



Sawcut Gorge, Isolated Hill Scenic Reserve, South Marlborough

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Decisions, decisions

The latest labour market data highlighted that the New Zealand economy is continuing to grow at a solid pace. But at the same time, they showed that inflation remains low and that we still have lingering spare capacity.

It's a combination of conditions that has left the RBNZ between a rock and a hard place. While the risks of OCR cuts have increased, we remain sceptical that the RBNZ will pull the trigger due to the continued strength in the domestic economy.

Developments over the past week, particularly the March quarter employment report, have highlighted the two key challenges that the RBNZ is currently weighing up. First is the weakness in inflation. Even looking through the recent oil related drop in prices, inflation has been lingering below the mid-point of the RBNZ's target band for three years now. And the longer it remains low, the greater the risk that we see a sustained and material downshift in domestic inflation expectations and pricing behaviour. As emphasised in their recent communications, this risk is clearly front of brain for the RBNZ as it would make it harder for them to achieve their medium-term inflation target. Consequently, the weak March quarter wage data will have been an unwelcome surprise. Wage inflation based on the private sector LCI was just 1.8% in the year to March - lower than market expectations and the RBNZ's last published forecasts. In fact, despite strengthening economic growth, we haven't seen any material lift in nominal wage growth since the 2008/09 recession.

On top of this, we've seen signs of lingering spare capacity in the economy, which is pouring cold water on the possibility of a near-term pick-up in domestic inflation. In March the unemployment rate was 5.8% - unchanged from December's upwardly revised level. Behind this result has been strong growth in the size of the labour force. Continued improvements in the labour market have encouraged more people to enter the labour force from both on- and off-shore. This has resulted in the labour force growing by a massive 73,000 people over the past year, and has pushed the participation rate to a record high of 69.6%.

Decisions, decisions continued

This low inflation environment certainly makes cuts in the OCR look tempting. But inflation is not the only thing that matters for monetary policy. The second factor that the RBNZ is conscious of is the strength of economic activity, which remains robust. In recent weeks we've highlighted the strength of household spending and the positive indications for business investment. Adding to these signs of strength were the March quarter employment figures. Employment in the economy was up a solid 0.7% over the March quarter, resulting in a 3.2% gain for the year. And in addition to more people having jobs, they're also working more hours, with strong gains in both the HLFs and QES measures of labour hours (up 1.4% and 2% respectively over the quarter).

And of course, we can't forget the Auckland housing market, which is continuing to sizzle away. The latest data from Barfoot and Thompson showed that prices in Auckland were up 4.8% over the March month, leaving them 13.5% higher for the year.

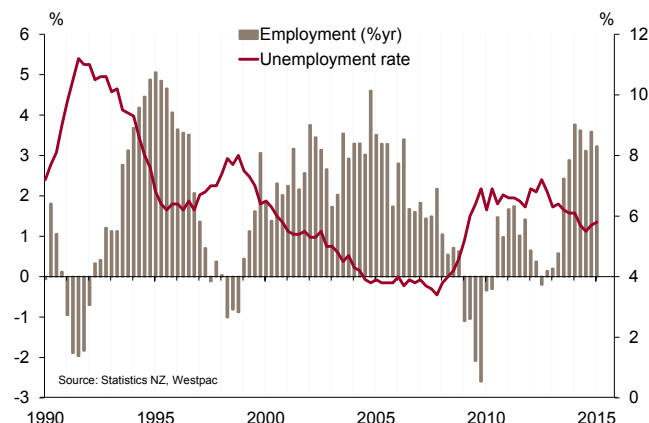
In contrast to the strength in the domestic economy, the external sector is still facing some strong headwinds. In particular, incomes in the dairy sector are set to take a significant hit this year. Prices in the latest GlobalDairyTrade auction fell 3.5%, leaving them down 25% since mid-February. Fonterra has downgraded its payout forecast for this season to \$4.50/kg, and we've pencilled in a payout of \$5.70/kg for next season.

But even with such headwinds, the outlook for growth is looking solid. Rate cuts now would risk super-charging already strong domestic demand conditions (especially in the housing market), potentially creating more inflation down the line.

