

Weekly Commentary

19 September 2016



Smooth sailing

June quarter GDP data confirmed that the NZ economy remains on a firm footing. But perhaps more pleasingly, it also hinted that growth is becoming a little more broad-based. We also got our first look at how the housing market is responding to the new RBNZ lending rules. These are just two of the factors that the RBNZ will be weighing up as it considers interest rate settings ahead of this week's OCR review. We expect it will opt to leave the OCR unchanged but continue to signal that further easing is likely further down the track.

Last week's GDP data confirmed the New Zealand economy remains on a firm footing. GDP grew 0.9% in the June quarter. While this was a touch below expectations, the downside surprise was offset by upward revisions to March quarter growth estimates. This meant annual GDP growth of 3.6% in the year to June was bang in line with market expectations.

But while the headline number is certainly impressive from an international perspective, perhaps one of the most promising aspects of the GDP data was that growth was relatively broad-based. That's in contrast to recent quarters where the headline figure has been flattered to some degree by volatile 'one off' effects. In the June quarter, growth was spread across a wide range of sectors, with most parts of the economy expanding.

Unsurprisingly, the construction sector was a particular standout. The sector grew by an impressive 5%, meaning that over the first half of the year, construction activity jumped a massive 10% (by comparison, the overall economy grew 1.8%). And the building boom has a way to run yet. Nationwide, consent issuance has continued to trend higher in recent months. In Auckland, the newly minted Unitary Plan should provide developers with greater certainty, and support a step up in residential construction in the region over the coming year.

One reason that residential construction activity has been so strong is because of very strong population growth. More people in the country means more roofs over heads are needed. But strong population growth is also driving activity in other sectors. The healthcare sector is expanding as more people demand its services, while the pace of retail spending is also growing at a rapid clip.

Another sector that made a strong contribution to growth in the June quarter was real estate services – no surprise given the rampant housing market and a sharp lift in sales volumes in the June quarter. But with sales volumes declining more recently, and the RBNZ's latest LVR restrictions now in force, we'd expect a slower pace of growth over the remainder of the year.

Last week we got important information on how the RBNZ's latest round of LVR restrictions are impacting the housing market. The August REINZ house sales report showed house prices dropped 2.2% in the month, with falls most heavily concentrated in Auckland (where property investors play a bigger role) and the rest of the North Island. That said, prices are still up almost 12% on a year ago.

While the fall in August may look dramatic at first glance, it's actually a pretty muted market reaction given the impact that tighter lending restrictions and tax changes have had in the past. We'll wait and see what the next few months bring.

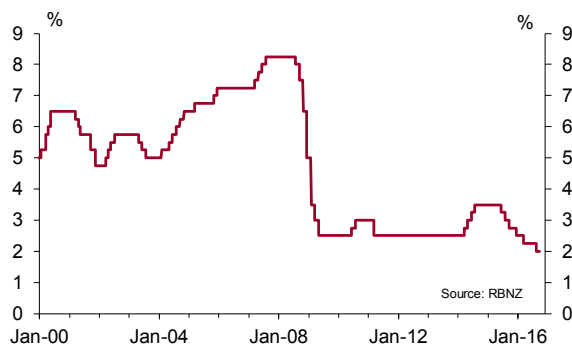
Smooth sailing continued

but we haven't seen anything yet to change our view that the latest lending restrictions will have a transitory impact on house price growth, and that low interest rates will continue to add fuel to the housing market fire over the next year.

Updated GDP data, along with recent housing market developments, are just two factors the RBNZ will be mulling over when it considers interest rate settings this week. In addition, since the August *Monetary Policy Statement*, international dairy prices have jumped almost 30%. This in turn has been a catalyst for the NZ dollar to take another step up. The TWI is currently around 3% above where the RBNZ assumed it would be tracking in the August *MPS*.

This Thursday's OCR review will consist of only a one-page statement. But we suspect that if the RBNZ were to run a full set of forecasts today, the resulting interest rate track would look very similar to that published back in August. Given this starting point, the fact the RBNZ never committed itself to any action as early as September, and the potential to send the NZ dollar higher if there is any kind of communication misstep, we suspect the RBNZ won't be keen on rocking the boat unnecessarily.

Official Cash Rate



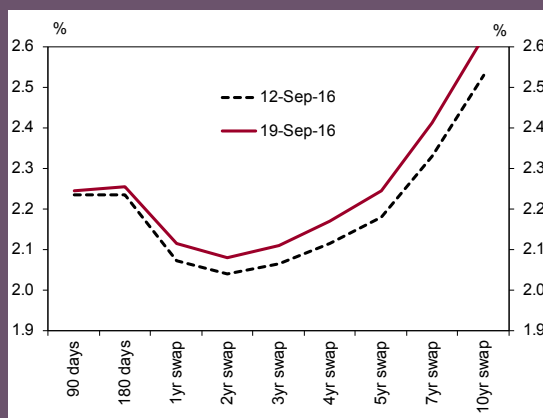
We think the RBNZ will stick to much the same language used in the August *MPS*. That is, it will continue to signal the strong likelihood of at least one more rate cut by repeating its message that "further policy easing will be required to ensure that future inflation settles near the middle of the target range." We expect that a 25 basis point rate cut will be delivered in November.

