



Cape Reinga lighthouse, North edge of New Zealand

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## Onwards and upwards

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Recent developments – a slowly strengthening New Zealand labour market, the Reserve Bank of Australia’s decision to take rate cuts off the table for the time being, and further evidence of the improved fortunes of the primary export sector – will have left the RBNZ comfortable with its plans to embark on a measured series of OCR hikes, starting with 25 basis points in March.

Last week’s December quarter labour data confirmed that New Zealand’s accelerating and broadening economic upturn is now finally extending to the jobs market. The unemployment rate fell to 6% – its lowest in four and a half years – numbers employed rose strongly for a second straight quarter, and private sector wage growth inched up.

If anything the numbers were a smidgen stronger than we or the markets had expected. But there were enough soft patches in the details to remind us that at this stage of the economic cycle the labour market’s recovery remains fairly hodge-podge, and isn’t yet at the point of adding to inflation concerns. While the Reserve Bank has enough reason to raise interest rates, there was nothing in these reports to up the ante.

Two details stood out. First, strong employment growth was matched by rising labour market participation, which will have helped ease concerns that the economy is running up against capacity constraints. In particular, youth participation now seems to be on the rise again after falling sharply in late 2012.

Secondly, the Reserve Bank will have taken special note of the latest wage data. While there were pockets of accelerating wages (in agriculture, manufacturing, professional services, and healthcare) there is still no serious sign that wage pressures are becoming more widespread. In fact, construction sector wage inflation outside Canterbury has been slowing for two quarters now. (Surprisingly, construction sector wage inflation in Canterbury has slowed as well – the Canterbury wage premium may have started to plateau as more workers are being drawn into the region.)

# Onwards and upwards continued

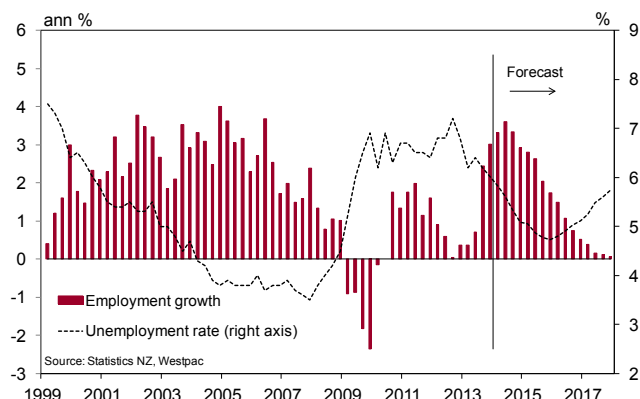
It's worth stressing that while these facts make hikes less urgent, they don't obviate the need to get interest rates back to more normal levels. Wages tend to be the last shoe to drop in the inflation cycle, so we would put more weight on the latest CPI release, which did show housing-related price pressures getting stronger and spreading beyond the Canterbury region. And with New Zealand's labour force participation already very high by international and historical standards, it's not clear for how much longer an expanding labour force will continue to meet demand for workers.

The Reserve Bank of Australia's decision last week to drop the signal that it could cut the cash rate further will also have added to the RBNZ's sense that it is safe to hike in a steady and well-signalled manner. The change in the RBA's stance appears to have halted the upward trend in the NZD/AUD for now. That said, we remain of the view that the NZD/AUD will rise back to 94 cents later this year as the need for further monetary stimulus in Australia becomes more apparent.

Finally, while the latest merchandise trade and export price data offered no major surprises, they confirmed that improving agricultural production and global prices at multi-decade highs are now a major contributor to New Zealand's economic upswing. Perhaps the most interesting point now emerging from the trade data is the sheer importance of Chinese demand for New Zealand's export fortunes. Dairy exports to China jumped 79% in 2013 compared to a year earlier, and now make up a third of our total dairy exports. China is now New Zealand's largest merchandise export market.

The remarkable thing is that this has been happening at a time when Chinese growth has been rather modest by its own historical standards, and when hard commodity prices are well down on a year ago. Indeed, growth in China's imports from New Zealand has far outpaced growth in its imports from other developed countries of late.

