

Weekly Commentary

3 October 2016



A spring in their step

We've released our surveys of confidence in conjunction with McDermott Miller in the past two weeks. The broad message is that New Zealanders are feeling a bit more confident than they were three months ago, particularly around the strength of their local economies and the state of the jobs market. Other data released last week, including building consents and merchandise trade, are also consistent with economic growth running at a solid clip.

Regional economic confidence bounced sharply in many parts of the country in September, with residents in 9 of 11 regions expecting that their local economies will be better off in 12 months time. The surveys were run around the time that global dairy prices were rising sharply, and Fonterra had upgraded its farmgate milk price forecast for 2016/17 by 50 cents to \$4.75/kgMS (they've since bumped the forecast up by a further 50 cents to \$5.25/kgMS). So it's not surprising that confidence improved in dairy-exposed regions such as Waikato, Taranaki and Southland.

But the improvement in confidence was broader than just dairy. Most regions are benefitting from solid growth in homebuilding, rising house prices, increasing tourist numbers and strong population growth.

Wellington shot to the top of the national leaderboard in September, as confidence in the region's economic prospects surged. This is potentially off the back of an acceleration in house prices this year after years of little change. Wellington's surge in confidence bumped the Bay of Plenty to second place after five quarters at the top. While regional economic confidence fell in the quarter, it remains strongly upbeat helped by strong horticulture and tourism sectors.

Auckland was the only other region to see a dip in regional confidence in the quarter. While residents are still upbeat about the wider economy and the state of the jobs market,

they are becoming less optimistic about the region's prospects. This may be recognition that the city's housing and transport issues will take a long time to resolve.

One surprise this quarter was the improvement in the Canterbury results. Regional economic confidence was the strongest in 18 months, and workers were considerably more upbeat about employment conditions. These improvements were unexpected given that the level of rebuild activity appears to have plateaued and with it, we would have thought, growth and job prospects. Instead, the pick-up in confidence may be linked to the improving dairy story, which will support rural areas in the region.

However, while confidence in most regions has improved, this doesn't mean conditions are even across regions. A report we released last week looking at patterns in regional retail spending highlighted stark differences since 2012.¹ Auckland has by far seen the biggest rise in retail spending – consistent with the big rise in house prices, strong population growth and decent jobs growth. And not surprisingly, Canterbury has also had a big lift in retail spending over this period, as reconstruction activity provided a powerful boost to demand. However, retail spending in the rest of the country has been more subdued despite rising house prices, especially in Wellington. It may be that as the rise in house prices is a recent development,

¹ <http://www.westpac.co.nz/assets/Business/Economic-Updates/2016/Bulletins-2016/A-look-at-retail-spending-by-region-September-2016.pdf>

A spring in their step continued

consumers haven't had time to respond yet. And for some rural regions it's also likely that low dairy prices and job insecurity have weighed on spending.

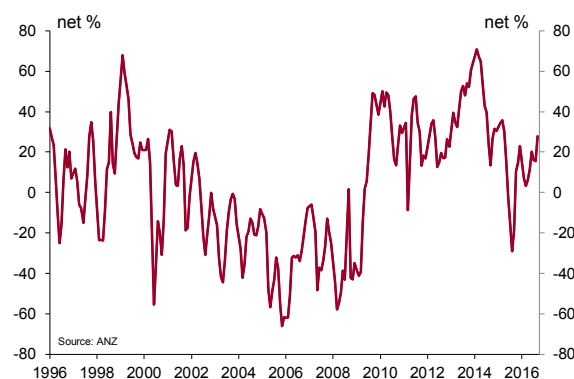
Full steam ahead

At a national level, data released last week are consistent with the economy continuing to grow at a decent clip. Business confidence picked up in September to its highest level since April 2015, and more firms expect their own activity to strengthen over the year ahead.

Construction firms remain among the most optimistic, although are less exuberant than a couple of months ago. This tempering of expectations is not surprising as the exceptional growth in building the first half of the year was always going to be near on impossible to maintain given the capacity constraints in the industry. Still, the number of dwelling consents issued in the three months to August was 17% higher than a year earlier, suggesting plenty of homebuilding in the pipeline for the remainder of this year.

But strength in demand is broader than construction. Confidence rose across sectors in September, with services and manufacturing at the head of the pack. Trade data for August also highlighted strength in domestic demand, with imports much stronger than expected. While imports in August were 3.1% lower than a year earlier, the headline value is being held down by lower oil prices and a higher NZ dollar. And these low values are masking what looks to be a decent underlying volumes picture, especially for consumer goods – consistent with an acceleration in consumer spending this year.

