

Weekly Commentary

12 September 2016



Something for everyone

Data on economic activity over the past few months has been positive. This trend didn't change last week, as the final indicators for June quarter GDP – building, manufacturing and wholesale trade surveys – showed solid gains in the quarter. And encouraging for growth going forward, dairy prices continued to march higher in last week's auction, to be up nearly 30% from July. Markets have been paying attention to these good news stories, pushing the NZ dollar to the highest level since May last year.

NZ economy put in strong showing through June quarter

We expect the June quarter national accounts, released on Thursday, to show the New Zealand economy in good shape. After decent, but not spectacular, growth of 0.7% in the March quarter, we're forecasting that quarterly growth picked up to 1% in June. This would push annual growth to 3.5% - the fastest pace since 2014.

The biggest contribution to quarterly growth is (again) expected to come from construction (which is forecast to rise by 4.1%), but gains are expected to be relatively broad based across sectors. The agricultural sector looks to have put in a better showing this quarter, as milk and meat production rebounded after a poor start to the year (on weather-related concerns). Growth in manufacturing production looks to have been strong, and the signs are positive on the consumer front, with retail sales recording the fastest quarterly growth since 2006. Meanwhile, the biggest drag on growth is expected to come from the mining sector, as NZ oil production trends down. However, a lack of information on oil exploration means this series can be notoriously volatile and hard to predict on a quarterly basis.

If anything, the risks to our forecast for the production measure of GDP are skewed to the upside. Indeed, growth

in the expenditure measure of GDP is expected to print even stronger, boosted by a surge in goods export volumes (up about 10% in the quarter), although the two measures of GDP often diverge on a quarterly basis.

The surge in goods export volumes also bodes well for the current account (released Wednesday), with the annual deficit expected to narrow to 2.6% of GDP. Providing more persistent support for the current account balance has been strength in services exports, led by a boom in tourism. The services balance is now about 1.7% of GDP, up from only 0.4% two years ago.

Signs for future growth are positive

Indicators suggest that solid growth can be maintained for some time yet, although maybe not at the heady quarterly pace expected in Q2. Our Local Knowledge indicator, which is a compilation of monthly activity data, showed that activity indicators perked up in July after falling back a little in the latter part of Q2.¹ This points to a continuation of solid growth in Q3, which also lines up with business confidence that held steady through July and August after picking up through Q2.

And since then, the fortunes for the dairy sector have improved, with global dairy prices rising nearly 30% since

¹ <http://www.westpac.co.nz/assets/Business/Economic-Updates/2016/Monthly-Files-2016/NZ-Local-Knowledge-6-September-2016.pdf>

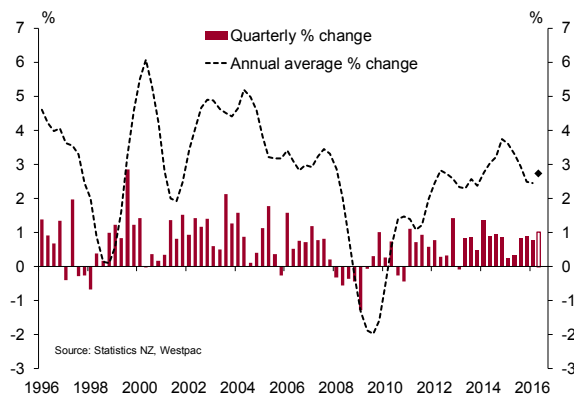
Something for everyone continued

July, including an 8% rise in last week's auction (August's business confidence survey will have captured part of the August price rise). Fundamentals have (not unexpectedly) moved in favour of dairy producers over the past month or so, with improved demand coinciding with lower milk supply from key global exporters. Most important on the supply front has been the drop in European milk production. Closer to home, we expect domestic production to eventually be down around 3% this season (2016/17) off the back of a reduced herd size, and lower spending on supplementary feed. However, with farmers getting back to basics in an effort to reduce costs, pasture conditions (and therefore weather) will be an important swing factor for New Zealand production this season.

