

# Weekly Commentary

7 November 2011

## Between the cracks

The Greek drama playing out over the past week is a reminder of the continuing uncertainty that led the RBNZ to put off rate hikes until March next year. Meanwhile, the New Zealand economy has been going through a soft patch since the middle of the year, of which this week's disappointing employment figures are the latest sign. That means more subdued inflation pressures, allowing the RBNZ to keep rates on hold until June – as we believe it eventually will if the global economy continues to disappoint.

Risk sentiment in global funding markets remains the big swing factor around our OCR call. As the RBNZ has signalled, if tight conditions in those markets persist, local banks could face higher funding costs, which could in turn translate into a higher spread between mortgage and deposit rates and the OCR. A key early indicator of those costs – the cost of insuring against default for Australasian banks – has come off its peaks over the past month, as a resolution to the European sovereign debt crisis has started to look a little more within reach. That has potential implications not just for the RBNZ's hiking plans, but, with the New Zealand economy particularly sensitive to changes in global funding conditions, for the NZ dollar, for which we've nudged our forecasts up just a bit. But the recent political theatre around Greek acceptance of a bailout deal shows that a full resolution still has a long way to go, and in the meantime markets remain very jittery. As long as that uncertainty lasts we think the RBNZ will be reluctant to begin raising rates.

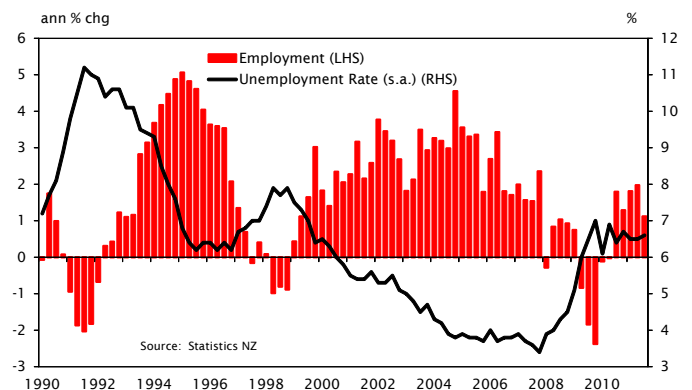
And with evidence that the economy experienced a renewed slowdown around the middle of the year, the Bank will come under less immediate pressure to do so. The latest signs of softness came in Thursday's Household Labour Force Survey (HLFS), which showed employment growing just 0.2% in the September quarter after zero growth in June. With a pickup in the number of people looking for work, that was enough to send the unemployment rate back up a notch to 6.6%. And Tuesday's Labour Cost Index showed wage pressure continuing to be fairly contained as well, the RBNZ's preferred measure rising 2% over the year to September, unchanged from June.

There's a couple of possible reasons for the slowdown we've seen: migration has come off significantly since the start of the

year as an increasing number of Kiwis have left for Australia, and government cutbacks have probably been a factor as well. The latest HLFS points to ongoing economic disruption in Christchurch following the earthquakes as a third reason. The weak jobs growth was largely down to a sharp fall in employment in Canterbury (though jobs also fell in Wellington) – ex-Canterbury, employment was up a decent 1%. At the same time, unemployment in Canterbury has come down over the past few quarters, while in the rest of the country it's risen from 6.6% to 6.8%. That suggests that dislocation in Christchurch has led people to look for job opportunities elsewhere, but that activity in the rest of the country hasn't been strong enough to enable all of those leaving to find employment. Certainly, the HLFS estimate of the drop in Canterbury employment over the past 6 months pretty much matches a fall in the region's working-age population, and we know from migration data that most of those people moved within the country rather than overseas. (We should point out, though, that at about 20,000 the HLFS employment drop in Canterbury looks rather on the high side – particularly in light of tax data showing a loss of about 3,500 taxpayers to the region in the six months to August.)

The jobs that have been shed in Canterbury over the past year have largely been in the retail and services space, particularly accommodation and restaurants. One would have hoped that the Rugby World Cup would provide a temporary offset (filled jobs data from Statistics NZ's new National Employment Indicator and the Quarterly Employment Survey had hinted in that direction).

