

10 August 2015



Weekly Commentary

Kea, Arthurs Pass National Park.

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Losing altitude

Developments over the past week have added to signs that momentum in the economy is dissipating, and have reinforced our expectations that a sharp slowdown in growth is on the cards over the coming year.

In our past few reports, we've highlighted that some of the big drivers of New Zealand's recent economic strength have been dissipating. Developments over the past week have reinforced that message.

First up, the outlook for earnings in the dairy sector has continued to deteriorate. Global dairy prices fell another 9.3% in the latest GlobalDairyTrade auction, taking them to their lowest level in 13 years. And as in the previous auction, many prices were 'limit down', implying that the downward pressure on prices is likely to spill over into the next auction as well.

Given the sharp falls in global prices, Fonterra has revised its forecast milk price payout for the current season to \$3.85/kg. That will be even lower than last season's very weak outcome, and will pull export earnings down by around \$1.2 billion compared to the 2014/15 season - equivalent to around 0.5% of annual GDP.

Looking ahead to the 2016/17 season, we expect some recovery in prices as global demand and supply conditions rebalance. However, at this stage we're only assuming a payout of \$5.20/kg, which would still be below the average of the past ten years. Of course, there's still a huge degree of uncertainty around how dairy prices will perform over the current season, and that goes doubly so for next season. But whatever the outcome, many in the farming sector are going to be facing some tough conditions over the next couple of years. And importantly, the resulting reductions in earnings, spending and employment will have a dampening impact on the economy more generally.

The second concern that we've been highlighting is that the boost to growth from the Canterbury rebuild is fading. Evidence of this was seen in the latest labour market figures, which showed that employment growth in Canterbury has slowed



Losing altitude continued

sharply from 7.7% per annum last year, to just 1% this year. And that impulse looks set to get even smaller, and will eventually turn negative, over the coming years. Our recent report "*Forewarned is forearmed*"¹ looks at the dynamics of Canterbury's labour market, and how labour market conditions in the region might evolve as the rebuild eventually starts to wind down.

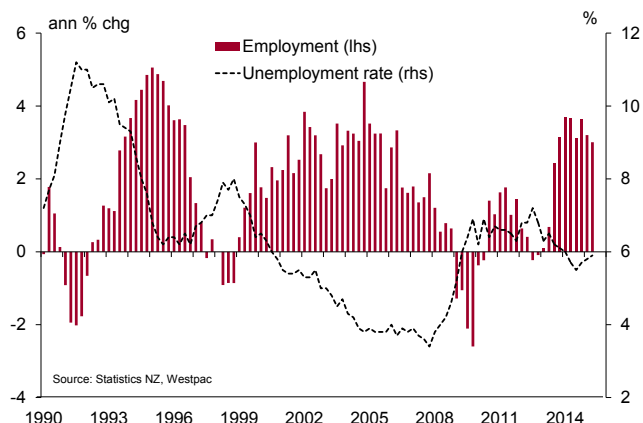
Providing some offset to the above developments is the lower NZD, which will be a welcome relief to those in the export sector. Nevertheless, with two significant drivers of New Zealand's recent economic strength dissipating, a sharp slowdown in economic growth is still on the cards for the coming year. We've already seen consumer and business confidence falling sharply (particularly in the agricultural and construction sectors). In addition, labour market data for the June quarter indicate that real economic activity is also softening.

The June quarter labour market data showed that the unemployment rate has increased to 5.9%. Underlying this was cooling labour demand, with weak employment growth of 0.3% over the quarter, as well as falls in the various measures of labour hours. Some of the softness in the June quarter labour data does reflect a pull-back after over-sized gains earlier in the year. However, looking over a range of labour market indicators in recent months, we are left with a softer labour market picture than we had anticipated a few months ago.

In addition to softening labour demand, wage inflation has remained stubbornly low. The private sector LCI (including overtime) was 1.8% in the year to June, and hasn't shown any material increase for four years now. With signs that momentum in the economy is slowing, it's likely that wage inflation will remain subdued for some time yet.