New Zealand employment and unemployment



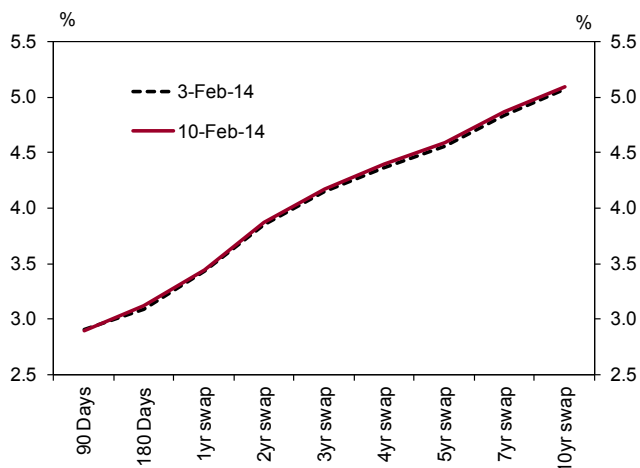
While it's a well-publicised fact that structural changes in Chinese demand for food are underway, what we probably haven't sufficiently appreciated is the importance of New Zealand specific factors – notably New Zealand's Free Trade Agreement with China (signed in 2008, around the time when New Zealand's exports to China seriously took off), the less tangible benefits this has yielded in terms of business relationships, and New Zealand's reputation for stringent food safety standards (even after the recent high-profile scares).

That would explain why the current sweet spot of high global prices and favourable growing conditions for farmers has lasted for a lot longer than we initially thought likely. Since these factors are structural rather than cyclical, apart from a small dip this year we now expect high prices for New Zealand's export commodities to persist over the medium term.

## Fixed vs Floating for mortgages

We are indifferent between fixing and floating at present. Interest rates are currently higher for longer fixed terms. However, we expect floating rates and short-term fixed rates to rise substantially over the coming three years. In our view, floating and short-term fixed rates offer no better or worse value than longer-term fixed rates.

NZ interest rates

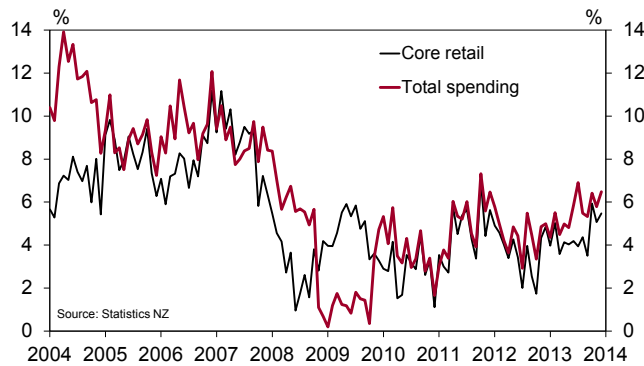


## NZ Jan electronic card transactions

Feb 12, last: 1.0%, Westpac f/c: 0.6%

- Electronic card spending rose a very strong 1.9% in the last quarter of 2013, with the gains widely spread across all retail categories. An improving labour market, rising house prices and strong growth in rural incomes are all likely to have contributed to stronger spending in the quarter. Over the past year, card spending rose 6.5%.
- A further rise in consumer confidence in January and a modest decline in petrol prices in the month (adjusted for the usual seasonal patterns) suggest that this strong trend continued into the New Year. January spending figures from Paymark (New Zealand's biggest card processor) should be released by early next week, providing further information.

