

# Weekly Commentary

17 October 2011

## Clear as mud

The economic indicators for September are rolling in, and there's a sense that the first half of the Rugby World Cup (RWC) was as much of a hindrance as a help. It may be that some activity has been displaced to other times of the year, rather than cancelled outright. But at a time when the global economy is slowing and we're on alert for signs that the NZ economy is vulnerable, the unknown impact of the tournament is greatly complicating matters. Meanwhile, the recovery in Christchurch appears to be moving ahead, though at a cost to the taxpayer that has yet to be fully pinned down.

Electronic card transactions rose 0.2% in September, a modest pickup after a 0.5% drop in August. While the official series doesn't provide a domestic/foreign breakdown, the Paymark figures from the previous week showed that spending on overseas-issued cards rose sharply, in line with the 50,000 or so additional visitors over the month. But that suggests that spending by locals was soft over the month. The strongest gains were in hospitality, apparel and fuel, which are arguably more tourism-oriented; in contrast, there was only a small gain in consumables (which is mostly supermarkets), and a drop in non-retail spending, which includes items like domestic travel.

Two monthly BNZ surveys – business confidence and manufacturing activity – showed sizeable drops on their latest readings. Both surveys collect a great deal of anecdotal feedback, and among those who mentioned the RWC the balance of comments was clearly towards a negative impact. We doubt that's the only thing behind the decline in confidence, but there were no other factors that consistently emerged – few respondents cited the recent turmoil in global markets.

On a more positive note, the accommodation survey showed a surge in guest nights by domestic travellers – in August. It's likely that many people shifted their holiday or business travel plans forward into August, in order to avoid the crowds and higher prices during the RWC (whether actual or just perceived).

Finally, house sales fell 3% (seasonally adjusted) in September. The biggest falls were in the main North Island centres, with Auckland down 6%, Waikato down 9% and Wellington down 10% – arguably, the regions with the greatest RWC hosting duties. Even so, this was the third straight monthly drop in nationwide home sales, indicating that the market is cooling now after a strong start to the year.

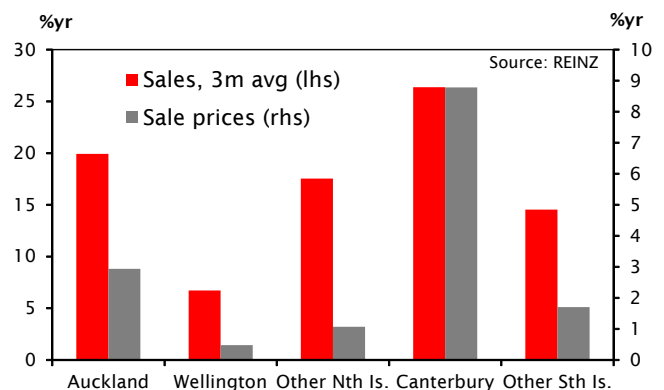
The nationwide figures mask a high degree of regional variation in housing markets. The Auckland market led the rest of the country on the way up, with sales starting to climb in late 2010 and prices picking

up since around March this year. However, Auckland has also seen the most noticeable cooling in sales in the last few months, which is likely to start taking some pressure off prices into next year. Most other regions have seen sales gradually rise this year, and prices appear to have arrested their declines in the last few months, as the supply of houses on the market has tightened up.

The exception, for obvious reasons, has been Canterbury. Sales bottomed out in March, following the devastating February earthquake, but have been rising sharply since then (though briefly interrupted by the 13 June aftershocks) as people have snapped up the houses available in the less quake-affected regions. Prices have also been driven higher, as you would expect when the supply contracts so dramatically – sale prices in September were up 8.8% on a year ago, and topped their 2007 peaks.

We get the sense that the ball has started rolling on Christchurch's recovery since late July, when the Government announced which areas could be rebuilt and which will be abandoned. There's no doubt that the recovery is going to take a great amount of effort over the course of the next several years. But the things that can be done quickly, are now being done – house sales are picking up, building consents surged in August, and job advertisements have picked up for professions outside of construction and engineering (which have remained high since the February quake). The BNZ business confidence survey in September highlighted a great deal of concern in the construction sector about delays to rebuilding; those concerns were absent in the October survey.

