

Weekly Commentary

9 April 2018



Shifting sentiment?

Last week was relatively quiet on the NZ data calendar. Broad-based strength in NZ export commodity prices supported another lift in the commodity price index, while whole milk powder prices unexpectedly ticked higher in the latest GlobalDairyTrade auction. Looking ahead to this week, we will get a read on how businesses sentiment is faring as the dust settles following the change of Government. Anecdotally, changes to labour laws and challenges finding the right staff remain key concerns for firms.

Commodity prices rose 1.2% in March, bringing prices to their highest level since 2014. For the rural sector, and the New Zealand economy more broadly, the real positive is the widespread nature of the strength in prices. Beef, lamb, seafood, horticulture and forestry prices are all at robust levels. And while dairy prices aren't at the front of the pack, recent dairy auctions have shown a lift in whole milk powder prices (a key determinant of the farmgate milk price). Last week's result was a little stronger than we had pencilled in, pushing whole milk powder prices to the highest level since January, and supporting the firm \$6.55 payout forecast for the current season.

The highlight for this week is likely to be the release of NZIER's latest Quarterly Survey of Business Opinion (QSBO). This is probably the most comprehensive read we get on the mood of New Zealand businesses. It's a useful indicator of how economic activity is shaping up in the first quarter of the year, and also gives us a read on demand for labour and capacity pressures both in the broader economy and the labour market.

Business confidence plunged in the wake of last year's election and change of government. Although monthly surveys of business confidence have shown some improvement, the level of confidence certainly remains well below levels seen prior to the election. When asked about the outlook for their own businesses however, firms are more upbeat. While the own activity measures in business

confidence have also eased since the election, the fall has not been nearly as dramatic. Evidently, firms are much more confident in their own ability to continue to operate given the new political backdrop, than they are in the economy more broadly to adapt to the change.

Our view is that the more pessimistic outlook for the broader economy will lead firms to think twice about their forthcoming investment and hiring decisions. Anecdotally, the cloud of uncertainty surrounding how some of the Government's policies will be implemented has been relatively slow to clear. For example, firms cite the slow passage of the Employment Relations Amendment Bill (which amongst other things abolishes the 90 day trial period for workers at firms with more than 20 employees and introduces measures designed to allow unions better access to workers) as one source of lingering uncertainty. Questions over just what industry-wide fair pay agreements will entail also remain unresolved for some.

As a consequence of the drop in business confidence, our macroeconomic forecasts incorporate both a lull in business investment and slower growth in employment over the course of 2018 as firms wait for some of this uncertainty to dissipate. Workers seem to agree, with a slight drop in the Employment Expectations component of the latest Westpac McDermott Miller Employment Confidence Survey.

Shifting sentiment?... continued

Of course changes to labour laws and the Government's policy of targeting a \$20/hr minimum wage also come at a point in the economic cycle when firms are reporting significant challenges in sourcing both skilled and unskilled labour. In the QSBO these measures of difficulty finding labour have been trending into 'tighter' territory, most notably since around 2015, and we will be keeping a close eye on how these measures evolve in this week's release. Generally, the more difficult it becomes for firms to find the right person for the job, the more pressure we eventually expect to see on wage rates as firms are forced to pay up to attract the staff they need.

Aside from these standard market forces that play a role in setting wages, the government also plays its part by setting the minimum wage. The new Government's policy is to target a minimum wage of \$20/hour by April 2021 (economic conditions permitting). The first step down the pathway to achieving this goal came through on 1 April, when the minimum wage rose from \$15.75/hr to \$16.50.

Increases to minimum wages have generally outpaced inflation over time. And this year's 4.8% increase is not that much bigger than we've seen in recent years. However, the

planned increases over the coming three years are more significant. We expect around 18% of the workforce will be captured by the minimum wage by the time it reaches \$20/hr in 2021.¹ Anecdotally firms' concerns about minimum wage increases extend beyond simply the headline figure. Other workers who are paid a little above the minimum wage are likely to also get an increase in order to maintain relative wage differentials. Compared to other countries, New Zealand's minimum wage is high relative to the average wage, meaning changes to the minimum wage impact a relatively large share of the workforce (a share that will increase even more as the minimum wage heads towards \$20).

