Flashnote

HSBC Global Research

Macro
New Zealand Economics

The RBNZ Observer

Comfortably on hold

- **CPI inflation fell to just +1.0 y-o-y in Q3, which is the bottom edge of the RBNZ's target band**
- **At the same time, activity indicators continue to paint a picture of robust economic growth at an above-trend pace**
- **Given this plumb position, we see the RBNZ remaining on hold next week, but we still see further rate hikes in H2 2015, as we expect inflation to pick up from here**

Low inflation could prompt a more dovish outlook

The RBNZ will no doubt head into the end of 2014 feeling rather pleased. Having delivered 100bp of hikes between March and July, it has taken some of the steam out of the economy; however, at the same time, activity has not slowed dramatically. House price inflation has eased to a much more comfortable pace and inflation remains low.

Indeed, inflation has continued to undershoot expectations. At just +1.0% y-o-y in Q3, inflation was well below the RBNZ's forecast, published in September, of +1.3% y-o-y. The set of forecasts published next week will, therefore, have a lower starting point for inflation and is, therefore, likely to look more dovish than the previous set – perhaps significantly so.

In September, the RBNZ's published 90-day rate forecasts implied that it expected the next hike would come in H1 2015. With a lower inflation outlook, this hike is likely to be pushed out by a quarter or two at least, in our view.

Given continued low inflation, we believe it is reasonable to ask whether the RBNZ was perhaps too aggressive in lifting the cash rate four times in a row. Certainly doing so was a risk, given the uncertainty over what impact higher interest rates would have on the economy. However, it does appear to have left the economy is a plumb position of high growth and low inflation, at least for now. It is also fair to say that the central bank is ahead of the game, which often means it may not have to tighten policy as much in future to keep inflationary pressures under control.

Looking ahead, we expect that over 2015 the lower NZD will put upward pressure on tradable inflation and continued growth in the domestic economy will push non-tradable inflation higher. With the cash rate still well below neutral, rates will most likely have to rise further at some point, in our view. We have two 25bp hikes pencilled in over H2 2015 and another two 25bp of hikes pencilled in for 2016.

5 December 2014

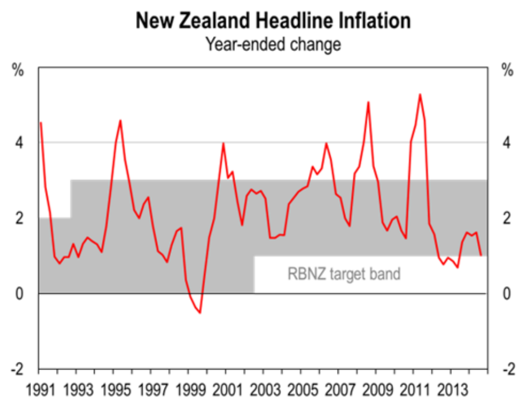
Paul Bloxham
Chief Economist, Australia and New Zealand
HSBC Bank Australia Limited
+61 2 9255 2635
paulbloxham@hsbc.com.au

Daniel Smith
Economist, Australia and New Zealand
HSBC Bank Australia Limited
+61 2 9006 5729
daniel.john.smith@hsbc.com.au

View HSBC Global Research at:
http://www.research.hsbc.com

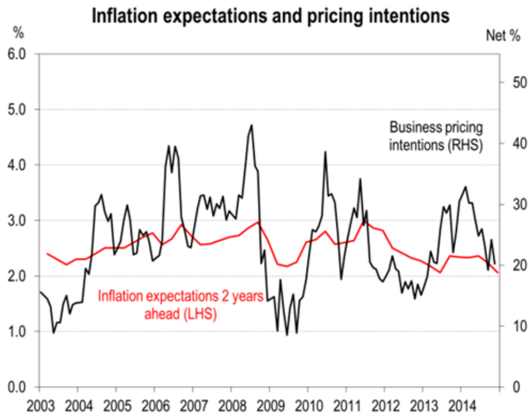
Issuer of report: HSBC Bank Australia Limited

1. Inflation now at the bottom of the RBNZ's target band



Source: Statistics New Zealand

2. Pricing intentions and inflation expectations have fallen



Source: Thomson Reuters Datastream, RBNZ

Inflation still undershooting

In the September Monetary Policy Statement, the RBNZ lowered its inflation outlook due to a reassessment of how economic growth was feeding through into inflation. The Q3 CPI print, released in November, proved to be even weaker than the September forecasts had predicted, with annual inflation falling to the bottom of the target band at just +1.0% versus the RBNZ's forecast of +1.3% (Chart 1).

Near-term inflation indicators such as the proportion of businesses planning to raise prices remain fairly subdued. Inflation expectations also fallen over recent quarters (Chart 2). The labour market also appears to retain sufficient slack to keep wage growth restrained for now.

