



Church of the Good Shepherd, Lake Tekapo.

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The hangover

The Auckland housing market is now suffering a hangover from its recent excesses, food price inflation has proven very low, and world dairy prices are dropping again. This reinforces our view that the Reserve Bank will need to reduce the OCR further than the market is currently expecting.

The message from the REINZ's October housing report was decisive. Nationwide house sales fell by 7%, the time taken to sell a house lengthened, and the house price index fell 4% – the biggest single-month decline on record going back to 1992. The weakness was especially concentrated in Auckland, with sales down 15% and prices down almost 5% in just one month.

This confirms the idea that some of the recent froth in the Auckland market was driven by investors getting in ahead of the new regulations. From 1 October, all investment properties bought and sold within two years will be subject to income tax on the capital gain. (Previously, the tax hinged on an assessment of the buyer's intentions, a test which still applies for investment properties sold after two years.) In addition, overseas buyers are now required to register for tax and open a bank account in New Zealand.

At this stage it's not clear whether these measures will have a sustained dampening effect on the housing market, or to what extent they simply brought purchases forward. But either way, it appears that investors have done their dash for now, and the Auckland housing market is likely to suffer the resulting hangover for at least a few more months.

This is an important development for the Reserve Bank on two fronts. Firstly, the RBNZ has noted in recent statements that it sees the Auckland housing market as a growing risk to the financial system. The latest *Financial Stability Report*, released last week, expanded on these concerns. The RBNZ again noted that prices in Auckland look stretched relative to incomes and that rental yields are low. The report also highlighted the large role of investors in the Auckland market, who may be at greater risk of default than owner-occupiers during a downturn.

The hangover continued

The RBNZ is not proposing any further policy moves at this point, instead preferring to wait and see the impact of the new tax rules, as well as the tightening of loan-to-value limits for Auckland property investors which came into force this month. That said, its recent focus on collecting data on debt-to-income ratios could be laying the groundwork for further lending restrictions along these lines in the future.

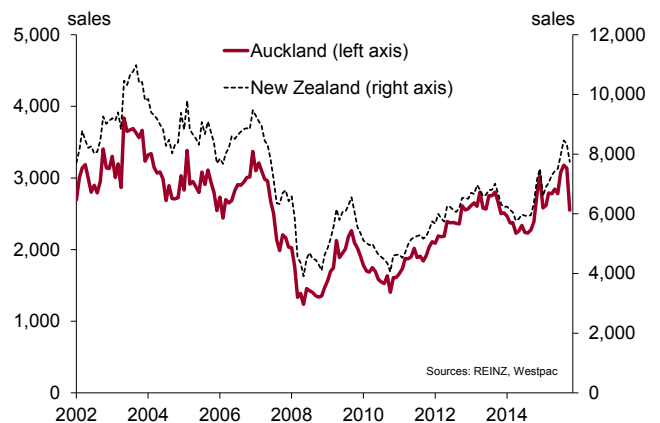
Secondly, the slowing in the housing market is crucial to the interest rate outlook. The rampant Auckland housing market has been seen by the RBNZ as an impediment to cutting the OCR too far or too fast. If the housing market remains off the boil in coming months, it would give the RBNZ more leeway to cut the OCR further in order to bring inflation back towards its target.

And they'll need that leeway, because right now inflation is continuing to track below expectations. Food prices fell 1.2% in October, and on a year-on-year basis are down 0.5%, the weakest in almost three years. Lower dairy prices were not surprisingly a factor, as the low farmgate milk price flows through into retail prices. But generally speaking, there's a distinct lack of passthrough from the lower New Zealand dollar into food prices, which make up almost 20% of the consumer price index.

We have nudged down our December quarter CPI forecast to a 0.2% decline (which would take annual inflation down to 0.3%). A small decline is fairly normal for a December quarter, given the usual seasonal downdraft in fresh food prices. But the RBNZ isn't looking for 'normal'; it's looking for the weaker NZD to generate a sustained lift in the prices of tradable goods. In the September *Monetary Policy Statement* the RBNZ expected annual inflation to be comfortably back within the 1-3% target range by early next year. On our forecasts, there's a real risk that inflation could actually remain below 1% for most of 2016.

And if the RBNZ needed any more motivation to cut the OCR further, the renewed decline in world dairy prices will be cause for concern. Despite the likelihood of a drop in New Zealand's milk production, dairy prices have fallen back by around 10% in the last two GlobalDairyTrade auctions, and milk futures are suggesting that this week's auction will be another very poor one.

