

Weekly Commentary

5 October 2009

NZ confidential-ial

The local data calendar has lately been dominated by confidence surveys, all of which have been notably positive.

The NBNZ business confidence survey rose sharply for the sixth straight month, with general business conditions reaching their highest since April 1999 and own-activity expectations the highest since June 2002. The latter measure is a useful indicator for contemporaneous GDP, and at face value the readings over the September quarter are consistent with growth in excess of 1% – this would be much stronger than our current forecast of 0.4% and a far cry from the RBNZ's pick of 0.1%.

As we've seen in previous months, the details of the survey were less emphatic than the headline measures, more consistent with an economy in the early stages of recovery than one that's roaring ahead. Employment intentions turned net positive (just) for the first time since March last year, but as yet aren't sufficient to absorb the growth in the labour force. Profit expectations rose slightly to a net 7%, while investment intentions were broadly flat at a net 2%.

One important point to recognise – and one that will give the RBNZ a degree of comfort in its current stance – is that expectations of stronger activity are showing no sign of translating into expectations of higher prices. Inflation

expectations and pricing intentions have eased sharply since the second half of 2008, and right now are close to the previous lows seen in 2003, when annual inflation was running below 2% (albeit for some temporary reasons).

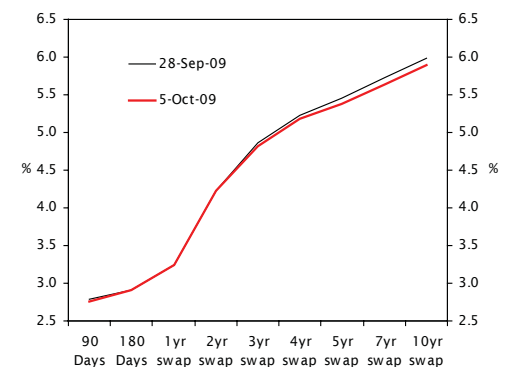
The Westpac employment confidence survey – a companion to the previous week's consumer confidence – rose by 6.9 points to 103 in September, the second biggest quarterly gain in the history of the survey. Current employment conditions are still seen as tough, with fewer respondents saying they are earning more now than a year ago, and more saying that jobs are hard to get. This is in line with our view that the unemployment rate will push higher and wage growth will slow further in coming quarters.

However, workers are far more cheerful about the outlook for next year, with the expectations index rising sharply to 122.1, not far from the record high of 125.1. A net 14% of respondents expected jobs to be more plentiful in a year's time, and a net 34% expected to be earning more. Perceived job security rose to a net 18%, compared to -1% in March, indicating that concerns about mass layoffs are fading. As workers feel more secure, they are more likely to be willing to spend and may even perceive themselves to be in a better position to demand

higher wages (though actually getting them is another matter).

An objection that is sometimes raised against using these surveys – especially the surging headline measures – as an indicator of growth is that they are coming from such a low starting point; after a deep and protracted recession, there may be a sense that things surely can't be any worse in twelve months' time. But this is fine for our purposes, since we are forecasting GDP growth to be coming from a low base as well. Over the five quarters of recession, the level of GDP fell by 2.9%. If we also consider population growth and incremental productivity gains, it's safe to say the level of GDP is some way below potential. That means there are plenty of easy gains to be made on growth over the next couple of years.

NZ Interest Rates



*Yield curve is yields on bank bills to 180 days, fixed interest rate swaps for 1 year onwards.

This aspect of growth from a low base has also given rise to the idea of a 'technical' or 'statistical' recovery, one that is only apparent in the data. Of course, this prompts the question of how else we would be able to observe a recovery. Presumably the alternative to hard data is 'feeling', and it is fair to say that for many people it won't feel like a recovery yet. The level of activity has some way to go to get back to previous levels, and wage growth and job prospects are likely to remain soft for a while.

This week's event calendar is also dominated by a major survey. The NZIER *Quarterly Survey of Business Opinion*

(Tues) covers similar ground to the monthly surveys, and the correlation between them points to another significant improvement in the headline confidence measures. But the focus will be on key details such as the difficulty of finding workers and capacity utilisation – the latter rose sharply in the June survey, putting some question marks around the true degree of slack in the economy. The responses on performance over the last three months could also be instructive: the 'green shoots' of recovery have been apparent for a good six months, and it's time to see whether they have translated into a visible improvement in business conditions, or whether businesses are still running on hope.

