



Castle Hill, Canterbury.

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The laggardly labour market

Unsettling news continues to emerge from China, and from some of New Zealand's key export industries. But we should not to lose sight of the bigger picture. Last week's building consents data, and this week's labour market data, will serve as useful reminders that New Zealand remains in the grip of a veritable boom in domestic demand.

Two weeks ago we discussed the sharp price declines at recent GlobalDairyTrade auctions, and revised our forecast of Fonterra's farm gate milk price to \$6.00 per kg of milk solids.

Last week Fonterra revised its own forecast to \$6.00 per kg of milk solids. Although Fonterra's forecast coincides with ours, the announcement may still have come as a shock to farmers. A drop from last season's \$8.40/kg milk price to \$6.00 would amount to a reduction in the collective income of New Zealand dairy farmers of about \$4.1bn, or 1.8% of GDP.

The final milk price for the season remains very uncertain, and hinges on how upcoming GlobalDairyTrade auctions evolve. All eyes will be focussed keenly on this week's auction, which will take place early on Wednesday morning.

In coming to our \$6.00/kg milk price forecast, we assumed a further small decline in auction prices over the short term, followed by a period of stability and then a very sharp rebound in prices towards the end of 2014. This matches our impression of consumer demand in China. There is no doubt that Chinese households remain under a cloud. The July Westpac MNI China Consumer Sentiment Indicator rose a paltry 1.9%, and remains well lower than it was in May. However, there have been widespread signs of a recovery in heavy industry in China, and we expect that will percolate through to households by the end of this year.

Our proposal for higher milk prices at the end of the year is also a function of the usual seasonal lift in Chinese dairy imports, the natural conclusion of the inventory cycle that is taking place among milk wholesalers in China at present, and the possibility of subdued growth in New Zealand production volumes (farmers will have less incentive to boost production by buying in extra feed this year).

The laggardly labour market continued

This negative dairy news underscores our conviction that the New Zealand dollar will trend down over the months ahead. After peaking above 88 cents earlier this year, the New Zealand dollar is now trading around 85 cents, and we are forecasting an average of 83 cents for the remainder of the year. However, if we focus our attentions on the next week or two, there may be a hiatus in the downward trend. Late last week US data showed lower-than-expected employment growth and inflation, which could prompt a period of weakness in the US dollar – or at least might temporarily halt the US dollar's rise. The flipside would be a short-term rise in the New Zealand dollar.

One should avoid getting too caught up in the downbeat export story, however. We are starting to see early signs of stabilisation in log export prices, after very sharp declines earlier this year. Meat prices are going from strength to strength, and could head higher still amid very tight global supply conditions.

And for every story of export gloom, there is an equal and opposite story of domestic boom. Last week's data showed that residential building consents rose another 3.5% in June, to their highest level since 2007. Non-residential building consents are also trending steadily higher. Of course, the current construction boom is very much centred on Auckland and Canterbury, in contrast to the nationwide construction boom of last decade.

The marquee economic event this week will be the suite of labour market data relating to the June quarter, which is published on Wednesday. Over the past year plenty of jobs have been created, but demand for labour has been met by an ample supply of new workers. Booming net migration has boosted the labour force, and there has been a rapid increase in the rate of labour force participation, which reached an all-time high of 69.3% in March.

Our research suggests that rising labour force participation is due to a combination of the "encouraged worker effect" arising from the economic upturn, a structural increase in participation among older people (unlike many countries, government superannuation in New Zealand is not means-tested, so people are not penalised for continuing to work past the retirement age) and a tightening of eligibility for welfare benefits.

Labour force participation rate



We expect Wednesday's Household Labour Force Survey (HLFS) will continue the same themes. We expect another solid lift of 0.8% in the number of people employed, which would equate to a 4% increase from a year earlier. But we also anticipate decent growth in the labour force, meaning unemployment will fall only slightly, from 6.0% to 5.8%.

We think there's room for the participation rate to rise a bit further still over the next few years, before the negative effects of an ageing population start to dominate. But it's extremely unlikely that it will continue to rise at the pace of the past year. It is a similar story for net migration, which we expect to peak soon. Over the years ahead, a greater proportion of the growing demand for workers will have to be met from the ranks of the unemployed. We expect the unemployment rate to fall to 5.5% by the end of this year and below 5% next year.

