



Church of the Good Shepherd, Lake Tekapo.

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Sigh of relief

The dairy sector's sigh of relief has continued, with yet another sharp increase in the GlobalDairyTrade (GDT) auction price last week. Dairy prices have risen a stunning 63% in two months, and some products are now trading at prices that we regard as above the long-run sustainable level.

Clearly, the worst has been avoided for dairy farmers. We are now forecasting a farmgate milk price for the current season of \$5.30 per kg of milksolids for Fonterra suppliers. That is still not a great number – it is roughly the break-even mark for an average farm, and will still leave some in the red. But the situation is a whole lot more manageable than a milk price below four dollars would have been.

One probable reason for the sudden lift in milk prices is concern about the supply of milk coming out of New Zealand. Fonterra has forecast that milk collections will be 5% down this season compared to last, mainly because farmers have reacted to low milk prices by culling cows among other volume-reducing measures. Now we have meteorologists saying that an El Niño weather pattern this summer is a near-certainty, meaning a high risk of drought that could further curtail milk production.

We are wary of extrapolating too far from the current high level of global dairy prices. New Zealand farmers may start to make more generous decisions about feed intensity and the like now that payout forecasts are higher, which could boost milk production relative to forecast. Any drought premium in the current price must eventually unwind. And dairy prices are starting to look anomalous against the backdrop of lacklustre global commodity prices more generally.

Our forecast for a \$5.30 farmgate milk price assumes modest rises at the next couple of GDT auctions, but a pullback in global prices early next year once the period of highest drought risk is past. These assumptions give a forecast farmgate milk price of \$5.20 for the 2016/17 season.

Sigh of relief continued

New Zealand's export sector more generally will have been buoyed by the signing of the TPP free trade agreement last week. Tariffs on New Zealand exports to TPP countries will be almost completely eliminated, the only exceptions being dairy exports to Canada, USA, Mexico and Japan, and beef trade with Japan. And even in these cases, conditions will improve for New Zealand exporters. One measure of the benefit to New Zealand exporters is the tariff payments that will be eliminated, estimated at \$259m a year. This compares the \$115m a year in the case of the New Zealand-China Free Trade Agreement. But the experience of the China FTA showed that the gains overwhelmingly come from increased trade volumes and new business opportunities, and will be much larger than the tariff savings alone.

On the import side, the benefits to New Zealand consumers will be more limited. There are already few barriers to importing into New Zealand, so only \$20 million per annum of tariffs will be eliminated. Furthermore, New Zealand will have to switch to the international norm for copyright of 70 years, rather than the current 50. As New Zealand is a net importer of intellectual property, this will impose a cost to New Zealand consumers estimated at \$55 million per annum.

Turning to New Zealand domestic data, last week's September *Quarterly Survey of Business Opinion* was a continuation of recent themes. Businesses' confidence in the general economic outlook fell sharply and now stands at the lowest level since March 2011 (just after the worst Canterbury earthquake). But when asked about domestic trading conditions for their own businesses, responses were moderate rather than downbeat, and were no worse than the June quarter.

That corroborates the run of resilient minor data we have had over recent weeks. Local Knowledge, our compilation of bellwether high-frequency data, had a very strong month in August. Last week's September electronic card transactions data registered a very robust 0.9% increase. And the housing market data we've had to date has shown no sign of a slowdown through to September. Taken together, all of this

implies that GDP growth in the September quarter was closer to 0.7% than our previous forecast of 0.5%.

That the economy has been faring well is good news, but it is important to keep things in perspective. China's economic woes have sparked a downturn in global trade from which New Zealand cannot stand aloof. And falling business and consumer confidence is as good a sign as any that economic growth is set to slow as we have been warning.

Still, the positive run of data combined with rising global dairy prices does leave us comfortable with our call that the Reserve Bank will leave the OCR on hold in October (currently, markets are pricing roughly a 25% chance of a cut, and roughly half of economists are calling a cut). It was always going to take some form of data shock to force the RBNZ to cut in October. So far, no such shock has been forthcoming. The final opportunity will come on Friday this week, when the September quarter Consumers' Price Index is released. We are bracing for yet another weak number, mainly reflecting changes in various government charges. Our forecast of 0.1% quarterly inflation is less than the Reserve Bank's forecast of 0.3%. However, our annual inflation forecast of 0.2% is in line with the RBNZ's forecast, because there have been revisions to the March and June quarter inflation data. Inflation data along the lines we anticipate would not be enough to tip the balance in favour of an October OCR cut.