However, we expect inflation will rise gradually over 2015. As we set out in recent research, we expect the lower NZD to push tradable inflation up. We also expect continued growth in the economy to erode what spare capacity remains, giving rise to greater price pressures in the non-tradable sectors. For a more detailed discussion see Bloxham and Smith (2014) *New Zealand digest: The 'lowflation' conundrum*, 26 November. With inflation likely to rise from here, we expect the RBNZ to retain a tightening bias.

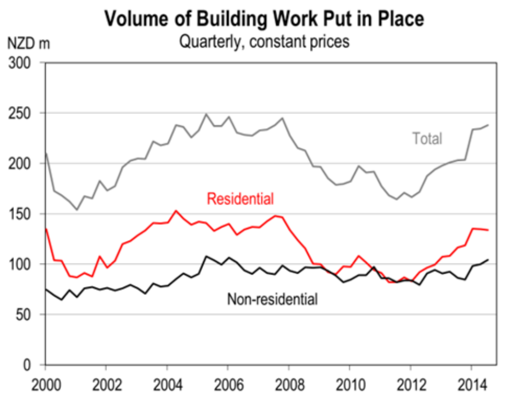
3. Labour cost growth remains well contained

Source: Statistics New Zealand

4. Confidence has fallen but still implies above trend growth

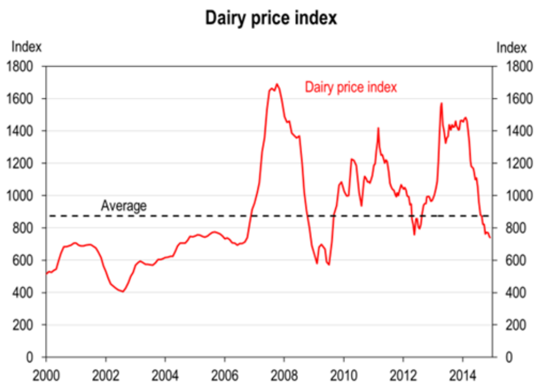
Source: Statistics New Zealand

5. Commercial construction is driving building growth



Source: Statistics New Zealand

6. Dairy prices have fallen to low levels



Source: GlobalDairyTrade

Growth is still running above its trend

New Zealand remains on course to be one of the fastest growing OECD economies in 2014. Most activity indicators have moderated since earlier in the year but remain at high levels overall (Chart 4). Retail sales rose by slightly more than expected in Q3, while construction activity has continued to rise.

There has been some evidence over recent months that growth in residential construction is slowing, but commercial construction is accelerating, mostly in Canterbury (Chart 5). Residential repair work is slowing, but many of the major commercial projects are starting to get underway. Commercial construction is likely to be a major driver of growth over 2015. We see the Canterbury rebuild continuing to support GDP growth in 2015.

The major risk to GDP growth is a further fall in dairy prices, which could further constrain income growth (Chart 6). We do expect dairy prices to recover some ground over coming months as Chinese dairy inventories are run down. At current levels, Chinese dairy imports look unsustainably low and, as they pick up, prices should get some support. The lower NZD will also help partly offset the impact of lower dairy prices on national income growth. Nevertheless, the current farm-gate milk price forecast for 2014/15 of NZD5.30 per kg of milk solids looks increasingly optimistic and is likely to be revised next week.

7. HSBC's main forecasts for New Zealand

	Year-average (%)				Year-ended (%)						
	2013	**2014f**	**2015f**	**2016f**	**Q214**	**Q314f**	**Q414f**	**Q115f**	**Q215f**	**Q315f**	**Q415f**
GDP	2.8	3.5	3.0	2.8	3.9	3.4	3.2	2.9	3.0	3.2	3.1
CPI	1.1	1.4	1.8	2.0	1.6	1.0	1.3	1.6	1.8	1.9	2.0
Unemployment rate	6.2	5.7	5.2	4.8	5.6	5.6	5.5	5.4	5.3	5.2	5.0
NZD/USD ^	0.83	0.77	0.75	0.75	0.85	0.86	0.77	0.76	0.75	0.75	0.75
Cash rate^	2.50	3.50	4.00	4.50	3.25	3.50	3.50	3.50	3.50	3.75	4.00
Market Pricing											
OIS Implied^	NA	3.51	3.70	NA	NA	NA	3.51	3.52	3.54	3.60	3.70

Source: HSBC forecasts. ^end-period

Disclosure appendix

Analyst Certification

The following analyst(s), economist(s), and/or strategist(s) who is(are) primarily responsible for this report, certifies(y) that the opinion(s) on the subject security(ies) or issuer(s) and/or any other views or forecasts expressed herein accurately reflect their personal view(s) and that no part of their compensation was, is or will be directly or indirectly related to the specific recommendation(s) or views contained in this research report: Paul Bloxham and Daniel Smith

Important Disclosures

This document has been prepared and is being distributed by the Research Department of HSBC and is intended solely for the clients of HSBC and is not for publication to other persons, whether through the press or by other means.

