

Weekly Commentary

21 November 2011

The world came to play

The most important release last week was the September quarter retail trade numbers, where the much anticipated spending boost from the Rugby World Cup was at last glaringly apparent. Yet despite this good news early in the week, NZ interest rates have fallen sharply in recent days on the back of developments in international markets.

The world came to play in New Zealand during September and October as the country hosted the Rugby World Cup – and we finally have the data to show they managed to fit a bit of spending in too. Retail sales volumes rose a hefty 2.2% in the September quarter. This was a much stronger result than we or the market expected after other spending indicators (such as electronic card transactions data) had suggested tournament spending was low. The absence of such strong growth in retail spending in electronic cards data suggests an abnormally large portion of the spend was in cash rather than on cards (which is broadly consistent with international tourist spending patterns). The biggest contribution to the quarterly growth in the retail trade survey was from food and beverage spending. Sales at supermarket and grocery stores, specialised food retailers and liquor outlets were all up strongly.

The underlying details of the survey suggests a more subdued lift in domestic spending. Durable goods for example showed a mixed picture. Department store sales were flat and furniture sales fell (although volatile from quarter to quarter, this category has been trending south for a number of quarters). However, there was further growth in spending on electronic goods.

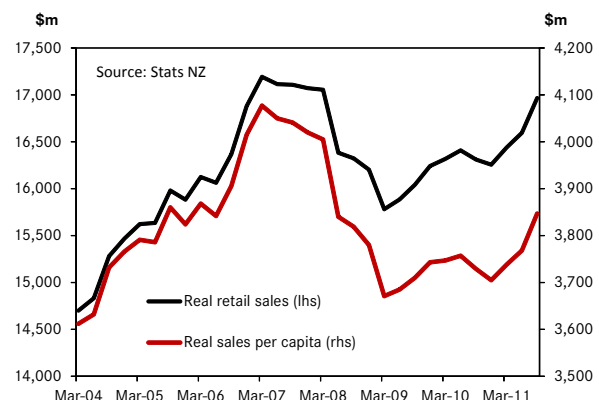
The regional split showed Canterbury retailers continuing to edge their way back to normality. Two major shopping malls reopened in the quarter, helping to drive the 3.8% quarterly growth in retail trade in the region (the strongest gain in any of the regions). We're obviously keeping a close eye on developments in the region as it rebuilds following the devastating earthquakes. And it is clear that activity is taking place. Fletchers reported that 21,000 full scope repairs are either completed or in progress at the moment – that's on top of around 40,000 emergency and heating repairs already completed during the year. And this activity is leading to increased demand for labour. The Department of Labour's Jobs Online report showed that (online) advertised vacancies in the Canterbury region were 46.7% higher than a year ago in October.

As we look ahead over the next few years, the mammoth reconstruction task in Canterbury will become a key driver of economic growth. In turn, this will generate significant pressure on resources, driving costs higher – particularly in the construction sector. Consequently, we've been on the lookout for signs of how the pressures on construction costs are evolving. We observed sharp gains in the first half of this year, but this week's PPI data for September showed some moderation in pace. Construction output prices rose 0.7% in Q3, following a 1.6% increase in Q2; annual inflation ticked up from 3.0% to 3.2%.

The positive tone to domestic data last week did nothing to stand in the way of offshore developments which catapulted NZ interest rates sharply lower. The NZ 2-year swap rate fell to a new all-time low of 2.69% and the OIS market has moved to price in the possibility of interest rate cuts. Markets are now pricing around an 900% chance of a 25bp cut in the OCR by March.

The catalyst for the renewed pessimism in financial markets was a further deterioration in the European sovereign debt crisis. With key politicians now openly contemplating the possibility of some countries exiting the Euro, markets have started to speculate about which countries may be headed for the door. Greece is clearly the prime contender, but speculation is growing that it may not stop there. The risk is that should the Euro disintegrate, it will then be harder for a number of debt laden European sovereigns to

Real retail sales



convince investors of their ability to repay their debt. This has seen interest rates on sovereign debt for almost all European countries spike higher (with the exception of Germany). Conversely, outside Europe interest rates have fallen sharply as markets contemplate the possibility of a much bigger hit to global growth prospects.