Card transactions, annual % change

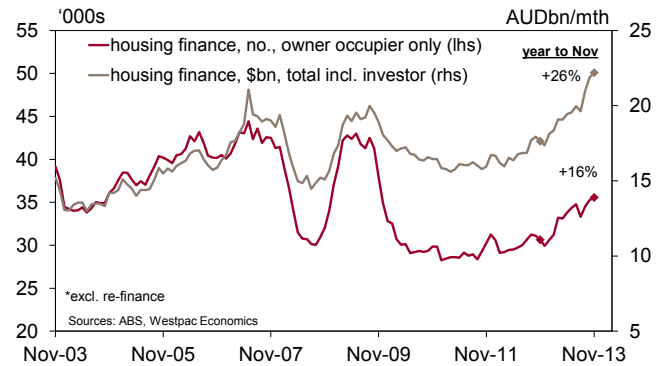


## Aus Dec housing finance (no.)

Feb 11, Last: 1.1%, WBC f/c: -1.5%  
Mkt f/c: 0.9%, Range: -3.0% to 4.0%

- The number of housing finance approvals rose 1.1% in Nov to be up 15.3%yr. This is only telling part of the story though, with the measure only covering owner-occupier approvals. Investors have been a major force since mid-2013: the value of loans to this segment rose 2.9% in Nov to be up 32.6%yr (the number of loans is not available and hence is excluded from the headline total – the coverage and classification is a quirk of the way APRA collects the original information from lenders).
- While housing markets finished 2013 with a flourish, Sydney in particular, industry data suggests owner-occupier finance approvals declined in the final month of the year. We expect the ABS measure to show a 1.5% decline. The value of loans to investors is likely to again show strength.

New finance approvals

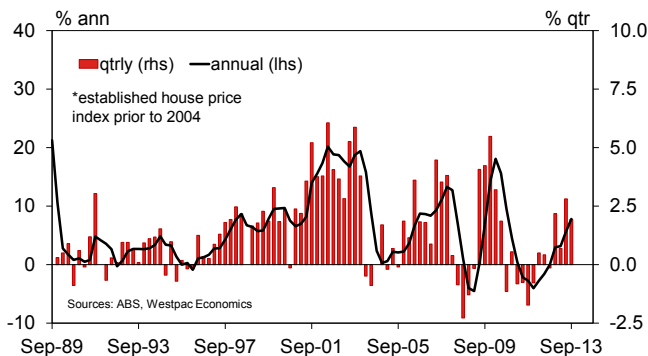


## Aus Q4 residential property price index

Feb 11, Last: 1.9%, WBC f/c: 3.0% (all dwellings measure)  
Mkt f/c: 3.0%, Range: 2.0% to 3.5%

- The ABS house price index showed a 1.9% gain in Q3 to be up 7.6%yr, with Sydney leading the way, up 3.6%qtr and 11.4%yr.
- The ABS is making major changes to this release this quarter including a name change and supplementing the existing established house price index, which covers detached houses only, with an attached dwellings price index. They will also produce a combined, 'all dwellings' measure named the residential property price index. We expect this to become the 'headline' measure from the release. Note that these changes will also see the publication released a week later.
- Available private measures show Q4 gains of: 3.3%qtr, 8.6%yr (APM); and 3.1%qtr, 8.6%yr (RP Data-Rismark). Overall we expect the broad ABS measure to show a 3.0% gain for Q4.

Residential property price index, ABS measure

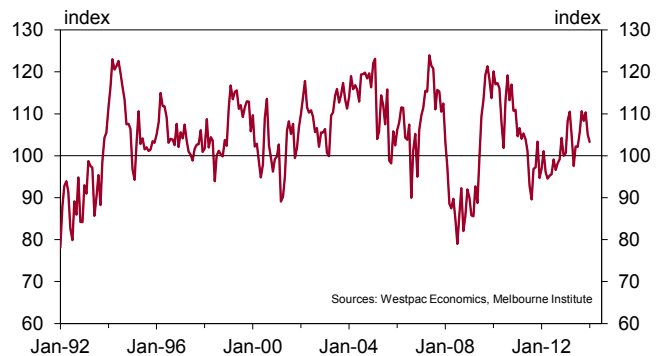


## Aus Feb Westpac-MI Consumer Sentiment

Feb 13, Last: 103.3

- The Westpac-Melbourne Institute Consumer Sentiment Index slipped from 105.0 in Dec to 103.3 in Jan, adjusting for the usual holiday 'feelgood' factor (worth about 4pts every Jan). The further slippage is consistent with the Dec survey which showed a fading post-election boost to confidence amid renewed concerns about the economy and job security.
- The Feb survey is in the field from Feb 3-9. It will incorporate reactions to the RBA's Feb policy decision which showed a clear change of stance with rates firmly on hold vs an apparent easing bias in previous months. Local economic data has been thin on the ground in recent weeks aside from the surprisingly strong Q4 CPI. Financial markets may have more of a bearing on sentiment with a continued sell-off in global markets – since the Jan survey was conducted, US equities are down 3.6% and Australia's ASX is down 3.3%.

