



Lake Taupo

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Winding down for Christmas

As 2015 draws to a close we take a look at where the economy is currently sitting, and some of the key issues we'll be facing over the coming year.

First up, how has the last year gone?

The latest GDP figures showed that the economy grew by 0.9% in the September quarter, taking growth for the year to 2.3%. That's not a bad outcome, and similar to the rates of growth that we're seeing in many of our trading partner economies. It's also notable that much of the growth we've seen has been a result of strengthening domestic demand, with services accounting for most of the growth in the September quarter.

But while the past year certainly wasn't a bad one, if we look a little closer, some of the gloss starts to come off the headline numbers. Over the past year, we've actually seen quite a sharp deceleration in growth - down from a rate of 3.7% in 2014. And the growth that we have seen comes on top of strong population growth as a result of record high net immigration. In per-capita terms, annual GDP growth over the past year was just 0.4% (down from rates of above 2% though 2014).

There are certainly some bright spots in the economy. The construction sector is humming along with work continuing apace in Canterbury and strong demand in Auckland. In addition, we're seeing firm growth in household spending. Nevertheless, we're left with a picture of an economy that - while still healthy - has clearly lost momentum.

Looking to the year ahead, there are several key areas we'll be watching.

1. Immigration: As mentioned above, this has been a key factor supporting demand in the economy (including demand for housing). It has also provided a sizeable boost to the economy's productive capacity. We expect that net immigration will remain elevated over the coming year before gradually easing back. However, with signs that the New Zealand economy is losing momentum at the same time as the Australian



Happy holidays!

This is the last Weekly Commentary for 2015.

Weekly Commentary will resume 11 January 2016.



Winding down for Christmas continued

labour market is picking up, there is some risk that we see migration flows start to turn earlier than expected.

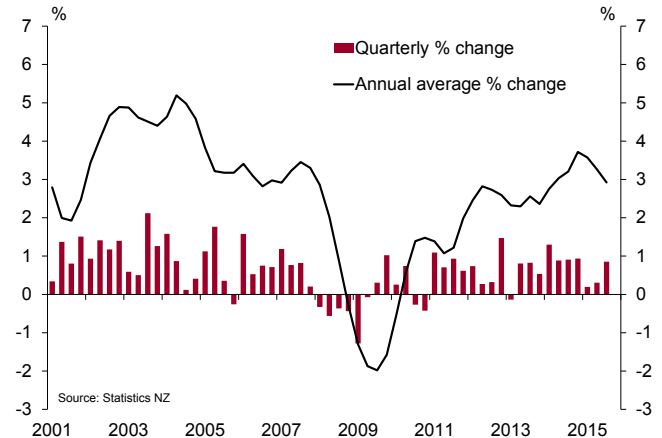
2. The housing market: After strong gains in 2015, house price inflation is set to take a step down over the next year as a result of new lending and taxation regulations. We've already seen these changes prompt sharp moves in the Auckland housing market, and we expect nationwide house price inflation will slow over the coming year. The RBNZ will be watching conditions in the housing market closely given their concerns that cuts in the OCR aimed at boosting consumer price inflation might also prompt a resurgence in the housing market, with associated risks for financial stability. This will also be an important influence on spending more generally in the household sector.

3. The agricultural sector: Drought conditions and continued low global prices for dairy are set to be a significant drag on earnings over the coming year, and it's inevitable that this will spill over to the economy more generally.

4. The Fed: Over the past week the Fed tightened rates for the first time in nine years, taking the target range for the Fed Funds Rate to 0.25–0.50%. The tone of the accompanying statement was upbeat on the outlook for the labour market and economy more generally. However, the Fed remained cautious on the path forward for interest rates, noting that future changes in the Fed Funds Rate were expected to be "gradual". This does not mean a mechanical process will be followed, or that rate hikes will be equally spaced. Instead, rates will be increased in a considered manner, based on incoming data. In line with the FOMC's own forecasts, we anticipate that the Committee will increase the Fed Funds Rate four times in 2016 and another four times in 2017. Continued hikes by the Fed would be a welcome development for the RBNZ as it would likely take some of the pressure off the NZD, boosting imported inflation and reducing the need for further OCR cuts. But as discussed below, there are challenges for inflation on several fronts.