So, what's the RBNZ to do? On balance, we think economic growth and the housing market will remain too strong for the RBNZ to pull the trigger. Consequently, we expect that the OCR will remain on hold through the coming year. But we must admit, the risk of cuts has increased. The merest whiff of a downturn in demand will be enough to push the RBNZ over the line.

Even though we're not picking a change in the OCR anytime soon, we still expect a change in policy settings over the coming months. This will come in the form of tighter macro-prudential settings. The RBNZ has been acutely aware of the growing pressures in the property market, and has been consulting on possible changes in the capital requirements

Employment growth and unemployment



associated with lending on residential investment properties. We'll be watching the RBNZ's upcoming *Financial Stability Report* (out Wednesday 13 May) to see how this process has been shaping up.

In addition, we expect that the RBNZ will look at introducing some form of lending restrictions for property investors over the coming months. While we don't expect any new policy announcements in the *Financial Stability Report*, we do expect the ground work to be laid, with the report likely to include a focus on the continued strengthening in Auckland house prices.

The week ahead

Today we are releasing our latest *Quarterly Economic Overview*. This report (<http://www.westpac.co.nz/assets/Business/Economic-Updates/2015/Bulletins-2015/Westpac-QEO-May-2015-EMAIL.pdf>) outlines our thinking on the major factors that are shaping the economic landscape, and how we think policy will respond.

Also out over the coming week will be the March quarter retail trade figures and the latest REINZ house sales data, as well as updates on electronic card spending, food prices, and the latest Performance of Manufacturing Index.

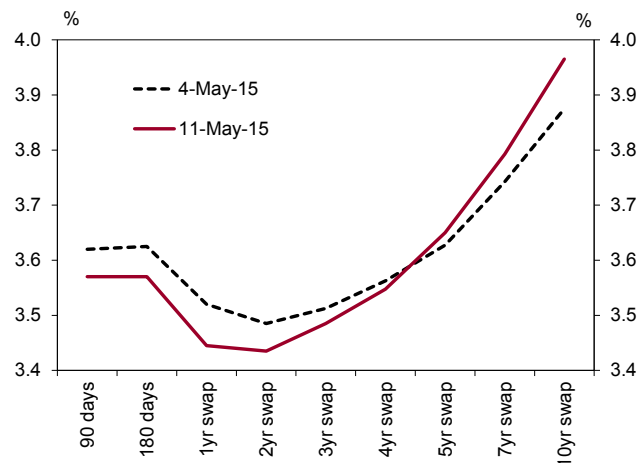
Fixed vs Floating for mortgages

Among the current standard fixed rates, the best value for borrowers with a deposit of 20% or more probably lies in the two-year and three-year terms. However, there is a possibility that fixed mortgage rates will fall even further over the weeks ahead. Waiting a while before fixing might offer even better value.

Four- and five-year rates still seem high relative to where we think shorter-term rates are going to go over the coming four or five years, though the gap has narrowed in recent weeks, and these longer-term rates do offer the benefit of stability.

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.

NZ interest rates

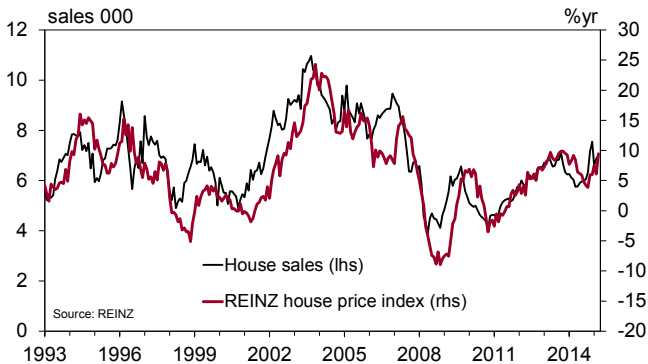


NZ April REINZ house sales and prices

Sales Last: 20.3%yr. Prices last: 9.5%yr.

- The Auckland housing market is taking off in a fashion that makes 2013 look tame by comparison. Meanwhile, other regions of NZ are more lacklustre.
- A range of data has suggested that the overall trend of extremely rapid price increases in Auckland remains intact. We would expect REINZ data to fall in line with that trend, although the data can be choppy from month to month.
- The housing market is a key reason we are sceptical of calls for imminent OCR cuts. As annual price and sales calculations begin to reflect the state of the housing market in recent months, markets may sit up and take notice.

