



Hobbiton, Matamata

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## A plus and a minus

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In recent weeks we have variously discussed the impact on the economy of plunging crude oil prices, the Reserve Bank's shift away from a tightening bias, and the prospect of drought. The latest edition of our flagship *Economic Overview*, released earlier this week, draws all those threads together into a fresh set of forecasts.

As we noted last week, the dry summer will have a significant impact on agricultural production this year. Drought has now been officially declared for large parts of the South Island, and despite recent rains other parts of the country also remain drier than usual. This is a double blow for farming regions already braced for the lowest dairy payout in five years, and it is likely to take a big chunk out of quarterly GDP growth in the first half of this year, thanks to a sharp fall in milk production in coming months and lower meat production later this year (after an initial boost due to early culling).

However, in our judgement the positive development of cheaper petrol prices is likely to have a bigger knock-on effect on the wider economy. Accordingly, we have lifted our forecasts for New Zealand GDP growth over the next two years combined – albeit with more of the growth occurring in 2016, when the farm sector is expected to enjoy better growing conditions. Essentially, the impact of drought is sharp but concentrated, whereas the benefits of cheaper fuel are spread far more widely, affecting disposable incomes and profit margins across the economy – and as a result are more likely to spill over into consumption and investment decisions. What's more, by demolishing any signs of inflation, falling petrol prices have indirectly contributed to the recent drop in fixed mortgage rates, which will fuel housing demand and further stimulate consumer spending in already buoyant urban parts of the country.

Last week's economic data, which allowed us to test that hypothesis against a read of activity in the retail and housing markets in early 2015, offered mixed evidence in its favour. As expected, electronic card spending on non-fuel retail items surged in January, but house sales took an unexpected breather from their steep post-election ascent.

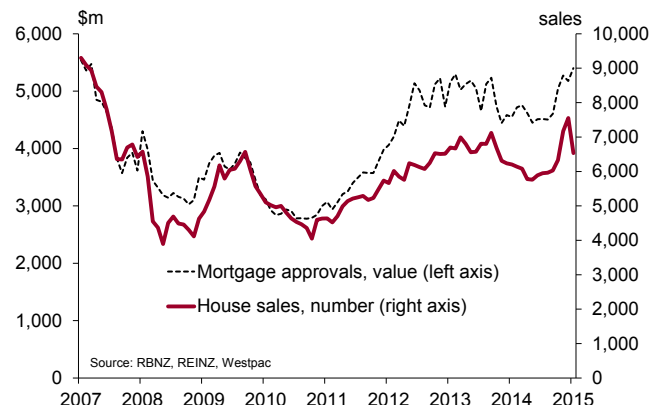
# A plus and a minus continued

Total electronic card spending (which isn't adjusted for inflation) has been dampened by falling petrol prices in recent months, but excluding the fuel category it has been on a strong rising trend since the second half of last year – all the more so in the context of generalized low inflation. Our estimates, which are heavily informed by the cards data, suggest that retail sales volumes rose at close to a 1.5% pace for a second quarter in a row in the December quarter (we will get official confirmation in this week's Retail Trade Survey). And that strong trend appears to have continued into the New Year. While retail card spending fell 0.4%, that was entirely due to a 6.7% drop in spending on fuel. 'Core' (ex-fuel and vehicle-related) card spending actually rose 0.9% in the month, with the gains spread across food, hospitality and durable goods.

By contrast, the latest housing data showed a surprising pull-back in sales, raising the question how much of the resurgence in house sales in the September election was simply a one-off release of pent-up demand. That said, at this stage there is no corroborating evidence for a slowdown – mortgage approvals have resumed their upward trend after a small December dip, suggesting a renewed lift in sales down the track. Another reason for scepticism is that inventory available for sale on realestate.co.nz, New Zealand's most comprehensive real estate website, fell to just 21.4 weeks' worth of sales in January, the lowest since early 2007. That hints at a lack of stock on the market crimping house sales, rather than a drop-off in demand. So we will await another month's data before passing judgement.

