



Rere Waterfall, Gisborne.

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## Down but not out

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Last week we expressed scepticism that threatened or actual currency intervention by the Reserve Bank would have a sustained impact, or that the NZ dollar was on the cusp of a sustained slide. After a week of currency gyrations, our view hasn't changed.

To be sure, on last Monday the Kiwi fell by more than half a cent on confirmation that the Reserve Bank had sold \$521m in August. While that had been widely rumoured at the time, perhaps markets needed evidence that the Reserve Bank is willing to put its money where its mouth is. Based on previous intervention episodes – the last occurred in mid-2008, when the Reserve Bank cumulatively sold more than \$1.5bn over several months – markets may also plausibly have inferred that the Reserve Bank might follow up with more.

More importantly, we then had more evidence that NZ's export environment has weakened – another 10% drop in global whole milk powder prices on last week's GlobalDairyTrade auction – and another lift in market sentiment around the US dollar following a strong US jobs print over the weekend.

In our view, those developments do offer some justification for the current weakness in the NZ dollar – particularly the latest drop in dairy prices, though oddly markets barely budged on the news. It's difficult to identify a catalyst for the renewed fall in this week's dairy auction prices, which comes after a period of calm over the previous couple of months. The most obvious candidate is the deteriorating sentiment about China's growth prospects, which seems to be weighing on both hard and soft commodity prices more broadly.

In any case, the lower exchange rate will only go so far to soften the blow for New Zealand dairy farmers. With wholesale prices now at such a low point, we've decided to revise our payout forecast for the current season down further, from \$5.30 to \$4.80, and over the next few weeks we will also be taking a hard look at our \$6.60 forecast for the 2015/16 season. Our core view remains that Chinese growth will slowly improve over the year ahead, and that global dairy supplies will ease back. But for this season at least, any resulting lift in dairy prices is likely to be later and weaker than we had previously pencilled in.



# Down but not out continued

Even so, we're still not persuaded of the case for a further substantial fall in the exchange rate from here. We have set out our thoughts in an article reviewing what we do and don't know about the drivers of the NZ dollar (see 'Great expectations – what drives the NZ dollar?' at <http://www.westpac.co.nz/wib/economic-updates/economic-research-and-strategy>).

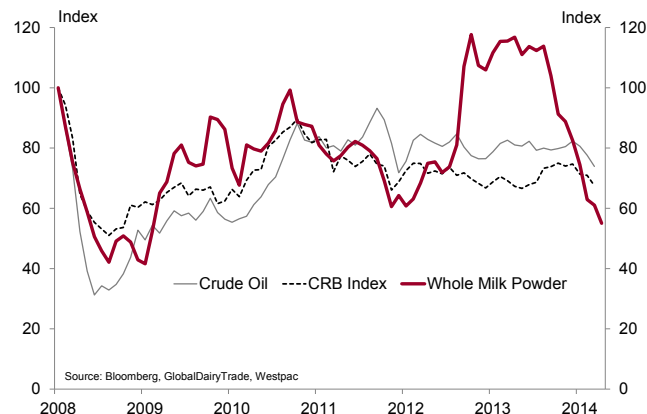
We're particularly wary of arguments based on the 'unsustainable' level of the exchange rate, which are based on highly theoretical concepts of fair value. For example, one popular approach is to calculate what level of the exchange rate would stabilise the economy's net foreign debt. That this calculation has many moving parts goes without saying – not least the level of net foreign debt itself. New Zealand's net foreign debt has shrunk dramatically in recent years (partly as a result of data revisions) – implying a less overvalued exchange rate.

A seemingly more pragmatic focus on near-term indicators isn't necessarily more conclusive if applied too literally. For instance, when commodity prices surged last year the NZ dollar hardly budged – perhaps because financial markets chose to look through a temporary shortage in global dairy supplies. By the same token, it's not clear how far the exchange rate should now follow commodity prices on the way down.