House sales, seasonally adjusted



The one potential hitch to further interest rate cuts is what happens with the exchange rate. The much stronger than expected US payrolls figures for October have strengthened the perceived odds of the Fed hiking interest rates at its December meeting. The channel through which this matters for New Zealand is the exchange rate: higher US interest rates could be expected to boost the US dollar and weaken the NZ dollar.

Indeed, the NZD has shed a few cents against the USD in recent weeks. But with the trade-weighted index above 70, it's still higher than was assumed in the September *Monetary Policy Statement* and, in our view, too high to generate the degree of imported inflation that the RBNZ is anticipating.

We remain confident in our view that the RBNZ won't stop at a 2.5% cash rate, and will take it down further to 2% next year.

Fixed vs Floating for mortgages

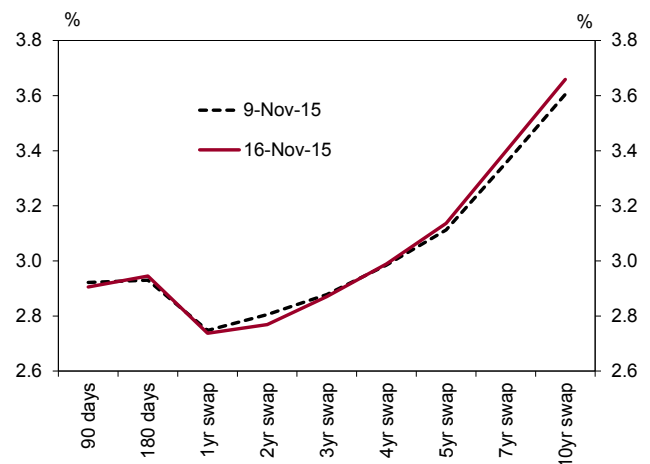
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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

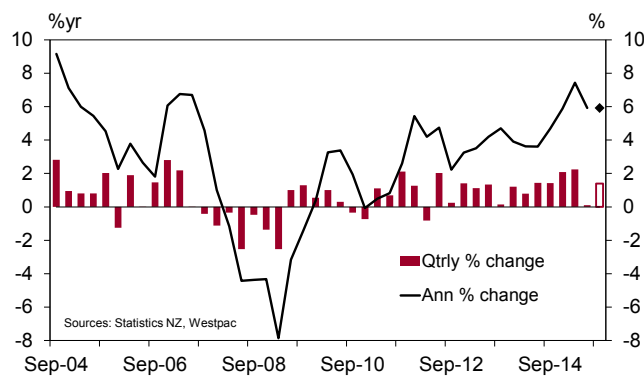


NZ Q3 real retail sales

Nov 16, Last: 0.1%, Westpac f/c: 1.4%, Mkt f/c: 1.4%

- After stopping for air in Q2, retail spending has been growing at a strong pace over the past few months. Based on electronic card spending data, we expect the retail sales report to show that nominal sales grew by 1.1% over Q3, with volumes up a solid 1.4% (including strong growth in core sales).
- Growth has been supported by continued softness in prices, as well as low borrowing costs and a strong tourist season. In addition, strength in the housing market through mid-2015 has provided a significant boost to spending on furnishings and other durable items.

Real retail sales

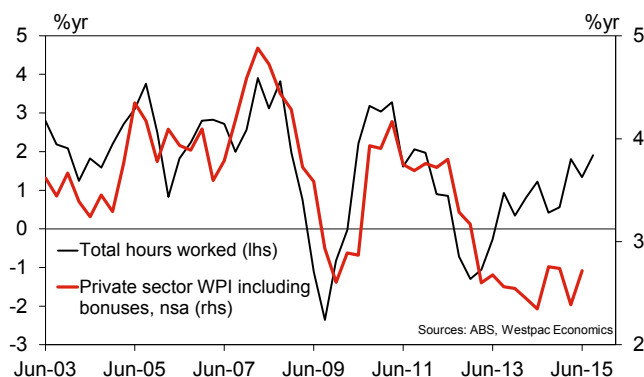


Aus Q3 Wage Price Index

Nov 18, Last: 0.6%, WBC f/c: 0.6% Mkt f/c: 0.6%, Range: 0.5% to 0.7%

- Total hourly wage rates ex bonuses (WPI) rose 0.6% in Q2, bang on market expectations and a touch stronger than Westpac's 0.5%qtr forecast. It followed a 0.5%qtr in Q1 and three consecutive 0.6%qtr prints. The annual pace was flat at 2.3%yr, a moderation from the 2.5%yr in 2014Q4 holding the annual pace at a record low. The WPI started in the September quarter of 1997.
- Private sector wages lifted just 0.5%qtr in Q2 following a 0.5%qtr in Q1 and 0.6%qtr in each of the previous three quarters. The annual pace was a record low of 2.2%yr from 2.3%yr in Q1 (revised from an original estimate of 2.2%yr).
- Wages have underperform relative to labour market indicators, such as full-time employment and hours worked, as the declining terms of trade was a drag on national incomes. We don't see any significant change to this.

