



Sawcut Gorge, Isolated Hill Scenic Reserve, South Marlborough

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# The plot thickens

There has been plenty to mull over in the past week, including the recently announced new property tax rules, a mildly stimulatory Budget, and surprisingly resilient inflation expectations. We remain firmly of the view that an OCR cut in June is unlikely, although where the OCR heads later in the year is a closer call.

In its April OCR review, the RBNZ stated that it would keep the OCR on hold unless the domestic economy cooled and wage and price setting behaviour settled below the 2% inflation target, in which case it could reduce the OCR.

With that in mind, recent developments have given both proponents and sceptics of OCR cuts plenty to chew on. On the one hand we have had the Government's announcement of tighter property tax rules and another weak dairy auction. But we also had surprisingly resilient inflation expectations, continued very strong migration, and a Budget that was on the stimulatory side of expectations.

The biggest new developments are the proposed property tax changes and the inflation expectations surveys. The former has created fresh risks around the domestic economic outlook – though we tentatively believe the impact on the housing market will be fairly limited. Meanwhile, the expectations data have allayed fears around New Zealand wage and price setting trends, at least for the time being.

The proposed tax rules apply to houses bought on or after 1 October, the same timing as the RBNZ's new LVR restrictions aimed at Auckland property investors. The new rules will sharpen up what has long been a fuzzy area of tax law. Currently, capital gains on property sales are taxed if the IRD can show an intention to resell for profit. In practice that has been difficult to enforce, particularly for offshore sellers. The proposed new rules supplement this 'intention' test with a 'bright-line' test whereby gains on any investment property – defined as any property other than the seller's main home – will be taxed if the sale occurs within two years of purchase. The rules will be bolstered by tighter identification requirements, which should bring greater transparency around

# The plot thickens continued

the role played by off-shore buyers. The Government is also considering introducing a withholding tax on off-shore property sellers in 2016.

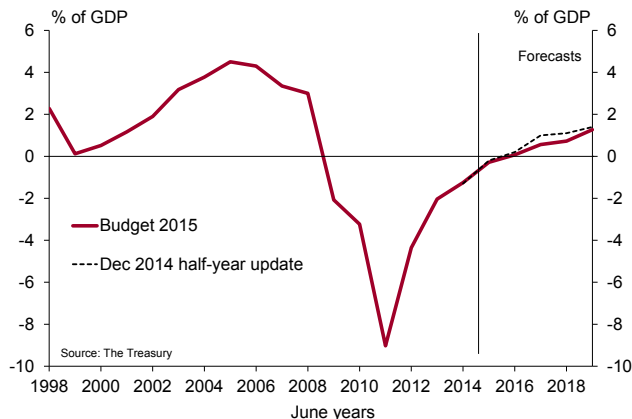
What impact will these rule changes have on the Auckland property market? At this stage any answer has to be very tentative. We wouldn't be surprised if they slowed turnover in what has been an increasingly investor-driven market, but the impact on house prices is much less certain. Two benchmarks that might come to mind are late 2010 – when the combination of tax changes and rising mortgage rates caused house prices to fall – and early 2014, when prices slowed to a crawl in the wake of the first round of LVR restrictions. But unlike the 2010 tax changes, the new rules do nothing to change the tax advantages enjoyed by longer-term property investors (rather than property flippers). And the wider context is very different too, with migration near record levels and fixed mortgage rates undergoing another round of reductions last week.

Our current forecasts are for nationwide house prices to rise another 10% this year. That already allows for the LVR restrictions, but we haven't yet drawn a conclusion of the combined impact of the tax rules and the drop in mortgage rates for the market. We will be watching monthly housing data very carefully for any sign of a market slowdown – and we suspect that the RBNZ will be doing likewise.

Last week's other big development was the RBNZ's own latest survey of inflation expectations. Most economists, ourselves included, would have expected inflation expectations to fall away to around 1.6%, given how far actual inflation has dropped. Instead, the RBNZ's 2-year-ahead measure rose a touch, from 1.8% to 1.85%. It is not alone. The Marketscope household survey, also released last week, showed one-year-ahead inflation expectations falling from 2.6% to 2.4%, but expectations of inflation five years ahead rising from 3.4% to 3.6%. Meanwhile, the latest AON-Hewitt survey of economists, and the latest ANZBO survey of businesses (both released in late April), showed inflation expectations holding steady.

