



Cape Reinga lighthouse, North edge of New Zealand

In this issue

Fixed vs floating	2
The week ahead	3
Data calendar	5
New Zealand forecasts	6
International forecasts	7

Showtime

Last week's data largely supported our outlook for the New Zealand economy. New Zealand's export commodity prices rose to a new record, and the terms of trade edged up to set a fresh 40 year high. Building activity printed a bit softer than expectations but we think this will be temporary and the Auckland housing market remains in slowdown mode. All eyes now turn to this week's *Monetary Policy Statement* from the RBNZ.

New Zealand's strong export performance was once again a feature of last week's data calendar. New Zealand's terms of trade rose to a fresh 40 year high in the December quarter. Over the course of 2013, the terms of trade climbed 20%, largely thanks to higher export prices. And this strong run has continued into the first few months of 2014. World prices for New Zealand's main commodity exports rose further in February, surpassing January's record high. Even when translated into NZD terms prices they are at exceptional levels, within a whisker of all time highs.

But it's not just high prices that have been boosting exporters' incomes. There has also been strong growth in the volumes of product being shipped out the door. Export volumes jumped almost 10% in the December quarter, driven largely by a rebound in dairy exports. The bounce in production actually occurred in the September quarter (and contributed a major part of the 1.4% rise in GDP) but wasn't shipped until Q4.

While conditions in the agriculture sector remained favourable in the December quarter, we won't see a repeat of the big bounce in production. Indeed, some recent indicators of Q4 GDP growth have been coming in a touch below expectations. Building work put in place fell in the December quarter as a modest lift in home building was more than offset by a drop in non-residential construction. But it's likely this weakness will prove temporary. Construction in Canterbury continues to power ahead, while activity is also increasing in the undersupplied Auckland market. Furthermore the underlying pace of consent issuance has picked up over the past few months. Nonetheless, slower than

Showtime continued

expected growth in the construction sector in the December quarter, combined with softer retail trade activity have led us to pare back our Q4 GDP growth estimate from 1.1% to 0.9% (we'll finalise this forecast in the next week or so following the release of the last of the sectoral indicators).

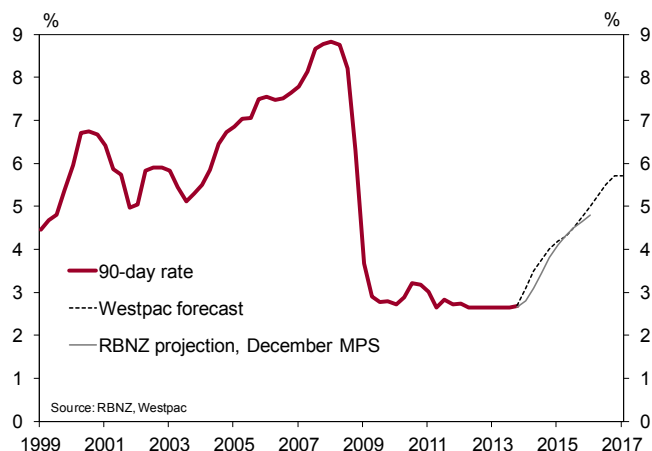
A slight downgrade to Q4 GDP growth estimates certainly won't be enough to derail the RBNZ. A 25 basis point OCR hike this week has been well signalled and is probably as close as we can get to a done deal. Markets are certainly viewing it as such, putting a 96% probability on such a move. So with widespread agreement on the headline, attention will turn to the content of the accompanying *Monetary Policy Statement* for signals on the likely future path for interest rates. Back in December, the Bank's projections suggested that the OCR would need to rise by at least 200 basis points over the next couple of years. Developments since then are likely to have prompted an upgrade to this assessment.

It's also worth noting that the March *MPS* is likely to include an additional year of projections (out to March 2017). This should give us a clearer idea of where the RBNZ sees the peak in this cycle. The bank's view is that the long-run 'neutral' level of the 90 day rate is around 4.5% (that's the level which would neither decrease or increase inflation if the economy were operating at full capacity) and it will probably show that rates need to rise above this level for a time in order to get inflation pressures under control.