### Household Labour Force Survey

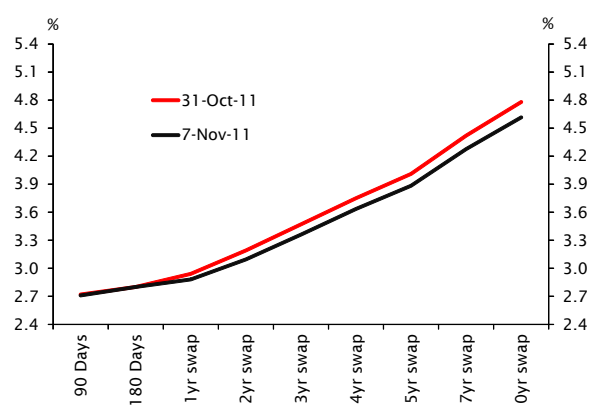


But on that front the HLFS disappointed – though a 1% rise in hours worked suggests that existing staff did work longer hours as a result of the Cup. Most tellingly, part-time jobs, which is where you would have expected to see a Cup effect most clearly, actually fell in the quarter. That's not to say that the Rugby World Cup didn't boost hiring, but as we've been seeing in the economy more generally, its net effects have been pretty mixed overall. Latest Paymark data did show a more convincing Rugby World Cup boost to retail spending in October than in September (transactions rose 2.7% on our estimates – we expect a similar number from this week's official cards spending data). But the details continue to suggest that while spending by tourists was strong, the impact on spending by locals was close to zero, with as much displacement as stimulus.

So overall the economy appears to have fallen between the cracks somewhat. Things will start to look very different once Christchurch reconstruction gathers steam and the related money flows enter the economy – which is why we continue to expect the RBNZ's balance to tip in favour of rate rises by mid-2012. We aren't there yet, though there are signs that construction activity has already started to pick up. After years in the doldrums, the HLFS showed employment in the construction sector rising more than 5% in the September quarter – the strongest quarterly rise since 2006. And though consent issuance has been bumpy – it fell a surprising 17% in September – it remains well above mid-year lows, with standout strength in Canterbury and Auckland. Still very few consents in Canterbury have been specifically identified as quake-related, but it does look as if a building response to the housing shortages that have developed in Christchurch and Auckland is finally underway.

**Fixed versus floating:** Floating remains a relatively low-risk option for now, although fixing will become a consideration again by early next year. Little upward pressure on interest rates from offshore looks likely any time soon, and in its October review the RBNZ confirmed that it will watch and wait while global financial conditions remain this uncertain. But rate hikes remain likely over the longer term, and if current pressures in offshore markets persist, higher bank funding costs could drive additional increases in future mortgage rates, independently of RBNZ action – indeed, our expectation for OCR hikes to be delayed until June 2012 is at least as much a reflection of this risk as of the state of the economy. Based on our latest forecasts and current market pricing, fixing for two or three years is likely to result in a lower interest bill than remaining on floating for the entire period.

#### NZ interest rates



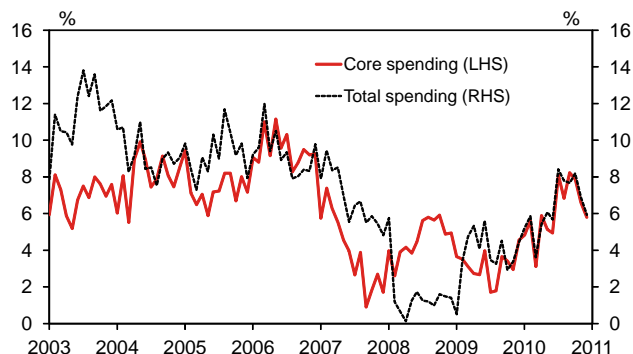
## Key Data Previews

### NZ Oct electronic card spending

Nov 9, Last: 0.2%, WBC f/c: 2.5%

- Growth in total card spending was fairly subdued in September, with a lift in spending by overseas visitors during the first half of the Rugby World Cup, but softer spending on domestically-issued cards. Anecdotes from business surveys suggested that net impact of the tournament was ambiguous, with some activity likely to have been displaced.
- Figures from Paymark (which processes about 75% of all card transactions) showed a more substantial lift in October spending, during the finals of the RWC - though the details again suggest that spending by visitors accounted for the majority of the increase. Hospitality, apparel and fuel led the gains.

