



Emerald Lakes, Tongariro National Park

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Priced for perfection?

Solid domestic data last week, along with further guidance from the Reserve Bank, all served to reinforce the message that the OCR will be heading up next year. That said, we suspect that financial markets may be getting a step or two ahead of themselves in pricing in the path to OCR hikes. We think there are still a number of hurdles that could become more apparent in the next few months.

First, the good news. The ANZ business confidence survey has been consistently strong over this year and took another leg higher in September, reaching its highest level since 1999. The details of the survey were also encouraging, with expected profits, employment and investment intentions and capacity utilisation all picking up sharply in the last few months.

Those details are likely to be replicated in this week's *Quarterly Survey of Business Opinion*. More importantly, it will detail the extent to which firms' positive sentiment has translated into action over the last three months. The *QSBO* tends to be the most reliable early indicator of quarterly GDP growth, and the readings in the previous two quarters correctly pointed to reasonable underlying growth outside of the effects of the drought (note that the agricultural sector is not directly covered in this survey). With farm production now starting to recover (milk production has been particularly strong thanks to the warm winter), we are expecting GDP to rebound by 1% in each of the next two quarters.

As activity picks up, the next phase to watch for will be a build-up in price pressures. Surveyed pricing intentions in the monthly confidence survey have risen noticeably in the last six months, particularly in retail and construction, although expectations of general inflation remain low. Any evidence in the *QSBO* of capacity constraints and/or rising costs will be important.

Also in the last week, residential building consents for August rose 1.4%, maintaining their upward trend although slightly off the peaks reached earlier this year. While it was disappointing to see an 11% drop in consents in the under-supplied Auckland housing

Priced for perfection? continued

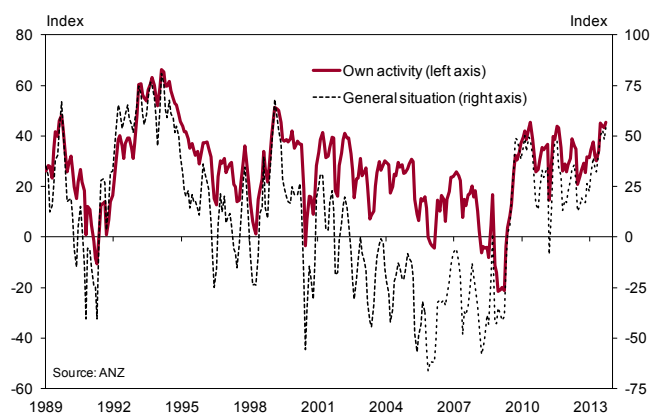
market, the regional breakdown is always choppy and the latest fall is not out of the ordinary. Consents in Christchurch have taken a step up in the last three months, quite likely reflecting government pressure to speed up the post-earthquake rebuild process.

Finally, credit growth accelerated to 4.4%yr in August, with the details reflecting a housing market that continued to march higher, and a farm sector turning its focus from the recent drought to what promises to be a much more positive year ahead.

Of course, August was also the month in which the RBNZ announced its intention to restrict the volume of high loan-to-value ratio (LVR) mortgage lending. There are plenty of anecdotes forthcoming about the effect this may be having on the housing market, none of which add up to a consistent story – and frankly nor would we expect them to at this stage. There is still a substantial pipeline of pre-approved loans that will allow home buyers to shop around for the next few months; on the other hand, any intentions to “rush for the door” will have been constrained by the low number of available listings. We suspect that the dampening effect of the LVR restrictions won’t become apparent in the aggregate figures until around November.

Bear in mind that our forecast (and the RBNZ’s projection) for OCR hikes from early next year already incorporates some dampening in the housing market in coming months. The RBNZ had two opportunities last week to underscore that message. Assistant Governor John McDermott delivered a speech on ‘neutral’ interest rates, noting that the neutral 90-day rate appears to have fallen from around 6% before the recession to around 4.5% today – with the implication that 90-day rates will gravitate towards that level over the next few years. Governor Graeme Wheeler, in an opinion piece about the LVR restrictions, was even more explicit – repeating the message from the September *Monetary Policy Statement* that the RBNZ expects to raise rates by 200 basis points between early 2014 and early 2016 if the housing market pans out as expected. However, if the LVR restrictions don’t have the desired effect, interest rates will need to go even higher.

