

7 September 2015



## Weekly Commentary

Kea. Arthurs Pass National Park.

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## Mixed fortunes

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A major theme of our outlook for the New Zealand economy is that the dairying downturn and the peaking of the Christchurch rebuild will weigh on confidence, and drive a slowdown in growth over the next couple of years. Last week's events had a direct bearing on those themes, though with some wildly differing implications.

Business confidence has indeed fallen sharply – the August survey showed confidence at its lowest level since mid-2009, when the economy was just starting to emerge from recession. Not surprisingly, confidence has fallen to record lows in the agricultural sector, but the decline over the last several months has been consistent across every sector. (Construction sector confidence rose in August, but it remains well below where it was even a few months ago.) Businesses also reported that they are winding back plans for hiring and investment, and fewer expect to be able to raise their prices. There are clearly concerns that the dairying downturn will have significant fallout for the wider economy.

However, in the last week we have also had a reasonably strong run of hard indicators of economic activity relating to June or July. Consents for new dwellings rose 20% in July, breaking out of the flat trend over the last year. Auckland was a major contributor to this growth, as building activity edges closer to the levels needed to meet population growth (though still about 25% shy of where it needs to be). Consents in Canterbury also rose for a third straight month, though they are still well below the peak reached late last year.

The building work survey for the June quarter reinforced the fact that the building industry is still in growth mode at the national level. Work put in place rose by 1.6% for the quarter, led by a 5% increase in non-residential construction (possibly related to quake strengthening). This puts a slight upside risk to our forecast of 0.7% GDP growth for the June quarter, but we will finalise this number next week once the last few industry reports are released.

The figures available to date also suggest that the property market remains in the ascendancy. Mortgage lending in July had its biggest monthly increase since February



# Mixed fortunes continued

2008. Early housing market data for August suggest a rise in listings, sales and prices. The finer details hint at some of the pre-positioning we would expect to see ahead of the new tax rules (from October) and LVR restrictions (now delayed until November): house price growth in Auckland has slowed, while prices have accelerated in other parts of the upper North Island. The REINZ house sales figures for August, expected to be published later this week, will shed some more light on this.

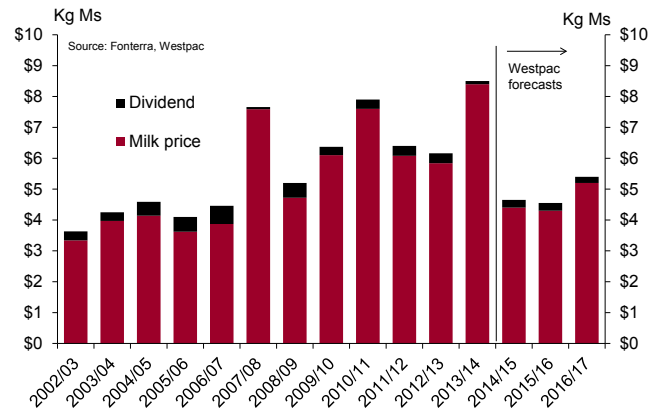
Finally, dairy prices rose sharply again in the latest GlobalDairyTrade auction. Prices have risen 27% in the last two auctions, effectively reversing the plunge seen in the previous two auctions. Hence, we have revised our forecast of the farmgate milk price for this season back to where it was, from \$3.70/kg to \$4.30/kg. Our forecast of \$5.20/kg for next season remains unchanged.

The turnaround in prices was sparked by Fonterra's announcement last month that it expects its milk collection to be down 1.5% for this season, on the expectation that dairy farmers will scale back in response to low prices. But for higher prices to be sustained, New Zealand dairy farmers will have to live up to that forecast. And the other major dairy producers will need to join in as well: the somewhat dated figures we have at present (up to June) show that Northern Hemisphere milk production has been accelerating, not slowing. So we're very cautious about assuming further substantial price gains over the rest of this season.

While the pickup in dairy prices will come as welcome relief to farmers, they remain at very weak levels – a milk price of \$4.30/kg for this season would still be below break-even for much of the industry. At this point, it's likely that an increased payout would largely be put towards reduced borrowing requirements, rather than any additional spending.