True, compared to their own past history that still leaves these surveys at extremely low levels. And other inflation measures have continued to slide. But as they stand the latest set of inflation expectations surveys has weakened the case for OCR cuts.

Operating balance (excluding gains and losses)



Thursday's Budget contained few surprises on the day but was, on balance, slightly more stimulatory than we might have expected. While the total quantum of spending was in line with the Government's previous plans, this was achieved by cutting expenditure in some areas and boosting it in others. The new mix of spending is likely to be slightly more stimulatory than the old. The main savings initiatives – a cut to Kiwisaver subsidies, and a new levy on international travellers – seem unlikely to have much effect on New Zealand households' spending decisions. By contrast, many of the new spending initiatives – including a flagship policy of increasing transfers to low-income families with children – are likely to have a higher impact on domestic demand. That said, we felt that this reallocation of spending was an improvement in the deployment of state funds.

With the Government sticking to its previous spending plans, but low inflation eating into its revenues, the Treasury's forecasts for budget surpluses have been pared back further. In our view, the forecasts are still a little optimistic. We anticipate a significant economic slowdown later in the decade as the Canterbury rebuild unwinds, population growth slows, and the housing market cools. That could well see the Government's books return to deficit – which is worrying in the context of long-run population aging.

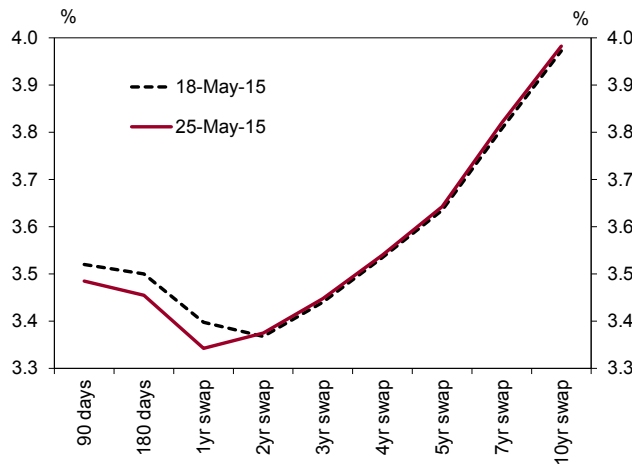
## Fixed vs Floating for mortgages

With short-term interest rates more likely to fall than to rise over the year ahead, borrowers should feel in no hurry to fix.

Longer-term fixed rates do offer the benefit of stability. For borrowers with a deposit of 20% or more, the best value probably continues to lie in the two-year ahead and three-year ahead terms. Four- and five-year rates still seem high relative to where we think shorter-term rates are going to go over the next four or five years, though the gap has continued to narrow.

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

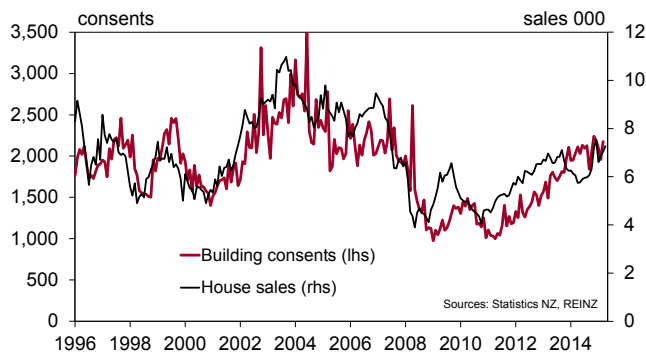


## NZ Apr building consents

May 29, Last: +11.0%, Westpac f/c: -3.0%

- After three months of declines, residential building consents rebounded 11% in March, providing some reassurance that the upturn in the construction sector remains on track.
- Consents in Canterbury seem to have passed their peak, which is in line with our view on the profile of the quake rebuild, while consents in Auckland are still tracking up towards the levels needed to meet population growth.
- April consents are likely to see some retracement, particularly in the volatile units category which was above average in March.