The final glimmer of hope for those still seeking an October OCR cut lies in the exchange rate. The New Zealand dollar is up sharply to almost 67 cents against the US dollar, although the rise on a trade weighted basis has been less marked. This will certainly weigh on the Reserve Bank's mind. But our judgement is that even the higher exchange rate is not enough to outweigh the shock rise in dairy prices.

Looking beyond the next interest rate decision, we are still comfortable with our view that the RBNZ will need to cut the OCR by more than markets currently anticipate, and are forecasting a 2% low point for the cash rate.

Fixed vs Floating for mortgages

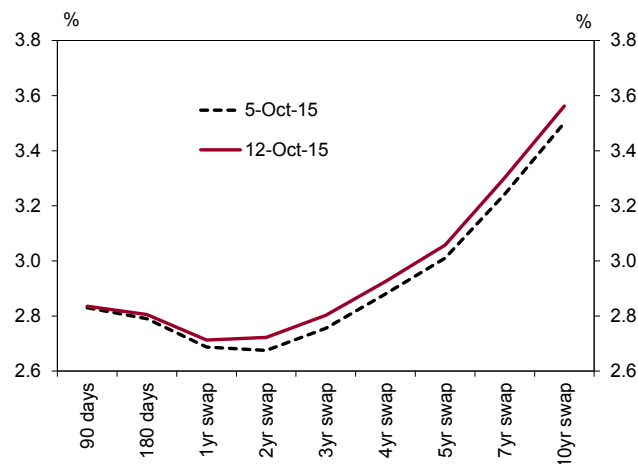
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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

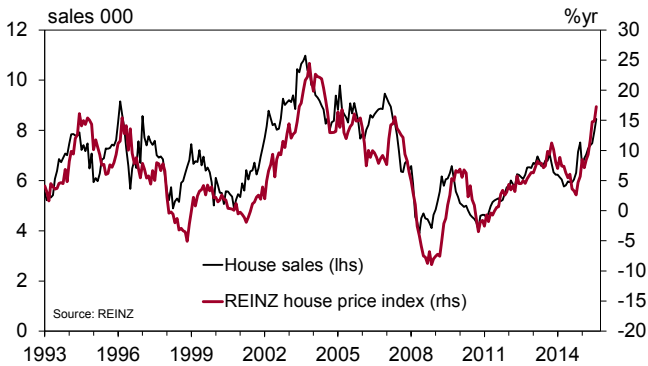


NZ Sep REINZ house prices and sales

Oct 12-16, Sales last: 6.2%, Prices last: 17.3%yr

- REINZ is due to publish its nationwide house sales figures early this week. Indications to date are that the housing market remained active in September, ahead of the upcoming restrictions on property investment.
- From October all investment properties bought and sold within two years will be subject to tax on capital gains, and from November lending restrictions will be tightened for investment properties in Auckland. We expect these measures to have a modest but temporary impact on turnover and house price growth.
- These policies may also have unintended consequences. There is growing evidence that investor interest is radiating beyond Auckland to nearby centres like Hamilton and Tauranga, where house prices are up more than 10% on a year ago.

