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RBNZ taking centre stage

It's all eyes on the RBNZ right now. The past week saw the release of their latest consultation document on the treatment of investor property lending, and their March *Monetary Policy Statement* will be released at 9:00 am this Thursday.

With regards to the *Monetary Policy Statement*, we expect that the RBNZ will leave the OCR on hold at 3.5%. The accompanying press statement is expected to have a broadly neutral tone and signal that rates are likely to remain on hold for some time.

Central to what the RBNZ does this week is how they are viewing the outlook for inflation over the next couple of years. At the end of 2014, annual inflation fell to just 0.8%. Over the coming months we expect it to fall even further, reaching a low of around 0.2% and remaining outside the RBNZ's target band for some time.

However, on its own, we don't think that the current weakness in inflation is enough to prompt the RBNZ to shift to an easing bias. In large part, inflation is currently low as a result of sharp declines in international oil prices in late-2014. While these declines will weigh on annual inflation through 2015, they don't imply a sustained reduction in inflation. In fact, oil prices have already bounced about 35% from their January lows, and this has been passing through to higher prices at the pump in recent weeks. Furthermore, interest rate reductions can do little to offset the effects of declines in oil prices that have already occurred, and hence would have only a limited impact on near-term inflation.

Before cuts from the RBNZ are a realistic possibility, there would need to be the risk of a significant disruption to economic or financial conditions. On this front, there are some concerns, particularly with regards to conditions in the external sector. Dry conditions are continuing to weigh on agricultural production. In addition, although dairy export prices were up 1.1% in the latest auction, these are still well down on their levels from last year. And looking at the total basket of New Zealand's export commodities, prices are currently down around 17% compared to last year. On top of this, the NZD is lingering at elevated levels.

RBNZ taking centre stage continued

The above conditions have resulted in some strong headwinds for the economy. But at the same time, the outlook for domestic demand continues to look firm. This is being underpinned by strength in the housing and construction sectors, which is supporting more generalised increases in demand. We expect that this will be a persuasive factor for the RBNZ when thinking about inflation over the next few years.

The latest building work put in place figures provided a timely reminder of the strength in construction activity. Building work put in place increased by 0.3% in Q4 to be up 17% over the year - the strongest annual pace of growth in nearly 15 years. This was underpinned by a 4.3% increase in residential investment spending, which reached a seven-year high. We did see some pull back in non-residential construction in the December quarter. However, the strong upward trend in consents shows that there is a significant pipeline of non-residential work for the next few years.

The latest house price figures from QV also point to continued strength in housing demand, with nationwide prices up 6% over the past year, and prices in Auckland up 13%.

Weighing up the near-term downside risks for growth and the positive medium-term demand outlook, we expect the RBNZ will keep the OCR on hold for some time. The tone of Thursday's press statement is expected to echo that of the January OCR review which signalled an extended pause, but kept the RBNZ's options open.

Strength in the housing market isn't just a concern for the RBNZ in terms of controlling inflation. Strong growth in house prices, if not consistent with wider economic fundamentals, also raises risks for financial stability. The RBNZ have been looking how they could address such risks for some time. As part of this process, they have released a consultation document looking at possible increases in bank capital requirements for lending on investment properties. This policy isn't really a new or unexpected development. It is the latest iteration of a policy proposal that they released in late 2013, and that they have been discussing publicly in recent months. This latest update focused on what sort of lending could be classified as lending to residential property investors.

The proposed measures aim to enhance the financial stability of the economy. Under the proposal, all locally incorporated banks will be required to classify lending to property investors separately from other types of lending, and they would be required to hold higher levels of capital given the risks associated with different types of lending. Lending to property investors is viewed as higher risk than lending to owner-occupiers, and higher capital requirements would provide a larger safety buffer for banks in the event of a crisis.

Such restrictions would affect housing demand by increasing the average cost of funding for banks, which would then be passed on to borrowers. At the margin, this would slightly reduce the need to raise the OCR in response to pressures in the housing market. However, past studies have suggested that the impact would be equivalent to no more than a single OCR hike. It's also notable that many banks have already classified lending to properties as separate from other types of lending, and adjusted lending terms accordingly.

