Weekly Commentary

20 February 2012

Home and away

Last week brought more evidence that the New Zealand consumer is steadily getting into better shape. While the big release of the week – December quarter retail spending – was, as expected, heavily influenced by overseas visitor spending during the Rugby World Cup, the details suggested a solid pickup in spending by locals as well. The contrast between consumers' expressed confidence and their actions is a little puzzling, but perhaps should be read as a reminder of how easily the recovery could be derailed by unexpected events.

REINZ data indicated that nationwide house sales were flat in January, in seasonally adjusted terms. We suspect the market was simply taking a breather after a cumulative 13% rise in sales in the last three months of 2011, and in fact the RBNZ's weekly mortgage approvals data have continued to show good upward momentum since the start of the year. The stratified house price index was up 0.9% for the month and 4.3% on a year ago.

The pick up in the housing market is unlikely to worry policy makers at this stage – it's coming from a very weak starting point, and neither the level of sales nor the rate of price growth have topped even the short-lived housing recovery in 2009. However, it's notable that the housing upturn is becoming more widespread, having been initially concentrated in two regions with notable supply constraints: Auckland, due to a severe degree of under-building in recent years; and Canterbury, due to the loss of housing stock in the earthquakes. Sales are now growing strongly in most regions and additional data from Quotable Value shows that prices have been rising strongly in all of the main centres in recent months (although some are still down on a year-to-year basis).

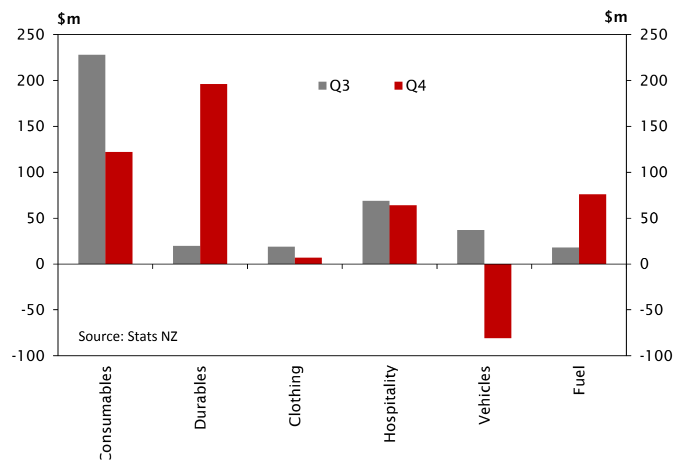
A broad-based improvement in the housing market is consistent with a pick up in household spending; the retail trade survey provided further proof of this. Sales volumes rose 2.2% in the December quarter, on top of a 2.4% rise in the September quarter. Core sales (excluding vehicles and fuel) were even more impressive, rising by 2.9%, the biggest quarterly increase since the survey began in 1995.

Retail spending in both of the last two quarters was boosted by the Rugby World Cup, which attracted around 130,000 overseas visitors (peaking during the finals in October). Nearly half of the rise in December quarter sales came from supermarkets (+1.8%), specialised food stores (+10.4%), accommodation (+3.9%) and cafes, restaurants and bars (+2.2%) – some of the obvious beneficiaries of increased tourist spending during the RWC. Spending in these areas was also stronger than indicated by the monthly electronic cards data – the inference here being that the high number of overseas visitors meant a higher than usual proportion of cash and cheque transactions, which are only captured in the retail survey.

However, what was notable this time – and markedly different to the September quarter – was the strong gains in the durable goods categories: electronic goods were up 10.1%, furniture up 7.6%, department store sales up 7.2%, and hardware and building supplies up 2.5%. These groups are more representative of demand by New Zealand households than of a rugby-related spike in tourist spending. While lower prices – particularly a 3% drop for electronics – would have encouraged volume growth, spending was still up strongly even in dollar terms.

On their own, the retail figures suggest some upside risk to our current forecast of 0.4% GDP growth, although there may be

Quarterly changes in retail sales



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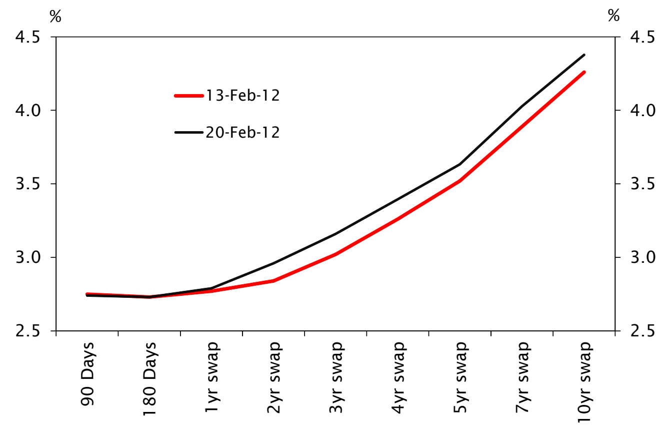
offsetting factors. Some of the boost in Q4 spending was met by a rundown of inventory levels, in contrast to the large inventory build-up of Q3; that could mean, for instance, a fall in manufacturing or wholesaling if there was less restocking by retailers during the quarter.