REINZ house prices and sales

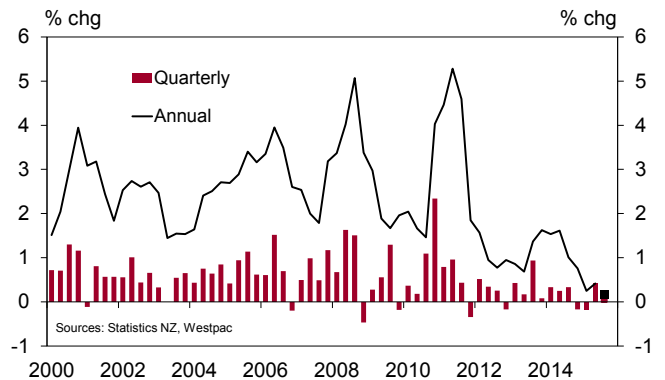


NZ Q3 Consumer Price Index

Oct 16, Last: 0.4%, Westpac f/c: 0.1%, Mkt f/c: 0.2%

- We expect an increase of just 0.1% in the September quarter CPI. This would take annual inflation down to a new low of 0.2%, which we think will mark the ultimate low point for this cycle.
- Government charges will have a significant impact this quarter. A steep drop in vehicle registration fees will alone reduce inflation by around 0.3 percentage points.
- Our forecast is below the Reserve Bank's estimate of 0.3% for the quarter. However, we think it would take a significantly weaker result to prompt a fourth consecutive OCR cut at the October 29 review, given the rapidly improving outlook for dairy prices.

NZ CPI inflation

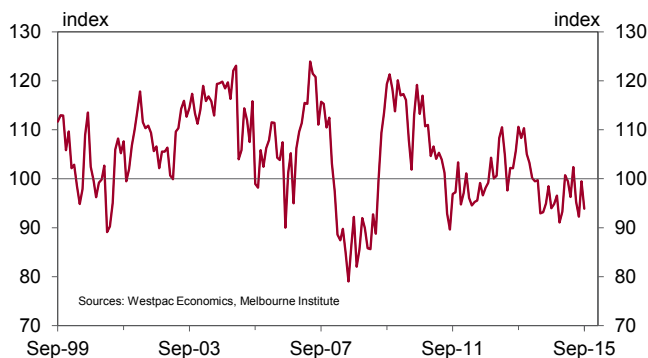


Aus Oct Westpac-MI Consumer Sentiment

Oct 14 Last: 93.9

- The Westpac-Melbourne Institute Consumer Sentiment Index lapsed back into pessimistic territory in Sep, falling from 99.5 in Aug to 93.9. Sharp falls in global equity markets and concerns about China's growth prospects were a clear factor.
- The Oct survey is in the field over the week ended Oct 10. Sentiment may continue to be affected by financial market turbulence although both the ASX and the AUD have staged recoveries since the Sep survey (up 3.4% and 2c US respectively). The US Fed's decision not to begin raising rates in Sep may factor although these sorts of international developments tend to have a low register with the Australian consumer. Closer to home, sentiment is more likely to be affected by the leadership change with Malcolm Turnbull replacing Tony Abbott as PM in mid-Sep.

Consumer Sentiment Index

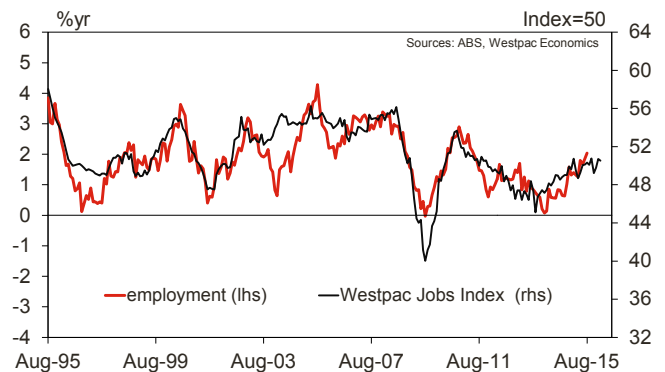


Aus Sep employment change

Oct 15, Last: 17.4k, WBC f/c: 15k Mkt f/c: 7.1k, Range: 0k to 25k

- Total employment rose a sound 17.4k in August, well above market expectations for a 5k rise. Total employment has grown 235.0k (or 2.0%yr) in the year to August, an acceleration from 213.8k (or 1.9%yr) in July.
- Two key issues should be noted. The first is that population rebenchmarking shaved 31.1k off total employment in the year to July. Secondly, the July surge in participation was not corrected suggesting that changes made to government benefits policy did indeed lift the job seeker count.
- Westpac's Jobs Index suggest total employment growth should peak at 2%yr then moderate. So we are tempted for forecast a negative but remember that Aug/Sept 2014 saw significant volatility associated with changes to the supplementary surveys. As such, we are going with a trend number.