Other popular 'fundamental' explanations of short-term movements in the exchange rate include interest rate differentials, house prices, and net immigration. All of these have correlated more or less well with the exchange rate in the past, but that's probably because they are all indicators of the general (relative) health of the economy, rather than direct drivers of the exchange rate.

One summary of this information is provided by our monthly 'Local Knowledge' indicator, which canvasses a range of high-frequency indicators of New Zealand economic conditions. On that basis, the latest round of August data actually points to a slight lift in economic momentum in recent months compared to the June quarter.

Commodity prices



A slightly more timely read was provided by the last week's ANZ business confidence survey. While general business sentiment continued to slide in September, the survey details were actually more positive than in previous months. Own-activity expectations, which correspond more closely with GDP growth, were up a fraction this time, while intentions for investment, hiring and exports were all a few points higher.

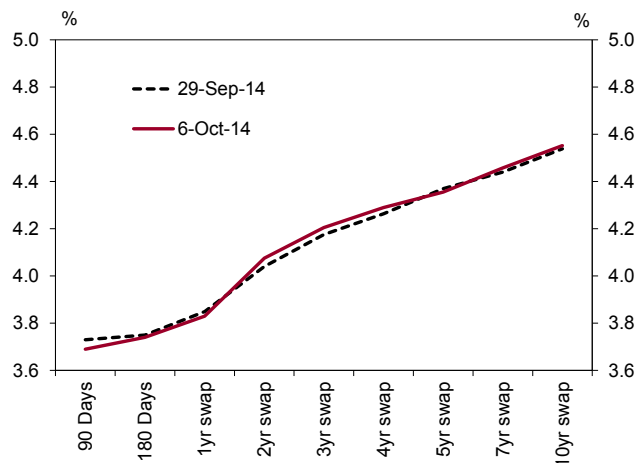
Admittedly, both these gauges predate the latest drop in dairy prices and payout forecasts (that will also be true of the NZIER's Quarterly Survey of Business Opinion, released tomorrow). But they are a reminder that New Zealand's domestic environment is still relatively healthy. Historically, large and sustained falls in the NZ dollar have typically coincided with a severe economic downturn – still an unlikely scenario, and not one we should be cheering for.

## 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

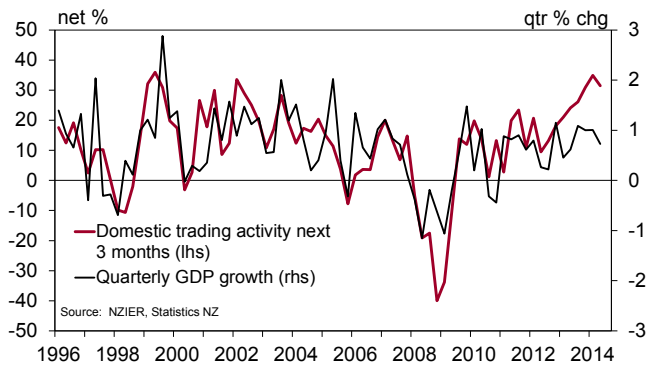


## NZ Q3 NZIER business opinion

Oct 7, Last: 32

- New Zealand business sentiment fell back from 20 year highs in the June quarter. Monthly business surveys suggest it may have eased further since then. The survey will have been in the field for most of September, but with responses heavily weighted towards the period before the 20 September election.
- The survey's report of businesses' past own activity is an important early indicator of GDP growth in the quarter. Our current forecast is that GDP growth held steady at 0.7% in the September quarter.
- With the Reserve Bank now increasingly focused on inflation, the survey's indicators of price pressures will also be closely watched. These generally firmed in the June quarter, although the CPI itself didn't reciprocate.