Electronic card transactions for September (Fri) will also provide some guidance as to how far the strong lift in consumer confidence has translated into action. Coming a mere nine days after the reference month, this is a very timely gauge of consumer spending.

Finally, Fonterra's next online milk powder auction will be held on Tuesday night. After a combined 56% rise in prices in the last two auctions, there is a lot of interest as to whether these gains can be sustained. The high volumes exported in recent months suggest that domestic stocks have been run down to extremely low levels, which will have contributed to the strength in prices.

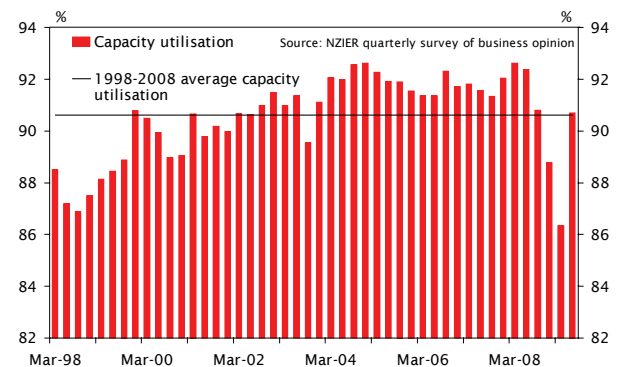
Key Data Previews

NZ Q3 NZIER business confidence

Oct 6, Last: -25%

- The June QSBO showed an improvement in business sentiment compared to the depths of the recession in March, though most of the key indicators remained negative.
- The ongoing recovery in domestic activity will drive a further pickup in business sentiment for Q3, with monthly confidence surveys suggesting the headline measures should turn positive. Detailed questions on the past three months could also be instructive as to how far the 'green shoots' of recovery have translated into a visible improvement in business conditions.
- The RBNZ's expectation of no rate hikes until the latter part of 2010 rests on inflation pressures remaining subdued. The June QSBO gave mixed signals on this question: we saw the largest quarterly jump in capacity utilisation in the history of the survey, but costs and pricing intentions were soft and ease of finding workers remained high.

QSBO capacity utilisation

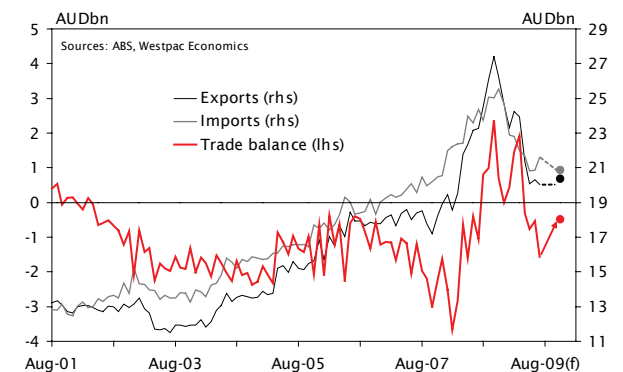


Aus Aug international trade balance, AUDbn

Oct 6, Last: -\$1.56bn, WBC f/c: -\$0.5bn, Mkt f/c: -\$0.9bn

- The deficit rose \$1.018bn in Jul to \$1.556bn. Exports fell 1.4% with -27% in non-monetary gold and -3.6% in rural. But non-rural goods saw a vol rise, with values up 1.1% but prices -0.3%. This slowed the downtrend in exports to -2.7%mtm (best since Dec-08). Imports rose 3.5% slowing their downtrend to -0.2%mtm (best since Oct-08). Capital goods remain weak but consumption goods are in an accelerating uptrend.
- Port data implies non-rural export vol gains in August (iron ore, coal) but flat prices and a 2.1% s.a. drag temper our f/c for non-rural values to +3%. Rural vols were up slightly, but with prices -2.6% and a 5.5% s.a. drag, we f/c -5% for rural exports, giving +1.5% for total exports. Merchandise import data implies -4.6% for goods (largely price with AUD up 4%) and we f/c -3.5% for total imports, combining with the export rise to narrow the deficit more than \$1bn from last month.