REINZ house prices and sales

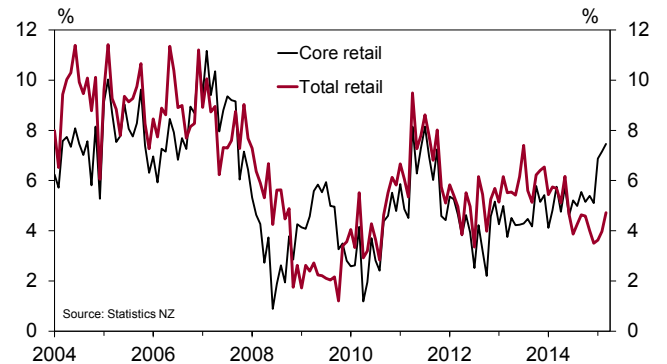


NZ April retail electronic card spending

May 11, last 0.8%, Westpac f/c: 0%

- Electronic retail spending surged in the three months to March - excluding fuel and vehicle related items, it exhibited its fastest quarterly growth since late 2006. This is all the more impressive as it has occurred in the context of very low inflation.
- Some loss of momentum is likely to have occurred in April, as a strong summer tourist season has come to an end and petrol prices have risen, unwinding some of the boost to consumers' purchasing power that occurred late last year.
- Weak advance figures from card processor Paymark released over the weekend support this view. That said, recent methodological changes have made it harder to interpret this indicator. We have tentatively pencilled in flat growth over the month.

Card transactions, annual % change

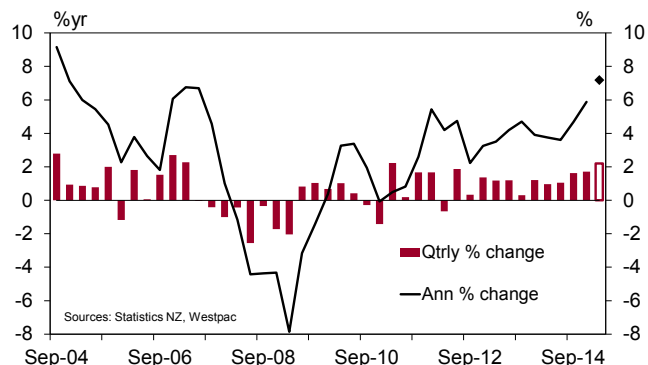


NZ Q1 real retail sales

May 14, Last: 1.7%, Westpac f/c: 2.2%, Mkt f/c: 1.6%

- Indications are that New Zealand retail activity stormed ahead in the March quarter, with electronic card spending rising 1.3% despite falling prices. We estimate that retail prices fell around 1% (seasonally adjusted) in the March quarter, dragged down by plunging petrol prices.
- Rapid population growth, rising labour incomes, and the wealth gains from rising house prices are boosting domestic spending, while retail activity has also benefitted from strong growth in tourist numbers, further reinforced by the Cricket World Cup.
- We have assumed a modest rise in vehicle sales, reflecting rising vehicle registrations, and flat non-store sales after a very strong December quarter. These categories can be volatile, but are not large enough to pose a risk to the very strong overall trend.

Real retail sales

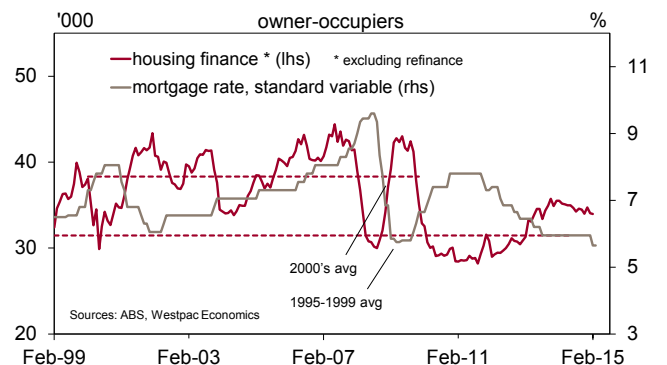


Aus Mar housing finance (no.)

