



Sunrise over Mt. Ruapehu crater.

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Stormy weather

Local developments largely took a back seat last week to the unfolding dramas of China's share price plunge and Greece's potential exit from the euro zone. While a sense of calm was starting to return by the end of the week, both situations remain fluid, and the consequences for New Zealand of a more serious turn of events are uncertain.

The China story in particular is cause for concern for New Zealand, as a major exporter of primary products to Chinese consumers. Of course, at times like this, financial prices tend to be pushed around by the need to liquidate positions, rather than any view on their fundamentals. That can sometimes lead to perverse outcomes – such as the New Zealand dollar actually finishing the week higher, reflecting the extent of short positioning in the currency in recent times. Nevertheless, it's clear that the market views China's woes as a poor backdrop for New Zealand's commodity exports – dairy futures are implying another steep fall in prices at this week's GlobalDairyTrade auction.

Last week's data continued the recent theme of slowing momentum in the New Zealand economy. The June *Quarterly Survey of Business Opinion* showed that a net 7% of businesses expect conditions to improve over the coming six months. That's down from March's 20% result, and well below the results seen over the past year. In fact, business confidence hasn't been this low since 2012. That theme continued throughout the survey, with businesses reporting slowing activity, reduced hiring and investment plans, and little in the way of increasing prices or margins.

The results were varied across sectors. On the positive side, the building industry appears to be powering ahead (much more so than was suggested by the monthly ANZ business survey). While building consents have flattened out in the last year, there is a significant amount of work still in the pipeline, for both the Christchurch rebuild and the rest of the country. Manufacturers were concerned about the wider outlook, but were more upbeat about their own performance. Notably, these two sectors reported that capacity utilisation was at its highest in the history of the survey going back to 1961, which stands in contrast with the evidence elsewhere of a lack of inflation pressures.

Stormy weather continued

The weakness in confidence was most pronounced among retailers. However, that seems to overstate the degree to which the sector's fortunes have turned in recent months. In the early part of this year, a sharp drop in petrol prices left more money in consumers' pockets, resulting in a sharp rise in core (ex-automotive) retail spending. Now that fuel prices have risen back towards their previous highs, that effect has gone into reverse: core spending has been more or less flat over the June quarter. But that's far from a sign of weakness – it's more accurate to say that the level of retail spending rose sharply in the March quarter (up 2.7% in real terms) and has maintained that level since.

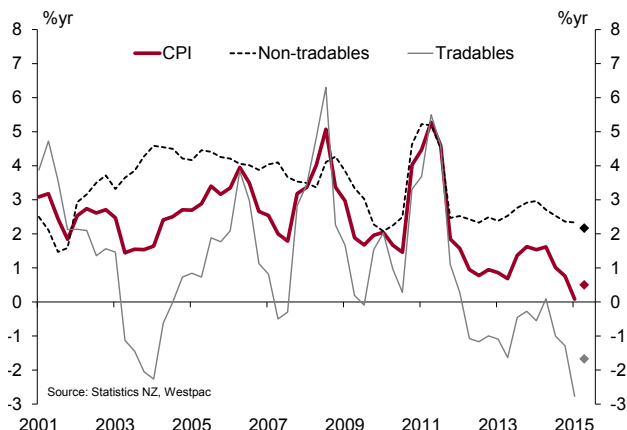
The influence of the fall and subsequent rebound in fuel prices will also be apparent in Thursday's CPI release. We expect a 0.7% rise for the quarter, of which about 0.5 percentage points is due to fuel. This would lift the annual inflation rate from 0.1% last quarter to a still-subdued 0.5%.

Outside of fuel, we expect tradable goods inflation to remain modestly negative. While the NZD trade-weighted index was down 2% on average over the quarter, we find that exchange rate movements typically take the best part of a year to fully pass through to tradables prices.

Non-tradables inflation, which is driven more by domestic conditions, is expected to remain subdued, slowing to a five-year low of 2.2%/yr. One particular aspect will be notable for its absence: electricity prices are normally a significant plus in the June quarter CPI. But this year saw a steep cut to lines charges in Wellington, which offset price hikes elsewhere.

Our forecast of a 0.7% quarterly increase in the CPI is quite a bit higher than the Reserve Bank's forecast of 0.4% in its June *Monetary Policy Statement*, with the difference coming on

CPI inflation



the tradables side. However, we suspect that a stronger than expected outturn would actually be welcomed by the Reserve Bank, which has set its sights on dragging inflation back towards its 2% target midpoint (via a weaker exchange rate). We expect another OCR cut at the 23 July meeting, followed by two more cuts in September and October.

