24 March 2014

Weekly Commentary

Cape Reinga lighthouse, North edge of New Zealand

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Consumers in the passenger seat

New Zealand's economic performance over 2013 leaves it well positioned to achieve around 4% economic growth over 2014. That would be the fastest growth the economy has seen since 2004. Unlike in the mid-2000s, though, this economic growth won't depend on a consumer borrowing and spending spree.

Last week's GDP report confirmed that the New Zealand economy gathered a good head of steam at the end of last year. GDP grew 0.9% in the December quarter – slower than the 1.2% growth seen in the September quarter, but a fairer reflection of the economy's underlying trend. Whereas growth in the September quarter was boosted by a post-drought recovery in agricultural production, a broad range of sectors and industries shared the love this time.

As expected, the largest contributions came from manufacturing – including a 6.2% rise in machinery and equipment manufacturing – and wholesale trade (probably best thought of as a proxy for general economic activity than a driver of growth in itself). Other notable contributions included a 1.3% rise in finance and insurance, a 1.1% rise in retail trade, a 1.0% rise in transport and warehousing, and a 1.3% rise in healthcare and social assistance.

There were a few lumps and bumps, but nothing to raise any alarm. As heralded by earlier building work data, the construction sector had a second slow quarter, rising just 0.4%. That may seem odd given the prominence of the Christchurch rebuild, but it comes after a 29% lift in the two years following the February 2011 earthquake, and recent building consent issuance suggests there is a substantial amount of work still in the pipeline. Meanwhile agricultural output eased by a modest 1.6% following its massive rebound of 13.3% in September (revised down from 17% but still the biggest quarterly increase on record).

Overall, there was nothing in the GDP numbers to challenge our view that the economy will grow at a roughly 4% annual pace over 2014. That would make 2014 the best year for the New Zealand economy – in growth terms – since 2004. Very much in contrast to the mid-2000s, however, we expect this growth to be largely driven by income (an insurance-funded Canterbury rebuild and agricultural export receipts), rather than debt-fuelled spending.

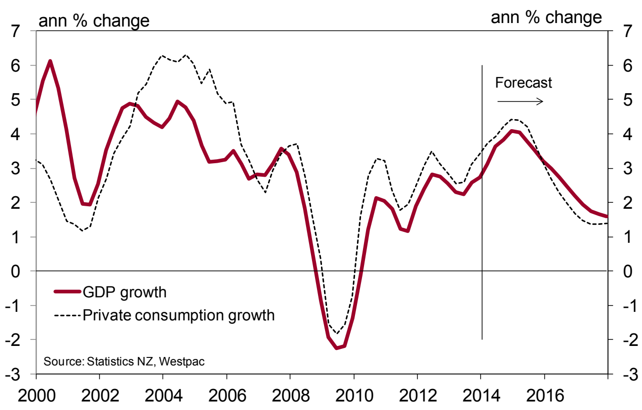
That has certainly been the case to date. New Zealand's current account deficit narrowed sharply in the December quarter, to 3.4% of GDP, as September's rebound in agricultural production, coupled with sky-high global prices, translated into a surge in export receipts, while imports actually fell. That resulted in a further improvement in New Zealand's net international liabilities, to 69.3% of GDP (after stripping out outstanding reinsurance claims, which flatter the numbers further) – still high by international standards, but significantly down from the almost 86% of GDP during the depths of the global financial crisis.

Of course, things needn't stay this way. At the end of 2003, New Zealand's current account deficit was just 2.5% of GDP, but by the end of 2005 it had blown out to over 7%. What's different this time around is the financial environment. Fixed-term interest rates have risen a lot sooner in this cycle, and house prices are at a much higher level compared to incomes and rents than they were back in 2004, meaning less room for further upside. Household debt levels are also higher.

That makes a spending spree less likely – and for now at least, there are still no signs of one on the horizon. According to the latest Westpac McDermott Miller consumer confidence survey (surveyed at the start of March), consumers' economic optimism is now almost as high as it was at its peak during the mid-1990s and mid-2000s boom periods. But consumers' attitudes towards their own finances and towards spending, while much more positive than even a year ago, are still well below what they were in the mid-2000s.