Hours worked have lifted but wages have not

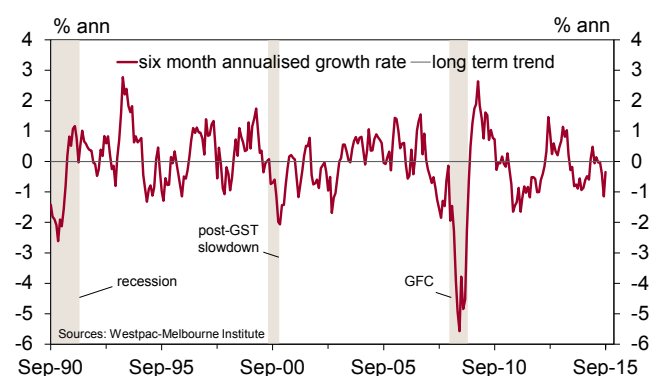


Aus Sep Westpac-MI Leading Index

Nov 18, Last: -0.35%

- The 6mth annualised growth rate of the Leading Index lifted from -1.14% in August to -0.35% in September. The Leading Index has been pointing to below trend growth for 5mths suggesting the H12015 softness has extended into H2.
- The Oct read will include a mixed bag of component updates. On the positive side: the Westpac-MI Consumer Expectations Index rose 5.5%; the ASX200 rose 3.6% vs -3.1% last month; dwelling approvals edged up 2.2%; and total hours worked surged 1.2%qtr. Against this, the Westpac-MI unemployment expectations index retraced some of last month's big move (+3.3% vs -13.7% - higher reads indicate a more pessimistic view on jobs), and commodity prices reversed lower in AUD terms (-3.1% vs +3.5% last month), US industrial production dipped 0.2% and the yield gap narrowed slightly.

Westpac-MI Leading Index

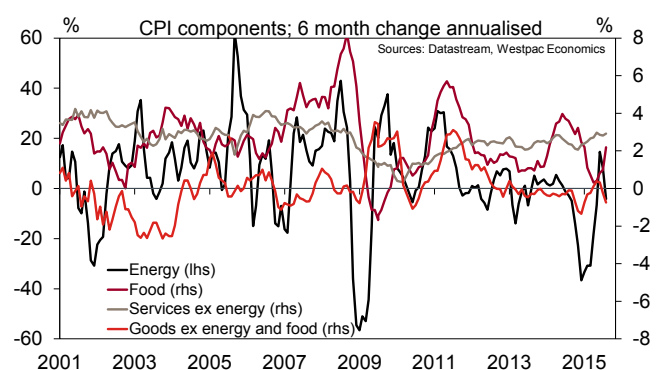


US October CPI

Nov 17, Last: -0.2%, WBC f/c: 0.2%

- The US headline CPI has remained at the whim of oil prices over the past year.
- Following a further 0.2% decline in September, annual inflation decelerated to 0.0%yr - a stark contrast to the 1.9%yr core outcome (ex food & energy).
- October should see the beginning of a new uptrend in annual inflation, as the deflationary oil impulse ebbs and underlying core pressures exert more influence.
- For the time being, we will continue to see headline inflation near zero, but momentum will pick up. This should see the FOMC progressively gain greater confidence in their medium-term 2.0%yr target during the first half of 2016.

