Australia & New Zealand weekly.

Week beginning 27 February 2017

- Australia: Q4 GDP & partials, Q4 current account & trade balance, private sector credit, dwelling approvals.
- NZ: Feb business confidence, Q4 terms of trade, Q4 building work put in place.
- US: Yellen speaks, Q4 GDP 2nd est, manufacturing surveys, PCE deflator.
- Central banks: Bank of Canada rate decision.
- Key economic & financial forecasts.

Information contained in this report was current as at 24 February 2017

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Australian economy emerging from mid-2016 weakness. 2017 outlook positive

Overview

The Australian National Accounts, to be released on Wednesday March 1, will provide an estimate of economic activity for the December quarter.

In the September quarter, the Australian economy stumbled, contracting by 0.5%. Annual real GDP growth slowed from an above trend 3.1% to 1.8%. Key negatives were: uncertainty around the July Federal election; the impact of tighter lending conditions 2015H2; sluggish employment after a hiring burst / overshoot in 2015; and consumer caution.

In Q4, the economy rebounded, although not sharply in our view, as suggested by a still sluggish labour market. The arithmetic of our Q4 GDP forecast of 0.4% is: domestic demand 0.6%; net exports +0.1ppts; and inventories -0.3ppts. Annual GDP growth edges lower to 1.6%.

Labour market conditions were relatively subdued in the December quarter. Employment was flat, with a fall in full-time offset by a rise in part-time. Against that, hours worked rose, up 0.5%. Underlying wages growth is sluggish, although the national accounts measure has shown a little more strength of late. Also of note, when considering real household incomes, consumer prices increased by 0.5% in the quarter, which is a little stronger than the outcomes recorded this time a year ago.

Domestic demand in the December quarter rebounded by 0.6%, reversing a 0.5% contraction in Q3. In summary: consumer spending strengthened, particularly retail sales; home building activity bounced back from weather disruption; business investment appears to have stabilised, after 12 consecutive declines. Net exports also improved, from a surprise subtraction of 0.2ppts to a small positive of 0.1ppts. Export volumes resumed their upward trend after supply disruptions.

A key risk to our Q4 GDP forecast is around inventories. We assess that there was an involuntary stock run-up in Q3, one which will be corrected in Q4. Private non-farm inventories swing from adding 0.2ppts in Q3 to subtracting a forecast 0.3ppts in Q4. The Business Indictors survey on Monday will reveal this estimate.

Consumer spending is also a risk to our view. It could be that the improvement is a little greater than we have allowed for. Again, the Business Indictors survey will provide some guidance here, publishing an estimate of wage incomes and hence spending power.

On national income, conditions have improved dramatically. The terms of trade jumped an estimated 10% in the December quarter on a spike in commodity prices. Nominal GDP growth is forecast to grow by 2.7% in Q4 alone, lifting annual growth to 5.5%, the strongest since the end of 2011 and in stark contrast to a weak 1.9% increase in 2015. Company profits will benefit most, with a sharp rise to be posted for the December quarter.

As to the estimate of real GDP on an income basis, keep in mind that the sum of nominal measures (such as profits) will need to be discounted by a sizeable deflator. We estimate that the GDP deflator increased by around 2.3% in the quarter.

Looking ahead, our view remains that the economy is likely to emerge from this soft patch. Prospects for 2017 remain constructive, supported by: RBA rate cuts in 2016; with the Federal election behind us; a likely improvement in jobs momentum from the current undershoot (as suggested by our jobs index); the drag from the mining investment downturn waning; commodity prices boosting national income; an improvement in global conditions; and greater optimism in financial markets. We continue to expect real GDP growth of 3.0% for the year to December 2017.

Detail

Household consumption (0.6%): Consumer spending grew by only 1.8% annualised over the June and September quarters, with outcomes of 0.5% and 0.4%. That represented a significant slowing from the 3.1% increase in the year to March. Households reigned in their spending as incomes came under pressure from labour market weakness. For December, spending improved to a forecast increase of 0.6%. Real retail sales rose by 0.86% in the quarter, after a flat Q3. Against that, motor vehicle sales went in to reverse, down more than 1% after edging higher in Q4. As to the risks around this forecast, we see them as tilted to the upside, possibly a gain of 0.7% in Q4.

Dwelling investment (1.3%): Home building activity rebounded, although not sharply, up 1.3% in Q4, reversing the 1.4% dip in Q3 which was in part due to bad weather. New home building advanced, but rates of growth have moderated, with a gain of 0.9%qtr, 6.7%yr in Q4 2016, after a 15% increase in 2014 and a 12% rise in 2015. Renovations are advancing at a solid pace, albeit with some volatility, up 2.2%qtr, 6.8%yr in Q4, consistent with positive fundamentals for the sector.

New business investment (0.3%): Business investment appears to have stabilised in Q4, after a run of 12 consecutive negative quarters, including a 3.2% fall in Q3. Private infrastructure activity did fall further, as the dominant mining investment downturn continues. However, the rate of decline moderated, to a fall of 3.5%, taking the level of work to 23% below that of a year ago.

Commercial building activity was even more volatile than normal over the second half of 2016. An 11.5% drop in Q3, a necessary pull-back given earlier falls in approvals, was followed by a 5% rebound in Q4. Recently, approvals have lifted, led higher by social building projects. Equipment spending was little changed, up 0.4%, with a surprise bounce in mining (the first rise since 2014) offsetting a dip in spending by the service sectors.

Public spending (0.4%): Public demand, 20% of the economy, enjoyed two years of above trend growth, the year to June 2015, +3.4%, and the year to June 2016, +4.3%. However, the 2016/17 year began on a weak note, with a 0.6% decline in Q3. That fall corrected for a 2.8% jump in Q2, the strongest quarterly gain since March 2010, associated with the fiscal stimulus package.

We anticipate only a modest 0.4% rise in public demand in Q4. Investment may have been flat in the quarter, despite the upward trend led by major transport projects. Notably, the Construction survey reported public works down a surprising 1.6% in the quarter. As to consumption, which is around 80% of public demand, it appears that jobs growth in the sector slowed in 2016 after the above par staffing additions in 2015.

Net exports (+0.1ppt): Export earnings increased by around 12% in the quarter, the bulk of which was due to higher prices. Export volumes grew by an estimated 2%, an improvement on a relatively flat Q3, but still not the strong performance we had come to expect. Supply disruptions and bottlenecks, which have contributed to higher commodity prices, are a factor. In Q4, volumes were led higher by iron ore, LNG, rural goods, and services.

