

Weekly Commentary

10 October 2016



Spring Flourish

The latest Quarterly Survey of Business Opinion shows businesses have a real spring in their step. Confidence is up strongly and firms have an upbeat view of how their own business is faring. For now, there's little evidence of strong growth translating into inflation pressure, but there are signs that this could be set to change.

While official data can be very comprehensive, it often comes with a substantial lag. In contrast, survey data can provide a timely heads up on how the economy is tracking. And last week's Quarterly Survey of Business Opinion (QSBO) suggests the economy is performing pretty well indeed.

Headline confidence rose to its highest level since 2014, while firms' view of their own activity (which tends to correlate most closely with GDP growth) also rose strongly. On its own, it suggests an acceleration in growth from the 0.9% quarterly pace observed over the first half of this year and highlights upside risk to our 0.8% forecast for the September quarter.

Of course the QSBO survey is not the only early read we get on how GDP growth is shaping up. And the message has not been quite as unambiguously positive from other indicators of economic activity released over the last month. Recent data shows that both milk and meat production (in seasonally adjusted terms) were pretty soft over July and August. Also, tourism growth appears to have taken a bit of breather after a very strong run with international arrivals flat in recent months. This suggests the QSBO survey could be overstating things a bit when it comes to measured GDP growth.

One factor helping support the surge in business confidence has been the 30% rise in dairy prices since July. Yet while improving prices have no doubt come as a relief to farmers,

we continue to be wary of the durability of the recent lift. The last couple of GlobalDairyTrade auctions, where the whole milk powder prices have fallen 4%, tend to support this cautious view.

There is no doubt that fundamentals have moved in favour of dairy producers in recent months. Milk production in key exporting regions has fallen and demand, particularly out of China, has firmed. However, production is coming off a strong starting point and we suspect there may be a seasonal component to the lift in demand. In addition, much will depend on how the NZ production season progresses over the next few months. So for now, we are sticking with our \$5 farm gate milk price forecast for the current season, which is contingent on some further moderation in prices before the end of the year. This is a little below Fonterra's \$5.25 pick, but broadly in line with where other dairy processors' forecasts are sitting. Of course, if prices maintain their current level, or even drift higher, there is upside risk to our \$5 forecast.

The improvement in dairy prices adds weight to the view that the NZ economy is sitting in something of a sweet spot, for now. Despite solid growth, inflation remains low, allowing the RBNZ to maintain its stimulatory policy settings. And it looks like this position could be maintained a little longer yet with little sign of inflation pressure. In the QSBO the number of firms reporting higher costs (both experienced

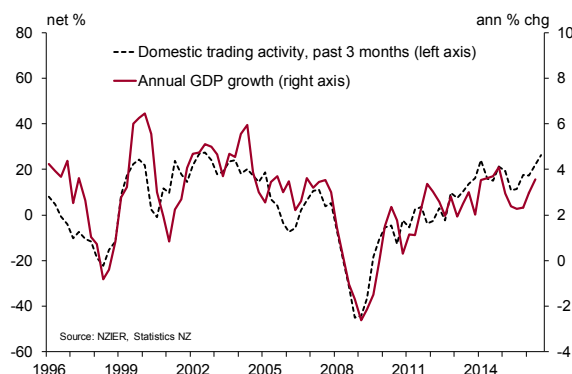
Spring Flourish continued

and expected) edged up a touch in the quarter but remains at a very low level overall. What's more, firms reported a fall in prices last quarter, and only 7% expect to increase prices over the next three months.

But the survey also hints that solid growth is starting to eat into the economy's capacity, particularly in the labour market. Over time, this is likely to lead to upward pressure on wages and prices. Firms' hiring intentions rose to their highest level in over 40 years, while there was also a sharp lift in the amount of overtime they expect to require over the next three months. But while the desire to hire more workers is clearly there, firms are also finding it increasingly difficult to find both skilled and unskilled labour. This suggests further growth in employment in the September quarter along with downward pressure on the unemployment rate which currently sits at 5.1%. While higher wage inflation will not happen overnight, the pressure on employers to lift wages is likely to grow as spare capacity in the labour market starts to be used up, inflation tracks higher and net migration-led growth in the labour force starts to slow.

