



Rere Waterfall, Gisborne.

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Keep on keepin' on

Last week's releases completed the suite of confidence surveys for the latest quarter. The message across the surveys has been broadly similar: New Zealanders have become more concerned about the general state of the economy over the course of this year, but are still relatively comfortable with their own positions.

The September *Quarterly Survey of Business Opinion* showed that confidence in general economic conditions declined sharply for a second quarter, with a net 20% of firms feeling confident about the environment compared to a net 52% in March. The moderation in general sentiment in recent months is not surprising, given the 100 basis points of tightening by the Reserve Bank this year, the sharp price declines for some of our key exports, and perhaps the uncertainty around the outcome of last month's election.

However, when firms were asked about their own experiences, and their expectations for the near future, the results were remarkably similar to those in the June quarter survey. This is consistent with the economy continuing to expand at a healthy pace over the second half of this year, supported by continuing increases in construction activity (particularly in Auckland and Canterbury), as well as the boost to demand from strong population growth. Importantly, these factors appear to be contributing to more generalised strength in economy activity, with the number of firms planning on increasing capital expenditure and staff numbers remaining at above-average levels.

The tone of the QSBO chimes with Westpac-McDermott Miller's household surveys for the September quarter. Consumer confidence fell but remained at a historically high level, while confidence about their own regions' performance generally held up well – even in the rural areas, where the reality of a substantially lower dairy payout for this season may not have been felt by many yet. And the Employment Confidence Index actually bucked the trend with a small increase over the September quarter, with more households reporting pay increases and a greater availability of jobs. The labour market typically lags the broader economic cycle, so last year's economic upswing will still be the dominant factor here.

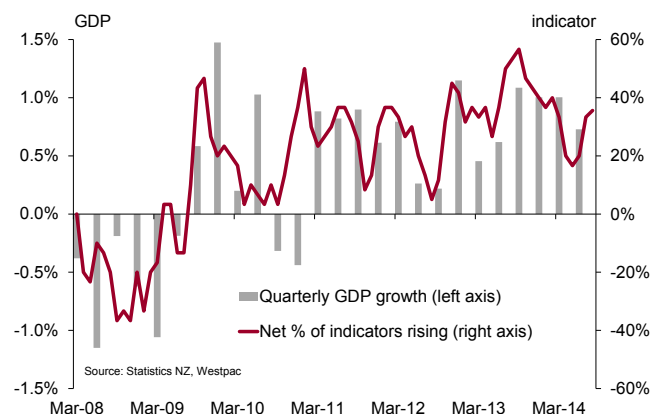
Keep on keepin' on continued

As an early indicator of quarterly GDP growth, the QSBO suggests a September quarter outcome at least as strong as the 0.7% increase recorded in the June quarter, through probably slower than the 1.0% rise in March. Our *Local Knowledge* report, which compiles 20 timely but less-watched indicators of economic activity, also points to a modest uptick in the economy's momentum since June. For now we're happy to stick with our forecast of 0.7% growth in the September quarter, with the risks slightly more to the upside given that agricultural output (which is not directly covered in the QSBO) appears to have rebounded from its June quarter drop.

Of course, focusing on output misses the fact that some of the biggest questions concerning the New Zealand economy in recent months have been around prices. World dairy prices have almost halved from the record highs reached in February this year, as strong growth in global milk production, slowing Chinese demand and Russia's ban on imports from several Western countries have collided. We expect Fonterra's milk price for this season to fall to \$4.80/kg, which if realised would be the lowest since the 2008/09 season. Even that forecast remains highly uncertain: New Zealand is entering the seasonal peak for milk production, so swings in the prices being struck at the twice-monthly GlobalDairyTrade auction can have a sizeable impact on the outlook for the full-season payout.

A lower New Zealand dollar in the last few months has provided some minor relief to exporters. But as we explained last week, the case for a large, sustained fall in the exchange rate is far from clear-cut, and the currency's small bounce in the last week underscores our point. Much of the fall in the NZ dollar has come via a stronger US dollar, as the market has anticipated interest rate hikes by the Federal Reserve next year. But the USD lost some ground last week after the Fed emphasised that those rate hikes could be some time away, not least because a stronger USD would threaten to dampen inflation pressures for longer.