As to imports, they trended higher in 2016, including an estimated 1.5% increase in Q4, with gains in services and a surprise rise in capital goods.

Taken together, this implies net exports contributed 0.1ppts to Q4 GDP growth, a turnaround from a 0.2ppts subtraction in Q3. Note, given such sharp swings in export prices a relatively small error on our price / volume split for exports could materially alter the net exports estimate.

Private non–farm inventories (-0.1%, -0.3ppts contribution): Inventories are a key risk to our Q4 GDP forecast. We assess that there was an involuntary run-up in Q3, one which will be corrected in Q4, thereby weighing on output growth.

In Q3, retailers and wholesalers were caught out by weak sales. The upshot, a $1.7bn, 1.8% run-up in inventories. Manufacturing inventories continued their structural decline, down $0.4bn, while elsewhere inventories slipped $0.1bn. Taken together, total inventories rose 0.8% in Q3, after a 0.2% rise in Q2, to be 0.7% above the level of a year ago. Inventories added 0.2ppts to Q3 GDP growth. For Q4, we expect destocking in the retail and wholesale sectors to contribute to a 0.1% decline in total inventories. That implies inventories will subtract 0.3ppts from Q4 GDP growth.

The Business Indicators survey (Monday), the Balance of Payments (Tuesday) and public demand data (Tuesday) will provide further guidance to the risks surrounding our forecast for GDP (published Wednesday).

Andrew Hanlan, Senior Economist

Data wrap

Aus Jan MI-Westpac Leading Index

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index, which indicates the likely pace of economic activity relative to trend three to nine months into the future, fell from 1.36% in December to 1.30% in January.
- This marks the sixth consecutive month where the growth rate in the Index is at or above trend. That followed a period of fifteen consecutive months where the growth rate had been below trend. That sustained period of below trend growth in the series had been pointing to the weakness we have seen in the economy in the September quarter (although no lead indicator could have prepared us for a negative growth print).
- However, the run of six consecutive above or at trend readings is signalling a better outlook for the first half of 2017. In particular, whereas over the September–November period the Index had been losing momentum, albeit still in positive territory, the December and January results represent a very strong rebound.
- Westpac concurs with the forecast of the Reserve Bank of 3% growth through 2017. That growth rate is above trend and consistent with the positive leads from the Index over the last six months.
- Potential complications for this growth rate lie with the Australian dollar. Although the recent strength in the Australian dollar is entirely understandable given the recent surge in commodity prices, the intensity and timing of any boost to spending from the rising terms of trade is always uncertain. On the other hand a higher Australian dollar can be expected to challenge services and manufacturing export growth. For now our forecasts for commodity prices and the Australian dollar envisage that we are near the peaks although we do not expect much correction to commodity prices or the Australian dollar through the remainder of 2017.
- Certainly we have more concerns for growth beyond 2017. Prospects for growth in 2018 look discouraging. Housing construction is likely to be contracting through 2018 while export growth will slow and the terms of trade are likely to be falling, slowing nominal income growth. Prospects for an offsetting boost from household spending and business investment are not encouraging. Eventually, however, a substantial correction to the Australian dollar will provide considerable relief for growth prospects in 2019.
- The Leading Index growth rate has lifted over the last six months from a 0.28% in August to the current 1.30%. Over that period the key drivers of that improvement have been restricted to a narrow group of components. Rising commodity prices (0.82 percentage points); the steepening of the yield curve (0.51 percentage points); average monthly hours worked (0.38 percentage points) and US industrial production (0.01 percentage points).
- On the other hand there was considerable drag from the share market (ASX 200), (–0.29 percentage points); dwelling approvals (–0.25 percentage points); the Westpac – MI Unemployment Expectations index (–0.14 percentage points) and Westpac MI Consumer Sentiment Expectations Index (–0.01 percentage points).
- As discussed above the steepening yield curve signals supportive monetary policy and the commodity prices are boosting incomes through the terms of trade.
- The Reserve Bank Board meets on March 7. Yesterday's Board minutes for the February meeting confirmed the Board's view that the economy is likely to grow by around 3% in 2017 and 2018. The assessment around the outlook for consumption growth was a little more subdued. However buoyant housing markets in both Sydney and Melbourne are continuing to weigh on their considerations. In addition a boost to activity and global confidence has brightened the near term outlook. Inflation is assessed to be gradually moving towards the Bank's target zone while business investment prospects are improving.
- Westpac expects that cash rate will remain on hold through 2017 and 2018.

Aus Q4 construction work

- Construction work stabilised in the December quarter, down 0.2%, after a surprisingly sharp fall in the previous three months, -4.4%, a period disrupted by bad weather.
- The December result, not greatly different from our expectations, -0.8%, does not alter our view on Q4 GDP. We are forecasting GDP growth of 0.4%qtr, 1.5%yr for Q4 after the contraction in Q3, -0.5%qtr, 1.8%yr.
- Construction activity has been trending lower over recent years as mining investment returns to more normal levels. The downturn in mining investment was again evident, with private infrastructure activity contracting by 3.5% in Q4, which was not as weak as we anticipated, -6%.
- The end of the downturn in mining investment is approaching as work on the remaining gas projects under construction is completed progressively over the year ahead. Even so, private infrastructure activity still has a little further to fall. Notably, commencements are around $9.5bn a quarter, some $3bn, or 25% below the current value of work done.
- Private new home building activity bounced back in the December quarter, advancing by 0.9% after a 1.9% decline in September, a result constrained by bad weather. Activity near-term will be supported by earlier strength in approvals, which hit record highs in 2016, and a sizeable work pipeline. Beyond that, a downturn in home building is on the horizon. Approvals fell back in the December quarter, down 15%, led lower by NSW and Qld, coming off high levels.
- Renovation work advanced at a moderate pace, with a 2.2% rise in Q4 to be 7.0% above the level of a year ago and follows a 4.5% increase in 2015. The upswing is consistent with the positive fundamentals for the sector.
- Private commercial building activity was more volatile than normal over the past half year. A 10.8% fall in Q3, a pull-back that which was overdue given earlier falls in approvals, was followed by a 5.1% rebound. Recently, approvals have lifted, led higher by social building projects
- Public works, which have strengthened since mid-2015 as major transport projects get underway, slipped in Q4, down 1.6%. Although, it may be that this figure is revised, as occurred with the estimate for Q3, upgraded to +1.4% from -0.2%.

Data wrap

- By state, the construction story was as expected. Weakness continues in the mining state of WA, -6.3%qtr, -41.5%yr; an emerging stabilisation in Qld after an earlier retreat, -1.5%qtr, -1.7%yr; strength in the south-east, with NSW leading the way, +2.2%qtr, +10.5%yr, and Victoria performing solidly, +2.4%qtr, +5.1%yr.