Deficit to fall with NR X vols up, M vals down

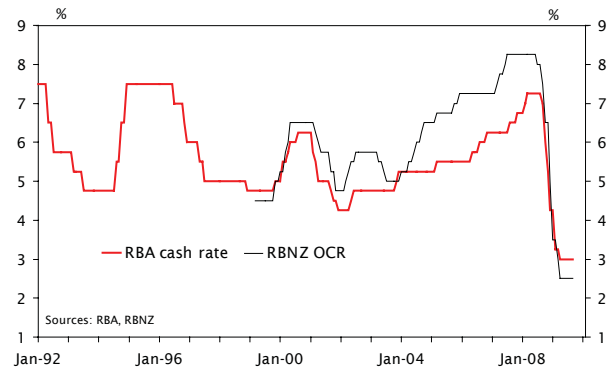


Aus RBA policy announcement

Oct 6, Last: 3.00%, WBC f/c: 3.00%

- Governor Stevens has stated a desire to lift interest rates from current “emergency lows”, at some stage. It is widely expected that the tightening cycle will begin before year’s end. While the rate hike option will be on the table at this meeting, we favour November, following the inflation update.
- In discussing monetary policy, the Governor stressed that it operates within an inflation targeting framework. It is this framework that will prompt / guide needed adjustments to rates. Moreover, these adjustments “will be timely and ahead of a build-up of imbalances that would occur if interest rates were kept low for too long”.
- The balance of economic indicators clearly suggest that the likelihood of inflation being persistently below the target now looks low. Accordingly, we agree that rates need to be lifted from current emergency lows.

RBA: rates at unsustainable historic low

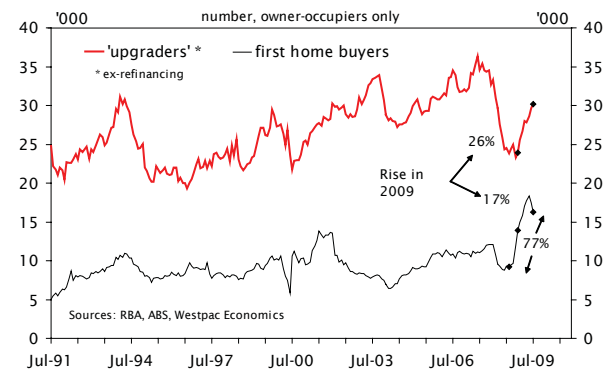


Aus Aug housing finance

Oct 7, Last: -2.0%, WBC f/c: -1.5%, Mkt f/c: flat

- Housing finance is expected to ease modestly for a second consecutive month after a strong surge. We’re forecasting a 1.5% decline - driven by a drop in lending to first home buyers, from elevated levels. Lending to upgraders, up 26% so far this year, is set to strengthen further.
- The story of this year has been a surge in finance with pent-up demand for housing unleashed by a 41 year low in variable mortgage rates and government incentives for first home buyers. The incentives triggered a burst of demand from FHBs.
- Investors have yet to play a major role in this cycle, with tighter lending standards a constraint. With the likelihood that this constraint will ease in time, we anticipate investors will return in greater numbers as 2010 progresses.

Housing finance to first home buyers off highs

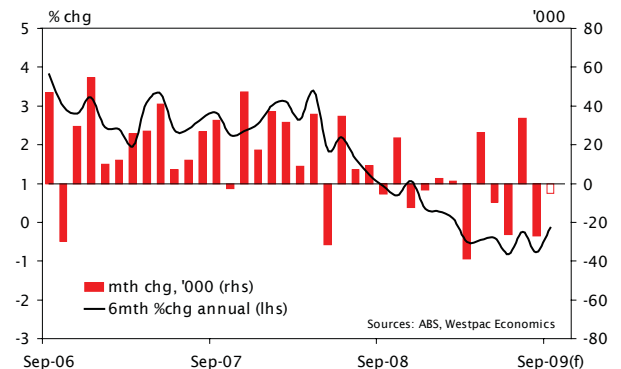


Aus Sep employment chg

Oct 8, Last: -27.1k, WBC f/c: -5k, Mkt f/c: -10k

- Employment fell 27.1k in August taking trend growth to -0.24%yr, the weakest since Jan-93. Full-time employment continued to underperform with a 30.8k fall, its fourth consecutive fall (for a cumulative loss of 109.8k), taking trend growth to -2.27%yr, the weakest since Apr-92.
- With job ads rising in August for the first time since Apr-08, their trend deviation measure has tentatively troughed, implying a low point for annual jobs growth in Jan-10. This measure remains consistent with a low of around -1.7%yr. However, our view is for jobs growth to trough at a more resilient -1%yr with employers reducing hours worked more than outright staffing. Our forecast -5k for September jobs would take trend growth to -0.3%yr in line with our prognosis, with a more resilient performance this month also consistent with less-negative business survey employment indices.