Looking ahead, this week is a relatively quiet one on the domestic data front. We get figures on card spending (which will likely show a pickup after a sharp fall in August) and the September food price index (which will allow us to nail down our September quarter inflation forecast). But most interest will probably be in September REINZ housing data. August figures revealed a 2.2% fall in nationwide house prices in the month as tighter LVR restrictions started to bite. We will be looking to see whether this impact extended into September.

QSBO domestic trading activity and GDP growth

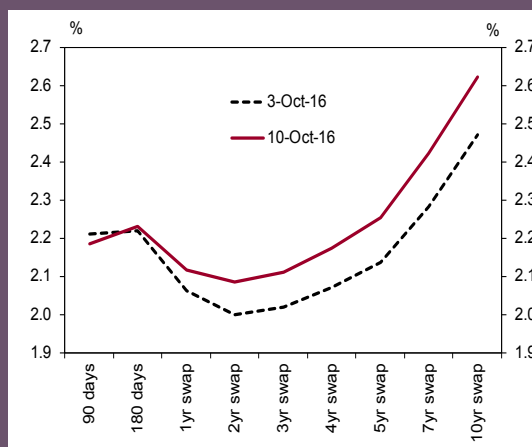


Fixed vs Floating for mortgages

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



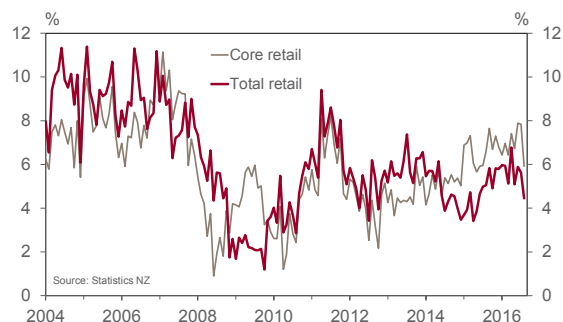
The week ahead

NZ Sep retail card spending

Oct 11, last: -0.4%, WBC: f/c +0.9%, Mkt f/c: 0.8%

- Spending fell sharply in August, with declines seen in nearly all categories. There was a particularly marked decline in spending on hospitality. This follows strong gains in the previous two months which were boosted by elevated tourist numbers, and it was inevitable that we would see some softening as tourist numbers eased back to normal levels.
- We expect the September report to show that spending growth has resumed, with a firm 0.9% gain expected over the month. Spending continues to be supported by a range of factors including increases in consumer confidence, low interest rates, and widespread gains in house prices

Card transactions, annual % change



Aus Aug housing finance (no.)

Oct 11, Last: -4.2%, WBC f/c: -2.5%

Mkt f/c: -1.5%, Range: -4.0% to 3.0%

- Australian housing finance approvals were weaker than expected in July the total number of owner occupier loans down 4.2%*mth*. The value of housing finance approvals to investors rose 0.5%. Combined, the total value of all home loans ex refi was down a milder 2.2%*mth*, and down 5.4%*yr*. The main driver over the past year has been a slowdown in loans to investors after a tightening in lending criteria. The August figures are expected to see another decline with industry data pointing to a 3% fall in owner occupier approvals. A range of other measures point to a firming in housing market conditions since mid-year, with rate cuts in May and August providing support. That may show through in firmer approvals to investors in August (for which we have no reliable industry data) and in the months to come.

New finance approvals: total



NZ Sep REINZ house prices and sales

Oct 10-14 (tba), Sales last: +1.3%, Prices last: 11.7%*yr*

- The housing figures for September will reflect the continued impact of the tighter loan-to-value ratio restrictions, which were effectively enforced from late July.
- The August figures showed a drop in prices for the month, after a strong run-up ahead of the lending restrictions. Sales actually rose slightly in seasonally adjusted terms, but had already slowed in previous months, perhaps reflecting the decline in available listings.
- Preliminary data suggests that the market may have steadied in September rather than declining further. We expect that the impact of the tighter LVR restrictions will be temporary, as it has been in the past.