Over the past year the softness in wage inflation was less of a concern as households' real purchasing power was still growing at a solid pace. That was because while wage inflation was low, inflation in the prices of goods and services was even lower. Notably, last year's sharp falls in petrol prices had, until recently, put quite a bit of cash back into households' pockets. But over the coming year households' purchasing power is going start looking a lot less healthy. Petrol prices

Employment and GDP



have reversed their earlier declines, and the fall in the NZD will result in the prices of a range of imported goods rising over the coming months. Combined with lingering softness in wage growth and a likely pick-up in unemployment, this means that many households will find their budgets getting squeezed.

Overall, the above developments don't mean that the economy is toppling over just yet. But with the drivers of economic growth dissipating, it's clear that the wind is coming out of the economy's sails.

This week we are releasing our latest quarterly Economic Overview for New Zealand. This report (which will available on our website) looks at the coming slowdown in depth, and how we think policy will respond.

Also out over the coming week will be retail spending figures for the June quarter (14 August), electronic card spending statistics for July (11 August), and the July manufacturing PMI. Over the course of the week, we'll also receive REINZ house sales and price figures for July.

1 Available here: <http://www.westpac.co.nz/assets/Business/Economic-Updates/2015/Bulletins-2015/Forewarned-is-forearmed-August-2015.pdf>

Fixed vs Floating for mortgages

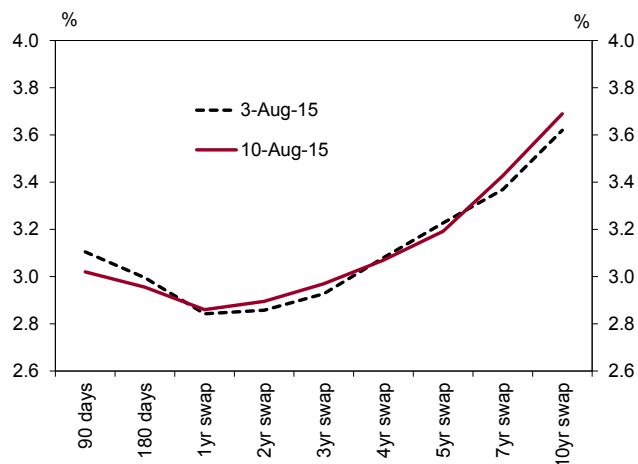
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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

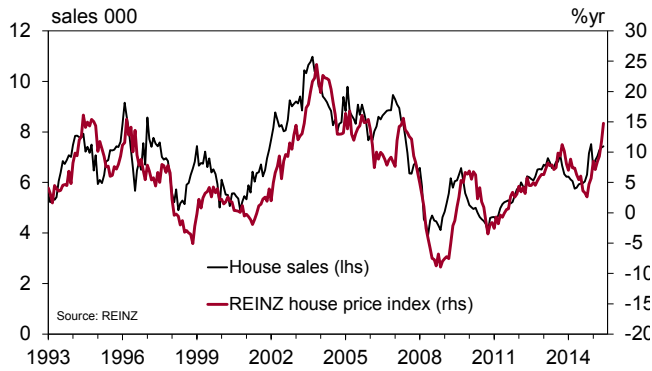


NZ Jul REINZ house prices and sales

Aug 10-14 (tbd), Sales last: 0.7%, Prices last: 14.8%yr

- The July REINZ report is due to be released by the 10th working day of the month (i.e. Friday).
- Recent housing reports have suggested that the nationwide market remains tight. Loan approvals reached a new cycle high in July, while available listings continued to set new record lows.
- However, there have been some early signs of convergence in price trends. The unsustainably rapid rise in Auckland house prices may be moderating, but prices are starting to accelerate in other centres. Christchurch is an exception, with prices flat to falling as the city's housing stock is gradually restored.