Aus Q4 wage price index

- Low wage growth continues to reflect excess slack in the labour market.
- Total hourly wages ex bonuses increased 0.5% in Q4 in line with the market's expectation. This is an improvement on the 0.4% in Q3 but is still a very low figure relative to historical standards.
- The annual rate matched last quarter's historical low of 1.9%yr.
- Private sector wages grew 0.4% taking the annual rate to a new low of 1.8%yr. On the other hand, public sector wages grew 0.6% boosted by the health sector. However at 2.3%yr annual growth, it too is at its annual low.
- Low wage growth is contrasted by the fall in the unemployment rate. However, softness in the labour market can be seen in the underemployment rate. Indeed, a near record high underemployment rate coincides with record low wage growth. Constructing a Phillips Curve using wage growth and the underemployment rate, gives us a still higher estimate of 2.5% wage growth based on the underemployment rate of 8.2%.
- Breaking it down by state, WA made a new low to 1.4%yr and remains the state with the lowest wage growth. Qld improved a touch to 2.0%yr with the last two quarters showing a bit of a divergence from WA's steady decline. Tas was the fastest state at 2.4%yr with SA second on 2.2%yr. NSW and Vic came in at 2.1%yr and 1.9%yr respectively, though there continued to be strong construction wage growth in Vic at 2.9%yr.
- The standout industries remained health and education, both posting wage growth of 2.4%yr. Mining remained the weakest industry at 1.0%yr with no signs of the rise in the Terms of Trade being passed through to wage incomes.
- Low wage inflation matches below target core inflation. Whilst this suggests that the effect on household's purchasing power has been partially cushioned by low inflationary pressure in the goods market, it is premature to infer that the wage setting process has been influenced by low core inflation with decelerating wage inflation prevalent for a longer time.

Aus Q4 capex and capex expectations 16/17 & 17/18

- The latest ABS survey of private business CAPEX provided an update for the December quarter 2016 and the 5th estimate of plans for 2016/17, as well as the initial estimate for 2017/18. The survey was conducted during January and into February.
- Notably, the mining investment downturn continues to dominate this survey.
- In the December quarter, total capex spend declined by 2.1%, broadly as we anticipated but below market expectations (mkt median -0.5% and Westpac f/c -2.5%).
- The detail also met our expectations. Building & structures fell by 4.1% and equipment spending was little changed, edging 0.4% higher.
- Mining capex fell sharply in Q4, -9.3%. The non-mining sectors advanced, after declining in Q3, weakness in part due to uncertainty surrounding the July Federal election. Services rose 1.8% in the quarter and manufacturing increased by 3.2%.
- Estimate 5 for 2016/17 is weak, but not as weak as Estimate 4 from three months earlier. Est 5 is $112bn, some 9% below the corresponding estimate a year ago, while Est 4 was down 14%. Upgrades were reported for mining, -27% vs -34%, and services, 6% vs 4%.
- Estimate 1 for 2017/18 is $80.6bn, some 3.9% below the corresponding estimate a year ago. Mining is the source of weakness, with Est 1 on Est 1 at -20%. For services, Est 1 on Est 1 is +8%. However, switching to calculations based on average realisation ratios (RRs) - the method preferred by the official family - the services estimate swings to an implied fall of 3%.
- For policy makers, the upgrade to 2016/17 plans is welcome and suggests that businesses are responding to some positive developments over the past three months. For 2017/18, the investment outlook appears lacklustre and a deal of uncertainty persists. The mining investment downturn while nearing the end still has a little way to run. For services, no real surprise that at this very early stage investment plans are on the soft side.
- Note, the capex survey has its limitations. The survey provides only partial coverage of total business investment, thereby overweighting the importance of the mining sector. Preliminary estimates of capex plans are, by their nature, an inaccurate guide to the ultimate outcome - the extent of the error varies by asset, by industry and from year to year.

Round–up of local data released over the last week

Date	Release	Previous	Actual	Mkt f/c
Wed 22	Jan Westpac–MI Leading Index	1.30%	1.36%	-
	Q4 wage cost index	0.4%	0.5%	0.5%
	Q4 construction work done	-4.9%	-0.2%	0.5%
Thu 23	Q4 private new capital expenditure	-4.0%	-2.1%	-0.5%
	2016/17 capex plans, AUDbn	107	112	-
	2017/18 capex plans, AUDbn	-	80.6	84.8

New Zealand: week ahead & data wrap

In the zone

This week we released our latest *Quarterly Economic Overview*. In broad terms, New Zealand is currently in a sweet spot. The economy has been growing at a steady pace, and we're expecting above-trend GDP growth for the next couple of years. At the same time, inflation is looking very well contained.

We're now entering our seventh year of continued GDP growth. That's one of the longest periods of continued expansion in New Zealand's history. Looking ahead, we expect momentum in activity will be sustained for some time yet, with GDP growth of 3.6% forecast in 2017, and 3.4% in 2018.

Normally at this late stage of the economic cycle, we wouldn't expect to see growth accelerating. However, record levels of net migration mean that the economy's demand base is continuing to swell, with population growth surging to more than 2% per annum. That's a rapid pace for any developed economy. Underlying the strength in migration are New Zealand's relatively stable and positive economic conditions, including the strength of our labour market. This has seen increases in the number of people arriving on work visas. It's also seen more New Zealanders choosing to stay on shore, or come back from overseas (especially from Australia). While net inflows are expected to ease back from the record level reached in 2016, it's likely to remain at elevated levels for some time yet.

Strong population growth is boosting demand for a range of goods and services, and is adding to the demand for housing. But a notable feature of the current migration cycle is that arrivals have been skewed towards working age people. The resulting increase in the labour force is boosting the economy's productive capacity, and has limited pressure on wages in most sectors.

Also helping to sustain the momentum in activity is a large pipeline of construction work, which is heavily centred on Auckland. Strong population growth and low building in previous years have left Auckland with an under-build of around 35,000 homes - that's about 6% of the current housing stock. On top of that, the region's population is expected to grow by around 15% over the next decade. This means we'll need to a protracted period (around 10 years) of strong home building in the region, as well as increases in infrastructure spending. That won't be an easy task, with stains on capacity already emerging with building levels still below the required pace. It's likely that Auckland's housing shortage will get worse before it gets better.

Increasing construction in Auckland and elsewhere is helping to offset changing conditions in Canterbury. Six years on from the devastating February quake, close to two-thirds of planned work is now complete. There's still a lot to get done, and construction levels in the region remain strong. However, construction activity has started to gradually ease back. We've also seen a reorientation of work, with residential construction winding down, while non-residential work continues.