### Card transactions, annual % change

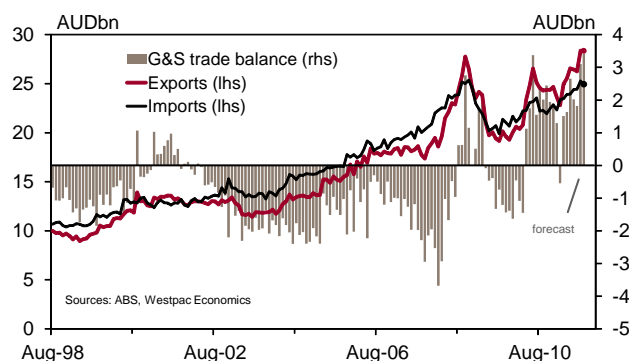


### Aus Sep trade balance, AUDbn

Nov 8, Last: 3.1, WBC f/c: 3.4 Mkt f/c: 3.0, Range: 2.0 to 3.9

- Australia's trade surplus is forecast to improve to \$3.4bn in September from \$3.1bn for August. If so, this would be a record, just eclipsing the June 2010 surplus of \$3.371bn.
- The Aussie weakened in September (-2.4% vs USD and -1% on the TWI), thus raising import costs and lifting export values.
- Exports are forecast to be flat. Volumes are likely to be a negative, on a moderation in iron ore shipments after a strong August. Commodity prices were mixed. On balance, they were a little lower in USD terms and thus up a little in AUD terms.
- Imports are forecast to decline by -1.2%, implying softer volumes for the final month of the quarter. However, for the quarter as a whole, volume rose solidly.

### Trade surplus: could hit a fresh record in September

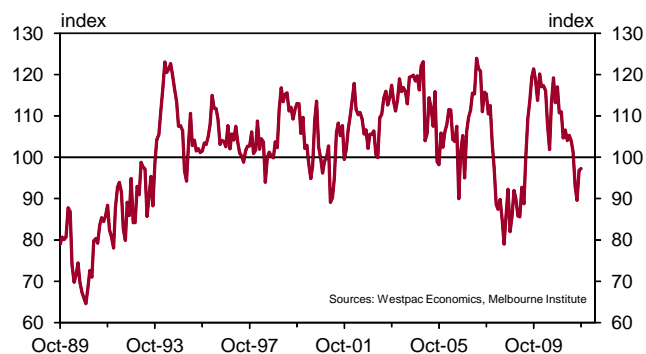


### Aus Nov Westpac-MI Consumer Sentiment

Nov 9, Last: 97.2

- Consumer sentiment posted a small 0.4% rise in Oct after a surprisingly strong 8.1% gain in Sep. Sentiment has reversed just over half of the 14.9% slump into deeply pessimistic territory between Apr and Aug but remains pessimistic overall. The small net move in Oct conceals powerful cross-currents with volatile swings in financial markets and the RBA shifting to a clear easing bias at its Oct meeting.
- The Nov survey will be dominated by the RBA's decision to cut the cash rate by 25bps. Other influences will again be mixed with more financial market turbulence emanating from Europe (although the ASX is +0.3% and AUD +4½¢ vs the USD since the Oct survey). Local economic news has also been mixed with soft housing numbers but solid retail sales and a subdued inflation read. The sharp falls in commodity prices are probably beyond the ken of most consumers.

### Consumer sentiment

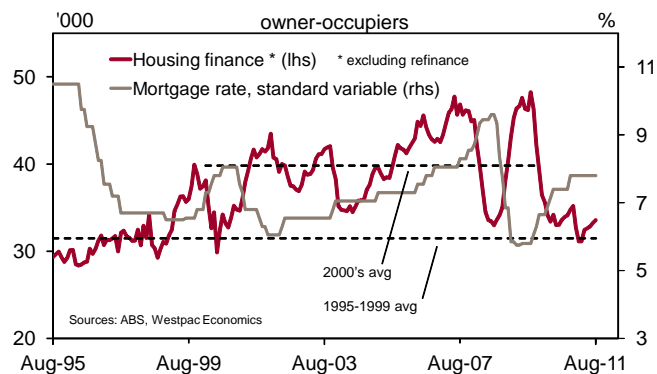


### Aus Sep housing finance (no.)

Nov 9, Last: 1.2%, WBC f/c: 3.0% Mkt f/c: 1.5%, Range: flat to 3.0%

- Housing refinance has made a partial recovery in recent months following a weak start to the year. We expect this to continue, forecasting a rise of 3% for September.
- If new lending (ex-refinancing) rises by 3% in the month, this would trim the decline for the year to date to around -1½%.
- Lower fixed rates have been a plus, down to 6.6% in September from 7.35% in June and below variable at 7.8%.
- The weak start to 2011 reflected the negatives of the RBA's November 2010 rate hike and flood disruptions. Lending to owner-occupiers remains soft, with the current level only a little above that over the second half of the 1990s. This highlights the headwinds facing the sector: interest rates, household's desire to pay down debt and falling house prices.