### September house sales and prices vs year ago



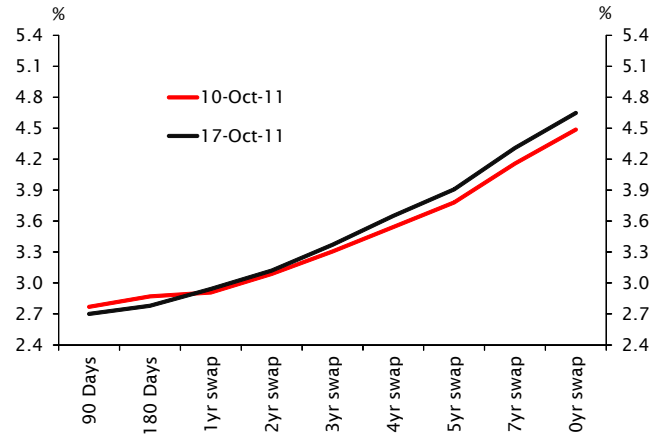
The Government's share of quake costs made up a substantial part of its \$18.4bn operating deficit in the June 2011 fiscal year. The deficit was \$1.7bn wider than projected in the May Budget, largely due to an increase in EQC's liability (net of reinsurance) to \$7.5bn, compared to \$3.1bn in the May Budget (and the \$7.1bn indicated in late August). That was partly offset by lower than anticipated spending on the likes of infrastructure, due to delays in assessments. That spending will fall into the 2012 fiscal year, adding to a deficit that was already projected to be \$9.7bn in May.

Quake-related costs will be largely concentrated in those two fiscal years, and in themselves don't represent an ongoing drag on the fiscal balance. But the additional borrowing required will add to interest servicing costs for years to come. That means at least one of three things could change in the Pre-Election Fiscal Update, to be published on 25 October. The first is that the projected return to surplus could be pushed out beyond the 2014/15 fiscal year - though the Government has already reaffirmed its commitment to that target. The second is that revenue will need to be higher than forecast. But there are no current plans to increase revenue, other than an increase in EQC levies that will bring in less than \$200m a year; and given the recent deterioration in the global environment, it's unlikely that Treasury will be revising up its economic forecasts. That leaves the third option of even tighter limits on spending growth than was projected in the Budget.

**Fixed vs. floating:** In its recent *Monetary Policy Statement*, the Reserve Bank confirmed it is in no hurry to raise rates while conditions in financial markets and the Eurozone remain this volatile. It also noted that if current conditions in bank funding markets persist, banks will

face higher funding costs, which in turn, raises the possibility of higher mortgage rates in the future, independent of changes in the OCR. The recent ratings downgrades are likely to have reinforced that view, and floating rate borrowers may prefer to take a wait and see approach in this environment. Yet the trend of rising rates over the longer term remains intact. Based on our current forecasts of the OCR rising to 6% over the next three years, fixing for two or three years is likely to result in a lower overall interest bill than remaining on floating.

**NZ interest rates**



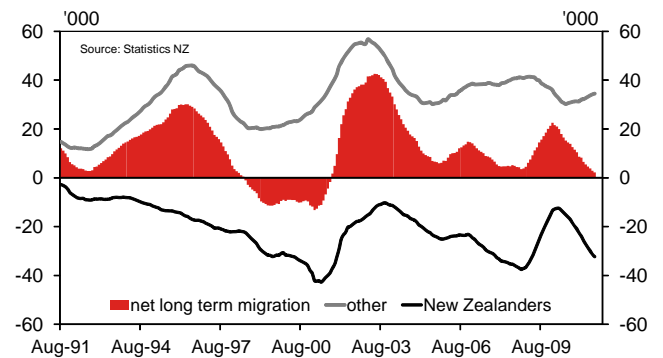
**Key Data Previews**

**NZ Sep net immigration (s.a.)**

Oct 18, Last: 200, WBC f/c: 60

- Net migration turned unexpectedly positive in August, for the first time in 6 months. The surprise was on the arrivals side of the ledger - departures to Australia continued to be well above average.
- We're wary of reading too much into one month's worth of arrivals and expect the trend of strong departures to continue into September.
- But unemployment across the Tasman is rising as the ex-mining parts of the economy batten down the hatches. This will make Australia a steadily less attractive destination and we expect departures to slow considerably over the next year.

