



Sunrise over Mt. Ruapehu crater.

In this issue

Fixed vs floating	2
The week ahead	3
Data calendar	4
New Zealand forecasts	5
International forecasts	6

How low can you go?

The challenges facing the New Zealand economy have continued to mount, prompting us to change our expectations for rate cuts from the RBNZ. We now expect the RBNZ to cut the OCR to a record low of 2.0% by the end of this year. This will involve one reduction of 50bp - most likely in September, but possibly as early as this week's July OCR Review. We expect 25bp reductions in the OCR at each of the other three meetings this year.

In recent weeks we've noted the increasing signs that the economy is losing momentum, including sharp declines in household and business confidence. On top of those earlier developments, there have been two major developments over the past week that have prompted us to change our OCR call.

The first is the continued sharp decline in global dairy prices. Prices were down 10.7% in the latest GlobalDairyTrade auction, taking them to their lowest level in six years. There were large declines for almost every product, and that downward pressure is likely to spill over into the next auction in early August. We've made a significant downward revision to our forecast for Fonterra's milk price for the current season. We now anticipate a payout of \$4.30/kg, which would be even lower than last season's already very weak outcome. This means export earnings will be around \$2 billion lower than we had expected.

Two very low payout years in a row signals tough times ahead for many in the dairying sector. But the impact of lower prices will also be felt more widely in the economy. Household and investment spending in rural communities can be expected to drop back. In addition, it's inevitable that challenging conditions in the rural sector will pass through to lower confidence in the economy more generally. This signals downside risk for businesses' investment and hiring decisions over the coming year.

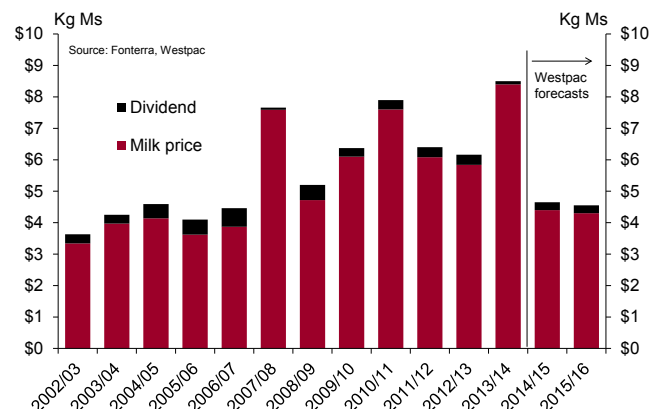
How low can you go? continued

The second major development over the past week has been the lingering softness in inflation. Consumer prices rose by 0.3% over the past year. While this is up from the very weak March result, it's still the second slowest pace in 15 years. And the underlying detail won't be of much comfort to the RBNZ. The main factor boosting inflation was higher petrol prices, which will weigh on household demand over the coming months. At the same time, the domestic side of the inflation picture continue to look very weak. Non-tradables inflation was just 2% in the year to June. That's the lowest level since 2001. And it's not just because of a few rogue prices. The RBNZ's sectoral core inflation measure is languishing at very low levels.

Inflation will pick up over the coming year as last year's sharp falls in oil prices drop out of annual figures, and the fall in the NZD pushes up the prices of imports. But the extent of any pick-up in the domestic components of inflation still looks likely to be modest. Indicators of cost pressures remain low, wage pressures are muted, and the heightened concern around both domestic and international economic conditions means that businesses are likely to remain cautious when it comes to adjusting prices for the next while.

Adding to the challenges for the economy is that one of the major drivers of growth in recent years, the Canterbury rebuild, is starting to dissipate. In recent years, increases in the amount of reconstruction work completed each quarter provided a significant boost to GDP growth and employment. However, as discussed in our recent report *"Peak or Plateau: Update on the Canterbury rebuild"*¹, reconstruction spending is starting to level off around nine months earlier than we had expected. There is still a large amount of reconstruction work to be completed. But we will no longer see the very large increases in construction spending that we saw in recent years. Instead, we expect that rebuild activity will continue around current strong levels over the next year or so, before it starts to gradually wind down from about mid-2016. This will dampen nationwide GDP growth over the coming year, and will pass through to softer employment and spending in the economy through the latter part of the decade.

Fonterra payout history and forecasts



Putting all this together, we think that economy will need a significant shot in the arm to get inflation back to levels that the RBNZ is comfortable with on a sustained basis. We're projecting a 25bp cut at this week's OCR review, a 50bp cut in September, and two more 25bp cuts in October and December.