### Owner-occupier finance & the rate cycle

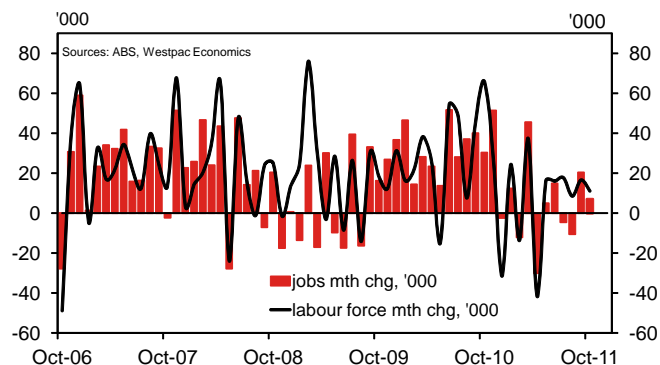


## Aus Oct employment ('000)

Nov 10, Last: 20.4k, WBC f/c: 7.0k Mkt f/c: 10k, Range: -10k to 20k

- The Sep labour force survey had the statistical bounce we were looking. Total employment rose 20.4k following a drop of 15k in the previous two months. The composition revealed a similar unwinding of the component weakness with a 10.8k rise in full-time and a 9.6k rise in part-time. The trend towards female employment continues with female employment rising 18.1k (+34.6k over the last six month) while only 2.3k males found work (for a loss of 39.4k over the last six months).
- We don't think the labour market is weakening nor do we think it is strengthening. The leading indicators are softening but they have been lagging the ABS data. Our forecast for a 7k rise will generate an average monthly growth of almost 2k per month over the last three months; a soft but not collapsing labour market.

## Labour force vs. jobs growth

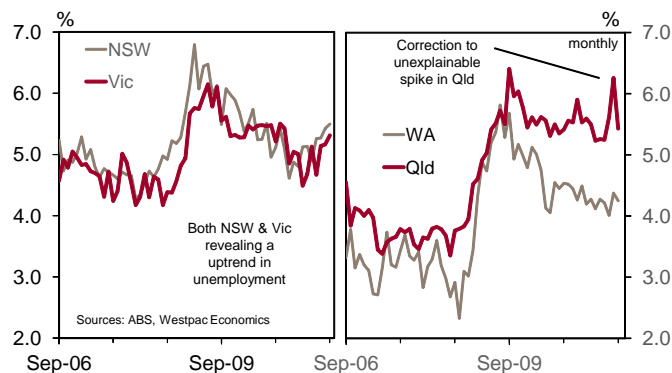


## Aus Oct unemployment rate

Nov 10, Last: 5.2%, WBC f/c: 5.3% Mkt f/c: 5.3%, Range: 5.2% to 5.4%

- Despite the strong rise in jobs, participation also rose resulting in a 11.1k rise in the labour force. So in the end the unemployment rate did round down to 5.2% (5.248%) from 5.3% (5.29%) but that is a small move of 0.04%.
- The state data on unemployment also revealed ongoing divergent trends. Unemployment rose in NSW (5.5% from 5.4%) and Vic (5.3% from 5.2%) and improved in Qld (that crazy spike in August to 6.2% was unwound to a still high 5.4%) while WA continues to benefit from the resources boom (4.3% from 4.4%).
- We are expecting the labour force to grow 11.1k as we are forecasting the participation rate to remain flat at 65.6%. This more than offsets the 7k rise in jobs so the unemployment rate rises to 5.3%.