If there are renewed questions around the underlying momentum of housing demand, it's clear that the housing market has continued to tighten. Prices rose another 1.2% in January and are now up 7.5% on a year ago, while the number

House sales and mortgage approvals



of days it took to sell the average house fell to their lowest level since May. The latest resurgence in house prices has clearly been dominated by Auckland, where the price index is up 15% on a year ago, but prices are rising at more modest rates in other centres as well.

The mix of continued rises in house prices, a strong outlook for the wider non-farm economy, and pain in the agricultural sector will become a worsening conundrum for the RBNZ in the months ahead. In our view its most likely response to that conundrum will be to keep the OCR on hold well into next year, and to attempt to tame the housing market with a further tightening of the regulatory screws. Exactly what form that could take is not yet clear, but our forecasts assume that macro-prudential tightening of some kind will occur later this year.

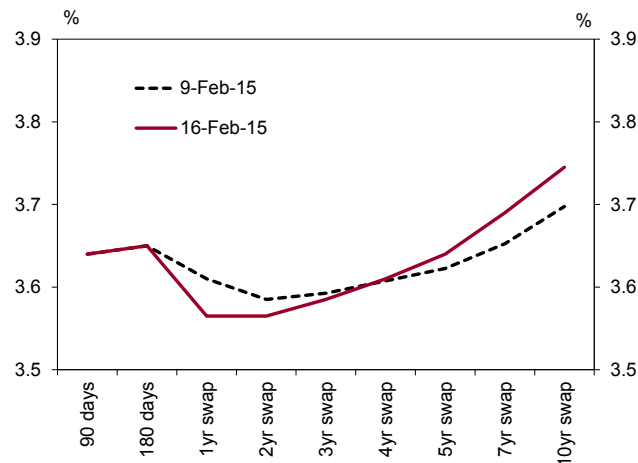
## Fixed vs Floating for mortgages

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 seem high relative to where we think shorter-term rates are going to go over the coming four or five years, though they do offer 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

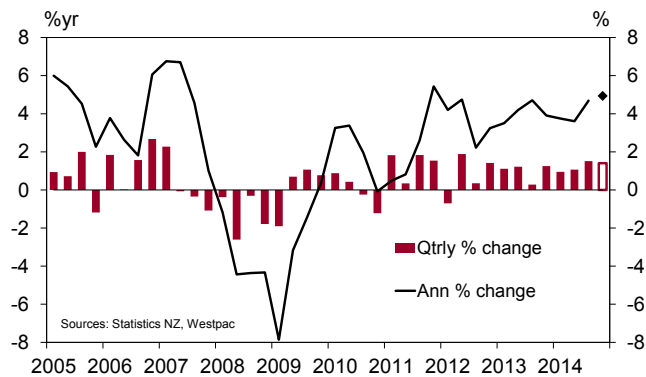


## NZ Q4 real retail sales

Feb 16, Last: 1.5%, Westpac f/c: 1.4%, Mkt f/c: 1.3%

- We expect another quarter of strong growth in retail activity in the December quarter. As in September, electronic card spending saw a decent increase in the December quarter, translating into above-average volume growth thanks to low inflation.
- While all signs are pointing towards an outturn that's comfortably above 1%, it's less clear just how strong it will be. On their own, our main indicators – card spending, car registrations and the December quarter inflation data – suggest retail growth could be above 1.5%. However we have moderated our forecast to reflect the ongoing recent trend of underperformance in car sales. Statistics NZ's reweighting of its price deflators this quarter will add additional uncertainty.

