

# Weekly Commentary

A weekly outlook for New Zealand, Australia and US markets

6 July 2009

## Easing off

With the New Zealand economy showing some signs of stabilisation, we have revised our interest rate forecasts and no longer anticipate further OCR cuts in this cycle.

Over recent months the RBNZ will have noted the resilience of activity in developing Asia and Australia, an improvement in credit market conditions, rising business and consumer confidence, a pickup in the housing market, and a strong turnaround in net migration. The latter is particularly important for the RBNZ. Just a few months ago they were forecasting a net inflow for this year of around 6,000; as of May, the annual inflow was over 11,000 and appears set for a net inflow of more than 20,000 this year. While the cause of the turnaround in migration is different from previous cycles – mostly New Zealanders either staying or returning home – history shows that the net flow can have a powerful influence on economic activity.

We acknowledge that there are still substantial risks to an economy that's already a year and a half into recession: the NZ dollar is stubbornly and unhelpfully high, longer-term interest rates have pushed up, swine flu has the potential to extend the recession for another quarter or so, and there is always the risk of another round of upheavals in global financial markets. But in our minds, these are not enough to justify further rate cuts as a central view.

While the market is pricing in rate hikes before early 2010, we think it will be more

like the latter part of 2010, as the RBNZ has signalled. Initially, rate hikes will be aimed at taking the OCR back to neutral from extremely low levels, once the economy is on a firmer footing. But the RBNZ has plenty of time on its side – the spare capacity that has built up in the New Zealand and global economies after the prolonged recession will keep inflation pressures at bay for some time.

This week's data releases were generally on the positive side. The trade balance rose to an \$858m surplus, the strongest May outturn on record. Exports of primary products performed well, due to stable or stronger commodity prices in NZ dollar terms, while imports were soft (especially fuel and vehicles) due to a mix of lower prices and volumes.

Residential building consents rose 3.5% in May following April's 11.2% increase, with much of the strength coming from apartments. Consents are up 29% from the multi-decade lows seen in January this year, but with net migration on the rise, a further pickup in building activity will be needed to deal with an emerging shortage of housing. Meanwhile, the value of non-residential consents was boosted by large projects for a second month (an airport redevelopment in April and sports stadiums in May).

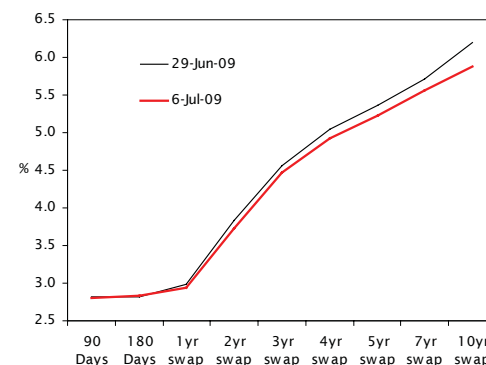
The Westpac-McDermott Miller employment confidence survey rose from 93.2 to 96.1 in Q2, after taking a pounding in the previous six months. While workers remain very pessimistic about current conditions

in the jobs market, they are more positive about the outlook for jobs and pay a year from now. Growing confidence about jobs could translate into consumers taking a less cautious stance in coming months.

The monthly NBNZ business confidence survey rose again in June, moving further away from the record lows seen in the first three months of this year. However, the details were mixed – generally better activity expectations, but parlous profits. The results also varied greatly across sectors – confidence in the construction sector was the highest since May 1999, perhaps reflecting the pickup in the housing market and anticipation of government infrastructure spending. However, the agriculture sector was less confident than in May, following Fonterra's payout forecast of \$4.55/kg for the 2009/10 season, which was at the low end of expectations.

Confidence won't have been helped by recent developments in dairy prices. The

NZ Interest Rates



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

**Westpac**

monthly commodity price index recorded a 3.3% drop in world dairy prices, and Fonterra's latest online auction saw a similar drop – and that's in US dollar terms. The resilience of the NZ dollar in recent months adds further downside risk to forecast payouts to NZ dairy farmers. However, we caution against extrapolating from current conditions in such a volatile international environment. We expect world dairy prices to remain weak for the rest of 2009 as world demand remains soft and stockpiles build in the US and EU, but some reduction in global supply is expected to emerge in 2010. And, notwithstanding the inherent difficulty of forecasting the currency, we do expect the NZD to ease lower in the

second half of this year.