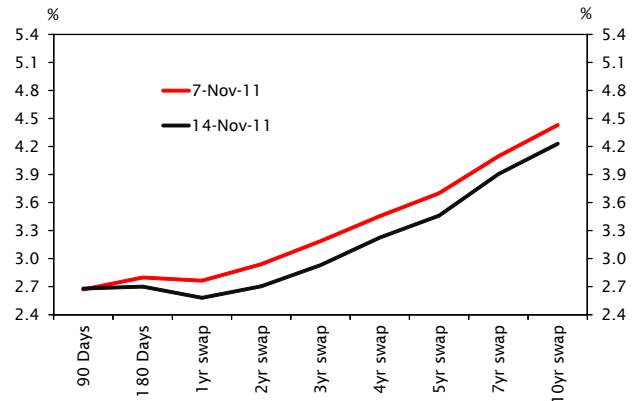
While we agree the outlook for Europe has certainly taken a turn for the worse, as the situation currently stands (and unlike markets), we don't see the growing risks as a big enough catalyst for the RBNZ to be seriously contemplating interest rate cuts in the near term. Remember, at 2.5% the OCR is already at a record low. This is as low as it was during the height of the 2008/09 Global Financial Crisis when the outlook for both the economy and inflation was much more negative than it is now. We'd seen the collapse of huge financial institutions, commodity prices nosedive and growth plummet worldwide. And, perhaps most importantly, there was certainly not \$20bn of reconstruction activity in the offing. We're still pencilling in rate hikes to begin in June next year, although we do acknowledge the growing risk that a further deterioration in Europe could delay this start date.

This week's calendar is looking a touch more lively on the domestic front with credit card spending, net migration, merchandise trade and inflation expectations data all due out. While the RBNZ's survey of 2-year ahead inflation expectations will be worth a look, with headline inflation set to fall sharply and other measures of inflation pressures subdued, it won't have the same prominence it may have had 6 months ago. On the other hand, we'll be following the migration data very closely over the coming months. Our medium-

term economic forecasts are underpinned by an expected pick up in net migration next year as fewer Kiwis move across the Tasman as relative job prospects in Australia deteriorate.

Fixed versus floating: Fixed mortgage rates are currently good value given where we think floating rates are heading. But there is little need to leap in just yet as fixed rates could remain at these levels for a while, or even head lower. Those with interest rates linked directly to the swap curve may find swaps with duration 1 year or longer attractive at these levels.

NZ interest rates



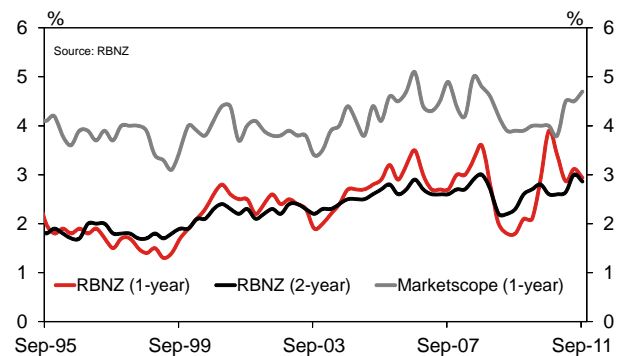
Key Data Previews

RBNZ 2-yr inflation expectations survey

Nov 22, Last: 2.9%

- Inflation expectations have been uncomfortably high for the past two quarters. The RBNZ argues this is a temporary blip associated with high headline inflation, following the GST hike last October. By contrast, we believe that elevated inflation expectations reflect concerns about the inflation impact of the Christchurch reconstruction effort. The test of who is right will have to wait until early 2012, when the GST drops out of the annual inflation headline.
- For this quarter, we expect expectations to dip slightly from last quarter's 2.9%. Surveys of pricing intentions have been fairly friendly, the most recent inflation data was surprisingly soft, and the slowing global economy portends lower inflation.