## Unemployment on the rise in the south-east



## Key Data and Events

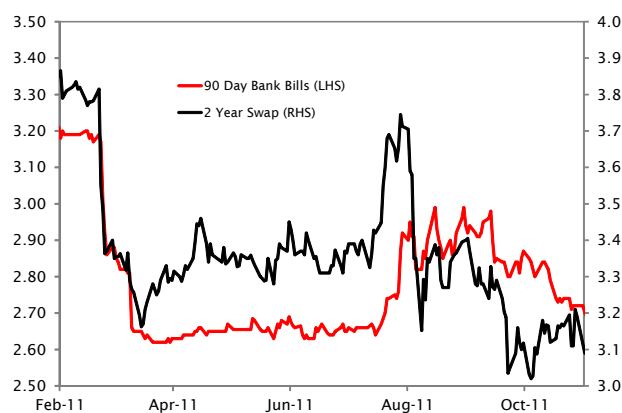
		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 07</b>					
<b>Aus</b>	Oct ANZ job ads %mth	-2.1%	-	-	Has become more of a coincident than leading indicator of jobs
<b>Eur</b>	Nov Sentix investor confidence	-18.5	-	-30.0	Latest Greek/Italian uncertainties to hit sentiment hard.
	Sep retail sales	0.1%	0.1%	0.0%	French and German data suggest further softness in sales.
<b>Ger</b>	Sep industrial production	-1.0%	0.1%	0.5%	Momentum from orders overhang unwinding.
<b>US</b>	Sep consumer credit \$bn	-9.5	5.0	-	Aug saw first fall since Sep last year.
	Fedspeak	-	-	-	Rosengren
<b>Tue 08</b>					
<b>Aus</b>	Sep trade balance, AUDbn	3.1	3.0	3.4	Potentially a record surplus. Imports -1% & exports flat (see textbox).
	Oct NAB business survey	2.0	-	-	Conditions up 5pts to +2 in Sep (avg'd 0 last 5mths). Confid' -2 in Sep.
<b>Ger</b>	Sep exports	3.5%	-	-	Volatile, probably due a steep fall soon.
<b>UK</b>	Oct BRC retail survey %yr	0.3%	-	-	Guide to UK retailing.
	Oct RIC house prices net balance %	-23%	-	-	Still a significant majority of surveyors reporting prices down.
	Sep industrial production	0.2%	0.1%	0.1%	Industrial sector losing momentum at end of Q3.
<b>US</b>	Oct NFIB small business optimism	88.9	-	88.0	Renewed decline likely.
	Nov IBD-TIPP economic sentiment	40.3	-	38.0	Latest equity jitters to hit sentiment.
	Fedspeak	-	-	-	Kocherlakota, Plosser - both dissenters to recent easing bias.
<b>Can</b>	Oct housing starts	7.3%	3.8%	-	Gain mainly due to multiples.
<b>Wed 09</b>					
<b>NZ</b>	Oct card spending	0.2%	-	2.5%	A substantial boost at the business end of the Rugby World Cup.
<b>Aus</b>	Nov Westpac-MI Consumer Sentiment	97.2	-	-	Rate cut should give a decent boost.
	Sep housing finance (no.)	1.2%	1.5%	3.0%	Lending levels remain weak. Partial recovery after weak start to 2011.
<b>Chn</b>	Oct consumer price index %yr	6.1%	-	-	Non-food non-shelter yet to decisively turn.
	Oct producer price index %yr	6.5%	-	-	Commodity prices have turned.
	Oct industrial production %yr	13.8%	-	-	6mth %saar at 7.1%, core IVA at 8.2%yr.
	Oct fixed asset investment %ytd	24.9%	-	-	Transport, real estate and manufacturing all now slowing down.
	Oct retail sales %yr	17.7%	-	-	Auto sales subdued, jewellery elevated, appliances mundane.
	Sep current account ¥bn sa	652.6bn	-	-	Very slim by historical standards as trade and asset income both struggle.
<b>UK</b>	Oct BRC shop price index %yr	2.7%	-	-	Guide to part of CPI basket.
	Sep visible trade balance £bn	-7.8	-8.0	-	Deficits a little narrower following methodology change.
<b>US</b>	Sep wholesale inventories	0.4%	0.6%	0.5%	Guide to Q3 GDP revision.
	Fed chair Bernanke	-	-	-	At small business conference.
<b>Can</b>	Sep new house prices	0.1%	0.1%	-	Prices growth has slowed in Q3.
<b>Thu 10</b>					
<b>NZ</b>	RBNZ Financial Stability Report	-	-	-	Focus on European debt woes, developments in bank regulation.
<b>Aus</b>	RBA Assist Gov (Economic) Philip Lowe	-	-	-	to Agriculture Roundtable Conference 2011, Melbourne, 9:30am AEDT
	Oct employment ('000)	20.4	10	7.0	Leading indicators point to +15k/mth but Oct to offset outsized Sept.
	Oct unemployment rate	5.2%	5.3%	5.3%	Softer jobs growth, flat participation and unemployment rises 0.1ppt.
	Nov Westpac-MI unempl' expectations	5.0% <sup>mth</sup>	-	-	Up 36%yr to October as consumers became worried about jobs.
	Nov MI inflation expectations median	3.1% <sup>yr</sup>	-	-	Peaked at 4.6%yr in Jan, highlights easing inflationary pressures.
<b>Chn</b>	Oct trade balance USDbn	14.5	-	-	Exports beginning to flag, commodity imports to weaken.
<b>Eur</b>	EU Commission Autumn forecasts	1.9%	-	0.2%	Likely substantial downgrade to 2012 eurozone growth f'cast.
<b>UK</b>	BoE rate decision	0.5%	0.5%	0.5%	No policy adjustment likely for a few months after Oct's QE restart.
<b>US</b>	Oct import prices	0.3%	0.2%	0.0%	Energy prices about unchanged, US dollar less weak.
	Sep trade balance \$bn	-45.6	-46.0	-45.4	Small falls in exports and imports to narrow deficit slightly.
	Initial jobless claims w/e 4/11	397k	-	405k	No clear break in trend below 400k, yet.
	Oct federal budget \$bn	-140.4	-110.5	-	In focus given European concerns, debt ceiling, ratings agencies.
	Fedspeak	-	-	-	Evans.
<b>Can</b>	Sep trade balance C\$bn	-0.6	-0.45	-	Last surplus was in Jan.
<b>Fri 11</b>					
<b>NZ</b>	Oct Food prices	-1.0%	-	+0.4%	Annual inflation to fall sharply as vege prices ease, GST hike drops out.
<b>Chn</b>	Oct new loans RMBbn	470	-	-	Tentative date. Market fixated with shadow banks at present.
	Oct money supply M2 %yr	13.0%	-	-	Tentative date. Wealth management products not captured here.
<b>Jpn</b>	Sep tertiary industry index %mth	-0.2%	-	-	Down 9% since early '10 with tsunami & subsidy expiry both weighing.
	Oct domestic CGPI %mth	-0.1%	-	-	Yen strength and commodity weakness to manifest soon.
<b>UK</b>	Oct core PPI %yr	3.8%	-	-	Core output prices.
<b>US</b>	Nov UoM consumer sentiment prelim	60.9	61.0	58.5	Latest equity jitters to hit sentiment.
	Fedspeak	-	-	-	Evans, Williams.