### QSOB domestic trading activity and GDP

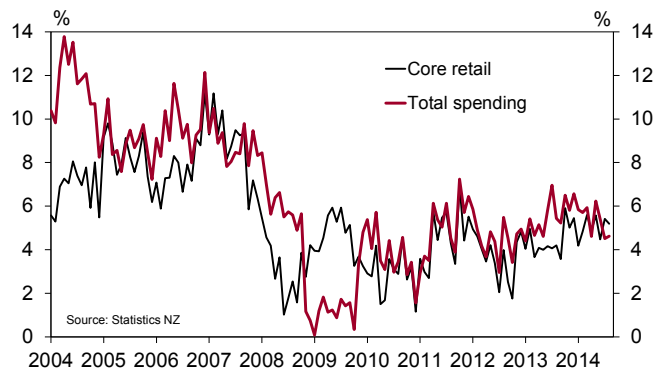


## NZ Sep retail electronic card spending

Oct 9, last 0.5%, Westpac f/c: 0.4%

- The trend pace of retail electronic card spending has slowed this year, consistent with slower house price inflation and a moderation in consumer confidence.
- Against this slower trend a pop higher in core spending growth in July and August (excluding petrol and vehicle related spending) was somewhat surprising. With petrol prices roughly flat in September, we expect to see a return to a more moderate 0.4% pace of growth in both core and retail spending in the month.

### Card transactions, annual % change

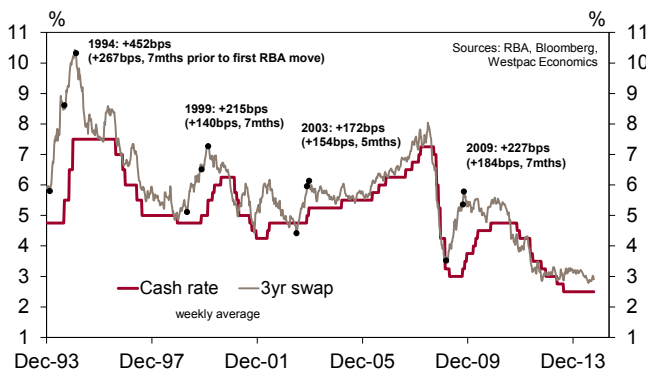


## Aus RBA policy decision

Oct 7, Last: 2.50%, WBC f/c: 2.50%  
Mkt f/c: 2.50%, Range: 2.50% to 2.50%

- The RBA is widely expected to leave interest rates unchanged following the October Board meeting.
- Rates have been on hold since August 2013, when they were lowered by 0.25% to 2.50%, down from a peak of 4.75% at the start of November 2011.

### RBA cash rate, 3 year swap

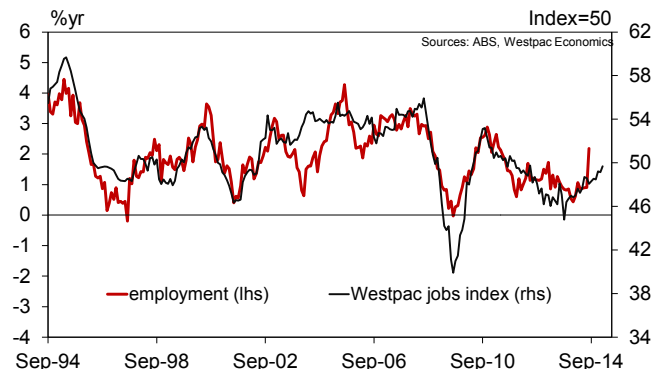


## Aus Sep employment

Oct 9, Last: 121.0k, WBC f/c: -70k,  
Mkt f/c: -30k, Range: -100k to 30k

- Total employment lifted by 121.0k in Aug eclipsing market expectations for a +15k rise and the survey high of 35k. The result of such a large monthly surge was an acceleration in the annual growth pace from 0.9%yr to 2.2%yr, the fastest pace since April 2011.
- To put it another way, employment grew 1.0% mth or, in American terms, 13.3% annualised. You have to go back to Jul 1994 to find a similar rise; before that you have to go back to Aug 1991. It was also very curious that most of the rise was accounted for by a 106.7k rise in part-time employment.
- We are suspicious that changes to the ABS survey process, which applied only to the month of Aug, affected the normal significant negative seasonality in that month. For this reason, we are looking for a significant correction in September.

