



Sawcut Gorge, Isolated Hill Scenic Reserve, South Marlborough

In this issue

Fixed vs floating	2
The week ahead	3
Data calendar	5
New Zealand forecasts	6
International forecasts	7

Tighty, loosey

The Reserve Bank has carried through on its recent call for “action to reduce housing imbalances”. The latest six-monthly *Financial Stability Report*, released last week, detailed a new set of loan-to-value ratio (LVR) restrictions targeted at what is seen as the frothiest end of the market: property investment in Auckland. While some in the market will no doubt see this as removing a barrier to OCR cuts, we’re not entirely convinced.

The RBNZ has proposed that from 1 October, all new lending on investor property in the Auckland region will be capped at an LVR of 70%. For owner-occupied housing loans within Auckland, the share of high-LVR lending will remain capped at 10%, while outside of Auckland the high-LVR share for all types of residential lending will be lifted to 15%.

We should stress here that the RBNZ’s move is not a challenge to our forecasts. Since last November, we’ve been saying that the next move on macro-prudential policy would be a further tightening, with a likely implementation date in the second half of 2015. In our latest *Economic Overview* we predicted a 10% rise in house prices this year; without a macro-prudential tightening we would have forecast something even higher.

In fact, the new restrictions are on the mild side of what we expected. The LVR cap on investor property loans had to be at least as tight as 70%, since very few investor loans are done at above 80%. The Auckland-specific cap on property investor loans is less intrusive than a nationwide cap would have been. And the easing of the high-LVR share for the rest of the country was an unexpected stimulus, although the impact may be modest as the existing 10% cap hasn’t been binding lately.

We can now surmise that the softer than expected LVR restrictions were the result of consultation with the Treasury, given the Government’s announcement over the weekend of a tightening of the existing capital gains tax for active property trading. Instead of the current, difficult-to-police ‘intentions’ test, the tax will be assessed on all

Tighty, loosey continued

investment properties sold within two years of purchase. This will have some dampening effect on house prices, to the extent that short-term property traders make up a small segment of the market.

The RBNZ estimated that the new LVR restrictions could reduce Auckland house price growth by 2-4%, which would imply around 1-2% on the national average. That's not a huge impact, and could easily be cancelled out if the RBNZ delivered the interest rate cuts that the market is anticipating. This is a key reason why we decided against forecasting OCR cuts in our latest *Economic Overview*, although we acknowledge that it is a finely balanced call.

The RBNZ's decision to tighten lending restrictions in Auckland was couched in the language of financial stability rather than monetary policy. The RBNZ is concerned that the steep rise in house prices could be followed by an equally steep decline, leaving many borrowers underwater and leading to a rise in loan losses. A number of theories have been advanced for the Auckland housing market's strength, with no real agreement as to whether current prices are justified. In our latest edition of *Home Truths*¹, we showed that many of these stories don't stack up: construction costs haven't risen nearly fast enough to account for property prices, muted rental inflation suggests that a shortage of houses is only playing a modest role, and 'bubble' behaviour doesn't explain why it would be limited to one city.

Instead, we propose an overlooked factor that fits better with the facts: the recent liberalisation of building and subdivision rules, combined with a widespread expectation of population growth, has pushed up the perceived value of land in Auckland. In the long run, this is a desirable policy move – it will encourage the development of more compact, more affordable dwellings in central Auckland. But the short-term impact is a windfall gain for the existing landowners.

We should note that this proposal says nothing about whether the expectations underpinning today's land prices are correct or not. But it does account for the confusion in some quarters

as to why making it easier to build has increased property values, rather than reduced them. And it militates against the idea that rising property prices in Auckland are a growing risk to financial stability.

Turning back to monetary policy, last week's data once again highlighted the tension between strong domestic demand and low inflation. Retail spending, in inflation-adjusted terms, rose 2.7% in the March quarter, the biggest increase since the current series began in 2003. Falling prices in most categories mean that consumers are getting more bang for their buck. The latest quarter was also influenced by the sharp fall in fuel prices, which gave consumers leeway to spend more on other items. That idea is supported by the electronic cards figures for April, which showed a drop in overall spending as fuel prices rose again.

The coming week features two notable factors for the inflation outlook. The RBNZ's survey of inflation expectations (Tues) is an important input to the RBNZ's thinking, particularly given the RBNZ's current concerns that consumers and businesses could settle into a low-inflation mindset. The previous survey showed that expectations for inflation two years ahead had fallen to 1.8%, and it's likely they will fall further in response to the last CPI release, which showed inflation at a 15-year low of just 0.1%.