We continue to forecast a farm gate milk price of \$5 this season (Fonterra is now forecasting \$4.75). However, this view remains contingent on a partial retracement of the recent lift we have seen in dairy prices later in the season, as we suspect the magnitude of the recent gains have been overdone relative to the news on the supply front. However, even though an improved milk price compared to the \$3.90 estimate for last season (Fonterra will confirm the payout on 22 September) will bolster revenues and confidence in the dairy sector, cash flows will remain tight for some time yet, keeping a lid on spending.

Markets have been paying attention to these good news stories, pushing the NZD/USD higher to just shy of 75 cents. The positive news flow in NZ has coincided with a string of disappointing data in the US, including on employment and

Production-based GDP growth



services activity, which have seen markets put the idea of a US rate hike in September firmly on ice. We still hold the view that conditions in the US economy are firm enough for a rate hike in December, which should provide some respite for the NZD/USD.

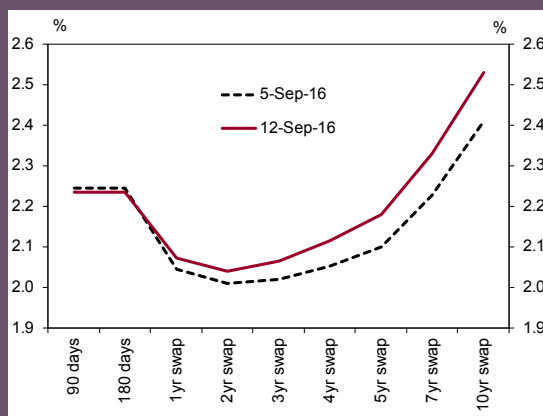
That said, one area locally where we could start to see some cracks appearing is the housing market, following the RBNZ's announcement in July of tighter lending restrictions. We will get an update on how the market fared in August, with data from REINZ expected to be released this week. We expect a drop in sales and cooling house price inflation over the next few months. But it will take time to determine if this is any more than a temporary impact, as was the case with previous LVR tightenings.

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 Aug REINZ house prices and sales

Sep 12-16 (tbd), Sales last: -5.9%, Prices last: 16.3%/yr

- The REINZ house sales report for August is likely to be released early this week. This will be the first hard evidence on the impact of the tighter loan-to-value ratio limits that the RBNZ announced in late July.
- Sales had already slowed in recent months, which may have been in part due to a lack of listings. The drop in mortgage approvals in recent weeks indicates that sales are likely to slow further in the near term.
- House price growth is also likely to cool in the near term, as it did after previous loan-to-value restrictions. However, we expect the impact on prices will once again be temporary. Homebuyers' willingness to pay rests on factors such as borrowing costs, rental yields and tax treatment, none of which are altered by the LVR limits.

REINZ house prices and sales

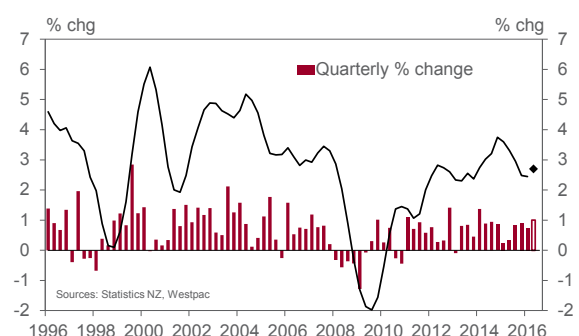


NZ Q2 GDP

Sep 15, Last 0.7%, Westpac f/c: 1.0%, Mkt f/c: 1.0%

- We expect a solid 1% rise in June quarter GDP, a step-up from 0.7% growth in March. Construction is again expected to be the main contributor to growth, despite the Canterbury rebuild having peaked. Instead, building accelerated across the country over the quarter.
- Agricultural production looks to have rebounded after concerns about drought hampered production in the March quarter. However, other parts of the primary sector look weaker, with a decline in mining expected to be the biggest drag on GDP growth.
- Consumer spending appears to have perked up, supporting retail spending and the broader services sector. While spending is being boosted by a rapidly growing population, low interest rates and rising house prices are also providing support.