The dairying downturn will have a major influence on the Reserve Bank's *Monetary Policy Statement* on Thursday, compared to the projections that were published three months ago. The OCR decision itself seems fairly straightforward: having said in the July review that "some further easing seems likely", there is ample reason for the RBNZ to deliver some of that easing now. We expect a 25 basis point cut to 2.75%, with

Fonterra payout history and forecasts



a statement that provides some flexibility around the timing of a further cut to 2.5% in the coming months.

However, we don't think the RBNZ will be ready yet to entertain our view that the OCR will need to go as low as 2.0%. A speech by RBNZ Governor Wheeler in July gave the impression that 2.5% (which was the low point after the Global Financial Crisis) is a 'line in the sand' below which the RBNZ will not take the OCR except in a recession. Financial markets have accordingly refused to price any material risk of the OCR falling below 2.5% despite the turmoil in global markets, and the NZ dollar has gained ground against the Australian dollar.

Our forecast of a 2.0% low in the OCR is not founded solely on pessimism about the economy. Rather, it's a view on what's needed to bring inflation back to 2% over the medium term, an aim that the RBNZ has reasserted recently. Inflation has been persistently below the midpoint of the RBNZ's target range for several years, and with the economy now slowing it will be difficult to generate much home-grown inflation in the years ahead. And we're not convinced that a weaker NZD will generate enough imported inflation to offset this. Even if our assessment is correct, though, the question is how soon the RBNZ will come to share this view.

## Fixed vs Floating for mortgages

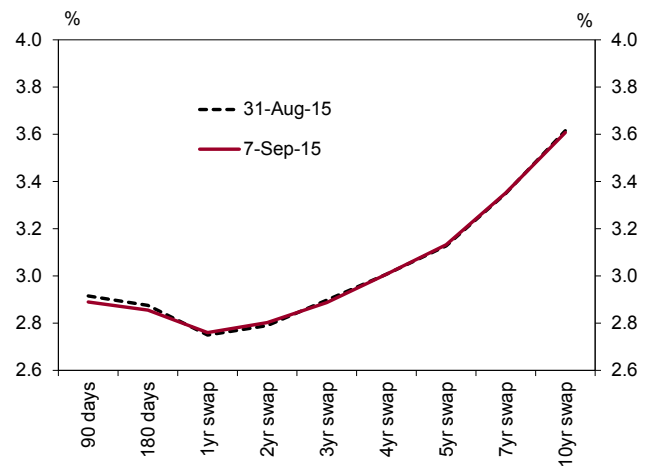
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

Longer-term fixed rates do offer the benefit of stability, but even those looking to fix may want to wait a while longer.

For borrowers with a deposit of deposit of 20% or more, the best value probably continues to lie in the two-year ahead and three-year ahead terms. Four- and five-year rates still seem high relative to where we think shorter-term rates are going to go over the next four or five years.

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.

NZ interest rates

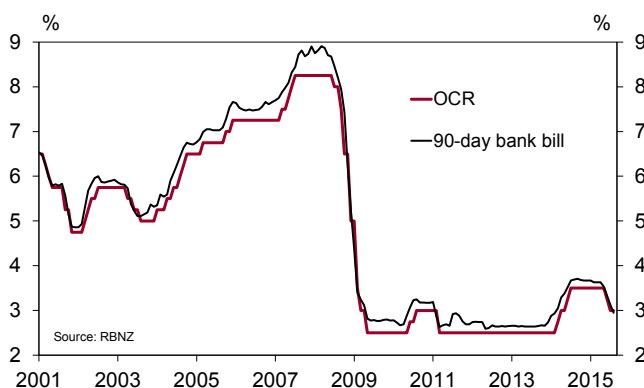


## RBNZ Monetary Policy Statement

Sep 10, Last: 3.00%, Westpac f/c: 2.75%, Market f/c: 2.75%

- The RBNZ will almost certainly cut the OCR 25bps to 2.75% next Thursday. The forecasts and language will probably imply one further OCR cut.
- We think the RBNZ will seek to keep its options open as to the timing of the next cut. A follow-up in October will depend on the domestic data and whether the Fed begins raising rates this month (and whether this drives further NZD weakness).
- Currently markets and the RBNZ are resistant to the idea of the OCR falling below its previous low of 2.5%. However, we believe the weak economy and low inflation will break that resistance by the end of the year.