REINZ house prices and sales

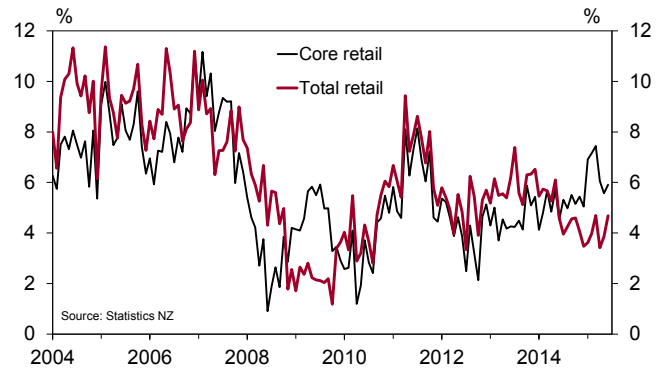


NZ July retail electronic card spending

Aug 11, last 0.5%, Westpac f/c: 0.6%

- After surging at the start of the year, electronic card spending has had a much slower run in the last few months. That includes June, when a 0.5% rise in the value of spending was entirely due to a lift in fuel prices.
- We suspect this overstates the degree to which spending has slowed. Spending in the March quarter received a boost from falling petrol prices, which freed up spending on other goods and services. This effect has gone into reverse as petrol prices have risen.
- That said, we are braced for more soft reads in coming months. Consumer confidence has already come off significantly and is likely to fall further as the dairy downturn percolates through the economy.

Card transactions, annual % change

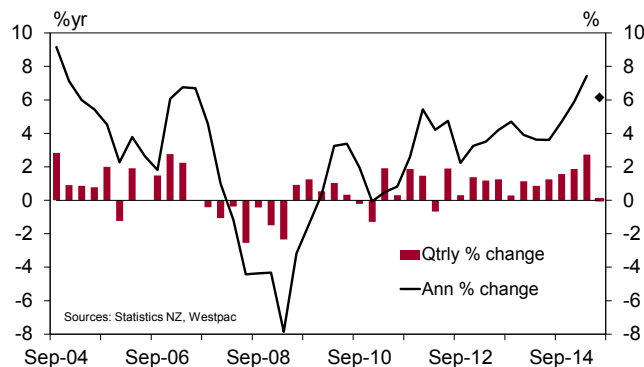


NZ Q2 real retail sales

Aug 14, last: 2.7%, Westpac f/c: 0.1%

- New Zealand retail activity had a storming start to the year, but electronic card spending data point to a sharp slowdown since. We expect a 0.1% lift in both volumes and values in the June quarter.
- This would add to the recent evidence that the New Zealand economy has cooled. That said, we would caution against overstating its significance. Falling petrol prices boosted consumers' purchasing power in the March quarter, but have since recovered significant ground. Looking through this volatility, retail trade grew at a healthy pace through the first half of the year.
- We are braced for a deeper slowdown in the second half of the year, as concerns around dairy prices increasingly weigh on domestic spending.

Real retail sales



Aus Aug Westpac-MI Consumer Sentiment

Aug 12, Last: 92.2

- The Westpac-Melbourne Institute Consumer Sentiment Index fell 3.2% in July from 95.3 in June to 92.2, well below the 100 line marking 'neutral' and also a new low for the year. Offshore events were the main drivers, with the survey week coinciding with an escalating crisis in Greece and China's sharemarket slump.
- The August survey is in the field from August 3-10. With the considerably calmer situation in both Greece and China, sentiment ought to recover from July's weak read. Other aspects of the backdrop have shown little change, with the RBA leaving rates on hold as expected at its Aug policy meeting, official labour force figures showing 'mixed' results in July (jobs and unemployment up), and house prices continuing to post solid gains in Sydney and Melbourne. The ASX is up 3.3% since the July survey, but the AUD is 1¢ lower vs the USD.