NZ business confidence



However, the high NZ dollar is also dampening export receipts, which were also dragged lower in August by an inevitable pullback in export volumes. This was especially true for dairy exports. And with dairy production expected to decline this season (we've pencilled in a 3% fall), lower dairy volumes will continue to drag on export receipts in coming months, although the recent improvement in global prices will temper this later in the year.

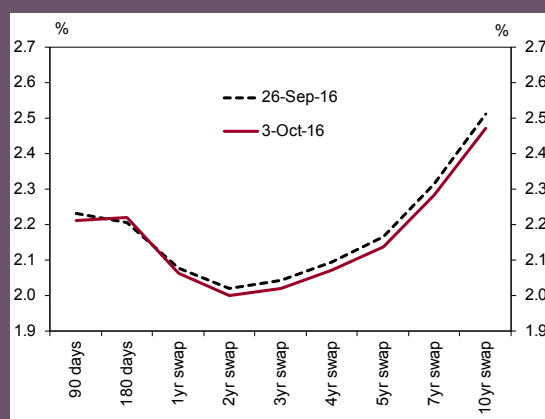
This week, the QSBO for September will provide another update on how businesses are faring. Of particular interest will be the survey's measures of prices and costs. Despite decent growth there has been little evidence to date that firms have been able to increase prices, so we will be looking for any change here.

Fixed vs Floating for mortgages

For borrowers with a deposit of 20% or more, the best value probably lies in the two-year rate or shorter terms. Four- and five-year rates seem high relative to where we think shorter-term rates are going to go over the next four or five years. That said, fixing for a longer term does offer the borrower greater stability.

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



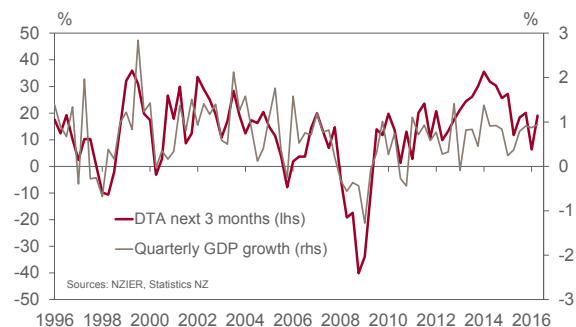
The week ahead

NZ Q3 Quarterly Survey of Business Opinion

Oct 4, Last: 18, General business situation

- The June quarter survey result showed a rebound in business confidence as firms overcame their nervousness at the beginning of the year. This renewed confidence was well-founded given the continuation of decent growth in the quarter.
- We expect another strong result on the activity side, with indicators remaining positive in recent months. And if anything, this strength has broadened across regions, with recent gains in dairy prices supporting rural confidence.
- The survey's measures of costs and prices will be of particular interest. There has been little evidence to date that firms have been able to increase prices. Even in the construction sector where firms are reporting increased difficulty in finding labour, the number of firms reporting cost increases is relatively low.

QSBO domestic trading activity and GDP



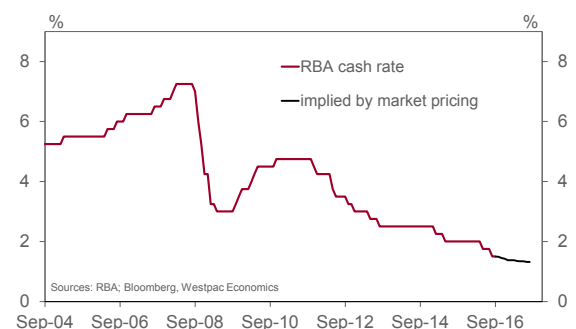
Aus RBA policy decision

Oct 4, Last: 1.50%, WBC f/c: 1.50%

Mkt f/c: 1.50%, Range: 1.50% to 1.50%

- The RBA is in "wait and see" mode as they assess the impacts of the rate cuts delivered in May and August, totalling 50bps.
- Inflation has been the key surprise. Core inflation is now expected to be 1.5% in 2016, undershooting the RBA's February forecast of 2.5% and below the 2-3% target band. The Bank still carries a clear 'implicit' easing bias evident in its inflation forecasts ("likely to remain below 2% over most of the forecast period") and rhetoric ("while prospects for growth were positive, there was room for stronger growth, which could be assisted by lower interest rates").
- We expect rates to be on hold for the remainder of this year and throughout 2017 reflecting an expected emerging comfort around inflation and with Australian economic growth at or above trend, exerting a downward tilt on the unemployment rate.