Consumer Sentiment

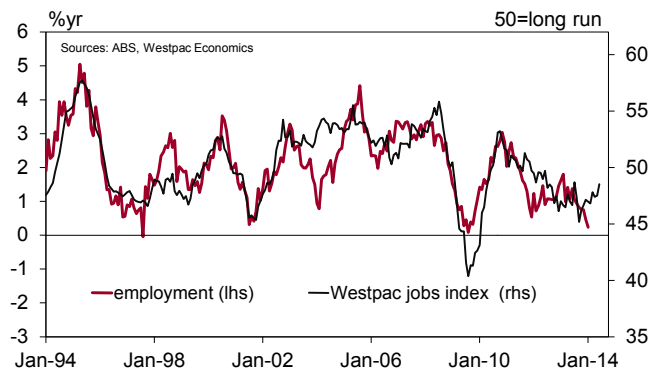


## Aus Jan employment

Feb 13, Last: -22.6k, WBC f/c: 25k  
Mkt f/c: 15k, Range: 5k to 40k

- Total employment fell 22.6k in Dec, softer than the statistical correction Westpac was looking for (-10k), but significantly weaker than market expectations (+10k).
- Last year saw an insipid rate of employment growth. Total employment lifted just 0.5%yr or 54.6k in the year to Dec (an average of just 4.5k per month). This was weaker than what the leading indicators had been suggesting. In particular, total employment fell 27.6k in the last six months of the year, composed of a 69k fall in full-time and a 41.8k part-time gain.
- The business surveys have become less pessimistic about employment, so we think the drag of the last six months has passed. However, our forecast for a 25k bounce in total employment is more about statistical noise (see below) than the start of a run of robust positive employment numbers.

Businesses are decidedly less pessimistic about jobs

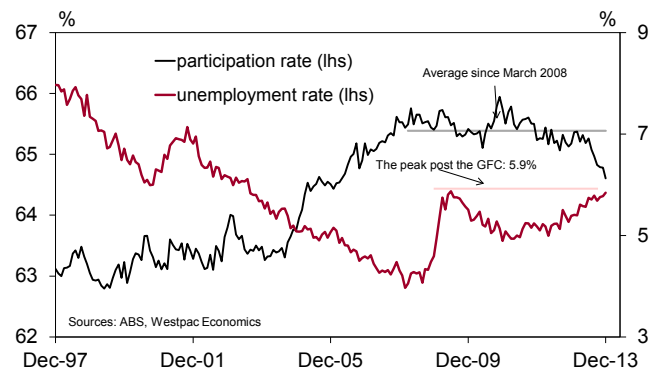


## Aus Jan unemployment rate

Feb 13, Last: 5.8%, WBC f/c: 6.0%  
Mkt f/c: 5.9%, Range: 5.7% to 6.0%

- That Dec saw some statistical noise, rather than a pure weak print, is highlighted by the 0.2ppt point fall in the participation rate. This allowed the ABS to report a flat unemployment rate of 5.8% in Dec. At two decimal places, the unemployment rate rose from 5.77% to 5.85%; close to the 0.1ppt rise we had been forecasting. Had it not been for the dip in the participation rate, the unemployment rate would have risen to 6.1%.
- Sometimes, especially when total employment is tracking sideways, you can see a correlation in the volatility between total employment and participation. We see a partial reversal of the Dec volatility in Jan.
- We are looking for a modest bounce in participation to 65.7% (it was 64.8% in Nov), lifting the unemployment rate to 6.1%.