## New Zealand Economic and Financial Forecasts

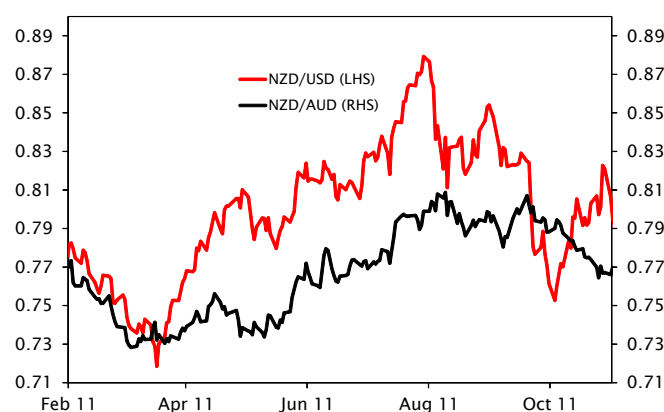
Economic Growth Forecasts	March years				Calendar years			
	2010	2011e	2012f	2013f	2010	2011f	2012f	2013f
% change								
GDP (Production) ann avg	-0.7	1.6	2.3	3.8	1.6	2.0	3.7	3.0
Employment	-0.1	1.8	1.3	2.9	1.3	1.9	3.0	2.1
Unemployment Rate % s.a.	6.1	6.5	6.3	5.3	6.7	6.5	5.5	4.8
CPI	2.0	4.5	2.4	2.6	4.0	2.7	2.3	2.8
Current Account Balance % of GDP	-1.9	-3.6	-4.6	-6.3	-3.5	-4.0	-6.1	-5.5