Energy prices stabilising, core to fore



Data calendar

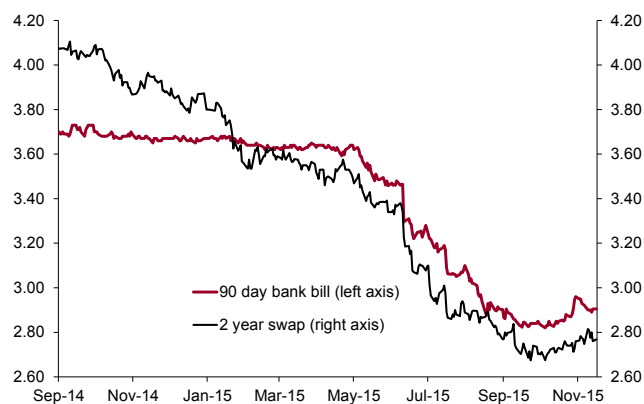
		Last	Market median	Westpac forecast	Risk/Comment
Mon 16					
NZ	Oct BusinessNZ PSI	59.3	–	–	Service sector activity has remained firm in recent months.
	Q3 retail sales volumes	0.1%	1.4%	1.4%	Solid growth thanks to buoyant housing market and tourist spending.
Aus	Oct new vehicle sales	5.5%	–	–2.5%	Industry figures suggest sales slipped back after strong-ish Sep.
Eur	Oct CPI %mth	0.2%	0.1%	0.1%	At 1.0%yr, core inflation still a long way below target.
UK	Nov Rightmove prices	0.6%	–	–	Lending restrictions are likely to dampen growth.
US	Nov Empire manufacturing survey	–11.4	–5.0	–	Soft external demand is weighing on manufacturing.
Tue 17					
NZ	Q4 two year ahead inflation expectations	1.94%	–	–	After earlier sharp falls, inflation expectations have recently stabilised.
Aus	RBA minutes	–	–	–	Discussion of risks around the growth forecasts a key focus.
Eur	Oct ZEW survey expectations	30.1	–	–	Investor sentiment reliant on ECB.
UK	Oct CPI	–0.1%	0.2%	–	Headline inflation remains low, though core has lifted slightly.
	Sep ONS house price inflation %yr	5.2%	–	–	ONS measure; dated relative to other measures. Has been steady.
US	Oct CPI	–0.2%	0.2%	0.2%	Annual headline inflation to edge higher to 0.1%yr.
	Oct industrial production	–0.2%	0.1%	–	USD continues to impact activity, as does the low oil price.
	Nov NAHB housing market index	64	64	–	At decade highs, out of kilter with actual activity.
	Fedspeak	–	–	–	Tarullo on shadow banking at Brookings Institute.
Wed 18					
NZ	GlobalDairyTrade auction results	–7.4%	–	–	Futures pointing to sizable fall in prices.
Aus	Oct Westpac–MI Leading Index	–0.35%	–	–	Below trend momentum continued in Q3 but may be improving?
	Q3 wage price index	0.6%	0.6%	0.6%	Wages are underperforming the improvement in the labour market.
Chn	Oct 70-city new house prices %net bal	28.6	–	–	40 rising 20 falling in Sep. Worrying cessation of broadening of late.
	Oct 70-city 2ndary house prices %net bal	30.0	–	–	40 rising 19 falling in Sep. Cycle low reached in Sep-14 at –100%.
US	Oct housing starts	6.5%	–3.8%	–3.0%	A partial reversal seems likely; uptrend slowing.
	Oct building permits	–4.8%	3.2%	1.0%	Continues to be driven by multiples activity.
	Minutes of the Oct FOMC meeting	–	–	–	Market will be looking for any divergence from telegraphed Dec view.
	Fedspeak	–	–	–	Dudley, Mester, and Lockhart on panel on payment systems.
	Fedspeak	–	–	–	Kaplan on economic conditions; Lockhart at The Clearing House, NY.
Thu 19					
Chn	Nov MNI business indicator	55.6	–	–	With flash PMI discontinued this very timely survey comes into its own.
Eur	Sep current account €bn	–13.7	–	–	Global growth a notable negative; weaker EUR would be nice.
	ECB meeting minutes	–	–	–	Account of the October meeting where Draghi shifted the stance.
UK	Oct retail sales	1.9%	–0.1%	–	Low inflation and the strengthening labour market boosting spending.
US	Jobless claims	276k	–	–	Claims remain very low.
	Nov Philly Fed business outlook survey	–4.5	0.0	–	Business conditions have softened due to external headwinds.
	Fedspeak	–	–	–	Lockhart speaks on US economy in Atlanta.
Fri 20					
Eur	Nov consumer confidence	–7.7	–7.5	–	Activity growth and ECB continue to support.
UK	Oct public sector borrowing, £bn	8.6	–	–	Strengthening domestic activity is boosting tax revenues.
US	Nov Kansas City Fed manuf survey	–1	–	–	Has picked up, but remains moderate.
	Fedspeak	–	–	–	Bullard speaks on economy in Arkansas.
Sat 21					
US	Fedspeak	–	–	–	Williams speaks on monetary policy in Berkeley.

