



Surf break, Piha.

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The good oil

In a few short months, crude oil prices have fallen to levels not seen since 2009. The resulting drop in petrol prices will only reinforce the mix of strong domestic demand and low inflation that New Zealand has enjoyed of late.

Commentators have rightly pointed out that the recent slide in oil prices is 'good' deflation - the basic driver has been surging North American oil production, though the recent softening in global demand has no doubt also played a role. And the latest slide occurred after OPEC dispelled fears that it would cut its production levels to prop up prices.

We are sceptical that oil will stay this cheap for long. The new sources of Canadian and US oil are relatively expensive to extract, and the taps can be turned off more easily than in conventional oil wells. That suggests that production levels may be more responsive to lower prices than in past decades, which will limit how far prices fall.

For now, though, the oil producers are clearly pursuing cash flow rather than pricing power. For oil importing countries such as New Zealand that will provide some much-needed support for the terms of trade, which dropped 4.4% in the September quarter and are likely to follow wholesale global dairy prices down further over the next six months.

On its face, last week's Fonterra dairy auction brought more bad news on that score, with a further heavy fall in whole milk powder prices. That said, the fact that all other products on offer saw price gains suggests that stock overhangs are now the main factor weighing on prices, not a more fundamental weakness in demand. That supports our view that the current price weakness will prove temporary. So for now our season milk price forecast remains at \$4.80/kg; Fonterra will review its current \$5.30 forecast this week.

In more concrete terms, the drop in crude oil prices has pushed New Zealand petrol prices below \$2 a litre for the first time in over two years, boosting consumers' disposable incomes while raising the possibility that inflation could fall below the Reserve Bank's 1% target band in the next quarter or two. That will almost certainly dampen financial markets' expectations of additional rate hikes from the RBNZ - particularly now that actual rate cuts are looking more likely across the Tasman (following some very disappointing Australian GDP data, we now expect two 'insurance cuts' from the RBA



The good oil continued

early next year). And that in turn could push mortgage rates down further, adding fuel to a warming housing market.

In short, falling oil prices will reinforce the dynamic of strong domestic demand, low inflation, and rising asset prices that has become such a feature of the New Zealand economy recently. We've listed evidence of this dynamic in recent weeks: business confidence has popped back up since the election, even as fewer businesses are planning to raise their prices. And Auckland's housing market is clearly taking off again after a pre-election hiatus, though reports by a major real estate company last week of a 17% jump in sales in November probably overstate the full picture (the Real Estate Institute will publish a full set of figures some time this week).

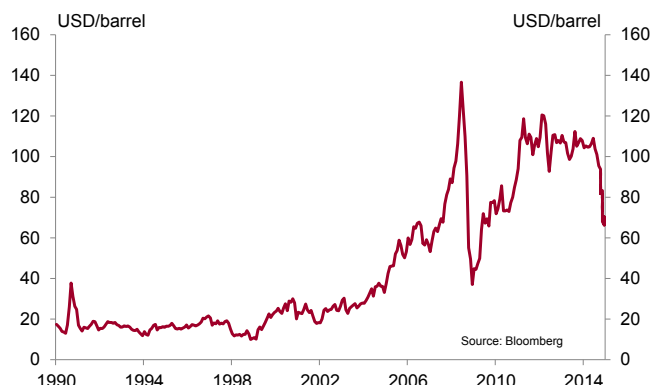
One surprising exception to the strong run of domestic economic data has been construction activity. True, we've now also seen a post-election lift in residential building consents, which rose 8.8% in October. But that still leaves consent issuance (excluding apartments) below its June peak, with a particular lack of momentum in Auckland. And a disappointing building work survey showed residential construction activity falling slightly in the September quarter.