May 12, Last: 1.2%, WBC f/c: 1.0%
Mkt f/c: 1.0%, Range: 1.0% to 2.5%

- Housing finance to owner occupiers rose 1.2% in Feb but historical estimates were revised up significantly lifting the trajectory for approvals from about flat to a slight rise (trending at a +3% annualised pace).
- Revisions relate to problems the ABS has had with its estimates of first home buyer approvals. Notably the Feb report also showed a 3.4% drop in the value of loans to investors which may be an early sign that efforts by regulators to curb activity in this segment are starting to impact.
- Industry data suggests owner-occupier approvals remained firm in Mar. Auction markets remain hot with a clear post RBA rate cut pick-up in Melbourne. Overall, we expect Mar to show a 1% rise in owner-occupier approvals. The value of investor approvals will again be of intense interest.

Owner-occupier finance & the rate cycle

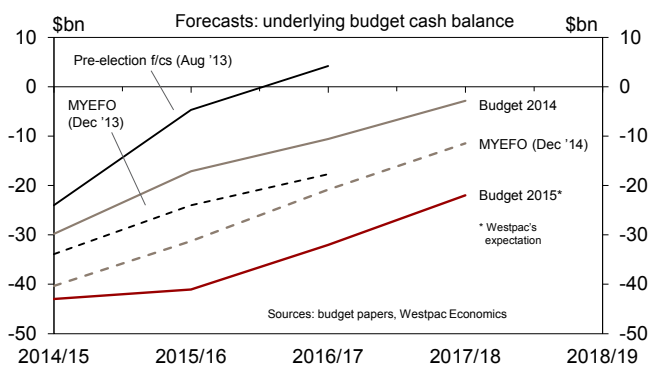


Aus 2015 Federal budget, AUDbn

May 12 Last: -43, WBC f/c: -41 Mkt f/c: -40, Range: -49 to -28

- The Federal budget position has deteriorated since the Government's December Mid-Year Economic & Fiscal Outlook.
- Notably, a larger than expected negative income shock from plunging commodity prices has squeezed national income. Hence, revenues will fall short of earlier expectations.
- For the 2014/15 year, expected slippage of \$2.6bn would see the deficit at \$43.0. For 2015/16, with forecast nominal GDP growth to be lowered by 1ppt to 3.5%, slippage blows out to \$10bn, resulting in a deficit of \$41bn (2.5% of GDP).
- Annual slippage in the order of \$10bn would see the deficit moderating to \$32bn in 2016/17 and then decline further, to \$22bn (1.2% of GDP) in 2017/18. For more detail, and a discussion of the economic forecasts, see our Budget Preview.

Federal budget: slippage

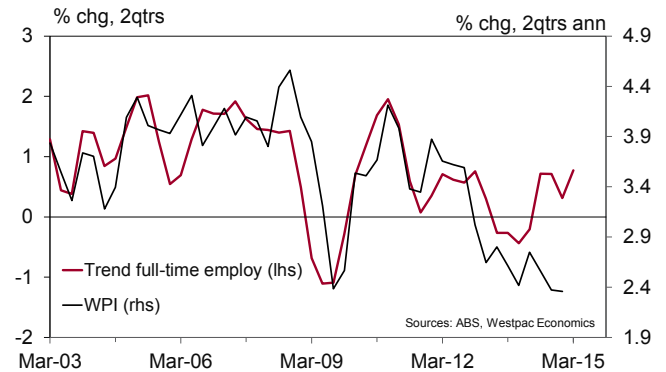


Aus Q1 Wage Price Index

May 13 Last: 0.6%, WBC f/c: 0.6% Mkt f/c: 0.6%, Range: 0.5% to 0.7%

- Total hourly wage rates ex bonuses (WPI) rose 0.6% in Q4, spot on Westpac and market consensus and the third consecutive 0.6% print.
- The annual pace eased back to 2.5%yr, a slight moderation from the 2.6%yr print in Q3 and on par with the series low of 2.5%yr in 2014Q2. The WPI series started in 1997Q3 and if you would like to be exact, at two decimal places the 2.47%yr print is the lowest on record.
- The labour market did improve through 2014 and into early 2015. However, wages have underperformed the labour market suggesting the income drag from a declining ToT is having a meaningful impact. As such, we can't see any near term pickup in the pace of wage inflation and suggest the risks to our forecast lie to the downside.