Real retail sales

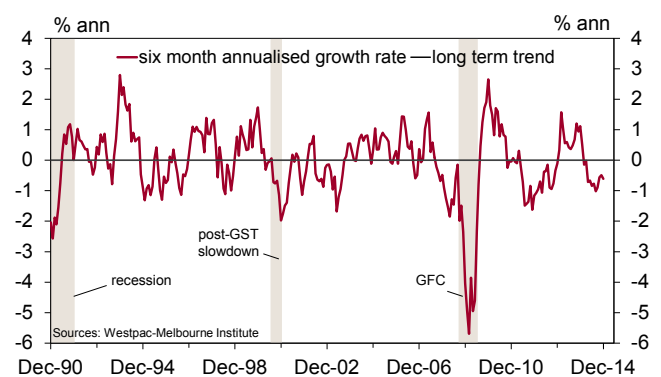


## Aus Jan Westpac-MI Leading Index

Feb 18, Last: -0.61%

- The six month annualised growth rate of the Index, which indicates the likely pace of economic growth 3 to 9mths into the future, declined from -0.49% in November to -0.61% in December. The sub-zero readings, which have been sustained now for 11 months in a row, point to below-trend momentum heading into 2015.
- The Jan update will include more positive component reads on the consumer expectations (+10.3% in Jan), the ASX (+3.0%), consumers unemployment expectations (-1.9%) and hours worked (+0.6%) but softer readings on commodity prices (down -1.2% in Jan), dwelling approvals (down -3.3% in Jan), and a further narrowing in the yield gap.

Westpac-MI Leading Index

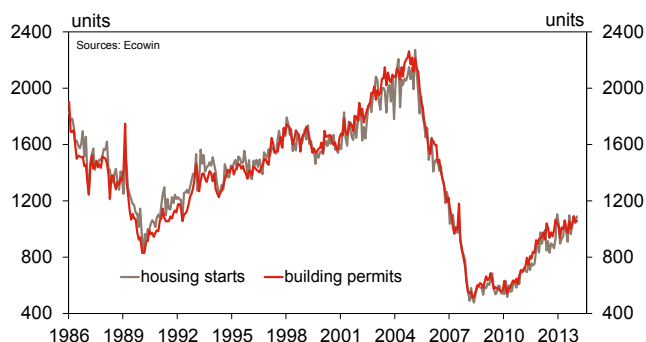


## US Jan housing starts and building permits

Feb 18, Last: 4.4%, WBC f/c: -2.5% Feb 18, Last: 0.6%, WBC f/c: flat

- Apparent since mid-2013 has been a flattening in the trend growth of housing starts and permits. Broadly, existing debt liabilities and weak wage growth are restricting housing market activity to cash-rich buyers, primarily in the existing market. What strength we have seen in new building has principally been due to investors looking to take advantage of lower home ownership by increasing the supply of rental apartments. Growth in this segment looks to have moderated substantially.
- As occurred in 2014, the abnormally cold weather of January also likely impacted construction in some parts of the country. The consequence is likely to be a decline in housings starts, in the order of 2.5%. A more positive outcome is expected for building permits, given they do not depend on the weather. We expect a broadly flat result, with a continuation of the fledgling uptrend in single dwellings offset by weakness in multiples.