The flow on effect on inflation of changes to the minimum wage will depend on the extent to which firms can pass on cost increases. This will vary across industries and with the state of the labour market more generally. A minimum wage hike is unlikely to spark a wage-price spiral on its own, but if this trend was already underway, it could be exacerbated by the change. To this end, this week's QSBO will give us an update on how firms' cost pressures and pricing intentions have evolved over the last three months.

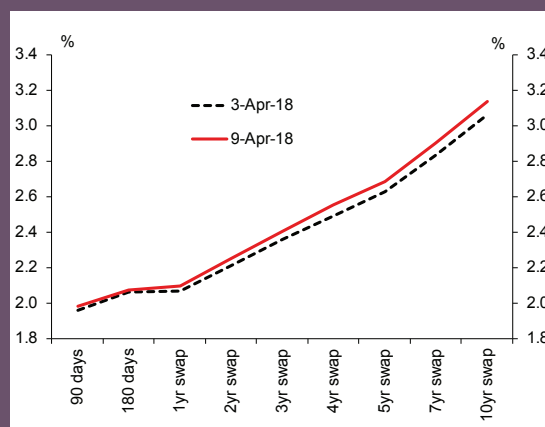
¹We will have further detail on how the minimum wage changes impact on wages and inflation in a forthcoming bulletin.

Fixed vs Floating for mortgages

For borrowers with a deposit of 20% or more, the best value lies in the two-year rate or shorter fixed terms. Three-to-five-year rates seem high relative to where we think short-term rates are going to go over that time. Some lending and deposit rates have been falling recently, so it may be worth waiting to see if there are further modest reductions in fixed-term rates.

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



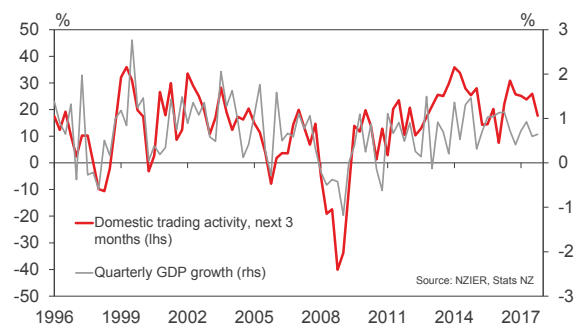
The week ahead

NZ Q1 Survey of Business Opinion

Apr 10, Domestic trading activity - Last: +18

- Business confidence fell sharply in the December quarter as firms became more nervous about the outlook for the broader economy in the wake of the change of Government. Firms' outlook for their own activity also fell albeit not as sharply.
- Since then, monthly measures of business sentiment have improved off their lows. However, confidence continues to linger well below pre-election levels. We will be looking to see if this trend rings true for the QSBO as well.
- Of interest will be how the survey's key inflation gauges are tracking. We'll also take note of how capacity pressures in the construction sector are evolving and any further tightening in labour market indicators.

QSBO domestic trading activity and GDP

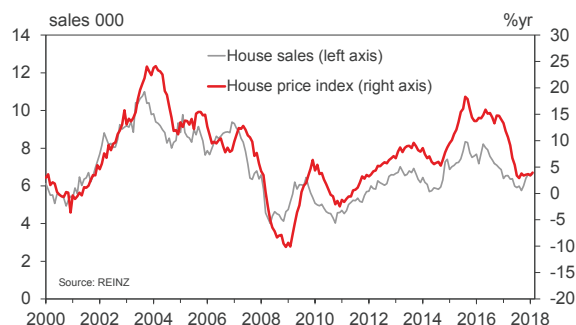


NZ Mar REINZ house sales and prices

Apr 9-13 (tbc), Sales last: +1.5%, Prices last: 3.9%/yr

- After slowing in early to mid-2017, the New Zealand housing market has been more positive in recent months. House prices lifted 1.5% over the three months to February - slightly less in Auckland and Canterbury, slightly more elsewhere. Market turnover has also picked up, albeit less emphatically.
- March will probably be another relatively buoyant month. Banks have been reducing mortgage rates and lending more freely.
- However, later in 2018 we expect a marked housing market slowdown. The bright-line test for taxing capital gains on resold properties will be extended from two to five years from April 1, foreign buyers will be restricted from mid-year, and further tax changes designed to cool house prices can be expected. At the same time, population growth is slowing and fixed mortgage rates will soon stop falling.