Consumer Sentiment Index

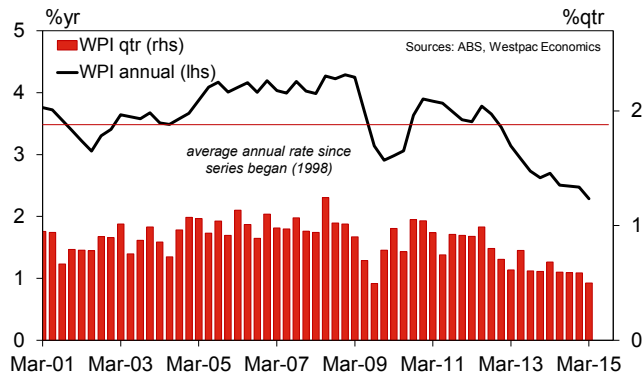


Aus Q2 wage price index

Aug 12, Last: 0.5%, WBC f/c: 0.5%
Mkt f/c: 0.6%, Range: 0.5% to 0.8%

- Total hourly wage rates ex bonuses (WPI) rose 0.5% in Q1, below Westpac and the market consensus forecasts, following three consecutive 0.6% prints. The annual pace eased back to 2.3%yr, from 2.5%yr in Q4. This is a new record low for the annual pace of the WPI, which started in the September quarter of 1997.
- Private sector wages lifted 0.4%qtr following a 0.6%qtr gain in each of the previous three quarters. At 0.42%qtr unrounded, it is only just pipped at the post for a record low by the 0.40%qtr print of Q3 2009. The annual pace hit a record low of 2.2%yr.
- In Q2, we have seen an improvement in the labour market, with stronger employment growth through 2015H1 and, up to June, a drop in the unemployment rate. However, we suspect the decline in the terms of trade will prove a headwind for wage claims.

Wage inflation holds record lows

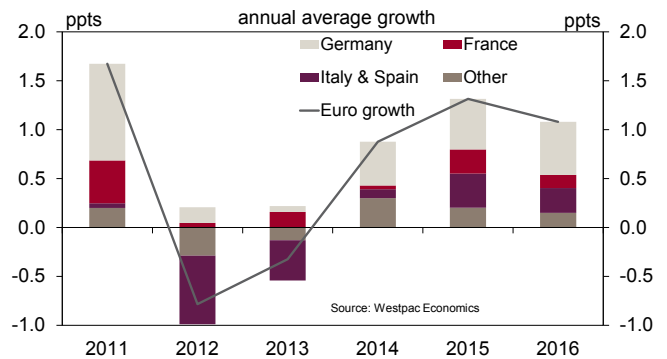


Euro Area Q2 GDP

Aug 14, Last: 0.4%, WBC f/c: 0.4%

- Despite continued anxiety surrounding Greece, 2015 has been a positive year for the Euro Area in aggregate. This has in large part been due to the liquidity and confidence effects of the ECB's well-telegraphed, long-term alternative easing program.
- Broadly, while these policy actions are yet to stoke a desire for greater capacity amongst businesses, households have responded with great enthusiasm. Consumer spending has firmed noticeably, as has credit growth.
- We anticipate another healthy gain for GDP in Q2 of 0.4%, in line with the Q1 result. That will see annual growth firm to 1.3%yr. The cross-country growth breakdown is likely to remain mixed, with: particularly strong growth continuing in Spain; robust expansion in Germany; but more modest gains in Italy and France.