The key release next week is the NZIER's *Quarterly Survey of Business Opinion* on Tuesday. The *QSBO* is a useful indicator of contemporaneous GDP, though in the last two quarters it has pointed to much worse outcomes than the actual GDP outturns of -1.0%. Some of the difference may have reflected the fact that the survey doesn't cover the agriculture sector, which was a relative bright spot in previous quarters. By the same token, the Q2 survey could be relatively insulated from the recent concerns about dairy payouts. We expect to see an improvement in general business conditions, in line with the monthly

confidence survey. The main focus, however, will be around any evidence of further slackening in the labour market and in capacity pressures.

**Fixed vs. floating:** With the RBNZ nearing the end of its easing cycle, short-term rates are unlikely to fall significantly further, while long-term rates will continue to anticipate the next tightening cycle. For those borrowers currently on floating rates who have been looking to time their re-entry into fixed rates, we recommend fixing now for six months to one year, which are easily the most favourable rates on offer.

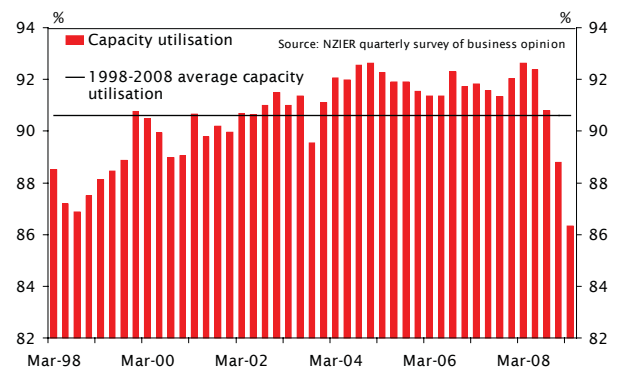
## Key Data Previews

### NZ Q2 NZIER business confidence

Jul 7, Last: -65%

- The *Quarterly Survey of Business Opinion* was extremely weak in the March quarter, with many of the key components at or close to record lows. The survey indicated that firms were starting to feel the pinch from falling global demand, on top of the ongoing domestic recession.
- Low interest rates, rising net migration and a stabilisation in the housing market have provided some support to domestic activity in recent months, and there are also signs that the pace of contraction in the global economy is slowing. Monthly business confidence surveys have risen sharply from their lows, and we expect the quarterly survey to do the same.
- Since the *QSBO* excludes agriculture, it may not fully capture some of the recent negatives for the economy – weak world prices for dairy products and an unhelpfully strong NZ dollar.

### QSBO capacity utilisation

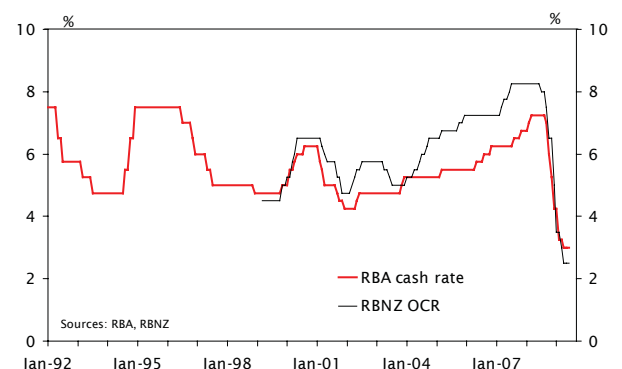


### Aus RBA policy announcement

Jul 7, Last: 3.00%, WBC f/c: 3.00%, Mkt f/c: 3.00%, Range: 3.00% to 3.00%

- The RBA is expected to again leave rates unchanged at its July meeting. The Bank has been in 'watch and wait' mode since March, assessing the impact of previous aggressive rate cuts. With a recovery gaining traction in the housing sector and evidence of stabilisation abroad the Bank is unlikely to see an immediate need for additional stimulus.
- At 3%, the cash rate is at an extreme low. Market interest rates are also at historic lows with variable mortgage rates in particular at their lowest levels in 40 years.
- Despite this, we continue to see the RBA making additional cuts by year end to counter an expected deterioration in labour markets. The timing and size of moves will be a tactical decision but we see 2.5% as the eventual low point.