REINZ house prices and sales

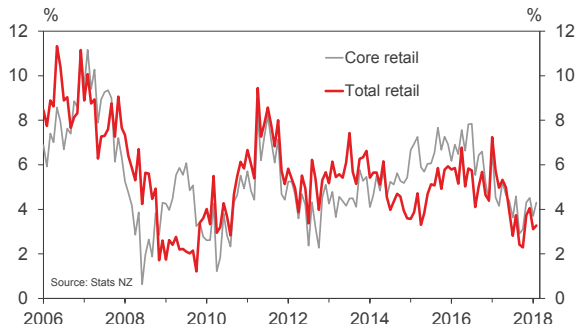


NZ Mar retail card spending

Apr 12, Last: -0.3%, WBC f/c: +0.6%

- Retail spending fell 0.3% in February. However, this followed a large 1.4% gain in January, and still left us with a fairly healthy picture of spending growth over the past year. The softness in February's spending figures was centred on two categories. The first was consumables, which Stats NZ suggested may have been affected by poor weather through the month. The other was fuel spending, which was weighed down by a fall in prices.
- We're expecting to see a 0.6% gain in retail spending in March, underpinned by a 0.7% lift in core categories. In part, this is a recovery from earlier weather related disruptions. In addition, we expect to see solid increases in categories such as hospitality through the Easter holiday period. Such gains are only partially offset by falls in fuel prices.

Card transactions, annual % change

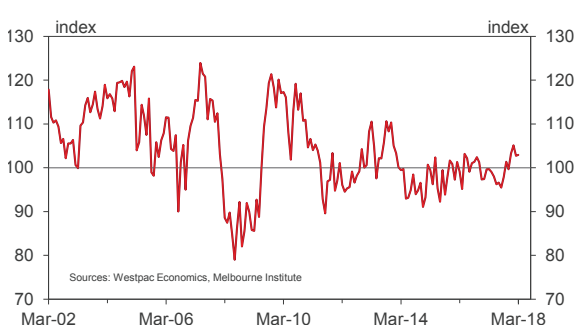


Aus Apr Westpac-MI Consumer Sentiment

Apr 11, Last: 103.0

- The Westpac-Melbourne Institute Consumer Sentiment Index rose 0.2% to 103.0 in March from 102.7 in February. The index remains in net optimistic territory above the 100 mark but below January's reading of 105.1. The survey detail suggests the negative impact of market volatility on sentiment in February eased but has been partially offset by new concerns about longer term prospects for the economy.
- The April survey is in the field over the week ended April 8. Financial markets have again been unsettled, the ASX200 down 2.9% since the March survey and US-China trade relations deteriorating further. Continued house price declines locally are also likely to be weighing on sentiment.

Consumer Sentiment Index



The week ahead

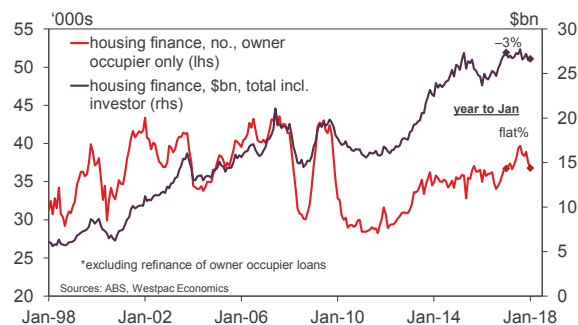
Aus Feb housing finance (no.)