5. Stubbornly low inflation: This will be the key concern keeping policy makers at the RBNZ awake at night. Weakness in commodity prices, particularly oil prices, was a key

Production-based GDP growth



contributor to the very low levels of inflation in New Zealand over the past year. Developments in recent months have highlighted the risk that this could continue to be a significant drag on imported inflation over 2016. On top of this, retailers are reporting that competitive pressures mean that their ability to push through price increases is limited. Finally, growth in the population is helping to limit inflation in the labour market.

The above conditions, combined with a still gradual recovery in the global economy and slowing domestic growth, lead us to expect that the RBNZ will need to cut the OCR further over the coming year. But there is a question about when this will occur. The RBNZ has stated that they think the easing in policy to date will be enough to generate a sustained lift in inflation back to around 2%. However, we have our doubts. We expect that by mid-2016, the lingering softness in inflation and slowdown in growth will be apparent, and will prompt the RBNZ to cut rates again.

We'd like to wish all our readers the best for the holiday period and the New Year. Our regular economic reports will resume in early 2016.

Fixed vs Floating for mortgages

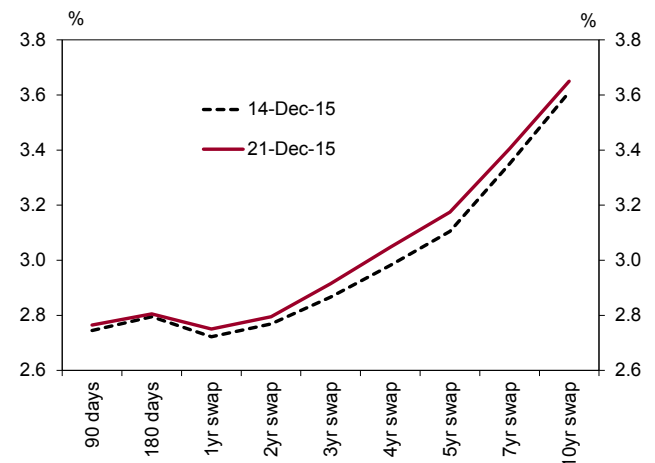
With short-term interest rates likely to fall further, borrowers should feel in no hurry to fix.

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 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

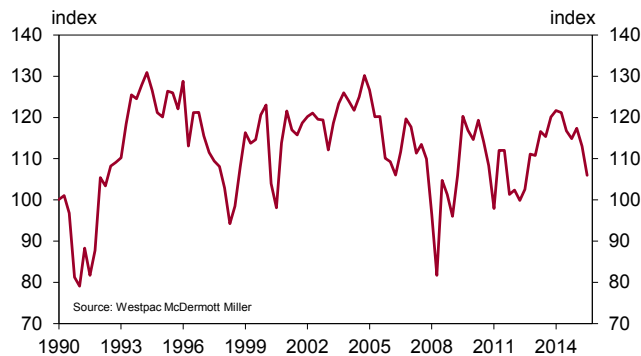


NZ Q4 Westpac-MM Consumer Confidence

December 21, Last: 106.0

- Consumer confidence fell sharply through mid-2015, with weakness concentrated in rural regions. This was likely a response to earlier negative news around earning in the agricultural sector. However, confidence was down across the economy.
- But while consumers became noticeably less optimistic about the wider economy, the September confidence survey showed that their attitudes to spending remained resilient.
- The December quarter survey was in the field over 1-11 December.