There may also still be some skepticism around how long the current sweet spot for dairy farmers will last. In the survey details, we noted that while consumer confidence has spread to smaller urban centres, rural consumers remain relatively cautious, and have actually become more so over the past three months.

New Zealand GDP and consumer spending

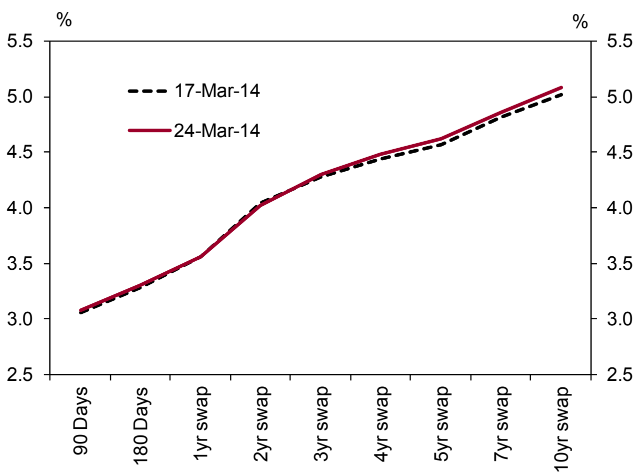


Our own view has long been that dairy prices would moderate in the near term as more supply came on stream, but that rising demand from emerging markets, and New Zealand's growing penetration of those markets, would provide significant support for New Zealand's export prospects in the medium term. The near-term moderation now seems to be coming to pass – global dairy prices have fallen a total of 9% over the past two Fonterra auctions. Looking further ahead, the announcement by the Chinese central bank of direct convertibility between the Renminbi and the NZ dollar was a largely symbolic development, but it's one more step along the path of closer economic relations between New Zealand and China. At the margin, it will reduce the costs of trade between the two economies, particularly at a time when China has decided to allow greater volatility in USD/CNY.

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 has kicked off what is widely expected to be an extended series of increases in the Official Cash Rate. This view is more or less embedded in current fixed-term mortgage rates, which implies that the costs of fixing or floating are expected to be similar over the longer term. However, with floating rates likely to rise further in coming months, borrowers who value certainty in their repayments over the near term should consider fixing now.

NZ interest rates

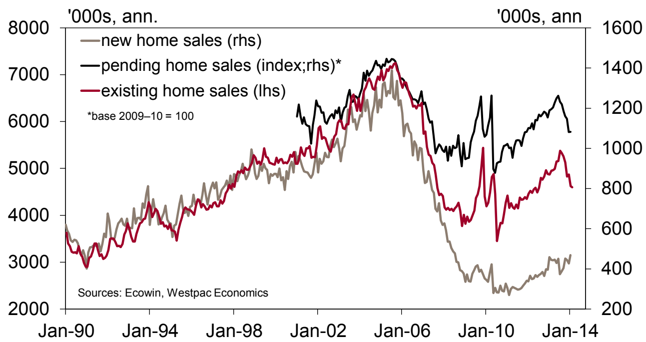


US Feb new/pending home sales

Mar 25, New: Last: 9.6%, WBC f/c: –9.5%
Mar 27, Pending: Last: 0.1%, WBC f/c: –2.0%

- New home sales are volatile and often revised; adding complexity is the recent tendency of January new home sales to rise sharply in original terms back to levels that prevailed during the summer. The seasonals assume that Nov-Dec-Jan are the weakest months for sales due to the winter, so the raw lift in Jan 2013 and Jan 2014 translated into very sharp sales spikes after seasonal adjustment. It is doubtful that Feb 2014 new sales bettered Jan's raw number given snow disruption and collapsing homebuilder confidence re present and future sales. But even a flat raw Feb would print near a 10% seasonally adjusted fall, so there is downside risk around our –9.5% forecast.
- Pending home sales fell 6% in Dec, and were flat in Jan. If snow disrupted sales, Feb was likely even more disrupted so we expect a further sales decline, before a moderate bounce in March.