Jobs Index is pointing to a softer pace for H2

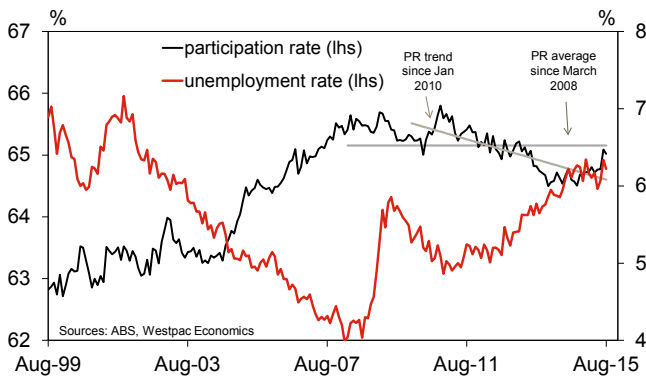


Aus Sep unemployment rate

Oct 15, Last: 6.2%, WBC f/c: 6.2%
Mkt f/c: 6.2%, Range: 6.1% to 6.3%

- In August, the participation rate fell 0.1ppts to 65.0% and the unemployment rate eased back to 6.2% (6.22% unrounded). So, while the resilience in the participation rate suggests changes to government policy are a factor, the small pull-back in August suggests that some statistical volatility also played a part.
- As such, we are happy to accept that it is likely that a large part of the recent jump in participation is permanent (notwithstanding any further changes to government policy).
- Westpac is looking for the participation rate to hold at 65% which will result in a 11.9k rise in the labour force. This is behind our forecast for the unemployment rate to hold at 6.2%.

Unemployment and participation rates

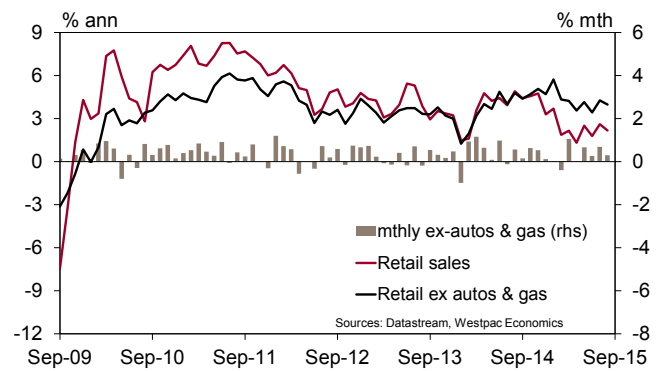


US Sep retail sales

Oct 14, Last: 0.2%, WBC f/c: 0.1%

- US retail sales have shown only modest momentum in recent months; weak petrol prices remain a significant negative for this nominal sales measure.
- Highlighting the impact of petrol prices, headline retail sales are up 2.2% over the year to August. In contrast, core retail sales (which exclude autos & gas) are up 4.4%yr. This divergence is likely to persist for some time yet.
- Partial data for the month of September is soft, suggesting we are likely to see another subdued outcome. A meek 0.1% gain seems most probable, albeit with a significant chance of upward revisions to prior months.
- Autos & gas are likely to be a marginal negative in the month; and, as a result, we expect the core series to rise 0.2%.