NZ OCR and 90-day rate

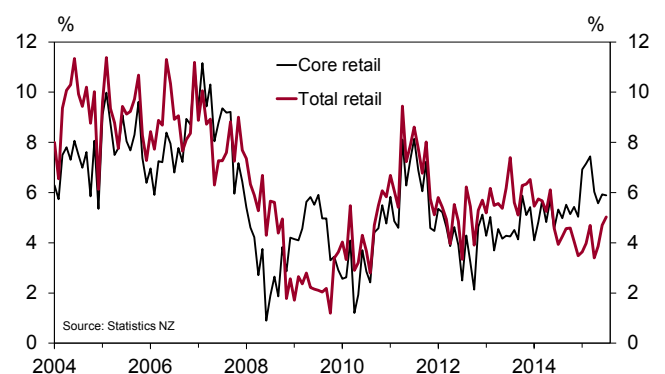


## NZ August retail electronic card spending

Sep 10, last 0.4%, Westpac f/c: 0.1%

- Retail card spending has slowed after a very strong start to the year, albeit not especially sharply – in July the level of core (ex-fuel and vehicle-related) spending was still 5.9% higher than a year ago.
- But the economic climate has chilled significantly in the last few months, and consumer confidence has fallen sharply. We would expect to see a more noticeable loss of momentum in retail activity in the months ahead, although migration and tourist spending will continue to provide some support.
- We expect core spending slowed from 0.5% to 0.3% in August; also, falling petrol prices will have weighed on fuel spending, making for a 0.1% rise in retail card spending overall.

Card transactions, annual % change

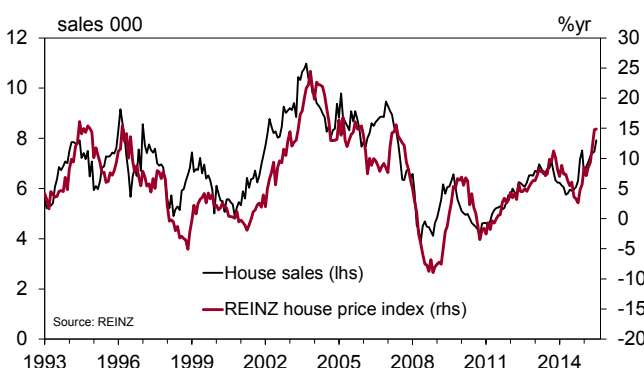


## NZ Aug REINZ house prices and sales

Sep 11 (tbc), Sales last: 6.1%, Prices last: 14.9%yr

- There is no fixed date for the release of the REINZ house sales figures, but we expect it to be towards the end of the week.
- Early data for August suggests that housing markets across New Zealand are shifting gear. Auckland is experiencing frenetic turnover, but a slowdown in the rate of price inflation. However, prices are accelerating in other parts of the upper North Island.
- These trends are consistent with the pending regulatory changes: tighter tax rules for property investors from October, and a tightening of LVR limits in Auckland (with a loosening in the rest of the country) from November.

REINZ house prices and sales

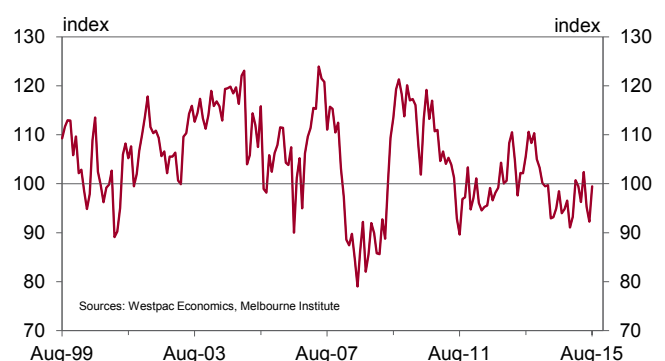


## Aus Sep Westpac-MI Consumer Sentiment

Sep 9 Last: 99.5

- The Westpac-Melbourne Institute Consumer Sentiment Index rose 7.8% in Aug from 92.2 in July to 99.5. The gain was mainly a rebound from a sharp fall in the previous month's survey which had been conducted during an escalating crisis in Greece and the slump in China's sharemarket.
- The Sep survey is in the field over the week ended Sep 6. The situation in Europe has remained calmer, but financial markets have again seen sharp falls sparked by renewed concerns over China as well as unease ahead of a prospective Fed rate hike. The ASX is down 8.2% since the Aug survey, tipping the market over the 10% technical correction threshold. The AUD has also fallen sharply, down 3.6c to 70c US, marking the lowest survey-week read since Apr 2009. Sentiment may also be affected by a disappointing Q2 national accounts update that showed growth slowing to 0.2%qtr, 2.0%yr.