While this policy may not on its own have a significant impact, it could lay the ground work for more targeted policies down the track. Indeed, the RBNZ consultation document noted that the proposed policy "is partly to facilitate the introduction of a macro-prudential property investor policy, should that become necessary."

Looking to the week ahead, in addition to Thursday's *Monetary Policy Statement*, we'll receive updates on manufacturing activity (Monday), electronic card spending (Tuesday), food price inflation (Thursday) and the latest PMI (Friday). The latest REINZ housing market figures are also due for release over this week.

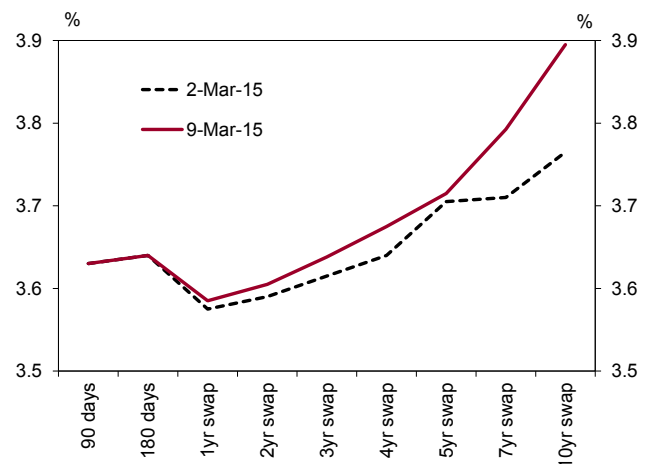
Fixed vs Floating for mortgages

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

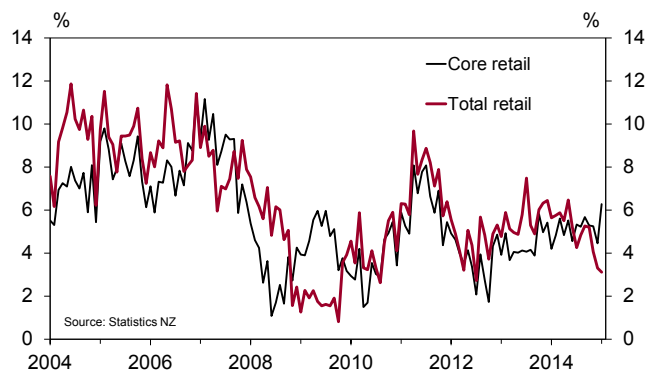


NZ Feb retail electronic card spending

Mar 10, last -0.4%, Westpac f/c: 0.2%

- Figures from Paymark (New Zealand's largest cards processor) suggest that electronic retail spending rose 0.2% in January.
- This number is not adjusted for inflation, and will in part reflect the recent rebound in petrol prices. We estimate that petrol prices rose a seasonally adjusted 4.5% in February.
- That suggests that underlying spending may have taken a step back from January's breakneck pace. In January, 'core' (ex fuel and vehicle related) spending was up by more than 7% on a year earlier, the fastest annual growth since early 2012. Five percent is likely to be closer to the mark this month.

Card transactions, annual % change

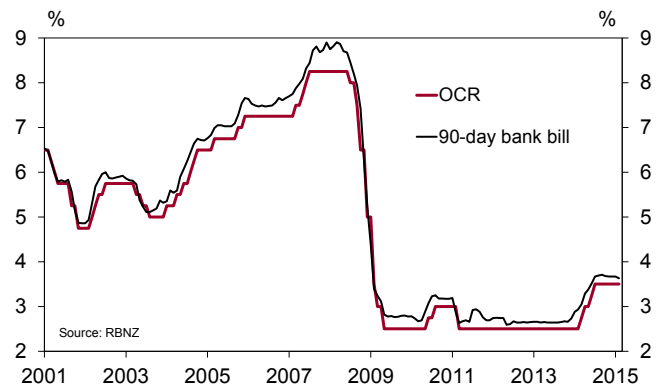


RBNZ Monetary Policy Statement

Mar 12, Last: 3.5%, Westpac f/c: 3.5%, Market f/c: 3.5%

- The RBNZ moved to a firmly neutral stance in its January OCR review, and a subsequent speech Governor Wheeler went into detail on the considerations behind that change. With conditions little changed since then, Thursday's *Monetary Policy Statement (MPS)* is likely to cover similar ground.
- We expect the RBNZ's 90-day interest rate projections will be around 40bps lower than in December. That would allow for a flat track through to at least early 2016, and then rising very gradually further ahead.
- The *MPS* is likely to include an extended discussion on the current low level of inflation and how this is affecting the stance of monetary policy.
- The RBNZ will repeat its warning that the level of the NZ dollar is unjustified and unsustainable.