RBA cash rate & market pricing



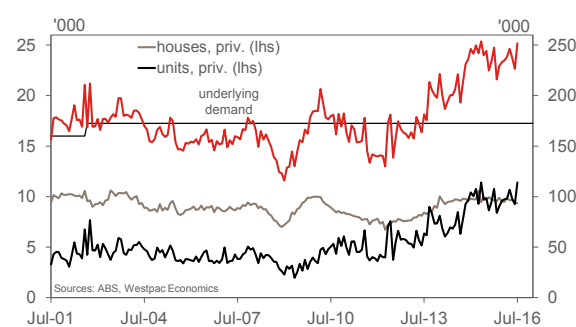
Aus Aug dwelling approvals

Oct 4 Last: 11.3%, WBC f/c: -5.0%

Mkt f/c: -6.0%, Range: -9.0% to -3.8%

- Dwelling approvals came in much stronger than expected in July with an 11.3% jump. Remarkably, the July reading was the second highest on record despite a clear softening in wider market conditions and specific issues facing the investor segment and around developers' financing. Rather than weakening, activity in the segment thought to be most exposed to these concerns spiked - high rise approvals rose 45% to the second highest monthly level on record. Approvals were softer ex high rise.
- This high rise spike is very likely to retrace in August. We expect a 5% decline in approvals overall with risks to the downside. While recent rate cuts in May and August are giving some support the main driver of declines is weaker investor demand, including from non-resident buyers.

Dwelling approvals



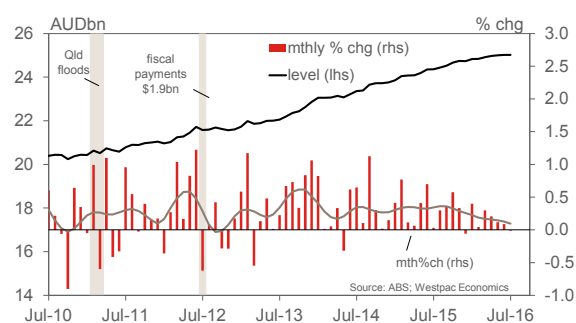
Aus Aug retail trade

Oct 5, Last: flat, WBC f/c: 0.3%

Mkt f/c: 0.2%, Range: 0.0% to 0.7%

- Retail sales disappointed in July with a flat result slowing annual growth to 2.7%. However, weakness was concentrated in department store sales, -6.2% after a 4.5% gain, where volatility may reflect shifts in the timing of winter sales which were reportedly brought forward in 2016 due to warm weather. August should see some improvement - we expect a 0.3% gain. Although the weather, aggressive price discounting and unfavourable consumer spending patterns for goods retailers have made gains hard to come by, an interest rate cut and lift in consumer sentiment should help in August. Housing-related retail is also due for a catch-up with spending in the segment now lagging well behind the upturn in residential building. Note that the Masters home improvement closures were only announced at the tail-end of the month.

Monthly retail sales



The week ahead

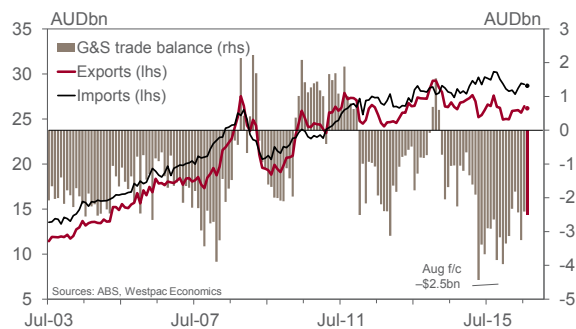
Aus Aug trade balance, AUDbn

Oct 6, Last: -2.4, WBC f/c: -2.5

Mkt f/c: -2.3, Range: -3.0 to -1.7

- Australia's trade balance remains in deficit, albeit tempered somewhat by the recent bounce in commodity prices. For August, we anticipate little change in the deficit, forecasting a \$2.5bn outcome, after a \$2.4bn result for July. That follows averages of \$2.5bn in Q2, \$2.9bn in Q1 and \$3.7bn in Q4.
- Export earnings are forecast to edge 0.9% lower. Gold, having jumped \$0.9bn in July, is likely to reverse, although that should be partially offset by higher prices for coal and iron ore.
- Imports are forecast to fall by 0.5%, with fuel expected to moderate after an above par result in July.
- *NOTE: Since January, there is additional uncertainty around the import and trade forecast. The ABS no longer publishes the customs goods imports ahead of the trade release.*