### Official interest rates: pause continues

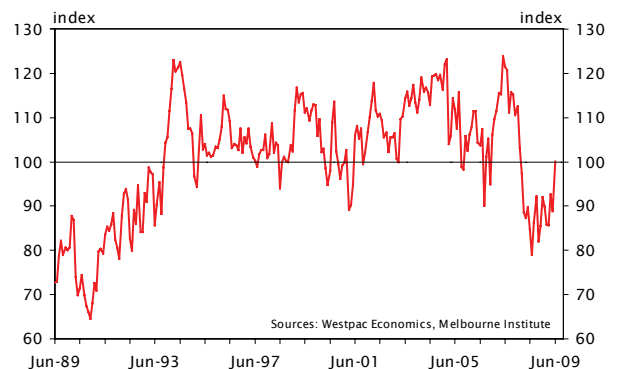


## Aus Jul Westpac-MI Consumer Sentiment

Jul 8, Last: 100.1

- The *Westpac-Melbourne Institute Index of Consumer Sentiment* jumped 12.7% from 88.8 in May to 100.1 in June. This was the biggest monthly rise in 22 years. The burst of exuberance was mainly due to the release of Q1 GDP figures, which showed a small rise in activity, meaning the economy had dodged recession – or at least its ‘technical’ definition of two consecutive quarters of contraction.
- The July survey is in the field in the week ending July 6. Sentiment is likely to be impacted by: some slippage in equities (ASX down over 2% since the last survey); but better than expected retail sales figures for May (+1%) and more signs of firming in housing markets (albeit with a surprisingly sharp fall in dwelling approvals in May). Tax cuts rolled out on July 1. The CBA also increased its floating mortgage interest rate 10bps (though other banks left their rates unchanged). The survey is being conducted before the RBA’s rate decision.

## Consumer Sentiment

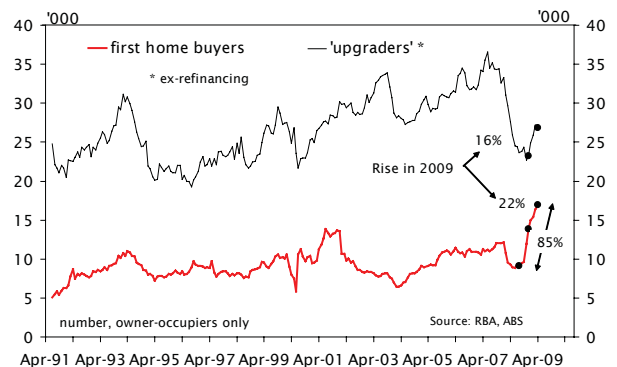


## Aus May housing finance

Jul 8, Last: 0.9%, WBC f/c: 2.5%, Mkt f/c: 1.3%, Range: flat to 2.5%

- We’re forecasting housing finance approval numbers to rise by a moderate 2.5% in May. However, we’re mindful of the risk of disappointment in May given uncertainty at that time. While the boost to the first home buyers grant has now been extended, on 24 April the Prime Minister said “All good things must come to an end”.
- More generally, the upswing in housing finance is set to continue given extremely expansionary settings, pent-up demand and brisk population growth.
- New lending to owner-occupiers surged 32% over the eight months to April. Over the last four months, finance to upgraders rose by 16% and to first home buyers by 22%. Investor finance jumped 15% over the last two months, but is only up 4% since last August.