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



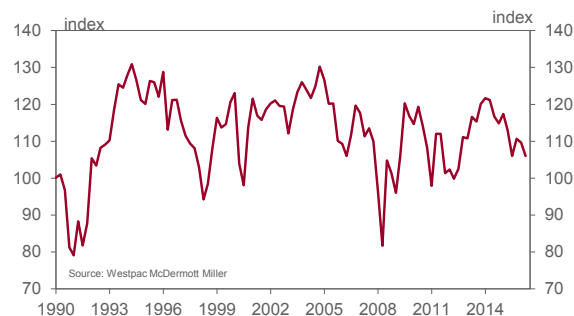
The week ahead

NZ Q3 Westpac-MM Consumer Confidence

September 19, Last: 106.0

- Consumer confidence fell to below average levels through mid-2016 as households became increasingly worried about where the economy is heading over the next few years. Concerns around economic conditions were particularly acute among those on middle incomes.
- However, while nervousness about the general economic outlook increased, households remained more optimistic about their personal economic situation. As a result, they remain in the mood to spend.
- The September quarter survey was in the field over 1-11 September.

Westpac-McDermott Miller consumer confidence



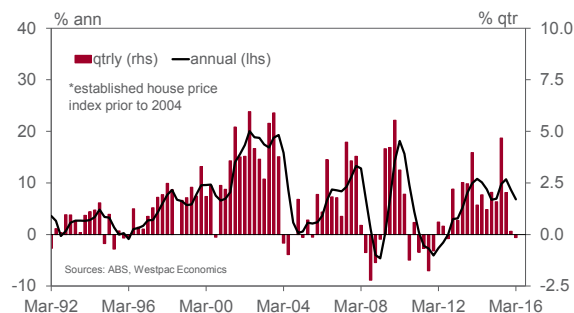
Aus Q2 residential property price index

Sep 20, Last: -0.2%, WBC f/c: 0.5%

Mkt f/c: 3.0%, Range: 0.5% to 5.5%

- Note that the ABS residential property price index is more dated than private sector measures but still gains attention due to its 'official' tag. For Q1, it showed a 0.2% fall, with annual growth easing to 6.8%, down from a peak of 10.7% in Q3 2015.
- Private sector measures registered Q2 price moves ranging from 1.6%qtr, 1.7%yr (REIA) to 1.7%qtr, 2.4%yr (APM), 1.9%qtr, 6.0%yr (Residex), and 3.9%qtr, 8.4%yr (CoreLogic). Note that the last of these was affected by a methodology change that boosted estimates in May-June. The ABS measure tends to track the APM series - a 0.5%qtr gain would bring it in line with APM's annual growth rate of 2½%. More timely data shows mixed results since Q2 with Residex showing a dip in July but the CoreLogic measure tracking a 3.2% gain for Q3.

Residential property price index, ABS measure

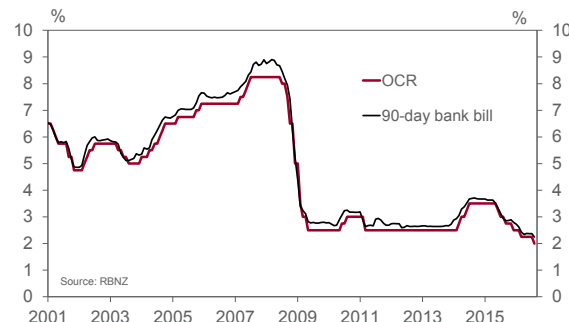


NZ RBNZ OCR review

Sep 22, last: 2.00%, Westpac: 2.00%, Market: 2.00%

- We expect the Reserve Bank to hold the OCR at 2% next week. Developments since August have been more or less balanced for the inflation outlook. GDP and dairy prices have risen more than expected, but the exchange rate is stronger and the housing market has cooled a little.
- In August, the RBNZ signalled that another 25bp OCR cut in November was highly likely, with the possibility of a further cut beyond this. Given that the case for the November cut doesn't appear to have diminished, we expect the RBNZ to use similar wording to August in next week's one-page statement.
- Our forecast is for a November rate cut, followed by an extended pause. Technical factors will see inflation rise back towards the middle of the target range by the second half of next year.