Although the building momentum in the New Zealand economy, stellar export prices and sky-high business confidence will no doubt all rate a mention in March *MPS* as reasons why the Bank is raising interest rates, on the other side the ledger sits the stronger New Zealand dollar and the slowing housing market.

In December the Reserve Bank was expecting house price inflation to be lingering around 10% in the early part of this year, but recent developments suggest this will need to be revised down. Last week Barfoot and Thompson (the largest real estate agency in Auckland) released its February sales figures, showing the effects of the Reserve Bank's restrictions on low

90-day rate projections



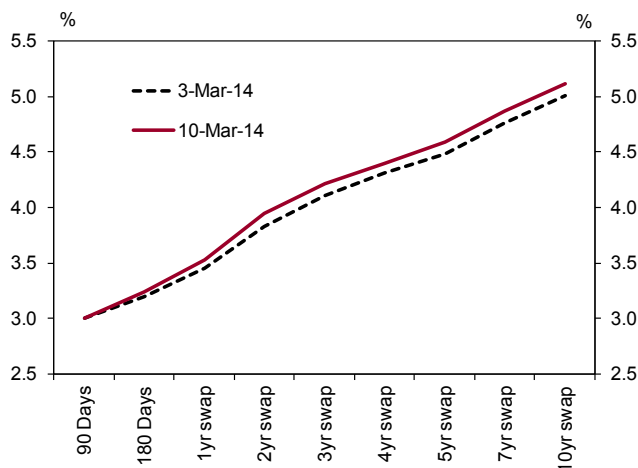
equity lending continue to reverberate around the Auckland market. Sales volumes fell 13.2% in February and are now down 23% from their October peaks. The fall has been particularly sharp for lower priced homes (the habitat of first home buyers) while there has been little impact on more expensive properties.

Strong commodity prices and a central bank expected to raise rates substantially over the next couple of years have ensured that the NZD has remained elevated. Against the USD it is currently sitting just below 85c while the TWI is within a whisker of all time highs (though both were lower at the time the Bank was drafting the *Monetary Policy Statement*). But for now this doesn't appear to be hammering business confidence, and although the high exchange rate will continue to keep a lid on inflation in traded goods, it will only partially offset rising domestic inflation pressure. In January, the Reserve Bank commented that the current high level of the exchange rate didn't appear sustainable in the long run. It may well convey a similar message this week. But this won't be enough to deter them from beginning to raise the OCR.

Fixed vs Floating for mortgages

We believe that fixing and floating will offer similar value over the course of the next three years. The Reserve Bank is widely expected to start raising the OCR this month, kicking off an extended series of rate hikes. This view is more or less embedded in current fixed-term mortgage rates, which implies that the cost of fixing or floating will be similar over the longer term. However, with floating rates likely to be rising over coming months, borrowers who value certainty in their repayments should consider fixing now.