The other important factor is the 2015 Budget (Thurs). The Government has announced a further cut to the ACC motor vehicle levy next year, on top of the one that takes effect in July this year. We estimate that these cuts will reduce inflation by 0.3 percentage points over each of the next two years. In normal times, the RBNZ would have the wiggle room to look through a policy effect of this magnitude. But at a time when it is already struggling to forecast a return to 2% inflation over the medium term, the case for OCR cuts becomes incrementally stronger.

¹ Available at www.westpac.co.nz/assets/Business/Economic-Updates/2015/Monthly-Files-2015/NZ-Home-Truths-Special-Edition-14-May-2015.pdf

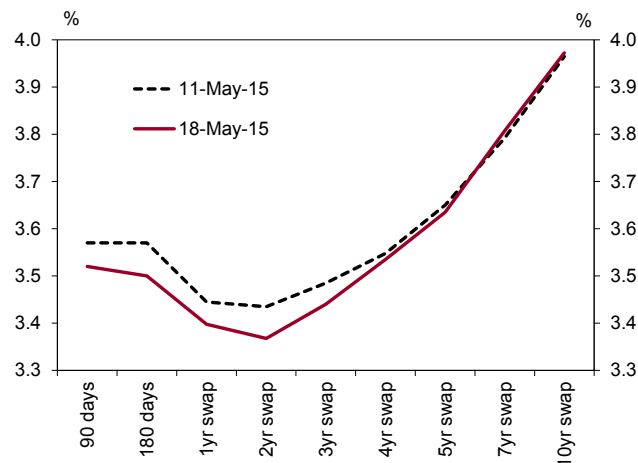
Fixed vs Floating for mortgages

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

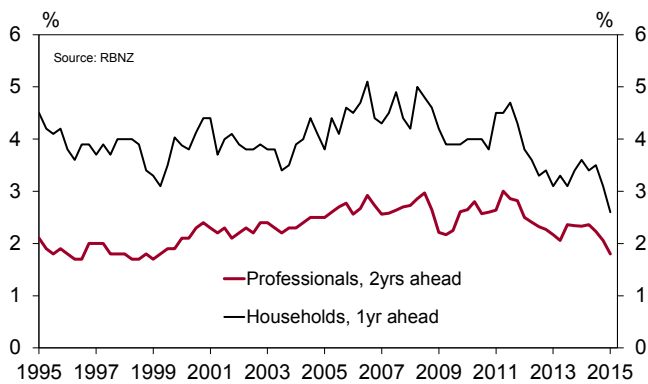


RBNZ Q2 survey of inflation expectations

May 19, 2yrs ahead last: 1.8%

- Surveys of inflation expectations have taken on greater importance now, in light of the RBNZ's concern that wage- and price-setting behaviour could settle at levels that are too low to be consistent with the RBNZ's inflation target midpoint of 2%.
- The March quarter survey found that expectations of inflation two years ahead had fallen to 1.8%, the lowest since June 1999 when annual inflation had just turned negative for a short period.
- Inflation expectations tend to be influenced by past inflation, so the RBNZ would not be surprised to see a further drop in the latest survey. The true test will be if inflation expectations remain subdued as headline inflation rises again, once the effect of the one-off drop in fuel prices washes out.

RBNZ survey of inflation expectations

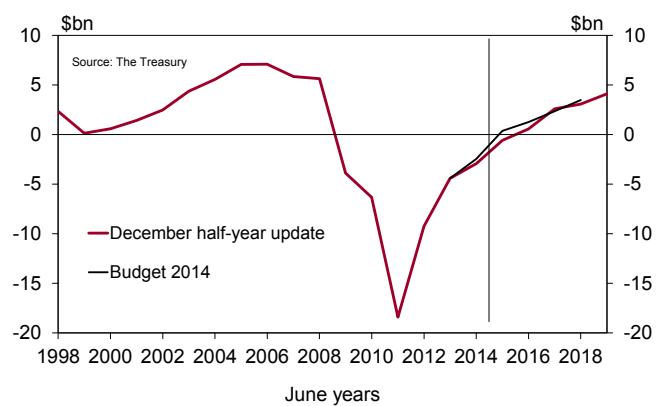


NZ Budget 2015

May 21, 2014/15 balance last: -\$572m

- The 2015 Budget is likely to see a return to the theme of fiscal discipline after last year's mini spend-up.
- Softer than expected inflation will mean lower tax revenue and operating surplus projections over the next few years.
- By reducing motor vehicle levies, the Government has found a way to deliver tax cuts in a way that reduces rather than adds to inflation pressures.
- The Treasury's economic forecasts are likely to be similar to our own, though we question whether a forecast of rising surpluses in the later years is consistent with the wind-down phase of the Christchurch rebuild over that time.