The key reason we think the RBNZ will wait until September to cut by 50bp instead of at this week's decision is the continued strength in the housing market. Last week's figures showed that house price inflation has accelerated to 15% on an annual basis. The RBNZ will be mindful about pouring more fuel on an already hot market. However, by the time September rolls around, it's likely that momentum in the housing market will have slowed in response to softening economic confidence, as well as changes in regulations around lending and home sales. This will make the RBNZ more comfortable about cutting rates. It would also coincide with the RBNZ's September *Monetary Policy Statement*, giving them the change to fully explain their thinking.

¹ Available here: <http://www.westpac.co.nz/assets/Business/Economic-Updates/2015/Bulletins-2015/Update-on-the-Canterbury-Rebuild-July-2015.pdf>

Fixed vs Floating for mortgages

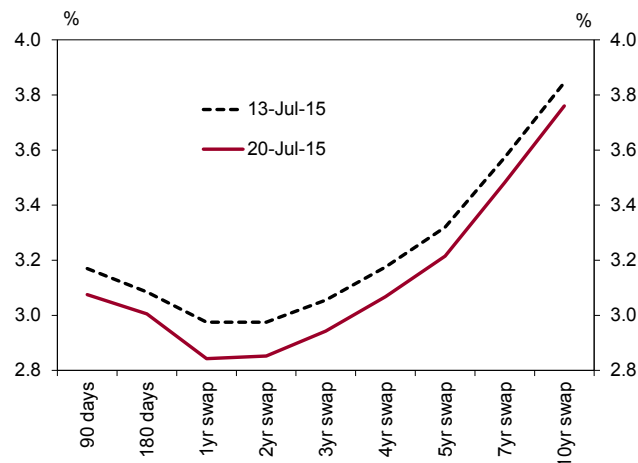
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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

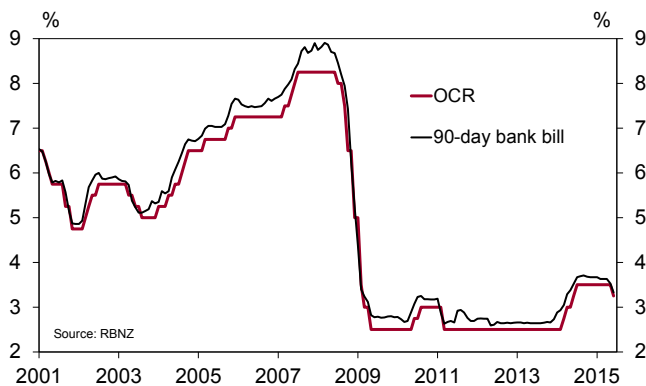


NZ Jul RBNZ OCR review

Jul 23, Last: 3.25%, Westpac f/c: 3.00%, Mkt f/c: 3.00%

- When the RBNZ cut the OCR 25bp in June, it dismissed the strong housing market and emphasised the terms of trade, inflation, and the output gap.
- Since June, data relating to these factors has been horrible: Q1 GDP growth was just 0.2%, dairy auction prices have slumped 17%, consumer and business confidence have fallen sharply, and inflation has once again proven soft.
- At least a 25bp reduction at the July review is a sure bet, and there is a possibility of a 50bp reduction. Markets themselves could be the deciding factor. Should market pricing move to price a significant chance of a 50bp reduction, the RBNZ may be obliged to deliver. Otherwise, 25bp is more likely.

NZ OCR and 90-day rate

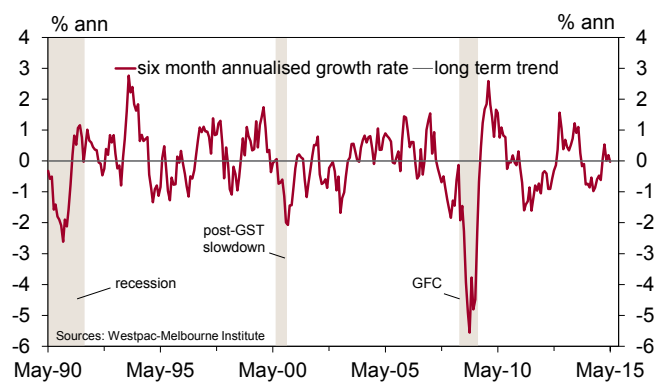


Aus Jun Westpac-MI Leading Index

Jul 22, Last: -0.02%

- The 6mth annualised growth rate of the Index fell back from +0.19% in April to -0.02% in May, a disappointing result after four above trend monthly reads.
- The June update looks likely to show a further easing in the growth pulse. Component updates will incorporate a sharp fall in the ASX (-5.6% vs a flat May) and a further decline in the Westpac-MI Consumer Expectations Index (-2.3% after an 11% fall last month). Other components should provide a material offset with dwelling approvals up 3.7%, hours worked up 0.3%, commodity prices posting a decent 2.9% rise in AUD terms in June (ahead of the rout in July), US industrial production rose 0.3% and the yield spread widening slightly (usually a more positive sign for growth prospects).