**Net Migration**

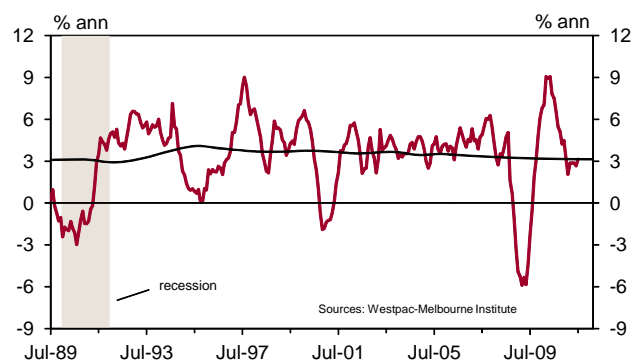


## Aus Aug Westpac-MI Leading Index

Oct 19, Last: 3.1% annualised

- The annualised growth rate of the *Westpac-Melbourne Institute Leading Index* was 3.1% in July directly in line with its long term trend. The index growth rate slowed abruptly between May and Feb but has stabilised since then. Disruptions from severe weather events in early 2011 have thrown the leading index around through the first half of the year but are now dropping out of the picture.
- The Aug update will include new monthly figures on: dwelling approvals which jumped sharply (+11.4% though mainly on what appears to be a one-off spike in apartment approvals); the ASX, which continued its slide albeit at a milder pace (-2.9% in Aug vs -3.4% in Jul - the market fall accelerated in Sep with a 6.9% plunge); money supply (+0.2% vs +0.7% in Jul); and US industrial production (+0.2% vs +0.9% in Jul).

## Westpac-MI Leading Index



## Aus Q3 trade price indexes

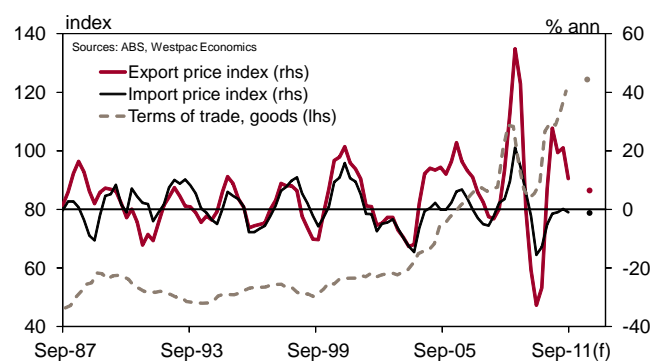
Oct 21,

Exports: Last: 6.0%, WBC f/c: 3.8%, Mkt f/c: 3.6%

Imports: Last: 0.8%, WBC f/c: 0.5%, Mkt f/c: 0.5%

- Australia's terms of trade climbed higher in the September quarter. This was ahead of a likely moderation in the December quarter, in response to slowing global demand.
- The export price index is forecast to rise by around 3.8% in Q3. Commodity prices were up (+3.8% in USD terms), on strong demand from Asia.
- The import price index is forecast to be little changed, +0.5%. Oil prices reversed, -13%, acting to reduce import costs.
- The AUD weakened (-2% vs the TWI and -1% against the USD), increasing the cost of imports and reducing export values.