The shortfall isn't big enough to affect our forecast of a 0.8% rise in September quarter GDP, but it does raise the question why we aren't seeing more evidence of a residential building boom, given the Canterbury rebuild, a worsening Auckland housing shortage, and plenty of optimism in the building industry. One answer may simply be volatility – residential building jumped 15% in the March quarter, so the level of building activity has effectively continued to run at post-2007 highs since then. A post-election recovery in consent issuance may also take a few more months to fully come through.

Given all the other compelling reasons to expect a further ramp-up in residential building activity we aren't changing our forecasts just yet, but suffice it to say we will be monitoring this segment of the data closely.

That brings us to Thursday's RBNZ *Monetary Policy Statement*. Much discussion has focussed on whether or not the Reserve Bank will reintroduce the reference to 'further policy tightening' that was dropped in the October statement.

Dubai oil price



We think this discussion is misplaced. In our view – supported by subsequent Reserve Bank commentary such as the latest *Financial Stability Report* – the clear implication of the October statement was that the Reserve Bank's tightening bias had been watered down but not eliminated. Our read of developments since then is that this is still the Reserve Bank's intended message.

Importantly, though, that needn't mean pointed changes to the Statement's 'bottom line' policy paragraph. More likely, the one-page summary will be very similar in tone to what the Reserve Bank issued in October. The tightening bias will be revealed naturally via the accompanying document and interest rate forecasts. These are likely to be lower than those issued in September, but to show rising interest rates nevertheless – an outcome that should create little market surprise. Meanwhile, the Reserve Bank is likely to maintain its rhetoric against the 'unjustified and unsustainable' NZ dollar.

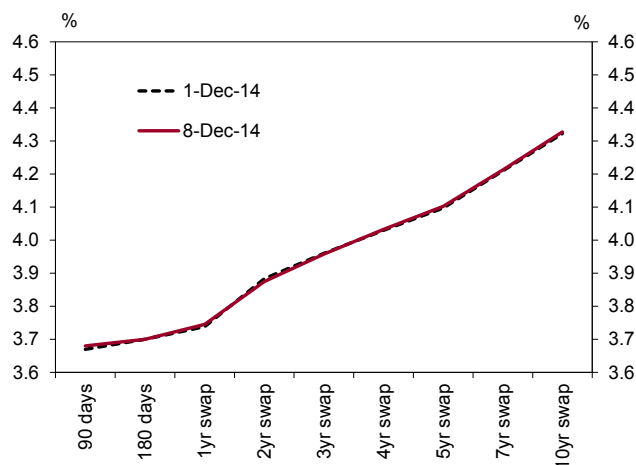
One interesting question is how the Reserve Bank will treat the recent upturn in the housing market data. The growing likelihood of a second wind in housing market is a key reason why we remain comfortable with our view that the Reserve Bank will resume OCR hikes in September next year. But it's probably a bit too soon for the Reserve Bank to abandon its more sanguine house price forecasts, though it is well aware where the risks lie.

Fixed vs Floating for mortgages

Among the standard fixed rates, the best deal for borrowers with a deposit of 20% or more is the two-year term, which offers substantial value relative to where we expect short-term rates to go over the next two years. Current three-year rates offer slightly less value, but it may be worth waiting a few weeks for further 'specials' that could make them the most appealing option. Four- and five-year rates seem high relative to where we think shorter-term rates are going to go over the coming four or five years, though they do offer stability.