### NZ housing activity

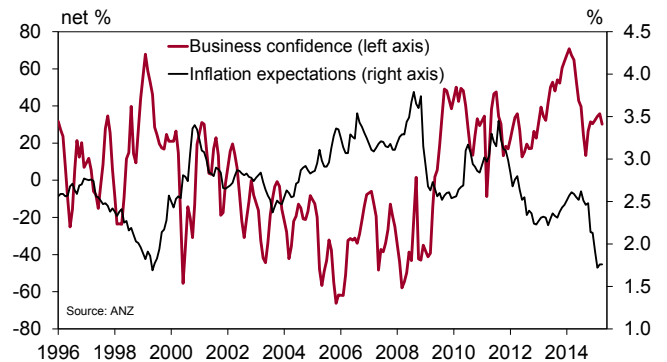


## NZ May business confidence

May 29, Activity outlook last: 41.3

- The April business opinion survey revealed a modest softening in business conditions. But looking through seasonal variations, we were left with a positive picture of business sector activity in New Zealand.
- We expect that business confidence will have remained at robust levels in May, consistent with continued strength in domestic demand. As has been the case in recent months, strength is expected to remain concentrated in the construction sector.
- The survey's inflation gauges will be closely watched. Despite softness in inflation, businesses' inflation expectations and pricing intentions have stabilised in recent months. However, with the inflation outlook for the next few years looking soft, it remains to be seen if the decline in inflation expectations has really been arrested, or if this was just a pause.

### NZ business confidence and inflation expectations

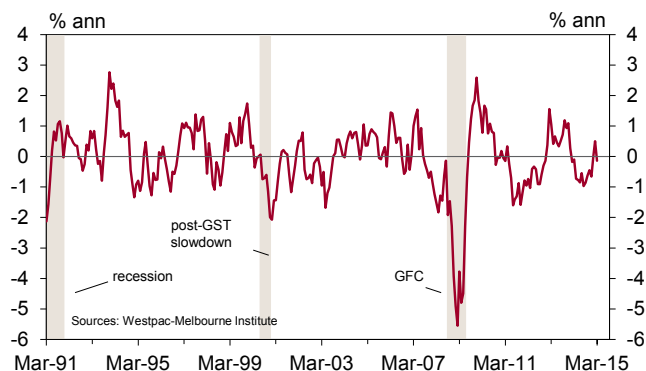


## Aus Apr Westpac-MI Leading Index

May 27, Last: -0.14%

- The 6mth annualised growth rate of the Index fell from +0.5% in Feb to -0.14% in Mar, a disappointing result reversing what was a promising above trend result that had snapped a 12mth run of negatives.
- The Apr reading will include a mixed bag of updates. The last month has seen: markedly more positive reads on the Westpac-MI Consumer Expectations Index and the Westpac-MI Unemployment Expectations Index, both of which posted post-Budget improvements in May (+10% and -5.8% respectively, the latter representing a more upbeat outlook for unemployment); upticks in dwelling approvals (+2.8%) and total hours worked (+0.3% in Mar); and a slight widening in the yield spread (+0.16bps). Against this, the month has also seen more weakness for commodity prices (-3.6% in AUD terms); US industrial production (-0.3%); and the ASX (-1.5%).

### Westpac-MI Leading Index

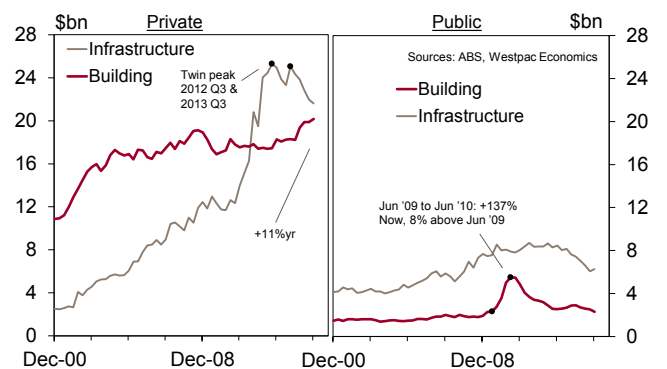


## Aus Q1 construction work done

May 27, Last: -0.2%, WBC f/c: -1.8%  
Mkt f/c: -1.2%, Range: -5.0% to 3.8%

- Construction activity weakened in 2014, a trend that most likely extended into 2015. In Q1, total work is forecast to decline by -1.8%qtr, -6.6%yr.
- Conditions across private and public construction activity most likely softened in Q1, with the exception of home building.
- Private infrastructure activity, which accounts for 40% of total construction, is trending lower. Work fell 11% in 2014 as the mining investment boom deflates. The private non-residential building cycle has passed its peak, with approvals taking a step lower in 2014, and public works have weakened of late.
- Private new home building activity is experiencing a strong upswing. Work jumped 16% in 2014 and a solid gain is expected in Q1. The sector accounts for 1/4 of total construction activity.