Wages have not respond to employment

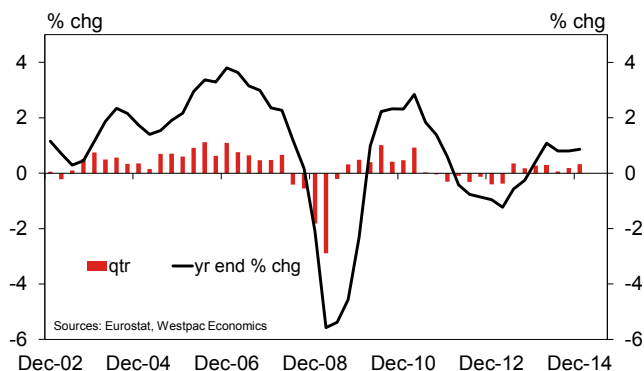


Eurozone Q1 GDP

May 13: Last: 0.3%, WBC f/c: 0.5%

- Early figures show Spanish GDP accelerating to 0.9% in the first quarter and Belgian growth a little stronger at 0.3%. The Bundesbank expects a "further sharp increase" in German growth (we estimate 0.7% in Q1). Stop-start French and Italian GDP growth reflects ongoing competitiveness problems that so far have drawn only half-hearted attempts at structural reform. But even these recalcitrants should see economic growth accelerate modestly this year as the economy, along with all the Eurozone, is supported by the tailwinds associated with lower oil prices and the weaker euro.
- The Eurozone should print 0.5% growth in Q1, the fastest yet of the now two-year old recovery from the 2011-2013 recession. That is considerably faster than the stalled US economy could manage in Q1.

Euro zone GDP

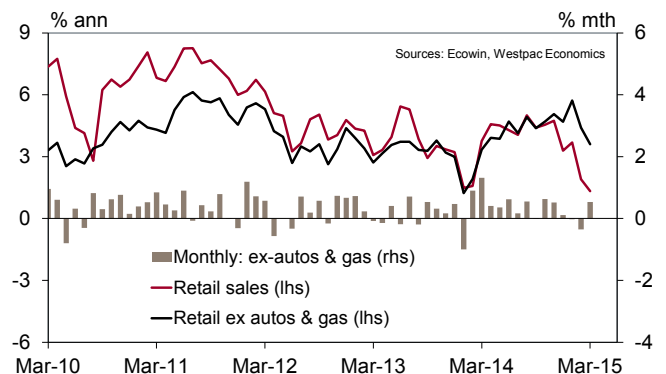


US Apr retail sales

May 13, Last: 0.9%, WBC 0.2%

- Retail sales rose 0.9% in March, their fastest rise in a year. Although the detail was lacklustre in places, there was a bounce apparent in parts of the report from cold weather disruption earlier in the quarter. Auto sales rose 2.7% in March, and there were solid gains in furniture, building materials, clothing, department stores and miscellaneous. But electronics, food, gasoline and non-store retailing recorded declines, and other storetypes recorded only modest gains.
- Core retail ex autos and gasoline rose 0.5% in March, after weak Dec-Feb data. This is partly due to lower import prices weighing on nominal sales. The consequent real income boost may allow for increased spending in coming months although the USD weakened in April. We already know auto sales slipped in Apr but gasoline prices rose. Weaker jobs growth, if confirmed, could weigh on sales.