Contribution to Euro area annual growth

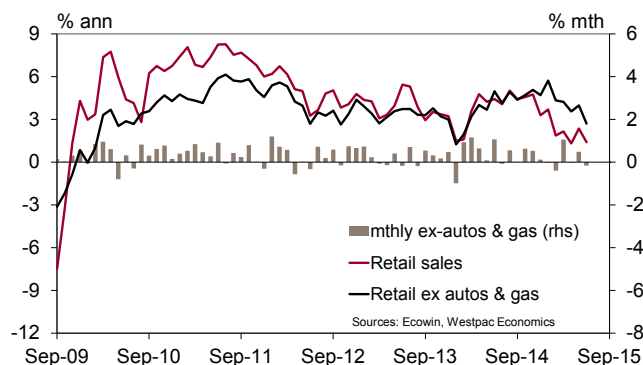


US July retail sales

Aug 13, Last: -0.3%, WBC f/c: 0.4%

- Retail sales disappointed in June, falling 0.3%. This result was partly attributable to weaker auto sales; however, core retail sales (ex autos and gas) still fell 0.2% in the month.
- In annual growth terms, momentum has steadily edged lower in recent months, with the June prints for total and core retail sales growth of 1.4%yr and 2.7%yr well below their respective peak growth rates, of 5.7%yr (Jan-15) and 5.1% (Nov-14).
- A continued improvement in the labour market; robust consumer confidence; and firming expectations around incomes all point to stronger discretionary spending.
- Yet, as has been the case throughout this recovery, caution is likely appropriate. In July we anticipate a moderate rebound from recent weakness, with headline growth of 0.4%.