US housing starts & permits, stalled uptrend



# Data calendar

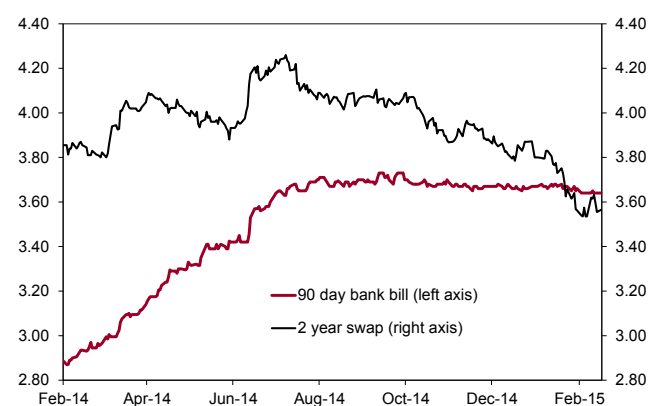
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 16</b>					
<b>NZ</b>	Q4 real retail sales	1.5%	1.3%	1.4%	A strong finish to what was a strong year for retail spending.
	Jan Performance of Services Index	56.5	–	–	Manufacturing survey fell sharply in January.
<b>Aus</b>	Jan new vehicle sales	3.0%	–	–1%	Industry figures show unadjusted sales about on a par with Jan 2014.
<b>UK</b>	Feb house prices, %yr	8.2%	–	–	Rose 1.4% in January; Rightmove measure.
<b>US</b>	Presidents' Day	–	–	–	Public holiday. No settlement.
<b>Tue 17</b>					
<b>Aus</b>	RBA Minutes of Feb Board meeting	–	–	–	Detail around decision. Watch for inclusion of an easing bias.
<b>Chn</b>	Jan new 70 city prop. prices %net bal	–91.4%	–	–	Developers are stringing out the inevitable discounting process.
	Jan 2'ndary 70 city prop. prices %net bal	–75.7%	–	–	Wealthy coastal cities have stabilised, slow motion carnage elsewhere.
	Feb MNI business indicator	53.7	–	–	Survey of listed manuf & services firms. Leads flash PMI on occasion.
<b>Eur</b>	Feb ZEW survey, expectations	45.2	–	–	Sentiment received boost from ECB; how long will it be sustained?
<b>Ger</b>	Feb ZEW survey, expectations	48.4	55.5	–	Expectations well ahead of reality at 22.4.
<b>UK</b>	Jan CPI, %yr	0.5%	0.4%	0.4%	Oil price deflation impact significant, with inflation elsewhere benign.
	Dec house prices, %yr	10.0%	–	–	ONS measure; official data lags well behind private estimates.
<b>US</b>	Feb Empire manufacturing survey	9.95	9.00	8.50	Momentum waning for manufacturing; USD effect?
	Feb NAHB housing market index	57	58	56	Future sales and foot traffic deteriorated in January.
	Q4 mortgage foreclosures	2.39%	–	–	Tentative date; foreclosure and delinquency rates now relatively low.
<b>Wed 18</b>					
<b>NZ</b>	GlobalDairyTrade auction	9.4%	–	–	Drought warning for NZ has pushed world prices higher.
<b>Aus</b>	Jan Westpac–MI Leading Index	–0.61%	–	–	Negative, i.e. below trend, for 11 of the last 12 months.
<b>Eur</b>	Dec construction output	–0.1%	–	–	Up 2.2%yr; greater credit provision needed for stronger trend.
<b>UK</b>	Bank of England February minutes	–	–	–	Softer growth and weak inflation has taken rate hikes off agenda.
	Dec ILO unemployment rate	5.8%	5.7%	–	Prior 3 months saw 37k jobs added.
<b>US</b>	Jan housing starts	4.4%	–1.5%	–2.5%	New building weak; weather also abnormally unfavourable (again).
	Jan building permits	0.6%	1.1%	flat	Uptrend in new housing activity stalled through 2014.
	Jan PPI	–0.3%	–0.4%	–0.3%	Final demand measure; annual growth weak at 1.1%yr.
	Jan industrial production	–0.1%	0.4%	0.3%	Momentum absent; ISM points to continuation of soft trend.
	Fed minutes for 27–28 January meeting	–	–	–	Strong labour market balanced against USD; oil; and actual spending.
<b>Can</b>	Dec wholesale sales	–0.3%	–	–	Weaker than expected in Nov, but followed two months of gains.
<b>Thu 19</b>					
<b>NZ</b>	Q4 producer prices (outputs)	–1.1%	–	–0.5%	Further cut to dairy payout, partly offset by higher electricity prices.
	Feb ANZ consumer confidence	128.9	–	–	Cheaper fuel could provide a confidence boost.
<b>Chn</b>	Lunar New Year	–	–	–	Year of the sheep.
<b>Eur</b>	Dec current account, €bn	18.1	–	–	Weaker Euro supportive of exports; global backdrop less so.
<b>UK</b>	Feb CBI trends total orders	4	–	–	Weaker than expected in January; exports expected to be soft in Q1.
<b>US</b>	Feb Philadelphia Fed survey	6.3	8.5	7.0	In Jan, current activity fell sharply; but future activity held firm.
	Jan leading index	0.5%	0.3%	0.2%	Composite measure made up of actual data outcomes.
	weekly initial jobless claims, '000	304	–	–	Surprised to the high side last week, up 25k.
<b>Fri 20</b>					
<b>Eur</b>	Feb consumer confidence	–8.5	–8.0	–	Modest improvement in Jan on ECB; will it be bettered?
	Feb Markit composite	52.6	53.0	–	Manufacturing just expansionary at 51.0; services better at 52.7.
<b>UK</b>	Jan public sector net borrowing, £bn	12.5	–9.6	–	£13.1bn excluding banking groups in Dec.
	Jan retail sales	0.4%	–0.2%	–	Core was soft in Dec at 0.2%; oil prices supportive of stronger growth.
<b>US</b>	Feb Markit PMI	53.9	53.6	–	Preliminary reading for ISM alternative.
<b>Can</b>	Dec retail sales	0.4%	–	–	Helped by promotions, retail sales hit a new record high in Nov.