Operating balance (excluding gains and losses)



Aus May Westpac-MI Consumer Sentiment

May 20 Last: 96.3

- The Westpac-Melbourne Institute Consumer Sentiment Index sank back into pessimistic territory in Apr weighed down by the absence of a follow-up rate cut to the RBA's Feb move, higher petrol prices, a continued slide in key commodity prices and nervousness ahead of the Federal Budget.
- The May survey will capture reactions to both the RBA's latest rate cut – finally delivering on its easing bias – and the Federal Budget. Last year's May sentiment reading set the tone for the second half with confidence struggling to recover from a sharp post-Budget drop. This time around the Government has been at lengths to ensure a less negative reception. Aside from policy factors, sentiment this month may also be influenced by: a sharp sell-off in the sharemarket (ASX down 4.2% since Apr); a 3c rally in the AUD to over 80c US; further gains in house prices and another firm read on official job numbers.

Consumer Sentiment Index

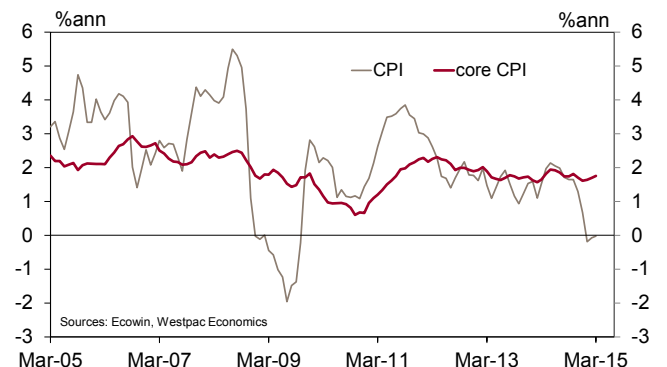


US Apr CPI forecast

May 22, Last: 0.2% WBC f/c: 0.2%

- Mar CPI rose 0.2%. Food prices posted a rare fall in March, offsetting some of the 1.1% rise in energy prices (3.9% rise in gasoline). The core CPI was also up 0.2%, with a further rise in clothing, autos and other imported (or import competing) prices to early to reflect pass-through of the recently weaker USD. Services prices ex energy rose 0.2%, with rents up 0.3%, medical care up 0.4% but transport prices flat, weighed down by post-Easter airfare discounting.
- The PPI suggests food prices remain soft but Department of Energy reports show gas prices rising again in April. Weak core outcomes are typically due to one or more of autos, clothing, tobacco, rents or medical care either falling or posting below trend gains. With the dollar weaker and airfares unlikely to fall again, we expect the third straight month of 0.2% gains for both headline and core CPI.

US consumer price inflation



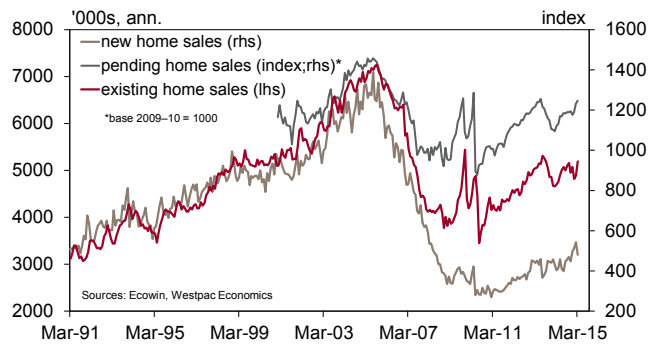
US Apr housing starts & existing home sales

May 19, housing starts, Last: 2.0% WBC f/c: 7.0%

May 21, existing home sales, Last: 6.1% WBC f/c: -1.0%

- The housing market's recent malaise looks to be partially lifting with home sales rising out of their recent ranges. However homebuilder confidence has been stalled for 2yrs and latest activity data has still disappointed, noting poor weather was also a factor earlier in the year.
- If homebuilder sentiment (out May 18) builds on its April recovery and the resumption of solid construction jobs growth in April is a guide, single family starts should drive a bounce-back in starts in Apr even with some offset from multiples.
- Established home sales should slip though, adding to the uncertainty about the sector's prospects. Mortgage rates remain supportive. However, pending contracts suggest completed sales slowed a touch in April, with some upside likely thereafter.