### Construction work: divergent trends

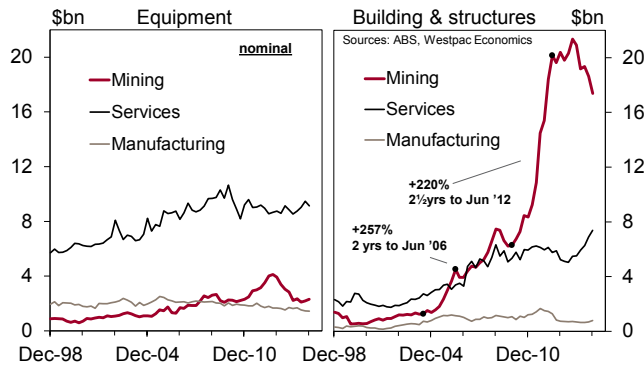


## Aus Q1 private business capex

May 28, Last: -2.2%, WBC f/c: -2.4%  
Mkt f/c: -2.4%, Range: -5.4% to 0.8%

- Private business capex weakened in 2013 and in 2014, with falls of around 4% in each year.
- In Q1, we expect private business capex to fall by 2.4%, a fall in line with the 2.2% drop in Q4.
- Building & structures activity softened in 2014, down -2.6%qtr, -7.3%yr in Q4. For Q1, we expect a fall of just over 3%, with infrastructure led lower by the mining sector and with building work also declining.
- Equipment spending rose almost 5% in 2014 but finished the year on a soft note, declining by 1.3% in Q4. With business confidence evaporating of late we expect a decline of 0.8% in Q1, with weakness likely to be spread across the three broad industry groups - mining, services and manufacturing.

### CAPEX: by industry by asset

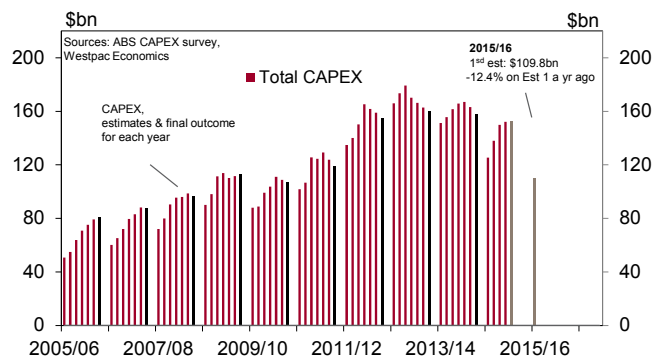


## Aus 2015/16 capex expectations, AUDbn

May 28, Last: 109.8

- The December quarter survey included the 1st of seven estimates of capex spending for the 2015/16. The March survey will report the 2nd estimate.
- Estimate 1 was \$109.8bn, which is 12.4% lower than Est 1 for 2014/15. By industry, weakness was broad based, with: mining -18.8%; manufacturing -11.9%; and services -1.8%.
- We caution that Est 1 and Est 2 of capex plans are often an unreliable guide to actual spending. In 2013/14, Est 1 on Est 1 was -8.8%, while the outcome was -1.6%.
- We expect business investment to decline in 2015/16, down 6% in real terms, broadly in line with the falls in the previous two years. Mining investment is deflating from an unsustainable historic high and non-mining investment is expected to be broadly flat against the backdrop of patchy demand conditions.