Local Knowledge indicators and quarterly GDP



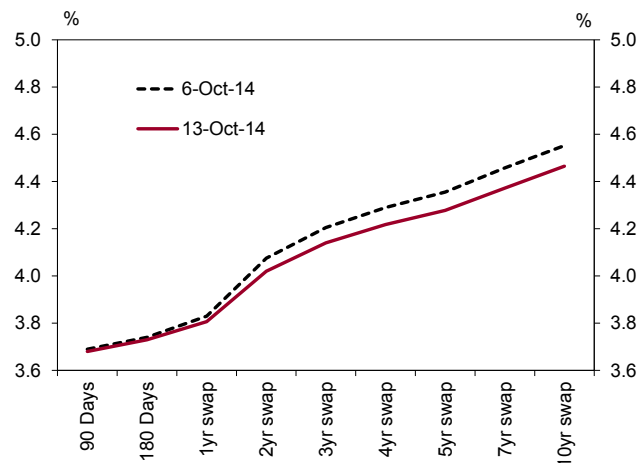
Inflation pressures also remain subdued in New Zealand, in spite of the economy's solid pace of growth. While the September QSBO found a greater number of firms reporting that they had raised their prices in the last three months, this hasn't been a good indicator of the official figures in recent quarters. Perhaps more to the point, there's been no substantial rise in the number of firms reporting an increase in costs that they might need to pass on to consumers. We'll be finalising our September quarter CPI forecast this week, but as it stands we see annual inflation slowing from 1.6% to 1.2%, which would be the slowest pace since the plunge to 0.7% in June last year.

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, the best deals for borrowers with a deposit of 20% or more are clustered around the two-year term, and these offer substantial value relative to where we expect shorter-term rates to go over the next two years. There is little point in fixing for just one year, given that these rates are higher than the two-year rate in most cases. Opting for three- or four-year terms would require higher payments up front, but could help to insulate the borrower if the Reserve Bank follows through with an extensive OCR hiking cycle.

NZ interest rates

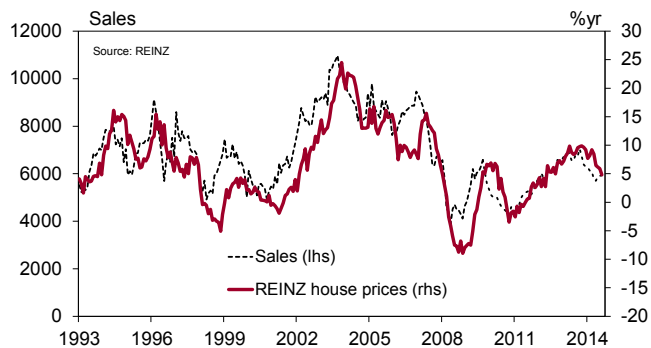


NZ Sep REINZ house prices and sales

Oct 13 (tbc), Sales last: 0.4%, Prices last: 4.8%yr

- Definitive data has shown that New Zealand house price inflation slowed sharply in early 2014, and rebounded sharply in the June quarter. However, the REINZ's price and data series were not useful for detecting these price gyrations, possibly because of distortions introduced by the LVR restrictions.
- Over recent months the REINZ house price index has been weak, hinting at a renewed slowdown in the housing market. However, given the REINZ data's lack of concordance with other housing data in recent times, it is not clear whether this was signal or noise. Hopefully this month's data will help with that question.
- House sales fell 19% between September and April, and rose 4% between April and August. We suspect September sales will remain subdued due to election-related uncertainty. Sales might rebound in October.