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

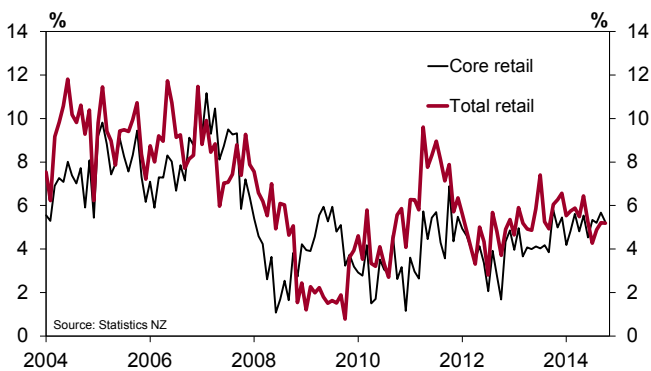


NZ Nov retail electronic card spending

Dec 9, last 1.0%, Westpac f/c: 0.1%

- Retail electronic card spending bounced back strongly in October, in keeping with other domestic indicators, notably of housing market activity.
- However, this momentum may not carry through to November. Card spending is typically choppy from month to month. And while early indications are that the housing market continued to strengthen in November, this does not appear to have translated into stronger consumer confidence just yet.
- Over time, falling petrol prices will boost disposable incomes and consumer confidence, but their immediate impact is likely to be to further dampen dollar spending.

Card transactions, annual % change

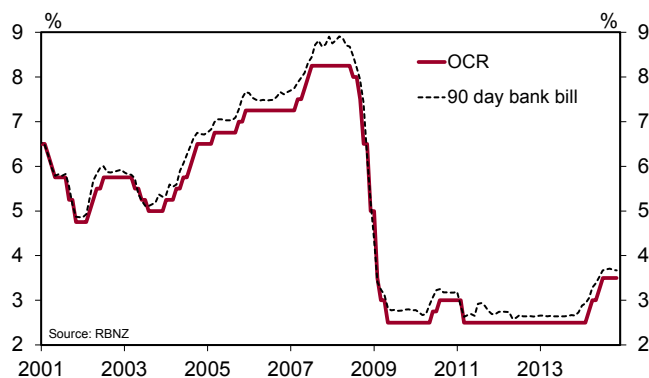


NZ RBNZ Monetary Policy Statement

Dec 11, Last: 3.5%, Westpac f/c: 3.5%, Market f/c: 3.5%

- Economic developments since the October OCR review have been broadly balanced. Hence, we expect that the December Monetary Policy Statement will be aimed at expanding on and clarifying the messages of the October review.
- Those messages are: that inflation is currently very low but is expected to return to 2% eventually; that the OCR is firmly on hold for now but is expected to rise in coming years; and that the exchange rate is uncomfortably high.
- We expect the next OCR hike to be delayed until September 2015.

NZ OCR and 90 day rate

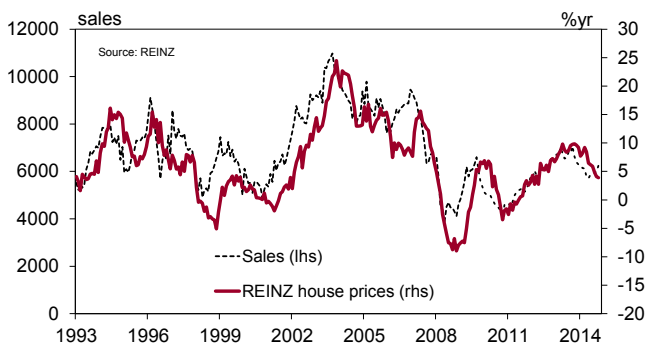


NZ Nov REINZ house prices and sales

Dec 12 (tbc), Sales last: +4.7%, Prices last: 3.9%yr

- The housing market has clearly regained momentum since the September election. Nationwide house sales rose almost 5% in October, and figures from two major realtors suggest a further pickup in November. Mortgage approvals and property listings also rose in November.
- Lower fixed-term mortgage rates and migration-led population growth is also likely to be adding to housing demand.
- The trend in prices tend to lag sales by several months, so we wouldn't be surprised to see some further slowing in the near term. That said, there are signs that prices in Auckland, already the most buoyant market, have started to accelerate again.