### Total CAPEX: estimates & actuals

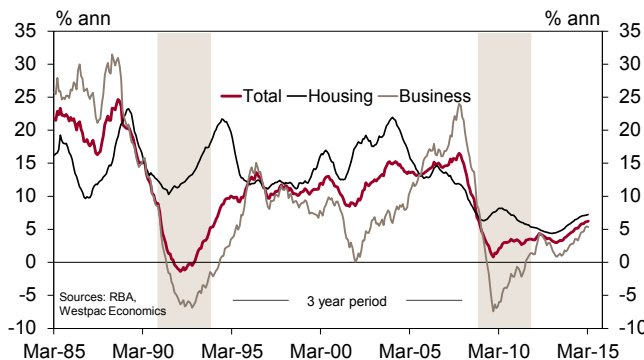


## Aus Apr private credit

May 29, Last: 0.5%, WBC f/c: 0.5%  
Mkt f/c: 0.5%, Range: 0.5% to 0.7%

- Credit to the private sector advanced by 6.2% over the year to March 2015, accelerating from a 4.4% rise during the previous year. Both households and business have responded to interest rates falling to historic lows.
- For April, we expect a gain of 0.5%, in line with the March outcome and the average pace of recent months.
- Housing credit grew by 0.6%, 7.3%yr in March, with annual growth up from 5.9% the year prior. Lending to the sector has received a further boost from the RBA's February rate cut.
- Business credit accelerated from 2.7%yr in March 2014 to 5.3%yr in March 2015. However, in the most recent month, there was a loss of momentum, with a gain of only 0.2%, consistent with the down-step in new lending.

### Credit mix: annual growth

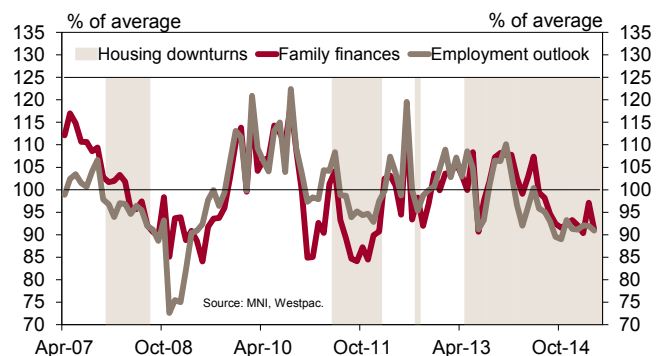


## Chn May Westpac MNI Consumer Sentiment

May 27, Last: 111.1

- The headline index decreased by 3.6pts in April, printing 111.1 versus 114.7 in March, -3.1% over the month and -5.3% over the year. The April outcome was 8.7% below the long run average. Chinese consumers remain anxious about their personal financial wellbeing and the economy more broadly.
- Positive developments in the inter-survey period include a 100bps RRR cut; an additional 25bps lending rate cut; the equity market; and signs that house price stabilisation has extended beyond the mega cities. Negative developments centre on further bad news around economic momentum.
- The lesson of Mar-April was that consumers seemed to require a shiny new policy bauble every month to keep their chins up. They got additional easing this time, so it would be disappointing if the policy sensitive aspects of the survey did not lift.

### Westpac MNI China CSI & housing downturns

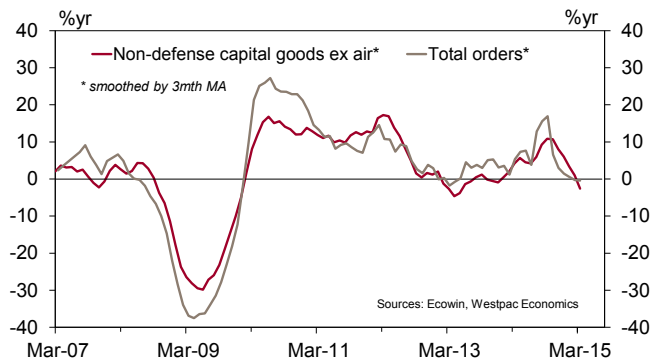


## US Apr durable goods orders: weak signals

May 26, Last: 4.7%, WBC f/c: -2.0%

- DGOs rose 4.7% in March. Indicators of underlying demand for equipment such as ex transport (0.3%) reflected the weak underlying orders picture.
- Critically, core capital goods orders ex defence & aircraft rose just 0.6% after falling fairly consistently since the middle of last year; shipments of same rose 0.9% after Feb's 0.1% rise. The recent slump in business investment spending risks becoming entrenched if a more substantial bounce in the core component is not recorded.
- But ISM factory orders have recovered less than a third of their recent plunge. Boeing orders looked not to have recovered in April. Auto orders were up 5% in March however; business equipment output was down 0.4%. These signals suggest a flat to negative headline.