One of the big drags on the economy in recent years was low global dairy prices and the associated weakness in export earnings. However, tighter supply conditions (especially in Europe) and a recovery in Chinese imports saw prices recover last year, and those gains have largely been sustained into 2017. Nevertheless, we don't expect that spending in rural communities will come roaring back just yet, with farmers expected to focus on debt repayment and delayed maintenance. On this front, a majority of Fonterra suppliers took up Fonterra's loan offer in the second half of 2015. They will need to begin making repayments once the milk price hits $6/kgms on the advanced schedule later this year.

There are some clouds on the horizon. Most notably, the global back drop remains a key source of risk, with high levels of uncertainty around the political environments in the US, UK and Europe, and associated concerns for global trade. We've also seen global interest rates rising in response to expectations of increased fiscal spending and tightening of policy from the Fed. Combined with tightness in domestic funding markets, this has seen NZ borrowing rates rising in recent months.

This increase in borrowing rates brings some of the risks around the domestic economy into sharper focus. Household debt levels have risen rapidly in recent years, with much of that leveraged against housing assets, including investment housing. However, the rise in borrowing rates, as well as last year's tightening in lending standards, has seen house price inflation slow, with some further softening expected over the coming year. A moderation in house prices inflation is a welcome development from a financial stability stand point. But at the same time, house prices are a key channel that monetary policy uses to affect activity. And with house price growth having eased off, it implies less of a boost to demand over the coming years. Nevertheless, it's still hard to picture outright declines in house prices given the scale of the housing shortage.

Inflation has now returned to within the Reserve Bank's target range of 1-3%, having spent the previous two years below that. However, there's still a challenge ahead in getting inflation to settle around 2%, which we don't expect to happen until the latter half of 2018. The tradables component of the CPI remains very soft, and with the strengthening of the New Zealand dollar over the last year or so, there's likely to be fresh downward pressure on imported goods prices over the coming year.

That leaves the onus on a pick-up in domestically-generated inflation in order to meet the overall target. And that means monetary policy will need to stay accommodative for quite a while longer, to spur growth in domestic spending and investment. But even with growth at rates that are moderately above trend, the economy doesn't look like it's at risk of significantly overheating, especially given the growth in the labour force. There is certainly little risk of the RBNZ having to act early to head off an overshoot of the inflation target.

Round-up of local data released over the last week

Date	Release	Previous	Actual	Mkt f/c
20 Feb	Jan BusinessNZ PSI	58.5	59.5	–
22 Feb	GlobalDairyTrade auction results	1.3%	–3.2%	–

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

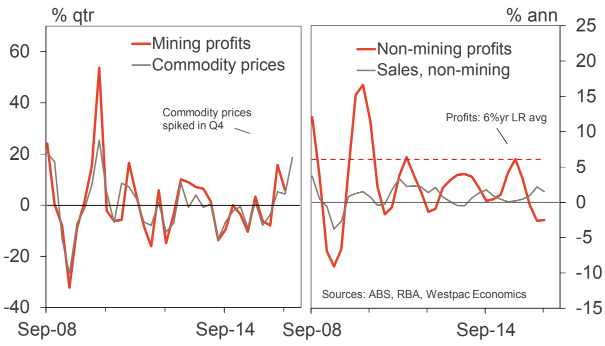
Data previews

Aus Q4 company profits

Feb 27, Last: 1.0%, WBC f/c: 9.5%
Mkt f/c: 8%, Range: 0% to 13%

- In Q3, company profits rose 1.0%, with mining up 5.8% on higher prices and non-mining down 0.7% as output contracted.
- In Q4, profits jumped sharply, up a forecast 9.5%, largely reflecting higher commodity prices. We expect mining profits to spike, +30%, while we anticipate a 1.3% rebound in non-mining profits as the economy emerges from the soft spot of mid-year.
- Note, the BI profit measure is impacted by the accounting treatment of changes in the value of inventories. For Q4, we expect company profits (ex finance) to increase by a still strong 8%.

Company profits: boost from commodities

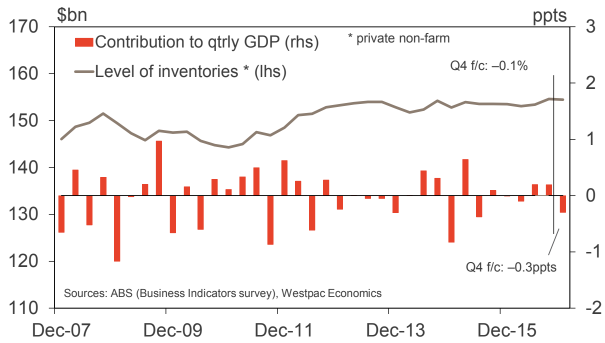


Aus Q4 inventories

Feb 27, Last: 0.8%, WBC f/c: –0.1%
Mkt f/c: 0.5%, Range: -0.1% to 1.0%

- In Q3, retailers and wholesalers were caught out by weak sales. The upshot, a $1.7bn, 1.8% run-up in inventories. Manufacturing inventories continued their structural decline, down $0.4bn, while elsewhere inventories slipped $0.1bn.
- Taken together, total inventories rose 0.8% in Q3, after a 0.2% rise in Q2, to be 0.7% above the level of a year ago. Inventories added 0.2ppts to Q3 GDP growth.
- For Q4, we expect destocking in the retail and wholesale sectors to contribute to a 0.1% decline in total inventories. That implies inventories will subtract 0.3ppts from Q4 GDP growth.
- This is a key judgement contributing to our below consensus Q4 GDP growth forecast of 0.4%qtr.

Inventories Q4 f/c: -0.1%; -0.3ppts cont’n

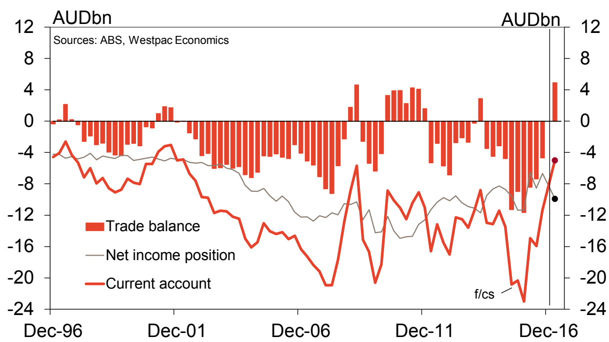


Aus Q4 current account, AUDbn

Feb 28, Last: –11.4, WBC f/c: –5.0
Mkt f/c: –4.0, Range: –2.0 to –9.6

- Australia's current account deficit (CAD) has narrowed markedly as commodity prices bounce sharply off their lows.
- In Q3, the deficit was $11.5bn, moderating from $15.9bn in Q2 and well down from $23bn (5.6% of GDP) at the end of 2015.
- For Q4, we expect the CAD to shrink to $5.0bn. At 1.2% of GDP this will be the smallest deficit since March 1980, associated with the early 1980s recession.
- The trade surplus in Q4 was $4.9bn, a turnaround from a $3.6bn deficit in Q3 (revised from -$4.7bn). There will be some leakage from higher export earnings to foreign owners - although the extent and precise timing is uncertain. We expect the income deficit to increase to $9.9bn from $6.7bn.