Lower interest rates are likely to work against policymakers' recent efforts to cool off the hot Auckland housing market. Tighter lending restrictions for investor property loans and tax rules for short-term investors come into force in October, but their effects are expected to be modest. The data available so far suggests that neither buyers nor sellers are rushing for the door ahead of the new policies; the REINZ sales figures for June (expected to be released today) will hopefully provide a fuller picture.

Fixed vs Floating for mortgages

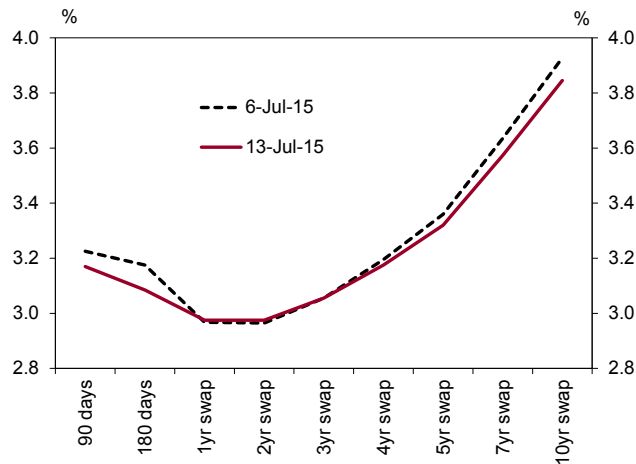
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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

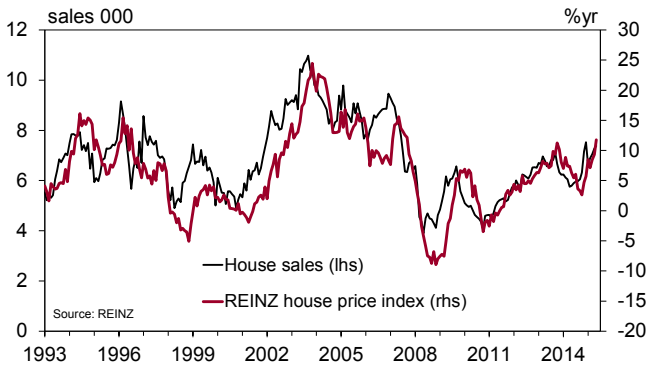


NZ Jun REINZ house prices and sales

Jul 13, Sales last: 1.4%, Prices last: 11.7%yr

- The housing market has continued to strengthen in recent months, fuelled by population growth, falling mortgage rates and a shortage of available listings. Price growth in Auckland has significantly outstripped the rest of the country; we think that the recent push to reduce regulation around the use of land in central Auckland has played an important part in this.
- Two housing policy measures were unveiled in May: a tightening of loan-to-value limits for property investors in Auckland (and a loosening for all buyers in the rest of the country) and a firming up of tax rules for investors who buy and sell within two years. The data available to date for June suggests a continuation of recent trends: neither buyers nor sellers are rushing for the door ahead of the new policies, which take effect in October.

REINZ house prices and sales

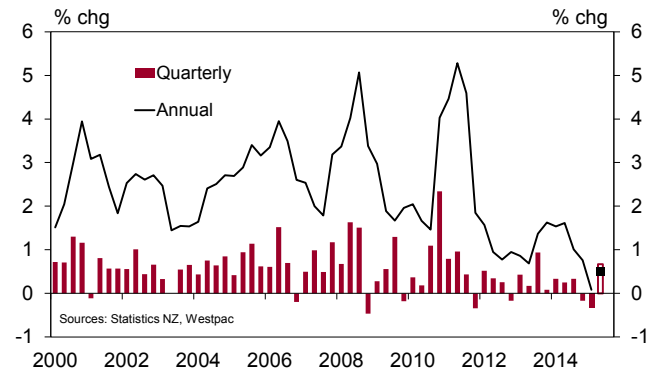


NZ Q2 Consumer Price Index

Jul 16, Last: -0.3%, Westpac f/c: 0.7%, Mkt f/c: 0.5%

- We estimate that the CPI rose by 0.7% in the June quarter, lifting annual inflation to a still-subdued 0.5%. The sharp fall in petrol prices that drove inflation towards zero last quarter has since been largely unwound.
- Elsewhere, inflation pressures have remained subdued to date, with the weaker New Zealand dollar not expected to have a significant impact just yet.
- Our forecast is higher than the Reserve Bank's estimate of a 0.4% increase. However, we suspect that the Reserve Bank would actually welcome a surprise to the upside, as it sets its sights on dragging inflation back towards the middle of its 1-3% target range.