REINZ house prices and sales



Aus Dec Westpac-MI Consumer Sentiment

Dec 10 Last: 96.6

- The Westpac-Melbourne Institute Consumer Sentiment Index rose 1.9% in Nov from 94.8 to 96.6 – a modest rise but still leaving sentiment at 'cautiously pessimistic' levels.
- The Dec survey is shaping as a critical reading not only for demand momentum heading into Christmas but also as a gauge of the hit to confidence more generally from recent negative developments. The survey will capture reactions to the continued slide in commodity prices, and partially related declines in the ASX and the AUD (–3.3% and –1.6c vs USD respectively since the Nov survey), and to the disappointingly weak Q3 national accounts report which had a 0.3%qtr rise in GDP but a second successive quarter of contracting national income, widely reported as an 'income recession'. Other economic news has been less bleak but Budget-related fiscal and political concerns may again be a factor.

Consumer Sentiment Index

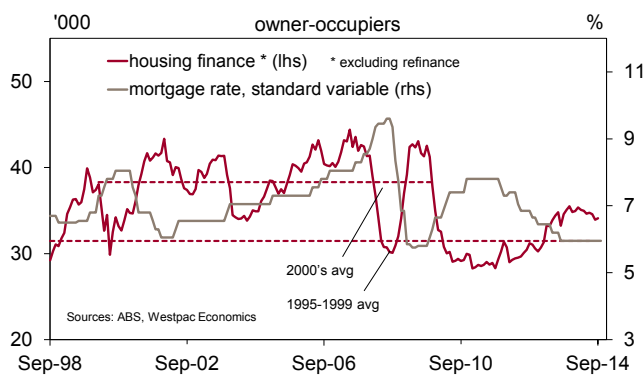


Aus Oct housing finance (no.)

Dec 10, Last: -0.7%, WBC f/c: flat
Mkt f/c: 0.1%, Range: -1% to 2%

- The number of owner-occupier housing finance approvals declined 0.7% in Sep to be down slightly (-0.5%) on a year ago. The detail was a little better than the headline number of new loans (i.e. ex refinancing) up 0.5%*mth* and construction-related loans still on a solid uptrend (+2.1%*mth*, +10.9%*yr*). The value of loans to investors also remained strong, up 3.7%*mth*, 25.4%*yr*.
- Industry data suggests owner-occupier finance approvals were flat in Oct. That will leave a modest downtrend in place – at just over a 3% annual pace – consistent with a lagged response to the observed weakening in consumer sentiment on 'time to buy a dwelling' since last year. The figures around investor activity will again be of great interest although recent commentary from the RBA and APRA seem to have 'dialled back' some of the concern in this area.

Owner-occupier finance & the rate cycle

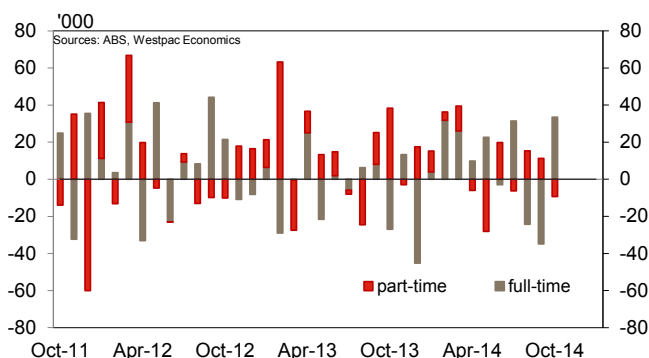


Aus Nov employment, chg

Dec 11, Last: 24.1k, WBC f/c: 10k
Mkt f/c: 15k, Range: flat to 35

- Total employment rose 24.1k, which in the game of forecasting is bang on Westpac's forecast for a 25k rise. The market had been expecting a 20k rise with a wide range of estimates from 0k to 35k.
- Full-time employment rose +33.4k following a -34.9k decline in Sep while part-time employment fell -9.4k following an 11.2k rise in Sep. Annual growth in full-time employment is looking more reasonable now at +65.2k/0.8%*yr* compared to +4.8k/0.1%*yr* in Sep.
- Our preferred labour market indicator has eased a touch as the jobs measures in the December business surveys softened. Nevertheless, it is still pointing to positive employment growth of around 1%*yr* which given base effects, suggests modest monthly gains in total employment.