REINZ house prices and sales



Aus Oct Westpac-MI Consumer Sentiment

Oct 12 Last: 101.4

- The Westpac-Melbourne Institute Consumer Sentiment Index edged up 0.3% in September to 101.4 from 101.0 in August. Despite a range of influences, sentiment has been relatively steady at just over 100 in recent months.
- This month's survey is in the field over the week ended Oct 8. The backdrop has been fairly quiet with the RBA leaving interest rates on hold as widely expected and other news flow both locally and offshore fairly light. Financial markets may be a slight positive with the ASX up 2.7% since the last survey, regaining ground lost in September. The AUD is largely unchanged.

Consumer Sentiment Index



Data calendar

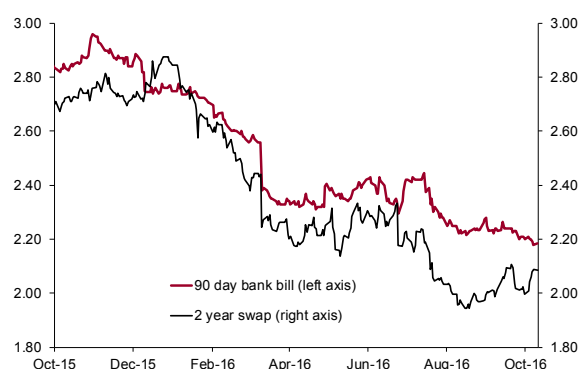
		Last	Market median	Westpac forecast	Risk/Comment
Mon 10					
NZ	Sep REINZ house sales	1.3%	-	-	Due by end of week. Housing market absorbing new LVR restrictions.
	Sep REINZ house prices %yr	11.7%	-	-	House prices cooled in Aug after a sharp run-up in recent months.
Chn	Sep aggregate financing, CNYbn	1470	1390	-	Aug saw upside surprise for aggregate financing and new loans...
	Sep new loans, CNYbn	949	1000	-	... the latter primarily supported by mortgage demand.
	Sep M2 money supply %yr	11.4%	11.6%	-	Bounced in Aug after reaching a 15-month low in Jul.
Eur	Oct Sentix investor confidence	5.6	5.0	-	ECB continues to provide support.
Ger	Aug trade balance, €b	19.5	19.0	-	Exports fell sharply in July; likely to see at least a partial reversal.
	Aug industrial production	-1.5%	1.0%	-	Growth remains unconvincing.
Tue 11					
NZ	Sep retail card spending	-0.4	0.8%	0.8%	Growth to recover following last month's tourism-related pullback.
Aus	Aug housing finance	-4.2%	-1.5%	-2.5%	Industry data soft again in Aug although investor loans may be up.
	Sep NAB business survey	7	-	-	Aug, business conditions index -2pts to +7, still well > LR avg.
Eur	Oct ZEW survey of expectations	5.4	-	-	Expectations aided by policy and continued gains for labour market.
US	Sep NFIB small business optimism	94.4	95.0	-	Has weakened considerably, in line with ISMs.
	Sep labour market conditions index	-0.7	-	-	The Fed's composite measure of labour market conditions.
	Fedspeak	-	-	-	Evans speaks on the economy and policy in Sydney, Australia.
	Fedspeak	-	-	-	Kashkari speaks in Minnesota.
Wed 12					
Aus	Oct Westpac-MI Consumer Sentiment	101.4	-	-	Fairly steady at 'slightly positive' level above 100 in recent months.
Eur	Aug industrial production	-1.1%	0.7%	-	July's fall reversed June's gain.
US	Sep monthly budget statement, \$b	-	29.3	-	Fiscal policy a well down the list of election topics.
	Aug JOLTS jobs openings	5871	5825	-	Hires; fires; quits; and job ads.
	Minutes of the Sept 20 to 21 FOMC meet	-	-	-	Further hints in favour of a December hike?
	Fedspeak	-	-	-	Dudley speak in Albany.
	Fedspeak	-	-	-	George speaks at Chicago Fed's Payments Conference.
Thu 13					
NZ	Sep BusinessNZ manufacturing PMI	55.1	-	-	Manufacturing conditions have softened, weakness in employment.
	Sep food price index	1.3%	-	-0.7%	Fresh food prices coming off their winter peak.
	Oct ANZ consumer confidence	121.0	-	-	Both this and the Westpac-MM measure perked up in Q3.
Aus	Oct MI inflation expectations	3.3%	-	-	Bumping around long run lows.
Chn	Sep trade balance USDbn	346.0	346.5	-	Export gain offset import rise and saw trade balance beat in Aug.
Ger	Sep CPI (final)	0.1%	0.1%	-	Inflation to remain absent.
UK	Sep RICS house price balance	12%	13%	-	Nervousness around the outlook is weighing on housing activity.
US	Initial jobless claims	249k	-	-	Claims remain tight, only a touch above their multi-decade low.
	Fedspeak	-	-	-	Harker speaks on the economic outlook in Philadelphia.
Can	Aug new house price index	0.4%	-	-	Gains in Vancouver and Toronto, but softness elsewhere.
Fri 14					
Aus	RBA Financial Stability Review	-	-	-	Half-yearly update on health of banking / financial system.
Chn	Sep CPI %yr	1.3%	1.6%	-	Set to remain well below 3%yr target for foreseeable future.
	Sep PPI %yr	-0.8%	-0.3%	-	Commodity price gains have seen PPI tend back to zero.
Eur	Aug trade balance, €b	20	20.4	-	ECB failing to materially weaken Euro and improve competitiveness.
UK	Aug construction output	0.0%	0.0%	-	Nervousness around the outlook is weighing on construction activity.
US	Sep PPI	0.0%	0.2%	-	Input price inflation has remained muted.
	Sep retail sales	-0.3%	0.6%	-	Have been underwhelming of late.
	Aug business inventories	flat	0.1%	-	A risk to growth through H2 2016.
	Oct Michigan consumer confidence (prelim)	91.2	92.0	-	Robust, aided in particular by enduring labour market strength.
	Fedspeak	-	-	-	Fed's Rosengren Gives Opening Remarks at Boston Fed Conference.
	Fedspeak	-	-	-	Kashkari speaks in Montana.
	Fed Chair Yellen	-	-	-	Giving keynote address at Boston Fed economic policy conference.