The apparent strength of retail spending by New Zealanders is hard to reconcile with the weakness of recent consumer confidence surveys (although ANZ-Roy Morgan's monthly survey has picked up slightly in the last three months, when seasonally adjusted). At the very least, we should read this as a reminder that there are still a number of risks to the economy that could see consumers snap their wallets shut again: a messy break-up in the euro zone, a renewed global downturn, or more delays to the recovery in Canterbury.

Even so, there is reason to think that households are coming from a stronger starting point than the confidence surveys are letting on. Retail spending in nominal terms was up 8.5% on a year ago (obviously including the temporary RWC effect, but even spending on durables was up 6.9%). Another indicator of willingness to spend that isn't captured in the retail survey: the number of Kiwis travelling overseas so far this year is tracking more than 10% above last year. Meanwhile, household deposits in the December quarter were up about 9% on the year before. When both spending and savings are growing strongly, it's hard not to conclude that incomes are growing too. The likelihood of low interest rates and subdued inflation through most of this year will be an added bonus for the consumer.

Fixed versus floating: Fixed mortgage rates are currently good value given where we think floating rates are heading over the next several years. But with a satisfactory resolution to the European debt crisis elusive, there is no immediate pressure on fixed rates to rise, so borrowers can afford to wait a little longer.

NZ interest rates



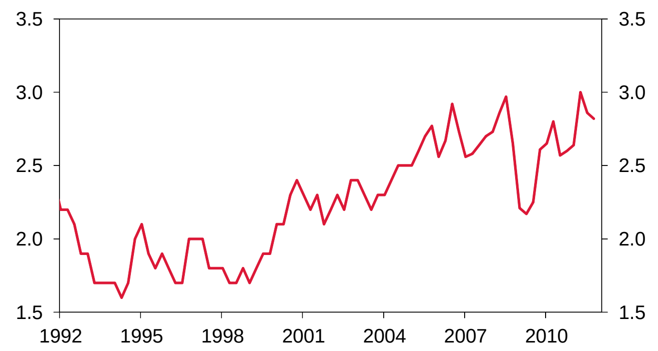
Key Data Previews

NZ Q1 RBNZ survey of inflation expectations

Feb 21, Last: 2.8%

- Annual inflation was boosted in the year following the October 2010 GST hike, reaching a 20-year high of 5.3% at one point. Inflation expectations also picked up during this time, but the RBNZ's stance has long been that this would reverse once the GST impact dropped out of the headline inflation rate.
- Consequently, the inflation expectations survey was largely off the radar last year – but this quarter will be the real acid test of the RBNZ's stance.
- Expectations for two years ahead tend to evolve slowly; we assume a modest drop from the previous reading of 2.82%. However, the much weaker than expected CPI outturns in the last two quarters may carry additional weight in respondents' minds.

RBNZ surveyed expectations of inflation 2 years ahead



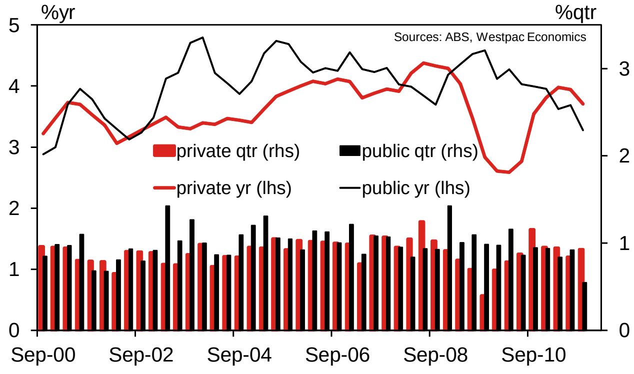
Aus Q4 Wage Price Index - total ex bonuses %qtr

Feb 22, Last: 0.7%, WBC f/c: 0.9%

Mkt f/c: 0.8%, Range: 0.5% to 1.0%

- Wages rose 0.7%qtr in Q3, softer than market expectations, due to a very muted 0.5%qtr rise in public wages.
- Consistent with a softer, but not collapsing, jobs market private sector wage inflation in Australia has moderated. The annual pace has eased from 4% in 2011Q1 to 3.6% in Q3.
- The Westpac-ACCI question on 'is labour easy or hard to find' has been a reliable leading indicator of wage inflation. The Dec read from the survey suggests it is still easy to find labour; that is consistent with rising unemployment, softer labour market conditions and easing wage pressures.
- We see a 0.9%qtr rise in the WPI easing the annual pace slightly to 3.5%yr from 3.6%yr. We expect the pace to continue to moderate from here.