NZ inflation expectation

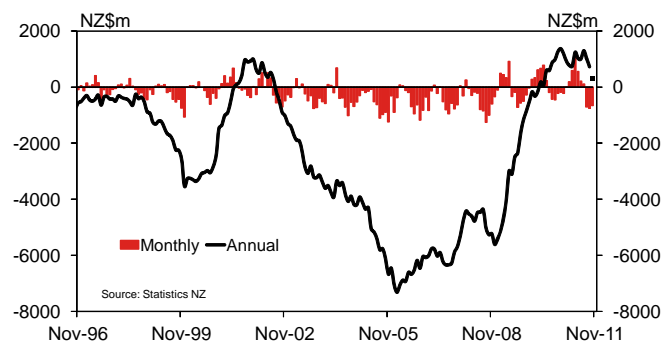


NZ merchandise trade balance

Nov 24, Last: -751, WBC f/c: -650

- We expect another sizable monthly trade deficit in October of \$650m.
- Export volumes should begin to trek higher at this time of year as dairy production moves into top gear. Meanwhile imports, which were surprisingly strong last month, are also expected to climb in the lead-up to Christmas.
- The annual trade balance has deteriorated quite sharply in recent months after a period of being supported by exceptionally high commodity prices. On our forecasts, the annual trade surplus is expected to fall to a touch under \$300m in October.

NZ merchandise trade balance

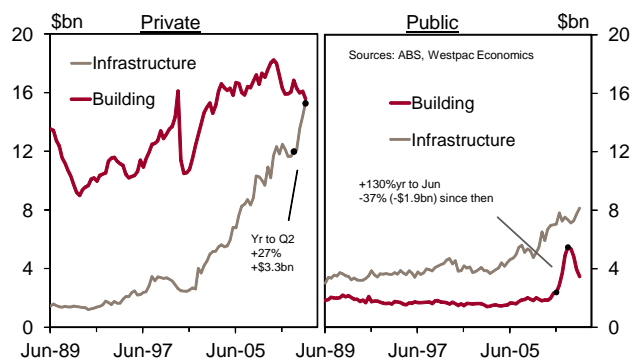


Aus Q3 construction work done

Nov 23, Last: 0.7%, WBC f/c: 1.0% Mkt f/c: 2.0%, Range: 0.5% to 4.0%

- Construction work is forecast to rise in Q3 by 1.0%qtr, 5.0%yr.
- Activity in Qld will be supported by post flood rebuilding. Work jumped 14.9% in Q2 following a weak Q1.
- Nationally, a rotation of activity is evident.
- Engineering construction work (public as well as private) is in an upswing. We expect another strong quarter, up around 5%qtr, 27%yr.
- In contrast, the Federal Government’s school building program is winding down. Also, private building activity remains patchy, with new residential activity likely to weaken in Q3. We expect total building work to weaken in Q3, down -3.5%qtr, -15%yr.