NZ interest rates

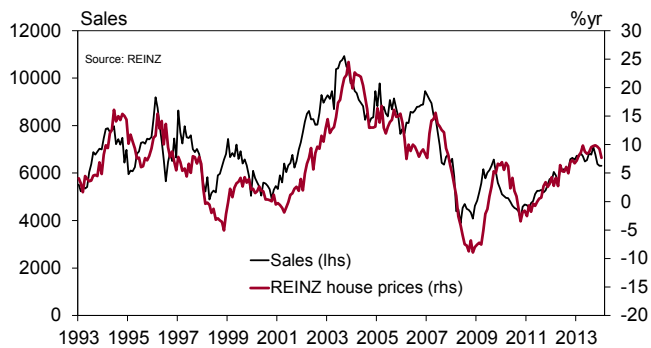


NZ Feb REINZ house prices and sales

Mar 10-14, Sales last: -0.1%, Prices last: 7.7%yr

- Higher mortgage rates and the RBNZ's new restrictions on high loan-to-value ratio (LVR) mortgage lending are now clearly working to cool the housing market. Sales have fallen 11% since the restrictions came into force last October, and the nationwide sales figures for January showed the first monthly drop in prices in almost two years.
- The REINZ figures for February (due sometime this week) are likely to show a further softening of the trend in prices, reflecting the lagged impact from the slowdown in sales.
- Our view has been that the LVR restrictions would bite hardest in the first 3-6 months. While this means it could take a few more months to confirm whether the market has bottomed out, there are tentative signs that mortgage lending is picking up again as banks initially cut back high-LVR lending by more than was needed in hindsight.

REINZ house prices and sales

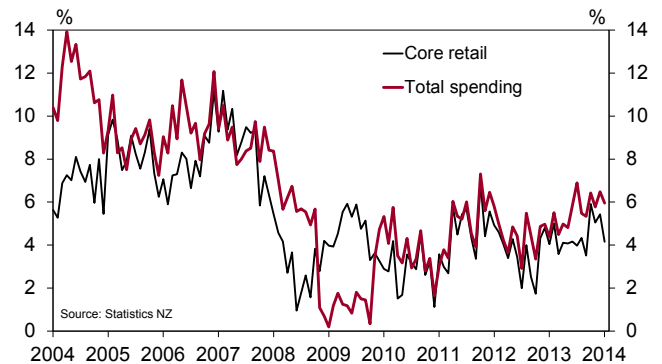


NZ Feb electronic card transactions

Mar 11, last: -0.1%, WBC f/c: 0.9%

- After a strong run towards the end of 2013, electronic card spending was surprisingly weak in January, falling across a majority of categories.
- We suspect this was monthly volatility rather than the start of a slowing trend. With consumer confidence at levels last seen in 2007 and retailers' confidence also up sharply, we expect to see cards spending rebound 0.9% in February. That said, February spending figures from Paymark (New Zealand's biggest card processor) should be released by early next week, providing further information.
- It is worth noting that the very strong growth in card transactions in the last few months of 2013 probably overstated the underlying trend in retail spending. The penetration of card spending has risen of late, perhaps encouraged by the introduction of contactless payment.

Card transactions, annual % change

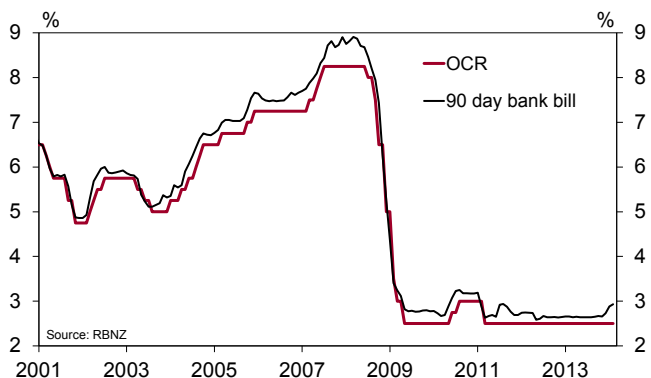


RBNZ Monetary Policy Statement

Mar 13, Last: 2.50%, Westpac f/c: 2.75%, Market f/c: 2.75%

- The RBNZ is expected to raise the Official Cash Rate by 25bps on Thursday in what would be one of the most well-signalled monetary policy moves in history. This will be the first in an extended series of hikes over the next few years to head off the inflation pressures generated by the strengthening economy and the Canterbury rebuild.
- The RBNZ's previous projections implied around 200bps of rate hikes over the next two years; developments since then suggest a modest upgrade to that profile. While this could still be considered a 'gradual' pace, it doesn't leave much room for drawing out the process – consecutive rate hikes at some stage are a given and, in our view, more likely to occur up front.
- In that light, we expect the language of the statement to be fairly clear about the likelihood of follow-up hikes at the April and June review dates.