NZ CPI inflation

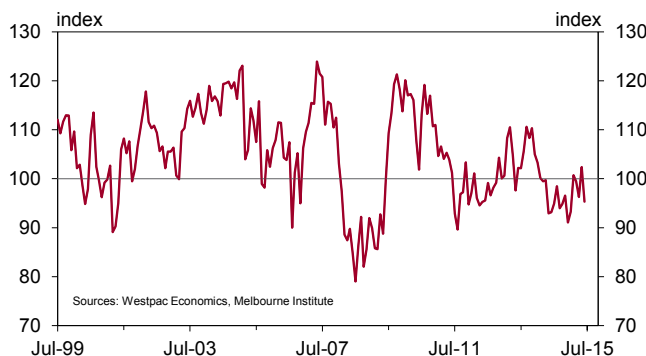


Aus Jul Westpac-MI Consumer Sentiment

Jul 15 Last: 95.3

- The Westpac-Melbourne Institute Consumer Sentiment Index disappointed in June, falling back sharply and unwinding all of May's post-Budget and post-rate cut lift to be 1% below its Apr level. Concerns around the economy, housing and job security returned to the fore.
- The July survey is in the field from July 6-12. Offshore events are likely to have a major impact with renewed turmoil in Greece and China's sharemarket collapse front and centre. Locally, the ASX is only down about 1/2% since the June survey but has seen volatile daily moves, the AUD is down 2c vs the USD and commodity prices have fallen sharply to be back near April lows. Other developments have been more benign with the RBA leaving the cash rate on hold as expected and June labour force data showing the unemployment rate nudging up to 6% in the month but broadly unchanged on a year ago.

Consumer Sentiment Index

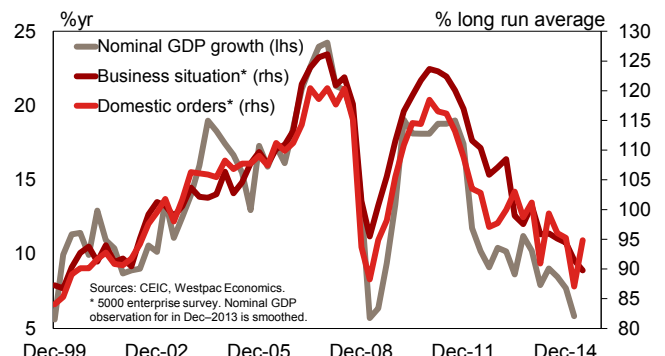


China Q2 real GDP

Jul 15, Last: 7.0%, WBC f/c: 7.0% Mkt f/c 7.0%

- The NBS estimated that China grew at a real rate of 7.0% over the year to March, up 1.3% seasonally adjusted in Q1. Our forecast for Q2 is for no change in the y/y rate, with downside risk based on a high base effect. Nominal GDP could improve a touch y/y though, as it tends to be more sensitive to swings in underlying demand conditions than the real estimate. A range of surveys and elements of the partial activity data have firmed a little q/q. The very weak price environment will again produce a negative deflator, and this will be the balancing item keeping real growth steady despite a small gain in y/y NGDP.
- Net exports were a major swing factor between Q4 and Q1. They will remain a modest support in absolute terms, but the Q1/Q2 swing will be minimal.
- A steady outcome of 7.0% would no doubt assist to calm a few of the frayed nerves produced by recent equity price action.