Aust jobs: surveys imply lesser Sep fall

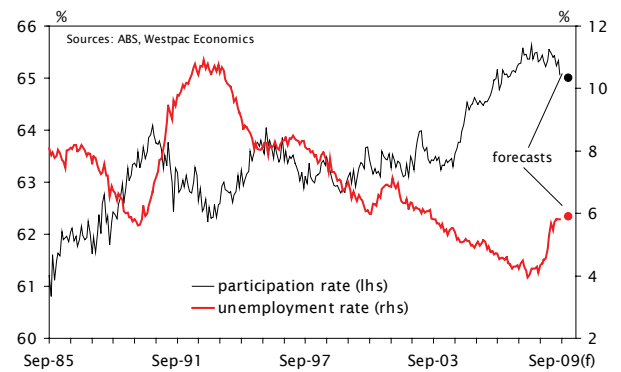


Aus Sep unemployment rate

Oct 8, Last: 5.8%, WBC f/c: 5.9%, Mkt f/c: 6.0%

- As usually seen in months of employment falls, the participation rate fell a 'large' 0.3ppts in August to 65.1% (from 65.34% to 65.06% to two decimals). This was sufficient to drive a 29.1k fall in the labour force, enough to offset the fall in employment and leave the unemployment rate unchanged at 5.8% for the third straight month. The trend rate continued to rise, but very gradually to 5.85% from 5.83%.
- With a further (albeit significantly milder) fall in employment forecast for September, the participation rate should edge lower again to 65.0%. However, this would result in around a 10k rise in the labour force, only partially offsetting the expected jobs fall, lifting the unemployment rate to 5.9%. Risks to our unemployment rate forecast lie to the upside though, from greater resilience in the participation rate after the 'large' August fall.

Unemployment and participation rates

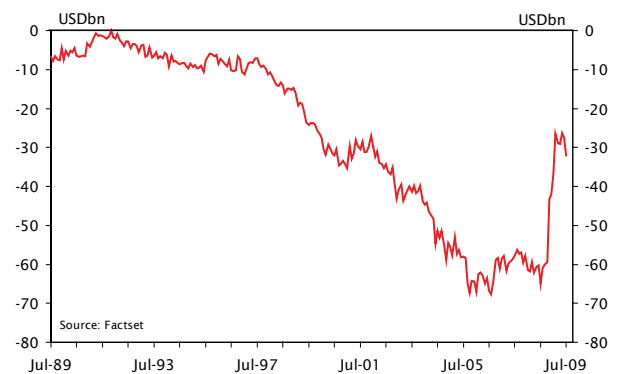


US August trade deficit to widen further

Oct 9, Last: -\$32.0bn, WBC f/c: -\$33.5bn

- The trade deficit narrowed dramatically earlier this year, from over \$60bn in mid 2008 to less than half that a year later, reflecting the collapse in global trade, weak domestic demand and sharply lower imported oil prices.
- In July, the deficit widened by \$4.5bn as roaring import growth (4.7%) far outpaced solid exports (2.2%), with higher oil prices only a minor factor. Auto imports and exports were especially strong, a function of "cash for clunkers", but the gains were pretty much across the board for both sides of the ledger, a clear sign that global trade is on the rise again.
- In August, import prices rose 2.0% (mainly oil), but ports data suggest decent export volumes. Boeing exports were up. But durable shipments were weak. Further gains of 2% (exports) and 2.5% (imports) would see the deficit widen to \$33.5bn.