Production-based GDP

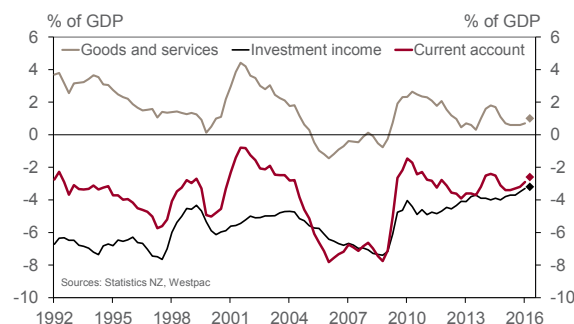


NZ Q2 current account % of GDP

Sep 14, Last: 3.0%, Westpac f/c: -2.6%, Mkt f/c: -2.6%

- We expect the annual current account deficit to narrow to 2.6% of GDP. The starting point in March should also improve, due to an upward revision to education exports.
- After a couple of soft quarters, merchandise export volumes surged in the June quarter, more than offsetting a decline in the merchandise terms of trade. Meanwhile, strong services exports, led by tourism, continue to support the current account.
- We expect the current account deficit to widen again over the next year, but to remain significantly below its pre-GFC levels.

Annual current account balance

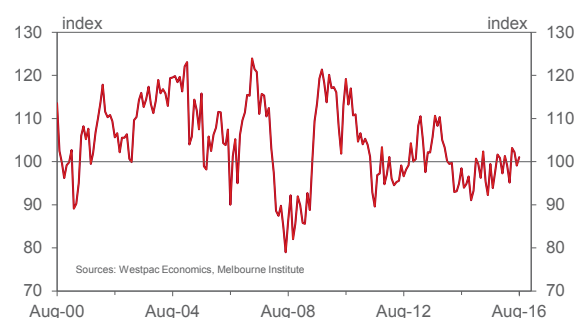


Aus Sep Westpac-MI Consumer Sentiment

Sep 14 Last: 101.0

- The **Westpac-Melbourne Institute Consumer Sentiment Index** rose 2% in Aug from 99.1 in Jul to 101.0. The rise mainly reflected a positive response to the RBA's Aug rate cut, albeit a more muted one compared to the move in May, which came as more of a surprise. Also, whereas the banks cut mortgage rates by 0.25% in May, they only reduced them by 0.10-0.14% in Aug; however, term deposit rates were increased rather than cut.
- The Sep survey is in the field over the week ended Sep 10. The RBA left rates on hold at its Sep 6 meeting as widely expected. Other factors have been mixed, with equity markets retracing (ASX down about 1.3%), the AUD a touch firmer, and official data showing the economy recorded above trend annual growth in the year to June despite a patchy second quarter.

Consumer Sentiment Index



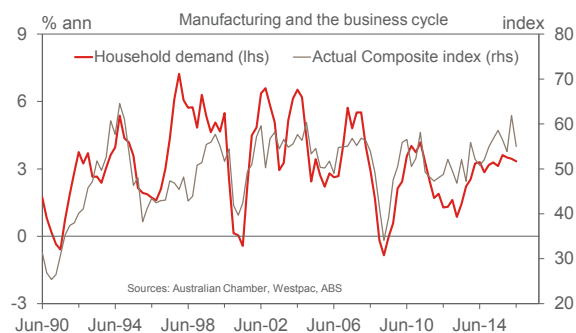
The week ahead

Aus Q3 Australian Chamber-Westpac survey

Sep 15, Last: 55.0

- The Australian Chamber-Westpac survey of the manufacturing sector provides a timely update on conditions in the sector and insights into economy-wide trends. The Actual Composite tracks household demand, highlighting the key linkages between the consumer, home building and manufacturing. The Q3 survey was conducted from early August to 2 September.
- In Q2, the Actual Composite moderated from a high starting point, down 6.9pts to a still positive 55.0, just a little below the 2015 average of 56.4. Strength is centred on a lift in new orders and output, as well as increased overtime. Manufacturing is benefitting from the strong upswing in new home building activity, in response to low interest rates, and the significant improvement in competitiveness of exporters and import competing firms. However, the mining investment downturn remains a major headwind.