NZ OCR and 90-day rate

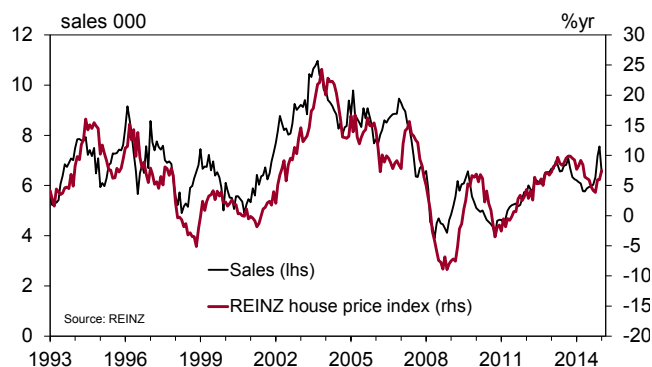


NZ Feb REINZ house prices and sales

Mar 13 (tbc), Sales last: -13.5%, Prices last: 7.5%yr

- Most housing indicators have shown a renewed upturn in the market in recent months. Sales and listings have picked up and prices have re-accelerated, especially in Auckland which has returned to double-digit annual growth.
- The notable exception was a sharp fall in sales in January, though this doesn't square with the continued strength of loan approvals over that time. January is typically the low point of the year for sales, so this result may reflect difficulties with seasonal adjustment.
- The February figures are due to be released by the 10th working day of the month (i.e. Friday), but are often earlier.

REINZ house prices and sales



Aus Mar Westpac-MI Consumer Sentiment

Mar 11, Last: 100.7

- The **Westpac-Melbourne Institute Consumer Sentiment Index** jumped by 8% in Feb, from 93.2 in January to 100.7, the first time since Feb 2014 that there has seen a majority of optimists over pessimists, albeit a miniscule one. The RBA's surprise rate cut and a sharp fall in petrol prices drove the gain, more than offsetting any negative effect from ongoing political tensions.
- The Mar survey is in the field from Mar 2 to 8. Potential influences include: the RBA's Mar decision to leave rates unchanged but adopt an explicit easing bias; petrol prices which have risen back up well over 10c a litre since the Feb survey; another solid 1.4% gain in the sharemarket after Feb's strong 9.7% surge; another lacklustre read on the economy from the Q4 national accounts. Political uncertainty remain an ongoing factor.

Consumer Sentiment Index

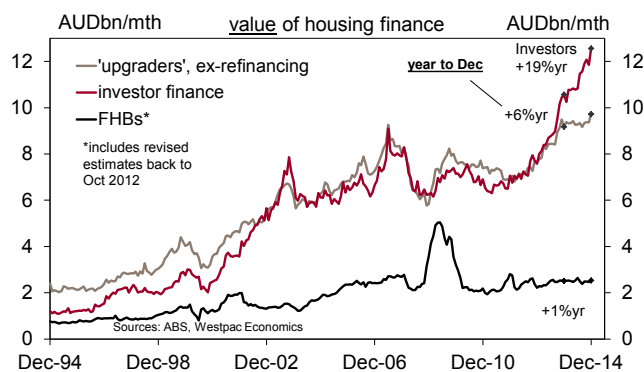


Aus Jan housing finance (no.)

Mar 11, Last: 2.7%, WBC f/c: -2.0%
Mkt f/c: -2.0%, Range: -5.0% to 1.0%

- Housing finance to owner occupiers rose 2.7% in Dec with the value of approvals to investors surging 6%. That follows a modest trend decline in owner-occupier activity through 2014 and a tentative flattening out in investor activity in Sep-Nov after strong surges in the first nine months of the year.
- Industry data points to a 2% dip in owner-occupier approvals in Jan. Note that the summer break sees a 15-20% drop in monthly approvals in Jan, so seasonally adjusted estimates can be more erratic in the month.
- Investor activity is arguably of more interest at the moment. While there are no industry guides to finance activity in this segment, the strong start to auction markets in 2015 suggests this segment, which has driven demand over the last year, remains buoyant.