NZ OCR and 90 day rate



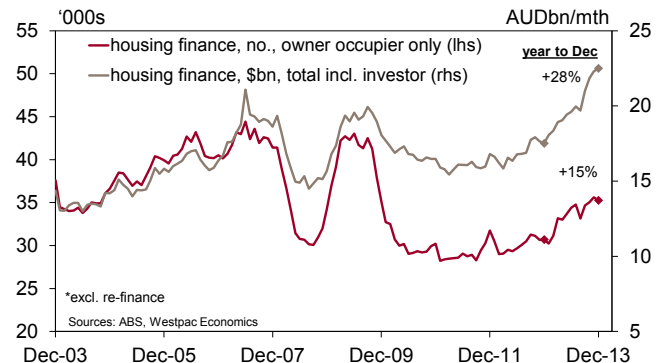
Aus Jan housing finance (no.)

Mar 11, Last: -1.9%, WBC f/c: flat

Mkt f/c: flat, Range: -3.0% to 3.9%

- The number of owner occupier finance approvals fell 1.9% in Dec after a 5.9% surge over the previous 3mths. Even with the soft finish, 2013 still saw a 14.1% gain for the year. That was despite continued weak activity in the first home buyer segment. Ordinarily that sort of growth would be considered strong, but compared to other aspects of the housing market (e.g. dwelling approvals up 35%; turnover up about 20%), the rise in finance approvals looks a little lacklustre. That is most likely because it excludes loans to investors.
- That wedge is likely to have been sustained in Jan. Industry figures suggest a flat month for new loans. That said, Jan housing data is always a potential wildcard given the impact of seasonal adjustment – unadjusted sales can show a 20-25% drop between Dec and Jan.

New finance approvals

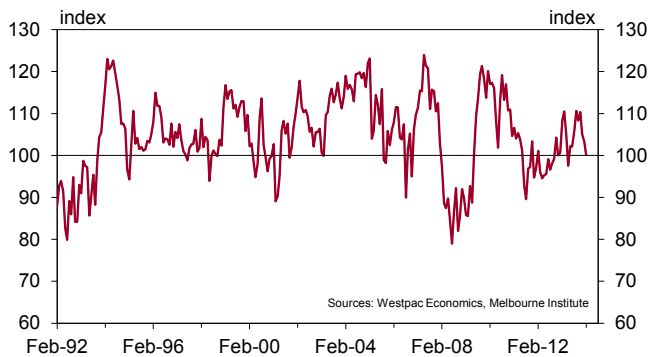


Aus Mar Westpac-MI Consumer Sentiment

Mar 12, Last: 100.2

- The Westpac-Melbourne Institute Consumer Sentiment Index has been under pressure in recent months. After hitting a post-election and post-rate cut high of 110.3 in Nov, the Index has slipped about 3pts a month to be back around neutral in Feb. The key driver has been renewed concerns about the economic outlook and jobs.
- This month's survey is in the field from Mar 3-9. It will cover reactions to the RBA's Mar policy decision; some relatively upbeat economic data (lopsided but positive Q4 GDP growth, and much better than expected reads on retail sales, dwelling approvals and trade). Financial markets have firmed since the Feb survey, the ASX up 5.4% despite turbulence associated with geopolitical tensions in Ukraine. Local sentiment may be more impacted by corporate layoff announcements by Qantas and Toyota.