Australia's trade position

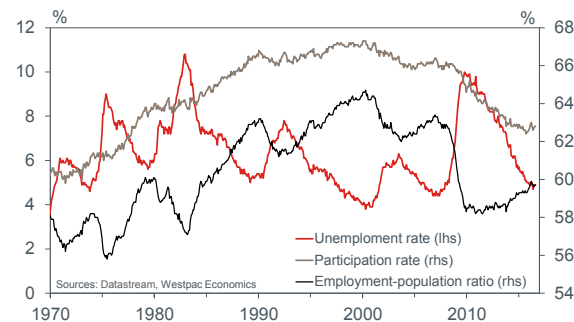


US Sep nonfarm payrolls

Oct 7, Last: 151k, WBC 160k

- Nonfarm payrolls disappointed market expectations in August, rising 151k. Owing to volatility, momentum in mid-2016 is best assessed as an average of the past five months. Doing so yields a monthly average gain of 173k, only marginally weaker than Q1's 196k, but a step down from 2016's strong 229k. Nonetheless, the pace of job creation remains above that needed to maintain the unemployment rate at its current level, given underlying population growth.
- However, the unemployment rate has remained at its current level of 4.9% through 2016. Why is this the case? Because, since September 2015, the participation rate has risen 0.4ppts, sustaining the unemployment rate. In September, we expect another moderate gain in jobs of around 160k and a stable participation rate will see the unemployment rate edge down to 4.8%.