Value of finance approvals by segment

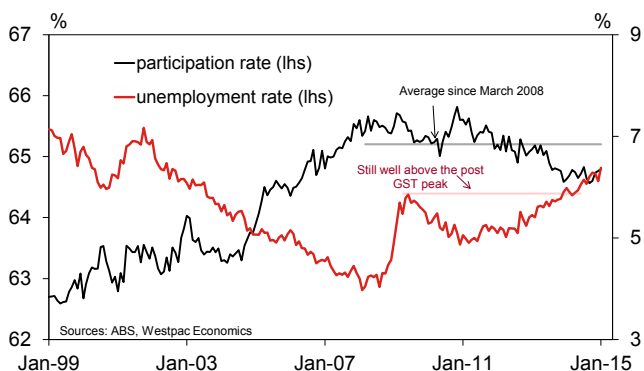


Aus Feb unemployment rate

Mar 12, Last: 6.4%, WBC f/c: 6.4%
Mkt f/c: 6.4%, Range: 6.5% to 6.3%

- Given a relatively modest decline of 12.2k in Jan why was there a large 0.3ppt rise in the unemployment rate to 6.4%? The reason is that the participation rate was basically flat at 64.8% (64.79% from 64.77%) so the labour force rose 22.3k. Normally when you get a weak employment print, you also get a fall in participation.
- During 2014, the trend decline in participation due to an aging population came to an end. Will it start again? Hard to say as demographic shifts can be very lumpy. For now, we would rather forecast a stable participation rate with some of the usual volatility month to month. Given that the participation rate was stable in Jan we are forecasting it to be stable again in Feb. Our 17k forecast for employment is just enough to hold the unemployment rate at 6.4% in February.

Unemployment and participation rates

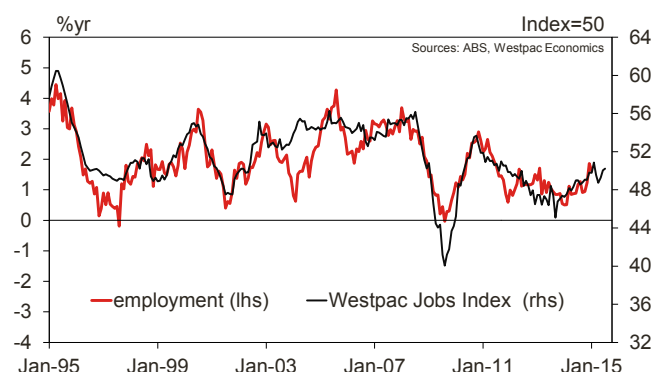


Aus Feb employment

Mar 12, Last: -12.2k, WBC f/c: 17k
Mkt f/c: 15k, Range: -5k to 25k

- Employment fell 12.2k in Jan compared to Westpac's forecast for +10k. The market had a wide range of estimates from -20k to +20k. The details also highlight broad based weakness in the labour market in Jan. Full-time employment fell 28.1k, following a 46.4k rise in Dec, while part-time employment rose 15.9k, following a 4.1k fall in Dec. Annual growth in full-time employment is 114.2k/1.4%yr compared to 70.8k/2.0%yr for part-time employment.
- But before we get too excited, the three month average change in total employment was +24.7k in Jan, +33.8k in Dec, +14.2k in Nov. So Jan was softer than expected but the trend pace is not that startlingly different from we saw at the end of 2014.
- Our job index suggests a loss of momentum in early 2015. A +17k in Feb takes the annual pace down to 1.4% from 1.6%.

