



Castle Hill, Canterbury.

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Taking a breather

Last week we released our latest Quarterly Economic Outlook. If you haven't seen it already, it's well worth a read (you can download it here <http://www.westpac.co.nz/business/economic-updates/economic-and-financial-forecasts/>). The team's flagship publication, it provides a summary of prospects for the New Zealand economy as well as discussing the outlook for interest rates, the exchange rate, the agricultural sector and delivering an overview of developments in the global economy.

This quarter we titled the publication "Taking a breather". As we've regularly pointed out, a range of indicators of activity in the New Zealand economy have softened noticeably over the past few months. This is important information, but rather than signalling a clear turning point in the New Zealand economic story, we think the slowdown over the last few months will prove to be a temporary phenomenon, in the midst of an ongoing broader economic upswing. Granted, the New Zealand economy is probably on a path which will eventually lead to a sustained economic slowdown, a lower exchange rate, falling house prices and falling interest rates. But with the construction boom set to peak, such a scenario remains a few years off yet.

One sector of the economy has already taken a breather and entered a recovery is the housing market. Having slowed substantially since late last year under the weight of the Reserve Bank's restrictions on low equity lending and rising interest rates, most recent data show renewed signs of life. Last week the REINZ reported that the volume of house sales in July edged a touch higher for the second straight month (led by solid gains in Canterbury, Wellington and the Waikato). And the week before the Quotable Value Residential Price Movement Index, our preferred measure of house price trends in the market, showed a 2.3% increase in the three months to July compared to a 0.1% rise over the first three months of the year. Other market gauges, such as days to sell or available listings all suggest that a "sellers' market" is developing, if only very slowly.

Taking a breather continued

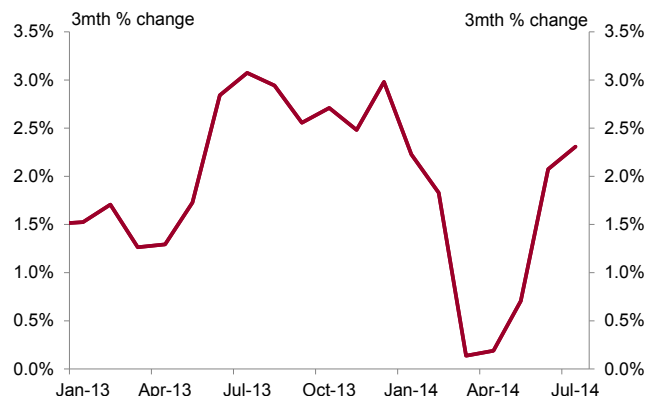
A modest, and ultimately brief, revival in the housing market around mid-year is something we have been foreshadowing for a while. Net migration soaring towards record highs (we'll get another monthly update this week but there appears to have been little to change the attitude of Kiwis opting for NZ over Australia), banks becoming more comfortable with the LVR restrictions and undertaking more low equity lending, and competition in the sector pushing some fixed mortgage rates below where they were when the RBNZ first started hiking rates in March, all support a period of sturdier housing market activity. House prices are on track to rise about five percent this year compared to almost 10% last year.

Looking over a longer horizon, two important drivers of the housing market are set to move from being a tailwind to being a headwind. The current net migration boom is likely to unwind as the recovering Australian economy once again entices Kiwis back across the Tasman, and mortgage rates will rise substantially as the RBNZ hikes the OCR. That should see house price inflation slow markedly, and may well even see a period of falling house prices later in the decade.

Yet in the meantime, the modest resurgence in the housing market is providing some support to the consumer sector. Already June quarter retail sales data showed a pickup in spending after a slow start to the year. Retail sales rose 1.2% in the quarter, almost matching the 1.3% pace of the December 2013 quarter, and a clear acceleration from a softer Q1.

Both the retail sales data and the housing market data will have reinforced the case for further rate hikes from the RBNZ next year. But for now, the RBNZ is firmly in pause mode. Falling dairy prices are set to be a drag on rural spending going forward, and retailers are continuing to operate in a competitive environment, meaning for now there is little sign of upward pressure on prices (on average retail prices were down 0.2% in the June quarter).