Westpac-McDermott Miller consumer confidence

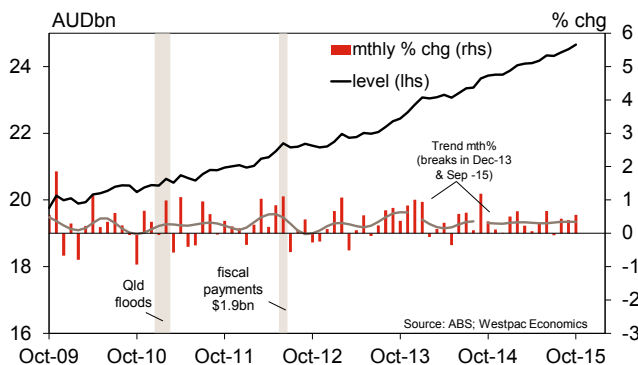


Aus Nov retail trade

Jan 8, Last: 0.5%, WBC f/c: 0.7%
Mkt f/c: 0.4%, Range: -0.2% to 0.7%

- Retail sales posted a 0.5% rise in Oct, following 0.4% gains in Aug and Sep. The pace of sales growth remains sub-par given a consistently more upbeat picture from private sector business surveys.
- Consumer sentiment posted a strong rally in Oct-Nov, with consumers' job loss fears also easing notably. Responses to specific questions on Christmas spending plans were also more upbeat than the last few years. Private sector business surveys also show a continued pick up in conditions across consumer-related sectors. Overall we expect this to translate into a pick-up in retail sales with a solid 0.7% gain pencilled in for Nov. There may be some upside risk to the result and to revisions but this is balanced by aggressive price competition which appears to be restraining nominal sales growth in key segments.

Monthly retail sales

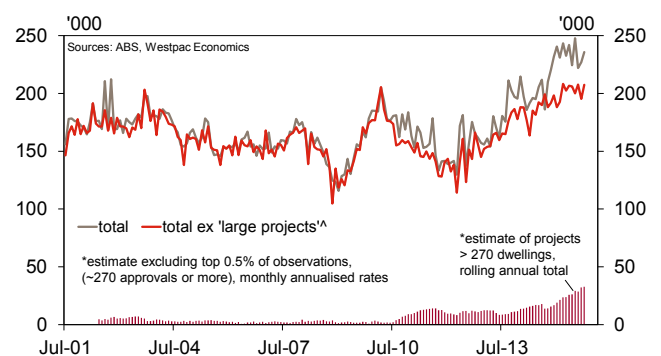


Aus Nov dwelling approvals

Jan 7 Last: 3.9%, WBC f/c: -3.0%
Mkt f/c: -3.0%, Range: -6.6% to flat

- Dwelling approvals posted another better than expected result in Oct with a 3.9% gain following on from Sep's 2.2% rise. While approvals still look to have passed a peak back in Mar they are holding up better than expected. The survey detail was mixed with the Oct gain driven by a spike in 'high rise' approvals although a broader measure of large projects based on more granular data was unchanged month to month suggesting a firmer 'underlying' picture.
- The Nov update should again provide more clarity around the extent of the slowdown in construction. We expect a 3% decline in line with what still looks to be very mild underlying downtrend. Wider market conditions slowed markedly late in the year, led by an abrupt cooling in the previously hot Sydney market. Construction activity tends to be slower to respond but may start to reflect this slowdown more in 2016.

Dwelling approvals: excluding 'large projects'

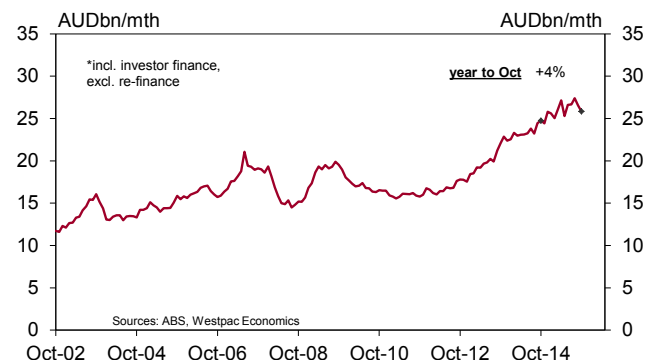


Aus Nov housing finance (no.)

Jan 15, Last: -0.5%, WBC f/c: -1.5%

- The number of owner occupier finance approvals dipped 0.5% in Oct, but was down 1.2% ex refi. The value of investor loans fell more sharply, -6.1% mth to be down 13.8% since Aug. Given regulatory measures impacting investor lending and the indirect spillover boost to owner occupier loans, the best gauge of broader market conditions is the combined total value of loans. This declined 2.7% in Oct to be off 5.6% in two months.
- Housing markets are showing clear signs of cooling off, especially in the previously 'hot' Sydney and Melbourne markets. We expect owner occupier approvals to show a 1.5% fall with the total value of loans - covering both owner occupiers and investors - likely to show a decline as well.