US housing sales

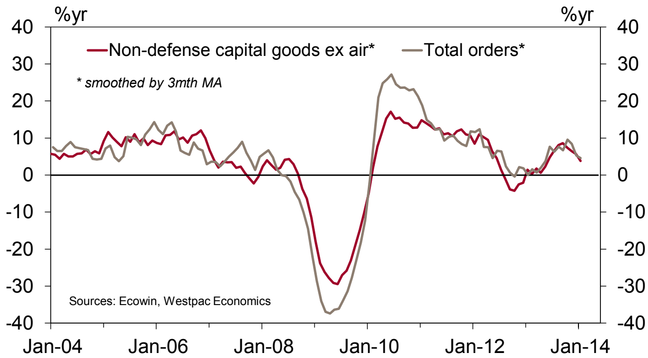


US Feb durable goods orders: mixed signals

Mar 26, Last: –1.0%, WBC f/c: 1.0%

- Durable goods orders fell 1.0% in Jan, with falling aircraft orders again a significant driver. Auto orders were down for the second month running. But defence bounced 26% after a 29% Dec loss and core capital goods orders excluding defence & aircraft rose 1.7%. That failed to reverse Dec's 1.8% fall, leaving a slightly weaker turn of year core orders picture, after a 4.1% annualised drop in the three months to November but a 3.4% rise in the Jun-Aug trimester.
- ISM factory orders recovered just a quarter of their Jan plunge. Boeing orders took off but the seasonals should adjust for much of that. But auto production rose 5% in Feb; business equipment output was up a decent 1.3%. These mixed signals suggest a close to flat headline; any rise in core capital goods orders would likely be modest.