Private vs. public sector wages

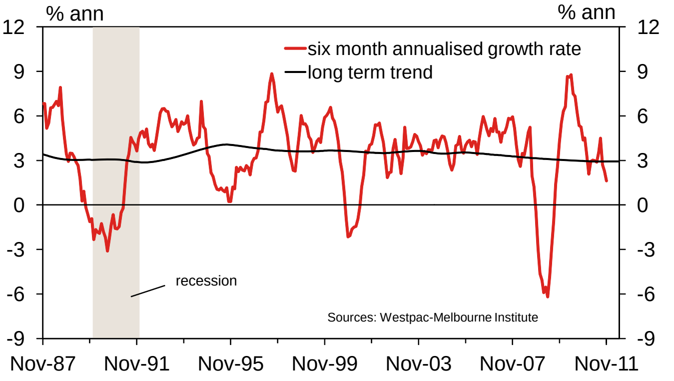


Aus Dec Westpac–MI Leading Index

Feb 22, Last: 1.6% annualised

- The annualised growth rate of the **Westpac–Melbourne Institute Leading Index** was 1.6% in November, below its long-term trend growth rate of 2.9% and well down from the 4.5% recorded in August.
- The December update will incorporated new monthly data on: dwelling approvals (–1%mth, but with the previous month's 8.4% gain revised up to 10.1%); equity markets (ASX –1.8%, extending November's 4.0% decline, though reversing over half of this so far in Jan-Feb); US industrial production (up 1%mth after a flat Nov, revised up from a 0.3% decline); and money supply (up 1.2% after a flat November).

Westpac - MI Leading Index



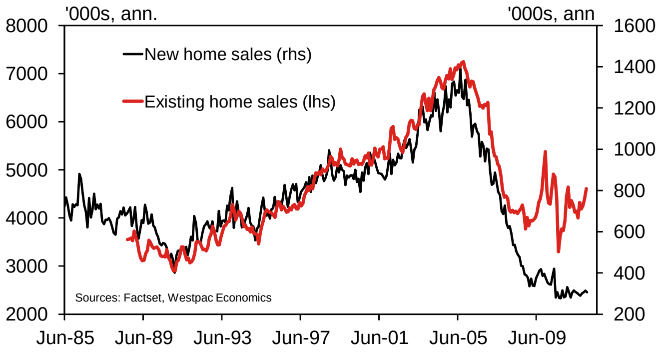
US Jan existing and new home sales

Feb 22, Existing home sales: Last: 5.0%, WBC f/c 2.0%

Feb 24, New home sales: Last: –2.2%, WBC f/c 1.5%

- Housing data were mostly stronger in Dec and Jan, including an ongoing recovery in single-family starts, an emerging uptrend in single family permits, and multiple monthly gains in existing home sales. Exceptions were modest declines in pending and new home sales, both after decent runs higher.
- With mortgage rates lower, home-builder confidence less weak and the recent US data tone positive in most sectors, including construction jobs in Jan, we have a bias towards mostly positive housing data for Jan. Steep gains in pending home sales in the first two months of Q4 in particular point to further rises in existing home sales, even though pending sales slipped 3.5% in Dec and contract cancellations are on the rise. New home sales are expected to bounce given the uptrend in starts and builder confidence. Both series will be revised heavily in the Jan reports.