New finance approvals: total



Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Mon 21					
NZ	Q4 Westpac MM consumer confidence	106	–	–	Confidence fell earlier in the year.
	Nov net migration	6210	–	5950	Trans-Tasman flow has turned net positive for first time since 1991.
Eur	Dec consumer confidence	–5.9	–5.9	–	Potential negative ECB impact in coming months.
US	Nov Chicago Fed national activity index	–0.04	–	–	Points to moderate growth.
Tue 22					
UK	Nov GFK consumer confidence	1	1	–	Confidence has eased back in recent months, but remains firm.
	Nov public sector borrowing, £b	7.5	11.8	–	Fiscal policy remains focused on a gradual return to surplus.
US	Q3 GDP, 3rd estimate	2.1%	1.9%	–	Unlikely to show major revisions.
	Oct FHFA house price index	0.8%	0.4%	–	Price growth has moderated, but still running at a healthy clip.
	Nov existing home sales	–3.4%	–0.2%	–0.5%	Momentum has slowed considerably; impending interest rate effect?
	Dec Richmond Fed manufacturing index	–3	–1	–	Soft external demand is weighing on manufacturing.
Wed 23					
NZ	Nov merchandise trade \$m	–964	–810	–900	Low dairy prices continuing to weigh on export earnings.
	Nov private sector credit growth %yr	7.1%	–	–	Mortgage lending should slow as new regulations take effect.
UK	Q3 current account balance, £b	–16.8	–21.9	–	Soft external demand is weighing on exports.
	Q3 GDP (final)	0.5%	0.5%	0.5%	Firm domestic demand is offsetting external headwinds.
US	Nov personal income	0.4%	0.2%	0.3%	Wages have gained some momentum; but gains need to endure.
	Nov personal spending	0.1%	0.3%	0.2%	Services spending is the key; retail sales have disappointed of late.
	Nov PCE deflator	0.1%	flat	0.1%	Annual headline inflation begins to firm, circa 0.4%yr.
	Nov durable goods orders (provisional)	2.9%	–0.2%	–0.5%	Little reason to expect near-term acceleration in investment growth.
	Nov new home sales	10.7%	2.0%	1.0%	Sales have softened; but home builder sentiment still strong.
	Dec consumer sentiment (final)	91.8	92.0	–	Uni of Michigan measure; current conditions exceed expectations.
Thu 24					
US	Initial jobless claims	271k	–	–	Claims have remained at low levels for an extended period.
Fri 25					
	Christmas day	–	–	–	Most markets closed.
Sun 27					
Chn	Nov industrial profits %yr	–4.6%	–	–	Trended lower in 2015, iron & steel profits particularly hard hit.
Mon 28					
US	Dec Dallas Fed manufacturing index	–4.9	–8.0	–	Has picked up, but remains soft.
Tue 29					
US	Oct S&P/C-S 20 city house prices	0.6%	–	–	Price growth has moderated, but still running at a healthy clip, 5.5%yr.
Wed 30					
UK	Dec Nationwide house prices	0.1%	–	–	Tentative date. House price inflation has slowed, but remains firm.
US	Nov pending home sales	0.2%	0.3%	–	Lead for existing home sales.
Thu 31					
Aus	Nov private sector credit	0.7%	0.6%	0.5%	Business +1.0% in Oct, more modest gain expected for Nov.
US	Initial jobless claims	–	–	–	Claims have been low, but holidays often result in some volatility.
	Dec ISM Milwaukee	45.3	–	–	Remains low with soft external demand a drag.
	Dec Chicago PMI	48.7	50.3	–	Weak external demand and the strong dollar are weighing on activity.
Fri 1					
	Happy New Year	–	–	–	Public holiday. Best wishes for 2016!
Sun 3					
US	Fedspeak	–	–	–	Williams speaks on equilibrium real interest rates.
Mon 4					
NZ	Day after New Year's Day public holiday	–	–	–	Markets closed.
Aus	Dec AiG PMI	52.5	–	–	Holding in positive territory above 50.
	Dec CoreLogic RP Data home value index	–1.5	–	0.2%	Q4 has seen a rapid cooling price growth, esp. in previously hot Sydney.
Eur	Dec Markit manufacturing PMI (final)	53.1	–	–	Moderate momentum persists; awaiting better global growth.
Ger	Dec Markit manufacturing PMI (final)	53.0	–	–	Domestic demand supported by tight labour market.
	Dec CPI (provisional)	0.1%	–	–	Annual headline inflation to remain weak around 0.3%yr.
UK	Nov net mortgage lending, £b	3.6b	–	–	Low mortgage rates have been boosting demand.
	Dec Markit manufacturing PMI (final)	52.7	–	–	Soft external demand is weighing on manufacturing.
	Dec Halifax house prices	–0.2%	–	–	Tentative date. Low interest rates are supporting demand.
US	Fedspeak	–	–	–	Mester speaks at AEA conference in San Francisco.
	Dec Markit manufacturing PMI (final)	51.3	–	–	USD clearly having a material impact on activity...
	Dec ISM manufacturing	48.6	49.5	–	... energy sector another lingering concern.