New Zealand forecasts

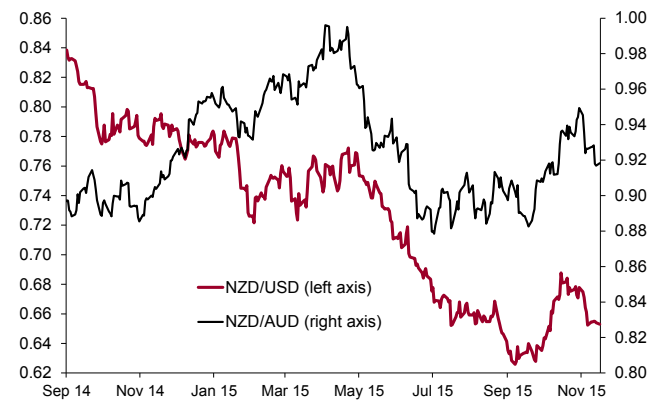
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.1	2.1	2.3	3.3	2.3	2.0
Employment	3.8	3.2	1.5	2.0	2.9	3.6	2.0	1.5
Unemployment Rate % s.a.	6.0	5.8	6.4	6.2	6.1	5.7	6.1	6.3
CPI	1.5	0.3	1.3	1.5	1.6	0.8	0.5	1.7
Current Account Balance % of GDP	-2.6	-3.4	-4.4	-4.3	-3.2	-3.1	-3.9	-4.5

Financial Forecasts	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Cash	2.50	2.25	2.00	2.00	2.00	2.00
90 Day bill	2.60	2.30	2.10	2.10	2.10	2.10
2 Year Swap	2.60	2.40	2.20	2.20	2.20	2.20
5 Year Swap	3.10	3.10	3.10	3.20	3.20	3.20
10 Year Bond	3.30	3.40	3.50	3.70	3.80	3.80
NZD/USD	0.64	0.63	0.62	0.62	0.62	0.62
NZD/AUD	0.94	0.95	0.94	0.93	0.90	0.89
NZD/JPY	78.1	77.5	76.9	77.5	78.1	76.3
NZD/EUR	0.60	0.61	0.60	0.59	0.58	0.57
NZD/GBP	0.43	0.43	0.42	0.42	0.41	0.40
TWI	70.5	70.4	69.3	69.0	68.1	67.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 16 November 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.75%	2.75%	2.75%
30 Days	2.89%	2.91%	2.86%
60 Days	2.90%	2.93%	2.85%
90 Days	2.91%	2.97%	2.85%
2 Year Swap	2.77%	2.76%	2.73%
5 Year Swap	3.14%	3.06%	3.03%

NZ foreign currency mid-rates as at Monday 16 November 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6530	0.6764	0.6798
NZD/EUR	0.6082	0.6126	0.5988
NZD/GBP	0.4288	0.4374	0.4402
NZD/JPY	79.87	81.44	81.14
NZD/AUD	0.9183	0.9499	0.9366
TWI	71.18	73.12	72.74



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014	2015f	2016f
Australia						
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	1.6	2.3
Unemployment %	5.2	5.3	5.8	6.2	6.3	6.0
Current Account % GDP	-2.8	-4.4	-3.4	-3.0	-4.0	-4.0
United States						
Real GDP %yr	1.6	2.2	1.5	2.4	2.4	2.8
Consumer Prices %yr	3.1	2.1	1.5	1.6	0.1	1.7
Unemployment Rate %	8.9	8.1	7.4	6.2	5.3	4.9
Current Account %GDP	-2.9	-2.9	-2.3	-2.2	-2.3	-2.3
Japan						
Real GDP %yr	-0.5	1.7	1.6	-0.1	0.6	1.3
Euroland						
Real GDP %yr	1.6	-0.8	-0.3	0.9	1.5	1.1
United Kingdom						
Real GDP %yr	1.6	0.7	1.7	3.0	2.5	2.5
China						
Real GDP %yr	9.5	7.7	7.7	7.3	7.0	6.6
East Asia ex China						
Real GDP %yr	4.5	4.6	4.2	4.1	3.5	4.0
World						
Real GDP %yr	4.2	3.4	3.3	3.4	3.0	3.6
Forecasts finalised 6 Nov 2015						

Interest Rate Forecasts	Latest	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Australia						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.23	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.95	2.85	2.90	3.00	3.10	3.30
International						
Fed Funds	0.125	0.375	0.625	0.875	1.125	1.375
US 10 Year Bond	2.31	2.35	2.50	2.70	2.90	3.00
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
AUD/USD	0.7135	0.68	0.66	0.66	0.67	0.69
USD/JPY	122.65	122	123	124	125	126
EUR/USD	1.0780	1.06	1.04	1.04	1.05	1.07
AUD/NZD	1.0900	1.06	1.05	1.06	1.08	1.11

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