US retail sales, momentum still limited

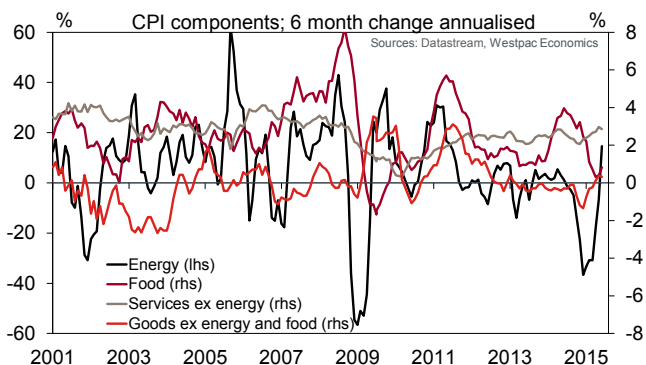


US Sep CPI

Oct 15, Last: -0.1%, WBC f/c: -0.2%

- As for retail sales, energy prices have been a notable negative for US headline inflation though 2015.
- As at August, annual headline inflation stood at just 0.1%. In contrast, the ex food & energy core was only marginally below the FOMC's medium-term target of 2.0%yr, at 1.8%yr.
- In September, weaker oil prices will likely see the headline measure fall again, circa -0.2%, leaving the annual inflation rate a touch below zero.
- This bout of deflation will prove fleeting. Oil has rallied in recent weeks, pointing to a firmer inflation pulse come October; while stronger global growth in 2016 will help oil build a more lasting base.

Energy prices stabilise; USD impact to lessen



Data calendar

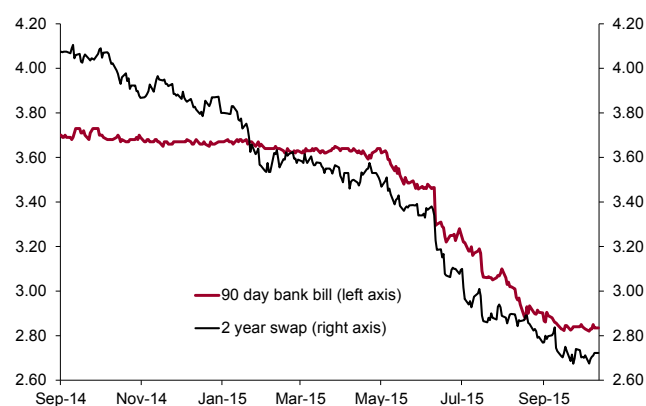
		Last	Market median	Westpac forecast	Risk/Comment
Mon 12					
NZ	Sep REINZ house sales	6.2%	–	–	Due this week. Activity remains strong ahead of new tax/lending rules.
	Sep REINZ house prices %yr	17.3%	–	–	House price strength has now spread beyond Auckland.
US	Fedspeak	–	–	–	Lockhart speaks on US economic outlook in Florida.
	Fedspeak	–	–	–	Evans speaks on policy and the economy in Chicago.
	Fedspeak	–	–	–	Brainard gives outlook and policy speech in Washington.
Tue 13					
NZ	Sep food price index	–0.5%	–	–0.5%	Seasonal decline in Sep. Trend remains flat despite weaker NZD.
Aus	RBA Deputy Governor Lowe speaking	–	–	–	Topic TBA, at CFA Institute Conference, Sydney 8.40 am AEDT.
	Sep NAB business confidence	1	–	–	Confidence has fallen from +8 to +1 since Jul; conditions firmer at +10.
Chn	Sep trade balance CNYbn	368	316	–	USD equivalents 60.2bn
	Sep USD exports %yr	–5.5%	–6.0%	–	Shipments to all major regions declining, non-Asian EM the weakest.
	Sep USD imports %yr	–13.8%	–15.9%	–	Food +8%, fuels and other raw materials down 'large' in value terms.
Eur	Oct ZEW survey expectations	33.3	–	–	Investors remain firmly in optimistic territory.
Ger	Sep CPI (final)	–0.3%	–0.3%	–	Harmonised basis; prices down 0.2%yr.
UK	Sep CPI	0.2%	0.2%	–	Inflation remains low with particular softness in import prices.
	Aug ONS house prices %yr	5.2%	–	–	ONS measure; dated relative to other measures. Has been moderate.
US	Sep NFIB small business optimism	95.9	95.5	–	Still below long-run average; but much improved on recent years.
	Fedspeak	–	–	–	Bullard speaks to NABE in Washington.
Wed 14					
NZ	June 2015 year fiscal accounts	–\$2.9b	–	–	Stronger than expected revenue could see a return to surplus after all.
Aus	Oct Westpac–MI Consumer Sentiment	93.9	–	–	Financial mkt turbulence weighed in Sep. Change of PM to impact Oct?
	Oct Westpac–MI unemp. expect. %mth	5.8%	–	–	Expectations have fallen 6 of the last 9 months, pace now just 1.1%yr.
Chn	Sep consumer prices %yr	2.0%	1.8%	–	Pork & fresh veg high, shelter edging up, non-food sideways at 1.1%.
	Sep producer prices %yr	–5.9%	–5.9%	–	Level of prices down ~12% from 2011 peak.
Eur	Aug industrial production	0.6%	–0.5%	–	Global economy a major headwind; domestic momentum robust.
UK	Aug ILO unemployment rate	5.5%	5.5%	–	Employment growth has moderated through mid-2015.
US	Sep Federal Monthly budget, \$bn	91	–	–	Tentative date.
	Sep retail sales	0.2%	0.2%	0.1%	Energy prices continue to impact this nominal sales measure.
	Sep PPI	flat	–0.2%	–	Has been subdued in recent months.
	Aug business inventories	0.1%	0.1%	–	Inventories a downside wildcard risk for H2 GDP growth.
	Fed's Beige book released	–	–	–	Economic conditions from around the 12 Fed regions.
Thu 15					
NZ	Sep Business NZ PMI	55.0	–	–	Has remained solid this year, but below last year's pace.
	Oct consumer confidence	110.8	–	–	Down sharply this year, but mild uptick in Sep as dairy prices improved.
Aus	Sep employment change	17.4k	7.1k	15k	Aug/Sep subject to greater than usual uncertainty due to changes to supplementary surveys. ABS adjustments & revisions can be significant.
	Sep unemployment rate	6.2%	6.2%	6.2%	FCAI figures point to solid bounce in Sep, led by passenger & SUVs.
	Sep new vehicle sales	–1.6%	–	5.0%	At subdued levels by historical standards.
	Oct MI inflation expectations	3.2%	–	–	Updated assessment of financial stability risks. Views on housing?
	RBA Oct Financial Stability Review	–	–	–	Claims have remained low for an extended period.
US	Initial jobless claims	263k	–	–	Annual headline inflation likely to (briefly) go negative.
	Sep CPI	–0.1%	–0.2%	–0.2%	Has fallen to low levels, soft global growth is weighing on demand.
	Oct Empire manufacturing survey	–14.7	–7.5	–	Fell sharply last month; the manufacturing sector is facing headwinds.
	Oct Philly fed survey	–6.0	–2.0	–	Bullard makes opening remarks at policy conference.
	Fedspeak	–	–	–	Dudley speaks at Brookings Institute.
	Fedspeak	–	–	–	Mester delivers remarks at event in New York.
Fri 16					
NZ	Q3 CPI	0.4%	0.2%	0.1%	Government charges set to take annual inflation to new cycle low.
Eur	Aug trade balance €bn	22.4	21.5	–	Little change expected; awaiting a stronger global economy.
	Sep CPI (final)	0.0%	0.2%	–	Headline annual inflation will likely remain (barely) sub zero.
US	Sep industrial production	–0.4%	–0.2%	–	ISM points to significant USD impact on US manufacturing.
	Aug JOLTS job openings, 000's	5753	–	–	Higher churn signals greater confidence in labour market health.
	Oct Uni of Michigan consumer sentiment	87.2	88.5	–	Currently at a very healthy level relative to history.
	Aug long-term TIC flows, \$bn	7.7	–	–	Detail on US Treasury purchases and holdings.