REINZ house prices and sales

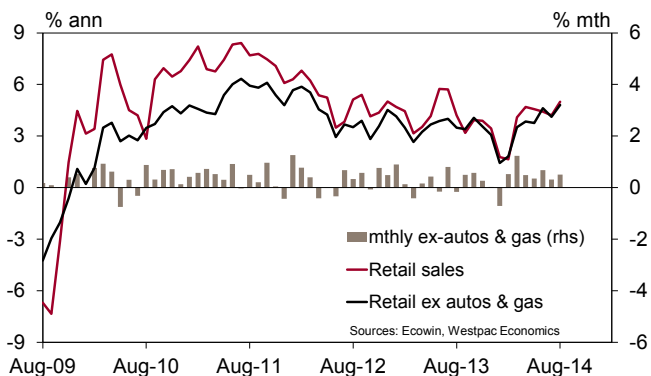


US Sep retail sales

Oct 15, Last: 0.6%, WBC -0.2%

- Retail sales rose 0.6% in August, driven by a 1.5% jump in auto sales, a 1.4% rise in building materials and a 2.4% 'miscellaneous' gain. Gasoline sales were down 0.8% on falling prices, and there was only one other storetype with contracting sales: general merchandise down 0.1%. Core retail rose 0.5%, July was revised higher, from 0.1% to 0.3%, and June was nudged up as well to 0.7%. The broad-based retail weakness initially reported for the start of Q3 turned out to be a non-pause that was revised away.
- Retail sales values in September will be dominated by falling gasoline prices and lower auto sales. The last six reports have seen core retail sales revised higher, so there is some scope for quite a weak advance report headline even if the real retail story is more robust. We expect a -0.2% headline and a 0.2% gain in core retail ex autos and gasoline.

US retail sales

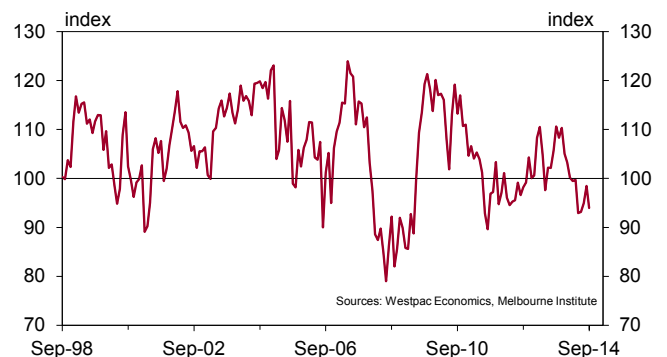


Aus Oct Westpac-MI Consumer Sentiment

Oct 15 Last: 94.0

- The Westpac-Melbourne Institute Consumer Sentiment Index fell by 4.6% in Sep from 98.5 in Aug to 94.0 giving up most of the gains seen following May's sharp post-Budget fall.
- The Oct survey is in the field in the week to Oct 12. It will capture reactions to the RBA's decision to again leave rates on hold, retaining its 'extended period of stability' guidance but giving more signs that the Bank and APRA are looking at measures to restrain investor housing activity. Economic data has been mixed with housing markets buoyant but retail sales flat and official labour data all over the place. Financial markets may be more of an influence this month with the ASX slumping 7% and the AUD down over 5½c US since the Sep survey. Budget-related concerns may ease though following signals from the Government that its looking to 'restructure' controversial measures currently stalled in the Senate.

Consumer Sentiment Index

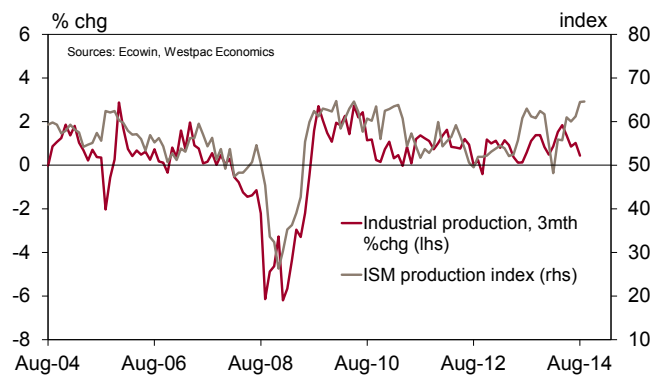


US Sep industrial production

Oct 16: Last: -0.1%, WBC f/c: 0.5%

- Industrial production fell 0.1% in August, as a 7.6% fall in auto production pulled factory sector output down 0.4%. But utilities gained 1.0% in warmer August after a further July fall due to mild weather limiting aircon use that month; mining was up 0.5% in August. Revisions were to the downside. Our Sep 0.7% IP forecast gain is supported by a jump in electricity utilities, but auto output swings are done for the year and ex auto manufacturing likely rose a mediocre 0.3%.
- Hours worked in factories rose 0.4% in Sep (and 0.5% for durables including autos) but ex auto manufacturing should also post a gain with the ISM production component edging up to a new high in the month and core capital goods orders sharply higher at the end of Q2 and rising further in Aug. These factors point to a moderate Sep rise in IP of at least 0.5%.