Westpac-AusChamber Composite & demand



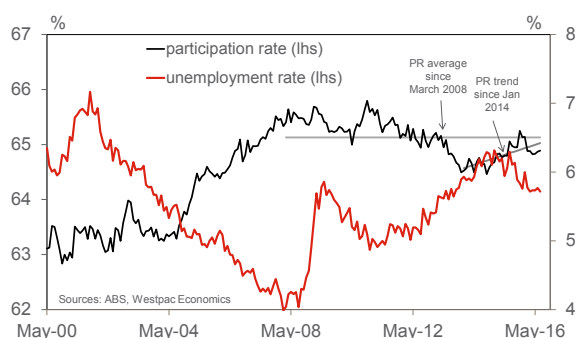
Aus Aug unemployment rate, %

Sep 15 Last: 5.7%, WBC f/c: 5.7%

Mkt f/c: 5.7% Range: 5.6% to 5.8%

- In July, the unemployment rate came in at 5.7%, an improvement from 5.8% in June. At two decimal places, the figures were 5.72% in July and 5.77% in June. In July, the participation rose ever so slightly, to 64.87% from 64.89%, resulting in an around "trend" rise in the labour force, +19.9k.
- Participation has been on a rising trend, but it does appear the surge in female participation has, at least for now, come to an end. Male participation is, at best, holding ground. For August, our forecast is for a flat participation rate which will generate an 18k rise in the labour force. With our forecast 15k gain in total employment, the unemployment rate is forecast to round down to a flat 5.7%.

Unemployment and participation rates

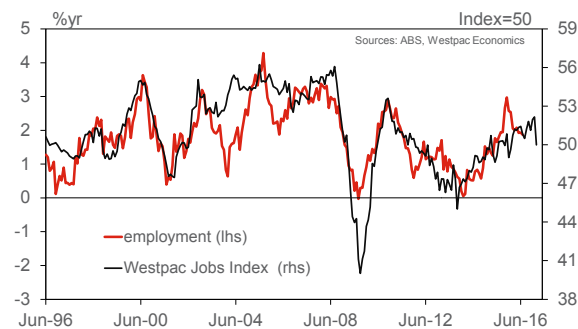


Aus Aug employment, '000

Sep 15 Last: 25.3k, WBC f/c: 15k, Mkt f/c: 15k, Range: -10k to 45k

- The 25.3k rise in total employment in July was bang on Westpac's estimate (25k) but stronger than the market's (10k). The 0.2% gain in the month left the annual pace flat at 1.9%/yr, with a total head count gain of 218.8k for the year.
- This solid gain in July followed a "trend" print in June (+15.5k revised from +7.9k) and a similar +15.3k gain in May (revised from a original estimate of 17.9k). However, the July detail was not as robust. There was a massive 71.4k jump in part-time employment; meanwhile full-time employment fell 46.1k.
- The Jobs Index softened in August as the AIGoup surveys moved markedly lower; but this is more about employment growth in early 2017, hence August "trend" forecast of 15k.

Jobs Index continues to firm

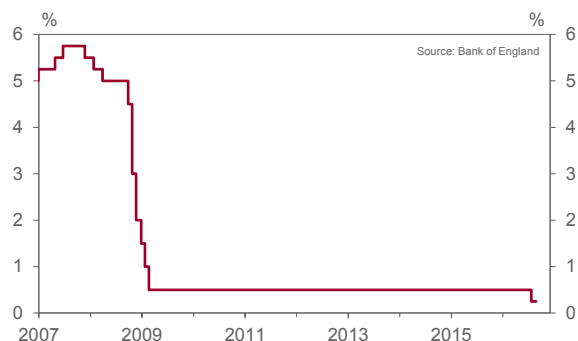


Bank of England bank rate decision

Sept 15, Last: 0.25%, WBC f/c: 0.25%

- At its August policy announcement, the Bank of England acted decisively to support the UK economy in the wake of the unexpected Brexit referendum result. As well as cutting the Bank Rate to a new record low of 25bps, the BOE introduced a range of measures to ensure that the rate reduction was passed on to borrowers and to support access to credit. This included purchases of government and corporate bonds, as well as a term funding scheme.
- The BOE has signalled that a further loosening in policy is likely, with the Bank Rate expected to be cut to a level a little above zero. But with recent economic indicators pointing towards a degree of resilience in activity, we don't expect this to occur until the November policy announcement.