This document is for information purposes only and it should not be regarded as an offer to sell or as a solicitation of an offer to buy the securities or other investment products mentioned in it and/or to participate in any trading strategy. Advice in this document is general and should not be construed as personal advice, given it has been prepared without taking account of the objectives, financial situation or needs of any particular investor. Accordingly, investors should, before acting on the advice, consider the appropriateness of the advice, having regard to their objectives, financial situation and needs. If necessary, seek professional investment and tax advice.

Certain investment products mentioned in this document may not be eligible for sale in some states or countries, and they may not be suitable for all types of investors. Investors should consult with their HSBC representative regarding the suitability of the investment products mentioned in this document and take into account their specific investment objectives, financial situation or particular needs before making a commitment to purchase investment products.

The value of and the income produced by the investment products mentioned in this document may fluctuate, so that an investor may get back less than originally invested. Certain high-volatility investments can be subject to sudden and large falls in value that could equal or exceed the amount invested. Value and income from investment products may be adversely affected by exchange rates, interest rates, or other factors. Past performance of a particular investment product is not indicative of future results.

HSBC and its affiliates will from time to time sell to and buy from customers the securities/instruments (including derivatives) of companies covered in HSBC Research on a principal or agency basis.

Analysts, economists, and strategists are paid in part by reference to the profitability of HSBC which includes investment banking revenues.

Whether, or in what time frame, an update of this analysis will be published is not determined in advance.

For disclosures in respect of any company mentioned in this report, please see the most recently published report on that company available at www.hsbcnet.com/research.

Additional disclosures

1 This report is dated as at 05 December 2014.
2 All market data included in this report are dated as at close 04 December 2014, unless otherwise indicated in the report.
3 HSBC has procedures in place to identify and manage any potential conflicts of interest that arise in connection with its Research business. HSBC's analysts and its other staff who are involved in the preparation and dissemination of Research operate and have a management reporting line independent of HSBC's Investment Banking business. Information Barrier procedures are in place between the Investment Banking and Research businesses to ensure that any confidential and/or price sensitive information is handled in an appropriate manner.

HSBC

Disclaimer

** Legal entities as at 30 May 2014*
'UAE' HSBC Bank Middle East Limited, Dubai; 'HK' The Hongkong and Shanghai Banking Corporation Limited, Hong Kong; 'TW' HSBC Securities (Taiwan) Corporation Limited; 'CA' HSBC Bank Canada, Toronto; HSBC Bank, Paris Branch; HSBC France; 'DE' HSBC Trinkaus & Burkhardt AG, Düsseldorf; 000 HSBC Bank (RR), Moscow; 'IN' HSBC Securities and Capital Markets (India) Private Limited, Mumbai; 'JP' HSBC Securities (Japan) Limited, Tokyo; 'EG' HSBC Securities Egypt SAE, Cairo; 'CN' HSBC Investment Bank Asia Limited, Beijing Representative Office; The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch; The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch; HSBC Securities (South Africa) (Pty) Ltd, Johannesburg; HSBC Bank plc, London, Madrid, Milan, Stockholm, Tel Aviv; 'US' HSBC Securities (USA) Inc, New York; HSBC Yatirim Menkul Degerler AS, Istanbul; HSBC México, SA, Institución de Banca Múltiple, Grupo Financiero HSBC; HSBC Bank Brasil SA – Banco Múltiplo; HSBC Bank Australia Limited; HSBC Bank Argentina SA; HSBC Saudi Arabia Limited; The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR; The Hongkong and Shanghai Banking Corporation Limited, Bangkok Branch

Issuer of report
HSBC Bank Australia Limited
Level 32
HSBC Centre
580 George Street
Sydney, NSW 2000, Australia
Telephone: +61 2 9006 5888
Fax: +61 2 9255 2205
Website: www.research.hsbc.com