Construction work: divergent trends

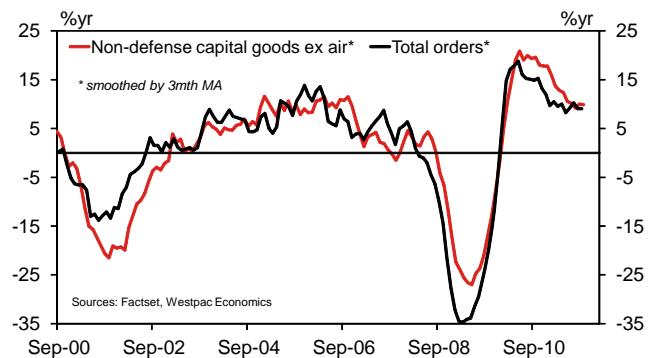


US durable goods orders to be held back by aircraft

Nov 23, Last: -0.6%, WBC f/c: -1.5%

- DGOs fell 0.8% in Sep. Transport orders explained most of the decline, with autos down a further 2.7% (despite increased sales) and aircraft reversing their Aug rise with a 26% drop (consistent with the Boeing data). Ex transport, orders rose 1.7%. Core capital goods orders were up 2.4% (they always rise in the last month of the qtr, but that compares to 0.8% in June).
- ISM factory new orders recovered to a six-month high in Oct after 3 months of contraction, but Boeing saw just 5 new jet orders last month (vs 61 in Sep; the seasonal factors may mute that loss) and core orders tend to fall in the first month of the quarter. Auto orders should recover given sales have picked up in recent months. Put together, these clues suggest a flat orders picture outside of aircraft whose decline may be enough to deliver a significantly negative headline.

US durable goods orders

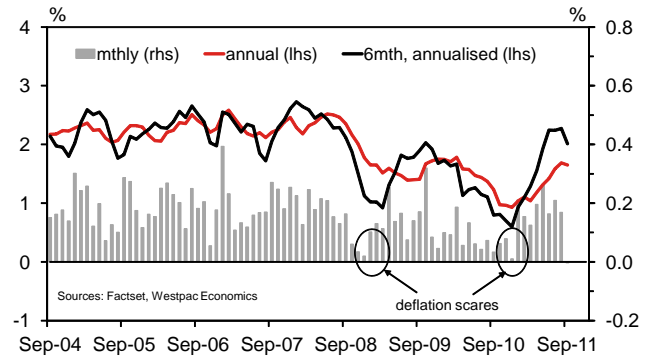


US core PCE deflator to rise 0.1% in Oct

Nov 23, Last: 0.0%, WBC f/c: 0.1%

- The core PCE deflator was flat in Sep. The report also showed a subdued 0.1% rise in personal income – wages and salaries growth of 0.3% was partially offset by flat government transfers and falling interest income. However, personal spending rose 0.6% with spending on durables like autos up 2.2%, although services spending growth was soft at 0.2%.
- The core CPI rose 0.014% in Oct, which suggests another soft core PCE outcome is likely. A 0.1% rise would hold the annual pace at 1.6–1.7%yr.
- The report should also include gains for personal income (0.2%) and spending (0.4%) in Oct as hours worked and hourly earnings picked up last month while retail sales were reasonably buoyant.