Monthly change in QV Residential Price Movement Index



This week is a relatively quiet one on the NZ data calendar. Markets will no doubt take an eager interest in outcomes of the latest fortnightly GlobalDairyTrade auction, while migration data will also be worth a look.

But the most substantive release will be Tuesday's Pre-Election Fiscal and Economic (PREFU) from the Treasury. With polling day for the general election fast approaching, The Treasury is required to produce an update of its economic and fiscal projections. The twin objectives of a return to surplus in 2014/15 and net debt below 20% of GDP are likely to remain intact. But with inflation tracking lower than the Treasury projected in the Budget just three months ago, revenue projections overall could be downgraded, leaving less wiggle room for new spending plans in later years.

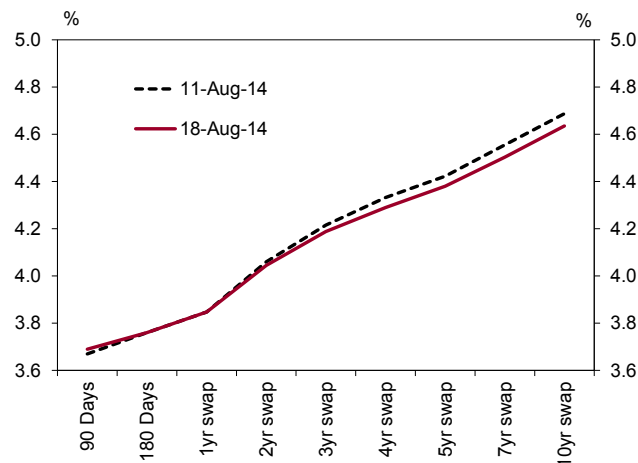
Fixed vs Floating for mortgages

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.

Among the standard fixed rates, we have no clear favourite. Shorter-term fixed rates, such as the six month or one year rate, are currently low but are expected to rise over the coming two years. Opting for the three or four year rate would require higher payments up front, but would help insulate the borrower if the Reserve Bank does follow through with an extensive OCR hiking cycle. At this stage, it is not clear which option will result in lower average mortgage payments over the life of the loan.

Banks sometimes offer "specials" on particular fixed terms. These are usually good value.

NZ interest rates

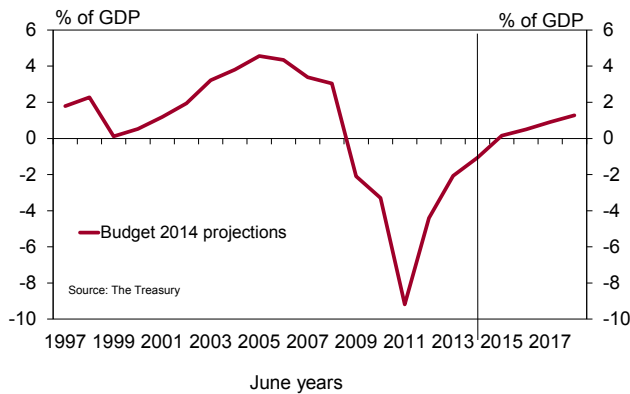


NZ Pre-Election Economic and Fiscal Update

Aug 19

- The Treasury will publish an update of its economic and fiscal projections ahead of the September 20 election in the PREFU.
- Treasury last updated its forecasts at the Budget back in May. Since then, inflation has been more subdued than expected, which could have a negative impact on revenue projections. This in turn would leave less wriggle room for new spending plans in later years.
- Despite this potential downgrade to revenue projections, the twin fiscal objectives of a return to surplus in 2014/15 and net debt remaining below 20% of GDP are likely to remain intact.