Wage growth has been very subdued in recent years, owing to the aforementioned abundance of supply in the labour market. That situation will evolve as unemployment falls, but any substantial pickup in wage pressures is probably more of a 2015 story. We expect this week's Labour Cost Index, released concurrently with the HLFS, will show that private sector annual wage inflation has remained at just 1.6%.

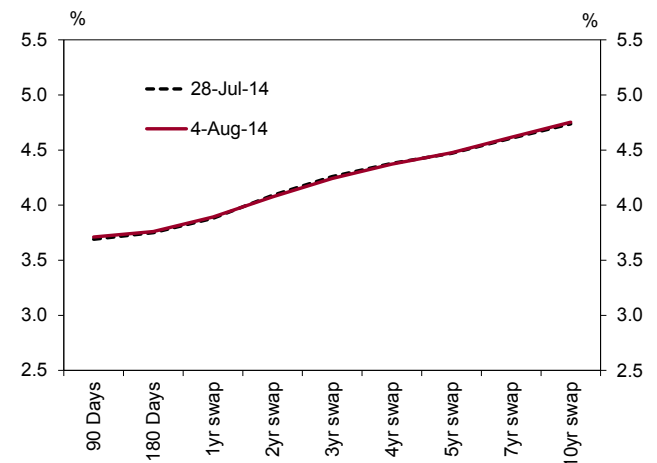
Fixed vs Floating for mortgages

Floating mortgage rates usually work out to be more expensive for borrowers than short-term fixed rates, such as the six month rate. However, floating may still be the preferred option for those who require flexibility in their repayments.

Among the standard fixed rates, we have no clear favourite. Shorter-term fixed rates, such as the six month or one year rate, are currently low but are expected to rise over the coming two years. Opting for the three or four year rate would require higher payments up front, but would help insulate the borrower if the Reserve Bank does follow through with an extensive OCR hiking cycle. At this stage, it is not clear which option will result in lower average mortgage payments over the life of the loan.

Banks sometimes offer "specials" on particular fixed terms. These are usually good value.

NZ interest rates

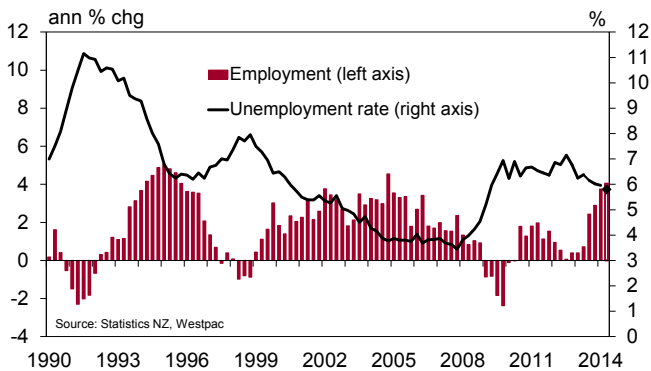


NZ Q2 Household Labour Force Survey

Aug 6, Employment: Last: 0.9%, WBC f/c: 0.7%, Mkt f/c: 0.7%
Unemployment rate: Last: 6.0%, WBC f/c: 5.8%, Mkt f/c: 5.8%

- With the New Zealand economy's upturn hitting its straps over the past year, the jobs market is now following suit. We expect another solid lift of 0.7% in the HLFS employment figures, a 4% increase from a year earlier.
- What's been surprising is the extent to which the labour market has been able to accommodate this jobs growth. The participation rate hit a record high of 69.3% in the March quarter, up from 67.9% a year earlier.
- There are plausible reasons for participation to be so high in NZ - a cyclical upturn, recent welfare reforms, and no financial penalties for working past retirement age. But it's unlikely to continue rising at the pace of the last year, which implies future jobs growth will increasingly have to come out of the ranks of the (officially) unemployed. We expect the unemployment rate to fall from 6.0% to 5.8% in Q2.