## International trade prices



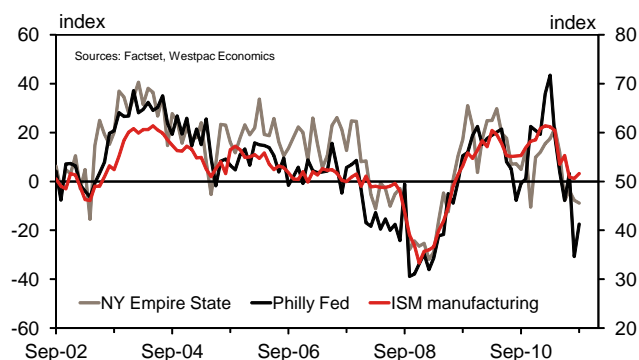
## US Oct NY and Philly Fed surveys

Oct 17, New York Fed: Last: -8.8, WBC f/c: -5.0

Oct 20, Philadelphia Fed: Last: -17.5, WBC f/c: -10.0

- Five months ago we wrote ahead of the May NY/Philly Fed: "We are concerned about the 2011 economic outlook and these surveys should be among the first to sustain a move lower in coming months, if our concerns are justified."
- The NY Fed fell from 21.7 in April to -7.8 in June, and has been little changed since. Over roughly the same period the Philly Fed dropped from 43.4 to -30.7, before recovering to -17.5 in Sep.
- There was certainly some overshoot in these surveys which cover just a hundred of so businessmen each and whose headlines are questions about business conditions, not composites of activity detail which has generally not been so negative. So with the dust settling, we expect higher but still sub-zero readings for both these surveys.

## US manufacturing surveys



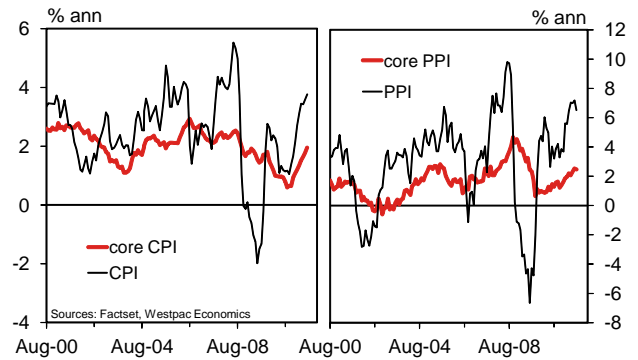
### US Sep PPI/CPI

Oct 18, PPI head/core: Last: 0.0%/0.1%, WBC f/c: 0.2%/0.1%

Oct 19, CPI head/core: Last: 0.4%/0.2%, WBC f/c: 0.3%/0.2%

- The headline PPI was flat in Aug; the core rate increased by just 0.1%. A 1% fall in fuel costs was offset by a large rise in tyre prices and smaller increases in finished foods and communications equipment. The Sep PPI should be constrained by lower food and fuel prices, but as ever the core rate will be susceptible to any volatility in vehicle prices.
- The CPI rose 0.4% in Aug thanks to a further 1.2% rise in energy, a 0.5% rise in food, a 1.1% gain in apparel and another solid 0.2% rise in the heavily-weighted rent component. The core CPI rose 0.244%, leaving the annual core rate at 2.0%yr, near its three-year high. Food price pressures and some issues with the seasonal adjustment of fuel will likely see the headline measure print at +0.3% in Sep, but we expect the core measure to remain subdued at +0.2%.

### US price inflation



### US Sep housing starts/permits/existing sales

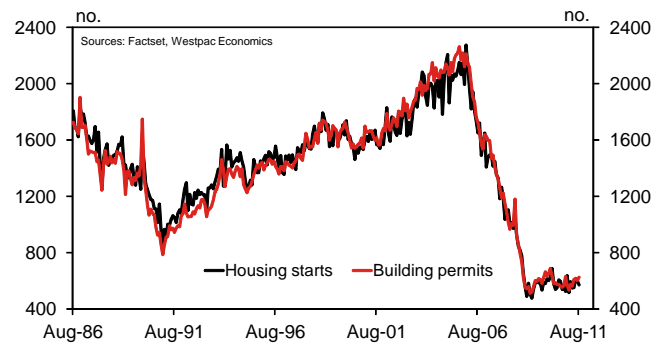
Oct 19, Starts: Last: -5.0%, WBC f/c: 2.0%

Oct 19, Permits: Last: 3.2%, WBC f/c: 0.0%

Oct 20, Existing home sales: Last: 7.7%, WBC f/c -2.0%

- The underlying house construction story remains bleak, with starts falling in Jul-Aug to be a little below their level when the economic recovery began more than two years ago, although a recent rise in permits suggests further declines are less likely in the short term. It is worse for existing home sales: despite a rise in Aug, sales are still 23% below the level reached in late 2009 during the early stages of economic recovery when the tax credit for homebuyers was in place. Pending sales of existing homes fell in Jul-Aug.
- Homebuilder sentiment is struggling, prices are still falling, more sales contracts are being cancelled before completion. We do not expect these Sep housing indicators to materially alter the depressed housing picture.