Monthly change in full-time/part-time employment

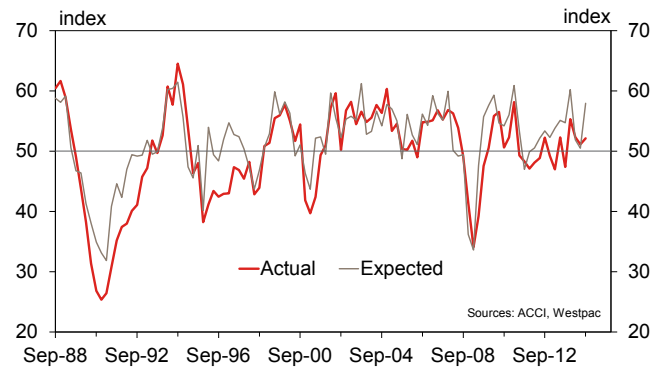


Aus Q4 ACCI-Westpac survey

Dec 11, Last: 52.1

- The December quarter 2014 ACCI-Westpac Survey of Industrial Trends will provide a timely update on the manufacturing sector and insights into economy wide trends. The survey was in the field from November 3 to December 1.
- In the September quarter, the Westpac-ACCI Actual Composite increased by 1pt to 52.1 (revised due to seasonal reanalysis from an originally published 52.7). That was the fourth consecutive reading above 50, with the improvement centred on a lift in new orders and output.
- The manufacturing sector is benefitting from rising building activity and the beginnings of a lift in service sector investment. However, the cycle remains relatively modest to date. Consumer spending is below trend, mining investment is turning down sharply and global fragilities persist.

Westpac-ACCI composite indexes. Actual & expected, sa

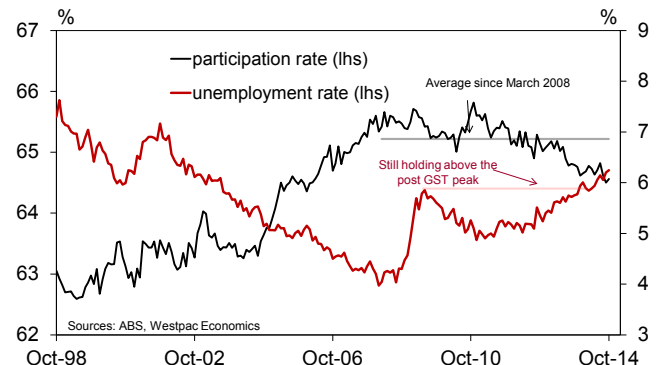


Aus Nov unemployment rate

Dec 11, Last: 6.2%, WBC f/c: 6.3%
Mkt f/c: 6.3%, Range: 6.1% to 6.4%

- In Oct the participation rate rose from 64.5% (64.50%) to 64.6% (64.56%) as a result of a 31.2k rise in the labour force. This was marginally more than the rise in total employment but the unemployment rate was flat at 6.2% when rounded; at two decimal places it was a small rise to 6.24% from 6.20%. Youth unemployment continues to rise hitting 14.0% in Oct which is the highest rate in 13 years.
- The ABS reports a modest uptrend in the unemployment rate from 6.0% in Jan to 6.2% in Oct. Were it not for the decline in the participation rate, it was 64.8% in Oct 2013, the unemployment rate would be much higher.
- Given ongoing population growth, and our expectation for a flat participation rate, the 10k gain in total employment is not enough and the unemployment rate is forecast to rise to 6.3%.