ANZBO business confidence



Financial markets are clearly persuaded that OCR hikes are on the way soon. But we’d caution that there are still some hurdles to our call for a March 2014 start to the tightening cycle. First, the exchange rate still plays an important role in the RBNZ’s deliberations; the fact that the currency has rebounded to around 3% above what was assumed in the September *MPS* will take some of the heat out of the RBNZ’s assessment of inflation and the pressure for interest rate hikes.

Second, the housing market is facing not just the recently imposed restrictions on high-LVR lending, but a substantial rise in fixed-term mortgage rates over the last few months. We have long emphasised that low interest rates have been the dominant driver of housing demand, so the recent rise in interest rates skews the risks towards a greater slowdown in the housing market than the RBNZ is anticipating.

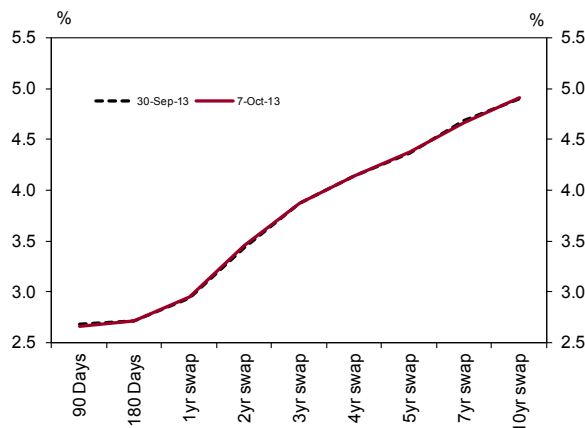
Together, these factors could see the RBNZ strike a more cautious tone in the October and December OCR reviews – although in our view it’s ultimately the strengthening domestic economy that will make the case for rate hikes next year.

Fixed vs Floating for mortgages

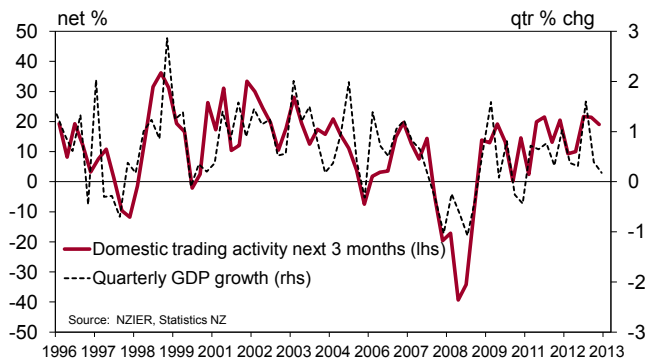
We are now indifferent between fixing and floating.

In our view, interest rate markets are now “fairly priced”. We expect short-term rates to rise substantially over the next three years. The level of long-term fixed rates, which are higher than short-term rates, is in tune with that expectation. This means we can discern no obvious interest rate advantage in any particular term. The choice really comes down to individual circumstances and preferences.

NZ interest rates



QSBO domestic trading activity and GDP

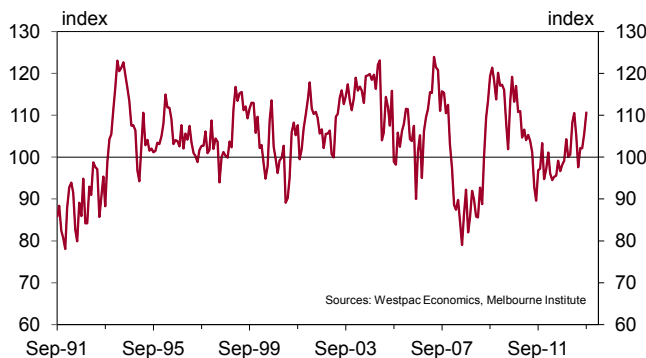


NZ Q3 NZIER business opinion

Oct 8, Last: 32

- General business sentiment rose to a three-year high in Q1 and remained there in Q2. Conditions look to have improved further since then, with the monthly ANZ business confidence survey for September reaching its highest level since 1999 (note that both surveys showed a strong downward bias during the 2000s boom).
- While GDP growth was substantially lower than implied by this survey over the first half of the year, that largely reflected the impact of drought (agriculture is not directly covered by the QSBO). With milk production rebounding strongly in recent months, Q3 growth is likely to exceed the signal from this survey.
- With the upturn in activity well-established, evidence of price pressures will become more important. Pricing intentions rose in the Q2 survey, but from very subdued levels.