### US housing starts & permits



## Key Data and Events

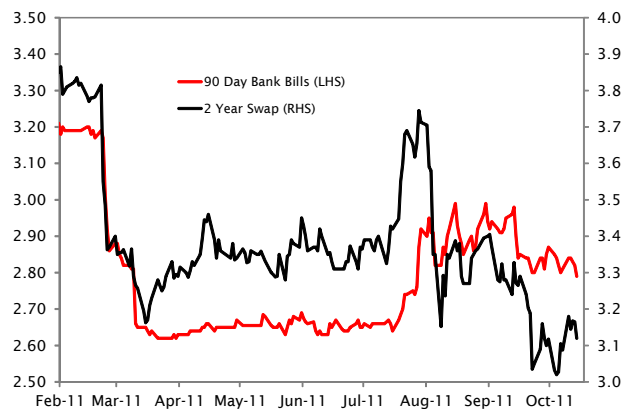
		Market Last	Westpac median forecast	Risk/Comment
<b>Mon 17</b>				
<b>Aus</b>	Sep new motor vehicle sales	3.3%	-	- Rebounded sharply following supply disruption, to be 1% above March.
<b>Jpn</b>	Aug capacity utilisation %mth	0.6%	-	- On an upswing as supply side of economy returns to normal.
<b>UK</b>	Oct house prices %yr	1.5%	-	- Rightmove index.
	Sep consumer confidence	48	-	49 Tentative date (17-21/10) for Nationwide index.
<b>US</b>	Oct NY Fed Empire factory index	-8.8	-4.0	-5.0 Still negative but correcting for downside overshoot in the summer.
	Sep industrial production	0.2%	0.2%	0.0% Hours worked down 0.4% in factories.
<b>Can</b>	Q3 business outlook survey	20	-	- Future sales index.
	Q3 senior loan officer survey	-49.6	-	- BoC survey of credit availability.
<b>Tue 18</b>				
<b>Aus</b>	Oct Minutes of RBA Board meeting	-	-	- Further clues on likelihood & timing of a rate cut.
<b>Chn</b>	Q3 real GDP %yr	9.5%	-	9.4% Soft Q3 a year ago keeps yoy rate high even as momentum stumbles.
	Sep industrial production %yr	13.5%	-	- PMIs and a number of other proxies indicate deceleration is likely.
	Sep fixed assets investment %ytd	25.0%	-	- Two distinct trajectories: infrastructure down, housing & manuf up.
	Sep retail sales %yr	17.0%	-	- Volumes mundane, with autos and appliances in post-subsidy lulls.
<b>Ger</b>	Oct ZEW analysts' survey	-43.3	-44.5	-45.5 Sentix suggests further slippage.
<b>UK</b>	Sep CPI %yr	4.5%	4.9%	4.8% Utility bill impact to lift CPI but downside risks abound in 2012.
<b>US</b>	Sep PPI	0.0%	0.2%	-0.2% Energy and food prices down in Sep.
	Sep PPI core	0.1%	0.1%	0.1% Core pressures muted by watch for vehicle price noise.
	Aug TIC data \$bn	9.5	-	- Net long term TIC flows.
	Oct NAHB housing market index	14	15	14 Still in the doldrums.
	Fed Chairman Bernanke	-	-	- "The effects of the Great Recession on central bank doctrine & practice".
	Fedspeak	-	-	- Lacker, Lockhart, Rosengren, Evans.
<b>Wed 19</b>				
<b>Aus</b>	Aug Westpac-MI Leading Index	3.1%	-	- Index for July in line with long term trend. Components mixed in Aug.
	RBA Assist Gov. (Financial Markets)	-	-	- Guy Debelle, speech to Finance & Treasury Assoc., Sydney, 8:45am.
<b>Jpn</b>	Aug all industry activity index %mth	0.4%	-	- New information on public sector and construction.
<b>Eur</b>	Aug current account €bn sa	-12.9	-	- Jul saw widest deficit since early 2009.