Unemployment and participation rates



Data calendar

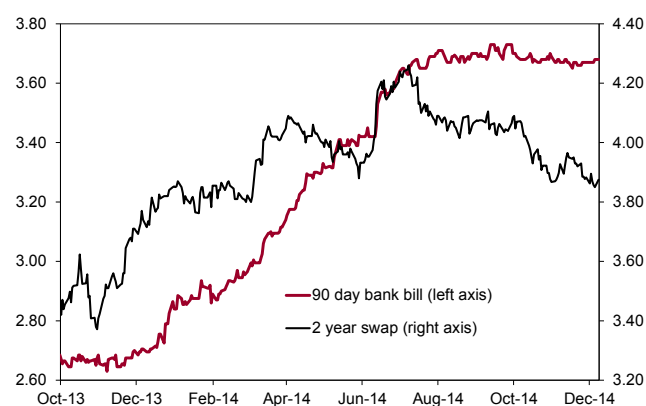
		Last	Market median	Westpac forecast	Risk/Comment
Mon 8					
NZ	Q3 manufacturing sales	-0.7%	-	-	Food manufacturing to rise on stronger milk production.
Aus	Nov ANZ job ads	0.2%	-	-	Job ads are up around 7%yr but the monthly momentum has slowed.
Eur	Dec Sentix investor confidence	-11.9	-10.0	-12.0	Unreasonable disappointment re ECB QE timing?
	Oct industrial production	1.4%	0.0%	-0.2%	German factory PMI mildly contractionary lately.
US	Nov labour market conditions	4.0	-	-	Fed's new indicator of jobs market.
Can	Nov housing starts	-7.0%	-	-	Multiples behind Oct fall.
	Oct building permits	12.7%	-	-	Non-res and multiples behind most of Sep rise.
Tue 9					
NZ	Nov retail electronic card spending	1.0%	0.3%	0.1%	Consumer confidence yet to rebound, petrol prices down in Nov.
Aus	Nov NAB business survey, conditions	13	-	-	Conditions up 12pts to +13 - a rogue number? Confidence -1pt to +4.
Ger	Q3 labour costs %yr	1.7%	-	-	Plunged to slowest annual pace since 2009 in Q1 but higher in Q2.
	Oct exports	5.5%	-	-	Exports' bounce unlikely to be sustained.
UK	Nov BRC sales %yr	0.0%	-	-	Same store sales. 4 of last 5 reports failed to show +ve annual growth.
	Oct exports	4.2%	-	-	With imports up almost 6% in Sep, the trade deficit widened by £1bn.
	Oct industrial production	0.6%	0.3%	0.4%	UK PMI still expansionary.
US	Nov NFIB small business optimism	96.1	96.3	-	Risk Nov payrolls report disappoints.
	Oct wholesale inventories	0.3%	0.1%	-	Inventories a drag on Q3 growth.
	Oct JOLTS	-	-	-	Job openings and labour turnover.
	Nov IBD-TIPP economic optimism	46.4	47.0	-	Confidence way up on last year.
Wed 10					
Aus	Dec Westpac-MI Consumer Sentiment	96.6	-	-	Stuck in cautiously pessimistic range; 'income recession' to impact?
	Dec Westpac-MI unemploy. expectat.	2.7%	-	-	Had been falling but index lifted in Nov and still at a high level.
	Oct housing finance approvals	-0.7%	0.1%	flat	Investor & construction-related approvals much stronger than headline.
Chn	Nov PPI %yr	-2.2%	-	-	Commodity price rout a major drag on producer prices.
	Nov CPI %yr	1.6%	-	-	Watching for further signs that house rental inflation has bottomed.
	Nov new loans RMBbn	548	-	-	Tentative date: demand for loans soft, lenders still cautious.
	Nov total credit supply RMBbn	663	-	-	Tentative date: Intermediated shadow under pressure, direct OK.
	Nov M2 money supply %yr	12.6%	-	-	Tentative date: net capital outflows, shift to FX deposits weigh on M2.
US	Nov monthly budget statement, \$bn	-80	-	-	Budget deficit running lower than last year.
Thu 11					
NZ	RBNZ Monetary Policy Statement	3.5%	3.5%	3.5%	Clarifying that the next OCR move is still up, but not for a while.
	Nov food price index	0.0%	-	-0.5%	Annual food price inflation remains close to zero.
Aus	Q4 Westpac-ACCI survey	52.1	-	-	In Q3, Actual Composite +1pt to 52.1. A moderate cycle.
	Nov employment chg	24.1k	15k	10k	Survey changes introduced significant volatility, does it continue in Dec?
	Nov unemployment rate	6.2%	6.3%	6.3%	Unemployment rate has been drifting higher from the May low of 5.9%
	Dec MI inflation expectations	4.1%	-	-	The new headline measure runs higher than the CPI but it did lift in Nov.
UK	Nov RICS house price balance	20%	17%	-	House prices losing momentum.
US	Initial jobless claims w/e 6/12	297k	-	-	Should be cleaner read with Nov's holiday/weather distortions past.
	Nov import prices	-1.3%	-1.8%	-	Oil prices tumbling.
	Nov retail sales	0.3%	0.3%	0.6%	Auto sales surged, cold weather may be a factor.
	Oct business inventories	0.3%	0.2%	0.2%	Inventories a drag on Q3 growth.
Can	Oct new house prices	0.1%	-	-	Running faster 1.6%yr pace.
	Q3 capacity utilisation %	82.7%	-	-	Upswing in CapU since 2009 has renewed after stalling in 2013.
Fri 12					
NZ	Nov manufacturing PMI	59.3	-	-	Activity has re-accelerated after a mid-year dip.
	Nov REINZ house sales	4.7%	-	-	Due this week. Sales should see a further post-election rebound.
	Nov REINZ house price index %yr	3.9%	-	-	Rising sales foreshadow a pickup in house price growth next year.
Chn	Nov fixed investments %ytd	15.9%	-	-	Structural weakness in heavy industry, cyclical trough in real estate.
	Nov retail sales %yr	11.5%	-	-	Some lift in family finances evident, plus decent 'Single's Day' sales.
	Nov industrial production %yr	7.7%	-	-	Soggy PMIs and weak 'business conditions' in Westpac MNI survey.
Eur	Oct industrial production	0.6%	0.0%	0.3%	Factory PMI virtually stalled for several months now.
UK	Oct construction output, %yr	3.5%	-	-	Construction PMI strong but moderating.
US	Nov producer prices final demand	0.2%	-0.1%	-0.1%	Energy prices still falling.
Can	Nov house prices %yr	5.4%	-	-	Teranet measure; prices accelerating again