Consumer Sentiment

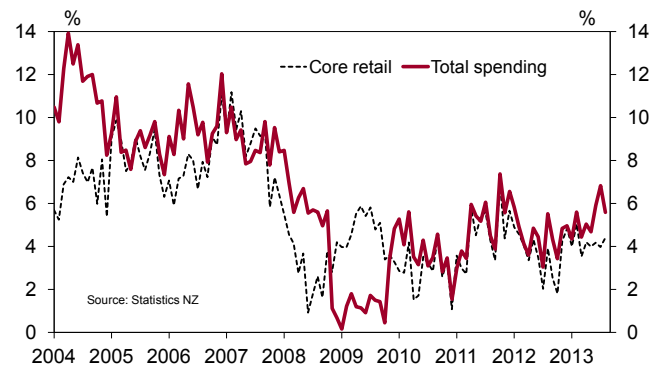


Aus Oct Westpac-MI Consumer Sentiment

Oct 9, Last: 110.6

- Consumer Sentiment surged 4.7% in September, eclipsing its March peak (just, 110.6 vs 110.5) to record the most positive reading since December 2010. The survey was conducted in the week leading into the Federal election and would have been influenced by widespread expectations of a Coalition victory.
- The Oct survey is in the field from Sep 30 to Oct 6. Factors that may influence sentiment include: the RBA's decision to leave rates on hold; generally soft economic data but wide media coverage of recent signs of strength in housing markets. News from abroad has been more downbeat with the weak US economy prompting the Fed to surprise markets with its decision not to taper bond purchases; the US government shutdown and renewed political instability in Europe. Sep's election boost may subside although evidence from the past suggests this can last several months.

Card transactions, annual % change

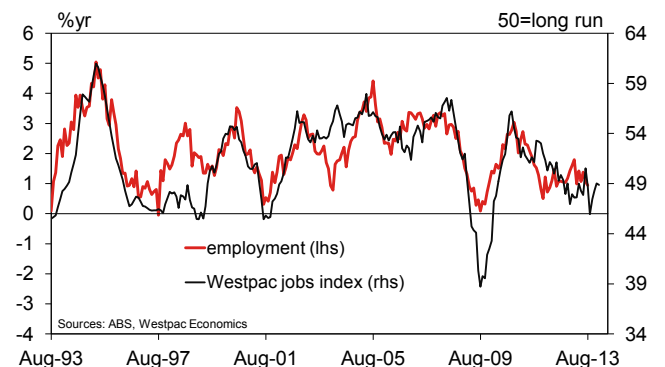


NZ Sep electronic card transactions

Oct 9, Last: 0.4%, WBC f/c: 0.5%

- Household spending recorded solid gains across the board in August. The annual pace of spending growth has been picking up since the start of this year, although it remains well below pre-recession levels.
- We've assumed a broadly on-trend month for September, with no special factors of note. Fuel prices fell over the month but on average were similar to August. September was warm but wet, which may have helped clothing sales to recover after a very warm and dry winter.
- Growth in ex-fuel spending to date has been largely volume-driven, as the rising NZ dollar has depressed the prices of imported goods. However, recent business surveys have shown a lift in pricing intentions, especially in retail, which may reflect the recent flattening out in the NZD's trend.