<b>UK</b>	Oct BoE minutes	-	-	- Was the decision to restart asset purchases unanimous.
<b>US</b>	Sep CPI	0.4%	0.3%	0.2% Food price pressure in the pipeline and seasonality issues re gasoline
	Sep core CPI	0.2%	0.2%	0.2% prices to lift the headline CPI but core should hold to 0.2% again.
	Sep housing starts	-5.0%	3.9%	2.0% Housing market still struggling with activity on most indicators now
	Sep housing permits	3.2%	-2.4%	0.0% below what it was when the eco recovery started 2 years ago.
	Fed beige book	-	-	- Regional economic analysis prepared ahead of Nov 2 FOMC.
	Fedspeak	-	-	- Lockhart, Rosengren.
<b>Can</b>	Sep leading index	0.0%	-	- Essentially stalled since late Q2.
<b>Thu 20</b>				
<b>Aus</b>	RBA Assist Gov (Financial Systems)	-	-	- Malcolm Edey, speech to ISDA, Sydney, 9:30am
	RBA Deputy Gov. Ric Battellino	-	-	- Australian & New Zealand Investment Conference, Sydney, 10:00am
<b>Eur</b>	Oct consumer confidence adv	-19.1	-20.0	-19.0 Consumer pessimism to stabilise.
<b>Ger</b>	Sep producer prices %yr	5.5%	5.5%	- Annual pace of gain drifting lower.
<b>UK</b>	Sep retail sales	-0.2%	-0.1%	-0.2% Constrained by weak incomes growth, fiscal austerity, pessimism.
<b>US</b>	Initial jobless claims w/e 14/10	404k	-	410k Settling back in low 400s.
	Sep leading index	0.3%	0.2%	0.3% Not indicative of imminent recession.
	Oct Philly Fed survey	-17.5	-9.0	-10 Still negative but correcting for downside overshoot in the summer.
	Sep existing home sales	7.7%	-2.5%	-2.0% Pending sales suggest declines in contracts closed in coming months.
	Fedspeak	-	-	- Bullard, Lockhart, Pianalto.
<b>Can</b>	Aug wholesale sales	0.8%	0.4%	- Autos, household goods and machinery drove the July rise.
<b>Fri 21</b>				
<b>NZ</b>	Sep net migration	200	-	60 Departures to remain high, for now.
<b>Aus</b>	Q3 export price index	6.0%	3.6%	3.8% Higher commodity prices & lower AUD.
	Q3 import price index	0.8%	0.5%	0.5% Import costs up on lower AUD, partially offset by reversal of crude oil.
<b>Chn</b>	Oct HSBC manufacturing PMI - flash	49.4	-	- Tentative date: below 50 in three previous readings.
	Oct MNI business conditions - flash	-	-	- Improved last time after a multi-month deceleration.
<b>Ger</b>	Oct Ifo business climate index	107.5	106.5	106.0 Business realising that Germany is slipping towards recession.
<b>UK</b>	Sep PSNCR £bn	11.8	-	- Public sector net credit requirement.
<b>US</b>	Fedspeak	-	-	- Kocherlakota.
<b>Can</b>	Sep CPI %yr	3.1%	3.0%	- Core rate was 1.9% yr in Aug.