NZ OCR and 90-day rate

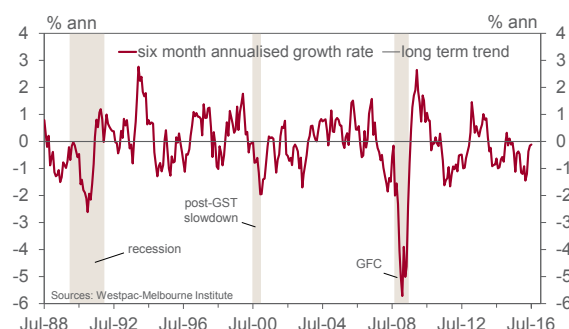


Aus Aug Westpac-MI Leading Index

Sep 21, Last: -0.12%

- The six month annualised growth rate in the Westpac-Melbourne Institute Leading Index rose from -0.15% in June to -0.12% in July. While the growth rate remains below zero, indicating below trend momentum, it has improved markedly from the -1.19% average reading in the first three months of the year.
- The August update will include mixed but on balance more positive data. On the soft side, the ASX200 declined -2.3% (vs +6.3% last month) and the Westpac-MI Consumer Expectations Index dipped 2%. More positively, US industrial production rose 0.7%; commodity prices posted another 0.8% gain (in AUD terms) and dwelling approvals jumped 12.3%. The yield spread also widened following the RBA rate cut. Labour markets remain mixed with Unemployment Expectations improving but total hours worked down a touch in August.

Westpac-MI Leading Index



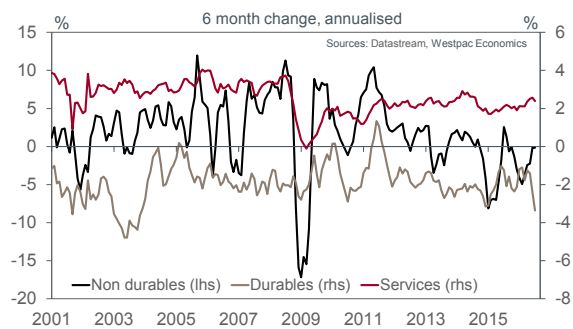
The week ahead

US FOMC September meeting

Sep 20-21, Last: 0.375%, WBC 0.375%

- The past month has seen a number of divergent views offered by Fed officials on the timing of the next hike. The market took their cue from the doves - rightly so in our view - pricing in a low probability of action in September.
- Available data has been solid, but not strong. And, on a headline basis, inflation is well below target. As such, the FOMC has time to reflect before taking their next step. As referenced by Governor Brainard, the asymmetric ability of the FOMC to respond to weaker conditions also needs to be taken into consideration.
- The September meeting will see updates to the FOMC's forecasts as well as a press conference. Of particular interest to us will be the Committee's longer-term expectation for the Fed Funds Rate, which current sits at 3.0%. Commentary on the consumer will also be key.