Operating balance (excluding gains and losses)

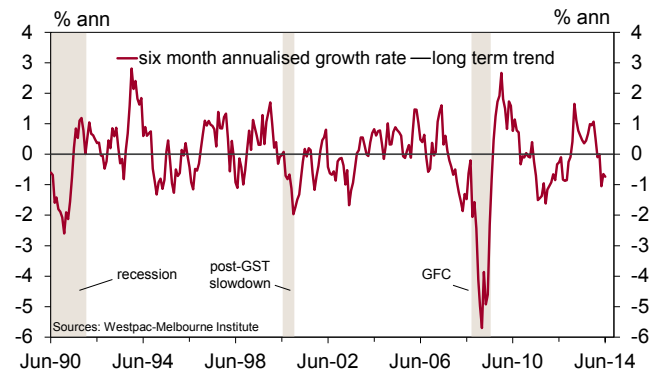


Aus Jul Westpac-MI Leading Index

Aug 20, Last: -0.73%

- The six month annualised growth rate of the Index has been below trend since Feb, indicating that growth in the Australian economy is likely to remain below trend over the remainder of 2014 with limited momentum into 2015.
- Components were mixed in July: the ASX surged strongly, posting a 4.5% rise in the month; the CSI Expectations Index rose 2.2% and consumers' unemployment expectations also improved (-3%, a decline indicating an improved outlook); but dwelling approvals fell back 4.7%; commodity prices continued to decline (-1.1%); the yield gap showed a further slight narrowing; and hours worked recorded a hefty 0.9% drop.

Westpac-MI Leading Index



US Jul CPI

Aug 19, Last: 0.3% WBC f/c: 0.0%

- Jun CPI rose 0.3%. New car prices fell 0.3%, rents were below trend on 0.2% and medical care rose just 0.1%, lowest yet this year. These held the core rate to 0.13%, despite clothing up 0.5% and tobacco up 1.0%. Airfares had jumped 8.4% in April-May but rose just 0.4% in June. Food prices rose 0.1% and energy's 1.6% was led by a 3.3% rise in gasoline prices.
- The PPI has shown falling food prices since May and DoE reports show gasoline prices reversed their recent upswing. Weak core outcomes are typically due to one or more of autos, clothing, tobacco, rents or medical care falling or below trend.
- Mildly higher readings for June's softer components, flat tobacco and a fall in apparel prices would see a flat headline CPI and another 0.1% core rate in July.

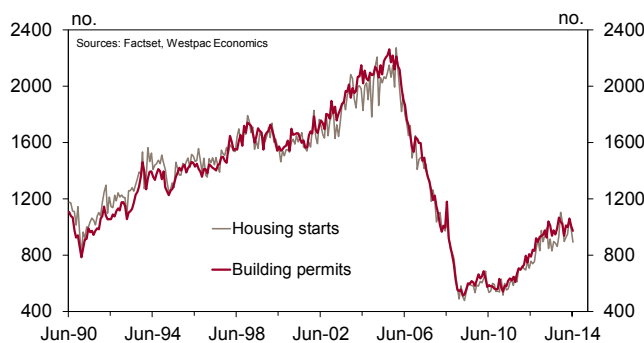
US Jul housing starts & existing home sales

Aug 19, housing starts, Last: -9.3% WBC f/c: 8.0%

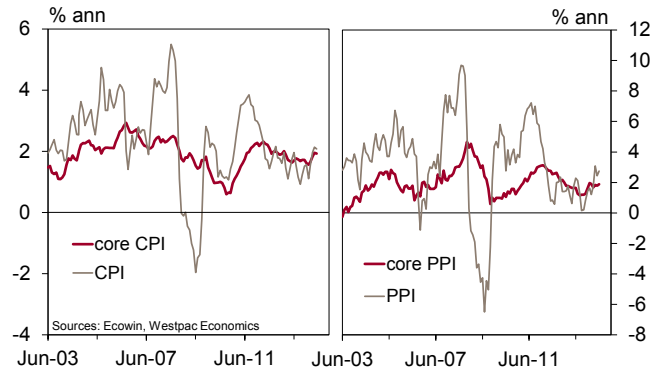
Aug 21, existing home sales, Last: 2.6% WBC f/c: -1.0%