In Australia, this publication has been distributed by The Hongkong and Shanghai Banking Corporation Limited (ABN 65 117 925 970, AFSL 301737) for the general information of its "wholesale" customers (as defined in the Corporations Act 2001). Where distributed to retail customers, this research is distributed by HSBC Bank Australia Limited (AFSL No. 232595). These respective entities make no representations that the products or services mentioned in this document are available to persons in Australia or are necessarily suitable for any particular person or appropriate in accordance with local law. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. This material is distributed in the United Kingdom by HSBC Bank plc. In the UK this material may only be distributed to institutional and professional customers and is not intended for private customers. Any recommendations contained in it are intended for the professional investors to whom it is distributed. This publication is distributed in New Zealand by The Hongkong and Shanghai Banking Corporation Limited, New Zealand Branch incorporated in Hong Kong SAR. This material is distributed in Japan by HSBC Securities (Japan) Limited. This material may be distributed in the United States solely to "major US institutional investors" (as defined in Rule 15a-6 of the US Securities Exchange Act of 1934); such recipients should note that any transactions effected on their behalf will be undertaken through HSBC Securities (USA) Inc. in the United States. Note, however, that HSBC Securities (USA) Inc. is not distributing this report, has not contributed to or participated in its preparation, and does not take responsibility for its contents. In Singapore, this publication is distributed by The Hongkong and Shanghai Banking Corporation Limited, Singapore Branch for the general information of institutional investors or other persons specified in Sections 274 and 304 of the Securities and Futures Act (Chapter 289) ("SFA") and accredited investors and other persons in accordance with the conditions specified in Sections 275 and 305 of the SFA. This publication is not a prospectus as defined in the SFA. It may not be further distributed in whole or in part for any purpose. In Korea, this publication is distributed by either The Hongkong and Shanghai Banking Corporation Limited, Seoul Securities Branch ("HBAP SLS") or The Hongkong and Shanghai Banking Corporation Limited, Seoul Branch ("HBAP SEL") for the general information of professional investors specified in Article 9 of the Financial Investment Services and Capital Markets Act ("FSCMA"). This publication is not a prospectus as defined in the FSCMA. It may not be further distributed in whole or in part for any purpose. Both HBAP SLS and HBAP SEL are regulated by the Financial Services Commission and the Financial Supervisory Service of Korea. The Hongkong and Shanghai Banking Corporation Limited Singapore Branch is regulated by the Monetary Authority of Singapore. Recipients in Singapore should contact a "Hongkong and Shanghai Banking Corporation Limited, Singapore Branch" representative in respect of any matters arising from, or in connection with this report. HSBC México, S.A., Institución de Banca Múltiple, Grupo Financiero HSBC is authorized and regulated by Secretaría de Hacienda y Crédito Público and Comisión Nacional Bancaria y de Valores (CNBV). HSBC Bank (Panama) S.A. is regulated by Superintendencia de Bancos de Panama. Banco HSBC Honduras S.A. is regulated by Comisión Nacional de Bancos y Seguros (CNBS). Banco HSBC Salvadoreño, S.A. is regulated by Superintendencia del Sistema Financiero (SSF). HSBC Colombia S.A. is regulated by Superintendencia Financiera de Colombia. Banco HSBC Costa Rica S.A. is supervised by Superintendencia General de Entidades Financieras (SUGEF). Banistmo Nicaragua, S.A. is authorized and regulated by Superintendencia de Bancos y de Otras Instituciones Financieras (SIBOIF).

This material is not and should not be construed as an offer to sell or the solicitation of an offer to purchase or subscribe for any investment. This document has been prepared without taking account of the objectives, financial situation or needs of any specific person who may receive this document. Any such person should, before acting on the information in this document, consider the appropriateness of the information, having regard to the personal objectives, financial situation and needs. In all cases, anyone proposing to rely on or use the information in this document should independently verify and check its accuracy, completeness, reliability and suitability and should obtain independent and specific advice from appropriate professionals or experts. HSBC has based this document on information obtained from sources it believes to be reliable but which it has not independently verified; HSBC makes no guarantee, representation or warranty and accepts no responsibility or liability as to its accuracy or completeness. Expressions of opinion are those of HSBC only and are subject to change without notice. HSBC and its affiliates and/or their officers, directors and employees may have positions in any securities mentioned in this document (or in any related investment) and may from time to time add to or dispose of any such securities (or investment). HSBC and its affiliates may act as market maker or have assumed an underwriting commitment in the securities of any companies discussed in this document (or in related investments), may sell them to or buy them from customers on a principal basis and may also perform or seek to perform banking or underwriting services for or relating to those companies. This material may not be further distributed in whole or in part for any purpose. No consideration has been given to the particular investment objectives, financial situation or particular needs of any recipient. (070905)

In Canada, this document has been distributed by HSBC Bank Canada and/or its affiliates. Where this document contains market updates/overviews, or similar materials (collectively deemed "Commentary" in Canada although other affiliate jurisdictions may term "Commentary" as either "macro-research" or "research"), the Commentary is not an offer to sell, or a solicitation of an offer to sell or subscribe for, any financial product or instrument (including, without limitation, any currencies, securities, commodities or other financial instruments).

MICA (P) 157/06/2014, MICA (P) 171/04/2014 and MICA (P) 077/01/2014