China: business conditions, orders & GDP

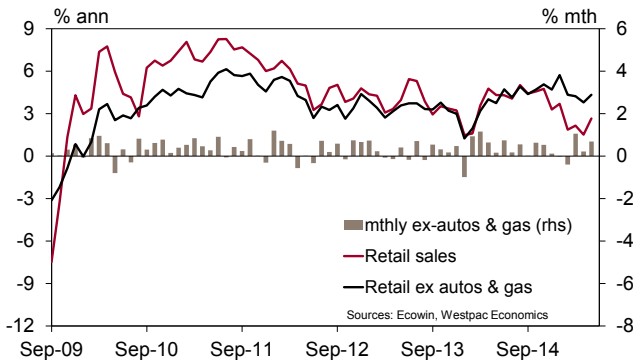


US June retail sales

Jun 14, Last: 1.2%, WBC f/c: 0.5%

- Retail sales found some momentum in May, rising 1.2% after a tumultuous weather and oil price affected four months to April (which saw a cumulative 0.5% gain). Core retail spending (ex autos & gas) posted a more modest 0.7% gain in May.
- In 2015, the FOMC has frequently noted its disappointment that the decline in petrol prices has not translated into stronger discretionary spending. Instead, as we have long cautioned, US households look to have held back, despite strong confidence and a favourable outlook toward incomes.
- We anticipate core retail spending growth will likely remain constrained in June, circa the 0.7% pace experienced in May. In contrast to May, auto & gas spending is likely to weigh on total activity in June, producing a modest 0.5% headline result.

US retail sales find a little momentum

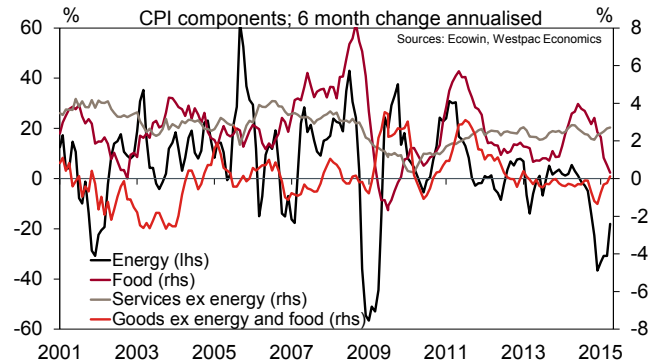


US June CPI

Jun 17, Last: 0.4%, WBC f/c: 0.3%

- Sectoral inflation trends have changed tack in recent months, with energy prices rising in three of the four months to May (most notably in May, 4.3%) as food inflation abated to nil. Goods (ex energy) pressures have remained limited, albeit now positive; while services (ex energy) pressures have persisted, broadly in line with the pace apparent since 2012.
- Annual headline inflation is currently flat, but it will firm towards core inflation's 1.8%/yr in coming months as the deflationary impact of 2014's oil price decline fade. Nonetheless, headline and core inflation will remain contained.
- In June, we foresee a further moderate 0.3% gain for headline inflation, with food and energy prices limited. Accordingly, core inflation will be similar in scale, circa 0.2%.