New Zealand forecasts

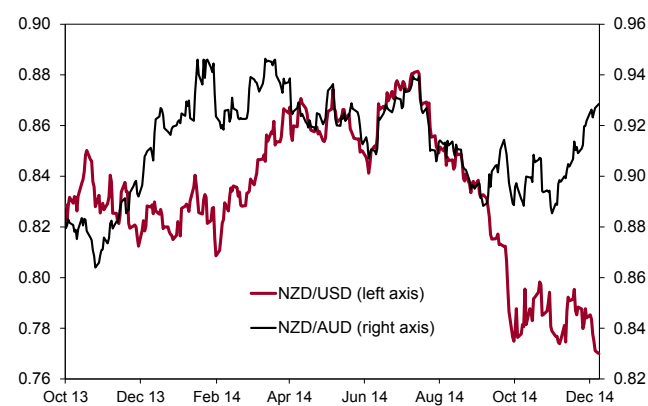
Economic Growth Forecasts	March years				Calendar years			
	2013	2014	2015f	2016f	2013	2014f	2015f	2016f
% change								
GDP (Production) ann avg	2.7	2.8	3.2	3.1	2.6	3.3	3.1	2.9
Employment	0.4	3.8	2.8	2.6	2.9	3.0	2.7	2.0
Unemployment Rate % s.a.	6.2	5.9	5.2	4.8	6.0	5.4	4.9	4.5
CPI	0.9	1.5	1.3	2.2	1.6	1.0	2.2	2.4
Current Account Balance % of GDP	-3.8	-2.7	-4.6	-5.8	-3.3	-3.4	-5.9	-5.0