New Zealand forecasts

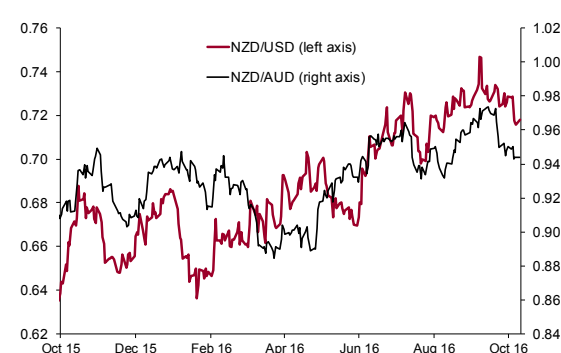
Economic Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2014	2015	2016f
GDP (Production) ann avg	3.6	2.5	3.5	2.9	3.8	2.5	3.4	3.1
Employment	3.2	2.0	3.9	1.6	3.6	1.4	4.7	2.0
Unemployment Rate % s.a.	5.4	5.2	5.0	4.5	5.5	5.0	5.1	4.6
CPI	0.3	0.4	1.1	1.7	0.8	0.1	0.9	1.6
Current 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 10 October 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.00%	2.00%	2.00%
30 Days	2.18%	2.20%	2.19%
60 Days	2.20%	2.21%	2.22%
90 Days	2.19%	2.23%	2.25%
2 Year Swap	2.09%	2.02%	2.08%
5 Year Swap	2.26%	2.17%	2.25%

NZ foreign currency mid-rates as at Monday 10 October 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7180	0.7248	0.7262
NZD/EUR	0.6419	0.6456	0.6509
NZD/GBP	0.5788	0.5588	0.5586
NZD/JPY	74.15	73.26	74.21
NZD/AUD	0.9437	0.9509	0.9702
TWI	76.91	77.04	77.84

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	1.73	1.80	1.80	1.80	1.80	1.80	1.80	1.80
10 Year Bond	2.17	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	1.69	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	0.7575	0.74	0.73	0.71	0.69	0.68	0.68	0.68
USD/JPY	103.89	102	101	101	102	102	103	104
EUR/USD	1.1119	1.10	1.07	1.05	1.04	1.03	1.03	1.03
AUD/NZD	1.0615	1.04	1.06	1.06	1.06	1.08	1.10	1.11

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