Consumer Sentiment Index

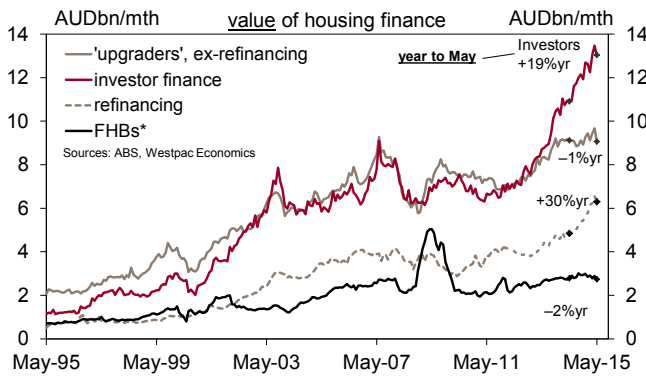


## Aus Jul housing finance (no.)

Sep 9, Last: 4.4%, WBC f/c: 0.8% Mkt f/c: 0.7%, Range: -3.0% to 2.0%

- Housing finance approvals to owner occupiers rebounded strongly in June, rising 4.4% after a surprisingly sharp 7.3% drop in May. Construction-related approvals were softer and the value of finance approvals to investors edged 0.7% lower.
- Industry data suggests some of this partial rebound carried into July. We expect approvals to nudge another 0.8% higher. Recent volatility makes underlying trends difficult to pinpoint, especially given that some of the Jun-Jul rise may also be a response to the RBA's May rate cut. Adding to this, the next few months may also see disruptions associated with APRA's 'macroprudential' measures, aimed at restricting growth in investor lending and increased capital requirements. These have resulted in banks applying tighter lending criteria and raising rates on investor loans (+27bps on average), which may indirectly boost owner-occupier approvals.

### Value of finance approvals by segment

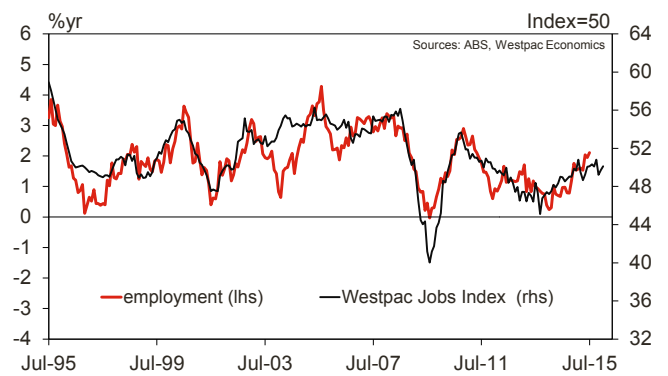


## Aus August employment change

Sep 10, Last: 38.5k, WBC f/c: -15k Mkt f/c: 5k, Range: -20k to 15k

- Total employment surged 38.5k in July, well above market expectations for a 10k rise and more than double Westpac's forecast of +15k. Total employment has grown 243.6k (or 2.1%yr) in the year to July, a slight acceleration from the 225.6k (or 2.0%yr) in the year to June.
- Stepping back from the monthly volatility, the three-month average change in employment was 29.2k in July (highest since March 2014) compared to 13.5k in June, 27.1k in May, 26.4k in April and 28.0k in March 2014. The underlying trend in employment appears to have returned to its earlier strength.
- Westpac's Jobs Index was hinting that employment growth could touch a 2%yr pace in the first half of this year, but it has since eased back to around 1¼%yr; hence our forecast for -15k, easing the annual pace back to 2.0%yr, from 2.1%yr.