US durable goods orders



Data calendar

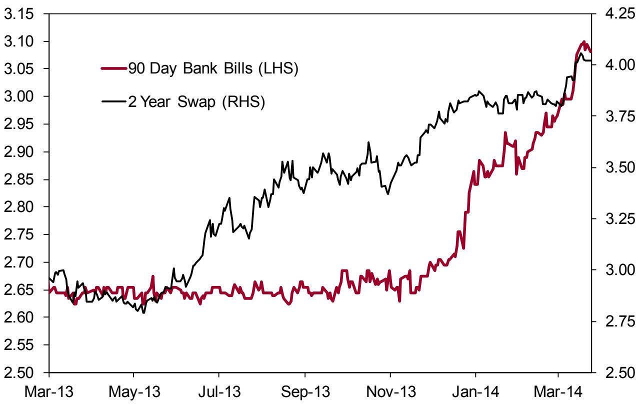
		Last	Market median	Westpac forecast	Risk/Comment
Mon 24					
Chn	Mar HSBC/Markit flash manuf PMI	48.3	–	–	Expect some improvement, but 50 may be a bridge too far.
Eur	Mar PMI factory adv	54.8	53.0	53.0	Feb saw distance between French and German PMIs narrow further.
	Mar PMI services adv	52.6	52.6	52.5	Composite PMI fact/ser was 53.2 in Feb.
UK	Mar house prices %yr	9.4%	9.5%	–	Tentative date for Nationwide index due 24-28/3.
US	Feb Chicago Fed national activity index	–0.39	–	–0.60	Based on 80 or so data inputs, not a business survey. Weather impact.
Tue 25					
Aus	RBA Deputy Governor Lowe	–	–	–	Speaking, ASIC annual forum, Sydney, 3.45pm
Ger	Mar Ifo business climate index	111.3	–	110.5	Chinese growth, Ukraine concerns to weigh on sentiment.
UK	Feb CPI %yr	1.9%	1.7%	1.8%	BRC shop prices index suggests further fall; core just 1.6% yr in Jan.
	Feb producer prices %yr	1.2%	1.1%	–	PPI core output measure.
	Jan house prices %yr	5.5%	–	–	ONS series.
	Mar CBI retail survey	37	28	–	Reported sales index just as volatile as official Dec-Jan retail.
	Feb mortgages no.	50.0k	49.5k	–	BBA data covering 70% of market; FfL support ended in Jan.
US	Feb new home sales	9.6%	–4.9%	–9.5%	NAHB implies weather impact in month when seasonals unfavourable.
	Jan house prices %yr	13.4%	13.3%	–	S&P Case Shiller 20 city index.
	Jan house prices	0.8%	0.7%	–	FHFA index, running 7.7% yr in Dec.
	Mar Conf Brd consumer confidence	78.1	78.6	80.0	Weekly confidence indicators higher.
	Mar Richmond Fed factory index	–6.0	–	2.5	Regional surveys responding differently to winter weather disruption.
	Fedspeak	–	–	–	Lockhart, Plosser.
Wed 26					
Aus	RBA Deputy Governor Lowe	–	–	–	Centre for International Finance & Regulation, Sydney, 9:35am.
	Financial Stability Review	–	–	–	Half yearly update.
	RBA Governor Stevens	–	–	–	Asian Investment Conference, Hong Kong, 2:30pm AEDT.
Ger	Apr GfK consumer confidence	8.5	8.5	–	Surveyed Mar but labelled April. At highest in seven years last month.
US	Feb durable goods orders	–1.0%	1.0%	1.0%	Boeing orders rise is seasonal, ISM cited weather, but IP up sharply.
	Fedspeak	–	–	–	Bullard.
Thu 27					
NZ	Feb merchandise trade, NZDmn	306	–	800	Another chunky monthly trade surplus expected.
Chn	Feb industrial profits %ytd	12.2%	–	–	Taking a hit, if weak manufacturing investment of late is any guide.
Eur	Feb money supply M3 %yr	1.2%	1.3%	–	LTRO repayment, contracting lending, but stress test deleverage over.
Ger	Feb retail sales	1.7%	–0.5%	–	Jan saw sales bounce by most since June 2011 (tentative release date).
UK	Feb retail sales incl autos	–1.5%	0.3%	0.8%	Jan sales reversed Dec bounce; BRC/CBI surveys noisy lately. Flooding.
US	Q4 GDP 2nd revision	2.4%	2.7%	2.5%	Partial data suggest little change in final revision.
	Initial jobless claims w/e 21/3	320k	325k	335k	Claims at year so far's low in latest two weeks. Not sustainable!
	Mar Kansas City Fed factory index	5	–	3	Jan-Feb survey did not sustain Dec weakness.
	Feb pending home sales	0.1%	0.0%	–2.0%	Snow likely impacted more on signings than closures. See box.
	Fedspeak	–	–	–	Bullard.
Fri 28					
Eur	Mar business climate indicator	0.37	0.41	0.35	Faster pace of Q4 GDP growth may be maintained if these surveys
	Mar economic confidence	101.2	101.2	101.2	hold recent gains. Note consumer confidence advance due Fri 21/3.
Ger	Feb CPI prelim %yr	1.2%	1.1%	–	German EU-harmonised inflation just 1.0% yr in Feb.
UK	Q4 GDP 2nd revision	0.7% a	0.7%	0.7%	More detailed breakdown.
	Q4 current account £bn	–20.7	–13.8	–	Deficit is volatile and much revised.
	Q4 business investment final;	2.4%a	–	–	Surveyed separately to national accounts capital formation data.
US	Feb core PCE deflator	0.1%	0.1%	0.1%	Core CPI rose 0.1% in Feb.
	Feb personal income	0.3%	0.3%	0.2%	Earnings up but hours worked down in Feb.
	Feb personal spending	0.4%	0.3%	0.1%	Spending disrupted though utilities spending should be sustained.
	Mar UoM consumer sentiment final	79.9 a	80.5	80.5	Weekly confidence data points to improved sentiment.
	Fedspeak	–	–	–	Evans, George.