Jobs index – an average of the business surveys

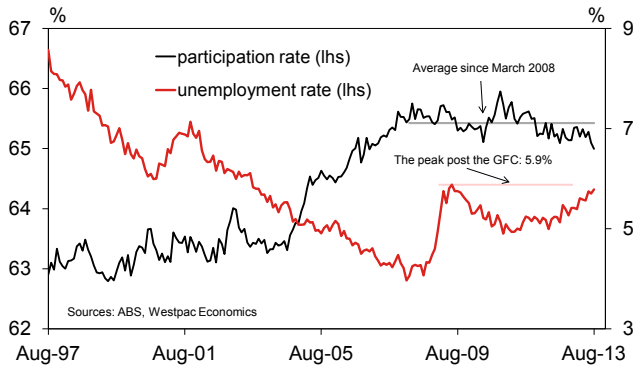


Aus Sep employment

Oct 10, Last: -10.8k, WBC f/c: 20k
Mkt f/c: 15k, Range: flat to 45k

- Total employment fell 10.8k in Aug, less than the market median and Westpac's forecast for +10k. This has seen the annual rate of employment growth fall to 0.9%/yr, more in line with what the leading indicators are suggesting.
- The mix of employment was also soft, -2.6k full-time and -8.2k part-time, and total hours worked was broadly flat.
- The employment to population ratio has fallen to 61.2%, which is below the low point hit in 2009 post the GFC. Growth in employment has been running well behind population growth.
- The drop in participation, from 65.3% in June to 65.1% in July and then to 65.0% in August, suggest some sample volatility may have been at play over the last few months, hence our forecast for a 20k bounce in September.

Unemployment and participation rates

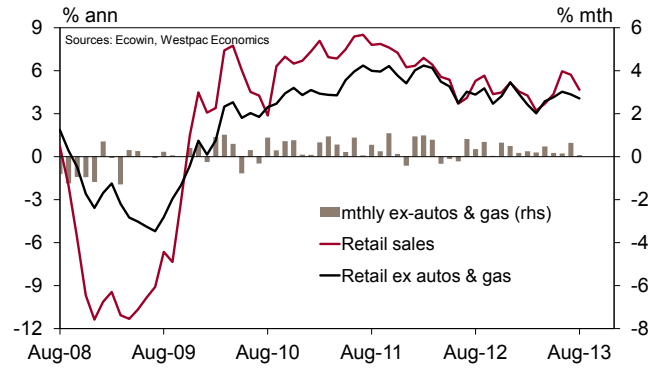


Aus Sep unemployment rate

Oct 10, Last: 5.8%, WBC f/c: 5.9%
Mkt f/c: 5.8%, Range: 5.7% to 5.9%

- The unemployment rate rose from 5.7% in July to 5.8% in Aug. At two decimal places, it was still a solid rise, from 5.70% (5.71% pre revisions) to 5.78%.
- The only thing holding back a larger rise in the unemployment rate was the surprising fall in the participation rate to 65.0% from 65.1% in July. Had the participation rate not fallen, the unemployment rate would now be 5.9%.
- We are forecasting a 0.1ppt rise in the participation rate which, given the trend rise in population, will generate a 37k lift in the working age population.
- Given that we are forecasting a 20k bump in employment, the unemployment rate is forecast to rise to 5.9%.

US retail sales



US Sep retail sales to remain sluggish

Oct 11, Last: 0.2%, WBC 0.0%

- Retail sales rose 0.2% in August. With autos up 0.9%, gasoline flat, and clothing, DIY, sporting goods and general merchandise all posting falls, and no standout strong storetypes in Aug, this was a weak report, but for an upward revision to July. Ex autos/gas, core retailing rose 0.1%, continuing the recent pattern whereby the first month of the quarter has tended to see solid core sales growth, before nearly stalling later in the quarter.
- Auto sales fell 2.6% in Sep and gasoline prices have been drifting lower. August income and spending data showed evidence of renewed consumer saving and although Sep payrolls, hours worked and earnings data are not yet available, the slower jobs growth revealed by the ADP survey, and falling consumer confidence, provide reason to expect another sluggish core retail outcome. On our forecasts a 0.2% core rise will just offset lower auto and gasoline sales.