New Zealand forecasts

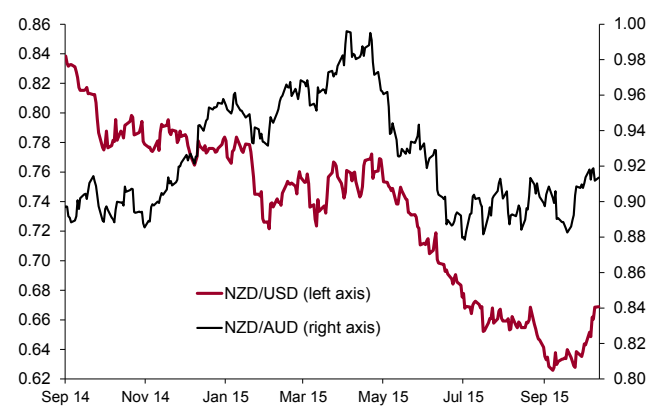
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.0	2.2	2.3	3.3	2.2	2.0
Employment	3.8	3.2	0.8	2.3	2.9	3.6	1.1	2.0
Unemployment Rate % s.a.	6.0	5.8	6.5	6.3	6.1	5.7	6.4	6.4
CPI	1.5	0.3	1.3	1.6	1.6	0.8	0.5	1.9
Current Account Balance % of GDP	-2.6	-3.4	-5.5	-4.6	-3.2	-3.1	-4.7	-5.0