US retail sales

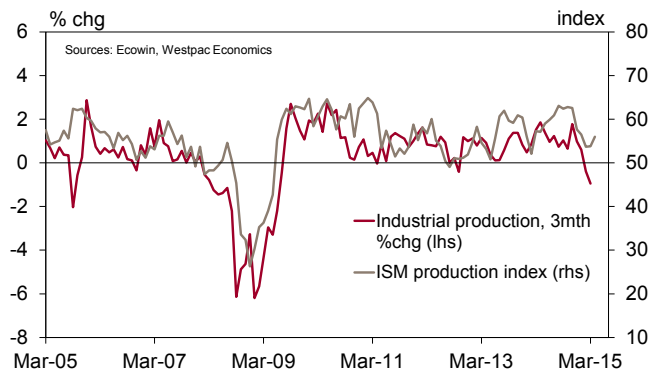


US Apr industrial production

May 15: Last: 0.6%, WBC f/c: flat

- March IP fell -0.6%. Manufacturing recovered 0.1%, thanks to an auto output bounce after three straight falls in Dec-Feb. Ex auto manufacturing fell 0.1% and has not recorded a rise yet this year. By market group, only business equipment recorded a March gain (modest at 0.2%), while consumer goods, defence, construction, business supplies, materials, and energy all declined. Utilities fell 6.7% in March as the weather warmed and mining fell 0.7% (fifth fall in 6 months) as the lower oil price rendered production uncompetitive.
- Four of the five Fed regional factory surveys pointed to falling activity in April, although the national ISM factory survey production index rose to a three month high. Auto sales were down in the month though orders had risen in March. Core capital goods orders slumped since Q3 2014. Factory hours worked data will be available May 8. But as things stand, another limp outcome is likely in April.

US industrial sector



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
sometime this week					
Chn	Apr total new credit RMBbn	1182	-	-	Room for a bounce in bills, trusts within softer seasonal overlay.
	Apr new bank loans RMBbn	996	-	-	PBOC survey implied demand improved in Q1, but standards tightening?
	Apr money supply M2 %yr	11.6%	-	-	Capital outflows not as pronounced as in Q1, interbank rates lower.
Mon 11					
NZ	Apr Electronic card spending	0.8%	0.5%	0%	Some moderation expected following a strong tourist season
	Apr REINZ house sales (yr%)	20.3%	-	-	Due this week. Loan data suggests a further lift in sales.
	Apr REINZ house prices (yr%)	9.5%	-	-	Auckland house prices are powering ahead.
Aus	Apr NAB business survey	6	-	-	Business conditions surprised in Mar, up 4pts to +6. Confidence @ +3.
UK	BoE policy decision	0.5%	0.5%	0.5%	Decision from May 7-8 meeting held over from last week due election.
US	Apr labour market conditions index	-0.3%	-	-	March had first negative reading since 2012.
Tue 12					
Aus	Mar housing finance, no.	1.2%	1.0%	1.0%	Owner-occupier finance f/c +1%. Investors, -3.4% in Feb of interest.
	Federal Budget, AUDbn	-43	-40	-41	2015/16, a \$10bn deterioration on MYEFO f/c.
UK	Apr BRC retail survey %yr	3.2%	-	-1.0%	Same store sales in March strongest since April 14 (earlier Easter effect?)
	Mar industrial production	0.1%	0.0%	0.3%	Factory PMI for Mar was highest since July last year, but fell in April.
US	NFIB small business optimism	95.2	96.0	95.3	Slippage in most Apr business surveys. But hiring intention rose.
	Mar JOLTS	5,133	-	-	Job openings and labour turnover.
	Apr federal budget \$bn	106.9	138	-	Budget position improved in recent years.
	Fedspeak	-	-	-	Williams at ABE.
Wed 13					
NZ	May RBNZ Financial Stability Report	-	-	-	Update on housing market, bank capital requirements.
	Apr food prices	0.1%	-	0.0%	Annual pace has picked up in recent months.
Aus	Q1 wage cost index	0.6%	0.6%	0.6%	Wages have underperformed the labour market & will continue to do so.
Chn	Apr retail sales %yr	10.2%	-	-	Planned discretionary outlays took a step down in Westpac MNI.
	Apr industrial production %yr	5.6%	-	-	Core sub-index close to flat and logistics, PMIs not encouraging.
	Apr fixed investment %ytd	13.5%	-	-	Heavy industry melting, real estate stabilizing, infrastructure sound.
Eur	ECB policy meeting account	-	-	-	More detail on how the April 16 meeting decision was reached.
	Mar industrial production	1.1%	0.1%	-0.4%	Solid PMI. French IP down 0.3% in Mar. German IP data nya.
	Q1 GDP	0.3%	0.5%	0.5%	8th (and fastest) straight qtr of meek recovery.
Ger	Q1 GDP	0.7%	0.6%	0.7%	Buba described Q1 as "a further sharp increase."
UK	BoE inflation report	-	-	-	How will BoE factor Q1 GDP; election uncertainty; Greece into fc/s?
	Apr unemployment ch'	-21k	20k	-20k	Benefit claimants. Q1 jobs likely have risen solid 222k.
US	Apr advance retail sales	0.9%	0.2%	0.2%	Auto sales down 3.5%, gasoline prices slightly higher.
	Apr retail sales ex auto, gas	0.5%	0.5%	0.3%	Core retailing barely risen since Oct-Nov sales spurt last year.
	Mar business inventories	0.3%	0.2%	0.3%	Key to extent of downward revision to Q1 GDP.
	Apr import prices %yr	-0.3%	0.2%	0.3%	Oil prices higher on avge than in Mar; US\$ weaker.
Can	Apr house prices %yr	4.7%	-	-	Teranet/National Bank index.
Thu 14					
NZ	Apr PMI	54.5	-	-	Softer pace of growth in Q1, possibly due to drought.
	Q1 real retail sales	1.7%	1.6%	2.2%	Indicators pointing to very strong spending growth amid falling prices.
Aus	Westpac China Resources Quarterly	-	-	-	Southern winter edition. 09:30 AEST. Westpac-Aust Govt collaboration.
UK	Apr house prices net bal %	21%	18%	-	RICS survey of member surveyors. Down from 55% a year earlier.
US	Initial jobless claims w/e 10/5	265k	-	270k	Claims at around their lowest yet this century.
	Apr final demand PPI	0.2%	0.1%	0.2%	Mar PPI constrained by food and services prices; energy higher in Apr.
Can	Mar new house prices %yr	1.4%	-	-	Had slowed to 1.3%yr in Dec 2013.
Fri 15					
UK	Mar construction output	-0.9%	4.0%	-	Construction PMI at lowest in nearly two years in March-April.
US	May NY Fed factory survey	-1.2	5.0	2.0	Modest bounce consistent with our view that US growth is slowing.
	Mar TIC data, \$bn	9.8	-	-	Net long term TIC flows.
	Apr industrial production	-0.6%	0.0%	0.0%	Factory hours worked not yet known. Business surveys, orders weaker.
	May UoM consumer sentiment prelim	95.9	96.5	95.5	300 responses in prelim; IBD-TIPP weaker in May with 900 replies.
Can	Apr existing home sales	4.1%	-	-	Feb-Mar saw first back to back sales gains since Jul-Aug last year.
	Mar manufacturing sales	-1.7%	-	-	Feb decline due to autos.

