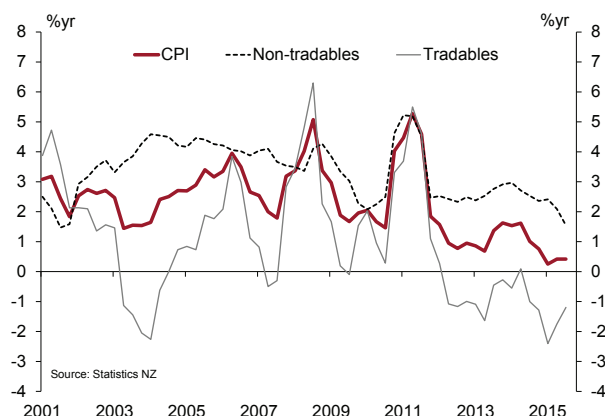


Signs of life in inflation

Sep quarter consumer prices rose 0.3%, annual inflation 0.4%

- The Consumer Price Index (CPI) rose by 0.3% in the September quarter, slightly more than expected.
- Changes in central government charges reduced the rate of inflation by around 0.4 percentage points.
- The lower New Zealand dollar is gradually putting upward pressure on the prices of tradable goods and services.
- But we remain sceptical that this effect will result in a sustained return to the 2% midpoint of the inflation target.
- We still expect the OCR to be cut further to 2%.
- However, we have changed our forecast of the timing of OCR reductions.

CPI inflation



The 0.3% rise in consumer prices over the September quarter was in line with the Reserve Bank's assessment, but a touch higher than the median market forecast of 0.2%. We were at the bottom of the range with our 0.1% estimate. The rise in prices was entirely on tradable goods and services, as the lower New Zealand dollar gradually filters through into higher retail prices.

Annual inflation remains very low for now at just 0.4%, partly due to factors that will wash out over time, such as cuts to government charges and the sharp fall in fuel prices early this year. Today's figures support the view that inflation is on track to return above 1% by early next year. However, a sustained return to the 2% midpoint of the RBNZ's target band remains a daunting challenge – even more so now that the New Zealand dollar has reversed more than a third of its decline.

Change to OCR forecasts for 2016

We were already of the view that the RBNZ wasn't inclined to cut the OCR again as soon as its 29 October review, and today's figures support the case for a pause this month. But we've also said that in order to return inflation to around 2% on a sustained basis, the RBNZ will ultimately need to deliver more than the single OCR cut that remains in its projections. We continue to expect the OCR to reach a low of 2% in this cycle.

However, this week's speech by Governor Wheeler showed that the RBNZ remains reluctant to consider such a move, especially if the benefits are outweighed by the costs of further inflating the housing market. We are sceptical of the RBNZ's view that a weaker New Zealand dollar will drive a sustained rise in inflation, but we also recognise that the RBNZ will probably need to see some evidence to the contrary before cutting further.

Previously we expected three consecutive OCR cuts in December, January and March; now our view is that these will be staggered over December, March and June. Our next Weekly Commentary will cover this in further detail.

CPI details

The breakdown of the September quarter CPI went against the recent run of play, with very subdued non-tradables prices but a pickup in tradables prices. The latter category provided all of the surprise relative to our forecast, although some of that is likely to be due to timing quirks.

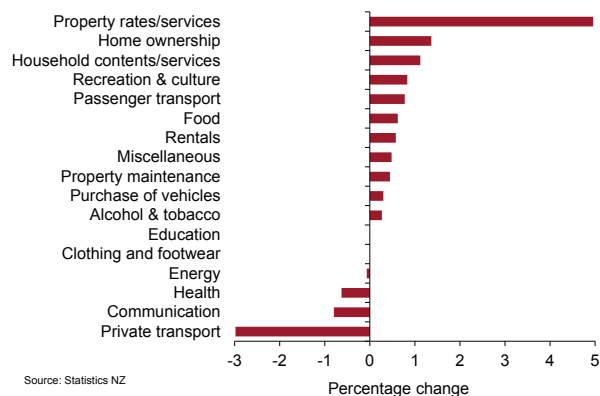
The 0.7% rise in tradables reflects the delayed impact of the fall in the New Zealand dollar over the past year, with rising prices (or at least slower price declines) in import-heavy categories such as household furnishings, appliances, clothing and cars. There were also larger than expected increases in international airfares and package holidays.