Unemployment and participation rates

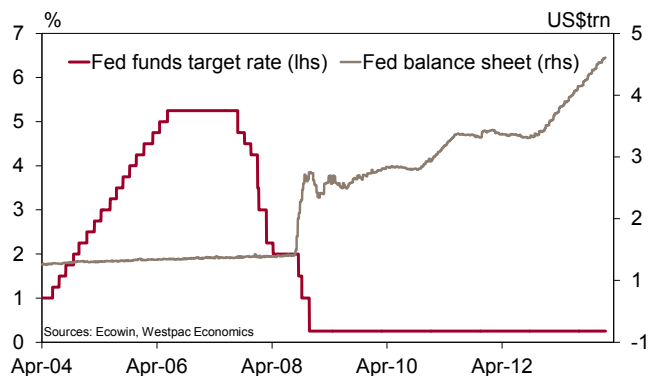


## US Fed chair Yellen testimony, policy report

Feb 11, repeated Feb 13

- At her Nov 14 confirmation hearing, Yellen supported the FOMC's then view: "unemployment ... is still too high ... inflation has been running below the Federal Reserve's goal of 2 percent and is expected to continue to do so for some time ... A strong recovery will ultimately enable the Fed to reduce its monetary accommodation ... I look forward to normalising monetary policy ... at the appropriate time ... supporting the recovery today is the surest path".
- A month later the Fed announced it would taper its bond purchases; subsequent data have revealed a faster recovery led by net exports and inventory building in H2 13, but weaker news on jobs, orders, and some business surveys.
- What prospect is there of growth slowing in 2014? How high is the hurdle to pause tapering? Don't expect answers to these!

Fed funds target rate and balance sheet

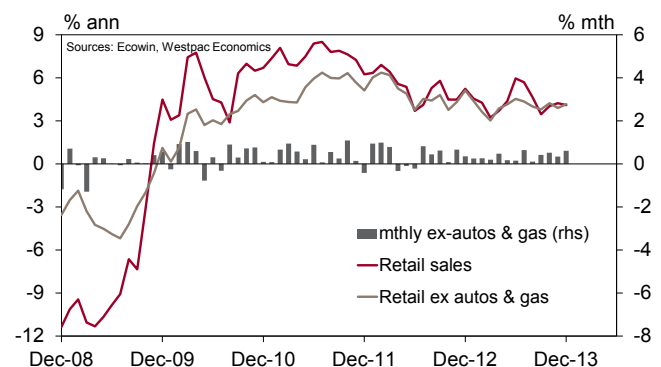


## US Jan retail sales: autos down, weather impact

Feb 13, Last: 0.2%, WBC f/c: -0.2%

- Retail sales rose 0.2% in Dec after a 0.4% rise in Nov (revised down from 0.7%). The detail was patchy, with falling auto sales, furniture, DIY electronics, etc (7 out of 14 storetypes recorded declines) offset by gasoline, food, clothing and non-store retailing gains. Core retail sales ex autos and gas rose 0.6% in Dec for a quarterly annualised gain of 5.1% in Q4, up from 4.1% in Q3.
- The Q4 pick up in core spending may have been weather-related (mild early in qtr, snow later) and was certainly at the expense of savings, with household income growth constrained. Weather disruption both boosts and hampers retailing at different times, and for different storetypes. Unit auto sales fell further in Jan; and gasoline prices averaged slightly higher. Net result is a small fall in total retail on our estimates, but flat ex autos and gasoline.

US retail sales



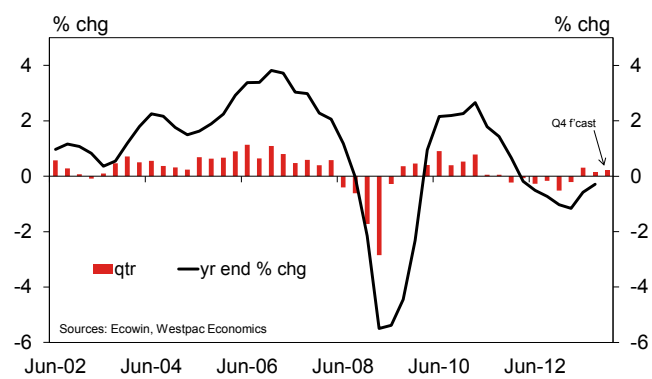
## Eurozone Q4 13 GDP

Feb 14, Last: 0.1%, WBC f/c: 0.2%

- The combination of nimble and pragmatic policy-making by ECB Chief Draghi, investor complicity (OMT\* is never going to be used given political reality in Italy, Portugal, etc, but it doesn't need to be if investors believe) and some genuine progress on the reform front has encouraged us to dial back our pessimism that the ever-present myriad of downside risks actually crystallises this year.
- Q4 GDP growth is unlikely to impress at 0.1%-0.2%, but it should at least be replicated this year, so we have revised up our 2014 growth forecast from -0.1% to 0.4%, still shy of official forecasts that growth could exceed 1%.
- Spain has already reported 0.3% Q4 growth. We expect Germany to print 0.3%, France looks to be flat (almost back in recession), and Italy 0.1%. Euroland Q4 growth could round up to 0.2%.