Current account: f/c –$5bn in Q4



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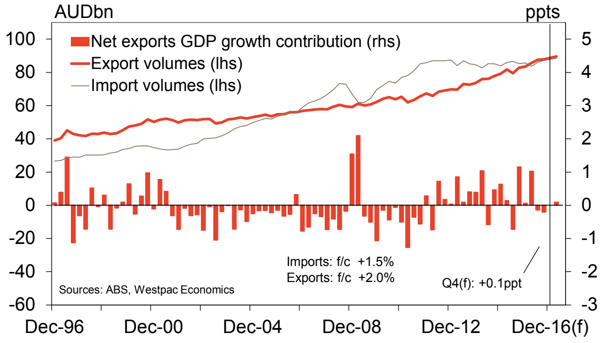
Data previews

Aus Q4 net exports, ppt cont'n

Feb 28, Last: –0.2, WBC f/c: +0.1
Mkt f/c: 0.2, Range: –0.3 to 0.7

- Export earnings rose by about 12% in Q4, while the import bill increased by around 1.5%. We estimate that the terms of trade increased by about 10%, as export prices jumped on higher commodity prices and import prices were broadly flat.
- Real net exports added an estimated 0.1ppts to Q4 GDP growth, following surprise back-to-back subtractions of 0.1 and 0.2.
- Export volumes rose an estimated 2% in Q4, led by iron ore, LNG, rural goods and services. That follows a rise of only 0.3% in Q3 in part due to supply disruptions in the resource sector.
- Import volumes, which trended higher in 2016, rose an estimated 1.5% in Q4, led by services and a surprise bounce in capital goods.

Net exports: f/c +0.1ppt in Q4

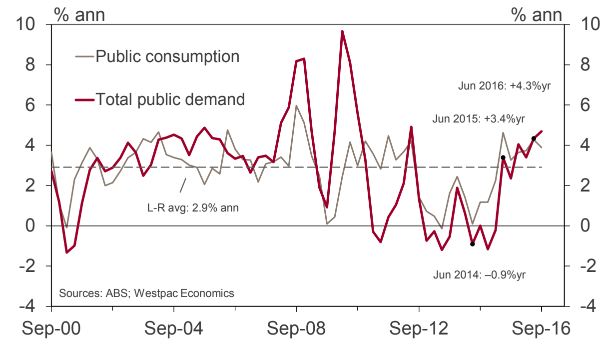


Aus Q4 public demand

Feb 28, Last: –0.6%, WBC f/c: 0.4%

- In Q3, public demand contracted by 0.6%, a correction to a 2.8% jump in Q2, the largest quarterly increase since March 2010, associated with the fiscal stimulus package.
- For Q4, we anticipate only a modest increase of 0.4%.
- Public consumption (around 80% of public demand) is expected to increase by 0.5%. Underlying public sector employment growth appears to have moderated in 2016 following above par staffing additions in 2015.
- Public investment is trending higher, led by transport infrastructure projects. However, we see the risk of a flat Q4, constrained by a surprise 1.6% decline in public construction work *(as reported in the construction survey)*.

Public demand: 2 years of above trend gains

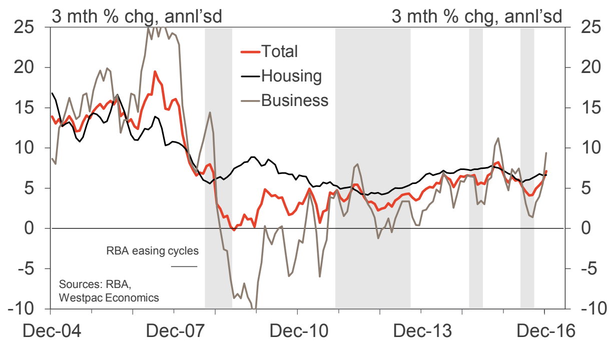


Aus Jan private sector credit

Feb 28, Last: 0.7%, WBC f/c: 0.5%
Mkt f/c: 0.5%, Range: 0.4% to 0.6%

- Credit to the private sector ended the 2016 year on a firmer note, with a gain of 0.7% in December. The result included a 1.1% jump in business credit, an outcome that is likely to be a one-off.
- For January, we anticipate a moderate 0.5% gain in total credit.
- Housing credit growth is robust, supported by RBA rate cuts in 2016. Expect a January result in line with that for December, at around 0.55%, or 6.8% annualised.
- In 2016, business credit grew by 5.6%, in what was a stop-start performance. Credit to businesses stalled around the July Federal election and then rose 2.3% in the December quarter as commercial finance rebounded. For January, we anticipate a 0.4% gain, mindful that finance eased back last month.

Credit: momentum shift



Data previews

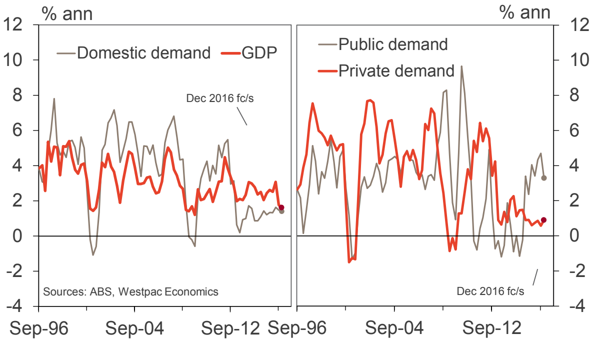
Aus Q4 GDP

Mar 1, Last: -0.5%qtr, 1.8%yr, WBC f/c: 0.4%qtr, 1.6%yr
Mkt f/c: 0.7%qtr, Range: 0.4%qtr to 1.0%qtr

- In Q3, the Australian economy stumbled, contracting by 0.5%, with annual growth slowing from an above trend 3.1% to 1.8%. Uncertainty around the July Federal election, a number of one-offs and sluggish consumer spending against the backdrop of weak jobs growth were key factors.
- In Q4, the economy rebounded, although not sharply in our view, as suggested by a still sluggish labour market.
- The arithmetic of our Q4 GDP forecast of 0.4% is: domestic demand 0.6%; net exports +0.1ppts; and inventories -0.3ppts. In Q4, consumer spending improved, home building activity rebounded from weather disruptions and business investment stabilised after a string of negatives.