# New Zealand forecasts

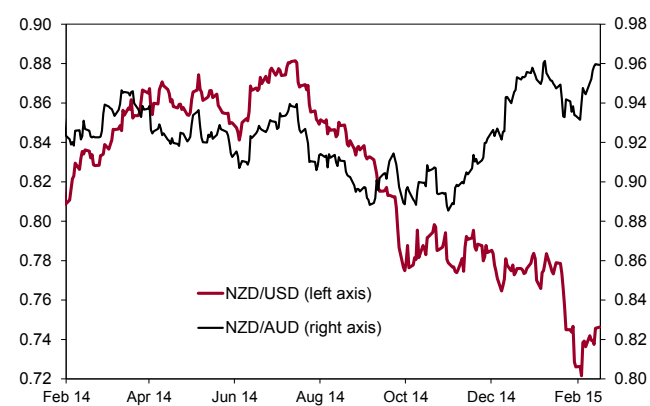
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
% change								
GDP (Production) ann avg	2.2	2.5	3.3	2.9	2.2	3.3	2.9	3.6
Employment	0.4	3.8	2.9	3.0	2.9	3.5	2.6	2.5
Unemployment Rate % s.a.	6.2	6.0	5.5	4.7	6.0	5.7	4.8	4.3
CPI	0.9	1.5	0.2	1.5	1.6	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 16 February 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.61%	3.65%	3.63%
60 Days	3.63%	3.66%	3.65%
90 Days	3.64%	3.66%	3.67%
2 Year Swap	3.57%	3.56%	3.74%
5 Year Swap	3.64%	3.57%	3.79%

NZ foreign currency mid-rates as at Monday 16 February 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7463	0.7244	0.7787
NZD/EUR	0.6538	0.6403	0.6740
NZD/GBP	0.4836	0.4827	0.5142
NZD/JPY	88.34	85.03	91.50
NZD/AUD	0.9593	0.9347	0.9472
TWI	77.28	75.32	79.30

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014e	2015f	2016f
<b>Australia</b>						
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
<b>United States</b>						
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
<b>Japan</b>						
Real GDP %yr	-0.3	1.8	1.6	0.4	1.0	1.7
<b>Euroland</b>						
Real GDP %yr	1.6	-0.6	-0.4	0.7	0.9	1.0
<b>United Kingdom</b>						
Real GDP %yr	1.1	0.3	1.7	2.6	2.5	2.7
<b>China</b>						
Real GDP %yr	9.3	7.7	7.7	7.4	7.3	7.5
<b>East Asia ex China</b>						
Real GDP %yr	4.5	4.5	4.3	4.1	4.8	5.8
<b>World</b>						
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
<b>Australia</b>						
Cash	2.25	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.36	2.20	2.20	2.20	2.22	2.25
10 Year Bond	2.50	2.40	2.50	2.70	2.90	3.20
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.250	0.500	0.750
US 10 Year Bond	1.98	1.90	2.00	2.20	2.50	2.80
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	0.7770	0.75	0.77	0.78	0.79	0.81
USD/JPY	118.60	118	120	122	124	124
EUR/USD	1.1420	1.14	1.15	1.15	1.16	1.17
AUD/NZD	1.0440	1.05	1.05	1.05	1.05	1.05

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