Apr 12, Last: -1.1%, WBC f/c: -1.0%

Mkt f/c: -0.4%, Range: -1.2% to 1.5%

- Australian housing finance approvals had a mixed month in Jan, the number of owner occupier approvals dipping 1.1% but the value of investor loans firming 1.1%. As always, housing data should be treated with extra caution around the summer holiday low period.
- Industry figures suggest Feb saw a similar dip in owner occupier approvals - we expect a 1.0% decline. It's difficult to envisage further gains in the value of investor loans although that would help explain the recent firming in total housing credit growth (i.e. the stock of debt outstanding, changes in which relate to both new loans and repayment behaviour).

New finance approvals*

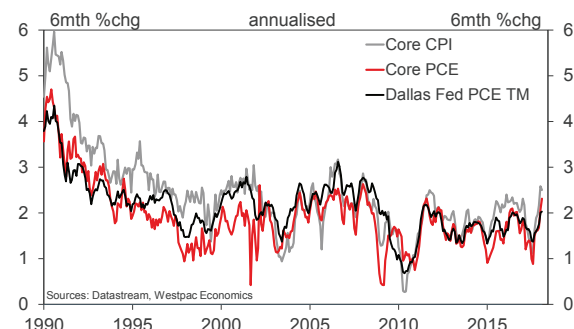


US Mar CPI

Apr 11, last 0.2%, WBC 0.0%

- Headline CPI inflation has settled a little above 2.0%/yr in recent months.
- Come March, the monthly gain for core prices is likely to again be circa 0.2%; however, for headline inflation, this will be offset by weaker energy prices, leaving total prices little changed for the month. There will be more movement in the annual rates however, particularly for core inflation. This is because the first of the weak outcomes from 2017 is set to drop out of the annual calculation, March's -0.1%.
- Annual core inflation is expected to jump from 1.8%/yr to 2.1%/yr in the month. Because of the weight of energy prices in the month, annual headline inflation is likely to only edge up 0.1ppt to 2.3%/yr.

Core inflation nearing target



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 09					
NZ	Mar REINZ house prices, %oyr	3.9%	-	-	Due this week. Prices firmed, but gains muted in Auckland...
	Mar REINZ house sales	1.2%	-	-	... and turnover remains subdued.
Eur	Apr Sentix investor confidence	24.0	24.0	-	Holding at elevated level despite trade frictions.
UK	Mar Halifax house prices	0.4%	-	-	Annual price growth continues to cool, esp. in London.
Tue 10					
NZ	Q1 QSBO general business sentiment	-11	-	-	Election uncertainty dampened Q4, but is now fading.
Aus	Mar NAB business survey	21	-	-	Conditions at historic high - ripe for a pull-back.
Chn	Mar M2 money supply %oyr	8.8%	8.9%	-	Tentative date 10-15.
	Mar aggregate financing, CNYbn	1170.0	1900.0	-	Tentative date 10-15.
	Mar new loans, CNYbn	839.3	1151.0	-	Tentative date 10-15.
Eur	ECB Praet speaks	-	-	-	Chief Economist at European Finance Forum event.
US	Mar NFIB small business optimism	107.6	-	-	Remain very positive.
	Mar PPI	0.2%	0.1%	-	Little interest in upstream prices; growth subdued.
	Feb wholesale inventories	1.1%	0.5%	-	Likely to support growth in Q1.
	Fedspeak	-	-	-	Kaplan in Beijing with media Q&A.
Wed 11					
Aus	Apr Westpac-MI Consumer Sentiment	103.0	-	-	So far has remained in net optimistic territory in 2018.
	RBA Governor Lowe	-	-	-	Regional variation in a national economy, Perth, 3pm AEST
Chn	Mar PPI %oyr	3.7%	3.2%	-	At whim of global commodity prices.
	Mar CPI %oyr	2.9%	2.6%	-	Upstream pressures easing; food inflation also slowing.
UK	Feb trade balance £bn	-3.1	-2.7	-	Brexit uncertainty and poor weather...
	Feb industrial production	1.3%	0.6%	-	... have dampened manufacturing sector conditions.
	Feb construction output	-3.4%	0.9%	-	Poor weather disrupted activity; public spending slowed.
US	Mar CPI	0.2%	0.0%	0.0%	Energy to offset core inflation.
	Mar monthly budget statement, \$bn	-215.2	-	-	Interest in this release set to grow.
Thu 12					
NZ	Mar retail card spending	0.1%	-	0.6%	Recovery from softness, supported by hospitality, etc.
Aus	Apr MI inflation expectations	3.7%	-	-	Holding lower from mid-2017 expectations.
	Feb housing finance	1.1%	-0.4%	-1.0%	Mixed month in Jan, see textbox.
Eur	Feb industrial production	-1.0%	0.4%	-	Partial reversal of Jan weakness due.
	Bundesbank Weidmann speaks	-	-	-	On a crisis proof monetary union.
UK	Mar RICS house price balance	0%	0%	-	House price softness centred on London.
US	Mar import price index	0.4%	0.1%	-	Tariffs will impact in 2018 if implemented.
	Initial jobless claims	242k	-	-	Remain at historically low levels.
	FOMC meeting minutes	-	-	-	Further colour on risks to outlook of interest.
Fri 13					
NZ	Mar BusinessNZ manufacturing PMI	53.4	-	-	Production & orders taken a step down in recent months.
Aus	RBA Financial Stability Review	-	-	-	Regular half year update.
Chn	Mar trade balance USDbn	33.7	25.0	-	Post LNY, business back to normal.
Eur	Feb trade balance €bn	19.9	-	-	Robust surpluses continuing.
UK	BOE Governor Carney	-	-	-	Speaking at Canada Growth Summit in Toronto.
US	Feb JOLTS job openings	6312	-	-	Hires; fires; quits; and openings.
	Apr Uni. of Michigan sentiment prelim.	101.4	101.0	-	Sentiment following labour market trend.
	Fedspeak	-	-	-	Kaplan Q&A, Rosengren on eco., Bullard on living standards.