### Jobs Index is pointing to a softer pace for H2

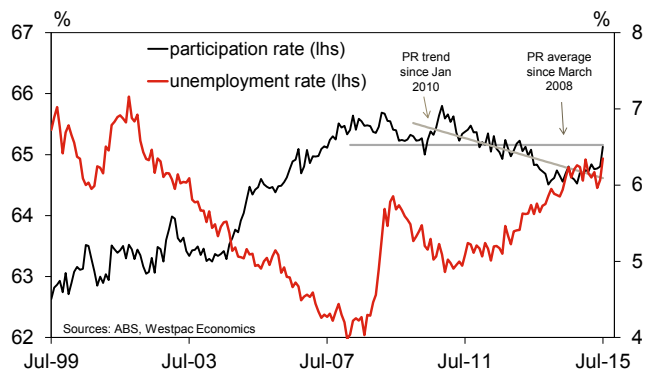


## Aus August unemployment rate

Sep 10, Last: 6.3%, WBC f/c: 6.2% Mkt f/c: 6.2%, Range: 6.0% to 6.4%

- Unrounded, the unemployment rate was 6.349% in Jul, a large jump from the 6.069% reported in Jun. In Jul, the labour force was just 113 people short of rounding up to 6.4%.
- The leap in unemployment was due to a surge in participation, from 64.8% to 65.1%. The participation rate is back to the average seen since Mar 2008 – the first time it has been so since early 2013. The surge in participation resulted in a 78.6k lift in the labour force. The last time the participation rate surged like this was back in Sep 2012; it was then followed by a 0.15ppt fall in Oct, and a 0.12ppt fall in Nov.
- Westpac is looking for a correction in the participation rate of -0.2ppts which will drive a 29.7k drop in the labour force. So even with a -15k forecast for employment, the unemployment rate eases back to 6.2%.