Consumer Sentiment

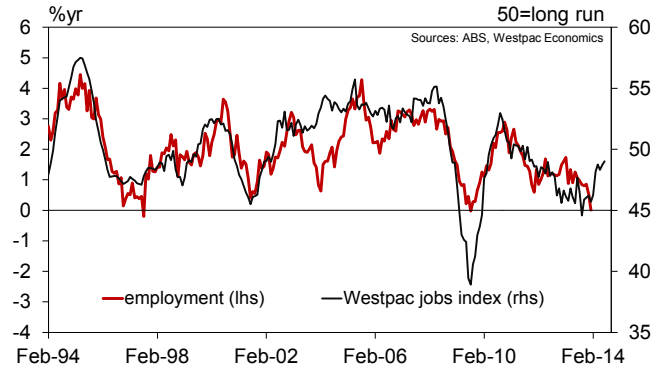


Aus Feb labour force - total employment chg '000

Mar 13, Last: -3.7k, WBC f/c: 20.0k
Mkt f/c: 15k, Range: 0 to 30k

- Total employment fell 3.7k in Jan, much weaker than the statistical lift Westpac was expecting (+25k).
- In the last 12 months, total employment was flat and the unemployment rate lifted from 5.4% to 6.0%, a decade high. More critically, the unemployment rate would have been higher without the stark fall in participation, from 65.3% to 64.5%.
- In Jan, full-time employment fell 7.1k (-91.6k for the year), part-time rose 3.4k (93.1k for the year), while hours worked lifted 1.3% in the month (2.0%yr).
- The labour indicators in business surveys improved in late 2014, suggesting the worst for the labour market may be past. Job ads suggest we are seeing something of a follow through. Our forecast is based on a correction to this new trend.

Jobs index has turned positive for 2014H1

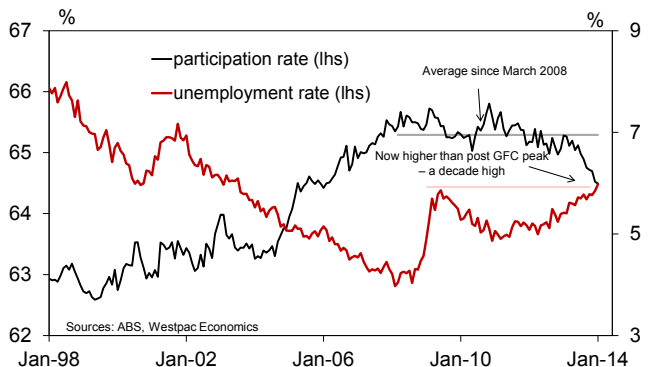


Aus Feb labour force - unemployment rate %

Mar 13, Last: 6.0%, WBC f/c: 6.0%
Mkt f/c: 6.0%, Range: 5.9% to 6.1%

- In Jan, a further small fall in the participation rate, from 64.52% to 64.49%, combined with a step down in the growth of the working age population, was enough to limit the lift in the labour force to just 12.9k.
- So, while the unemployment rate rose to 6.0% in Jan, it could have risen a lot more were it not for these constraints on the working age population. Westpac estimates that, with a steady participation rate, total employment needs to rise 20k in Jan just to hold the unemployment rate steady.
- As we are forecasting a 20k rise in total employment and a flat participation rate, we are also forecasting an unchanged unemployment rate of 6.0%. The risk here is that a lift in participation could result in a 6.1% unemployment rate.