\*Only Mythical Transactions

### Euro zone GDP growth



# Data calendar

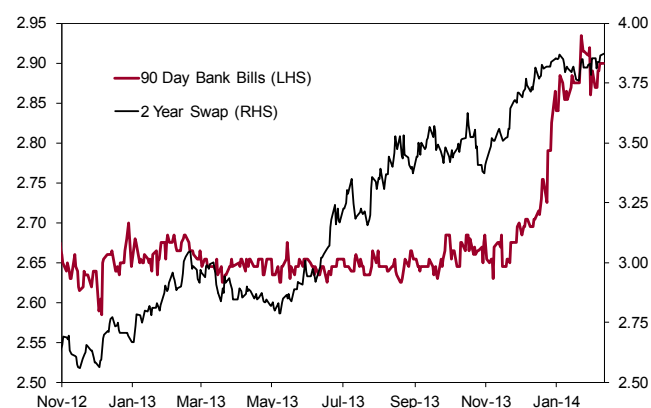
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 10</b>					
<b>Chn</b>	Jan new Yuan loans	482.5bn	1090bn	–	Tentative date.
	Jan aggregate finance RMB bn	1230.0	1900bn	–	Tentative date.
	Jan money supply M2 %yr	13.6%	13.3%	–	Tentative date.
<b>US</b>	Q4 mortgage delinquencies	6.4%	–	–	Down from 10% peak in Q1 2010. Data due any day this week.
<b>Can</b>	Jan housing starts	187.5k	185k	–	Soft landing for housing market? Starts down 15% since mid Q2 2012.
<b>Tue 11</b>					
<b>Aus</b>	Dec housing finance	1.1%	0.9%	–1.5%	Industry data shows a soft finish to 2013 for owner-occupier approvals.
	Jan NAB business survey	4	–	–	Confidence flat at 6; conditions improved 7pts to +4.
	Q4 ABS residential property price index	1.9%	3.0%	3.0%	ABS is making major changes to this release. See text box.
<b>UK</b>	Jan BRC retail survey %yr	0.4%	–	–	Same store sales.
	Dec wholesale inventories	0.5%	0.6%	–	Inventories accumulation flattered H2 2013 GDP growth.
<b>US</b>	Jan NFIB small business optimism	93.9	93.5	92.5	ISM surveys suggest some weather risk.
	Semi-annual report on policy	–	–	–	Janet Yellen's inaugural testimony as Chair. See text box.
	Fedspeak	–	–	–	Plosser.
<b>Wed 12</b>					
<b>NZ</b>	Jan electronic card transactions	1.0%	0.6%	0.6%	Strong upward trend in spending expected to continue.
<b>Aus</b>	Feb Westpac–MI Consumer Sentiment	103.3	–	–	Softened in Nov–Dec–Jan but still in positive territory.
	Feb Westpac–MI Unemp. Expect. %mth	0.7%	–	–	Have been drifting higher again lifting the annual rate to 5.2%yr.
<b>Eur</b>	Dec industrial production	1.8%	–0.5%	–	German and French data due Fri 7/2 and Mon 10/2 respectively.
<b>UK</b>	Bank of England inflation report	–	–	–	Will forward guidance thresholds be reworked?
	Jan federal budget \$bn	–28.5	–	–	Debt ceiling deadline as we go to press.
	Fedspeak	–	–	–	Lacker.
<b>Can</b>	Jan house prices %yr	3.8%	–	–	Teranet/National Bank index. Renewed acceleration in late 2013.
<b>Thu 13</b>					
<b>NZ</b>	Jan manufacturing PMI	56.4	–	–	Was consistently strong over 2013 despite rising NZD/AUD.
<b>Aus</b>	Jan employment	–22.6k	15k	25k	Labour market is soft but statistical noise accentuates Dec weakness.
	Jan unemployment rate	5.8%	5.9%	6.0%	A collapse in participation prevented a larger rise unemployment in Dec.
	Feb MI inflation expectations, %yr	2.3%	–	–	Expectations are still historically low but they have been drifting higher.
<b>UK</b>	Jan house prices net %	56%	–	–	RICS surveyors view on house prices with FFL loan subsidy withdrawn.
<b>US</b>	Jan advance retail sales	0.2%	0.0%	–0.2%	Auto sales lower; gasoline prices volatile in Dec–Jan.
	Jan retail sales ex & auto, gas	0.6%	0.1%	0.0%	Core retailing gains unsustainable given slow income growth, weather.
	Initial jobless claims w/e 8/2	331k	330k	335k	Week prior to payrolls survey week.
	Dec business inventories	0.4%	0.4%	0.2%	Inventories accumulation flattered H2 2013 GDP growth.
	Semi-annual report on policy	–	–	–	Repeated testimony; similar questions.
<b>Can</b>	Dec new house prices %yr	1.4%	–	–	Ongoing deceleration in new home prices.
<b>Fri 14</b>					
<b>NZ</b>	Jan food price index	–0.1%	–	0.9%	Food prices have been gradually trending higher since mid-2013.
<b>Aus</b>	RBA Assist. Gov Kent	–	–	–	Speech to CEDA Economic and Political Overview 2014, 9:05 AEDT.
<b>Chn</b>	Jan PPI %yr	–1.4%	–1.6%	–	Lessening rate of capital goods deflation.
	Jan CPI %yr	2.5%	2.4%	–	Food prices in focus after Dec decline.
<b>Eur</b>	Q4 GDP	0.1%	0.3%	0.2%	Spain reported up 0.3% already. See text box.
<b>Ger</b>	Q4 GDP	0.3%	0.3%	0.3%	Official estimate for 2013 suggests 0.3% in Q4; watch IP data Fri 7/2.
<b>Fra</b>	Q4 GDP	–0.1%	0.2%	0.0%	BdF 0.5% forecast contrasts with PMIs pointing to stalled at best.
<b>UK</b>	Dec construction output	–4.0%	–	–	Volatile data monthly, but PMI suggests gains ahead.
<b>US</b>	Jan import prices	0.0%	0.0%	–0.2%	Oil prices volatile in Dec–Jan, but average little changed.
	Jan industrial production	0.3%	0.3%	0.5%	Utilities up on cold weather, ISM noted severe disruption.
	Feb UoM consumer sentiment prelim	81.2	80.5	76.5	300 responses in prelim survey. How many have stocks?!
<b>Can</b>	Dec manufacturing sales	1.0%	0.5%	–	Aircraft and autos behind Nov rise.