Job strength to see unemployment rate trend lower



Data calendar

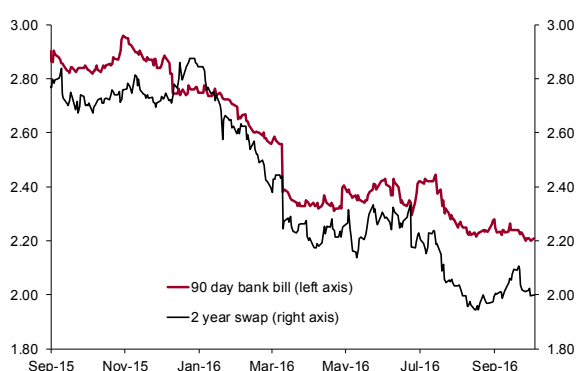
		Last	Market median	Westpac forecast	Risk/Comment
Mon 3					
Aus	Public holiday	-	-	-	Labour Day holiday, NSW, ACT & SA. Queen's Birthday, Qld.
	Sep AiG PMI	46.9	-	-	Manufact'g index -9.5pts to 46.9 in Aug. Likely reversal of surprise fall.
	Sep CoreLogic home value index	1.1%	-	0.7%	Market firming again but CoreLogic measure overstating price gains?
	Sep MI inflation gauge	0.2%	-	-	Annual growth in gauge at 1.2%, down from 1.7% a year ago.
Eur	Sep Markit manufacturing PMI	-	-	-	Flash showed improvement and positive outlook for manufacturers.
Ger	Sep Markit manufacturing PMI	-	-	-	German industry continues to experience moderate growth.
UK	Sep Markit manufacturing PMI (final)	53.3	52.1	-	Post-Brexit volatility expected to fade, revealing underlying softening.
US	Sep Markit manufacturing PMI (final)	51.4	-	-	Flash signalled a weak end to Q3...
	Sep ISM manufacturing	49.4	50.2	-	... and is a weak lead for the ISM measure.
	Aug construction spending	-	-	-	Structures investment weak and likely to remain that way.
Can	Sep RBC Canadian Manufacturing PMI	-	-	-	Oil prices still a negative, though currency an offset.
Tue 4					
NZ	Q3 Quarterly Survey of Business Opinion	18	-	-	Confidence rebounded in June quarter, but pricing indicators subdued.
Aus	Aug dwelling approvals	11.3%	-6.0%	-5.0%	July was 2nd highest month on record on high-rise spike, to reverse.
	Sep ANZ job ads	1.8%	-	-	Job ads trending higher, +8%/yr, consistent with positive backdrop.
	RBA policy decision	1.50%	1.50%	1.50%	RBA on hold, "watching & waiting", having cut in May & August.
US	Sep ISM New York	47.5	-	-	Regional manuf. surveys have been picking up, still at modest levels.
	Fedspeak	-	-	-	Lacker speaks at West Virginia economic outlook meeting.
Wed 5					
NZ	GlobalDairyTrade auction	1.7%	-	-	Milk price futures point to further consolidation.
	Sep ANZ commodity price index	3.2%	-	-	Likely to increase on the back of jump in dairy prices.
Aus	Aug retail sales	flat	0.2%	0.3%	Due for a better month but gains hard to come by in 2016.
	Sep AiG PSI	45.0	-	-	Services index slumped 8.9pts in Aug - in part due to a "long winter".
Chn	Sep Caixin China PMI services	-	-	-	Jpn and Inr services PMI's also due.
Eur	Sep Markit services PMI (final)	52.1	-	-	In contrast to manufacturing's modest growth,...
Ger	Sep Markit services PMI (final)	50.6	-	-	... services a real disappointment.
UK	Sep Markit services PMI (final)	52.9	52.0	-	Has retraced post-Brexit fall, but still points to soft activity.
US	Sep ADP employment change	177k	160k	-	Pace of jobs growth should moderate through 2016, but remain solid.
	Aug trade balance, \$bn	39.5	41.5	-	Beat in July as exports hit a 10-month high.
	Sep Markit services PMI (final)	51.9	-	-	ISM and Markit services PMIs both...
	Sep ISM non-manufacturing	51.4	53.0	-	... disappointed in Aug. Market will be hoping for a bounce in ISM.
	Aug factory orders	1.9%	-0.5%	-	Durable goods orders flat in the month.
	Fedspeak	-	-	-	Evans speaks on the economy and policy in Auckland, NZ.
	Fedspeak	-	-	-	Kashkari gives opening remarks at Minneapolis Fed conference.
	Fedspeak	-	-	-	Lacker speaks on Federal Reserve governance reform.
Thu 6					
Aus	Aug trade balance AUDbn	-2.4	-2.3	-2.5	Exports f/c -0.9% (commodity prices up, gold vol down) Imports -0.6%.
Eur	ECB policy meeting minutes	-	-	-	Tone of debate around QE to be of key interest.
US	Initial jobless claims	254k	-	-	Claims remain tight, only a little above their multi-decade low.
Fri 7					
Chn	Sep foreign reserves \$bn	-	-	-	Have remained fairly steady through 2016 after early volatility.
UK	Sep Halifax house prices	-0.2%	-	-	Housing market has softened, but tight supply still supporting prices.
	Aug industrial production	0.1%	0.1%	-	Manufacturing conditions have softened despite offset from the GBP.
	Aug trade balance, £bn	-4.5	-4.6	-	The fall in the GBP will take time to boost the UK's trade position.
US	Sep non-farm payrolls, '000	151	175	160	Surveys pointing to moderation in jobs growth.
	Sep unemployment rate	4.9%	4.9%	4.8%	Participation has kept unemployment rate unchanged.
	Aug wholesale inventories, final	-0.1% p	-	-	Remain a risk for growth in H2 2016.
	Fedspeak	-	-	-	Vice Chair Fischer speaks at Institute of International Finance meeting.
	Fedspeak	-	-	-	Mester speaks before the Shadow Open Market Committee.
	Fedspeak	-	-	-	George speaks on the economic outlook.
	Fedspeak	-	-	-	Brainard speaks at Institute of International Finance meeting.
Can	Sep Ivey PMI	52.3	-	-	Growth expected to remain sub-par despite recovery from wildfires.
Sat 8					
Chn	Sep foreign direct investment %yr	-	-	-	Foreign investors' appetite limited.

New Zealand forecasts

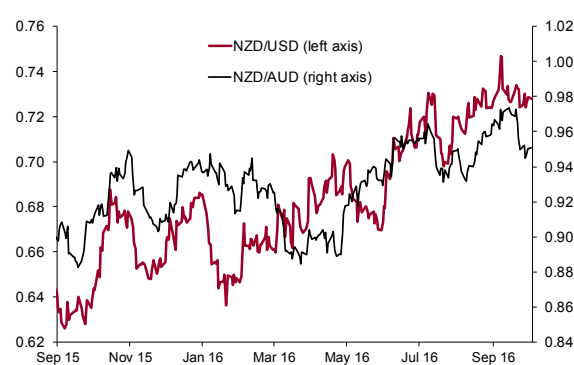
Economic Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2014	2015	2016f
GDP (Production) ann avg	3.6	2.5	3.5	2.9	3.8	2.5	3.4	3.1
Employment	3.2	2.0	3.9	1.6	3.6	1.4	4.7	2.0
Unemployment Rate % s.a.	5.4	5.2	5.0	4.5	5.5	5.0	5.1	4.6
CPI	0.3	0.4	1.1	1.7	0.8	0.1	0.9	1.6
Current Account Balance % of GDP	-3.5	-3.1	-3.3	-3.7	-3.2	-3.4	-3.0	-3.8