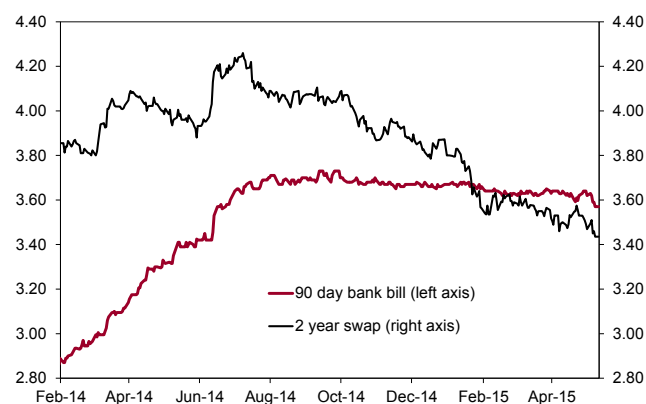


New Zealand forecasts

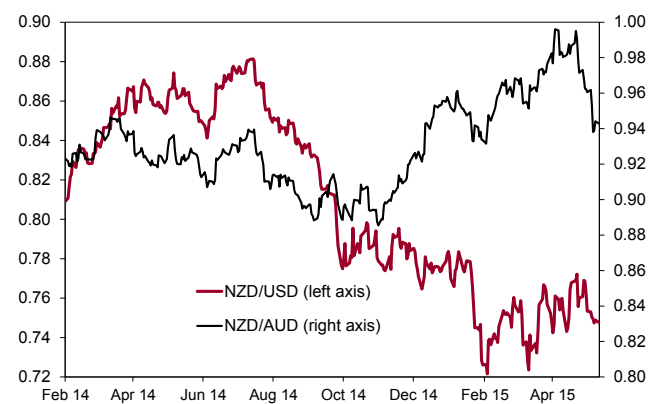
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
% change								
GDP (Production) ann avg	2.2	2.5	3.3	2.9	2.3	3.3	3.0	3.0
Employment	0.2	3.8	3.2	2.8	2.9	3.6	2.7	2.9
Unemployment Rate % s.a.	6.3	6.0	5.8	5.1	6.1	5.8	5.2	4.5
CPI	0.9	1.5	0.1	1.3	1.6	0.8	0.4	2.1
Current Account Balance % of GDP	-3.7	-2.6	-4.0	-4.9	-3.3	-3.3	-4.8	-4.6