US industrial sector



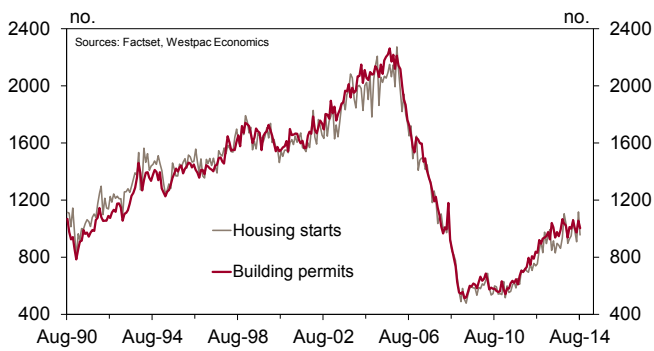
US Sep housing starts & permits

Oct 17, Housing starts: Last: -14.4%, WBC f/c: 6%

Oct 17, Housing permits: Last: -5.1%, WBC f/c: 3%

- Housing starts fell 14.4% in August, reflecting a 32% drop in multiples (three of the past six months have seen swings in excess of 30% here) and a 2.4% fall in single family starts.
- Housing permits fell 5.1%; multiples were again the driver with a 13% August fall. Single family permits slipped 0.8% after a modest 0.5% July softening for an annualised pace of 626k, lower than starts on 643k so possibly an ongoing constraining factor on starts heading into Q4. Compared to a year ago, single family permits were 0.8% yr lower, vs starts up 4.2% yr.