# New Zealand forecasts

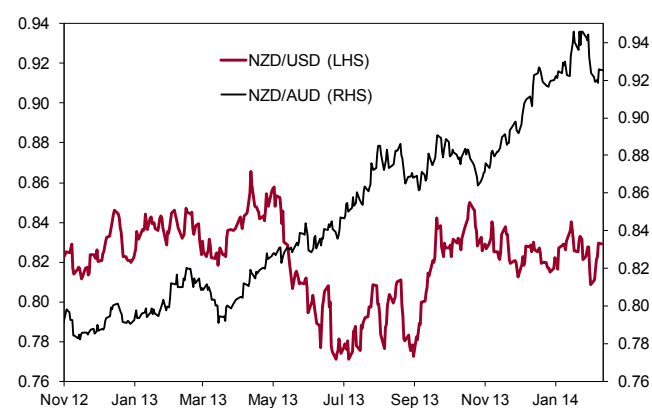
Economic Growth Forecasts	March years				Calendar years			
	2013	2014f	2015f	2016f	2012	2013e	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.2	4.2	3.0	2.6	2.8	4.2	3.2
Employment	0.4	3.3	2.8	1.5	0.4	2.9	3.0	1.7
Unemployment Rate % s.a.	6.2	5.8	5.1	4.8	6.8	6.0	5.1	4.7
CPI	0.9	1.4	1.8	2.3	0.9	1.6	1.7	2.2
Current Account Balance % of GDP	-3.9	-3.7	-5.7	-6.0	-4.1	-3.8	-5.0	-6.2