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 7					
Aus	Labour Day	–	–	–	Public holiday in NSW, SA, Qld.
Eur	Oct Sentix investor confidence	6.5	10.6	3	Italian politics, US shutdown negatives. Fed non-taper positive.
US	Aug consumer credit \$bn	10.4	12	–	Student and auto loans the main drivers, credit cards weaker.
Can	Aug building permits	20.70%	–	–	Rebound mainly due to commercial permits.
Tue 8					
NZ	Q3 NZIER business opinion	32	–	–	Ex-agri activity solid in H2 and latest quarter should maintain this.
Aus	Sep NAB business survey	–	–	–	Conditions soft, index +1pt to –6. Confidence jumped 9pts to +6.
	Sep ANZ job ads	–2.0%	–	–	Has fallen in 25 of the last 28 months to be down 18.5%yr in August
Chn	Sep HSBC-Markit services PMI	52.8	–	–	Mysteriously re-scheduled from last Friday.
Ger	Aug industrial production	–1.7%	0.90%	0.50%	Factory PMI over 50; size of any bounce in IP, exports and/or orders
	Aug exports	–1.1%	1.30%	0.50%	will be key determinants of Q3 GDP forecasts both for Germany
	Aug factory orders	–2.7%	1.00%	–0.5%	and the broader Eurozone.
UK	Sep BRC sales %yr	1.80%	–	–	Same store sales growth steady since freezing Mar-Apr weather.
	Sep house prices net balance	40%	–	–	RICS surveyors series. Approaching highs of previous cycles.
US	Sep NFIB small business optimism	94	–	92.5	Small business worried about impact of shutdown, as in late 1995.
	*Aug trade balance \$bn	–39.1	–39.3	–	Exports down 0.6%; imports up 1.6%: Jul deficit widened \$4.6bn
	Oct IBD-TIPP economic optimism	46	–	43	Govt shutdown should impact on Federal policies component.
	Fedspeak	–	–	–	Pianalto and Plosser
Can	Sep housing starts	–6.6%	–2.9%	–	Down three months running.
	Aug trade balance C\$bn	–0.9	–0.7	–	Exports down 0.6%; imports up 0.6%: Jul deficit widened.
Wed 9					
NZ	Sep electronic card transactions	0.40%	–	0.50%	Spending growth has been edging higher over the course of this year.
Aus	Oct Westpac-MI Consumer Sentiment	110.6	–	–	How well will Sep's election bump be sustained?
	Oct Westpac-MI unemp' expect. %mth	–6.6%	–	–	The index has fallen 8.2%yr but still 20% higher than its long-run average
UK	Sep BRC shop price index %yr	–0.5%	–	–	Minimal inflationary pressure on the high street.
	Aug industrial production	0.00%	0.20%	0.40%	55+ PMI readings imply rising output outside oil/utility volatility
	Aug trade balance £bn	–9.9	–8.8	–	Exports down £2bn; imports down £350mn: Jul deficit widened.
US	*Aug wholesale inventories	0.10%	0.30%	0.10%	Inventories expanded 1.1% in Jan but kept tight since then.
	Sep 17-18 FOMC minutes	–	–	–	Excessive Fedspeak makes clear it was close decision not to taper.
	Fedspeak	–	–	–	Evans
Thu 10					
NZ	Sep manufacturing PMI	57.5	–	–	Above 55 for six of the last eight months.
Aus	Oct MI inflation expectations %yr	1.50%	–	–	Sept was the lowest print on inflation expectations since early 1993
	Sep employment chg, '000	–10.8	15	20	The very low part. rate following two negatives points to a Sept bounce
	Sep unemployment rate	5.80%	5.80%	5.90%	A 0.1ppt rise in participation is enough to lift the unemployment rate
Chn	Sep FX reserves USDbn	3497	3520	–	Tentative date: July outflows, August and September inflows.
	Sep new bank loans RMBbn	711	659	–	Tentative date: Seasonal weakness in corp., households to remain firm.
	Sep M2 money supply %yr	14.70%	14.00%	–	Tentative date: Becoming less useful as a predictor of TSF.
	Sep total social financing RMBbn	1570	1200	–	Tentative date: August shadow bounce a surprise unlikely to repeat.
Eur	ECB commentary	–	–	–	ECB chief Draghi at Eco Club of NY.
UK	BoE policy decision APP £bn	375	375	375	On hold at 0.5% but Nov meeting will have more up-beat forecasts
US	*Sep import prices	0.00%	0.30%	0.20%	Oil prices little changed on avge relative to Aug.
	Initial jobless claims w/e Oct 4	308k	307k	–	Claims may be distorted by government shutdown.
	Sep federal budget \$bn	75.2	60	–	Impact of fiscal compromise/sequester plain to see.
	Fedspeak	–	–	–	Bullard and Williams
Can	Aug new house prices	0.20%	–	–	Running under 2% yr annual pace; slowest since 2010.
Fri 11					
NZ	Sep food price index	–0.50%	–	–0.70%	Seasonal drop in produce prices; annual inflation still near zero.
UK	Aug construction output	2.20%	–	1.10%	PMI survey and housing data suggest some momentum.
US	*Sep PPI	0.30%	0.20%	0.20%	Energy prices turning lower, food prices normalising.
	*Sep PPI core	0.00%	0.10%	0.10%	Core trend now barely 0.1%, some upside risk from vehicle prices.
	*Sep retail sales	0.20%	0.20%	0.00%	Auto and gasoline sales probably declined, offsetting cautious core
	*Sep retail sales ex autos & gas	0.10%	–	0.20%	retail sales growth for a flat overall outcome.
	*Aug business inventories	0.40%	0.30%	0.20%	Inventories expanded 1.0% in Jan but kept tight since then.
	Oct UoM consumer sentiment prelim	77.5	77	74.5	Govt shutdown should impact.
	World Bank-IMF annual meeting	–	–	–	Washington.
Can	Sep employment ch'	59k	15k	5k	Jobs growth has averaged 12k per month so far this year.
	Q3 BoC senior loan officer survey	–12.7	–	–	Credit availability relatively easy though not as loose as in 2011.
	Q3 business outlook survey	9	–	–	Future sales index