Jobs Index peaked as 2014 ended

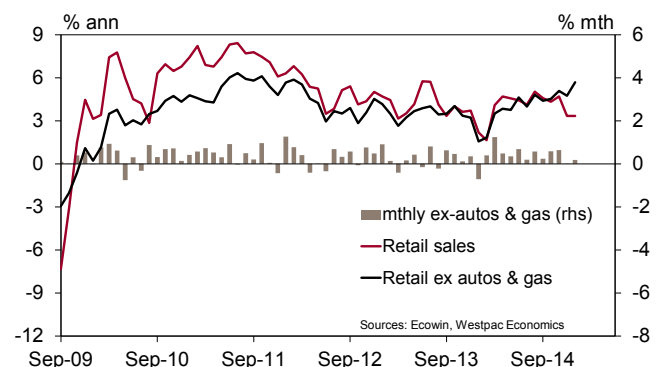


US Feb retail sales

Mar 12, Last: -0.8%, WBC f/c: 0.4%

- Retail sales reportedly fell 0.8% in Jan after a 0.9% decline in Dec. Modest gains of 0.4% and 0.3% had been seen in the two months prior to that. Annual growth therefore decelerated from a 5.0%yr peak in Aug '14 to just 3.3%yr in Jan.
- The sharp fall in the price of oil has had a notable effect on total sales; ex-autos & gas, annual sales growth actually accelerated modestly, from 4.8%yr to 5.7%yr. However, Dec and Jan were weak, averaging annualised growth of 1.2%.
- In Dec/Jan, we find no evidence of an oil-price induced boost to discretionary spending. The personal consumption data set suggests this is because the windfall has had to be spent on other non-discretionary purchases. Consequently, we expect an improved (but still modest) gain for total retail sales in February of 0.4%. The weather remains a risk to the result.