PCE inflation: goods offset services



Data calendar

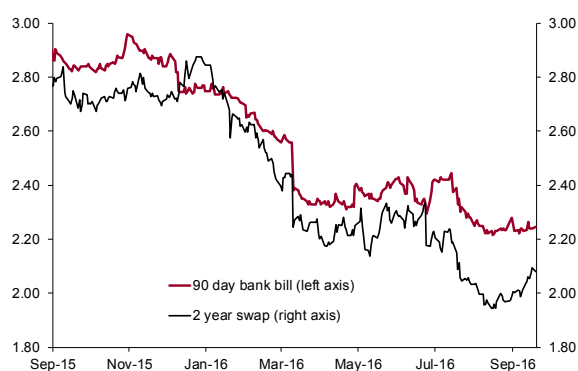
		Last	Market median	Westpac forecast	Risk/Comment
Mon 19					
NZ	Q3 Westpac MM consumer confidence	106.0	-	-	Consumer confidence fell to below average levels through mid-2016.
	Aug Performance of services index	54.2	-	-	Service sector conditions have softened in recent months.
Chn	Aug property prices	-	-	-	Tier-1 losing momentum; elsewhere gains still modest.
Eur	Jul current account balance, €b	37.6	-	-	Has narrowed since April on reduced investment income flow.
UK	Sep Rightmove house prices	-1.2%	-	-	Post-Brexit uncertainty is weighing on housing market conditions.
US	Sep NAHB housing market index	60	60	-	Housing market in robust shape.
Tue 20					
Aus	Q2 residential property price index	-0.2%	3.0%	0.5%	ABS measure, old news vs others, some of which point to a lift in Q3.
	RBA Minutes of September meeting	-	-	-	Commentary around inflation, housing & labour market of key interest.
US	Aug housing starts	2.1%	-1.6%	-	Starts & permits very volatile month to month...
	Aug housing permits	-0.8%	2.3%	-	... modest underlying uptrend apparent.
Wed 21					
NZ	Aug net migration, '000	5.6	-	5.3	Looking for further evidence annual flows have passed their peak.
	GDT Auction	7.7%	-	-	Futures suggest another lift in prices.
Aus	Aug Westpac-MI Leading Index	-0.12%	-	-	Below trend but has improved markedly in 2016.
	RBA Head of Economic Analysis	-	-	-	Alexandra Heath, Education & training pipeline conference, 12pm.
UK	Aug public sector borrowing, £bn	-1.5	-	-	Debt reduction goals are under pressure.
US	FOMC policy decision, midpoint	0.375%	0.375%	0.375%	December remains our pick for the next hike.
Can	Jul wholesale trade	0.7%	-	-	Likely pullback following earlier gains in motor vehicles and parts.
Thu 22					
NZ	RBNZ Official Cash Rate announcement	2.00%	2.00%	2.00%	RBNZ to remain on hold, but will continue to signal a future cut.
Eur	Sep consumer confidence	-8.5	-8.1	-	Has been robust in 2016, supported by ECB.
	ECB President Draghi speaking	-	-	-	Delivering keynote address at ESRB confidence in Frankfurt.
US	Aug Chicago Fed national activity index	0.27	-	-	Has picked up in recent months.
	Initial jobless claims	260k	-	-	Claims have remained consistently tight this year.
	Jul FHFA house price index	0.2%	0.3%	-	House price gains continuing.
	Aug existing home sales	-3.2%	1.1%	-	Momentum has slowed; but uptrend intact.
	Sep Kansas city Fed manufacturing activity	-4	-	-	Continues to signal subdued manufacturing activity.
Fri 23					
Eur	Sep Markit manufacturing PMI (provisional)	51.7	51.5	-	Manufacturing continues to see modest growth...
	Sep Markit services PMI (provisional)	52.8	52.8	-	... services sector aided by consumer demand.
Ger	Sep Markit manufacturing PMI (provisional)	53.6	53.2	-	German producers have competitive edge...
	Sep Markit services PMI (provisional)	51.7	52.1	-	... lack of growth in service sector surprising given low unemployment.
US	Sep Markit manufacturing PMI (provisional)	52.0	52.3	-	ISM surprised to downside in August; but Markit kept momentum.
	Fedspeak	-	-	-	Harker, Mester and Lockhart on panel at Philly Fed conference.
Can	Aug CPI	-0.2%	-	-	Headline rate to pick up as early softness in fuel prices passes.

New Zealand forecasts

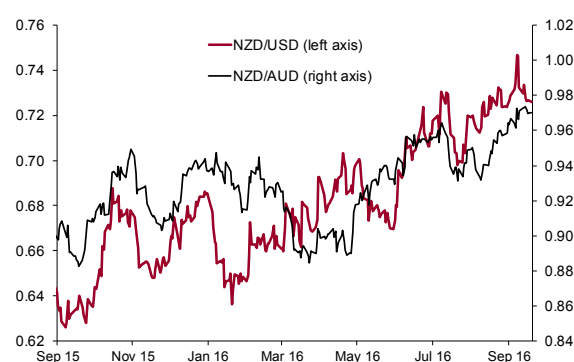
Economic Growth Forecasts	March years				Calendar years			
	% change	2015	2016	2017f	2018f	2014	2015	2016f
GDP (Production) ann avg	3.6	2.5	3.5	2.9	3.8	2.5	3.4	3.1
Employment	3.2	2.0	3.9	1.6	3.6	1.4	4.7	2.0
Unemployment Rate % s.a.	5.4	5.2	5.0	4.5	5.5	5.0	5.1	4.6
CPI	0.3	0.4	1.1	1.7	0.8	0.1	0.9	1.6
Current 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 19 September 2016

Interest Rates	Current	Two weeks ago	One month ago
Cash	2.00%	2.00%	2.00%
30 Days	2.19%	2.09%	2.09%
60 Days	2.22%	2.17%	2.16%
90 Days	2.25%	2.25%	2.23%
2 Year Swap	2.08%	2.01%	1.97%
5 Year Swap	2.25%	2.10%	2.09%

NZ foreign currency mid-rates as at Monday 19 September 2016

Exchange Rates	Current	Two weeks ago	One month ago
NZD/USD	0.7262	0.7280	0.7248
NZD/EUR	0.6509	0.6526	0.6409
NZD/GBP	0.5586	0.5474	0.5555
NZD/JPY	74.21	75.79	73.09
NZD/AUD	0.9702	0.9619	0.9531
TWI	77.84	77.73	77.03

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	2.11	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	0.7520	0.74	0.73	0.71	0.69	0.68	0.68	0.68
USD/JPY	102.00	102	101	101	102	102	103	104
EUR/USD	1.1240	1.10	1.07	1.05	1.04	1.03	1.03	1.03
AUD/NZD	1.0280	1.04	1.06	1.06	1.06	1.08	1.10	1.11

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