Unemployment and participation rates

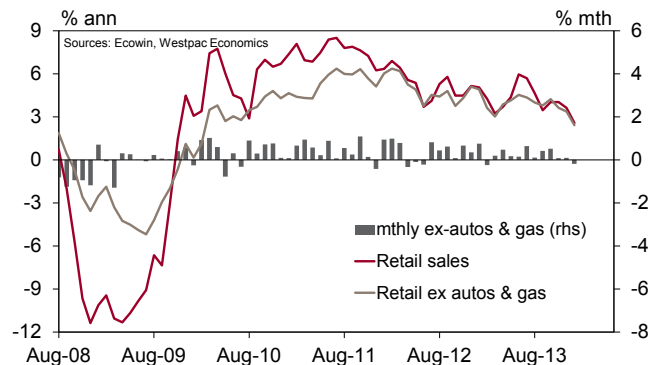


US Feb retail sales: weather masking weakness

Mar 13, Last: -0.4%, WBC f/c: 0.4%

- Retail sales fell 0.4% in Jan, and revisions were severely to the downside. For the core retail component (ex autos and gas), the monthly profile since Oct is 0.5%, 0.1%, 0.1%, -0.2%. In Q4, core retail was revised down from 5.1% annualised (then the fastest quarter since Q1 2012) to 3.7%; and more recently, it was running at a 2.2% pace in Nov-Jan, the weakest since mid 2012. Typically weather disruptions both boost and hamper retailing at different times and for different storetypes, but the broad-based weakness stretching back three months into mild November is more likely a reflection of constrained incomes growth with some subsidiary weather impact.
- Unit auto sales rose modestly in Feb; gasoline prices rose late month. We expect some weather disruption, but also panic buying. The advance Jan report might have missed the late-month deterioration in the weather, so there is potential for a downside revision. Expect an ex autos & gas sales bounce.

US retail sales



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
NZ	Feb REINZ house sales	-0.1%	-	-	Due this week. Sales have fallen 11% since new LVR limits.
	Feb REINZ house price index %yr	7.7%	-	-	Sale prices are now starting to respond with their usual lag.
	Q4 manufacturing sales	0.5%	-	-	Meat and dairy processing has returned to pre-drought levels.
Chn	Feb new loans RMBbn	1320	730	-	Tentative date: banks taking back market share as shadow struggles.
	Feb total credit RMBbn	2580	1300	-	Tentative date: Don't judge H2 real economy impact until Q1 is over.
	Feb M2 money supply %yr	13.2%	13.2%	-	Tentative date: Annual target unchanged at 13.0%.
Eur	Mar Sentix investor confidence	13.3	-	-	Ukraine escalation risk may be a factor.
US	Fedspeak	-	-	-	Plosser, in Paris.
Can	Feb housing starts	180k	190k	-	Starts down 29% since Q2 2012, 9 ppts since Oct 13; snow a factor.
Tue 11					
NZ	Feb electronic card transactions	-0.1%	0.9%	0.9%	Jan softness was out of line with record consumer confidence.
Aus	Feb NAB business confidence	4	-	-	Conditions index up in Dec & up again in Jan to +4, from -2 in Nov.
Ger	Jan exports	-1.0%	-	-	Dec fall was first since July.
	Q4 labour costs %yr	1.6%	-	-	Slowest pace of gain since the aftermath of 08/09 recession.
UK	Feb BRC retail survey %yr	3.9%	-	-	Same store sales. Jan pace fastest since Royal Wedding in 2011.
	Jan industrial production	0.4%	0.2%	-	Official data have failed to match stronger factory PMI readings.
US	Jan wholesale inventories	0.3%	0.5%	-	Inventories accumulation flattered H2 2013 GDP growth.
	Feb NFIB small business optimism	94.1	-	93.5	ISM surveys suggest some risk of weaker result, esp. given Jan rise.
Wed 12					