Financial Forecasts	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Cash	3.50	3.50	3.50	3.50	3.50	3.50
90 Day bill	3.60	3.65	3.70	3.70	3.70	3.70
2 Year Swap	3.40	3.50	3.60	3.70	3.80	3.80
5 Year Swap	3.50	3.60	3.70	3.80	3.90	4.00
10 Year Bond	3.20	3.30	3.40	3.50	3.60	3.70
NZD/USD	0.75	0.74	0.72	0.71	0.71	0.71
NZD/AUD	0.96	0.98	0.98	0.98	0.98	0.97
NZD/JPY	90.0	90.0	88.8	88.6	89.3	89.5
NZD/EUR	0.69	0.71	0.70	0.70	0.70	0.70
NZD/GBP	0.50	0.51	0.50	0.49	0.48	0.47
TWI	79.4	80.0	78.9	78.7	78.6	78.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 11 May 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.59%	3.61%	3.63%
60 Days	3.59%	3.61%	3.63%
90 Days	3.57%	3.63%	3.64%
2 Year Swap	3.44%	3.53%	3.51%
5 Year Swap	3.65%	3.61%	3.58%

NZ foreign currency mid-rates as at Monday 11 May 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7477	0.7643	0.7521
NZD/EUR	0.6678	0.7020	0.7102
NZD/GBP	0.4840	0.5018	0.5142
NZD/JPY	89.47	90.97	90.52
NZD/AUD	0.9429	0.9731	0.9808
TWI	77.31	79.22	79.16



International forecasts

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014	2015f	2016f
Australia						
Real GDP % yr	2.7	3.6	2.1	2.7	2.2	3.0
CPI inflation % annual	3.0	2.2	2.7	1.7	2.3	2.6
Unemployment %	5.2	5.3	5.8	6.2	6.5	6.5
Current Account % GDP	-2.8	-4.4	-3.3	-2.8	-3.2	-2.8
United States						
Real GDP %yr	1.6	2.3	2.2	2.4	2.2	3.2
Consumer Prices %yr	3.1	2.1	1.5	1.6	0.1	2.0
Unemployment Rate %	8.9	8.1	7.4	6.2	5.3	5.0
Current Account %GDP	-2.9	-2.9	-2.4	-2.4	-2.5	-2.5
Japan						
Real GDP %yr	-0.5	1.8	1.6	-0.1	1.0	1.7
Euroland						
Real GDP %yr	1.6	-0.8	-0.4	0.8	1.2	1.1
United Kingdom						
Real GDP %yr	1.6	0.7	1.7	2.6	2.5	2.7
China						
Real GDP %yr	9.3	7.8	7.8	7.4	7.0	7.0
East Asia ex China						
Real GDP %yr	4.4	4.5	4.3	4.1	4.4	5.0
World						
Real GDP %yr	4.2	3.4	3.3	3.4	3.2	4.0
Forecasts finalised 8 May 2015						

Interest Rate Forecasts	Latest	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
Australia						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.16	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.87	2.90	2.90	3.00	3.10	3.30
International						
Fed Funds	0.125	0.125	0.375	0.625	0.875	1.125
US 10 Year Bond	2.16	2.20	2.30	2.50	2.70	3.00
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
AUD/USD	0.7900	0.78	0.73	0.73	0.73	0.73
USD/JPY	119.70	120	122	124	124	125
EUR/USD	1.1230	1.09	1.05	1.02	1.02	1.02
AUD/NZD	1.0630	1.04	1.02	1.02	1.02	1.02

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Satish Ranchhod, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

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