### Unemployment and participation rates





# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 7</b>					
<b>NZ</b>	Aug REINZ house sales	6.1%	–	–	Due this week. Listings, loan approvals point to further strength.
	Aug REINZ house price index %yr	14.9%	–	–	Signs that house price inflation is radiating beyond Auckland.
<b>Aus</b>	Aug ANZ job ads %yr	9.3%	–	–	Growth in ads has eased back but structural issues remain a problem.
<b>Eur</b>	Sep Sentix investor confidence	18.4	15.0	–	Global developments to weigh; but regional growth & ECB positives.
<b>UK</b>	Aug Halifax house prices	–0.6%	0.5%	–	Tentative date. Annual house price inflation remains firm.
<b>US</b>	Labor Day	–	–	–	Public holiday.
<b>Tue 8</b>					
<b>NZ</b>	Q2 survey of manufacturing activity	–0.3%	–	–	The last major sectoral indicator ahead of Q2 GDP.
<b>Aus</b>	RBA Head of Fin. Stability Ellis speaking	–	–	–	Property & Fin. Stability, UNSW Real Estate Symposium, Sydney 9am AEST.
	Aug NAB business survey	6	–	–	Conditions index –4pts to +6 in July, an above LR avg reading.
<b>Chn</b>	Aug trade balance USDbn	43.0	49.4	–	Exports & imports both falling, poor reflection on demand home & abroad.
<b>Eur</b>	Q2 GDP, second estimate	0.3%	0.3%	0.3%	First estimate to be confirmed; country detail remains mixed.
<b>Ger</b>	Jul trade balance	24.0b	23.5b	–	Little change from Jun; exports and imports to firm.
<b>US</b>	Aug NFIB small business optimism	95.4	95.9	–	Small businesses continue to be at disadvantage to larger rivals.
	Aug 'labour market conditions index'	1.1	–	–	Federal Reserve's aggregate labour market indicator.
	Jul consumer credit, \$bn	20.74	18.00	–	Student and auto loans continue to drive aggregate momentum.
	Fedspeak	–	–	–	Fed's Kocherlakota speaks on monetary policy in Evanston, Illinois.
<b>Wed 9</b>					
<b>Aus</b>	Sep Westpac–MI Consumer Sentiment	99.5	–	–	Hit by offshore concerns in July; recovered Aug; vulnerable again in Sep?
	Sep Westpac–MI unemployment expect.	147.7	–	–	Down 2.4%yr but still 17% above the long run average.
	Jul housing finance	4.4%	0.7%	0.8%	Partial recovery from May drop to extend. May go haywire in coming months.
	RBA Deputy Governor Lowe speaking	–	–	–	Topic TBA, CEDA event, Melbourne 12pm AEST.
	RBA Assist Governor DeBelle speaking	–	–	–	Topic TBA, FX Global Code of Conduct Briefing, London, 7pm AEST.
<b>UK</b>	Aug BRC shop price index	–1.4%	–	–	Consumer prices inflation has remained subdued.
	Aug industrial production	–0.4%	0.2%	–	Low energy prices and soft trade are dampening production.
	Jul visible trade balance	–9.2b	–9.3b	–	A strong pound and modest european growth are weighing on trade.
<b>Can</b>	Bank of Canada rate decision	0.5%	0.5%	0.5%	Weakness in commodity prices weighing on the economy.
<b>Thu 10</b>					
<b>NZ</b>	RBNZ policy decision, MPS	3.00%	2.75%	2.75%	Inflation remains low and the economy is losing momentum.
	Aug electronic card spending	0.4%	0.3%	0.1%	Lower confidence and fuel prices are weighing on spending growth.
<b>Aus</b>	Aug employment chg '000	38.5k	5k	–15k	Employment growing 2.1%yr, above leading indicators, –15k forecast
	Aug unemployment rate	6.3%	6.2%	6.2%	takes it back to 2%, but falling participation will see unemployment ease.
	Sep MI inflation expectations	3.7%yr	–	–	Aug did jump from 3.4% in Jul but trend has held 3.4%yr since Apr.
<b>Chn</b>	Aug CPI %yr	1.6%	1.9%	–	Food upswing muted this year, shelter ex utilities firming modestly.
	Aug PPI %yr	–5.4%	–5.5%	–	Upstream sectors still facing deflationary excess supply.
	Aug new loans RMBbn	1480	850	–	Tentative date: pronounced shift back on balance sheet last month
	Aug aggregate financing RMBbn	719	1010	–	Tentative date: decline in off balance sheet items, equity market crunch
	Aug money supply M2 %yr	13.3%	13.3%	–	Tentative date: PBoC activity offsetting net capital outflows.
<b>UK</b>	Bank of England Bank rate decision	0.5%	0.5%	0.5%	Activity is firming, but rate hikes are off the cards until next year.
	Aug RICS house price balance	44%	46%	–	Low rates are supporting house prices.
<b>US</b>	Initial jobless claims	282k	–	–	Jobless claims remain at low levels.
	Jul wholesale inventories	0.9%	0.3%	–	Inventories a key risk to H2 2015 growth.
<b>Can</b>	Jul new housing price index	0.3%	–	–	Annual house price inflation remains modest.
<b>Fri 11</b>					
<b>NZ</b>	Aug Business NZ manufacturing PMI	53.5	–	–	The PMI has moderated but still points to health activity.
	Aug food price index	0.6%	–	0.3%	Annual food price inflation running at around 1%.
<b>Ger</b>	Aug CPI (final)	0.0%	0.0%	–	Annual inflation meek at 0.1%yr; should begin to firm hence.
<b>UK</b>	Jul construction output	0.9%	0.7%	–	Growth in the construction sector remains limited.
	Aug 12-month inflation expectations	2.2%	–	–	BoE/GfK measure; inflation expectations remain modest.
<b>US</b>	Aug PPI	0.2%	–0.1%	–	Inflation remains subdued.
	Sep U of Mich. consumer sentiment	91.9	91.5	–	Confidence robust ahead of September FOMC meeting.
	Aug Federal Monthly budget, \$bn	–149.2	–83.6	–	Payment shifting month to month creates significant volatility.
<b>Sun 13</b>					
<b>Chn</b>	Aug retail sales %yr	10.5%	10.6%	–	Westpac-MNI survey pointing to better times ahead.
	Aug industrial production %yr	6.0%	6.3%	–	Survey leads mixed, with confidence higher but activity lower.
	Aug fixed asset investment %ytd	11.2%	11.2%	–	Looking for signs of stability in public, housing; heavy manuf a write off.

# New Zealand forecasts

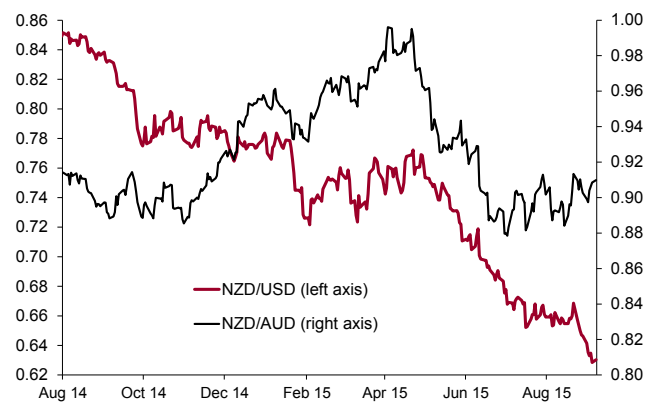
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.1	2.0	2.2	3.3	2.2	1.8
Employment	3.8	3.2	0.5	2.1	2.9	3.6	0.9	1.8
Unemployment Rate % s.a.	6.0	5.8	6.5	6.3	6.1	5.7	6.4	6.3
CPI	1.5	0.1	1.6	1.3	1.6	0.8	0.7	1.7
Current Account Balance % of GDP	-2.6	-3.6	-5.4	-4.4	-3.3	-3.3	-4.8	-4.8