### US durable goods orders



# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 25</b>					
<b>UK</b>	Bank holiday	–	–	–	Markets closed.
<b>US</b>	Fedspeak	–	–	–	Fischer.
	Public holiday	–	–	–	Memorial Day holiday.
<b>Tue 26</b>					
<b>NZ</b>	Apr merchandise trade balance NZ\$m	631	100	0	Seasonal decline in dairy exports, though prices received a boost.
<b>UK</b>	Apr mortgages £bn	45.9	–	–	BBA data covering 70% of market.
	May house prices %yr	10.9%	–	–	Tentative date for Nationwide index, due sometime this week.
<b>US</b>	Apr durable goods orders	4.7%	–0.7%	–2.0%	Most signals negative for orders.
	May services PMI (Markit) advance	55.0	–	54.0	Tracks ISM non-manufacturing better than factory PMI tracks ISM.
	Mar house prices	0.6%	0.5%	–	FHFA index.
	Mar house prices %yr	12.9%	11.9%	–	S&P Case Shiller 20 city index.
	May Conf Board consumer confidence	82.3	83.0	71.5	Weekly data suggest further slippage from multi year high in March.
	May Richmond Fed factory index	7.0	4.0	9.0	Apr saw sharp recovery from Feb-Mar weakness.
	May Dallas Fed factory index	11.7	9.0	9.0	Apr higher than at any point since early 2012.
	Fedspeak	–	–	–	Fischer.
<b>Wed 27</b>					
<b>Aus</b>	Apr Westpac-MI Leading Index	–0.14%	–	–	Slipped back below trend in Mar but still well up on 2014 lows.
	Q1 construction work done	–0.2%	–1.2%	–1.8%	New home building work up, but weakness elsewhere.
	RBA Deputy Gov Lowe speaking	–	–	–	Australian Regulatory Summit, Sydney, 10.45 am AEST.
<b>Ger</b>	Apr retail sales	–1.4%	1.0%	–	Due for release by 3/6, tentative date. Volatile, heavily revised series.
	Jun consumer confidence	10.0	10.1	–	GfK survey labelled June but taken early May.
<b>UK</b>	May CBI retail survey	30	22	–	Reported sales have swung weak-strong and back again since Nov.
	Fedspeak	–	–	–	Lacker.
<b>Can</b>	BoC policy decision	0.75%	0.75%	0.75%	The BoC assessed risks as roughly balanced in April.
<b>Thu 28</b>					
<b>Aus</b>	Q1 private new capital expenditure	–2.2%	–2.4%	–2.4%	Building & structures down (mining). Equipment down also.
	2015/16 capex plans, AUDbn	109.8	–	–	Est 1 12.4% lower than Est 1 for 2014/15, broad based weakness.
<b>Chn</b>	May Westpac MNI Cons. Sentiment	111.1	–	–	More policy easing & a broader based consolidation in housing markets.
	Apr industrial profits %yr	–0.4%	–	–	Weak nominal economy, PPI deflation, hindering industrial profitability.
<b>Eur</b>	May business climate index	0.32	0.35	–	These indicators may be impacted by the latest PMIs, which ...
	May economic confidence	103.7	103.5	–	were mixed, and the stronger GDP result released earlier this month.
<b>US</b>	Initial jobless claims w/e 24/5, '000	326	320	–	Up 28k in past week, while continuing claims lowest since Dec 2007.
	Apr pending home sales	1.1%	0.7%	1.0%	Sales higher but still struggling to lift to fresh cycle highs.
	Fedspeak	–	–	–	Williams, Kocherlakota.
<b>Can</b>	Q1 current account balance C\$bn	–13.9	–	–	Deficit narrowed last year.
	Apr industrial product prices	0.3%	–	–	Still in downtrend.
<b>Fri 29</b>					
<b>NZ</b>	Apr building consents	11.0%	–	–3.0%	Quake rebuild peaking, but Auckland's upturn still on track.
	May ANZ business confidence	41.3	–	–	Strength in domestic demand is supporting business confidence.
	Apr private sector credit %yr	5.7%	–	–	Housing lending has been gradually accelerating in recent months.
<b>Aus</b>	Apr private sector credit	0.5%	0.5%	0.5%	Annual growth at 6.2%, up from 4.4% a yr ago - boosted by lower rates.
<b>Eur</b>	Apr money supply M3 %yr	4.6%	4.9%	–	Focus on nascent recovery in lending.
<b>UK</b>	May GfK consumer confidence	–3	–2	–	Confidence at 7 year highs.
<b>US</b>	Q1 GDP first revision	0.2% a	–0.9%	–0.5%	Partial data for March and revisions now suggest economy contracted
	May Milwaukee NAPM	48.1	–	–	Much weaker in Apr than neighbouring Chicago PMI.
	May Chicago PMI	52.3	53.0	51.0	Business surveys struggling to recover recent losses.
	May UoM consumer sentiment final	88.6a	90.0	86.5	Weekly data suggest downward revision.
<b>Can</b>	Q1 GDP % annualised	2.4%	0.2%	–	Q1 growth to slow sharply, as in US.