Petrol deflation abates; food inflation slows



Data calendar

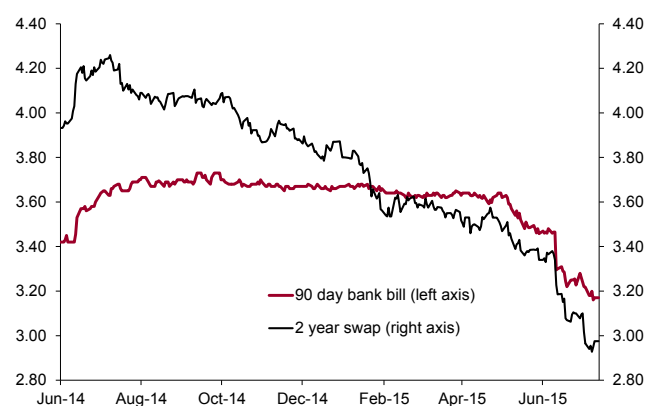
		Last	Market median	Westpac forecast	Risk/Comment
Sometime this week					
Chn	Jun new loans CNYbn	900.8	1050	–	Credit demand is soft ex-refinancing.
	Jun total credit supply CNYbn	1220	1400	–	Interbank turnover strong, equity financing firm ahead of July collapse.
	Jun M2 money supply M2 %yr	10.8%	11.0%	–	Net capital outflows ceased in May, plus CD initiative could help.
	Jun foreign reserves USDbn	3730	3703	–	Rate of decline slowed in Q2, following heavy rundown prior 3 qtrs.
Mon 13					
NZ	Jun REINZ house sales	1.4%	–	–	June figures to date suggest no change in recent trends.
	Jun REINZ house price index %yr	11.7%	–	–	House prices rising sharply in Auckland, more subdued elsewhere.
	Jun food price index	0.4%	–	1.6%	Produce prices rise in winter. Annual inflation running at around 1%.
Chn	Jun trade balance USDbn	59.49	57.1	–	Huge surplus predominantly a function of the lower import bill.
Tue 14					
Aus	Jun NAB business survey	7	–	–	May (post Budget & rate cut), conditions +3pts to 7, conf +4pts to 7.
Eur	May industrial production	0.1%	0.2%	–	Momentum has ebbed in recent months, up 0.8%yr.
	Jul ZEW investor survey	53.7	–	–	Impasse over Greece likely to have significant impact.
Ger	Jun CPI, final	–0.2%	–0.2%	–	Prelim provided downside surprise; harmonised annual change 0.1%yr.
UK	Jun CPI	0.2%	0.1%	–	With headline CPI 0.1%yr, BoE to hold tight for a long time yet.
	ONS house prices, %yr	5.5%	–	–	Broad-based softening across all price measures apparent of late.
US	Jun retail sales	1.2%	0.3%	0.5%	Auto & gas supported May; but will be drag in Jun.
	Jun NFIB small business survey	98.3	98.5	–	Detail has been volatile of late; headline likely broadly unchanged in Jun.
	Jun business inventories	0.4%	0.2%	–	Little need for inventory accrual at present; questions over end demand.
Can	Jun house prices	0.9%	–	–	Teranet/ National Bank measure; up a robust 4.6%yr.
Wed 15					
Aus	Jul Westpac–MI Consumer Sentiment	95.3	–	–	Unwound May's bounce in June. Greece/China news to impact July?
	Jul Westpac–MI unemploy. expectations	152.8	–	–	Consumers haunted by Job-loss fears despite steady official U/E rate.
Chn	Jun retail sales %yr	10.1%	10.2%	–	Sentiment higher in June, expected 'shopping' outlays also rose.
	Jun industrial production	6.0%	6.0%	–	Range of surveys (biz, consumer) point to 'no worse, possibly better'.
	Jun fixed asset investment %ytd	11.4%	11.2%	–	Manufacturing in decline, land sales a drag, property stability, infra up?
	Q2 GDP %yr	7.0%	7.0%	7.0%	See box. Nominal growth up a little, deflator to ensure steady real.
UK	May ILO unemployment rate	5.5%	5.5%	–	Stable circa current level through 2015-to-date.
US	Chair Yellen semi-annual testimony	–	–	–	To assess Yellen's tone versus collective FOMC position from minutes.
	Jun PPI final demand	0.5%	0.2%	–	Upstream price pressures absent, core up 0.1% in May and 0.1%yr.
	Jul Empire manufacturing survey	–2.0	3.25	–	NY manufacturing activity likely to bounce from weak level in Jul.
	Jun industrial production	–0.2%	0.2%	–	Manufacturing unchanged from Jan level; mining well down.
	Fedspeak	–	–	–	George in Kansas City; Mester in Ohio; and Williams in Phoenix.
Can	May manufacturing sales	–2.1%	0.3%	–	Disappointed in Apr, weakness broad based, though aerospace fall key.
	Bank of Canada policy decision	0.75%	0.75%	0.75%	Most likely on hold awaiting further information, but downside risks clear.
Thu 16					
NZ	GlobalDairyTrade auction	–5.9%	–	–	Futures markets suggesting another very weak result.
	Jun manufacturing PMI	51.5	–	–	Notably softer in the last two months; will lower NZD/AUD help?
	Q2 CPI	–0.3%	0.5%	0.7%	Rebound in fuel prices, underlying inflation subdued.
Aus	Jul MI inflation expectations, %yr	3.0%	–	–	Lowest since late 2013.
Eur	May trade balance, €bn	24.3	–	–	Export growth outstripped that of imports in April, widening surplus.
	Jun CPI, final	0.2%	flat	–	Annual inflation meek at 0.2%yr; core pressures modest at 0.8%.
	ECB policy meeting	0.05%	0.05%	0.05%	Policy on hold; financial support for Greece (or not) current focus.
US	Jul Philadelphia Fed business outlook	15.2	12.0	–	Stronger than NY survey in Jul; will likely ease back this month.
Fri 17					
NZ	Jul ANZ consumer confidence	119.9	–	–	June survey was weaker but preceded OCR cut.
US	Jun housing starts	–11.1%	6.2%	–	To bounce back in June; sans, volatility, continue (very modest uptrend).
	Jun building permits	9.6%	–11.2%	–	Erratic month to month on multiples activity; weak uptrend intact.
	Jun CPI	0.4%	0.3%	0.3%	Core pressure contained, albeit not far from FOMC's 2.0% PCE target.
	Jul consumer sentiment	96.1	96.5	–	Uni of Michigan measure; holding at elevated level. Greece?
	Fedspeak	–	–	–	Vice Chair Fischer in Washington.
Sat 18					
Chn	Jun 70-city property prices, new %net bal	–32.9%	–	–	21 up, 44 down in May, stress in periphery, stability in core cities.
	Jun 70-city property prices, 2'dary	+17.1%	–	–	39 up, 27 down in May, striking gains in Tier-1, healing underway.