US retail sales, momentum lacking



Data calendar

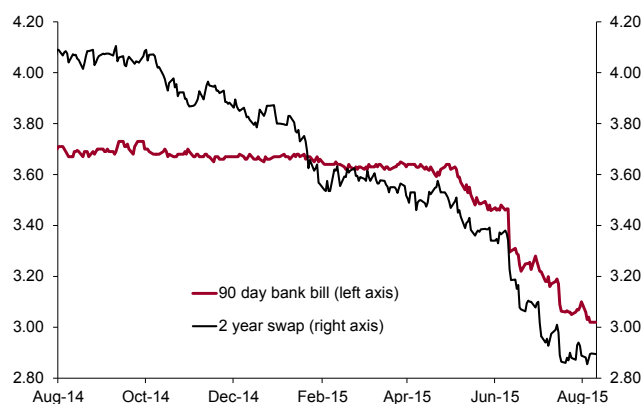
		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
NZ	Jul REINZ house sales %yr	0.7%	–	–	Due sometime this week. Loan approvals up strongly in July.
	Jul REINZ house price index %yr	14.80%	–	–	House prices rising sharply in Auckland, more subdued elsewhere.
Chn	Jul new loans RMBbn	1279	700	–	Bank funding abundant, willing borrowers less so. m/m drop seasonal.
	Jul aggregate financing RMBbn	1858	1007	–	New equity financing may be a rare zero. m/m drop seasonal.
	Jul money supply M2 %yr	11.8%	11.7%	–	May get a nudge from liquidity operations during equity carnage.
Eur	Aug Sentix investor confidence	18.5	20.0	–	Greece effect minor; confidence at elevated levels.
US	Fedspeak	–	–	–	Lockhart giving opening remarks at Workforce Conference.
	Jul labour market conditions index	0.8	–	–	Composite measure of labour market momentum from Fed.
Tue 11					
NZ	Jul electronic retail card spending	0.5%	0.5%	0.6%	Spending has lost some momentum in recent months.
Aus	Jul NAB business survey	11	–	–	In Jun, conditions surprised up 5pts to +11. Confidence, +2pts to +10.
Eur	Aug ZEW investor expectations	42.7	–	–	Well above average levels; great optimism over outlook.
US	Fedspeak	–	–	–	Lockhart speaks to Atlanta Press Club.
	Jul NFIB small business optimism	94.1	95.3	–	Small business much less constructive on economy than large firms.
	Jun wholesale inventories	0.8%	0.4%	–	Large inventory build in H1; likely to moderate come H2.
Wed 12					
Aus	Aug Westpac–MI Consumer Sentiment	92.2	–	–	July read impacted by Greek crisis and China share slump.
	Aug Westpac–MI unemploy. expect. %yr	-3.4%	–	–	The improvement (fall) in unemployment exp found a floor in Mar 2015.
	Q2 Wage Price index	0.5%	0.6%	0.5%	The labour market improved in 2015H1 but the terms of trade fell again.
	RBA Dep. Gov. Lowe speaking	–	–	–	Shann Memorial Lecture, topic TBA, Perth 8.00pm AEST.
Chn	Jul retail sales %yr	10.6%	10.6%	–	Services spending plans in Westpac-MNI were up, but shopping fell.
	Jul industrial production %yr	6.8%	6.6%	–	Consensus following weaker PMIs & softer consumer view of current biz.
	Jul fixed investment %ytd	11.4%	11.5%	–	Jun first non-decline of the year, with manuf & real estate both weak.
Eur	Jun industrial production	-0.4%	0.2%	–	Annual growth modest at 1.6%yr; small improvement likely.
UK	Jun ILO unemployment rate	5.6%	5.6%	–	Employment growth has slowed in recent months.
Can	Jul Teranet house prices	1.4%	–	–	Prices have risen 5.1% over year to Jun.
Thu 13					
NZ	Jul Business NZ manufacturing PMI	55.2	–	–	Manufacturing activity has been resilient in recent months.
	Jul food prices	0.5%	–	1.0%	Produce prices rise in winter. Annual inflation running at around 1%.
Aus	Aug MI inflation expectations %yr	3.4%	–	–	Moderated from a Feb peak of 4.0% as petrol price levelled out.
	RBA Assist. Gov. Kent speaking	–	–	–	'Recent Labour Market Developments', Brisbane 12.15pm AEST.
Eur	ECB account of policy meeting	–	–	–	Further details on ECB deliberations.
Ger	Jul CPI, final	0.3%	0.3%	–	Lingering impact of oil for annual inflation, 0.1%yr.
UK	Jul RICS house price balance	40%	42%	–	House prices have been strengthening.
US	Jul retail sales	-0.3%	0.5%	0.4%	Hope to see broad-based bounce in Jul after weak Jun result.
	Initial jobless claims	270k	–	–	Claims have remained low in recent weeks.
	Jun business inventories	0.3%	0.3%	–	Large inventory build in H1; likely to moderate come H2.
Can	Jun new housing price index	0.2%	–	–	Nationwide house price inflation has been stable for some time.
Fri 14					
NZ	Q2 real retail sales	2.7%	0.5%	0.1%	Growth to moderate after March's strong gain.
Eur	Q2 GDP, provisional	0.4%	0.4%	0.4%	Positive momentum to continue: Spain and Germany key.
	Jul CPI, final	0.0%	-0.6%	–	Annual inflation at just 0.2%yr.
Ger	Q2 GDP, provisional	0.3%	0.5%	–	Weaker Euro and strong labour market key strengths for Germany.
UK	Jun construction output	-1.3%	2.3%	–	A bounce is expected after last month's unexpected fall.
US	Jul PPI	0.4%	0.1%	–	Further fall in annual change likely, -0.7%yr in Jun.
	Jul industrial production	0.2%	0.3%	–	IP impacted by weak mining sector in recent months.
	Aug Uni of Mich consumer sentiment	93.1	93.5	–	Household confidence robust; income expectations continue to firm.

New Zealand forecasts

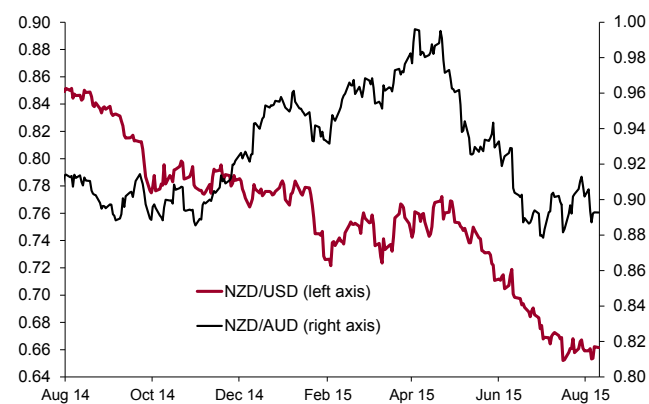
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.1	2.0	2.2	3.3	2.2	1.8
Employment	3.8	3.2	0.5	2.1	2.9	3.6	0.9	1.8
Unemployment Rate % s.a.	6.0	5.8	6.5	6.3	6.1	5.7	6.4	6.3
CPI	1.5	0.1	1.7	1.9	1.6	0.8	0.8	2.2
Current Account Balance % of GDP	-2.6	-3.6	-5.4	-4.4	-3.3	-3.3	-4.8	-4.8