US trade balance



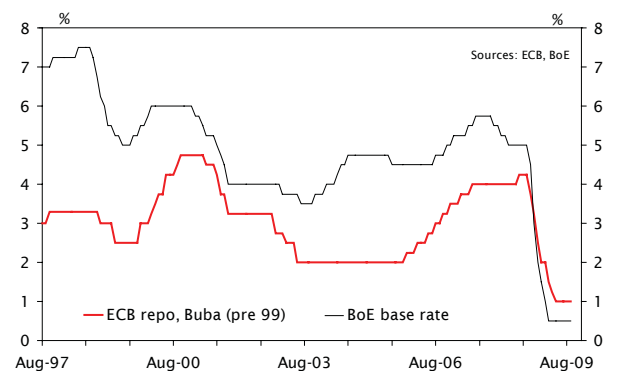
Bank of England and European Central Bank

Oct 8, BoE Last: 0.5%, WBC f/c: 0.5%

Oct 8, ECB Last: 1.0%, WBC f/c: 1.0%

- The BoE policy committee voted 9:0 in September to hold rates steady and leave the QE asset purchase program at £175bn. In briefings since then, BoE officials have been adamant that the impact of QE has been "significant". We believe it will probably be extended to at least £200bn but only after the next quarterly forecasting round in November. So another "no change" outcome is to be expected following the October meeting.
- Although the Euroland economy is emerging from recession, the fly in the ointment for the ECB is the continued declaration in M3 growth, to just 2.5% yr in August, and private sector lending to just 0.1% yr, but this provides justification for maintaining current easing policy settings, not easing them further.

ECB & BoE on hold



Key Data and Events

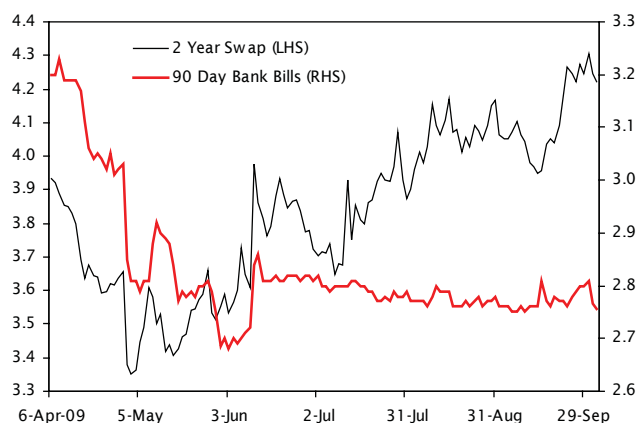
	Last	Market Median	Westpac Forecast	Comments	
Mon 5 Oct					
NZ	Sep ANZ commodity prices	4.2%	-	-	Dairy and forestry to drive strong increase in September.
Aus	Labour Day holiday	-	-	-	Public holiday in NSW, ACT & SA.
	Sep ANZ job ads	4.1%	-	-	In downtrend but deviation has troughed = Jan-10 low pt for jobs %yr.
US	Sep ISM non-manufacturing	48.4	50.0	49.5	The composite has struggled to reach 50 but activity already there.
	Fedspeak	-	-	-	FRBNY President Dudley.
Eur	Sep PMI services final	50.6a	50.6	50.7	Recent tendency for modest upward revision.
	Oct Sentix investor confidence	-14.6	-	-9.0	Equity upswing has continued; that should please investors.
	Aug retail sales	-0.2%	-0.4%	-1.0%	German retail sales known -1.5%, French consumer spending -1%.
UK	Sep PMI services	54.1	54.5	55.0	Uptrend to slow as economy grows in Q3-Q4, without accelerating.
Tue 6 Oct					
NZ	Q3 NZIER business confidence	-25%	-	-	Likely to turn positive as the economy moves clearly into recovery.
Aus	Aug international trade balance, AUDbn	-1.56	-0.9	-0.5	NR X vol rise tempered by sadj, rural prices for 1.5% X rise; M -3.5%.
	RBA policy announcement	3.00%	3.00%	3.00%	RBA has signalled intention to hike. We favour Nov rather than Oct.
UK	Aug industrial production	0.5%	0.1%	0.3%	PMI survey suggested less strong Aug outcome.
Can	Aug building permits	-11.4%	-	-	Very volatile data but uptrend seems to be emerging.
	Sep Ivey PMI	55.7	-	60.0	Not seasonally adjusted; always jumps in Sep.
Wed 7 Oct					
Aus	Aug housing finance (no.)	-2.0%	flat	-1.5%	Modest decline, after surge, as FHB segment losses altitude.
US	Sep federal budget \$bn	45.7	-	-	Tentative date, due 7-16/10.
	Aug consumer credit \$bn	-21.6	-10.0	-13.5	Temporarily increased auto sales should slow credit decline.
	Fedspeak	-	-	-	FRBKC President Hoenig.
Eur	Q2 GDP final	-0.1%a	-0.1%	-0.1%	Revision still possible.
Ger	Aug factory orders	3.5%	1.1%	2.0%	Aug gain would make it six straight monthly rises.
	Aug industrial production	-0.9%	-	2.0%	Orders gains mean factory output trend rising again.
UK	Sep consumer confidence	63	-	70	Nationwide index. GfK index surged in Nov.
	Sep BRC shop price index %yr	-0.1%	-	-	Early clue to part of the CPI basket.
Thu 8 Oct					
Aus	Sep employment chg	-27.1k	-10k	-5k	Job ads imply further H2 09 falls, but bus. surveys imply milder fall.
	Sep unemployment rate	5.8%	6.0%	5.9%	Jobs fall partially offset by participation fall to 65.0%, but upside risk.
US	Initial jobless claims w/e 3/10	551k	541k	540k	Last week's jump likely a temporary correction higher.
	Aug wholesale inventories	-1.4%	-1.0%	-1.2%	Doubts emerging about Q3 inventory-rebuilding contribution to GDP.
	Sep chain store sales %yr	-2.0%	-	-	Often gives a different message compared to the weekly reports.
Jpn	Aug current account ¥bn sa	1159	-	-	Income surplus should widen on rising foreign asset prices.
Eur	ECB rate decision	1.00%	1.00%	1.00%	Policy on hold; no tweaks to unconventional measures expected.
UK	BoE rate decision	0.50%	0.50%	0.50%	No change to rates or QE program expected.
Can	Sep housing starts	12.1%	-	-	Uptrend emerging here too but data still volatile.
Fri 9 Oct					
NZ	Sep electronic card transactions	0.3%	-	-	Growth expected given strong lift in consumer confidence.
US	Aug trade balance	-32.0	-32.6	-33.5	Deficit boost expected from import prices and autos.
	Fedspeak	-	-	-	FRBKC President Hoenig.
Jpn	Aug machinery orders	-9.3%	-	-	Despite rebound in manufacturing output, capex still in ice age.
UK	Sep PPI %yr	0.7%	0.9%	-	Core output measure.
	Aug visible trade balance £bn	-6.5	-6.35	-	Deficit downtrend has stalled in recent months.
Can	Sep employment change	27k	10k	-20k	Correction from Aug's surprise jobs jump.
	Q3 BoC senior loan officer survey	-	-	-	Update on credit availability, which was already improving in Q2.
	Q3 business outlook survey	-	-	-	Quarterly update on business conditions.