- The housing market's post winter bounce looks to have been short-lived with new and pending home sales, housing starts and permits all falling in June. Construction jobs and homebuilder sentiment posted gains in June and July, but they did that last year, just as H2 2013's housing slide began. Mortgage rates were rising sharply in mid 2013; they are steadier today, within 20bp of where they were a year ago.
- Housing starts and permits should both rise in July after back to back declines in the volatile multiples component. Permits for single family homes rose in May-June when starts of same were falling, so singles starts should rise too, although permits (singles) probably stalled.
- Existing home sales should slip given the pending sales pipeline, adding to the uncertainty about sector prospects.

US housing starts & permits



US price inflation



Data calendar

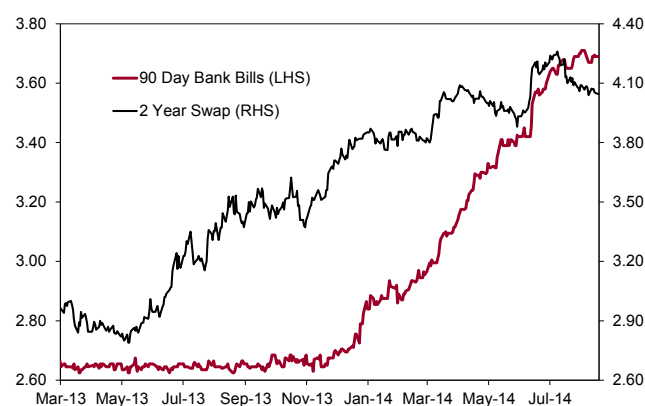
		Last	Market median	Westpac forecast	Risk/Comment
Mon 18					
NZ	Jul Performance of Services Index	54.7	–	–	Manufacturing and services surveys have both cooled lately.
Aus	Jul new vehicle sales	1.7%	–	–1.0%	Dip in Jul led by trucks; Passenger vehicles & SUVs up ~1%mo.
Chn	Jul 70 city house prices NEW %net	–67.1%	–	–	Previous cycle low was –75.7%. Likely to be surpassed.
	Jul 70 city house prices 2 nd ary %net	–64.3%	–	–	Secondary market hampered by discounting of new/off-plan.
	Aug MNI business indicator	58.2	–	–	Bullish July print not reflected in official data, but did lead flash PMI.
Eur	Jun exports	0.6%	–	–	May saw first export rise since Feb.
UK	Aug house prices %yr	6.5%	–	–	Rightmove index of asking prices.
US	Aug NAHB housing market index	53	53	50	Homebuilders missed the slowdown last year, more cautious this year.
Tue 19					
NZ	Q2 producer prices (outputs)	0.9%	–	–0.5%	Prices expected to dip, partially reversing Q1 rise.
	Pre-Election Economic & Fiscal Update	–	–	–	Treasury update of forecasts ahead of election, September 20.
	Q3 RBNZ 2yr inflation expectations	2.36%	–	–	An update on inflation expectations
Aus	RBA minutes	–	–	–	Gov's statement almost unchanged in Aug. Minutes to offer more insight?
Eur	Jun current account balance €bn	19.5	–	–	In surplus since 2011.
UK	Jul CPI % yr	1.9%	1.7%	1.5%	BRC shops prices suggest CPI has further to fall. Price war in s'mkts.
	Jul producer prices %yr	1.0%	–	–	Core output PPI.
	Jun house prices %yr	10.5%	–	–	ONS index.
US	Jul CPI	0.3%	0.1%	0.0%	Gasoline and food prices to fall. Mildly higher readings for June's
	Jul core CPI	0.1%	0.2%	0.1%	softer components, flat tobacco; fall in apparel prices. See text box.
	Jul housing starts	–9.3%	8.6%	8.0%	Starts pace for single family dwellings now running behind permits.
	Jul building permits	–3.2%	2.8%	4.0%	See text box.
Wed 20					
NZ	GlobalDairyTrade auction	–8.4%	–	–	Will prices find a floor after recent sharp declines?
Aus	Jul Westpac–MI Leading Index	–0.73%	–	–	Clear loss of momentum in 2014, components mixed in July.
	RBA Governor Stevens speaking	–	–	–	House of Rep's Standing Committee on Economics, Brisbane 9.30am AEST
Eur	Jun construction output	–1.5%	–	–	Recent falls in part due payback for mild weather boost in Ger, Q1.
Ger	Jul producer prices %yr	–0.7%	–0.7%	–	Edging up from recent lows at –1.1% yr.
UK	Aug Bank of England MPC minutes	–	–	–	Was there dissent in favour of a rate rise?
	Aug CBI industrial trends survey	2	–	–	Total orders index.
US	FOMC minutes	–	–	–	To Jul 29-30 meeting.
Can	Jun wholesale trade	2.2%	–	–	Steep rise in May due to autos.
Thu 21					
NZ	Jul net immigration	4,270	–	4,200	Strong flows underpinned by sluggish Australian labour market
Chn	Aug HSBC manufacturing PMI – flash	51.7	51.6	–	July official data put a question mark over recent positivism in PMI.
Eur	Aug PMI factory adv	51.8	51.0	51.3	PMIs have been running stronger than economy; sanctions impact.
	Aug PMI services adv	54.2	53.9	53.5	Composite PMI fact/ser was 53.8 in Jul.
US	Initial jobless claims w/e 16/8	311k	–	300k	Claims indicative of firms' desire to retain staff.
	Jul Philadelphia Fed factory survey	23.9	20.0	12.0	Mid-year slumps in 2010-11-12 began in Q2 or July; in 2013 in Oct.
	Jul existing home sales	2.6%	–0.8%	–1.0%	Housing appears to be stalling again on a range of indicators.
	Jul leading index	0.3%	0.6%	–	Only one negative month in last five quarters.
	Aug PMI factory advance	55.8	55.5	–	Some loss of momentum apparent. This index competes with ISM.
	Kansas Fed Jackson Hole Summit	–	–	–	Labour market focus for central bankers and academics.
Fri 22					
Eur	Aug consumer confidence advance	–8.4	–9.4	–10.0	Impact of sanctions, MH17, deflation in Spain, Italian recession.
UK	Jul retail sales	0.1%	–	0.6%	Private surveys suggest discounting had modest impact on volumes.
	Jul PSNCR £bn	11.8	–	–	Public sector net credit requirement. PSNB ex int'vns £11.4bn in Jun.
Can	Jun retail sales	0.7%	0.4%	–	May retail sales boosted by autos and DIY.
	Jul CPI % yr	2.4%	2.2%	–	BoC assesses recent spike in CPI to be transitory.