Household labour force survey

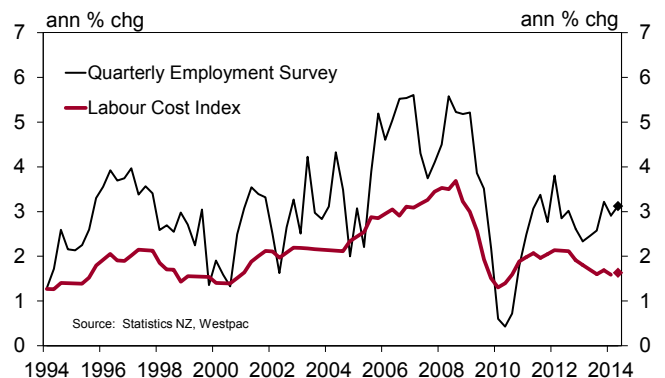


NZ Q2 Labour Cost Index

Aug 6, Private sector wages: Last: 0.3%, WBC f/c: 0.4%, Mkt f/c: 0.5%

- We expect private sector ordinary time wages, our preferred measure of labour cost inflation, to hold steady at 1.6% in the year to June.
- Labour cost growth has actually slowed over the last couple of years, at a time when most measures have been pointing to diminishing slack in the labour market. Record-high labour force participation may have helped to keep wage pressures lower than otherwise.
- But the more significant factor has probably been the legacy of subdued inflation over the last few years - a situation that we don't expect will change this year.

LCI and QES wages

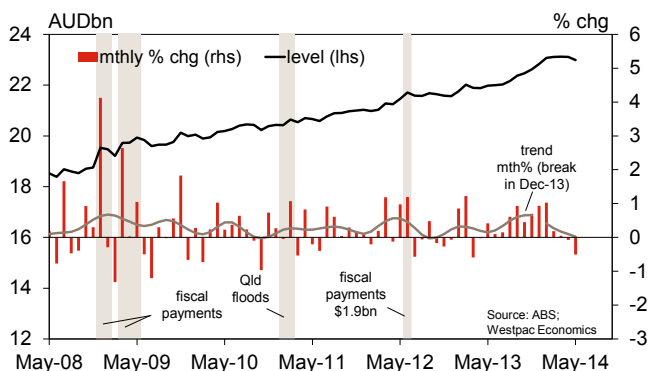


Aus Jun retail trade

Aug 4, Last: -0.5%, WBC f/c: 0.6%
Mkt f/c: 0.4%, Range: 0.0% to 0.6%

- Retail sales came in much weaker than expected in May, with a 0.5mth fall and downward revisions taking monthly sales 0.5% below their Feb level, a particularly disappointing result given that this is a nominal measure including price inflation. A sharp loss of confidence has weighed on spending. However, there were extenuating circumstances in the May month, with abnormally warm weather in NSW, Vic and SA affecting clothing and department store sales in these states - combined they contributed 0.34ppts to the 0.5% decline.
- Sentiment showed little improvement in June. However, business surveys and anecdotal reports suggest sales have been lacklustre/flat rather than falling. We expect retail sales to show a decent 0.6% rebound from May's weather-related weakness, with revisions also possible.

Monthly retail sales

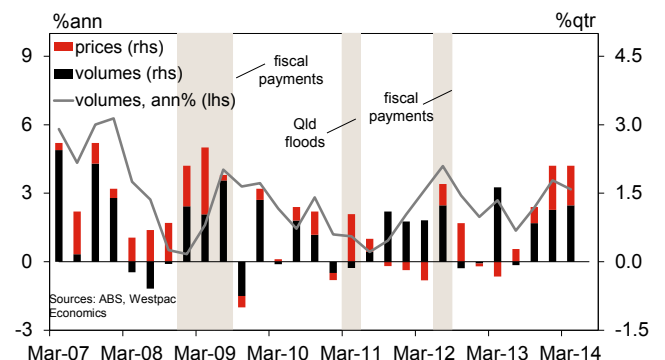


Aus Q2 real retail sales

Aug 4, Last: 1.2%, WBC f/c: -0.5%
Mkt f/c: -0.5%, Range: -0.9% to -0.2%

- Retailers had a cracker first quarter, with sales volumes up 1.2%qtr following a 1.1% gain in Q4 and a 1.4% rise in Q3. That said, there were already signs of a sharp slowdown evident in the monthly sales numbers. With a dip in Apr and sharp fall in May, the value of sales will be flat at best for Q2, even with a decent rebound in the June month. Factor in some gain in prices and volumes are clearly likely to be down. The detail from the Q2 CPI points to a retail price gain of 0.4-0.6% in the quarter, vs 0.8% in Q1. Prices for basic food, which accounts for 40% of retail sales, were up 0.4%. Overall, that points to a decline in real retail sales of about 0.5%qtr.
- Note that the link between this partial indicator and total consumer spending as reported in the national accounts is far from straightforward. Retail items in the accounts were much weaker than retail volumes in Q1.