US housing sales



Data calendar

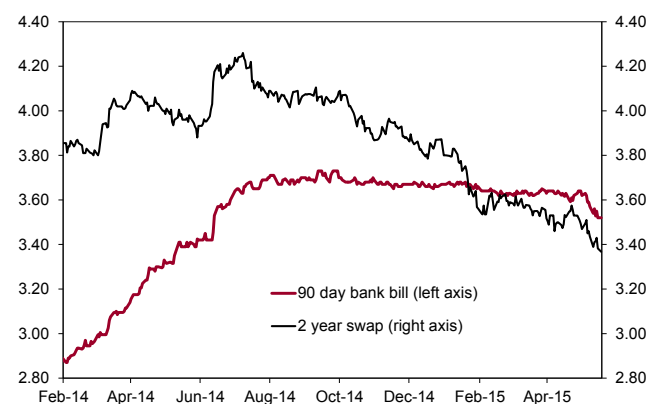
		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Apr Performance of Services Index	57.6	–	–	Services have remained strong as manufacturing has slipped.
Aus	RBA Deputy Governor Lowe speaking	–	–	–	Topic TBA, Corporate Finance Forum, Sydney 9.30 am AEST.
	Apr new vehicle sales	0.5%	–	–3.0%	Monthly FCAI figs show soft Apr after solid 4.4% rise in 3mths to Mar.
Chn	Apr dwelling prices new %net	–50.0%	–	–	Healing/stability broadened out to some smaller cities in March ...
	Apr dwelling prices secondary %net	–48.6%	–	–	... a positive sign, as tier 1 alone had escaped the rout beforehand.
UK	May house prices %yr	4.7%	–	–	Rightmove index of asking prices.
US	NAHB housing market index	56	57	58	Just as economy seems to sputter, housing shifts up a gear.
	Fedspeak	–	–	–	Evans in Stockholm.
Tue 19					
NZ	Q1 producer prices (outputs)	–0.1%	–	–0.8%	Oil prices down sharply, low hydro lakes raised power prices.
	Q2 RBNZ survey of inflation expectations	1.8%	–	–	Expectations are a critical focus for the RBNZ now.
Aus	RBA minutes	–	–	–	How will minutes compare to Governor's statement & SoMP?
Eur	Mar exports	2.9%	–	–	Exports rose 2.9% in Feb reversing Dec-Jan declines.
	Apr CPI %yr final	flat a	flat	–	Headline inflation back to 0% after four months' deflation
Ger	May ZEW survey of analyst expect'ns	53.3	50.0	50.0	Sentix slipped a little in May, ZEW slipped from high for year in April.
UK	Mar ONS house prices %yr	7.2%	–	–	Former DCLG series.
	Apr PPI %yr	0.1%	0.1%	–	Core output measure.
	Apr CPI %yr	flat	flat	0.1%	BRC shop prices suggest CPI close to finding a floor
US	Apr housing starts	2.0%	10.2%	7.0%	Starts pace for (single family dwellings) has been running ahead of ...
	Apr building permits	–5.4%	2.9%	5.0%	... permits. Multiples driving headlines.
Wed 20					
NZ	GlobalDairyTrade auction	–3.5%	–	–	No signs of demand strengthening in the near term.
Aus	May Westpac–MI Consumer Sentiment	96.3	–	–	To capture both rate cut and Federal Budget reaction.
	May Westpac–MI unemploy. expect.	8.5%	–	–	Deteriorated sharply again in Apr after promising start to the year.
Ger	Apr PPI %yr	–1.7%	–	–	Downtrend in annual pace of deceleration may have stalled.
	May BoE minutes	–	–	–	Inflation report hinted at ongoing debate about rates liftoff.
US	Apr 28-29 FOMC minutes	–	–	–	Was June still a favoured starting point by many for Fed hikes?
	Fedspeak	–	–	–	Evans in Munich.
Can	Mar wholesale sales	–0.4%	–	–	Feb fall due to autos, construction, mining.
Thu 21					
NZ	Net immigration, April (s.a.)	5,000	–	4,950	Net immigration likely to remain high until Australian job market improves.
	Budget 2015	–	–	–	Low inflation means a smaller forecast surplus for next year.
Aus	RBA Assist. Governor (Fin. System) Edey	–	–	–	Cards & Payments conference 2015, Melbourne, 8.50am AEST.
	May MI inflation expectations	3.4%	–	–	Up a touch in Apr but still well below 20yr average read of 4.5%.
Chn	May HSBC manufacturing PMI	48.9	49.4	–	April was surprisingly weak, little sign of any boost in end-demand.
	May MNI business indicator	48.8	–	–	Survey of ~200 listed firms across both manuf and services.
Eur	ECB policy meeting account	–	–	–	More detail on how the April 16 meeting decision was reached.
	Mar current account balance €bn	26.4	–	–	Feb saw second highest monthly surplus in euro history after Jan.
	May PMI factory adv	52.0	51.7	51.5	Recent growth acceleration picked up by PMI through Q1.
	May PMI services adv	54.1	53.8	51.9	from ECB may help sentiment. Composite PMI fact/ser was 52.1 in Oct.
	May consumer confidence advance	–4.6	–4.8	–	Slippage from multi-year high in Apr.
UK	Apr retail sales incl fuel	–0.5%	0.3%	1.0%	Early April Easter boost to March sales disappointing.
	May CBI industrial trends	1	–	–	Total orders index.
US	Apr Chicago Fed national activity index	–0.42	–	–	Based on data previously released, not surveyed.
	May 15 initial jobless claims	264k	–	266k	Firing remains at very low levels.
	May Philly Fed factory survey	7.5	8.2	3.5	Why is this index holding up? Only Fed regional survey not to fall <0.
	Apr existing home sales	6.1%	0.6%	–1.0%	Pending sales suggest a modest gain at best.
	Apr leading index	0.2%	0.3%	–	Q1 2015 slowest start to year since 2009. But not as weak as then!
	May Kansas City Fed factory index	–7	–	–2	Mar-Apr weakest pair of readings since mid 2009.
	Fedspeak	–	–	–	Williams in Munich.
Fri 22					
NZ	May ANZ consumer confidence	128.8	–	–	Confidence rose modestly on lower fuel prices.
Ger	Q1 GDP revision	0.3% a	0.3%	0.3%	More detail on the sluggish Q1 GDP growth data.
	May IFO business climate index	108.6	108.0	108.0	Renewed appreciating euro just one of many factors weighing on Ifo.
UK	Moody's UK ratings announcement	–	–	–	Thrice yearly tentative date for UK rating view to be published.
	Apr PSNCR £bn	6.7	7.8	–	Public sector net credit requirement.
US	Apr CPI	0.2%	0.1%	0.2%	Gasoline prices higher in Apr, food price risk to the downside but core ...
	Apr CPI core	0.2%	0.2%	0.2%	... pressures might have built a little.
	May Markit factory PMI adv	54.1	54.5	–	Recently fell more closely in line with weaker factory PMI.
Can	Mar retail sales	1.7%	–	–	Broad-based retail strength in Feb.
	Apr CPI %yr	1.2%	–	–	BoC core rate jumped to 2.4% yr in Mar, highest since 2008.