Retail sales: core sales stagnant in Dec/Jan



Data calendar

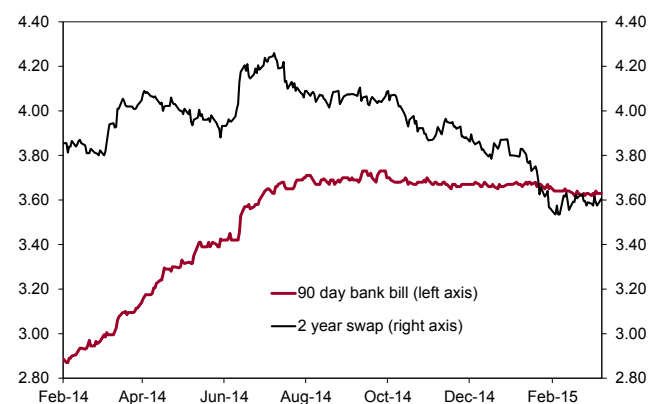
		Last	Market median	Westpac forecast	Risk/Comment
Mon 9					
NZ	Q4 manufacturing sales	0.4%	–	–	Manufacturing indicators generally strong through Q4.
Aus	Feb ANZ job ads	1.3%	–	–	Lifted 13.6% in the year to Jan but the value of this indicator has faded.
Eur	Mar Sentix investor confidence	12.4	15.0	13.0	Surged on ECB action; but how easy will further gains be?
Ger	Jan trade balance, €bn	18.9	19.1	19.5	Exports at historic highs; imports less so; trade balance robust.
US	Feb labour market conditions index	4.9	–	–	Fed's quantitative all-in-one measure of labour market momentum.
	Fedspeak	–	–	–	Kocherlakota in Minnesota; Mester on economy and monetary policy.
Can	Feb housing starts	187k	–	–	Upside surprise on multi starts in Jan; will likely reverse come Feb.
Tue 10					
NZ	Feb retail electronic card spending	–0.4%	0.4%	0.2%	Core spending unlikely to have sustained its January pace.
Aus	Feb NAB business survey	2	–	–	Conditions index steady at +2 in Jan. Confidence a little below LR avg.
Chn	Feb CPI %yr	0.8%	1.0%	–	Non-food still under downward pressure; but watch housing details.
	Feb PPI %yr	–4.3%	–4.3%	–	Pronounced deflationary pressure along most of the supply chain.
US	Feb NFIB small business optimism	97.9	99.0	98.0	Oil price has been key to trend of late; oil's jump in Feb a likely negative.
	Jan wholesale inventories	0.1%	–0.1%	–0.2%	Weaker growth in Q4 and weather likely saw pull back in stocks in Jan.
	Jan JOLTS job openings	5028	5028	–	A broader sample and output set than payrolls, but a month delayed.
	Fedspeak	–	–	–	Fisher (Dallas Fed) at Rice University on 10 years at the Fed.
Wed 11					
Aus	RBA Assistant Gov Economic, Chris Kent	–	–	–	Speaking at the National RSL Clubs Conference, Hobart, 9.00am
	Mar Westpac–MI Consumer Sentiment	100.7	–	–	Bounced 8% in Feb on rate cut, lower petrol prices.
	Mar Westpac–MI unemployment expect.	147.8	–	–	Are now down 5.2% in the year but remain at a very high level.
	Jan housing finance, no.	2.7%	–2.0%	–2.0%	Industry data soft in Jan. Investor activity still looks to be strong.
Chn	Jan-Feb retail sales %ytd	11.9%	11.6%	–	Anecdotes of steep declines in discretionary sales at the high end.
	Jan-Feb industrial production %ytd	7.9%	7.7%	–	Randomly excluded key industry detail in Jan-Feb print a year ago.
	Jan-Feb fixed investment %ytd	15.7%	15.0%	–	Annual target announced at 15.0%. Jan-Feb "re-set" establishes the tone.
UK	Jan industrial production	–0.2%	0.2%	0.1%	Momentum limited; soft EA growth and weak Euro a negative for UK.
Thu 12					
NZ	RBNZ Monetary Policy Statement	3.5%	3.5%	3.5%	Firmly on hold in the face of temporarily low inflation.
	Feb food price index	1.3%	–	–0.4%	Seasonal drop in produce prices, but some upward pressures linger.
Aus	Feb employment, chg '000	–12.2	15	17	Leading indicators pointing to a soft patch in early 2015.
	Feb unemployment rate	6.4%	6.4%	6.4%	Employment lagging population, unemployment rising but not this month.
	Mar MI inflation expectations	4.0%	–	–	The bump up in petrol prices has lifted expectations but not extremely.
Eur	Jan industrial production	0.0%	0.2%	0.2%	Weaker Euro a support for manufacturing in the region.
UK	Feb RICS house price balance	7%	6%	5%	Proportion of surveyors reporting price gains declining.
	Jan trade balance, £bn	–2.9	–	–	Dec saw deficit widen on rise in (cheap) oil imports.
US	Feb retail sales	–0.8%	0.4%	0.4%	Oil price a negative of late; core retailing has limited momentum.
	Feb import price index	–2.8%	0.1%	flat	Import prices have fallen on the back of stronger US dollar, –8.0%yr.
	Initial jobless claims	320k	–	310k	Despite recent uplift, firing remains weak historically.
	Jan business inventories	0.1%	0.1%	flat	Weaker growth in Q4 and weather likely saw pull back in stocks in Jan.
Can	Feb house price index	0.2%	–	–	Teranet/National Bank measure; up 4.7%yr.
Fri 13					
NZ	Feb manufacturing PMI	50.9	–	–	Sharp drop in Jan was largely concentrated around oil refining.
	Feb REINZ house sales	–13.5%	–	–	Due this week. Jan sales plunge doesn't square with loan approvals.
	Feb REINZ house sales	7.5%	–	–	Sale prices re-accelerating, especially in Auckland.
US	Feb PPI final demand measure, mth%	–0.8%	0.3%	0.4%	Partial reversal of Jan decline on higher oil price likely in Feb.
	Mar consumer sentiment, prelim	95.4	96.0	95.5	Higher oil prices and market interest rates to limit gain for Uni of Mich.
Can	Feb unemployment rate	6.6%	–	–	35.4k new jobs in Jan; all part time though.

New Zealand forecasts

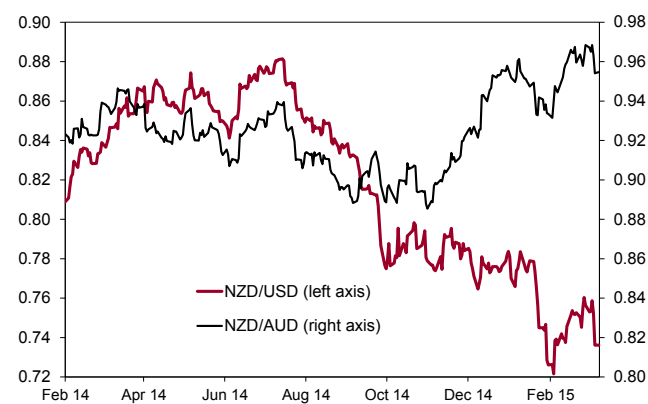
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
% change								
GDP (Production) ann avg	2.2	2.5	3.3	2.9	2.2	3.3	2.9	3.6
Employment	0.4	3.8	2.9	3.0	2.9	3.5	2.6	2.5
Unemployment Rate % s.a.	6.2	6.0	5.5	4.7	6.0	5.7	4.8	4.3
CPI	0.9	1.5	0.2	1.5	1.6	0.8	0.7	2.3
Current Account Balance % of GDP	-3.7	-2.6	-3.9	-5.0	-3.3	-3.1	-5.0	-4.6