US housing starts & permits



Data calendar

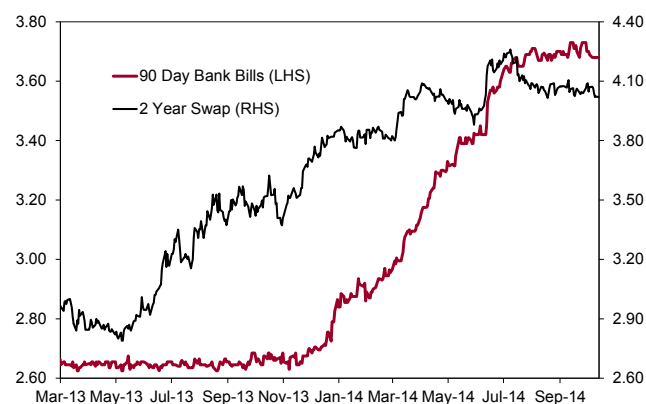
		Last	Market median	Westpac forecast	Risk/Comment
Sometime this week					
Chn	Sep foreign reserves, USDbn	3993	–	4010	Huge trade surpluses effectively recycled through sizeable outflows.
	Sep new loans, RMBbn	703	750	–	Surveys indicates loan demand is weak, hindering policy transmission.
	Sep new total credit, RMBbn	957	–	–	Down 40% from a year ago in August on trust/FX/bill shakeout.
Mon 13					
NZ	Sep REINZ house sales	0.4%	–	–	Due this week. Sales have stabilised in the last three months.
	Sep REINZ house price index	4.8%	–	–	Unclear whether recent price weakness is a signal or just noise.
	Sep food price index	0.3%	–	flat	Prices have been usually subdued over winter.
Chn	Sep trade balance USDbn	49.8	41.1	–	Q3 surplus easily the largest on record. Mkt assumes X +12%, M –2.4%.
US	Fedspeak	–	–	–	Evans.
Tue 14					
Aus	Sep NAB business confidence	8	–	–	Conditions +4 in Aug. Both less upbeat than July but above LR avg.
	RBA Assist Gov Debelle speaking	–	–	–	At Citi's 6th Aus & NZ Investment Conference, 9.30 am AEDT.
Eur	Aug industrial production %yr	–1.0%	–1.7%	–2.0%	German IP fell 4% in Aug.
Ger	Oct ZEW analysts' expectations	6.9	flat	–7.0	Sentix survey showed expectations slipping further negative in Oct.
UK	Sep BRC retail survey %yr	1.3%	–	–	Same store sales.
UK	Sep PPI %yr	0.9%	–	–	Core output measure.
	Aug ONS house prices %yr	11.7%	–	–	Fastest pace of gain since 2007.
	Sep CPI %yr	1.5%	1.4%	1.4%	BRC shop price index dipped back to –1.8%yr, just off –1.9%yr low
US	Sep NFIB small business optimism	96.1	–	95.5	Slightly lower headline, as with services ISM.
Wed 15					
Aus	Oct Westpac–MI Consumer Sentiment	94.0	–	–	Fell back near post-Budget lows in Sep. ASX fall to weigh in Oct?
	Oct Westpac–MI unemploy expectations	154.6	–	–	Has struggled to improve this year and from a very weak starting point.
	Sep new vehicle sales	–1.8%	–	2.5%	Industry figures point to lift after modest back to back falls in Jul-Aug.
Eur	ECB President Draghi speaking	–	–	–	At statistics conference, ECB dinner.
Ger	Sep CPI %yr final	0.8% a	0.8%	0.8%	German inflation three times faster than eurozone average.
UK	Sep unemployment ch'	–37k	–33.5k	–35k	Benefit claimants plunging despite slower jobs growth mid year.
	Aug employment 3mth ch'	74k	30k	–11k	Temporary jobs softness as Easter boost drops out of latest 3 months.
US	Sep PPI final demand	flat	0.1%	0.1%	Gasoline prices fell in Sep, food price pressures diminished.
	Aug business inventories	0.4%	0.4%	–	Factory stocks up 0.1%; wholesale stocks up 0.7%.
	Sep retail sales	0.6%	–0.2%	–0.2%	Gasoline prices down in Sep; auto sales lower too.
	Oct NY Fed factory survey	27.5	20.0	12.0	Sharply lower headline would mirror previous years' patterns.
	Fed beige book	–	–	–	Prepared ahead of the next FOMC meeting at the end of the month.
Can	Sep existing home sales	1.8%	–	–	Have not posted a decline since Jan.
	Sep house prices %yr	5.0%	–	–	Teranet/National Bank index growth rate at highest since 2012.
Thu 16					
NZ	GlobalDairyTrade auction	–7.3%	–	–	Prices still falling as NZ approaches peak milk production.
	Sep manufacturing PMI	56.5	–	–	Strong bounce in August after a slowdown since April.
Aus	Oct MI consumer inflation expectations	3.5%	–	–	Rose from 3.1% in Sep. Note new measure has LR avg of 4.5%.
Eur	Sep CPI %yr final	0.3% a	0.3%	0.2%	Flash was 0.25%yr before rounding. Core rate fell to 0.7%yr in Sep.
	Aug exports	–0.2%	–	–1.0%	German exports/orders/IP downside risks in Aug,
US	Initial jobless claims w/e 11/10	287k	–	285k	Claims trend about lowest seen yet this century.
	Sep industrial production	–0.1%	0.4%	0.5%	Factory hours worked rose 0.4% in Sep.
	Oct Philadelphia Fed factory survey	22.5	20.0	12.0	These surveys have tended to weaken late in the year.
	Oct NAHB housing market index	59	59	56	Upswing may have overstepped reality.
	Aug TIC data, \$bn	31.1	–	–	Net long-term TIC flows.
	Fedspeak	–	–	–	Plossser, Lockhart, Kocherlakota, Bullard.
Fri 17					
Eur	Aug construction output ma	0.0%	–	–0.2%	Construction fell 1.9% in Aug in Germany after a 2.7% July gain.
US	Sep housing starts	–14.4%	4.8%	6%	Starts pace for (single-family dwellings) still at 643k running below...
	Sep building permits	–5.1%	3.2%	3%	... permits on 626k.
	Oct consumer sentiment prelim	84.6	84.2	85.5	Uni of Michigan index.
	Fedspeak	–	–	–	Yellen at conference. Also Rosengren Sat 18/10.
Can	Jun CPI %yr	2.1%	2.0%	–	BoC core rate at 2.1% too, highest in over 2 years.

New Zealand forecasts

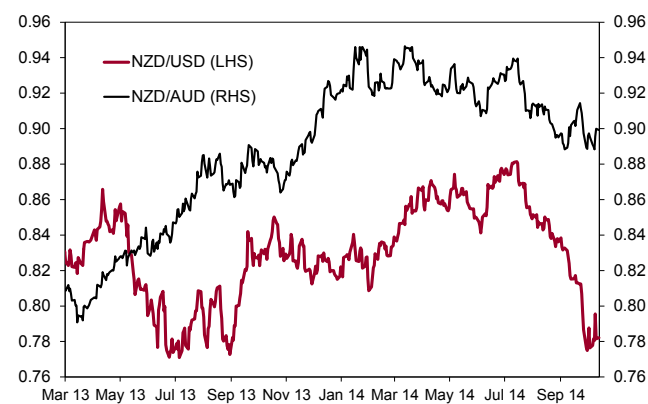
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.2	3.4	3.1	2.5	2.8	3.6	3.1
Employment	0.4	3.8	2.8	2.6	0.4	2.9	3.0	2.9
Unemployment Rate % s.a.	6.2	5.9	5.3	4.7	6.8	6.0	5.4	4.7
CPI	0.9	1.5	1.7	2.1	0.9	1.6	1.4	2.1
Current Account Balance % of GDP	-3.8	-2.7	-4.9	-4.8	-4.1	-3.3	-3.8	-5.2

