5	Confidence approaching 7 year highs.
US	Apr ADP private payrolls	191k	215k	185k	Slow Q1 GDP growth to weigh against payroll employment.
	Q1 GDP advance % annualised	2.6%	1.0%	1.2%	Snow disruption just partly responsible for slowest growth since late 12.
	Q1 employment cost index	0.5%	0.5%	0.5%	Costs remain subdued with job market still sub-par.
	Apr Chicago PMI	55.9	56.5	54.0	Chicago PMI bizarrely slowing as weather improves.
	Apr Milwaukee NAPM	56.0	–	–	Little watched.
	FOMC policy statmnt; asset purch \$bn	55	45	45	Softer data tone likely to see nuanced language shift but ongoing taper.
Can	Feb GDP	0.5%	–	–	Jan rise reversed Dec fall.
	Mar industrial product prices	1.0%	–	–	Strongest run of four straight gains in three years Nov-Feb.
Thu 1					
Aus	Q1 import price index	-0.6%	1.8%	2.2%	Currency weakened in Q1, down 2.8% on a TWI basis.
	Q1 export price index	-0.5%	1.5%	2.4%	AUD fell 3.4% vs USD, commodity prices down 1% in USD terms.
	Apr house prices, RPData Riskmark	2.3%	–	–	Are prices, after a strong run, losing momentum ?
	Apr AiG PMI	47.9	–	–	Manufacturing index sub 50, suggesting conditions are contracting
Chn	Apr NBS manufacturing PMI	50.3	50.5	–	Flash HSBC PMI improved 0.3ppts from March but from a lower base.
UK	Apr factory PMI	55.3	–	56.0	Mar was lowest reading since July last year, though still decent.
	Mar net mortgage lending £bn	1.7	–	–	BoE/Treasury FLS withdrawn for mortgages, but momentum ongoing.
	Mar net consumer credit £bn	0.6	–	–	Demand for consumer credit remains quite weak.
	Mar M4 money supply %yr	0.7%	–	–	M4 ex IOFCs up 3.0% 3m annualised in Feb (from 7.9% yr in Aug 12).
US	Mar core PCE deflator	0.1%	0.2%	0.2%	Core CPI was 0.2% in Mar.
	Mar personal income	0.3%	0.4%	0.2%	Quarterly totals will be known from GDP release on 30/4. Earnings
	Mar personal spending	0.3%	0.6%	0.7%	were flat in Mar, retail sales bounced sharply after snow disruption.
	Mar corporate layoffs %yr	-30.2%	–	–	Challenger series.
	Initial jobless claims w/e Apr 26	–	–	–	Claims trending lower but latest week not yet available.
	Apr ISM factory	53.7	54.0	54.0	Mixed regional survey detail so far for April.
	Apr Markit PMI factory final	55.4 a	–	55.4	Recent outcomes in stark contrast to national ISM survey.
	Mar construction spending	0.1%	0.7%	0.2%	Housing spending momentum may be softening in early 2013.
	Apr auto sales mn annualised	16.3	16.2	–	Guide to extent of consumer spending momentum in early Q2.
	Fed Chair Janet Yellen	–	–	–	Speaking to community bankers.
Can	Apr PMI	53.3	–	–	Much more stable than IVEY PMI.
Fri 2					
NZ	Apr ANZ commodity price index	-0.1%	–	–	Falling dairy prices to push index lower.
Aus	Q1 PPI	0.2%	–	0.4%	Upstream price pressures have been very subdued this cycle.
Eur	Mar unemployment rate %	11.9%	–	11.8%	Steady German jobless rate but slightly lower joblessness elsewhere.
	Apr PMI factory final	53.3a	–	53.4	Note France/Germany differential wider again in advance reports.
UK	Apr PMI construction	62.5	–	62.0	Sector PMI has soared over past year.
US	Apr non-farm payrolls ch'	192k	204k	190k	Q1 GDP growth slowed, unlikely to sustain jobs growth of 200k+ and
	Apr jobless rate	6.7%	6.6%	6.6%	household survey jobs to correct lower, holding jobless rate steady.
	Mar factory goods orders	1.6%	1.3%	–	Durables due 24/4 will provide early clue.
	Apr ISM New York	52.0	–	–	Early year strength dissipated in March.

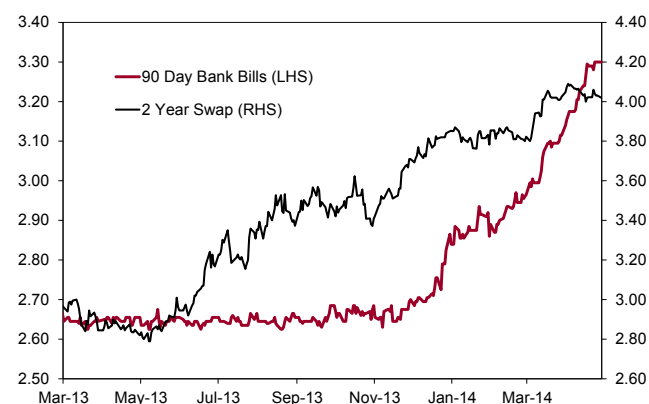


New Zealand forecasts

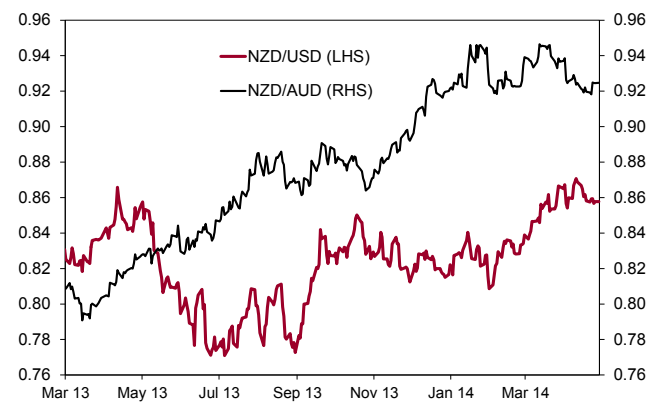
Economic Growth Forecasts	March years				Calendar years			
	2013	2014f	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.1	4.0	3.0	2.6	2.7	4.0	3.2
Employment	0.4	3.3	2.8	1.5	0.4	2.9	2.9	1.8
Unemployment Rate % s.a.	6.2	5.8	5.1	4.8	6.8	6.0	5.1	4.7
CPI	0.9	1.5	1.8	2.4	0.9	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 Monday 28 Apr 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.00%	2.75%	2.75%
30 Days	3.17%	3.05%	2.97%
60 Days	3.24%	3.13%	3.05%
90 Days	3.30%	3.22%	3.12%
2 Year Swap	4.02%	4.05%	4.03%
5 Year Swap	4.56%	4.63%	4.61%

NZ foreign currency mid-rates as at Monday 28 Apr 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8577	0.8683	0.8663
NZD/EUR	0.6197	0.6274	0.6294
NZD/GBP	0.5106	0.5195	0.5202
NZD/JPY	87.63	88.23	89.16
NZD/AUD	0.9247	0.9248	0.9373
TWI	79.76	80.47	80.82

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	2.2	2.4
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	2.68	2.55	2.55	2.55	2.55	2.65
10 Year Bond	3.96	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	2.70	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	0.9297	0.91	0.90	0.88	0.87	0.87
USD/JPY	102.30	104	103	102	103	104
EUR/USD	1.3820	1.36	1.34	1.30	1.28	1.28
AUD/NZD	1.0780	1.06	1.05	1.05	1.05	1.06

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