Financial Forecasts	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16
Cash	3.50	3.50	3.50	3.50	3.50	3.75
90 Day bill	3.70	3.70	3.70	3.70	3.75	4.00
2 Year Swap	3.50	3.60	3.70	3.80	4.00	4.20
5 Year Swap	3.60	3.70	3.80	3.90	4.10	4.40
10 Year Bond	3.30	3.40	3.50	3.70	3.90	4.20
NZD/USD	0.71	0.73	0.74	0.75	0.77	0.79
NZD/AUD	0.95	0.95	0.95	0.95	0.95	0.94
NZD/JPY	83.9	87.6	90.3	93.0	95.5	98.8
NZD/EUR	0.62	0.64	0.64	0.65	0.66	0.66
NZD/GBP	0.47	0.48	0.47	0.47	0.48	0.47
TWI	74.9	76.3	77.1	77.9	79.2	80.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 9 March 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.62%	3.63%	3.64%
60 Days	3.63%	3.63%	3.64%
90 Days	3.63%	3.63%	3.64%
2 Year Swap	3.61%	3.63%	3.57%
5 Year Swap	3.72%	3.73%	3.58%

NZ foreign currency mid-rates as at Monday 9 March 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7362	0.7527	0.7335
NZD/EUR	0.6794	0.6605	0.6486
NZD/GBP	0.4895	0.4888	0.4818
NZD/JPY	88.91	89.74	87.43
NZD/AUD	0.9547	0.9595	0.9447
TWI	77.28	78.07	76.20



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014e	2015f	2016f
Australia						
Real GDP % yr	2.7	3.6	2.1	2.7	2.7	3.5
CPI inflation % annual	3.0	2.2	2.7	1.7	2.1	3.0
Unemployment %	5.2	5.3	5.8	6.2	6.4	6.0
Current Account % GDP	-2.8	-4.4	-3.3	-2.9	-2.3	-1.0
United States						
Real GDP %yr	1.6	2.3	2.2	2.4	2.7	3.2
Consumer Prices %yr	3.1	2.1	1.5	1.6	1.0	2.1
Unemployment Rate %	8.9	8.1	7.4	6.2	5.5	5.0
Current Account %GDP	-2.9	-2.9	-2.4	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	-0.3	1.8	1.6	0.4	1.0	1.7
Euroland						
Real GDP %yr	1.6	-0.6	-0.4	0.7	0.9	1.0
United Kingdom						
Real GDP %yr	1.1	0.3	1.7	2.6	2.5	2.7
China						
Real GDP %yr	9.3	7.7	7.7	7.4	7.3	7.5
East Asia ex China						
Real GDP %yr	4.5	4.5	4.3	4.1	4.8	5.8
World						
Real GDP %yr	4.1	3.4	3.3	3.2	3.5	4.4
Forecasts finalised 6 February 2015						

Interest Rate Forecasts	Latest	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Australia						
Cash	2.25	2.25	2.00	2.00	2.00	2.00
90 Day Bill	2.37	2.40	2.20	2.20	2.20	2.20
10 Year Bond	2.63	2.60	2.50	2.90	3.00	3.10
International						
Fed Funds	0.125	0.125	0.125	0.375	0.625	0.875
US 10 Year Bond	2.11	2.10	2.10	2.50	2.70	2.90
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
AUD/USD	0.7769	0.75	0.77	0.78	0.79	0.81
USD/JPY	120.16	120	122	124	126	126
EUR/USD	1.1025	1.10	1.10	1.10	1.11	1.13
AUD/NZD	1.0389	1.05	1.03	1.03	1.03	1.03

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Disclaimer continued

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