New Zealand Economic and Financial Forecasts

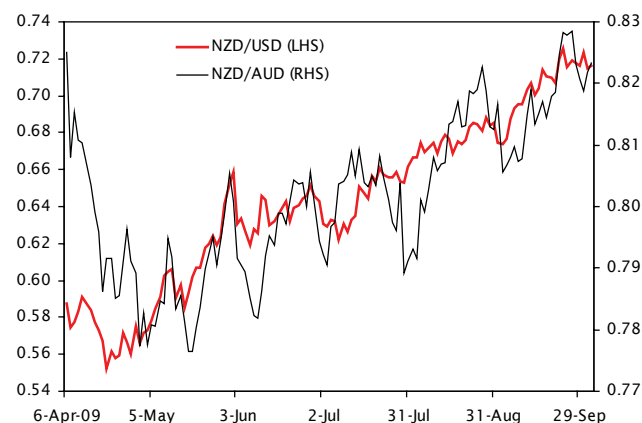
Economic Growth Forecasts	March years				Calendar years			
	2008	2009	2010f	2011f	2008	2009f	2010f	2011f
% change								
GDP (Production) ann avg	3.1	-1.1	-0.5	3.3	0.0	-1.5	2.8	3.7
Employment	-0.3	0.7	-1.0	0.9	0.9	-2.4	0.7	1.5
Unemployment Rate % s.a.	3.8	5.0	6.7	6.7	4.7	6.8	6.8	6.5
CPI	3.4	3.0	2.0	1.9	3.4	2.2	1.3	2.4
Current Account Balance % of GDP	-7.9	-8.1	-4.0	-5.0	-8.9	-4.2	-4.8	-5.8