Financial Forecasts	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16
Cash	3.50	3.50	3.50	3.75	4.00	4.25
90 Day bill	3.70	3.70	3.75	4.00	4.25	4.50
2 Year Swap	3.90	3.80	4.00	4.40	4.60	4.70
5 Year Swap	4.20	4.10	4.30	4.60	4.80	4.90
10 Year Bond	4.00	3.90	4.10	4.30	4.50	4.70
NZD/USD	0.77	0.77	0.76	0.79	0.80	0.81
NZD/AUD	0.93	0.94	0.95	0.95	0.94	0.93
NZD/JPY	91.6	93.2	93.5	98.8	100.0	101.3
NZD/EUR	0.63	0.64	0.64	0.66	0.65	0.65
NZD/GBP	0.49	0.50	0.49	0.50	0.49	0.48
TWI	77.7	78.5	78.4	80.8	80.7	81.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 8 December 2014

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.50%	3.50%	3.50%
30 Days	3.64%	3.64%	3.64%
60 Days	3.66%	3.66%	3.66%
90 Days	3.68%	3.67%	3.67%
2 Year Swap	3.88%	3.92%	3.92%
5 Year Swap	4.10%	4.19%	4.21%

NZ foreign currency mid-rates as at Monday 8 December 2014

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7700	0.7882	0.7776
NZD/EUR	0.6271	0.6373	0.6231
NZD/GBP	0.4942	0.5041	0.4895
NZD/JPY	93.58	92.92	88.91
NZD/AUD	0.9285	0.9094	0.8981
TWI	77.96	78.54	76.89



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014f	2015f	2016f
Australia						
Real GDP % yr	2.6	3.6	2.1	2.7	2.7	3.5
CPI inflation % annual	3.0	2.2	2.7	1.8	2.6	2.9
Unemployment %	5.2	5.3	5.8	6.3	6.4	6.1
Current Account % GDP	-2.8	-4.4	-3.3	-3.1	-2.4	-1.2
United States						
Real GDP %yr	1.6	2.3	2.2	2.2	2.5	3.2
Consumer Prices %yr	3.1	2.1	1.5	1.8	1.8	2.0
Unemployment Rate %	8.9	8.1	7.4	6.3	5.7	5.2
Current Account %GDP	-2.9	-2.9	-2.4	-2.3	-2.2	-2.2
Japan						
Real GDP %yr	-0.3	1.5	1.5	1.0	1.4	1.6
Euroland						
Real GDP %yr	1.6	-0.6	-0.4	0.7	0.9	1.0
United Kingdom						
Real GDP %yr	1.1	0.3	1.7	3.0	2.5	2.7
China						
Real GDP %yr	9.3	7.7	7.7	7.4	7.5	7.8
East Asia ex China						
Real GDP %yr	4.5	4.5	4.3	4.1	5.1	5.7
World						
Real GDP %yr	4.1	3.4	3.3	2.9	3.7	4.5
Forecasts finalised 5 December 2014						

Interest Rate Forecasts	Latest	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15
Australia						
Cash	2.50	2.50	2.00	2.00	2.00	2.00
90 Day Bill	2.71	2.65	2.20	2.20	2.20	2.20
10 Year Bond	3.03	3.10	3.10	3.30	3.35	3.35
International						
Fed Funds	0.125	0.125	0.125	0.125	0.250	0.500
US 10 Year Bond	2.25	2.30	2.40	2.60	2.70	2.75
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	0.8380	0.83	0.82	0.80	0.83	0.85
USD/JPY	119.90	119	121	123	125	125
EUR/USD	1.2380	1.23	1.21	1.19	1.20	1.23
AUD/NZD	1.0780	1.08	1.07	1.05	1.05	1.06

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Disclaimer continued

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