Financial Forecasts	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Cash	1.75	1.75	1.75	1.75	1.75	1.75
90 Day bill	1.90	1.90	1.90	1.90	1.90	1.90
2 Year Swap	2.00	2.10	2.10	2.10	2.10	2.00
5 Year Swap	2.30	2.40	2.50	2.50	2.50	2.50
10 Year Bond	2.50	2.50	2.60	2.70	2.80	2.80
NZD/USD	0.71	0.69	0.67	0.65	0.63	0.62
NZD/AUD	0.96	0.95	0.94	0.94	0.93	0.91
NZD/JPY	72.4	69.7	67.7	66.3	65.5	64.5
NZD/EUR	0.65	0.64	0.64	0.63	0.61	0.59
NZD/GBP	0.55	0.54	0.53	0.52	0.50	0.48
TWI	76.6	75.2	73.7	72.1	70.2	69.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 3 October 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.00%	2.00%	2.00%
30 Days	2.18%	2.19%	2.09%
60 Days	2.20%	2.22%	2.17%
90 Days	2.21%	2.25%	2.25%
2 Year Swap	2.00%	2.08%	2.01%
5 Year Swap	2.14%	2.25%	2.10%

NZ foreign currency mid-rates as at Monday 3 October 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7278	0.7262	0.7280
NZD/EUR	0.6480	0.6509	0.6526
NZD/GBP	0.5631	0.5586	0.5474
NZD/JPY	73.66	74.21	75.79
NZD/AUD	0.9506	0.9702	0.9619
TWI	77.42	77.84	77.73

International forecasts

Economic Forecasts (Calendar Years)	2012	2013	2014	2015	2016f	2017f
Australia						
Real GDP % yr	3.6	2.0	2.7	2.4	3.0	3.0
CPI inflation % annual	2.2	2.7	1.7	1.7	1.2	2.0
Unemployment %	5.3	5.8	6.2	5.8	5.7	5.6
Current Account % GDP	-4.4	-3.4	-3.0	-4.7	-3.5	-4.5
United States						
Real GDP %yr	2.2	1.5	2.4	2.4	1.6	2.1
Consumer Prices %yr	2.1	1.5	1.6	0.1	1.2	1.7
Unemployment Rate %	8.1	7.4	6.2	5.3	4.8	4.6
Current Account %GDP	-2.9	-2.3	-2.3	-2.6	-2.7	-2.6
Japan						
Real GDP %yr	1.7	1.4	0.0	0.5	0.6	0.5
Euroland						
Real GDP %yr	-0.9	-0.3	0.9	1.6	1.6	1.2
United Kingdom						
Real GDP %yr	1.2	2.2	2.9	2.2	1.6	0.6
China						
Real GDP %yr	7.7	7.7	7.3	6.9	6.4	6.2
East Asia ex China						
Real GDP %yr	4.6	4.2	4.1	3.7	3.7	3.9
World						
Real GDP %yr	3.5	3.3	3.4	3.1	3.2	3.4

Forecasts finalised 16 September 2016

Interest Rate Forecasts	Latest	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
Australia								
Cash	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.74	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	1.91	2.15	2.20	2.30	2.45	2.65	2.75	2.80
International								
Fed Funds	0.375	0.625	0.625	0.875	0.875	1.125	1.125	1.375
US 10 Year Bond	1.55	1.70	1.80	2.00	2.10	2.25	2.35	2.40
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40

Exchange Rate Forecasts	Latest	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18
AUD/USD	0.7620	0.74	0.73	0.71	0.69	0.68	0.68	0.68
USD/JPY	100.97	102	101	101	102	102	103	104
EUR/USD	1.1220	1.10	1.07	1.05	1.04	1.03	1.03	1.03
AUD/NZD	1.0500	1.04	1.06	1.06	1.06	1.08	1.10	1.11

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