Financial Forecasts	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Cash	2.50	2.50	2.75	3.00	3.25	3.50
90 Day bill	2.80	2.80	3.00	3.30	3.60	3.80
2 Year Swap	3.30	3.50	3.80	4.10	4.40	4.60
5 Year Swap	4.00	4.30	4.50	4.70	4.90	5.10
10 Year Bond	4.50	4.50	4.60	4.70	4.80	4.90
NZD/USD	0.76	0.73	0.71	0.75	0.78	0.80
NZD/AUD	0.77	0.76	0.76	0.77	0.77	0.78
NZD/JPY	58.5	55.5	54.0	58.5	63.2	67.2
NZD/EUR	0.58	0.58	0.59	0.61	0.61	0.63
NZD/GBP	0.50	0.49	0.49	0.50	0.49	0.49
TWI	68.0	66.6	66.2	69.0	70.6	72.4

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



## NZ interest rates as at market open on Monday 7 November 2011

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.77%	2.69%	2.68%
60 Days	2.82%	2.74%	2.69%
90 Days	2.81%	2.74%	2.71%
2 Year Swap	3.09%	3.20%	3.95%
5 Year Swap	3.78%	4.02%	3.88%

## NZ foreign currency mid-rates as at Monday 7 November 2011

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7675	0.8069	0.7949
NZD/EUR	0.5747	0.5792	0.5772
NZD/GBP	0.4935	0.5046	0.4963
NZD/JPY	58.895	61.371	62.156
NZD/AUD	0.7886	0.7700	0.7663
TWI	68.620	69.940	69.450

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2007	2008	2009	2010	2011f	2012f
<b>Australia</b>						
Real GDP % yr	4.6	2.6	1.4	2.7	1.2	2.8
CPI inflation % annual	3.0	3.7	2.1	2.7	3.5	3.3
Unemployment %	4.4	4.3	5.6	5.2	5.1	5.5
Current Account % GDP	-6.3	-4.5	-4.2	-2.7	-2.0	-3.5
<b>United States</b>						
Real GDP %yr	1.9	-0.3	-3.5	3.0	1.8	1.0
Consumer Prices %yr	2.9	3.8	-0.3	1.6	3.2	2.0
Unemployment Rate %	5.8	5.8	9.3	9.6	9.1	9.3
Current Account %GDP	-5.3	-4.7	-2.7	-3.2	-3.3	-3.0
<b>Japan</b>						
Real GDP %yr	2.2	-1.5	-6.6	4.3	-0.4	3.2
Consumer Prices %yr	0.1	1.4	-1.3	-0.7	0.2	0.6
Unemployment Rate %	3.9	4.0	5.1	5.1	4.6	4.5
Current Account %GDP	4.8	3.3	2.8	3.6	2.0	2.1
<b>Euroland</b>						
Real GDP %yr	2.8	0.3	-4.0	1.7	1.6	-0.6
Consumer Prices %yr	2.1	3.3	0.3	1.7	2.5	1.0
Unemployment Rate %	7.5	7.5	9.5	10.0	10.3	11.0
Current Account %GDP	0.2	-0.8	-0.7	-0.5	-0.5	0.0
<b>United Kingdom</b>						
Real GDP %yr	2.7	-0.1	-4.9	1.4	0.9	0.4
Consumer Prices %yr	2.3	3.6	2.2	3.2	4.0	2.2
Unemployment Rate %	5.3	5.6	7.6	7.8	8.3	9.0
Current Account %GDP	-2.6	-1.6	-1.3	-2.4	-2.0	-1.5

Forecasts finalised 7 November 2011

Interest Rate Forecasts	Latest (Nov 7)	Dec-11	Mar-12	Jun-12	Sep 12	Dec 12
<b>Australia</b>						
Cash	4.50	4.50	4.25	4.00	3.75	3.75
90 Day Bill	4.63	4.50	4.25	4.00	3.75	3.80
10 Year Bond	4.22	4.30	4.30	4.40	4.50	4.70
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	2.07	2.10	2.20	2.40	2.50	2.60
ECB Repo Rate	1.25	1.00	0.75	0.75	0.75	0.75

Exchange Rate Forecasts	Latest (Nov 7)	Dec-11	Mar-12	Jun-12	Sep 12	Dec 12
AUD/USD	1.0217	0.95	0.93	0.91	0.96	0.98
USD/JPY	76.789	76	76	76	78	81
EUR/USD	1.3777	1.30	1.26	1.22	1.27	1.28
AUD/NZD	1.2893	1.30	1.31	1.32	1.30	1.27

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