New Zealand forecasts

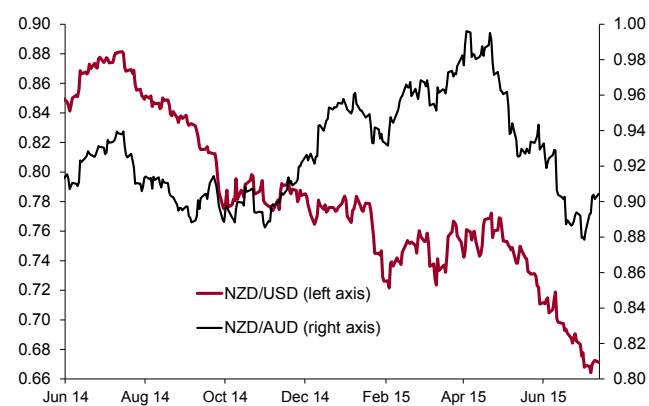
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.4	3.3	2.2	3.3	2.4	3.1
Employment	3.8	3.2	3.0	2.3	2.9	3.6	2.8	3.0
Unemployment Rate % s.a.	6.0	5.8	4.9	4.4	6.1	5.8	5.2	4.3
CPI	1.5	0.1	1.8	1.9	1.6	0.8	0.9	2.2
Current Account Balance % of GDP	-2.6	-3.6	-4.6	-4.3	-3.3	-3.3	-4.2	-4.4

Financial Forecasts	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Cash	2.75	2.50	2.50	2.50	2.50	2.50
90 Day bill	2.70	2.60	2.60	2.60	2.60	2.60
2 Year Swap	2.80	2.70	2.70	2.70	2.70	2.70
5 Year Swap	3.20	3.10	3.10	3.20	3.30	3.40
10 Year Bond	3.50	3.50	3.60	3.70	3.80	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 13 July 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.25%	3.25%	3.25%
30 Days	3.22%	3.34%	3.35%
60 Days	3.19%	3.31%	3.33%
90 Days	3.17%	3.26%	3.30%
2 Year Swap	2.98%	3.05%	3.21%
5 Year Swap	3.32%	3.40%	3.58%

NZ foreign currency mid-rates as at Monday 13 July 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6713	0.6838	0.6990
NZD/EUR	0.6047	0.6210	0.6231
NZD/GBP	0.4327	0.4358	0.4495
NZD/JPY	82.11	83.88	86.15
NZD/AUD	0.9044	0.8958	0.9026
TWI	70.80	71.71	72.98



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	2.5	2.5
Unemployment %	5.2	5.3	5.8	6.2	6.5	6.3
Current Account % GDP	-2.8	-4.4	-3.3	-2.8	-3.4	-3.4
United States						
Real GDP %yr	1.6	2.3	2.2	2.4	2.0	3.2
Consumer Prices %yr	3.1	2.1	1.5	1.6	0.1	2.0
Unemployment Rate %	8.9	8.1	7.4	6.2	5.3	5.0
Current Account %GDP	-2.9	-2.9	-2.2	-2.2	-2.3	-2.3
Japan						
Real GDP %yr	-0.5	1.8	1.6	-0.1	1.3	1.8
Euroland						
Real GDP %yr	1.6	-0.8	-0.4	0.8	1.4	1.2
United Kingdom						
Real GDP %yr	1.6	0.7	1.7	2.6	2.5	2.7
China						
Real GDP %yr	9.3	7.8	7.8	7.4	7.0	7.0
East Asia ex China						
Real GDP %yr	4.4	4.5	4.3	4.1	4.2	5.0
World						
Real GDP %yr	4.2	3.4	3.4	3.4	3.2	4.0
Forecasts finalised 10 July 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	3.07	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	2.38	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	0.7585	0.73	0.72	0.72	0.72	0.73
USD/JPY	123.17	126	128	128	129	130
EUR/USD	1.1093	1.08	1.07	1.07	1.07	1.07
AUD/NZD	1.1291	1.16	1.16	1.16	1.14	1.14

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