US core PCE deflator



Key Data and Events

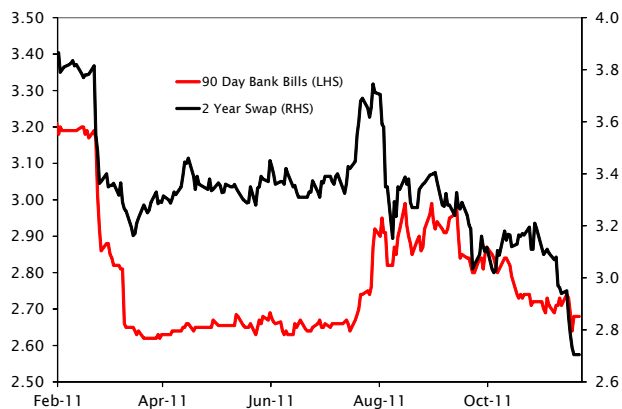
		Market Last	Westpac median	Westpac forecast	Risk/Comment
Mon 21					
Aus	RBA Assistant Governor Debelle	-	-	-	The Present and Possible Future of Secured Issuance, 2:10pm AEDT
Jpn	Oct trade balance ¥bn sa	-22	-185	-	Lower commodity prices & higher Cap U - softer external demand.
	Sep all industry activity index %mth	-0.5%	-0.8	-	Loses potency when released after advance GDP.
Eur	Sep current account €bn	-5.0	-	-	Consistent with 0.8% of GDP current account deficit since 2009.
	Nov consumer confidence adv	-19.9	-	-21.0	Austerity, euro breakdown, bank runs, failed states - big concerns.
US	Oct Chicago Fed national activity index	-0.22	-	-	Based on previously released activity data, not itself a survey.
	Oct existing home sales	-3.0%	-2.2%	-3.0%	Pending home sales down 3 months running, cancelled sales rising.
	Fedspeak	-	-	-	Atlanta Fed's Lockhart in Brazil.
Can	Sep wholesale sales	0.2%	-	-	Aug rise was due to prices, real sales fell.
Tue 22					
NZ	RBNZ 2-yr inflation expectations survey	2.9%	-	-	Could dip after soft inflation data last quarter
	October external migration s.a.	-660	-	-150	Weakening Aus. jobs market should see migration start to improve.
Chn	Nov HSBC manufacturing PMI flash	51.1	-	-	Tentative date. Back in synch with NBS measure in October.
UK	Oct PSNCR £bn	19.9	-	-	Public sector net credit requirement.
US	Q3 GDP 1st revision	2.5% a	2.5%	2.7%	Pos. net export/consumpt'n revision partially offset by lower stocks
	Nov Richmond Fed factory index	-6	-2	0	The regional Fed surveys have tended to improve lately.
	Nov 1-2 FOMC meeting minutes	-	-	-	Bernanke Q & A hinted at further QE involving MBS; more on that?
	Fedspeak	-	-	-	Minneapolis Fed's Kocherlakota in Canada.
Can	Sep retail sales	0.5%	0.5%	-	Aug sales partly boosted by autos, though ex auto up 0.4%.
Wed 23					
Aus	Q3 construction work done	0.7%	2.0%	1.0%	Upswing in infrastructure but building activity patchy.
	RBA Assistant Governor Debelle	-	-	-	APRA Basel III Implementation Workshop 2011, 10:20am AEDT
Eur	Nov PMI factory adv	47.1	46.5	46.0	Little achieved in Brussels, Cannes; ECB rate cut may help a bit.
	Nov PMI services adv	46.4	46.0	44.8	At levels associated with last recession - how deep this time?
	Sep industrial orders	2.0%	-	-3.0%	German orders plunged 4.3% in Sep.
UK	Nov BoE minutes	-	-	-	Somewhat superceded by the quarterly inflation report on 16/11.
	Oct mortgages	33.1k	-	-	BBA data, number of new loans fell back sharply in Sep.
US	Oct durable goods orders	-0.6%	-1.0%	-1.5%	Boeing data very weak. But ISM orders recovered in Oct.
	Oct personal income	0.1%	0.3%	0.2%	Small increase in hours worked, hourly earnings also higher.
	Oct personal spending	0.6%	0.3%	0.4%	Weaker than retail sales growth due to services spending pull-back.
	Oct core PCE deflator	0.0%	0.1%	0.1%	Core CPI up 0.014% in Oct.
	Initial jobless claims w/e 18/11	388k	385k	400k	Is a trend improvement really taking place?
	Nov Uni of Mich consumer sentim't final	64.2 a	64.5	63.5	Forecast assumes equities bias to the downside.
	Nov Kansas City Fed factory index	8	9	-	The only one of five Fed regional surveys that held above 0 this year.
	JSC on Deficit Reduction	-	-	-	\$1.2trn in spending cuts to be agreed otherwise it's "sequestration".
Thu 24					
NZ	Oct trade balance	-751m	-	-650m	Chunky trade deficit expected in Oct
Aus	RBA Governor Stevens	-	-	-	ABE Annual Forecasting Conference Dinner, 8:25pm AEDT
Ger	Q3 GDP revision	0.5% a	-	0.5%	More component detail.
	Nov IFO business climate index	106.4	105.5	105.0	Steady pace of decline to continue.
UK	Q3 GDP revision	0.5% a	-	0.4%	Trade and IP data suggest downward revision likely.
	Q3 business investment	11.6%	-	-	Measured on different basis to national accounts capital formation.
	Nov CBI industrial trends	-18	-	-	Total orders index.
	Q2 mortgage equity withdrawal £bn	-5.8	-6.0	-	Tentative date, due 24-30/11.
US	Thanksgiving	-	-	-	Markets closed.
Fri 25					
Jpn	Nov Tokyo CPI %yr	-0.5%	-0.5%	-	Core at -0.4% also. Yen and softer commodity prices drive headline.
	Oct national CPI %yr	0.0%	-0.1%	-	Output gap is large - selective areas of resource pressure possible.
	Oct corporate services prices %yr	-0.1%	-0.1%	-	Deflationary impulse to build in traded services.
Sing	Oct industrial production %yr	12.8%	9.1%	-	Weakness in NODX and soggy PMI bode ill for this release.
Ger	Oct import prices %yr	6.9%	6.9%	-	Recent euro weakness to add upward pressure.