Financial Forecasts	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Cash	2.75	2.25	2.00	2.00	2.00	2.00
90 Day bill	2.70	2.20	2.10	2.10	2.10	2.10
2 Year Swap	2.60	2.30	2.20	2.10	2.10	2.10
5 Year Swap	2.90	2.70	2.70	2.60	2.60	2.70
10 Year Bond	3.10	2.90	2.90	3.00	3.10	3.20
NZD/USD	0.64	0.63	0.62	0.63	0.65	0.67
NZD/AUD	0.90	0.90	0.89	0.91	0.92	0.92
NZD/JPY	77.4	77.5	76.3	78.7	81.3	84.4
NZD/EUR	0.59	0.59	0.58	0.59	0.60	0.61
NZD/GBP	0.42	0.42	0.41	0.42	0.42	0.43
TWI	69.2	68.9	67.8	69.4	70.7	72.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 7 September 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.00%	3.00%	3.00%
30 Days	2.95%	3.06%	3.11%
60 Days	2.91%	2.98%	3.07%
90 Days	2.89%	2.92%	3.02%
2 Year Swap	2.80%	2.85%	2.90%
5 Year Swap	3.13%	3.13%	3.19%

NZ foreign currency mid-rates as at Monday 7 September 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6303	0.6660	0.6615
NZD/EUR	0.5646	0.5852	0.6029
NZD/GBP	0.4152	0.4248	0.4269
NZD/JPY	74.95	81.15	82.14
NZD/AUD	0.9099	0.9134	0.8927
TWI	68.73	71.83	70.36



# International forecasts

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014	2015f	2016f
<b>Australia</b>						
Real GDP % yr	2.7	3.6	2.1	2.7	2.2	2.7
CPI inflation % annual	3.0	2.2	2.7	1.7	2.2	2.2
Unemployment %	5.2	5.3	5.8	6.2	6.5	6.3
Current Account % GDP	-2.8	-4.4	-3.3	-2.8	-3.7	-4.2
<b>United States</b>						
Real GDP %yr	1.6	2.3	1.5	2.4	2.2	2.8
Consumer Prices %yr	3.1	2.1	1.5	1.6	0.2	2.0
Unemployment Rate %	8.9	8.1	7.4	6.2	5.4	5.1
Current Account %GDP	-2.9	-2.9	-2.2	-2.2	-2.4	-2.4
<b>Japan</b>						
Real GDP %yr	-0.5	1.8	1.6	-0.1	1.0	1.7
<b>Euroland</b>						
Real GDP %yr	1.6	-0.8	-0.3	0.9	1.3	1.1
<b>United Kingdom</b>						
Real GDP %yr	1.6	0.7	1.7	3.0	2.5	2.5
<b>China</b>						
Real GDP %yr	9.3	7.8	7.8	7.4	7.0	6.8
<b>East Asia ex China</b>						
Real GDP %yr	4.4	4.5	4.3	4.1	3.7	4.0
<b>World</b>						
Real GDP %yr	4.2	3.4	3.4	3.4	3.1	3.6
Forecasts finalised 4 Sep 2015						

Interest Rate Forecasts	Latest	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
<b>Australia</b>						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.15	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.66	2.85	3.10	3.25	3.40	3.60
<b>International</b>						
Fed Funds	0.125	0.375	0.625	0.875	1.125	1.375
US 10 Year Bond	2.15	2.40	2.80	3.00	3.20	3.40
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
AUD/USD	0.6994	0.70	0.70	0.70	0.70	0.71
USD/JPY	119.83	121	123	123	124	125
EUR/USD	1.1129	1.09	1.07	1.07	1.07	1.08
AUD/NZD	1.0956	1.11	1.11	1.13	1.11	1.09

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## Disclaimer continued

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