### Westpac jobs index pointing to 1½%yr growth

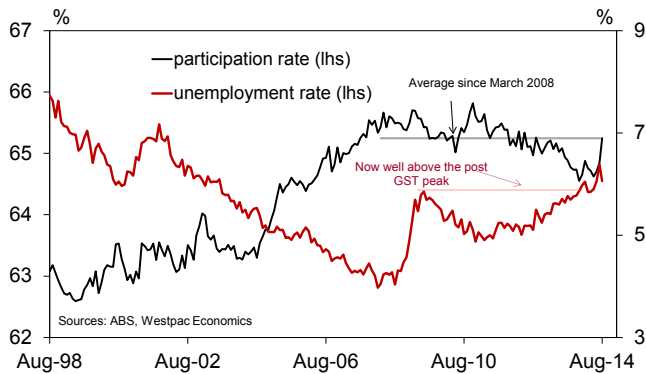


## Aus Sep unemployment rate

**Oct 9, Last: 6.1%, WBC f/c: 6.2%,  
Mkt f/c: 6.2%, Range: 6.3% to 6.0%**

- In Aug, even though there was a significant boost to participation, from 64.9% to 65.2%, it was not enough to more than marginally offset the rise in employment. The unemployment rate fell to 6.1% (6.06%) from 6.4% (6.37%). The market was expecting the unemployment rate to fall to 6.3% from 6.4%.
- For Sep, we are expecting participation to fall back to the level it was at in July and from there, continue the modest downtrend it has been exhibiting. If the changes to the Aug survey did affect employment responses, it is also likely to have affected the response to participation. If this is not the case, and our forecast for employment is correct, then there are upside risks to our unemployment rate forecast.

Unemployment and participation rates

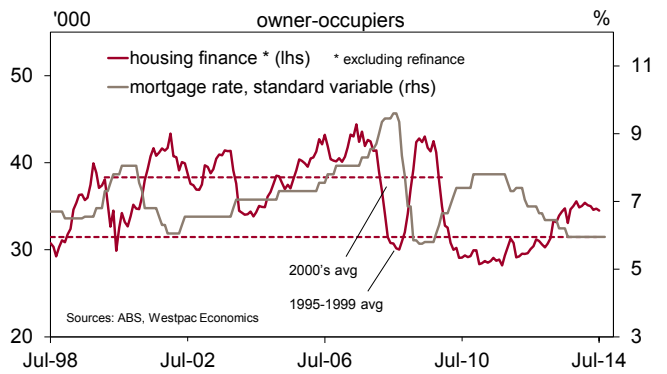


## Aus Aug housing finance (no.)

**Oct 10, Last: 0.3%, WBC f/c: flat  
Mkt f/c: 0.2%, Range: flat to 2.0%**

- The July finance approvals report showed essentially flat owner-occupier activity (number of approvals up 0.3%*mth* and just 1.7%*yr*) but a sharp lift in the value of new loans to investors (up 6.8%*mth* and just under 30%*yr*). The value of loans to this segment is now comfortably above those to 'upgraders', making up just under 50% of all new loans by value, on a par with the peak during the 2002-03 boom.
- Industry data suggests owner-occupier finance approvals held about flat in August. Cooling consumer sentiment towards house purchase and renewed job loss fears continues to point to modest declines in owner-occupier activity in coming months. Deteriorating affordability is clearly weighing on this segment. Investor activity is less affected by these considerations and likely to remain more resilient as a result.