Quarterly retail volumes and prices

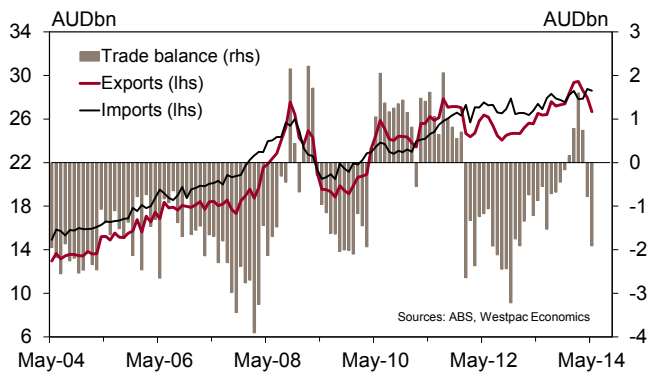


Aus Jun trade balance, AUDbn

Aug 5 Last: -1.9, WBC f/c: -2.2
Mkt f/c: -2.0, Range: -2.9 to -0.3

- Australia's trade balance is forecast to be a \$2.2bn deficit in June, widening by \$300mn from a \$1.9bn deficit in May.
- Export earnings are forecast to decline by 2%. We expect falls for iron ore, coal and rural goods, reflecting both lower prices and volumes.
- Imports are expected to decline by about 1%, as suggested by the ABS customs data. The AUD rose in the month, up 0.6% against the USD and 0.8% on a TWI basis. Taken together, this suggests import volumes inched a little lower in June.
- For the June quarter, our forecast suggests a cumulative trade deficit of almost \$5bn. That is a marked deterioration from a \$3bn surplus in the March quarter.

Australia's trade balance: -\$1.9bn in May

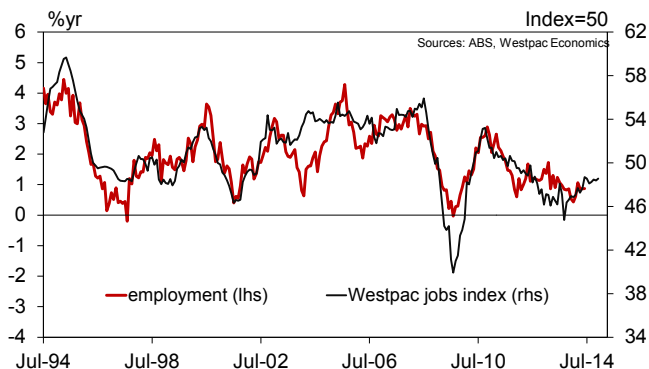


Aus July labour force employment '000

Aug 7, Last: 15.9k, WBC f/c: 5.0k
Mkt f/c: 13.9k, Range: 5k to 20k

- Total employment rose 15.9k in June, close to market expectations (+12k), but softer than Westpac's +25k forecast. There was a small revision in May, to -5.1k from -4.8k.
- The mix in employment was also on the soft side, with a 3.8k fall in full-time more than offset by a 19.7k rise in part-time. However, hours worked rose 0.9% following a 2.1% rise in May to be up 2.1%yr. Firms may be nervous about employing, instead deciding to work existing staff harder.
- The employment indicators for the business surveys are tracking sideways, if not improving slightly, suggesting the current momentum can continue. Our forecast for a modest 5k rise lifts the annual pace from 0.9%yr to 1.0%yr.

Employment and Westpac jobs index

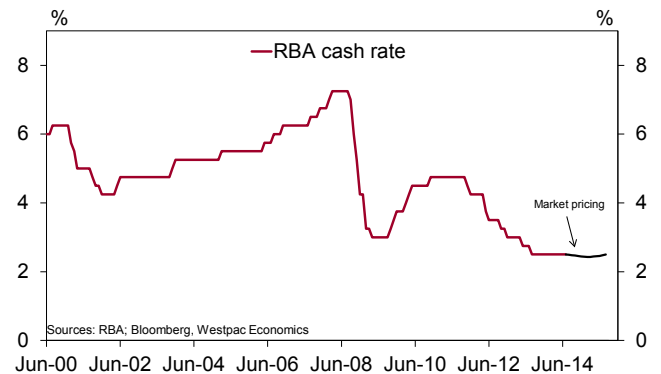


Aus RBA August policy meeting

Aug 5 Last: 2.50%, WBC f/c: 2.50%
Mkt f/c: 2.50%, Range: 2.50% to 2.50%

- At the July policy meeting, the RBA Board left the stance of policy unchanged, and the statement accompanying the decision was almost identical to that of June. The August policy meeting will likely see a very similar result.
- Since the July meeting, consumer sentiment has remained sub-par and retail sales declined in May. Against these negatives, a sharp lift in residential investment remains in train, and annual core inflation printed towards the top end of the target band in Q2. The Australian dollar has also eased back from circa USD0.945 at the time of the July meeting.
- Following the August meeting, Friday 8 August will see the release of the latest Statement on Monetary Policy, with updated growth and inflation forecasts.