Bank of England Bank Rate



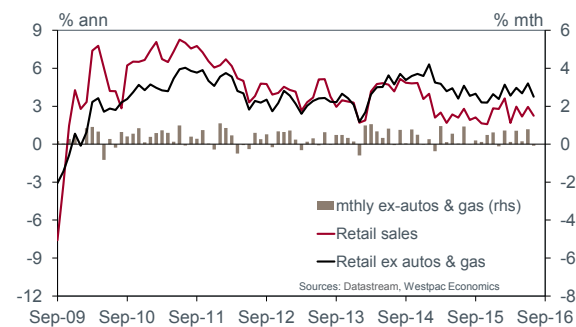
The week ahead

US Aug retail sales

Sep 15, Last: 0.0%, WBC 0.0%

- The FOMC's belief in the US consumer remains resolute. Yet, on the data to hand, their spending behaviour is best characterised as mixed.
- Total sales were flat in July following a 0.8% gain in June and a 0.2% rise in May. Similarly for core sales, July's 0.1% fall came after a 0.8% rise in June and a 0.1% gain for May.
- Growth over the year remains modest, with total sales rising 2.3%/yr; core sales are a little stronger, up 3.8%/yr.
- In the month of August, another flat outcome for total sales seems likely, with autos offsetting gains elsewhere. Gasoline sales should have an insignificant impact, meaning core sales should rise around 0.4%. Going forward, jobs; wages; and confidence should provide support for consumption.

Consumer spending mixed

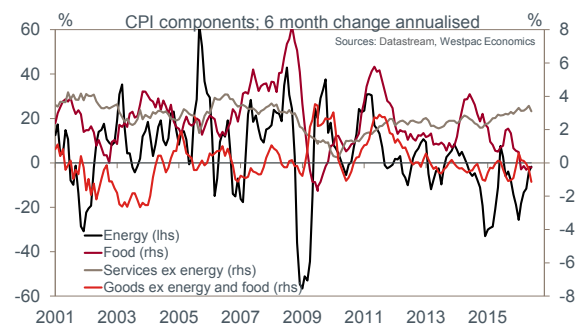


US Aug CPI

Sep 16, Last: -0.40%, WBC -0.40%

- There remains a material divergence between headline and core inflation in the US, as is the case in many other parts of the world.
- For the most part, that divergence is a matter of history, with recent outcomes for headline and core inflation converging near a 1.5%–2.0% annualised pace.
- For headline inflation, a 0.1% rise in August is set to follow July's flat result. That will leave annual inflation near 1.0%/yr.
- Core prices should again be a little stronger, rising 0.2% in August after July's 0.1% result. Annual core inflation will therefore remain above 2.0%/yr.
- Underlying the robust pace of core inflation is strength in services inflation, bolstered by rents; minimum wage related cost pressures; and financial services and insurance inflation.