Financial Forecasts	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Cash	3.50	3.50	3.75	4.00	4.25	4.50
90 Day bill	3.70	3.70	3.90	4.20	4.40	4.60
2 Year Swap	4.20	4.40	4.60	4.80	5.00	5.10
5 Year Swap	4.60	4.80	5.00	5.10	5.20	5.30
10 Year Bond	4.40	4.70	4.80	4.90	5.00	5.10
NZD/USD	0.80	0.81	0.83	0.83	0.82	0.81
NZD/AUD	0.89	0.90	0.90	0.89	0.87	0.85
NZD/JPY	88.0	89.9	93.0	93.8	93.5	93.2
NZD/EUR	0.63	0.64	0.65	0.65	0.64	0.62
NZD/GBP	0.49	0.50	0.50	0.48	0.47	0.45
TWI	78.7	78.8	81.1	79.8	78.4	77.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 13 October 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.64%	3.68%	3.66%
60 Days	3.66%	3.71%	3.67%
90 Days	3.68%	3.73%	3.73%
2 Year Swap	4.02%	4.04%	4.06%
5 Year Swap	4.28%	4.37%	4.44%

NZ foreign currency mid-rates as at Monday 13 October 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7821	0.7864	0.8149
NZD/EUR	0.6190	0.6196	0.6280
NZD/GBP	0.4864	0.4842	0.5008
NZD/JPY	84.08	85.88	87.36
NZD/AUD	0.8992	0.8979	0.9049
TWI	76.27	76.63	78.19



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013	2014f	2015f
Australia						
Real GDP % yr	2.2	2.6	3.6	2.3	3.2	3.2
CPI inflation % annual	2.8	3.0	2.2	2.7	2.2	2.8
Unemployment %	5.2	5.2	5.3	5.8	6.1	5.8
Current Account % GDP	-3.5	-2.8	-4.4	-3.3	-3.3	-2.0
United States						
Real GDP %yr	2.5	1.6	2.3	2.2	2.1	2.5
Consumer Prices %yr	1.6	3.1	2.1	1.5	1.9	1.9
Unemployment Rate %	9.6	8.9	8.1	7.4	6.3	5.8
Current Account %GDP	-3.0	-2.9	-2.9	-2.4	-2.4	-2.4
Japan						
Real GDP %yr	4.9	-0.3	1.5	1.5	1.0	1.4
Euroland						
Real GDP %yr	2.0	1.6	-0.6	-0.4	0.7	0.9
United Kingdom						
Real GDP %yr	1.7	1.1	0.3	1.7	2.6	2.1
China						
Real GDP %yr	10.4	9.3	7.7	7.7	7.4	7.5
East Asia ex China						
Real GDP %yr	7.7	4.5	4.5	4.3	4.1	5.1
World						
Real GDP %yr	5.4	4.1	3.4	3.3	2.9	3.7
Forecasts finalised 10 October 2014						

Interest Rate Forecasts	Latest	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Australia						
Cash	2.50	2.50	2.50	2.50	2.75	3.00
90 Day Bill	2.71	2.65	2.55	2.65	3.00	3.25
10 Year Bond	3.30	3.50	3.80	4.00	4.50	4.60
International						
Fed Funds	0.125	0.125	0.125	0.125	0.250	0.500
US 10 Year Bond	2.32	2.55	2.70	2.80	3.20	3.30
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
AUD/USD	0.8771	0.90	0.90	0.92	0.93	0.94
USD/JPY	107.79	110	111	112	113	114
EUR/USD	1.2699	1.26	1.26	1.27	1.28	1.29
AUD/NZD	1.1152	1.11	1.11	1.10	1.12	1.15

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