New Zealand forecasts

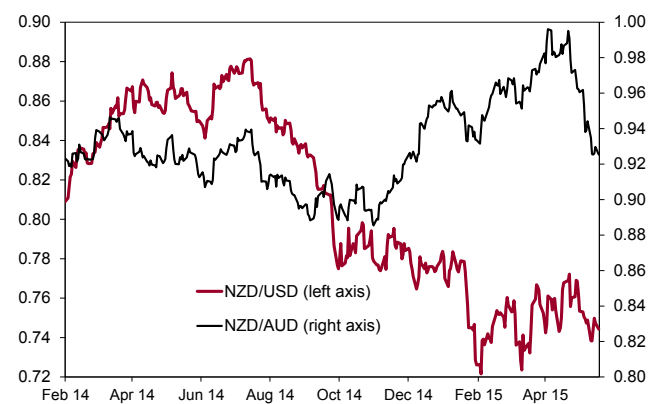
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
% change								
GDP (Production) ann avg	2.2	2.5	3.3	2.9	2.3	3.3	3.0	3.0
Employment	0.2	3.8	3.2	2.8	2.9	3.6	2.7	2.9
Unemployment Rate % s.a.	6.3	6.0	5.8	5.1	6.1	5.8	5.2	4.5
CPI	0.9	1.5	0.1	1.3	1.6	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	3.50	3.50	3.60	3.70	3.80	3.90
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 18 May 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.58%	3.61%	3.62%
60 Days	3.55%	3.62%	3.62%
90 Days	3.52%	3.62%	3.63%
2 Year Swap	3.37%	3.49%	3.52%
5 Year Swap	3.64%	3.63%	3.57%

NZ foreign currency mid-rates as at Monday 18 May 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7443	0.7532	0.7705
NZD/EUR	0.6507	0.6726	0.7121
NZD/GBP	0.4730	0.4975	0.5151
NZD/JPY	88.79	90.53	91.68
NZD/AUD	0.9254	0.9610	0.9838
TWI	76.50	78.04	80.10



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	2.14	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.90	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	2.21	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	0.8046	0.78	0.73	0.73	0.73	0.73
USD/JPY	119.55	120	122	124	124	125
EUR/USD	1.1384	1.09	1.05	1.02	1.02	1.02
AUD/NZD	1.0785	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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