Westpac-MI Leading Index

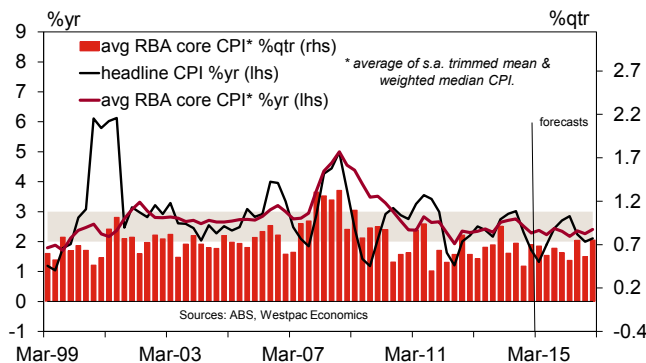


Aus Q2 Consumer Price Index

Jul 22, Last: 0.2%, WBC f/c: 1.0% Mkt f/c: 0.8%, Range: 0.3% to 1.0%

- The headline CPI lifted 0.2% in Q1 compared to Westpac's, and the market's, expectation of 0.1%. The annual rate is now 1.3%yr compared to 1.7%yr in Q4 and 2.3%yr in Q3.
- For the core measures, the trimmed mean gained 0.64% while the weighted median lifted 0.62%. The annual pace of the average of the core inflation measures is now 2.4%yr, a slight lift from 2.3%yr in Q4 but well below the 2.8%yr pace of 2014Q3.
- Westpac is forecasting a robust 1.0%qtr rise (1.9%yr) in the headline CPI for Q2. Behind this is a rebound in petrol, a solid bounce in fruit & vegetable prices and solid gains in medical & hospital services. Housing costs continue to rise.
- The average of the core measures is forecast to rise 0.5%qtr/2.2%yr. These key policy sensitive rates are not presenting a threat to the RBA's inflation target.

We are seeing the quick bounce in petrol prices



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 20					
NZ	Jun performance of Services Index	58.0	–	–	Services survey has been consistently strong this year.
Eur	May current account, £bn	22.3	–	–	Trade balance narrowed slightly in May to €21.2bn.
UK	Jul house prices	3.0%	–	–	Rightmove index; up 4.5%yr in June.
Can	May wholesale trade	1.9%	–	–	After two strong months, pull-back likely given aggregate growth lacking.
Tue 21					
NZ	Jun net immigration	5,140	–	4,900	Migration still very high but off the RBNZ's radar for now.
Aus	RBA Minutes July Board meeting	–	–	–	Any firming of the RBA's mild easing bias ahead of their August f/c review.
UK	Jun public sector net borrowing, £bn	10.1	8.9	–	Ex banking group measure; May was 8 year low on better tax receipts.
Wed 22					
Aus	Jun Westpac–MI Leading Index %dvt	–0.02	–	–	Component update for June likely to show a further easing, see textbox.
	Q2 CPI	0.2%	0.8%	1.0%	Fuel & fresh fruit spiking higher but supported by steady housing gains.
	Q2 avg RBA core CPI	0.7%	0.6%	0.5%	With extremes trimmed out core inflation eases to 2.2%yr from 2.4%yr.
	RBA Governor Stevens	–	–	–	Speech to the Anika Foundation, topic tba, Sydney, 1:05pm.
Chn	Jul MNI business indicator	53.5	–	–	Survey of listed firms only, so equity turmoil highly relevant.
UK	Bank of England Minutes	–	–	–	Any signs that the BOE might follow in FOMC's footsteps in 2016?
US	Jun existing home sales	5.1%	0.9%	1.2%	May saw strong bounce; June to pull back but see uptrend persist.
Thu 23					
NZ	RBNZ OCR review	3.25%	3.00%	3.00%	25bp cut most likely, but 50bp cut is possible.
Aus	Q2 NAB business survey	–	–	–	Q2 incl detail on capex plans. Conditions up 5pts to +11 in mnth of June.
Eur	Jul consumer confidence	–5.6	–5.8	–	Unchanged in June; but July likely impacted by Greece malaise.
UK	Jun retail sales, incl fuel	0.2%	0.4%	–	Core also up 0.2.% in May, 4.4%yr. Industry data positive for June.
US	Jun Chicago Fed activity index	–0.17	–	–	Continues to point to sluggish growth in aggregate demand.
	Jun leading index	0.7%	0.1%	–	Apr/May gave support to idea growth to strengthen into H2.
	Jul Kansas city Fed manufacturing index	–9	–	–	Energy sector has had a material impact; but stabilisation expected.
	Initial jobless claims, '000	281	–	–	Fell 15k last week to be in line with the 4 week moving average.
Fri 24					
NZ	Jun merchandise trade NZDmn	350	100	300	Dairy in decline again, meat exports strong.
Eur	Jul Markit manufacturing PMI - flash	52.5	52.5	–	Services measure also due, at 54.4 in Jun. Composite at 54.2.
Ger	Jul Markit/BME manuf PMI - flash	51.9	51.9	–	Has firmed over past two months; new export orders positive in Jun.
Chn	Jul Caixin manufacturing PMI - flash	49.4	49.8	–	Sponsorship taken over from HSBC by onshore news agency.
US	Jun new home sales	2.2%	–1.1%	–1.0%	Strength concentrated in south; little traction elsewhere.