## New Zealand Economic and Financial Forecasts

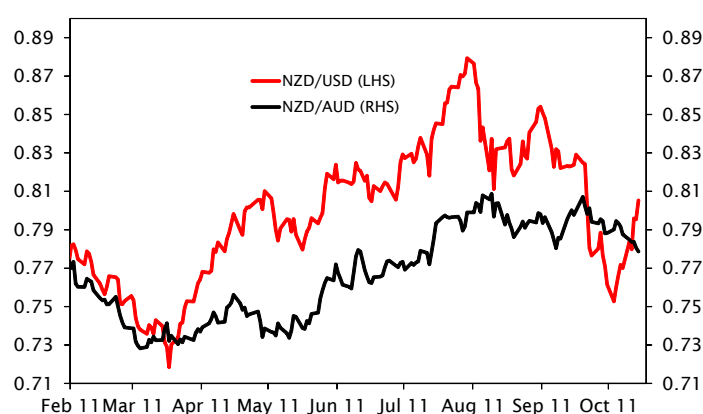
Economic Growth Forecasts	March years				Calendar years			
	2010	2011e	2012f	2013f	2010	2011f	2012f	2013f
% change								
GDP (Production) ann avg	-0.7	1.6	2.3	3.8	1.6	2.0	3.7	3.0
Employment	-0.1	1.8	1.6	3.0	1.3	2.3	3.0	2.0
Unemployment Rate % s.a.	6.1	6.5	6.1	5.0	6.7	6.3	5.1	4.5
CPI	2.0	4.5	2.8	2.7	4.0	3.1	2.4	2.9
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	0.73	0.71	0.69	0.74	0.77	0.78
NZD/AUD	0.77	0.76	0.76	0.77	0.79	0.80
NZD/JPY	55.5	54.0	52.4	57.7	62.4	65.5
NZD/EUR	0.56	0.56	0.57	0.58	0.60	0.61
NZD/GBP	0.48	0.47	0.46	0.48	0.49	0.49
TWI	66.0	65.2	64.2	67.5	70.0	71.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



## NZ interest rates as at market open on Monday 17 October 2011

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.70%	2.75%	2.80%
60 Days	2.78%	2.83%	2.83%
90 Days	2.79%	2.87%	2.85%
2 Year Swap	3.12%	3.12%	3.29%
5 Year Swap	3.91%	3.78%	3.94%

## NZ foreign currency mid-rates as at Monday 17 October 2011

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8034	0.7618	0.8029
NZD/EUR	0.5792	0.5712	0.6010
NZD/GBP	0.5075	0.4898	0.5251
NZD/JPY	61.854	58.712	63.674
NZD/AUD	0.7774	0.7880	0.8003
TWI	70.150	68.230	72.500

## 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	2.5
CPI inflation % annual	3.0	3.7	2.1	2.7	3.6	3.1
Unemployment %	4.4	4.3	5.6	5.2	5.1	5.6
Current Account % GDP	-6.3	-4.5	-4.2	-2.7	-2.2	-3.4
<b>United States</b>						
Real GDP %yr	1.9	-0.3	-3.5	3.0	1.6	1.3
Consumer Prices %yr	2.9	3.8	-0.3	1.6	3.1	2.0
Unemployment Rate %	5.8	5.8	9.3	9.6	9.1	9.4
Current Account %GDP	-5.3	-4.7	-2.7	-3.2	-3.4	-3.1
<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	0.8	0.3
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	8.0	8.2
Current Account %GDP	-2.6	-1.6	-1.3	-2.4	-2.0	-1.5

Forecasts finalised 10 October 2011

Interest Rate Forecasts	Latest (Oct 17)	Dec-11	Mar-12	Jun-12	Sep 12	Dec 12
<b>Australia</b>						
Cash	4.75	4.50	4.25	4.00	3.75	3.75
90 Day Bill	4.75	4.50	4.25	4.00	3.75	3.80
10 Year Bond	4.43	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	2.18	2.10	2.20	2.40	2.50	2.60
ECB Repo Rate	1.50	1.00	0.75	0.75	0.75	0.75

Exchange Rate Forecasts	Latest (Oct 17)	Dec-11	Mar-12	Jun-12	Sep 12	Dec 12
AUD/USD	1.0334	0.95	0.93	0.91	0.96	0.98
USD/JPY	76.99	76	76	76	78	81
EUR/USD	1.3871	1.30	1.26	1.22	1.27	1.28
AUD/NZD	1.2863	1.30	1.31	1.32	1.30	1.27

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