Aus	Mar Westpac-MI consumer sentiment	100.2	-	-	Fell back to 'neutral' in Feb. Mar includes update on risk attitudes.
	Mar Westpac-MI unemploy. expectat.	155.9	-	-	Back near last year's peak: renewed job loss fears weighing on sentiment.
	Jan housing finance approvals	-1.9%	flat	flat	No. of approvals excludes investors, the key to recent strength.
Eur	Jan industrial production	-0.7%	0.4%	-	German and French data due Fri 7/3 and Mon 10/3 respectively.
UK	Jan trade balance £bn	-7.7	-8.6	-	Exports up 1.9% and imports down 4.7% in Dec.
US	Feb federal budget \$bn	-218	-	-	Debt ceiling issue resolved a month ago.
Can	Feb house prices %yr	4.5%	-	-	Teranet/National Bank index. Renewed acceleration since late 2013.
Thu 13					
NZ	RBNZ Monetary Policy Statement	2.50%	2.75%	2.75%	A well-signalled hike with a strong possibility of follow-up moves.
	Feb food price index	1.2%	-	-0.2%	Annual food price inflation is starting to tick higher again.
Aus	Feb employment mth '000	-3.7k	15k	20k	Total employment has fallen 10.4k in 3 months. We are due a bounce.
	Feb unemployment %	6.0%	6.0%	6.0%	20k will hold unemployment as long as part rate does not bounce.
	Mar MI inflation expectations	2.3%	-	-	Inflation near middle of RBA band.
Chn	Jan-Feb fixed investment %ytd	19.6%	19.4%	-	Tends to "re-set" in Jan-Feb at a rate that doesn't "follow-on" from Dec.
	Jan-Feb retail sales %yr	13.6%	13.5%	-	Second year of Xi's public austerity drive hitting LNY official largesse.
	Jan-Feb industrial production %ytd	9.7%	9.5%	-	Output index in PMIs stronger than headlines, but pulse weaker late '13.
UK	Feb house prices net %	53%	52%	-	RICS surveyors view on house prices with FFL loan subsidy withdrawn.
US	Feb advance retail sales	-0.4%	0.2%	0.4%	Auto sales modestly higher; gasoline prices higher in late Feb.
	Feb retail sales ex & auto, gas	-0.2%	-	0.2%	Core flat since Oct on income growth & weather. Modest Feb bounce?
	Initial jobless claims w/e 7/3	323k	-	325k	Week prior to payrolls survey week.
	Feb import prices	0.1%	0.6%	1.0%	Oil prices sharply higher through Feb.
	Jan business inventories	0.5%	0.4%	0.2%	Inventories accumulation flattered Q3 2013 GDP growth, less so in Q4.
Can	Jan new house prices %yr	1.3%	-	-	Ongoing deceleration in new home prices.
	Q4 capacity utilisation	81.7%	82.0%	-	Little changed since late 2011.
Fri 14					
NZ	Feb manufacturing PMI	56.2	-	-	Consistently strong over the last year as the Ch'ch rebuild kicked in.
Chn	Feb foreign direct investment %yr	16.1%	6.7%	-	Was this an avenue for dubious inflows in Jan?
UK	Jan construction output	2.0%	-	-	Volatile data monthly, but PMI suggests gains ahead.
US	Feb PPI final demand	0.2%	0.2%	-	Reformulated PPI now includes services costs on top of factory and
	Feb PPI final demand core	0.2%	0.1%	-	input prices.
	Mar UoM consumer sentiment prelim	81.6	81.7	83.0	300 responses in prelim survey. How many have stocks?!