New Zealand forecasts

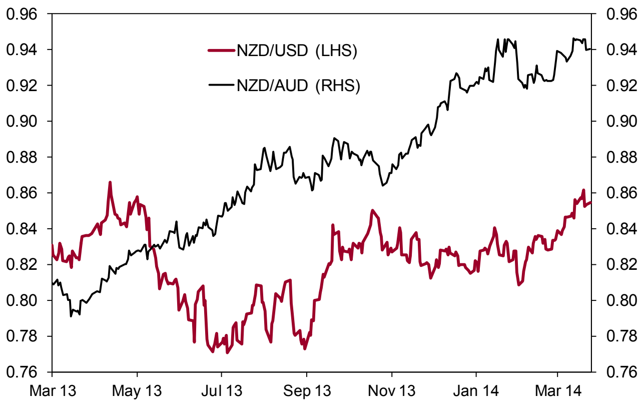
Economic Growth Forecasts	March years				Calendar years			
% change	2013	2014f	2015f	2016f	2012	2013e	2014f	2015f
GDP (Production) ann avg	2.3	3.1	4.0	3.0	2.6	2.7	4.1	3.2
Employment	0.4	3.3	2.8	1.5	0.4	2.9	3.0	1.7
Unemployment Rate % s.a.	6.2	5.8	5.1	4.8	6.8	6.0	5.1	4.7
CPI	0.9	1.6	1.8	2.3	0.9	1.6	1.8	2.2
Current Account Balance % of GDP	-3.9	-2.9	-4.5	-4.8	-4.1	-3.3	-3.7	-5.0

Financial Forecasts	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Cash	3.25	3.50	3.75	4.00	4.00	4.25
90 Day bill	3.50	3.75	4.00	4.20	4.30	4.50
2 Year Swap	4.10	4.30	4.50	4.65	4.80	5.00
5 Year Swap	4.70	4.80	4.90	5.05	5.20	5.35
10 Year Bond	4.80	5.00	5.10	5.20	5.30	5.40
NZD/USD	0.86	0.86	0.84	0.83	0.82	0.83
NZD/AUD	0.95	0.96	0.95	0.95	0.94	0.93
NZD/JPY	89.4	88.6	85.7	85.5	85.3	86.6
NZD/EUR	0.63	0.63	0.64	0.64	0.63	0.63
NZD/GBP	0.50	0.51	0.50	0.49	0.47	0.45
TWI	80.5	80.9	80.0	79.6	78.6	78.4

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 24 Mar 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.75%	2.50%	2.50%
30 Days	2.95%	2.87%	2.76%
60 Days	3.01%	2.93%	2.85%
90 Days	3.08%	3.01%	2.94%
2 Year Swap	4.02%	3.95%	3.82%
5 Year Swap	4.62%	4.59%	4.52%

NZ foreign currency mid-rates as at Monday 24 Mar 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8548	0.8443	0.8283
NZD/EUR	0.6196	0.6086	0.6033
NZD/GBP	0.5185	0.5043	0.4984
NZD/JPY	87.29	86.89	84.91
NZD/AUD	0.9406	0.9343	0.9228
TWI	79.98	78.97	77.85

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013	2014f	2015f
Australia						
Real GDP % yr	2.2	2.6	3.6	2.4	2.7	3.0
CPI inflation % annual	2.8	3.0	2.2	2.7	2.4	2.5
Unemployment %	5.2	5.2	5.3	5.8	6.3	6.0
Current Account % GDP	-3.5	-2.8	-4.1	-2.9	-3.1	-2.0
United States						
Real GDP %yr	2.5	1.8	2.8	1.9	2.1	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	-2.4	-2.3	-2.3
Japan						
Real GDP %yr	4.9	-0.3	1.5	1.6	1.5	1.3
Euroland						
Real GDP %yr	2.0	1.5	-0.6	-0.4	0.6	0.8
United Kingdom						
Real GDP %yr	1.7	1.1	0.2	1.8	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	3.8	4.7
World						
Real GDP %yr	5.2	3.9	3.2	2.9	3.2	3.7
Forecasts finalised 10 March 2014						

Interest Rate Forecasts	Latest	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
Australia						
Cash	2.50	2.50	2.50	2.50	2.50	2.50
90 Day Bill	2.66	2.55	2.55	2.55	2.55	2.65
10 Year Bond	4.13	3.90	3.70	4.00	4.20	4.20
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.74	2.60	2.60	2.80	3.00	3.20
ECB Repo Rate	0.25	0.25	0.25	0.25	0.25	0.25

Exchange Rate Forecasts	Latest	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15
AUD/USD	0.9020	0.91	0.90	0.88	0.87	0.87
USD/JPY	102.30	104	103	102	103	104
EUR/USD	1.3830	1.37	1.36	1.31	1.30	1.30
AUD/NZD	1.0590	1.06	1.05	1.05	1.05	1.06

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