New Zealand Economic and Financial Forecasts

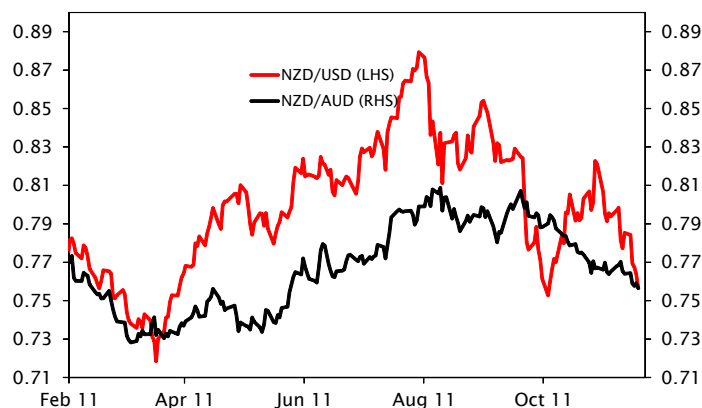
Economic Growth Forecasts	March years				Calendar years			
	2010	2011e	2012f	2013f	2010	2011f	2012f	2013f
% change								
GDP (Production) ann avg	-0.7	1.6	2.3	3.8	1.6	2.0	3.7	3.0
Employment	-0.1	1.8	1.3	2.9	1.3	1.9	3.0	2.1
Unemployment Rate % s.a.	6.1	6.5	6.3	5.3	6.7	6.5	5.5	4.8
CPI	2.0	4.5	2.1	2.6	4.0	2.4	2.3	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	0.76	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 21 November 2011

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.69%	2.68%	2.69%
60 Days	2.66%	2.69%	2.74%
90 Days	2.68%	2.71%	2.74%
2 Year Swap	2.71%	3.95%	3.20%
5 Year Swap	3.84%	3.88%	4.02%

NZ foreign currency mid-rates as at Monday 21 November 2011

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7566	0.7949	0.8069
NZD/EUR	0.5604	0.5772	0.5792
NZD/GBP	0.4791	0.4963	0.5046
NZD/JPY	58.092	62.156	61.371
NZD/AUD	0.7576	0.7663	0.7700
TWI	66.950	69.450	69.940

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2007	2008	2009	2010	2011f	2012f
Australia						
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
United States						
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
Japan						
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
Euroland						
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
United Kingdom						
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 21)	Dec-11	Mar-12	Jun-12	Sep 12	Dec 12
Australia						
Cash	4.50	4.50	4.25	4.00	3.75	3.75
90 Day Bill	4.59	4.50	4.25	4.00	3.75	3.80
10 Year Bond	4.03	4.30	4.30	4.40	4.50	4.70
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.97	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 21)	Dec-11	Mar-12	Jun-12	Sep 12	Dec 12
AUD/USD	.99868	0.99	0.96	0.93	0.97	1.01
USD/JPY	76.784	77	77	76	78	81
EUR/USD	1.3501	1.32	1.26	1.20	1.23	1.27
AUD/NZD	1.3200	1.30	1.32	1.31	1.29	1.29

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