Core inflation pressures robust



Data calendar

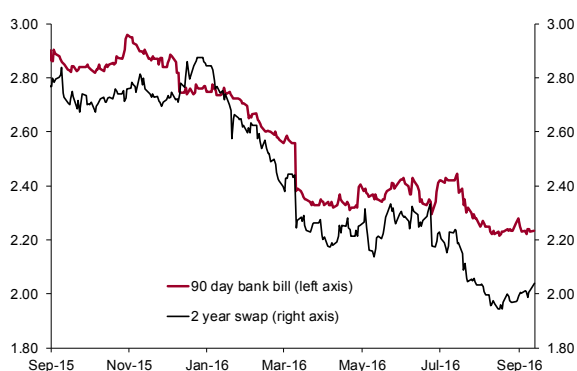
		Last	Market median	Westpac forecast	Risk/Comment
Mon 12					
NZ	Aug REINZ house sales	-5.9%	-	-	Due this week. Tighter LVR restrictions were announced in late July.
	Aug REINZ house prices, %yr	16.3%	-	-	Prices and sales are likely to cool temporarily.
US	Fedspeak	-	-	-	Lockhart speaks about monetary policy and the outlook.
	Fedspeak	-	-	-	Kashkari and Brainard on the economy.
Tue 13					
NZ	Aug food prices	-0.2%	-	0.9%	Seasonal rise in produce prices. Annual change still near zero.
Aus	Aug NAB business survey	8	-	-	Conditions > LR avg. Aug falls in AiG surveys point to downside risks.
Chn	Aug industrial production	6.0%	6.2%	-	Domestic and external demand unhelpful.
	Aug retail sales, %yr	10.2%	10.2%	-	Labour market weakness restraining willingness to spend.
	Aug fixed asset investment, ytd %yr	8.1%	7.9%	-	Currently reliant on SOE's for growth.
Eur	Sep ZEW survey of expectations	4.6	-	-	Investor mood still supported by ECB's actions.
Ger	Aug CPI (final), %yr	0.4%	0.4%	-	Despite labour market strength, inflation absent.
UK	Aug CPI, %yr	0.6%	0.7%	-	Headline inflation has been rising, lower pound will provide a boost.
	Jul house price index, %yr	8.7%	-	-	The housing market is showing signs of softening.
US	Aug NFIB small business optimism	94.6	94.8	-	Competition adds an additional headwind for smaller firms.
Wed 14					
NZ	Q2 current account, % of GDP	-3.0%	-2.6%	-2.6%	Deficit to narrow off the back of surge in goods export volumes in Q2.
Aus	Sep Westpac-MI Consumer Sentiment	101	-	-	Modest rate cut boost in Aug.
UK	Jul ILO unemployment rate	4.9%	-	-	Labour market resilient to Brexit thus far; expected to soften through H2.
Can	Aug Teranet/National Bank HPI	2.0%	-	-	Gains in Toronto and Vancouver underpinning strong increases.
Thu 15					
NZ	Aug BusinessNZ manufacturing PMI	55.8	-	-	Manufacturing sector conditions have eased but are still at firm levels.
	Q2 GDP	0.7%	1.0%	1.0%	Expected to be led by construction, but becoming more broad-based.
Aus	Sep MI inflation expectations	3.5%	-	-	Expectations have been stable but do highlight disinflationary risks.
	Q3 AusChamber-Westpac survey	55.0	-	-	Manufacturing boosted by housing upswing & lower AUD.
	Aug employment	25.3k	15k	15k	Business surveys have soften highlighting some risk towards year end.
	Aug unemployment rate	5.7%	5.7%	5.7%	A 'trend' rise in employment will be enough to hold unemployment flat.
	Aug new vehicle sales	-1.3%	-	-1.0%	Another soft month although sales are still up about 2% on a year ago.
Eur	Jul trade balance, €bn	23.4	-	-	Global headwinds continue to be felt.
	Aug CPI (final), %yr	0.2%	0.2%	-	ECB will be waiting a long time for inflation to tend to target.
UK	Aug retail sales	1.4%	-0.1%	-	Has been volatile, lower GBP boosting spending by tourists.
	BoE policy decision	0.25%	0.25%	0.25%	Resilience in activity will leave the BoE on hold for now.
US	Q2 current account balance, \$bn	-124.7	-119.8	-	Has been very stable in recent quarters.
	Aug retail sales	0.0%	-0.0%	0.0%	Household spending remains mixed.
	Initial jobless claims	259k	-	-	Claims have remained consistently tight this year.
	Sep Philadelphia Fed business outlook	2.0	1.0	-	Regional manufacturing conditions have been subdued.
	Aug PPI	-0.4%	0.1%	-	Input price inflation remains low.
	Sep Empire manufacturing	-4.2	-1.0	-	Points to slightly below trend growth in manufacturing output.
	Aug industrial production	0.7%	-0.2%	-	Manufacturing struggling at present.
	Jul business inventories	0.2%	0.1%	-	Surprise weak inventory detail from ISM highlights risk for Q3 growth.
Fri 16					
US	Aug CPI	0.0%	0.1%	0.1%	Core inflation above 2.0%/yr; headline still well below.
	Sep University of Michigan sentiment	89.8	91.0	-	Preliminary estimate; confidence remains robust.