*These US data releases will be delayed for the duration of the government shutdown.

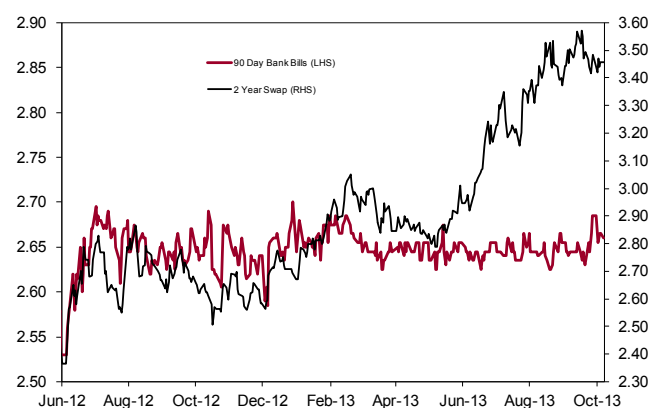


New Zealand forecasts

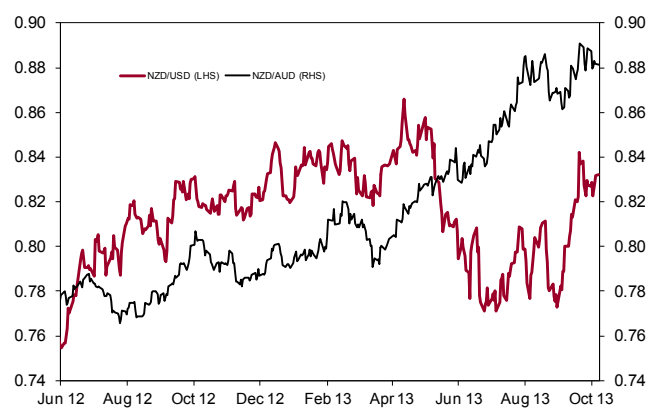
Economic Growth Forecasts	March years				Calendar years			
	% change	2012	2013f	2014f	2015f	2011	2012	2013f
GDP (Production) ann avg	1.9	2.7	2.9	3.8	1.4	2.7	2.7	3.7
Employment	1.0	0.4	2.5	2.8	1.5	-1.4	3.7	2.8
Unemployment Rate % s.a.	6.8	6.2	5.6	4.8	6.3	6.8	5.8	4.8
CPI	1.6	0.9	1.4	2.3	1.8	0.9	1.4	2.1
Current Account Balance % of GDP	-3.8	-4.5	-4.4	-5.4	-3.6	-4.7	-4.2	-5.4