RBA cash rate

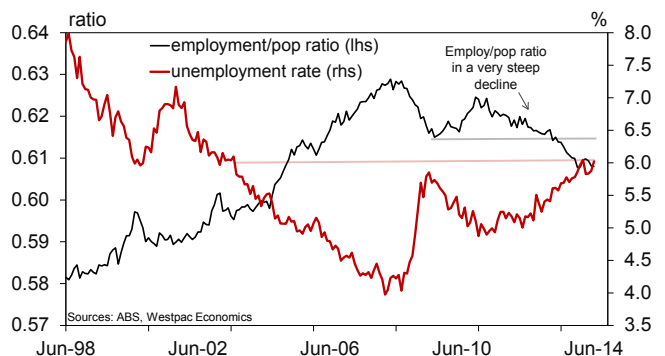


Aus July labour force unemployment rate %

Aug 7, Last: 6.0%, WBC f/c: 6.1%
Mkt f/c: 6.0%, Range: 5.8% to 6.1%

- In June, the unemployment rate surprised with a 6.0% print, higher than Westpac's forecast (5.9%) and the market (5.8%). This was due to the revision to May, which is now reported as 5.9% compared to an original estimate of 5.8%. The unemployment rate is now higher than the post GFC peak of 5.8% (May 2009).
- In the year to June, the unemployment rate has lifted from 5.7% to 6.0%. The only reason it is not higher is that the participation rate declined from 65.1% to 64.7%. If the participation rate had held around 65%, the unemployment rate would now be 6½%.
- For July, Westpac is forecasting the participation rate to hold around 64.7%. Assuming the working age population continues to grow at 1.8%yr, the unemployment rate should rise to 6.1%.

Unemployment vs. employment/pop ratio



Aus Jun housing finance (no.)

Aug 8, Last: flat, WBC f/c: 0.5%
 Mkt f/c: 0.5%, Range: -1.0% to 2.0%

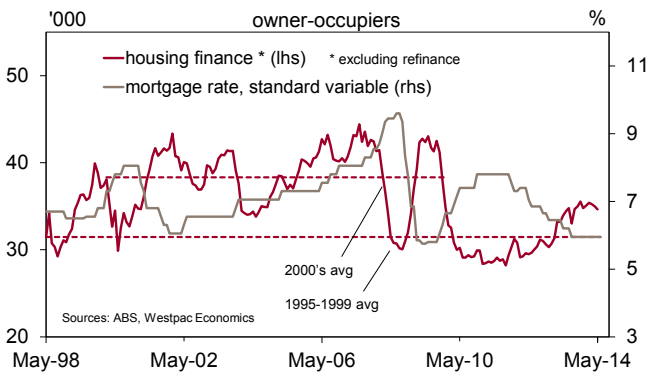
- Housing finance approvals were flat in May, showing more signs of 'topping out' after a strong surge in 2013.
- We expect modest declines to start to show through in coming months as a pull-back in consumer sentiment towards house purchase and renewed job loss fears affect decisions. That may not come to play in June however, with industry figures pointing to a slight uptick in finance approvals in the month (we expect a 0.5% gain). Note that the headline measure excludes investor approvals which have been a major driver of recent housing market strength and have maintained better momentum in 2014. This segment is captured in the totals for the value of approvals.