Financial Forecasts	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Cash	2.75	3.25	3.50	3.75	4.00	4.00
90 Day bill	3.10	3.50	3.75	4.00	4.20	4.30
2 Year Swap	3.90	4.10	4.30	4.50	4.65	4.80
5 Year Swap	4.60	4.70	4.80	4.90	5.05	5.20
10 Year Bond	4.70	4.80	5.00	5.10	5.20	5.30
NZD/USD	0.84	0.83	0.82	0.81	0.80	0.80
NZD/AUD	0.93	0.94	0.94	0.94	0.94	0.93
NZD/JPY	85.7	83.8	82.0	80.2	80.0	81.1
NZD/EUR	0.63	0.64	0.63	0.64	0.63	0.63
NZD/GBP	0.53	0.52	0.52	0.51	0.50	0.48
TWI	79.5	79.4	78.6	78.1	77.6	77.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 10 Feb 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.50%	2.50%
30 Days	2.69%	2.74%	2.72%
60 Days	2.79%	2.82%	2.79%
90 Days	2.90%	2.91%	2.86%
2 Year Swap	3.87%	3.81%	3.78%
5 Year Swap	4.59%	4.51%	4.63%

NZ foreign currency mid-rates as at Monday 10 Feb 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8289	0.8246	0.8296
NZD/EUR	0.6090	0.6034	0.6066
NZD/GBP	0.5053	0.4975	0.5033
NZD/JPY	85.00	84.70	86.23
NZD/AUD	0.9254	0.9422	0.9220
TWI	78.14	78.04	78.19

## International forecasts

### Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013f	2014f	2015f
<b>Australia</b>						
Real GDP % yr	2.3	2.6	3.6	2.4	2.6	3.0
CPI inflation % annual	2.8	3.0	2.2	2.7	2.3	2.5
Unemployment %	5.2	5.2	5.3	5.8	6.4	6.1
Current Account % GDP	-3.5	-2.8	-4.1	-3.1	-3.8	-2.7
<b>United States</b>						
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	1.7	1.7
Unemployment Rate %	9.6	8.9	8.1	7.4	7.1	6.6
Current Account %GDP	-3.0	-2.9	-2.7	-2.5	-2.5	-2.5
<b>Japan</b>						
Real GDP %yr	4.7	-0.6	2.0	1.8	1.8	1.4
Consumer Prices %yr	-0.7	-0.3	0.0	0.3	2.7	1.3
Unemployment Rate %	5.1	4.5	4.3	4.0	3.6	3.6
Current Account %GDP	3.6	2.0	1.1	0.9	0.9	1.9
<b>Euroland</b>						
Real GDP %yr	2.0	1.5	-0.6	-0.5	0.4	0.6
Consumer Prices %yr	1.7	2.7	2.2	1.4	1.2	
Unemployment Rate %	10.0	10.1	11.7	12.4	13.0	
Current Account %GDP	-0.1	0.0	0.9	1.0	1.0	
<b>United Kingdom</b>						
Real GDP %yr	1.7	1.1	0.2	1.9	2.6	1.9
Consumer Prices %yr	3.2	4.0	2.8	2.3	1.8	
Unemployment Rate %	7.8	8.4	8.0	8.5	8.5	
Current Account %GDP	-2.5	-1.9	-3.8	-2.5	-1.5	

Forecasts finalised 31 January 2014

Interest Rate Forecasts	Latest	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
<b>Australia</b>						
Cash	2.50	2.50	2.50	2.25	2.00	2.00
90 Day Bill	2.62	2.55	2.30	2.10	2.10	2.10
10 Year Bond	4.11	4.10	3.90	3.70	4.00	4.10
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.70	2.70	2.60	2.60	2.80	3.00
ECB Repo Rate	0.25	0.25	0.25	0.25	0.25	0.25

Exchange Rate Forecasts	Latest	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
AUD/USD	0.8952	0.90	0.88	0.87	0.86	0.85
USD/JPY	101.96	102	101	100	99	100
EUR/USD	1.3589	1.35	1.31	1.31	1.28	1.27
AUD/NZD	1.0864	1.07	1.06	1.06	1.06	1.06



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