New Zealand forecasts

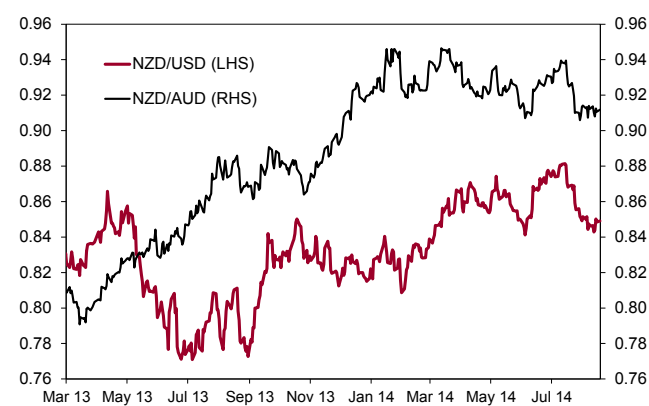
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.3	3.5	3.1	2.5	2.9	3.7	3.2
Employment	0.4	3.8	2.8	2.6	0.4	2.9	3.0	2.9
Unemployment Rate % s.a.	6.2	5.9	5.3	4.7	6.8	6.0	5.4	4.7
CPI	0.9	1.5	1.8	2.6	0.9	1.6	1.5	2.6
Current Account Balance % of GDP	-3.9	-2.8	-3.8	-4.2	-4.1	-3.4	-2.9	-4.4