US housing sales



Key Data and Events

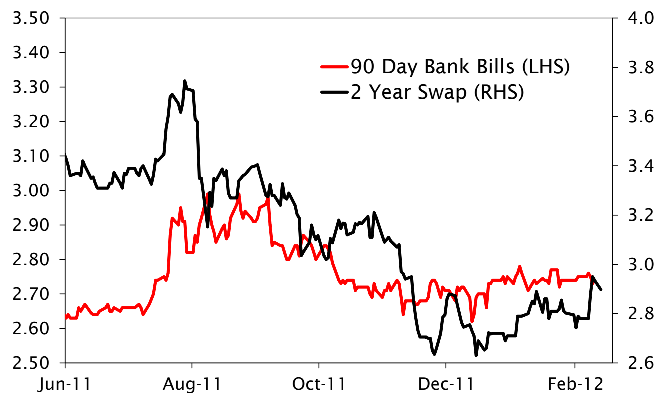
		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
NZ	Jan Performance of Services Index	50.6	–	–	Has not fallen below 50 since October 2009.
	Q4 producer prices (outputs)	0.2%	–	–	Construction cost inflation of most interest.
Jpn	Jan trade balance ¥bn sa	-567.6	-847.8	–	Trade deficit widen enough to push current acct into the red?
UK	Feb house prices % yr	0.4%	–	–	Rightmove index.
Tue 21					
NZ	Q1 RBNZ inflation expectations	2.8%	–	–	Has been off the radar recently but will be crucial this time.
Aus	RBA meeting Minutes	–	–	–	More details on reasoning behind surprise February decision.
Eur	Feb consumer confidence adv	-20.7	-20.3	-20.0	Sharp improvement in confidence less likely to show here.
UK	Jan PSNCR £bn	22.9	–	–	Public sector net credit requirement.
US	Jan Chicago Fed nat. activity index	0.17	–	–	Compiled from 80+ published data series.
Can	Dec retail sales	0.3%	-0.2%	–	Ex auto sales also up 0.3.% in Nov.
	Dec wholesale sales	-0.4%	0.5%	–	Nov saw first fall in seven months.
Wed 22					
Aus	Dec Westpac-MI Leading Index	1.6%	–	–	Further clarity on stance after surprise February decision.
	Q4 wage cost index - ex bonuses	0.7%qtr	0.8%qtr	0.9%qtr	Softer labour market, weaker wage claim but Q3 looks too soft.
Eur	Feb factory PMI adv	48.8	49.2	49.0	Still contractionary but only mildly so.
	Dec industrial orders	-2.7%	–	1.0%	German orders up 1.7% in Dec.
UK	Feb BoE minutes	–	–	–	Was £50bn extra QE decision unanimous?
US	Jan existing home sales	5.0%	1.0%	2.0%	See text box.
Thu 23					
Ger	Feb IFO business climate index	108.3	108.5	108.0	Off lows, still around level where Ger. entered 08 recession
UK	Jan mortgages	36.2k	–	–	BBA data.
	Feb CBI industrial trends survey	-16	–	–	Total orders least weak for four months.
US	Initial jobless claims w/e 18/2	348k	–	350k	Claims at 4-year low last week.
	Dec house price index	1.0%	–	–	FHFA index
	Feb Kansas Fed factory index	7	–	–	Dipped below 0 for just one month (Dec) in 2011.
Fri 24					
Ger	Q4 GDP prelim	-0.2% a	–	0.2%	First revision. Will include component detail.
UK	Q4 GDP 1st revision	-0.2% a	–	-0.2%	Will include more component detail.
	Q4 business investment	0.3%	–	–	Measured on different basis to capex component of GDP.
US	Feb consumer sentiment	72.5 a	72.5	73.0	Surveys suggest upward revision to Uni of Michigan index.
	Jan new home sales	-2.2%	2.6%	1.5%	See text box.

New Zealand Economic and Financial Forecasts

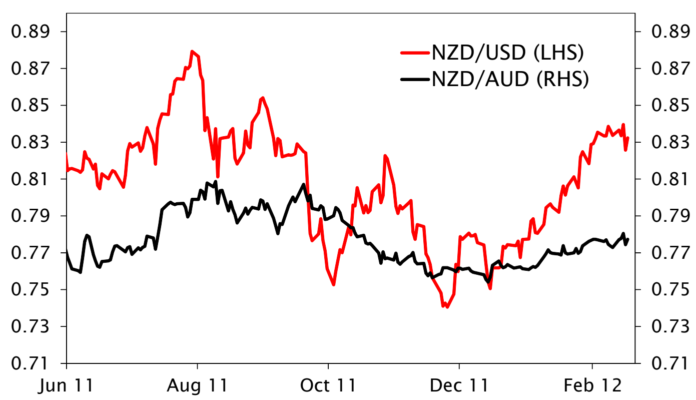
Economic Growth Forecasts	March years				Calendar years			
% change	2010	2011e	2012f	2013f	2010	2011f	2012f	2013f
GDP (Production) ann avg	-0.9	1.2	1.8	3.2	1.3	1.6	2.8	3.8
Employment	-0.1	1.8	0.7	2.4	1.3	1.5	2.0	2.9
Unemployment Rate % s.a.	6.1	6.6	6.4	5.7	6.7	6.3	5.9	5.1
CPI	2.0	4.5	1.7	2.2	4.0	1.8	2.2	2.4
Current Account Balance % of GDP	-1.9	-3.6	-4.4	-6.1	-3.5	-4.0	-5.7	-5.9