  For further detail, see our GDP preview on page 2.

Australian economic conditions

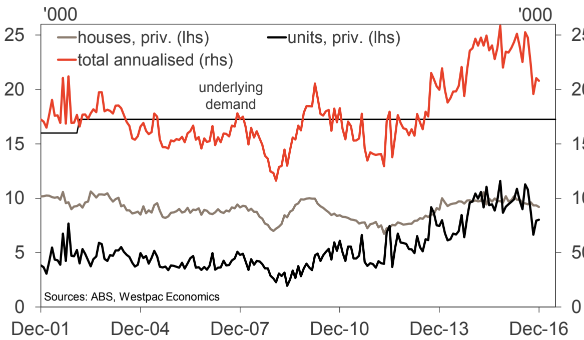


Aus Jan dwelling approvals

Mar 2 Last: –1.2%, WBC f/c: –1.0%
Mkt f/c: -0.5%, Range: -5.0% to 5.0%

- Dwelling approvals posted a slight 1.2% decline in Dec following a 7.5% gain in Nov that was a partial rebound from a sharp 23% drop over the previous 3mths. That earlier move marked the first definitive sign that Australia's high-rise driven building boom was starting to turn down. The Nov bounce and Dec stabilisation scales back the pace of the decline but leaves the downtrend intact – trend approvals are now down 13%yr. While the high-rise story is tracking our expectations, weaker than expected non high rise approvals are an area to watch.
- The Jan update is expected to see a further 1% decline, essentially reconfirming the downtrend over the second half of 2016. That said, the data is prone to wild swings in Jan due to difficulties adjusting for the summer low season – raw figures are marked up 25-30% in the month, hence regular monthly 'noise' tends to be amplified.

Dwelling approvals

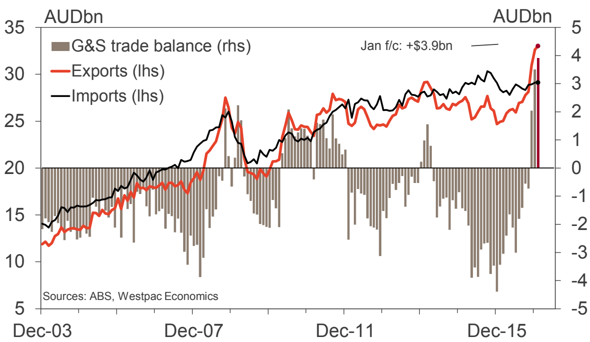


Aus Jan trade balance, AUDbn

Mar 2, Last: +3.5, WBC f/c: +3.9
Mkt f/c: +3.8, Range: +0.5 to +5.0

- Australia's trade account has moved well into surplus as a spike in commodity prices boosts export earnings.
- In December, the surplus widened to $3.5bn from $2.0bn. For January, we expect a surplus of $3.9bn.
- Export earnings are forecast to rise by 1.2%, +$0.4bn, on higher prices (coal and rural goods) and volumes (iron ore and LNG), partially offset by a pull-back in gold.
- Imports are expected to be flat, with a slightly firmer dollar placing downward pressure on prices.
- *NOTE: Since January 2016, there is additional uncertainty around the import and trade forecast. The ABS no longer publishes customs goods imports ahead of the trade release.*

Australia's trade surplus: approaching $4bn



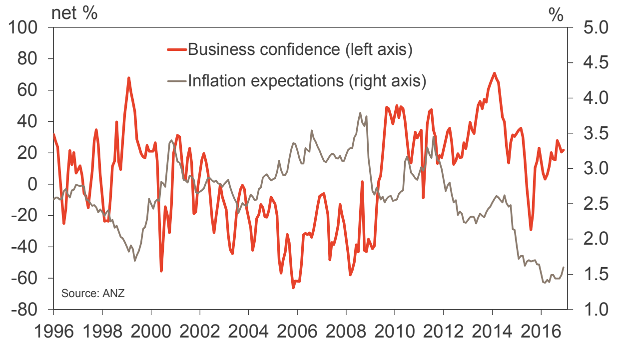
Data previews

NZ Feb business confidence

Feb 28, Last: 21.7

- The last survey back in December showed that firms finished 2016 on a chipper note, indicative of continued strong growth through the final quarter of the year.
- This month's survey will provide a vital update on how the economy has fared thus far this year. Against a backdrop of strong population growth, a large pipeline of construction and an improved outlook for the dairy sector, conditions should have remained favourable. However, tighter credit conditions and some cooling in the housing market may weigh on growth.
- Last month, both inflation expectations and pricing intentions recorded notable increases. Whether we see further strong gains is important for the path of inflation from here. While it's clear inflation has risen from its trough, we expect the rise back to 2% to be only gradual.

NZ business confidence and inflation expectations

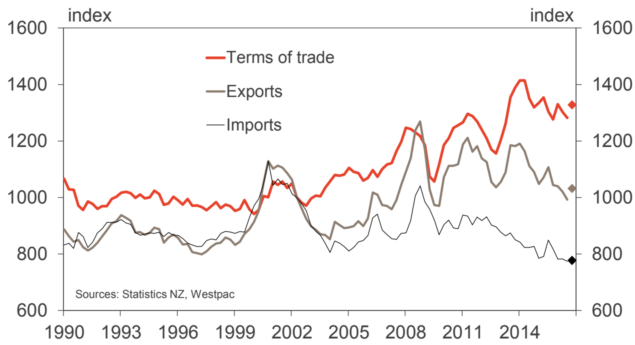


NZ Q4 terms of trade

Mar 1, Last: -1.7%, WBC f/c +3.7%

- The terms of trade is estimated to have risen 3.7% in the December quarter, unwinding the decline seen over the previous six months.
- The expected improvement is driven by an estimated 4.1% rise in export prices. Global dairy prices turned a corner in the second half of last year rising more than 50%, and these price gains began translating into export receipts in the December quarter. Export prices of other commodities, including meat and forestry, also look to have strengthened.
- Import prices are estimated to have risen a modest 0.4%, as a rise in fuel import prices looks to have been partly offset by lingering softness in global inflation and further strengthening in the NZ dollar which is helping to keep imported inflation contained.