However, the bulk of the surprise for us came from just two items. First, petrol prices rose by 1.6%, compared to our estimate of 0.7%. The reduction in regional discounting, which was reported during the June quarter, actually showed up in the CPI in the September quarter instead; this surprise has no bearing on our CPI forecasts from here on. Second, we were surprised to see a 0.7% rise in domestic airfares, given the introduction of Jetstar's sharply lower airfares on some domestic routes in September. We suspect this will show up next quarter instead, and we're inclined to shave down our December quarter CPI forecast by 0.1%.

Non-tradables prices were flat for the quarter, in line with our forecast and a touch softer than the RBNZ's forecast of a 0.1% rise. This category was weighed down by two changes in central government charges: a sharp reduction in the ACC levy component of vehicle registrations, and the provision of free doctors' visits for 6-12 year olds. Together these will shave around 0.4 percentage points off the inflation rate for the next year (and in fact the following year, as a second round of ACC levy cuts is scheduled for July 2016).

Aside from these two factors, the details of non-tradables prices were much as we expected. Local body rates rose by 5.7%, the biggest increase in eight years, led by the Auckland Council's 9.9% increase. Housing-related prices such as rents and new dwelling construction continued to rise, with the centre of gravity continuing to shift from Canterbury to Auckland. Energy prices were again close to flat, and prices for telco services continued to fall.

Components of quarterly inflation



Michael Gordon
Senior Economist

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5669

David Norman, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

Disclaimer

Things you should know: Each time someone visits our site, data is captured so that we can accurately evaluate the quality of our content and make improvements for you. We may at times use technology to capture data about you to help us to better understand you and your needs, including potentially for the purposes of assessing your individual reading habits and interests to allow us to provide suggestions regarding other reading material which may be suitable for you.

If you are located in Australia, this material and access to this website is provided to you solely for your own use and in your own capacity as a wholesale client of Westpac Institutional Bank being a division of Westpac Banking Corporation ABN 33 007 457 141 AFSL 233714 ('Westpac'). If you are located outside of Australia, this material and access to this website is provided to you as outlined below.

This material and this website contain general commentary only and does not constitute investment advice. Certain types of transactions, including those involving futures, options and high yield securities give rise to substantial risk and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. This material and this website may contain material provided by third parties. While such material is published with the necessary permission none of Westpac or its related entities accepts any responsibility for the accuracy or completeness of any such material. Although we have made every effort to ensure the information is free from error, none of Westpac or its related entities warrants the accuracy, adequacy or completeness of the information, or otherwise endorses it in any way. Except where contrary to law, Westpac and its related entities intend by this notice to exclude liability for the information. The information is subject to change without notice and none of Westpac or its related entities is under any obligation to update the information or correct any inaccuracy which may become apparent at a later date. The information contained in this material and this website does not constitute an offer, a solicitation of an offer, or an inducement to subscribe for, purchase or sell any financial instrument or to enter a legally binding contract. Past performance is not a reliable indicator of future performance. The forecasts given in this material and this website are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.

Transactions involving carbon give rise to substantial risk (including regulatory risk) and are not suitable for all investors. We recommend that you seek your own independent legal or financial advice before proceeding with any investment decision. This information has been prepared without taking account of your objectives, financial situation or needs. Statements setting out a concise description of the characteristics of carbon units, Australian carbon credit units and eligible international emissions units (respectively) are available at www.cleanenergyregulator.gov.au as mentioned in section 202 of the Clean Energy Act 2011, section 162 of the Carbon Credits (Carbon Farming Initiative) Act 2011 and section 61 of the Australian National Registry of Emissions Units Act 2011. You should consider each such statement in deciding whether to acquire, or to continue to hold, any carbon unit, Australian carbon credit unit or eligible international emissions unit.

Additional information if you are located outside of Australia

New Zealand: The current disclosure statement for the New Zealand division of Westpac Banking Corporation ABN 33 007 457 141 or Westpac New Zealand Limited can be obtained at the internet address www.westpac.co.nz. Westpac Institutional Bank products and services are provided by either Westpac Banking Corporation ABN 33 007 457 141 incorporated in Australia (New Zealand division) or Westpac New Zealand Limited. For further information please refer to the Product Disclosure Statement (available from your Relationship Manager) for any product for which a Product Disclosure Statement is required, or applicable customer agreement. Download the Westpac NZ QFE Group Financial Advisers Act 2008 Disclosure Statement at www.westpac.co.nz.