## Finance upswing broadly based in 2009

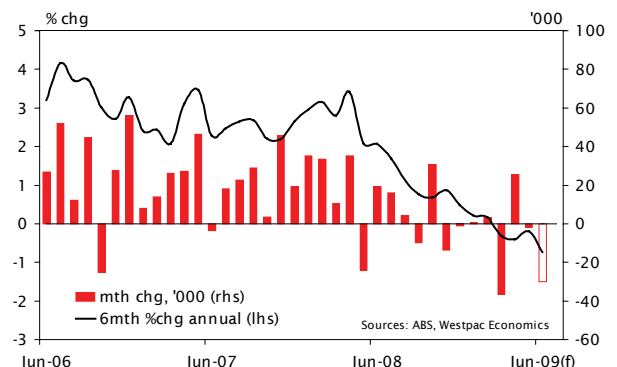


## Aus Jun employment chg

Jul 9, Last: -1.7k, WBC f/c: -30k, Mkt f/c: -20k, Range: -40k to flat

- Although employment fell only 1.7k in May, full-time was weak (-26.2k), trends continued to deteriorate and the unemployment rate continued its uptrend. Total jobs trend growth slowed to 0.14%yr (weakest since May-93), trend full-time jobs fell 6.7k (9th consecutive fall) and annual full-time trend growth fell to -1.01%yr (weakest since Oct-01).
- While signs of turning points in our preferred leading indicators of labour demand saw us bring forward (to 2008Q4) and raise our low point for jobs growth (to -1.6%yr) in the cycle, the indicators remain consistent with a more rapid jobs deterioration over 2009H2 in the interim. Also, despite recent gains, our short-term labour demand indicator points to a fall in 3m MA jobs growth towards -12k from the current -4.4k pace. Hence, we continue to look for near-term weakness, forecasting -30k in June, slowing trend growth to -0.04%yr.

## Aust jobs: leads imply near-term weakness

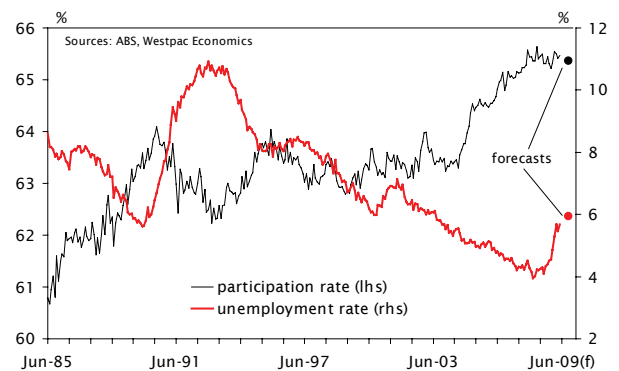


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**Aus Jun unemployment rate**

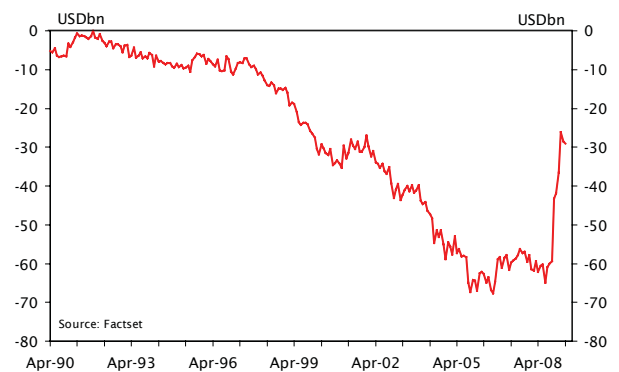
Jul 9, Last: 5.7%, WBC f/c: 5.9%, Mkt f/c: 5.9%, Range: 5.8% to 6.1%

- Without a large fall in total jobs to weigh, the participation rate reacted to the prior month's fall in the unemployment rate, rising to 65.5% in May from 65.4%. Stronger labour force growth boosted the impact on the unemployment rate (rose to 5.7% from 5.5%). The trend rate rose to 5.7% (highest since Oct-03) from 5.6%, up from a low of 4.1% in Apr-08.
- With higher unemployment in May, and a larger fall forecast for June jobs, the participation rate should pull back. However, resilience in female and aged worker participation argues for a less than usual dip. We forecast 65.4% (-0.1 ppts). This would partially offset the forecast 30k jobs fall, lifting unemployment to 5.9% (highest since Jul-03). Risks are to the upside from a greater jobs fall and/or more resilient participation rate.

**Unemployment and participation rates****US May trade deficit to widen further**

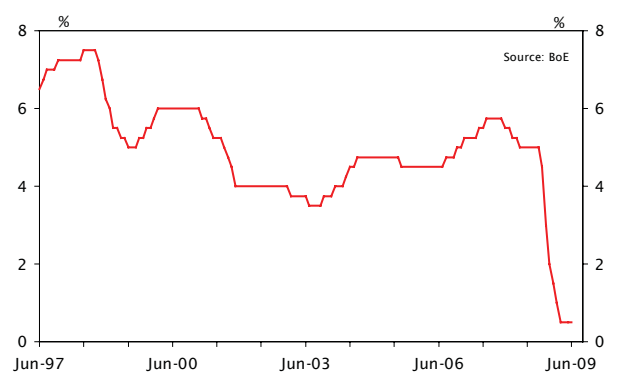
Jul 10, Factory Last: -29.2, WBC f/c: -30.5