Data calendar

		Last	Market median	Westpac forecast	Risk/Comment
Tue 5					
Eur	Dec CPI	-0.1%	-	-	Oil price still an issue; annual inflation pulse at 0.2%yr.
US	Fedspeak	-	-	-	Williams speaks on macro prudential policy implementation.
	Dec ISM New York	60.7	-	-	Remains at firm levels.
Wed 6					
NZ	GlobalDairyTrade auction	1.9%	-	-	Further gains likely as dry weather saps NZ milk production.
Chn	Dec Westpac-MNI China Cons. Sentiment	113.1	-	-	Uncertainty around economy & jobs still a major restraining factor.
Eur	Dec Markit services PMI (final)	53.9	-	-	Improving labour market across continent should...
Ger	Dec Markit services PMI (final)	55.4	-	-	... generate greater strength in services sector.
UK	Dec Markit services PMI	55.9	-	-	Domestic demand conditions have been firm.
US	Dec ADP employment change	217k	190k	180k	An often not terribly helpful guide for nonfarm payrolls.
	Nov trade balance, US\$bn	-43.9	-44.0	-	USD and soft global growth impacting balance.
	Dec Markit services PMI (final)	-	-	-	Momentum in the services sector remains robust...
	Dec ISM non-manufacturing	55.9	56.0	-	... healthy labour market and foreign demand key.
	Nov factory orders	1.5%	-	-	Trend remains weak.
	Minutes of Dec 15 to 16 FOMC meeting	-	-	-	An important guide on FOMC discussions and the outlook.
Thu 7					
Aus	Nov trade balance, \$bn	-3.3	-3.0	-	Commodity prices started to slide again in Nov, AUD held steady.
	Nov dwelling approvals	3.9%	-3.0%	-3.0%	Peaked in Mar but slowdown has been very mild to date.
Eur	Dec economic confidence	106.1	-	-	Potential ECB impact on confidence in outlook?
	Dec consumer confidence (final)	-	-	-	Unemployment falling; g'th persists; but ECB could cause it to waver.
	Nov unemployment	10.7%	-	-	2016 outlook depends on trend improvement continuing.
Ger	Dec Markit construction PMI	52.5	-	-	Stronger investment would be desirable.
US	Initial jobless claims	-	-	-	Claims have been low, but holidays often result in some volatility.
Fri 8					
Aus	Nov retail sales	0.5%	0.4%	0.7%	Will reported lift in sentiment & business conditions finally show through?
Ger	Nov industrial production	0.2%	-	-	Flat over the year; global economy a burden.
	Nov trade balance	22.5b	-	-	Exports and imports both fell in October.
UK	Trade balance, £b	-4.1	-	-	Low commodity prices and external demand are weighing on exports.
US	Dec non-farm payrolls	211k	200k	190k	Employment growth to slowly lose momentum with U/E at 5.0%.
	Dec unemployment	5.0%	5.0%	5.0%	Verging on full employment; limited further improvement expected.
	Nov wholesale inventories	-0.1%	-	-	Inventory accrual has moderated.