Financial Forecasts	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
Cash	2.50	2.50	2.50	2.75	3.25	3.50
90 Day bill	2.70	2.70	2.80	3.20	3.50	3.80
2 Year Swap	2.90	3.20	3.50	3.90	4.20	4.50
5 Year Swap	3.60	3.90	4.20	4.50	4.80	5.00
10 Year Bond	4.00	4.10	4.20	4.50	4.70	4.90
NZD/USD	0.80	0.76	0.78	0.80	0.82	0.81
NZD/AUD	0.76	0.76	0.76	0.77	0.77	0.79
NZD/JPY	60.8	58.5	60.8	64.8	68.9	66.4
NZD/EUR	0.62	0.62	0.62	0.63	0.64	0.65
NZD/GBP	0.52	0.51	0.51	0.52	0.51	0.51
TWI	70.7	69.2	70.5	72.2	73.6	73.4

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 20 February 2012

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.74%	2.73%	2.69%
60 Days	2.73%	2.74%	2.72%
90 Days	2.74%	2.74%	2.75%
2 Year Swap	2.96%	2.78%	2.81%
5 Year Swap	3.63%	3.34%	3.43%

NZ foreign currency mid-rates as at Monday 20 February 2012

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8378	0.8329	0.8053
NZD/EUR	0.6366	0.6350	0.6251
NZD/GBP	0.5288	0.5265	0.5177
NZD/JPY	66.633	63.737	61.97
NZD/AUD	0.7778	0.7766	0.7699
TWI	73.620	73.180	71.610

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2008	2009	2010	2011e	2012f	2013f
Australia						
Real GDP % yr	2.5	1.4	2.6	2.0	3.0	3.5
CPI inflation % annual	3.7	2.1	2.7	3.1	2.7	2.2
Unemployment %	4.3	5.6	5.2	5.1	5.6	5.3
Current Account % GDP	-4.5	-4.2	-2.9	-2.2	-3.3	-2.7
United States						
Real GDP %yr	-0.3	-3.5	3.0	1.7	1.7	2.1
Consumer Prices %yr	3.8	-0.3	1.6	3.2	2.0	2.0
Unemployment Rate %	5.8	9.3	9.6	9.0	8.8	8.8
Current Account %GDP	-4.7	-2.7	-3.2	-3.2	-3.2	-2.2
Japan						
Real GDP %yr	-1.7	-5.7	4.7	-0.8	1.6	2.0
Consumer Prices %yr	1.4	-1.3	-0.7	-0.3	-0.7	-0.3
Unemployment Rate %	4.0	5.1	5.1	4.5	4.4	4.4
Current Account %GDP	3.3	2.8	3.6	2.1	1.9	2.5
Euroland						
Real GDP %yr	0.3	-4.2	1.8	1.5	-1.0	0.3
Consumer Prices %yr	3.3	0.3	1.7	2.7	1.0	0.8
Unemployment Rate %	7.5	9.5	10.0	10.4	11.0	11.5
Current Account %GDP	-0.8	-0.7	-0.5	-0.5	0.0	0.0
United Kingdom						
Real GDP %yr	-1.1	-4.4	2.1	0.9	0.0	0.6
Consumer Prices %yr	3.6	2.2	3.2	4.0	2.2	1.5
Unemployment Rate %	5.6	7.6	7.8	8.3	9.0	9.2
Current Account %GDP	-1.6	-1.3	-2.4	-2.0	-1.8	-1.5

Forecasts finalised 13 February 2012

Interest Rate Forecasts	Latest (Feb 20)	Mar-12	Jun-12	Sep 12	Dec 12	Mar 13
Australia						
Cash	4.25	4.25	4.00	3.75	3.75	3.75
90 Day Bill	4.36	4.35	4.25	4.00	3.75	3.80
10 Year Bond	4.05	4.20	4.40	4.50	4.70	4.90
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.99	2.20	2.40	2.50	2.60	3.10
ECB Repo Rate	1.00	1.00	0.75	0.75	0.75	0.75

Exchange Rate Forecasts		Mar-12	Jun-12	Sep 12	Dec 12	Mar 13
AUD/USD	1.0770	1.05	1.00	1.02	1.04	1.06
USD/JPY	79.07	76	77	78	81	84
EUR/USD	1.3130	1.30	1.23	1.25	1.26	1.28
AUD/NZD	1.2872	1.31	1.32	1.31	1.30	1.29