Financial Forecasts	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Cash	2.50	2.75	3.00	3.25	3.50	3.75
90 Day bill	2.75	3.00	3.25	3.50	3.75	4.00
2 Year Swap	3.50	3.70	3.80	3.90	4.10	4.20
5 Year Swap	4.40	4.45	4.50	4.60	4.70	4.80
10 Year Bond	4.40	4.50	4.60	4.70	4.75	4.80
NZD/USD	0.83	0.84	0.82	0.79	0.77	0.76
NZD/AUD	0.87	0.90	0.91	0.91	0.90	0.90
NZD/JPY	81.3	81.5	78.7	75.1	71.9	71.1
NZD/EUR	0.63	0.64	0.64	0.64	0.64	0.63
NZD/GBP	0.53	0.53	0.51	0.51	0.50	0.48
TWI	77.7	78.8	77.9	76.5	74.8	74.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 7 Oct 2013

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.50%	2.50%
30 Days	2.64%	2.63%	2.64%
60 Days	2.65%	2.63%	2.64%
90 Days	2.66%	2.64%	2.65%
2 Year Swap	3.46%	3.49%	3.48%
5 Year Swap	4.37%	4.47%	4.48%

NZ foreign currency mid-rates as at Monday 7 Oct 2013

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.8321	0.8350	0.8007
NZD/EUR	0.6133	0.6161	0.6082
NZD/GBP	0.5192	0.5217	0.5123
NZD/JPY	80.95	82.79	79.81
NZD/AUD	0.8812	0.8914	0.8696
TWI	77.17	77.80	75.64

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
Australia						
Real GDP % yr	1.4	2.5	2.4	3.7	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.1	2.7
Unemployment %	5.6	5.2	5.2	5.4	6.1	6.7
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.6	-3.0
United States						
Real GDP %yr	-3.1	2.4	1.8	2.8	1.5	1.7
Consumer Prices %yr	-0.3	1.6	3.1	2.1	1.4	1.6
Unemployment Rate %	9.3	9.6	8.9	8.1	7.6	7.5
Current Account %GDP	-2.7	-3.0	-2.9	-2.7	-2.5	-2.7
Japan						
Real GDP %yr	-5.7	4.9	-0.5	1.9	1.9	2.4
Consumer Prices %yr	-1.3	-0.7	-0.3	0.0	-0.2	0.1
Unemployment Rate %	5.2	5.1	4.5	4.3	4.3	4.3
Current Account %GDP	2.8	3.6	2.0	2.1	2.0	2.0
Euroland						
Real GDP %yr	-4.4	1.9	1.6	-0.6	-0.5	-0.1
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.2
Unemployment Rate %	9.5	10.0	10.1	11.7	12.4	13.0
Current Account %GDP	-0.2	-0.1	0.0	0.9	1.0	1.0
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	0.2	1.1	0.9
Consumer Prices %yr	2.2	3.2	4.0	2.8	2.3	1.8
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.5	-1.9	-3.8	-2.5	-1.5

Forecasts finalised 4 October 2013

Interest Rate Forecasts	Latest	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
Australia						
Cash	2.50	2.50	2.25	2.00	2.00	2.00
90 Day Bill	2.57	2.60	2.35	2.10	2.10	2.10
10 Year Bond	3.99	3.75	3.60	3.40	3.80	4.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.60	2.35	2.40	2.40	2.80	3.00
ECB Repo Rate	0.50	0.50	0.50	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Dec 13	Mar 14	Jun 14	Sep 14	Dec 14
AUD/USD	0.9400	0.95	0.93	0.90	0.87	0.85
USD/JPY	97.25	97	96	95	94	93
EUR/USD	1.3620	1.36	1.33	1.28	1.23	1.20
AUD/NZD	1.1340	1.14	1.11	1.10	1.10	1.10

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

For email address changes contact:
WNRResearch@westpac.co.nz

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Disclaimer continued

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