New Zealand forecasts

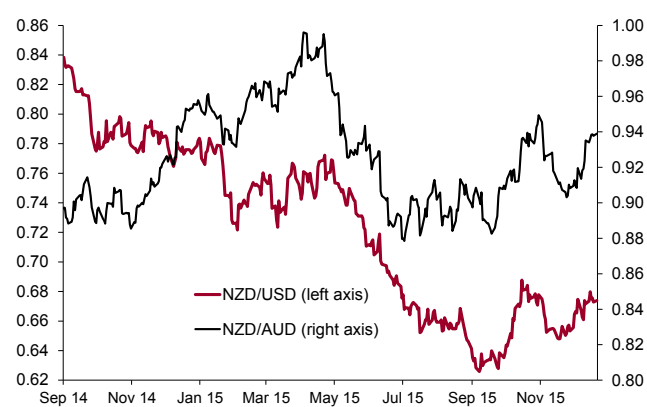
Economic Growth Forecasts	March years				Calendar years			
	2014	2015	2016f	2017f	2013	2014	2015f	2016f
% change								
GDP (Production) ann avg	2.5	3.2	2.2	2.2	2.3	3.3	2.4	2.0
Employment	3.8	3.2	1.0	2.3	2.9	3.6	1.2	2.1
Unemployment Rate % s.a.	6.0	5.8	6.4	6.3	6.1	5.7	6.3	6.4
CPI	1.5	0.3	1.1	1.5	1.6	0.8	0.3	1.7
Current Account Balance % of GDP	-2.6	-3.4	-3.7	-3.5	-3.2	-3.1	-3.4	-3.7

Financial Forecasts	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17
Cash	2.50	2.50	2.25	2.00	2.00	2.00
90 Day bill	2.70	2.60	2.20	2.10	2.10	2.10
2 Year Swap	2.70	2.50	2.30	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	3.80	3.80
NZD/USD	0.64	0.63	0.62	0.62	0.62	0.62
NZD/AUD	0.91	0.93	0.94	0.93	0.90	0.89
NZD/JPY	78.7	78.1	77.5	78.1	78.7	76.9
NZD/EUR	0.60	0.60	0.60	0.60	0.60	0.59
NZD/GBP	0.43	0.43	0.42	0.42	0.41	0.40
TWI	70.0	69.8	69.6	69.4	68.7	68.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 21 December 2015

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.50%	2.75%	2.75%
30 Days	2.64%	2.78%	2.85%
60 Days	2.70%	2.83%	2.84%
90 Days	2.77%	2.88%	2.88%
2 Year Swap	2.80%	2.75%	2.74%
5 Year Swap	3.18%	3.09%	3.09%

NZ foreign currency mid-rates as at Monday 21 December 2015

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.6739	0.6740	0.6560
NZD/EUR	0.6201	0.6200	0.6164
NZD/GBP	0.4518	0.4462	0.4319
NZD/JPY	81.65	83.03	80.56
NZD/AUD	0.9390	0.9182	0.9068
TWI	73.59	72.90	71.26

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2011	2012	2013	2014	2015f	2016f
Australia						
Real GDP % yr	2.7	3.5	2.0	2.6	2.3	2.8
CPI inflation % annual	3.0	2.2	2.7	1.7	1.7	2.2
Unemployment %	5.2	5.3	5.8	6.2	6.0	6.1
Current Account % GDP	-2.8	-4.4	-3.4	-3.0	-4.3	-5.5
United States						
Real GDP %yr	1.6	2.2	1.5	2.4	2.5	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	4.8
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	1.4
Euroland						
Real GDP %yr	1.6	-0.8	-0.3	0.9	1.4	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	6.6
East Asia ex China						
Real GDP %yr	4.5	4.6	4.2	4.1	3.6	3.8
World						
Real GDP %yr	4.2	3.4	3.3	3.4	3.1	3.5
Forecasts finalised 8 Dec 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	2.35	2.20	2.20	2.20	2.20	2.20
10 Year Bond	2.76	2.85	2.90	3.00	3.10	3.30
International						
Fed Funds	0.375	0.375	0.625	0.875	1.125	1.375
US 10 Year Bond	2.22	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	0.7135	0.70	0.68	0.66	0.66	0.67
USD/JPY	122.51	123	124	125	126	127
EUR/USD	1.0840	1.07	1.05	1.03	1.03	1.04
AUD/NZD	1.0654	1.09	1.08	1.06	1.06	1.08

Westpac economics team contact details

Dominick Stephens, Chief Economist
+64 9 336 5671

Michael Gordon, Senior Economist
+64 9 336 5670

Satish Ranchhod, Senior Economist
+64 9 336 5668

Anne Boniface, Senior Economist
+64 9 336 5669

David Norman, Industry Economist
+64 9 336 5656

Any questions email:
economics@westpac.co.nz

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Disclaimer continued

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