Financial Forecasts	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Cash	2.75	2.25	2.00	2.00	2.00	2.00
90 Day bill	2.65	2.30	2.10	2.10	2.10	2.10
2 Year Swap	2.70	2.30	2.20	2.30	2.40	2.50
5 Year Swap	3.10	2.80	2.90	3.10	3.30	3.40
10 Year Bond	3.30	3.20	3.30	3.50	3.70	3.90
NZD/USD	0.63	0.62	0.62	0.63	0.64	0.65
NZD/AUD	0.86	0.86	0.86	0.88	0.88	0.88
NZD/JPY	76.2	76.3	76.3	78.1	80.0	81.9
NZD/EUR	0.58	0.58	0.58	0.59	0.59	0.60
NZD/GBP	0.42	0.42	0.41	0.42	0.41	0.41
TWI	67.9	67.4	67.3	68.5	69.1	69.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 10 August 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.00%	3.00%	3.25%
30 Days	3.11%	3.12%	3.22%
60 Days	3.07%	3.09%	3.19%
90 Days	3.02%	3.06%	3.17%
2 Year Swap	2.90%	2.88%	2.98%
5 Year Swap	3.19%	3.17%	3.32%

NZ foreign currency mid-rates as at Monday 10 August 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6615	0.6570	0.6713
NZD/EUR	0.6029	0.5980	0.6047
NZD/GBP	0.4269	0.4235	0.4327
NZD/JPY	82.14	81.26	82.11
NZD/AUD	0.8927	0.9036	0.9044
TWI	70.36	70.15	70.80



International forecasts

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	2.4	3.0
CPI inflation % annual	3.0	2.2	2.7	1.7	2.2	2.2
Unemployment %	5.2	5.3	5.8	6.2	6.5	6.2
Current Account % GDP	-2.8	-4.4	-3.3	-2.8	-3.7	-4.2
United States						
Real GDP %yr	1.6	2.3	1.5	2.4	2.2	2.8
Consumer Prices %yr	3.1	2.1	1.5	1.6	0.2	2.0
Unemployment Rate %	8.9	8.1	7.4	6.2	5.4	5.1
Current Account %GDP	-2.9	-2.9	-2.2	-2.2	-2.4	-2.4
Japan						
Real GDP %yr	-0.5	1.8	1.6	-0.1	1.0	1.7
Euroland						
Real GDP %yr	1.6	-0.8	-0.3	0.9	1.3	1.1
United Kingdom						
Real GDP %yr	1.6	0.7	1.7	3.0	2.5	2.5
China						
Real GDP %yr	9.3	7.8	7.8	7.4	7.0	6.8
East Asia ex China						
Real GDP %yr	4.4	4.5	4.3	4.1	3.7	4.0
World						
Real GDP %yr	4.2	3.4	3.4	3.4	3.1	3.6
Forecasts finalised 7 Aug 2015						

Interest Rate Forecasts	Latest	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
Australia						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.15	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.82	3.00	3.10	3.25	3.40	3.60
International						
Fed Funds	0.125	0.375	0.625	0.875	1.125	1.375
US 10 Year Bond	2.26	2.60	2.80	3.00	3.20	3.40
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16
AUD/USD	0.7355	0.71	0.70	0.70	0.70	0.71
USD/JPY	124.44	125	127	127	128	129
EUR/USD	1.0864	1.06	1.05	1.05	1.05	1.06
AUD/NZD	1.1274	1.11	1.11	1.13	1.11	1.09

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Disclaimer continued

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