China, Hong Kong, Singapore and India: Westpac Singapore Branch holds a wholesale banking licence and is subject to supervision by the Monetary Authority of Singapore. Westpac Hong Kong Branch holds a banking license and is subject to supervision by the Hong Kong Monetary Authority. Westpac Hong Kong branch also holds a license issued by the Hong Kong Securities and Futures Commission (SFC) for Type 1 and Type 4 regulated activity.

Disclaimer continued overleaf.

Disclaimer continued

Westpac Shanghai and Beijing Branches hold banking licenses and are subject to supervision by the China Banking Regulatory Commission (CBRC). Westpac Mumbai Branch holds a banking license from Reserve Bank of India (RBI) and subject to regulation and supervision by the RBI.

U.K.: Westpac Banking Corporation is registered in England as a branch (branch number BR000106), and is authorised and regulated by the Australian Prudential Regulatory Authority in Australia. WBC is authorised in the United Kingdom by the Prudential Regulation Authority. WBC is subject to regulation by the Financial Conduct Authority and limited regulation by the Prudential Regulation Authority in the United Kingdom. Details about the extent of our regulation by the Prudential Regulation Authority are available from us on request. Westpac Europe Limited is a company registered in England (number 05660023) and is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. This material and this website and any information contained therein is directed at a) persons who have professional experience in matters relating to investments falling within Article 19(1) of the Financial Services Act 2000 (Financial Promotion) Order 2005 or (b) high net worth entities, and other persons to whom it may otherwise be lawfully communicated, falling within Article 49(1) of the Order (all such persons together being referred to as “relevant persons”). The investments to which this material and this website relates are only available to and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such investments will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely upon this material and this website or any of its contents. In the same way, the information contained in this material and this website is intended for “eligible counterparties” and “professional clients” as defined by the rules of the Financial Services Authority and is not intended for “retail clients”. With this in mind, Westpac expressly prohibits you from passing on the information in this material and this website to any third party. In particular this material and this website, website content and, in each case, any copies thereof may not be taken, transmitted or distributed, directly or indirectly into any restricted jurisdiction.

U.S.: Westpac operates in the United States of America as a federally licensed branch, regulated by the Office of the Comptroller of the Currency. Westpac is also registered with the US Commodity Futures Trading Commission (“CFTC”) as a Swap Dealer, but is neither registered as, or affiliated with, a Futures Commission Merchant registered with the US CFTC. Westpac Capital Markets, LLC (“WCM”), a wholly-owned subsidiary of Westpac, is a broker-dealer registered under the U.S. Securities Exchange Act of 1934 (‘the Exchange Act’) and member of the Financial Industry Regulatory Authority (‘FINRA’). This communication is provided for distribution to U.S. institutional investors in reliance on the exemption from registration provided by Rule 15a-6 under the Exchange Act and is not subject to all of the independence and disclosure standards applicable to debt research reports prepared for retail investors in the United States. WCM is the U.S. distributor of this communication and accepts responsibility for the contents of this communication. If you would like to speak to someone regarding any security mentioned herein, please contact WCM on +1 212 389 1269. All disclaimers set out with respect to Westpac apply equally to WCM.

Investing in any non-U.S. securities or related financial instruments mentioned in this communication may present certain risks. The securities of non-U.S. issuers may not be registered with, or be subject to the regulations of, the SEC in the United States. Information on such non-U.S. securities or related financial instruments may be limited. Non-U.S. companies may not be subject to audit and reporting standards and regulatory requirements comparable to those in effect in the United States. The value of any investment or income from any securities or related derivative instruments denominated in a currency other than U.S. dollars is subject to exchange rate fluctuations that may have a positive or adverse effect on the value of or income from such securities or related derivative instruments.

The author of this communication is employed by Westpac and is not registered or qualified as a research analyst, representative, or associated person under the rules of FINRA, any other U.S. self-regulatory organisation, or the laws, rules or regulations of any State. Unless otherwise specifically stated, the views expressed herein are solely those of the author and may differ from the information, views or analysis expressed by Westpac and/or its affiliates.

For the purposes of Regulation AC only: Each analyst whose name appears in this report certifies that (1) the views expressed in this report accurately reflect the personal views of the analyst about any and all of the subject companies and their securities and (2) no part of the compensation of the analyst was, is, or will be, directly or indirectly related to the specific views or recommendations in this report.