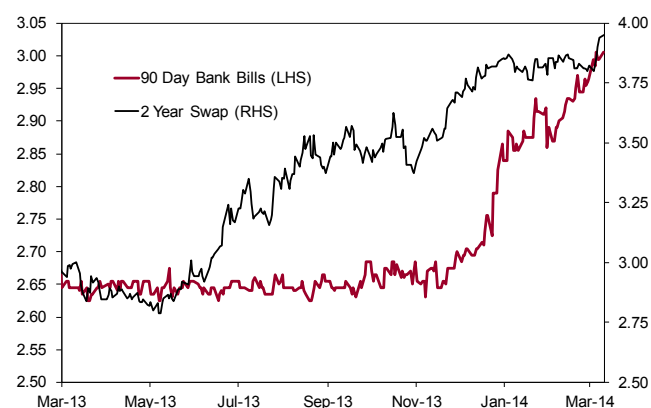


New Zealand forecasts

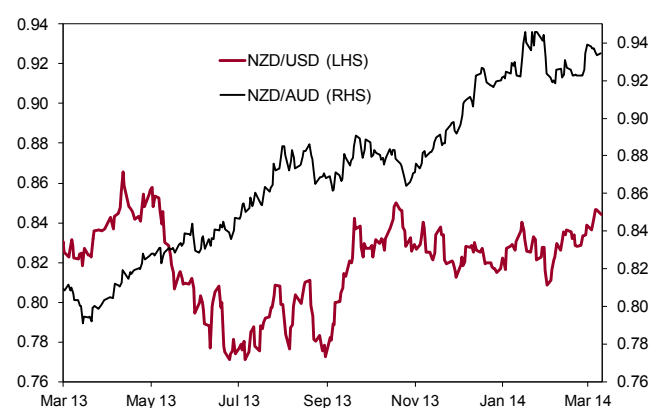
Economic Growth Forecasts	March years				Calendar years			
	2013	2014f	2015f	2016f	2012	2013e	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.1	4.0	3.0	2.6	2.7	4.1	3.2
Employment	0.4	3.3	2.8	1.5	0.4	2.9	3.0	1.7
Unemployment Rate % s.a.	6.2	5.8	5.1	4.8	6.8	6.0	5.1	4.7
CPI	0.9	1.6	1.8	2.3	0.9	1.6	1.8	2.2
Current Account Balance % of GDP	-3.9	-3.1	-5.1	-5.4	-4.1	-3.3	-4.3	-5.6

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	2.95	3.50	3.75	4.00	4.20	4.30
2 Year Swap	3.85	4.10	4.30	4.50	4.65	4.80
5 Year Swap	4.55	4.70	4.80	4.90	5.05	5.20
10 Year Bond	4.60	4.80	5.00	5.10	5.20	5.30
NZD/USD	0.83	0.84	0.84	0.83	0.82	0.82
NZD/AUD	0.93	0.95	0.97	0.97	0.96	0.95
NZD/JPY	85.6	84.8	84.0	82.2	82.0	82.5
NZD/EUR	0.61	0.64	0.64	0.65	0.65	0.64
NZD/GBP	0.50	0.51	0.52	0.51	0.49	0.48
TWI	78.4	80.1	80.2	79.8	79.2	78.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



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

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.50%	2.50%
30 Days	2.87%	2.76%	2.69%
60 Days	2.93%	2.85%	2.79%
90 Days	3.01%	2.94%	2.90%
2 Year Swap	3.95%	3.82%	3.87%
5 Year Swap	4.59%	4.52%	4.59%

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

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8443	0.8283	0.8289
NZD/EUR	0.6086	0.6033	0.6090
NZD/GBP	0.5043	0.4984	0.5053
NZD/JPY	86.89	84.91	85.00
NZD/AUD	0.9343	0.9228	0.9254
TWI	78.97	77.85	78.14



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013f	2014f	2015f
Australia						
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	-2.9	-3.2	-2.2
United States						
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	1.5	1.5
Unemployment Rate %	9.6	8.9	8.1	7.4	6.8	6.2
Current Account %GDP	-3.0	-2.9	-2.7	-2.3	-2.2	-2.2
Japan						
Real GDP %yr	4.7	-0.6	2.0	1.8	1.8	1.4
Euroland						
Real GDP %yr	2.0	1.5	-0.6	-0.5	0.4	0.6
United Kingdom						
Real GDP %yr	1.7	1.1	0.2	1.9	2.6	1.9
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	4.3	3.9	3.9	3.7	4.8
World						
Real GDP %yr	5.2	3.9	3.2	2.9	3.2	3.7
Forecasts finalised 7 February 2014						

Interest Rate Forecasts	Latest	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Australia						
Cash	2.50	2.50	2.50	2.25	2.00	2.00
90 Day Bill	2.66	2.55	2.30	2.10	2.10	2.10
10 Year Bond	4.17	4.10	3.90	3.70	4.00	4.20
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.73	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	0.9090	0.90	0.88	0.87	0.86	0.85
USD/JPY	102.97	102	104	103	102	103
EUR/USD	1.3859	1.36	1.33	1.31	1.29	1.27
AUD/NZD	1.0718	1.07	1.05	1.04	1.04	1.04

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Disclaimer continued

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