Financial Forecasts	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Cash	2.50	2.50	2.50	3.00	4.00	5.00	5.50
90 Day bill	2.80	2.90	3.00	3.60	4.60	5.50	5.90
2 Year Swap	4.30	4.50	4.70	5.00	5.40	5.85	6.15
5 Year Swap	5.50	5.60	5.70	5.90	6.10	6.30	6.45
10 Year Bond	5.90	6.00	6.10	6.20	6.30	6.40	6.50
NZD/USD	0.73	0.69	0.71	0.73	0.76	0.77	0.75
NZD/AUD	0.83	0.84	0.85	0.85	0.84	0.84	0.83
NZD/JPY	63.5	62.1	66.0	70.1	76.0	81.6	81.8
NZD/EUR	0.50	0.49	0.50	0.51	0.52	0.52	0.51
NZD/GBP	0.43	0.42	0.42	0.42	0.43	0.43	0.40
TWI	65.8	64.3	65.8	67.3	69.3	70.3	69.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 5 October 2009

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.78%	2.78%	2.77%
60 Days	2.79%	2.80%	2.77%
90 Days	2.76%	2.77%	2.75%
2 Year Swap	4.22%	4.09%	4.07%
5 Year Swap	5.39%	5.39%	5.35%

NZ foreign currency midrates as at Monday 5 October 2009

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7174	0.7069	0.6875
NZD/EUR	0.4908	0.4750	0.4811
NZD/GBP	0.4500	0.4365	0.4194
NZD/JPY	64.100	65.090	63.920
NZD/AUD	0.8265	0.8186	0.8080
TWI	65.350	64.610	63.540

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2004	2005	2006	2007	2008	2009f	2010f
Australia							
Real GDP % yr	3.8	2.8	2.9	4.0	2.4	0.7	2.5
CPI inflation % annual	2.6	2.8	3.3	3.0	3.7	1.9	2.0
Unemployment %	5.4	5.1	4.8	4.4	4.3	5.9	7.3
Current Account % GDP	-6.1	-5.8	-5.3	-6.3	-4.6	-4.0	-4.9
United States							
Real GDP %yr	3.9	3.1	2.8	2.1	0.4	-2.8	1.4
Consumer Prices %yr	2.6	3.4	3.2	2.9	3.8	-0.8	1.1
Unemployment Rate %	5.5	5.1	4.6	4.6	5.8	9.4	11.1
Current Account % GDP	-5.7	-6.1	-6.0	-5.2	-4.9	-2.9	-2.7
Japan							
Real GDP %yr	2.3	1.9	2.8	2.2	-1.0	-5.8	1.5
Consumer Prices %yr	-0.1	-0.3	0.2	0.1	1.4	-1.1	-0.7
Unemployment Rate %	4.5	4.4	4.1	3.9	4.0	5.3	6.4
Current Account % GDP	3.3	3.6	3.9	4.8	3.2	2.6	2.9
Euroland							
Real GDP %yr	1.9	1.8	3.1	2.7	0.6	-4.1	0.2
Consumer Prices %yr	2.1	2.5	2.0	3.1	1.6	0.3	0.7
Unemployment Rate %	9.0	8.8	7.9	7.3	7.8	10.0	11.5
Current Account % GDP	0.0	-0.2	-0.5	0.0	-0.2	0.0	0.4
United Kingdom							
Real GDP %yr	3.0	2.2	2.9	2.6	0.7	-4.4	0.5
Consumer Prices %yr	1.3	2.1	3.0	2.1	3.5	1.0	1.2
Unemployment Rate %	2.8	2.8	3.0	2.5	3.1	5.5	7.0
Current Account % GDP	-1.9	-2.6	-3.0	-2.8	-2.3	-3.0	-3.0

Forecasts finalised 4 September 2009

Interest Rate Forecasts	Latest (Oct 5)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Australia						
Cash	3.00	3.50	3.75	4.00	4.00	4.00
90 Day Bill	3.41	3.60	3.80	4.10	4.2	4.50
10 Year Bond	5.15	5.40	5.80	5.85	6.05	6.25
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.18	3.20	3.40	3.75	4.25	4.50
ECB Repo Rate	1.00	1.00	1.00	1.00	1.00	1.25
Exchange Rate Forecasts						
AUD/USD	0.8678	0.88	0.82	0.84	0.86	0.90
USD/JPY	89.28	87	90	93	96	100
EUR/USD	1.4627	1.46	1.40	1.42	1.44	1.47
AUD/NZD	1.2089	1.21	1.19	1.18	1.18	1.18

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