NZ Terms of Trade

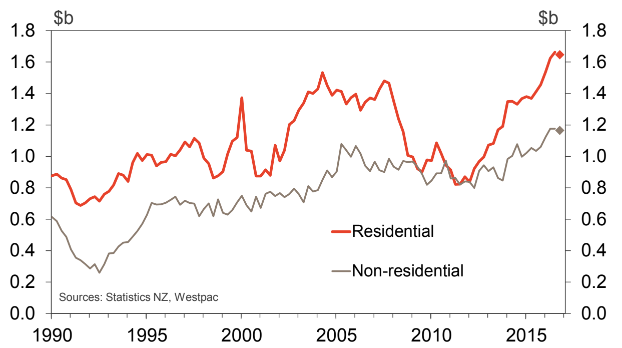


NZ Q4 building work put in place

Mar 3, Last: 1.4%, Westpac f/c: -1.0%

- We expect that nationwide construction levels declined by 1.0% in the December quarter. That follows strong growth earlier in 2016, and will still leave construction activity up more than 13% over the year.
- Aggregate building figures are masking stark regional differences. Softness in the December quarter is expected to be centred on Wellington and parts of the South Island that were affected by Kaikoura earthquake. This is an area of downside risk to our forecast. We're also seeing building levels in Canterbury easing back as residential repairs have been completed. Balanced against those trends, building activity remains strong in Auckland, though capacity constraints and regulatory changes may mean that we only see gradual increases in building through late 2016 and early 2017.

NZ real building work put in place



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Key data & event risk for the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 27					
Aus	Q4 company profits	1.0%	8.0%	9.5%	Profits up sharply, largely on higher commodity prices. See textbox.
	Q4 inventories	0.8%	0.5%	–0.1%	Destocking after unintended build-up. –0.3ppts impact on Q4 growth.
NZ	Jan net migration	6010	-	5900	Departures of New Zealanders still low, arrivals strong.
Eur	Jan M3 money supply %yr	5.0%	–	–	Credit data also due.
	Feb economic confidence	107.9	–	–	Confidence at elevated levels...
	Feb consumer confidence (final)	-6.2	–	–	.... amongst households...
	Feb business climate indicator	0.77	–	–	and firms.
US	Jan durable goods orders (provisional)	-0.5%	1.6%	–	Investment growth to firm (a little) in coming months.
	Jan pending home sales	1.6%	0.9%	–	Existing home market likely to slow in 2017.
	Feb Dallas Fed manufacturing survey	22.1	20.0	–	Manufacturing outlook has firmed. Strong gains in recent months.
	Fedspeak	-	-	-	Kaplan in Oklahoma.
Tue 28					
Aus	Q4 current account balance, AUDbn	–11.4	-4.0	–5.0	Smallest deficit since 1980. Export earnings boosted by higher prices.
	Q4 net exports, ppts cont'n	–0.2	+0.2	+0.1	Export vols +2% after flat Q3. Imports trend higher, +1.5%. See textbox.
	Q4 public demand	–0.6%	–	0.4%	A modest increase. Investment flat, defying uptrend. See textbox.
	Jan private sector credit	0.7%	0.5%	0.5%	Moderate gain. Dec boosted by oversized increase in business.
NZ	Jan trade balance, $m	-41	-150	20	Exports bolstered by higher dairy prices and recovery in meat exports.
	Feb ANZ business confidence	21.7	-	-	Ended 2016 on positive note; gauge of momentum in early 2017.
Jpn	Jan industrial production	0.7%	0.4%	-	Trending up since mid-2016. 4% gain Aug to Dec 2016.
Eur	Feb CPI %yr	1.8%	–	-	Underlying inflation stubbornly weak.
US	Q4 GDP (annualised, 2nd est.)	1.9%	2.1%	-	First estimated disappointed; slight upward revision likely.
	Jan wholesale inventories	1.0%	0.4%	-	Uncertain outlook argues against inventory accrual.
	Dec S&P/C-S 20 city house prices	0.9%	0.7%	-	Price growth to moderate.
	Feb Chicago PMI	50.3	53.0	-	Weaker than other indicators of the US manufacturing sector.
	Feb consumer confidence index	111.8	111.0	-	Strength has been centred on current conditions.
	Feb Richmond Fed index	12	10	-	Positive state of mind apparent.
Wed 1					
Aus	Q4 GDP	–0.5%	0.7%	0.4%	Economy emerging from soft-spot. Domestic demand rebounds.
	Q4 GDP, annual growth	1.8%	1.9%	1.6%	Annual growth has slowed from an above trend 3.1% in June.
	Feb CoreLogic home value index	0.7%	–	0.7%	Solid start to 2017. Feb to see annual price growth tip just over 10%.
	Feb AiG PMI	51.2	–	–	Jan, down 4.2pts. Manufn'g boosted by housing & lower AUD.
NZ	Q4 terms of trade	-1.7%	–	3.7%	Boosted by higher dairy prices, while import prices remain subdued.
Jpn	Feb Nikkei manufacturing PMI	53.5	–	-	Flash estimate showed index at 3 year high.
Chn	Feb non-manufacturing PMI	54.6	–	-	Uptrend has continued for services...
	Feb manufacturing PMI	51.3	51.1	-	... manufacturing edged back, but still near long-run average.
	Feb Caixin China PMI	51.0	50.7	-	Larger fall in Caixin likely suggests external demand softened.
Eur	Feb Markit manufacturing PMI - final	55.5	–	-	Flash showed more gains after it improved further in January...
Ger	Feb Markit manufacturing PMI	57.0	–	-	... with region led by Germany.
	Feb CPI (provisional)	-0.6%	–	-	Currently tracking at 1.9%yr.
UK	Feb Markit manufacturing PMI (final)	55.9	56.0	-	Post-referendum fall in GBP is supporting manufacturing.
	Jan mortgage approvals	67.9k	68.8k	-	Low borrowing rates supporting housing demand.
US	Jan personal income	0.3%	0.3%	-	Increased 3.5%yr in 2016 compared to 4.4%yr in 2015.
	Jan personal spending	0.5%	0.3%	-	Domestic demand has been stronger with confidence up.
	Jan PCE deflator	0.2%	0.5%	-	Market expects Fed preferred core measure to push up to 1.8%yr.
	Feb Markit manufacturing PMI (final)	54.3	-	-	Flash estimate indicates a slight reversal from recent gains.
	Feb ISM manufacturing	56.0	56.0	-	Currently quite strong and in line with other manufacturing surveys.
	Jan construction spending	-0.2%	0.7%	-	Surprise contraction in Dec with soft result from the public sector.
	Fedspeak	-	-	-	Williams in Santa Cruz, Bullard in Washington, Kaplan in Dallas.
	Federal Reserve Beige Book	-	-	-	Economic commentary from the regional Feds.
Can	Bank of Canada rate decision	0.50%	0.50%	0.50%	Inflation pressures remain benign, growth moderate.