New Zealand forecasts

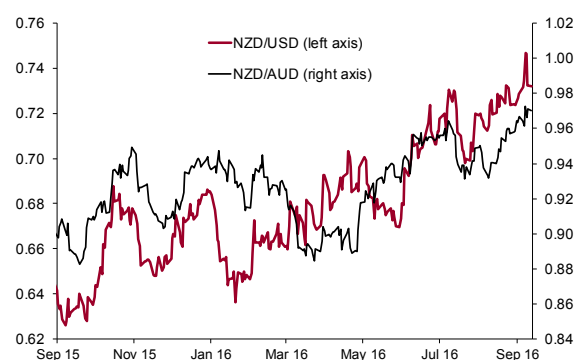
Economic Growth Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2014	2015	2016f
GDP (Production) ann avg	3.6	2.4	3.5	2.9	3.7	2.5	3.3	3.1
Employment	3.2	2.0	3.9	1.6	3.6	1.4	4.7	2.0
Unemployment Rate % s.a.	5.4	5.2	5.0	4.5	5.5	5.0	5.1	4.6
CPI	0.3	0.4	1.0	1.7	0.8	0.1	0.8	1.5
Current Account Balance % of GDP	-3.4	-3.0	-2.9	-3.4	-3.1	-3.2	-2.6	-3.5

Financial Forecasts	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17
Cash	2.00	1.75	1.75	1.75	1.75	1.75
90 Day bill	2.00	1.90	1.90	1.90	1.90	1.90
2 Year Swap	2.00	1.90	2.00	2.00	2.00	2.00
5 Year Swap	2.10	2.10	2.20	2.30	2.40	2.50
10 Year Bond	2.10	2.20	2.30	2.50	2.60	2.70
NZD/USD	0.72	0.69	0.67	0.65	0.63	0.63
NZD/AUD	0.94	0.93	0.92	0.92	0.91	0.91
NZD/JPY	73.4	71.1	68.3	65.7	64.3	65.0
NZD/EUR	0.65	0.64	0.63	0.62	0.59	0.58
NZD/GBP	0.55	0.54	0.53	0.51	0.49	0.48
TWI	76.9	74.8	73.3	71.7	69.9	68.9

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 12 September 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.00%	2.00%	2.00%
30 Days	2.12%	2.08%	2.10%
60 Days	2.18%	2.16%	2.17%
90 Days	2.24%	2.24%	2.24%
2 Year Swap	2.04%	2.00%	1.95%
5 Year Swap	2.18%	2.09%	2.08%

NZ foreign currency mid-rates as at Monday 12 September 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7321	0.7225	0.7190
NZD/EUR	0.6515	0.6458	0.6437
NZD/GBP	0.5517	0.5508	0.5561
NZD/JPY	75.11	73.65	72.74
NZD/AUD	0.9704	0.9570	0.9388
TWI	78.17	77.10	76.39

International forecasts

Economic Forecasts (Calendar Years)	2012	2013	2014	2015	2016f	2017f
Australia						
Real GDP % yr	3.5	2.0	2.7	2.5	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	-4.8	-4.6	-4.6
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	-2.4	-2.3	-2.3
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	1.5	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 12 August 2016

Interest Rate Forecasts	Latest	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
Australia						
Cash	1.50	1.50	1.50	1.50	1.50	1.50
90 Day Bill	1.72	1.80	1.80	1.80	1.80	1.80
10 Year Bond	1.96	1.95	2.15	2.20	2.30	2.45
International						
Fed Funds	0.375	0.375	0.625	0.625	0.875	0.875
US 10 Year Bond	1.60	1.50	1.70	1.80	2.00	2.10
ECB Deposit Rate	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40

Exchange Rate Forecasts	Latest	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17
AUD/USD	0.7654	0.77	0.74	0.73	0.71	0.69
USD/JPY	102.19	103	102	101	101	102
EUR/USD	1.1279	1.10	1.08	1.07	1.05	1.06
AUD/NZD	1.0348	1.07	1.07	1.09	1.09	1.10

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