Owner-occupier finance & the rate cycle





# Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 6</b>					
<b>NZ</b>	Q3 Westpac-MM employ. confidence	109.9	-	-	Confidence has gradually improved in the last two years.
<b>Aus</b>	Daylight saving	-	-	-	Begins in NSW, ACT, Vic, Tas, SA - but not in Qld, NT, WA.
	Public holiday	-	-	-	Labour Day in NSW, ACT, Qld, SA.
	Sep TD-MI inflation gauge, %yr	2.5%	-	-	The three month pace has slowed from 0.9% in May to 0.2% in Aug.
	Sep ANZ job ads	1.5%	-	-	Job ads now up 7.7%yr, the fastest pace since June 2011.
<b>Eur</b>	Oct Sentix investor confidence	-9.8	-	-7.8	Survey taken Oct 2-4 so capturing ECB presser, US payrolls data.
<b>Ger</b>	Aug factory orders	4.6%	-2.3%	-3.5%	Weak Jul euro orders bounce; foreign orders up 10%, vulnerable in Aug.
<b>UK</b>	Sep house prices 3mth/yr	9.7%	-	-	Tentative date for Halifax series, due sometime this week.
<b>US</b>	Aug labour market conditions index	-	-	-	New series compiled by Fed researchers based on 19 indicators.,
<b>Can</b>	Sep IVEY PMI	50.9	-	53.0	More volatile and weaker overall than RBS PMI.
<b>Tue 7</b>					
<b>NZ</b>	Q3 NZIER business opinion	32	-	-	Lower confidence suggests a more moderate growth pace.
<b>Aus</b>	RBA policy decision	2.50%	2.50%	2.50%	Rates on hold. Accompanying statement will be key focus.
<b>Chn</b>	Sep HSBC services PMI	54.1	-	-	Bounced in August after July collapse. NBS version edged lower in Sep.
<b>Ger</b>	Aug industrial production	1.9%	-1.5%	-1.0%	Factory PMI down sharply in Aug-Sep, but some orders still to be met.
<b>UK</b>	Aug industrial production	0.5%	0.1%	-0.2%	Collapsing PMI and pull-back in utilities as Aug much cooler than Jul.
<b>US</b>	Aug JOLTS report	-	-	-	Job openings, hires, quits and fires - a guide to job mkt dynamics.
	Oct IBD-TIPP economic optimism	45.2	-	43.0	Weekly indicators and Conf Brd Sep confidence much softer.
	Aug consumer credit \$bn	26	20.5	-	July auto loans surged ahead of Aug sales spike, but sales down in Sep.
	Fedspeak	-	-	-	George, Kocherlakota and Dudley (different locations).
<b>Can</b>	Aug building permits	11.8%	-	-	Residential permits led the way in July, up 18%.
<b>Wed 8</b>					
<b>UK</b>	Sep BRC shop price index %yr	-1.6%	-	-	Further rise would signal CPI bottoming, but renewed BRC fall possible.
	BoE credit conditions survey	-	-	-	Published by Financial Stability Committee.
<b>US</b>	Sep 16-17 FOMC minutes	-	-	-	Two dissenters, revised forecasts, higher dots, ahead of Oct end of QE.