Key data & event risk for the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Thu 2					
Aus	Jan dwelling approvals	–1.2%	-0.5%	–1.0%	Downturn emerged in 2016 H2. Jan data less reliable due to seasonality.
	Jan trade balance, AUDbn	3.5	3.8	3.9	Surplus widens further. Exports +2% (prices & vols), imports flat.
Eur	Jan unemployment rate	9.6%	–	-	Maintaining momentum. Dropped 0.8% in 2016.
US	Initial jobless claims	244k	–	-	Remains at very low levels.
Can	Q4 GDP (annualised)	3.5%	2.0%	-	Business gauges have improved, drag from oil prices has educed.
Fri 3					
Aus	Feb AiG PSI	54.5	–	–	Jan, down 3.2pts. Services a strong showing at turn of year.
NZ	Q4 building work put in place	1.4%	-	-1%	Earthquake disruptions and Canterbury rebuild winding down.
Jpn	Jan job to applicant ratio	1.43	1.44	-	Lower working age population causing labour market tightness.
	Jan household spending	–0.3%	0.3%	-	Continues to fall, though Dec was smallest fall in string of 10 declines.
	Jan National CPI %yr	0.3%	0.3%	-	Very low and no sign of wage pressures. Core CPI in deflation.
	Feb Tokyo CPI %yr	0.1%	-0.1%	-	Weakness in clothes and footwear.
	Feb Nikkei Japan PMI Services	51.9	–	-	Slight drop in January from 11 month Dec high of 52.3.
Chn	Feb Caixin China PMI services	53.1	–	-	Eased back in January, in contrast to modest gain for NBS measure.
Eur	Feb Markit services PMI (final)	55.6	–	-	Unchanged in January at solid level.
Ger	Feb Markit services PMI (final)	54.4	–	-	Germany surprised to the downside, despite strong economy.
UK	Feb Markit services PMI (final)	54.5	54.0	-	Has picked up, still at moderate levels.
US	Feb Markit services PMI (final)	53.9	-	-	A little softer than ISM measure, but still a robust level.
	Feb ISM non-manufacturing	56.5	55.4	-	Has seen strong readings in recent months, though jobs lagging.
	Fed Chair Yellen	-	-	-	Speaking at Executives Club of Chicago event.
	Fedspeak	-	-	-	Fischer, Evans and Lacker speaking at monetary policy forum.
	Fedspeak	-	-	-	Mester speaking on leadership in New York.

Economic & financial forecasts

Interest rate forecasts

	Latest (24 Feb)	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.78	1.80	1.80	1.80	1.80	1.80	1.80	1.80
3 Year Swap	2.10	2.10	2.20	2.35	2.50	2.40	2.30	2.30
10 Year Bond	2.73	2.95	2.95	3.00	3.05	3.15	3.25	3.40
10 Year Spread to US (bps)	36	30	30	25	20	15	15	10
International								
Fed Funds	0.625	0.625	0.875	0.875	1.125	1.125	1.375	1.375
US 10 Year Bond	2.37	2.55	2.65	2.75	2.85	3.00	3.10	3.30
US Fed balance sheet USDtrn	4.51	4.50	4.50	4.50	4.50	4.50	4.50	4.50
ECB Deposit Rate	0.00	–0.40	–0.40	–0.40	–0.40	–0.40	–0.40	–0.40
New Zealand								
Cash	1.75	1.75	1.75	1.75	1.75	1.75	1.75	1.75
90 day bill	1.99	2.00	2.00	2.00	2.00	2.00	2.00	2.00
2 year swap	2.32	2.40	2.50	2.50	2.50	2.50	2.50	2.50
10 Year Bond	3.23	3.30	3.45	3.50	3.60	3.65	3.75	3.90
10 Year spread to US	86	75	80	75	75	65	65	60

Exchange rate forecasts

	Latest (24 Feb)	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Jun 18	Sep 18
AUD/USD	0.7716	0.74	0.74	0.73	0.72	0.70	0.70	0.68
NZD/USD	0.7222	0.71	0.70	0.68	0.67	0.65	0.66	0.65
USD/JPY	112.72	116	118	118	120	122	124	126
EUR/USD	1.0584	1.05	1.03	1.01	1.00	1.00	0.99	0.98
AUD/NZD	1.0684	1.04	1.06	1.07	1.08	1.07	1.06	1.05

Australian economic growth forecasts

	2015	2016				2017		Calendar years			
	Q4	Q1	Q2	Q3	Q4f	Q1f	Q2f	2015	2016f	2017f	2018f
GDP % qtr / yr avg	0.6	1.0	0.6	–0.5	0.4	0.7	0.8	2.4	2.2	2.1	2.8
% yr	2.6	2.5	3.1	1.8	1.6	1.3	1.5	2.6	1.6	3.0	2.6
Unemployment rate %	5.8	5.8	5.7	5.7	5.5	5.6	5.6	5.8	5.5	5.5	5.4
CPI % qtr	0.4	–0.2	0.4	0.7	0.5	0.6	0.2	–	–	–	–
% yr	1.7	1.3	1.0	1.3	1.5	2.3	2.1	1.7	1.5	1.8	2.3
CPI underlying % qtr	0.5	0.2	0.5	0.4	0.4	0.6	0.4	–	–	–	–
% yr	2.1	1.6	1.6	1.5	1.6	1.9	1.8	2.0	1.6	1.8	2.4

New Zealand economic growth forecasts

	2016				2017			Calendar years			
	Q1	Q2	Q3	Q4f	Q1f	Q2f	Q3f	2015	2016f	2017f	2018f
GDP % qtr	0.7	0.7	1.1	0.9	0.9	0.7	1.1	–	–	–	–
Annual avg change	2.4	2.7	3.0	3.3	3.5	3.5	3.6	2.5	3.3	3.6	3.4
Unemployment rate %	5.2	5.0	4.9	5.2	4.8	4.6	4.4	4.9	5.2	4.4	4.3
CPI % qtr	0.2	0.4	0.3	0.4	0.5	0.2	0.4	–	–	–	–
Annual change	0.4	0.4	0.4	1.3	1.7	1.5	1.6	0.1	1.3	1.5	2.1

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