ECB and BoE on hold, but soon to diverge

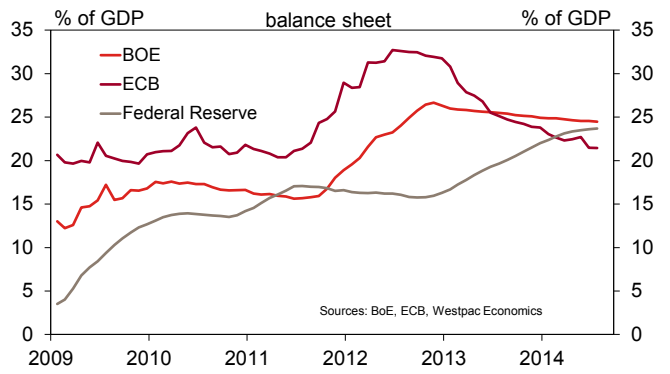
Aug 7, BoE Last: 0.5%, WBC f/c: 0.5%
 Aug 7, ECB Last: 0.15%, WBC f/c: 0.15%

- The Bank of England will update its inflation projections this month and these will show inflation around target in 2016; but this may not prevent a minority element on the MPC from seeking to begin retightening monetary policy as soon as this month. The minutes to this meeting on August 20 will be especially informative.
- Eurozone inflation dipped to 0.4%/yr in July. A third of the Eurozone by number (6 out of 18 member states) and 40% of the citizens of the Eurozone are now living in or on the edge of deflation, something which must increasingly preoccupy the ECB Council, determined not to let inflation expectations become unanchored. Expect ECB Chief Draghi to provide more guidance re policy easing options heading into 2015.