	G20 Fin Min & Central Bank Govs	-	-	-	Meeting, Washington.
<b>Can</b>	Sep housing starts	-3.7%	-	-	Building permits gain in July yet to show up in starts.
<b>Thu 9</b>					
<b>NZ</b>	Sep retail electronic card spending	0.5%	-	0.4%	August's 0.6% growth in core spending unlikely to be sustained.
<b>Aus</b>	Sep employment	120k	-30k	-70k	Significantly outsized rise appears to be due to survey changes.
	Sep unemployment rate	6.1%	6.2%	6.2%	A fall back to the July participation limits the rise in unemployment.
	RBA Head of Financial Stability Luci Ellis	-	-	-	Speaking, topic TBA, Sydney 12.55pm AEDT.
<b>Eur</b>	ECB commentary in US	-	-	-	ECB's Draghi at Brookings Inst. on monetary policy, with Fed's Fischer.
<b>Ger</b>	Aug exports	4.8%	-6.0%	-2.5%	July's exports surge unsustainable in near term given orders, geopol.
<b>UK</b>	Sep house prices net balance	40%	38%	-	RICS surveyors series. Down from 57% peak in March.
	BoE policy decision bank rate	0.5%	0.5%	0.5%	Spring next year (May) still most likely to see first rate hike.
<b>US</b>	Initial jobless claims w/e Oct 4	287k	-	285k	Claims holding below 300k for extended period, first time since 2006.
	Aug wholesale inventories	0.1%	0.3%	0.1%	Inventories rebuild a big contributor to Q2 GDP bounce.
	Fedspeak	-	-	-	Bullard and Williams.
<b>Can</b>	Aug new house prices	0.0%	-	-	Running 1.4% yr annual pace; slowest since start of year.
<b>Fri 10</b>					
<b>Aus</b>	Aug housing finance	0.3%	0.2%	flat	Headline figure excludes investor loans which kicked up in July.
	RBA Assist. Gov Financial System	-	-	-	Malcolm Edey, topic TBA, AB+F FINSIA conference, Sydney, 11.45am.
<b>UK</b>	Aug trade balance £bn	-10.2	-9.5	-	Jul exports rose 2.1%; imports up 3.9%; deficit second widest on record.
	Aug construction output	0.0%	-	1.1%	PMI survey and housing data suggest Jul lul temporary.
<b>US</b>	Sep import prices	-0.9%	-0.6%	-0.8%	Oil prices down and general dollar strength another price squasher.
	Sep federal budget \$bn	75.1	72.0	-	A year on for the government shutdown.
	Fedspeak	-	-	-	George, Plosser, Lacker (different locations).
	World Bank-IMF	-	-	-	Annual meeting, Washington.
<b>Can</b>	Sep employment ch'	-11k	-	22k	Jobs growth has averaged 11k per month so far this year.
	Q3 BoC senior loan officer survey	-12.8	-	-	Credit availability relatively easy though not as loose as in 2011.
	Q3 business outlook survey	24	-	-	Future sales index.
<b>Sometime from the 10th</b>					
<b>Chn</b>	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.