New Zealand forecasts

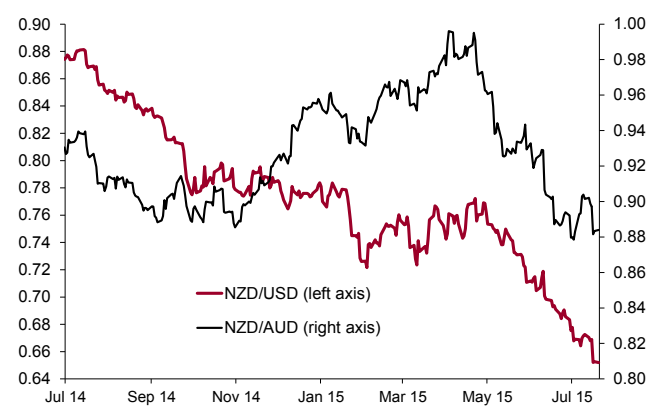
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.4	3.3	2.2	3.3	2.4	3.1
Employment	3.8	3.2	3.0	2.3	2.9	3.6	2.8	3.0
Unemployment Rate % s.a.	6.0	5.8	4.9	4.4	6.1	5.8	5.2	4.3
CPI	1.5	0.1	1.7	1.9	1.6	0.8	0.8	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	2.50	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	2.60	2.20	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 20 July 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	3.25%	3.25%	3.25%
30 Days	3.13%	3.31%	3.34%
60 Days	3.10%	3.27%	3.29%
90 Days	3.08%	3.23%	3.24%
2 Year Swap	2.85%	2.97%	3.07%
5 Year Swap	3.22%	3.36%	3.40%

NZ foreign currency mid-rates as at Monday 20 July 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6520	0.6657	0.6904
NZD/EUR	0.6019	0.6047	0.6068
NZD/GBP	0.4179	0.4279	0.4352
NZD/JPY	80.87	81.21	84.95
NZD/AUD	0.8840	0.8925	0.8890
TWI	69.36	70.27	71.72



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	2.5	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	2.14	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.97	3.00	3.10	3.25	3.40	3.55
International						
Fed Funds	0.125	0.375	0.625	0.875	1.125	1.375
US 10 Year Bond	2.36	2.60	2.80	3.00	3.20	3.30
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	0.7410	0.73	0.72	0.72	0.72	0.73
USD/JPY	124.10	121	123	123	124	125
EUR/USD	1.0880	1.08	1.07	1.07	1.07	1.08
AUD/NZD	1.1366	1.16	1.16	1.16	1.14	1.14

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Felix Delbrück, Senior Economist
+64 9 336 5668

Satish Ranchhod, Senior Economist
+64 9 336 5669

Any questions email:
economics@westpac.co.nz

Past performance is not a reliable indicator of future performance. The forecasts given in this document 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.

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 licence 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.

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.

Disclaimer continued overleaf.



Disclaimer continued

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.