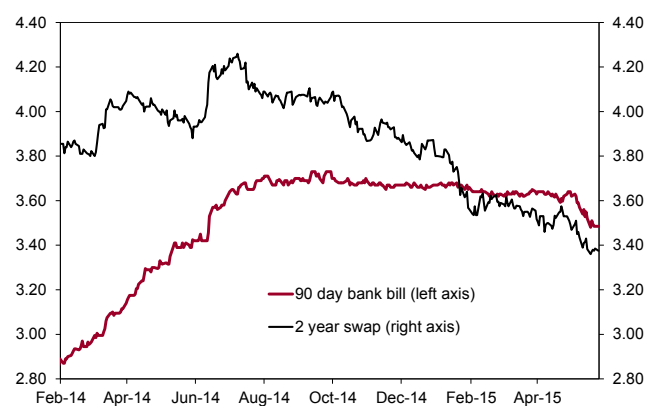


# New Zealand forecasts

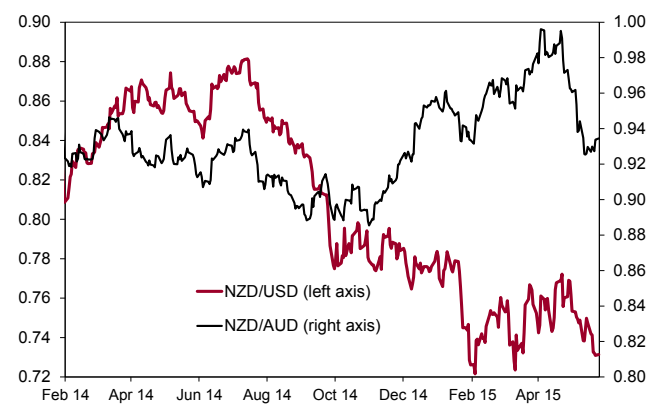
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
% change								
GDP (Production) ann avg	2.2	2.5	3.3	2.9	2.3	3.3	3.0	3.0
Employment	0.2	3.8	3.2	2.8	2.9	3.6	2.7	2.9
Unemployment Rate % s.a.	6.3	6.0	5.8	5.1	6.1	5.8	5.2	4.5
CPI	0.9	1.5	0.1	1.3	1.6	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 25 May 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.56%	3.59%	3.61%
60 Days	3.52%	3.59%	3.61%
90 Days	3.49%	3.57%	3.63%
2 Year Swap	3.38%	3.44%	3.53%
5 Year Swap	3.64%	3.65%	3.61%

NZ foreign currency mid-rates as at Monday 25 May 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7314	0.7477	0.7643
NZD/EUR	0.6648	0.6678	0.7020
NZD/GBP	0.4726	0.4840	0.5018
NZD/JPY	88.88	89.47	90.97
NZD/AUD	0.9345	0.9429	0.9731
TWI	76.02	77.31	79.22

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014	2015f	2016f
<b>Australia</b>						
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
<b>United States</b>						
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
<b>Japan</b>						
Real GDP %yr	-0.5	1.8	1.6	-0.1	1.0	1.7
<b>Euroland</b>						
Real GDP %yr	1.6	-0.8	-0.4	0.8	1.2	1.1
<b>United Kingdom</b>						
Real GDP %yr	1.6	0.7	1.7	2.6	2.5	2.7
<b>China</b>						
Real GDP %yr	9.3	7.8	7.8	7.4	7.0	7.0
<b>East Asia ex China</b>						
Real GDP %yr	4.4	4.5	4.3	4.1	4.4	5.0
<b>World</b>						
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
<b>Australia</b>						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.13	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.93	2.90	2.90	3.00	3.10	3.30
<b>International</b>						
Fed Funds	0.125	0.125	0.375	0.625	0.875	1.125
US 10 Year Bond	2.19	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	0.7920	0.78	0.73	0.73	0.73	0.73
USD/JPY	120.80	120	122	124	124	125
EUR/USD	1.1140	1.09	1.05	1.02	1.02	1.02
AUD/NZD	1.0730	1.04	1.02	1.02	1.02	1.02



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