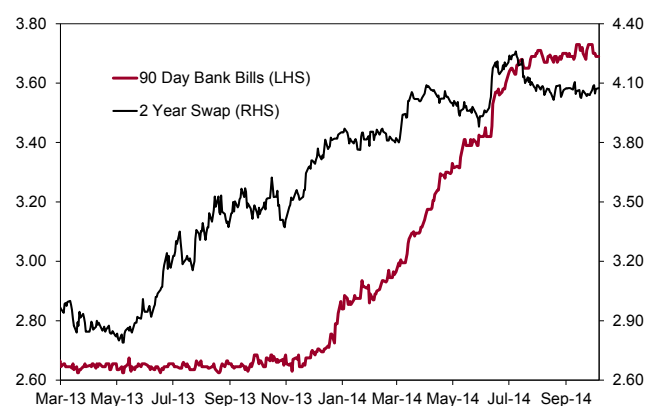


# New Zealand forecasts

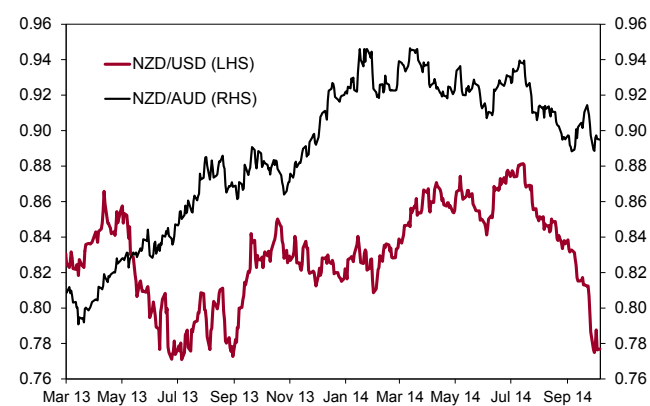
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2012	2013	2014f	2015f
% change								
GDP (Production) ann avg	2.3	3.2	3.4	3.1	2.5	2.8	3.6	3.1
Employment	0.4	3.8	2.8	2.6	0.4	2.9	3.0	2.9
Unemployment Rate % s.a.	6.2	5.9	5.3	4.7	6.8	6.0	5.4	4.7
CPI	0.9	1.5	1.7	2.1	0.9	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	0.81	0.81	0.84	0.83	0.82	0.81
NZD/AUD	0.90	0.90	0.91	0.89	0.87	0.85
NZD/JPY	89.1	89.9	94.1	93.8	93.5	93.2
NZD/EUR	0.64	0.64	0.66	0.65	0.64	0.62
NZD/GBP	0.51	0.50	0.50	0.48	0.46	0.45
TWI	78.8	78.8	81.1	79.7	78.4	77.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 6 October 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.66%	3.68%	3.66%
60 Days	3.68%	3.70%	3.67%
90 Days	3.69%	3.70%	3.69%
2 Year Swap	4.08%	4.06%	4.08%
5 Year Swap	4.36%	4.44%	4.45%

NZ foreign currency mid-rates as at Monday 6 October 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7769	0.8148	0.8313
NZD/EUR	0.6210	0.6350	0.6415
NZD/GBP	0.4869	0.5001	0.5136
NZD/JPY	85.21	88.88	87.30
NZD/AUD	0.8949	0.9122	0.8877
TWI	76.26	78.75	78.95



## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2010	2011	2012	2013	2014f	2015f
<b>Australia</b>						
Real GDP % yr	2.3	2.6	3.6	2.3	3.2	3.2
CPI inflation % annual	2.8	3.0	2.2	2.7	2.3	2.8
Unemployment %	5.2	5.2	5.3	5.8	6.4	6.1
Current Account % GDP	-3.5	-2.8	-4.4	-3.3	-3.0	-2.0
<b>United States</b>						
Real GDP %yr	2.5	1.8	2.3	2.2	2.0	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	5.7
Current Account %GDP	-3.0	-2.9	-2.9	-2.4	-2.5	-2.4
<b>Japan</b>						
Real GDP %yr	4.9	-0.3	1.5	1.6	1.6	1.4
<b>Euroland</b>						
Real GDP %yr	1.9	1.6	-0.6	-0.4	0.7	1.0
<b>United Kingdom</b>						
Real GDP %yr	1.7	1.1	0.3	1.8	2.6	2.1
<b>China</b>						
Real GDP %yr	10.4	9.3	7.7	7.7	7.4	7.5
<b>East Asia ex China</b>						
Real GDP %yr	7.8	4.4	4.0	4.0	3.9	5.0
<b>World</b>						
Real GDP %yr	5.2	3.9	3.2	3.0	3.1	3.7
Forecasts finalised 5 September 2014						

Interest Rate Forecasts	Latest	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
<b>Australia</b>						
Cash	2.50	2.50	2.50	2.50	2.75	3.00
90 Day Bill	2.71	2.55	2.55	2.65	3.00	3.25
10 Year Bond	3.46	3.60	3.80	4.20	4.50	4.70
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.250	0.500
US 10 Year Bond	2.43	2.70	2.70	2.80	3.20	3.20
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	0.8790	0.90	0.90	0.92	0.93	0.94
USD/JPY	108.80	110	111	112	113	114
EUR/USD	1.2650	1.26	1.26	1.27	1.28	1.29
AUD/NZD	1.1170	1.11	1.11	1.10	1.12	1.15

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## Disclaimer continued

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