Owner-occupier finance & the rate cycle



North Atlantic – central bank balance sheets



Data calendar

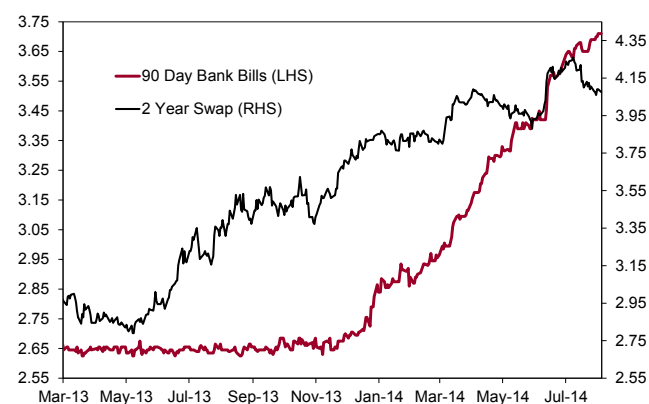
		Last	Market median	Westpac forecast	Risk/Comment
Mon 4					
NZ	Jul ANZ commodity price index	-0.9%	-	-	Falls in dairy and log prices to weigh on the index.
Aus	Bank holiday (NSW)	-	-	-	Markets closed in Sydney.
	Jun retail sales	-0.5%	0.4%	+0.6%	Sharp slowdown but bus. surveys suggest trend flat rather than falling.
	Q2 real retail sales	1.2%	-0.5%	-0.5%	Sharp turnaround after 3qtrs of 1%+ gains.
	Jul ANZ job ads %mth	4.3%	-	-	The trend in the through-the-year pace is now positive (+2.2%yr).
	Jul TD-MI inflation gauge	0.0%	-	-	June and July tend to be seasonally soft months.
Eur	Jun PPI %yr	-1.0%	-1.1%	-	German PPI less negative in June.
	Aug Sentix investor confidence	10.1	8.8	12.0	Steadier equity markets since mid July; PMI surveys stronger.
UK	Jul house prices %yr	8.8%	9.6%	-	Tentative date for Halifax index. Asking prices a touch down.
	Jul PMI construction	62.6	-	-	Solid momentum in survey not fully reflected in official data.
US	Jul ISM New York	60.5	-	-	Little watched.
Tue 5					
Aus	Jun trade balance, AUDbn	-1.9	-2.0	-2.2	Imports -1% & exports -2% on lower prices & volumes.
	RBA policy decision	2.50%	2.50%	2.50%	Friday's SoMP will expound on current policy stance and outlook.
Chn	Jul HSBC China services PMI	53.1	-	-	Corporate sector benefiting from easier policy, profitability improving.
Eur	Jul PMI composite final	54.0 a	54.0	54.0	Back at highs for year/cycle after falls in May-June.
	Jun retail sales	0.0%	-	0.7%	French consumer spending and German retail sales higher in June.
UK	Jul PMI services	57.7	58.0	57.0	UK economic growth moderating slightly in H2 2014.
US	Jul PMI services final	61.0 a	61.0	61.0	Recent close tracking with ISM services seems to have broken down.
	Jul ISM non-manufacturing	56.0	56.5	55.8	Economic growth in H2 2014 unlikely to match Q2's 4% GDP pace.
	Aug IBD-TIPP economic optimism	45.6	-	46.0	First read on August sentiment. Weekly indicators on the rise.
	Jun factory goods orders	-0.5%	0.6%	0.8%	Durable goods orders known up 0.7%.
Wed 6					
NZ	GlobalDairyTrade auction	-8.9%	-	-	Further downward pressure on dairy prices likely.
	Q2 HLFS employment	0.9%	0.7%	0.7%	Growth has so far been met from rising labour force participation...
	Q2 HLFS unemployment rate	6.0%	5.8%	5.8%	...which may have slowed the reduction in the unemployment rate.
	Q2 labour cost index	0.3%	0.5%	0.4%	Subdued inflation in recent years has kept the pressure off wages.
Ger	Jun factory orders	-1.7%	0.5%	-0.5%	Orders running 0.0% annualised pace in latest six months.
UK	Jul BRC shop price index %yr	-1.8%	-	-	June saw new cycle low, suggesting June CPI rise won't be sustained.
	Jun industrial production	-0.7%	0.7%	0.9%	57+ PMI readings imply output gains, so bounce expected.
US	Jun trade balance \$bn	-44.4	-44.5	-	Exports rose 1.0% but imports fell by 0.3% in May.
Can	Jun trade balance C\$bn	-0.2	-0.1	-	Exports up 3.5% in May, imports up 1.6%.
Thu 7					
Aus	Jul employment, chg '000	15.9	13.9	5.0	The leading indicators suggest momentum can hold around 1.0%yr.
	Jul unemployment rate %	6.0%	6.0%	6.1%	Employment growth less than population growth so rising unemploy.
Eur	ECB rate decision	0.15%	0.15%	0.15%	Further easing unlikely till after TLTROs. See text box.
Ger	Jun industrial production	-1.8%	-	-0.5%	IP down for three months running, not just due to construction either.
UK	BoE policy decision	0.5%	0.5%	0.5%	Will there be a minority vote for a rate rise? See text box.
US	Initial jobless claims w/e Aug 2	302k	-	305k	Auto plant shutdown distortion now passed, cleaner reads on layoffs.
	Jun consumer credit \$bn	19.6	18.3	-	Student and auto loans the main drivers in recent years.
Can	Jun building permits	13.8%	-2.0%	-	May rise led by multiples though singles higher too.
	Jul Ivey PMI	46.9	-	-	May-June saw first back to back sub 50 readings this decade.
Fri 8					
Aus	Jun housing finance	flat	0.5%	0.5%	Industry figures point to uptick but likely to soften in H2.
	Aug RBA Statement on Monetary Policy	-	-	-	Updates on activity and inflation forecasts.
Chn	Jul trade balance USDbn	31.56	-	-	Exports ~7% imports ~5% in June. Base effect more challenging for M.
Ger	Jun exports	-1.1%	1.3%	1.0%	Exports running -3.4% annualised pace in latest six months.
UK	Jun trade balance £bn	-9.2	-9.0	-	Exports up 0.7% and imports up 1.7% saw May deficit widen slightly.
	Jun construction output	-1.1%	-	-	Annual growth pace of 3.5%yr half what it was in Sep last year.
US	Jun wholesale inventories	0.5%	0.6%	-	Inventories gave big boost to Q2 GDP growth.
	Q2 productivity	-3.2%	1.3%	-	Growth broadly matched by hours worked...
	Q2 unit labour costs	5.7%	1.2%	-	... and ULC growth slows.
Can	Jul employment ch'	-9k	25k	10k	Volatile, but suggestive of a mild improvement in the labour market.
Sat 9					
Chn	Jul producer prices %yr	-1.1%	-	-	Deflationary impulse diminishing as activity improves.
	Jul consumer prices %yr	2.3%	2.3%	-	Food up in month, shelter slowing, W-MNI expectations rose a touch.