Financial Forecasts	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Cash	2.50	2.00	2.00	2.00	2.00	2.00
90 Day bill	2.40	2.10	2.10	2.10	2.10	2.10
2 Year Swap	2.50	2.30	2.20	2.20	2.20	2.20
5 Year Swap	3.10	3.10	3.10	3.20	3.20	3.20
10 Year Bond	3.40	3.50	3.60	3.70	3.70	3.70
NZD/USD	0.62	0.61	0.61	0.62	0.63	0.63
NZD/AUD	0.91	0.92	0.92	0.92	0.92	0.91
NZD/JPY	75.0	73.8	74.4	75.9	78.6	76.7
NZD/EUR	0.57	0.57	0.57	0.57	0.58	0.57
NZD/GBP	0.41	0.41	0.41	0.41	0.41	0.41
TWI	67.7	67.5	67.6	67.9	68.9	68.3

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 12 October 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.75%	2.75%	2.75%
30 Days	2.86%	2.85%	2.85%
60 Days	2.85%	2.85%	2.83%
90 Days	2.84%	2.85%	2.85%
2 Year Swap	2.72%	2.74%	2.73%
5 Year Swap	3.06%	3.09%	3.10%

NZ foreign currency mid-rates as at Monday 12 October 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6689	0.6365	0.6312
NZD/EUR	0.5887	0.5694	0.5568
NZD/GBP	0.4366	0.4190	0.4089
NZD/JPY	80.37	76.72	76.03
NZD/AUD	0.9135	0.9058	0.8910
TWI	71.58	69.52	68.49



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	2.2	2.7
CPI inflation % annual	3.0	2.2	2.7	1.7	2.2	2.0
Unemployment %	5.2	5.3	5.8	6.2	6.5	6.1
Current Account % GDP	-2.8	-4.4	-3.4	-3.0	-4.2	-4.7
United States						
Real GDP %yr	1.6	2.2	1.5	2.4	2.4	2.8
Consumer Prices %yr	3.1	2.1	1.5	1.6	0.1	1.7
Unemployment Rate %	8.9	8.1	7.4	6.2	5.3	4.9
Current Account %GDP	-2.9	-2.9	-2.3	-2.2	-2.3	-2.3
Japan						
Real GDP %yr	-0.5	1.7	1.6	-0.1	0.6	1.3
Euroland						
Real GDP %yr	1.6	-0.8	-0.3	0.9	1.5	1.1
United Kingdom						
Real GDP %yr	1.6	0.7	1.7	3.0	2.5	2.5
China						
Real GDP %yr	9.5	7.7	7.7	7.3	7.0	6.8
East Asia ex China						
Real GDP %yr	4.5	4.6	4.2	4.1	3.5	4.0
World						
Real GDP %yr	4.2	3.4	3.3	3.4	3.0	3.6
Forecasts finalised 9 Oct 2015						

Interest Rate Forecasts	Latest	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Australia						
Cash	2.00	2.00	2.00	2.00	2.00	2.00
90 Day Bill	2.18	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.69	2.85	2.90	3.00	3.10	3.35
International						
Fed Funds	0.125	0.375	0.625	0.875	1.125	1.375
US 10 Year Bond	2.10	2.35	2.50	2.70	2.90	3.00
ECB Repo Rate	0.05	0.05	0.05	0.05	0.05	0.05

Exchange Rate Forecasts	Latest	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
AUD/USD	0.7254	0.68	0.66	0.66	0.67	0.69
USD/JPY	119.92	121	121	122	123	124
EUR/USD	1.1290	1.09	1.07	1.07	1.08	1.10
AUD/NZD	1.0892	1.10	1.08	1.08	1.09	1.09

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Disclaimer continued

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