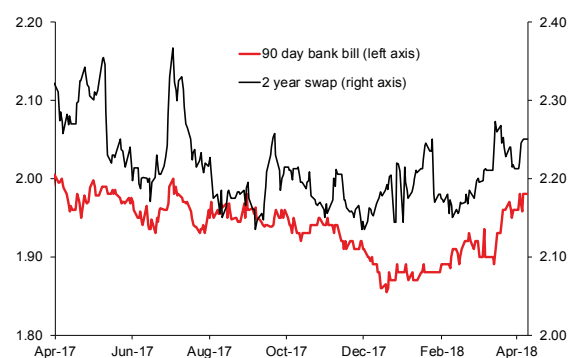
New Zealand forecasts

Economic Forecasts	Quarterly				Annual			
	2017	2018			Calendar years			
% change	Dec(a)	Mar	Jun	Sep	2016	2017	2018f	2019f
GDP (Production)	0.6	0.6	0.6	0.7	4.0	2.9	2.7	3.0
Employment	0.5	0.4	0.4	0.4	5.8	3.7	1.4	1.0
Unemployment Rate % s.a.	4.5	4.4	4.4	4.4	5.3	4.5	4.5	4.7
CPI	0.1	0.5	0.4	0.6	1.3	1.6	1.7	1.5
Current Account Balance % of GDP	-2.7	-2.2	-2.3	-2.5	-2.2	-2.7	-2.4	-2.7