New Zealand forecasts

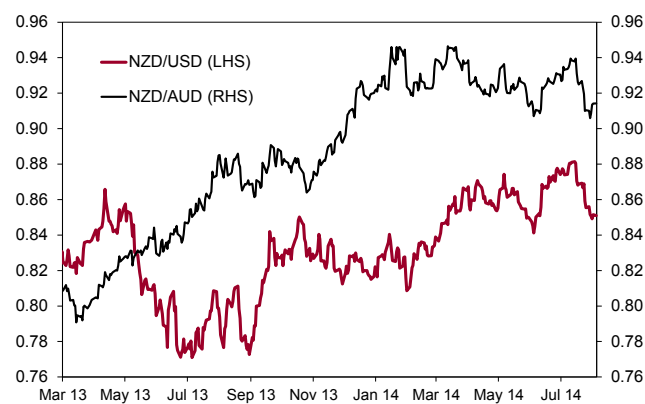
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.3	3.5	3.1	2.5	2.9	3.7	3.2
Employment	0.4	3.8	2.4	2.0	0.4	2.9	2.7	2.3
Unemployment Rate % s.a.	6.2	6.0	5.5	5.1	6.8	6.0	5.6	5.1
CPI	0.9	1.5	1.8	2.6	0.9	1.6	1.5	2.6
Current Account Balance % of GDP	-3.9	-2.8	-3.8	-4.2	-4.1	-3.4	-2.9	-4.4

Financial Forecasts	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Cash	3.50	3.50	4.00	4.25	4.50	4.50
90 Day bill	3.70	3.85	4.30	4.45	4.60	4.75
2 Year Swap	4.20	4.40	4.70	4.90	5.00	5.10
5 Year Swap	4.60	4.80	5.10	5.20	5.30	5.40
10 Year Bond	4.60	4.80	4.90	5.00	5.05	5.10
NZD/USD	0.83	0.83	0.84	0.84	0.84	0.84
NZD/AUD	0.91	0.92	0.93	0.91	0.90	0.89
NZD/JPY	83.8	83.0	84.8	85.7	86.5	87.4
NZD/EUR	0.62	0.63	0.64	0.64	0.63	0.64
NZD/GBP	0.50	0.49	0.49	0.47	0.47	0.47
TWI	78.1	78.5	79.4	78.8	78.6	78.7

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 4 August 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.25%	3.25%
30 Days	3.65%	3.58%	3.51%
60 Days	3.67%	3.62%	3.59%
90 Days	3.71%	3.65%	3.65%
2 Year Swap	4.08%	4.13%	4.24%
5 Year Swap	4.48%	4.54%	4.66%

NZ foreign currency mid-rates as at Monday 4 August 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8510	0.8710	0.8749
NZD/EUR	0.6337	0.6439	0.6435
NZD/GBP	0.5058	0.5097	0.5097
NZD/JPY	87.29	88.29	89.30
NZD/AUD	0.9142	0.9270	0.9341
TWI	79.72	81.03	81.42



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	3.2	3.0
CPI inflation % annual	2.8	3.0	2.2	2.7	2.5	2.6
Unemployment %	5.2	5.2	5.3	5.8	6.2	5.9
Current Account % GDP	-3.5	-2.8	-4.1	-3.2	-3.0	-2.5
United States						
Real GDP %yr	2.5	1.8	2.8	1.9	1.3	2.5
Consumer Prices %yr	1.6	3.1	2.1	1.5	1.8	1.8
Unemployment Rate %	9.6	8.9	8.1	7.4	6.3	5.8
Current Account %GDP	-3.0	-2.9	-2.8	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	4.9	-0.3	1.5	1.6	1.6	1.3
Euroland						
Real GDP %yr	2.0	1.6	-0.6	-0.4	0.8	1.0
United Kingdom						
Real GDP %yr	1.7	1.1	0.3	1.8	2.6	2.1
China						
Real GDP %yr	10.4	9.3	7.7	7.7	7.2	7.6
East Asia ex China						
Real GDP %yr	7.8	4.4	4.0	4.0	4.2	5.0
World						
Real GDP %yr	5.2	3.9	3.2	3.0	3.0	3.7
Forecasts finalised 4 July 2014						

Interest Rate Forecasts	Latest	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
Australia						
Cash	2.50	2.50	2.50	2.50	2.50	2.75
90 Day Bill	2.64	2.55	2.55	2.55	2.65	3.00
10 Year Bond	3.54	3.60	3.70	3.80	4.20	4.50
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.250
US 10 Year Bond	2.57	2.70	2.70	2.70	2.80	3.20
ECB Repo Rate	0.15	0.15	0.15	0.15	0.15	0.15

Exchange Rate Forecasts	Latest	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15
AUD/USD	0.9294	0.91	0.90	0.90	0.92	0.93
USD/JPY	102.92	101	100	101	102	103
EUR/USD	1.3386	1.33	1.31	1.31	1.32	1.33
AUD/NZD	1.0932	1.10	1.08	1.07	1.10	1.11

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