Financial Forecasts	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Cash	3.50	3.50	4.00	4.25	4.50	4.50
90 Day bill	3.70	3.85	4.30	4.45	4.60	4.75
2 Year Swap	4.20	4.40	4.70	4.90	5.00	5.10
5 Year Swap	4.60	4.80	5.10	5.20	5.30	5.40
10 Year Bond	4.60	4.80	4.90	5.00	5.05	5.10
NZD/USD	0.83	0.83	0.84	0.84	0.84	0.84
NZD/AUD	0.91	0.92	0.93	0.91	0.90	0.89
NZD/JPY	83.8	83.0	84.8	85.7	86.5	87.4
NZD/EUR	0.62	0.63	0.64	0.64	0.63	0.64
NZD/GBP	0.50	0.49	0.49	0.47	0.47	0.47
TWI	78.1	78.5	79.4	78.8	78.6	78.7

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 18 August 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.25%
30 Days	3.65%	3.65%	3.58%
60 Days	3.67%	3.67%	3.62%
90 Days	3.67%	3.71%	3.65%
2 Year Swap	4.06%	4.08%	4.13%
5 Year Swap	4.42%	4.48%	4.54%

NZ foreign currency mid-rates as at Monday 18 August 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8491	0.8510	0.8710
NZD/EUR	0.6341	0.6337	0.6439
NZD/GBP	0.5073	0.5058	0.5097
NZD/JPY	86.87	87.29	88.29
NZD/AUD	0.9115	0.9142	0.9270
TWI	79.59	79.72	81.03

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013	2014f	2015f
Australia						
Real GDP % yr	2.3	2.6	3.6	2.4	3.2	3.0
CPI inflation % annual	2.8	3.0	2.2	2.7	2.3	2.8
Unemployment %	5.2	5.2	5.3	5.8	6.4	6.1
Current Account % GDP	-3.5	-2.8	-4.2	-3.2	-3.1	-2.5
United States						
Real GDP %yr	2.5	1.8	2.8	2.2	1.9	2.5
Consumer Prices %yr	1.6	3.1	2.1	1.5	1.9	1.9
Unemployment Rate %	9.6	8.9	8.1	7.4	6.3	5.8
Current Account %GDP	-3.0	-2.9	-2.9	-2.4	-2.5	-2.5
Japan						
Real GDP %yr	4.9	-0.3	1.5	1.6	1.6	1.4
Euroland						
Real GDP %yr	2.0	1.6	-0.6	-0.4	0.7	1.0
United Kingdom						
Real GDP %yr	1.7	1.1	0.3	1.8	2.6	2.1
China						
Real GDP %yr	10.4	9.3	7.7	7.7	7.4	7.5
East Asia ex China						
Real GDP %yr	7.8	4.4	4.0	4.0	3.9	4.9
World						
Real GDP %yr	5.2	3.9	3.2	3.0	3.1	3.7
Forecasts finalised 8 August 2014						

Interest Rate Forecasts	Latest	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Australia						
Cash	2.50	2.50	2.50	2.50	2.50	2.75
90 Day Bill	2.64	2.60	2.55	2.55	2.65	3.00
10 Year Bond	3.38	3.60	3.70	3.80	4.20	4.50
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.250
US 10 Year Bond	2.41	2.60	2.70	2.70	2.80	3.20
ECB Repo Rate	0.15	0.15	0.15	0.15	0.15	0.15

Exchange Rate Forecasts	Latest	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
AUD/USD	0.9320	0.91	0.90	0.90	0.92	0.93
USD/JPY	102.50	101	100	101	102	103
EUR/USD	1.3360	1.33	1.31	1.31	1.32	1.33
AUD/NZD	1.0980	1.10	1.08	1.07	1.10	1.11

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