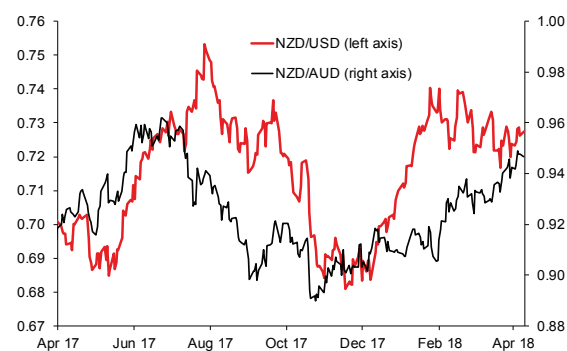
¹ Annual average % change

Financial Forecasts	Jun-18	Sep-18	Dec-18	Mar-18	Jun-19	Sep-19
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.90	1.90	2.05
2 Year Swap	2.20	2.20	2.30	2.40	2.55	2.70
5 Year Swap	2.70	2.75	2.90	3.05	3.15	3.25
10 Year Bond	2.90	3.00	3.20	3.30	3.35	3.40
NZD/USD	0.72	0.70	0.68	0.66	0.65	0.64
NZD/AUD	0.94	0.92	0.92	0.92	0.92	0.91
NZD/JPY	77.8	76.3	75.5	73.3	72.2	70.4
NZD/EUR	0.59	0.57	0.56	0.55	0.54	0.52
NZD/GBP	0.53	0.53	0.54	0.54	0.53	0.52
TWI	74.5	73.0	71.7	70.3	69.6	68.6

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on 9 April 2018

Interest Rates	Current	Two weeks ago	One month ago
Cash	1.75%	1.75%	1.75%
30 Days	1.88%	1.86%	1.78%
60 Days	1.92%	1.91%	1.84%
90 Days	1.98%	1.96%	1.90%
2 Year Swap	2.25%	2.23%	2.22%
5 Year Swap	2.69%	2.66%	2.75%

NZ foreign currency mid-rates as at 9 April 2018

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7275	0.7237	0.7295
NZD/EUR	0.5919	0.5860	0.5926
NZD/GBP	0.5160	0.5119	0.5265
NZD/JPY	77.79	75.73	77.91
NZD/AUD	0.9468	0.9395	0.9290
TWI	75.09	74.71	75.06

International forecasts

Economic Forecasts (Calendar Years)	2014	2015	2016	2017	2018f	2019f
Australia						
Real GDP % yr	2.6	2.5	2.6	2.3	2.7	2.5
CPI inflation % annual	1.7	1.7	1.5	1.9	2.1	1.9
Unemployment %	6.2	5.8	5.7	5.5	5.5	5.6
Current Account % GDP	-3.0	-4.7	-3.1	-2.3	-2.8	-3.8
United States						
Real GDP %yr	2.6	2.9	1.5	2.3	3.0	2.5
Consumer Prices %yr	1.6	0.1	1.3	2.1	2.5	2.0
Unemployment Rate %	6.2	5.3	4.9	4.4	4.0	3.8
Current Account %GDP	-2.3	-2.3	-2.3	-2.6	-2.5	-2.4
Japan						
Real GDP %yr	0.3	1.1	1.0	1.5	1.3	1.0
Euroland						
Real GDP %yr	1.3	2.0	1.8	2.5	2.1	1.6
United Kingdom						
Real GDP %yr	3.1	2.2	1.8	1.7	1.6	1.6
China						
Real GDP %yr	7.3	6.9	6.7	6.9	6.3	6.1
East Asia ex China						
Real GDP %yr	4.2	3.8	3.9	4.5	4.3	4.3
World						
Real GDP %yr	3.6	3.4	3.2	3.8	3.9	3.7

Forecasts finalised 6 April 2018

Interest Rate Forecasts	Latest	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	2.04	2.02	1.98	1.94	1.90	1.88	1.86	1.85
10 Year Bond	2.66	2.75	2.95	3.15	3.20	3.00	3.10	3.10
International								
Fed Funds	1.625	1.875	2.125	2.125	2.375	2.625	2.625	2.625
US 10 Year Bond	2.81	2.90	3.10	3.35	3.50	3.40	3.40	3.30
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.20	0.00	0.00	0.00

Exchange Rate Forecasts	Latest	Jun-18	Sep-18	Dec-18	Mar-18	Jun-19	Sep-19	Dec-19
AUD/USD	0.7687	0.77	0.76	0.74	0.72	0.71	0.70	0.70
USD/JPY	107.16	108	109	111	111	111	110	110
EUR/USD	1.2259	1.22	1.22	1.21	1.19	1.21	1.23	1.26
AUD/NZD	1.0580	1.07	1.09	1.09	1.09	1.09	1.09	1.08

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- (ii) physical separation of various Business/Support Units;
- (iii) and well defined wall/cell crossing procedures;
- (iv) a "need to know" policy;
- (v) documented and well defined procedures for dealing with conflicts of interest;
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