- The trade deficit widened for the second month in April, as exports fell more sharply than imports, despite rises in both import (mainly oil) prices and export prices. The underlying volumes picture was soft on both sides of the ledger, indicating ongoing weakness both in US and trading partner demand.
- In May, import prices rose a steeper 1.3% but volumes likely slipped further, although export prices also posted a steeper (but lesser) 0.6% gain. Durable goods shipments were down a fairly sharp 2.1% in May, but the export component of the ISM factory survey was significantly less weak and Boeing reported increased foreign sales that month.
- Assuming a 1% import rise, and flat exports, the deficit will widen by \$1.3bn to \$30.5bn in May.

**US trade: imports slump more than exports****Bank of England: no change to rates or QE**

Jul 9, BoE Last: 0.50%, WBC f/c: 0.50%, mkt f/c: 0.50%

- The BoE policy committee left rates on hold and made no adjustment to the asset purchase program started in March.
- Since the June meeting, there has been more evidence, acknowledged by BoE officials, that the economy might soon be bottoming out, even though the Q1 GDP contraction was revealed to be substantially deeper than first estimated (-2.4% vs -1.9% originally). Officials have also been musing about eventual policy tightening though that is still a long way off. The BoE's July quarterly credit survey found improved credit availability.
- Although the BoE still has a further £25bn of asset purchases it could announce without Treasury consultation, we suspect that won't happen before the August forecasting round, if at all, and rates will definitely not fall any further.

**BoE policy rate**

## Key Data and Events

		Last	Market Median	Westpac Forecast	Comments
<b>Mon 6 Jul</b>					
Aus	Jun TD-MI Inflation Gauge	-0.3%	-	-	Recent falls confirm price pressures easing rapidly; annual at low 1.5%yr.
	Jun ANZ Job Ads	-0.2%	-	-	Still in steep downtrend, but tentative sign of stabilisation in May.
US	Jun ISM Non-Manufacturing	44.0	46.0	45.5	Continuing to indicate a slower pace of contraction.
Jpn	May Leading Index	76.2	77.0	-	Business surveys are consistent with sound improvement in H2.
Eur	Jul Sentix Investor Confidence	-27	-25	-25	Less improvement, consistent with recent stock-market slippage.
<b>Tue 7 Jul</b>					
NZ	Q2 NZIER Business Confidence, net %	-65%	-	-	Expected to rise, consistent with a smaller decline in Q2 GDP.
Aus	RBA Policy Announcement, 2:30pm	3.00%	3.00%	3.00%	RBA firmly in 'watch and wait' mode.
Ger	May Factory Orders	flat	0.5%	-1.0%	Have not posted a decline since Feb - now bouncing along the bottom.
UK	May Industrial Production	0.3%	0.2%	-0.3%	PMI suggests recent upturn in factory output not beginning of trend.
Can	May Building Permits	-5.4%	0.8%	-	Sharp rise in March means permits downtrend less clear.
	Jun Ivey PMI nsa	48.4	50.3	47.0	Typically rises in June, so failure to do so would be weak.
<b>Wed 8 Jul</b>					
Aus	Jul Westpac-MI Consumer Sentiment	100.1	-	-	Will June's 'recession relief rally' be sustained?
	May Housing Finance	0.9%	1.3%	2.5%	Forecasting a moderate rise, but risk of disappointment (see text box).
US	May Consumer Credit \$bn	-15.7	-10.0	-	Decline in credit consistent with increased saving, less spending.
	Fedspeak	-	-	-	Evans, subject TBA.
Jpn	May Machinery Orders	-5.4%	2.4%	-	Excess capacity is extreme, so where is the incentive to invest?
	May Current Account ¥bn sa	966	1228	-	Trade position still under stress, but a better outcome on income.
	Jun Bank Lending %yr	3.1%	-	-	Credit multiplier to nominal GDP finally above one: but in a crisis?
Eur	Q1 GDP (F)	-2.5% a	-2.5%	2.5%	No revision expected.
Ger	May Industrial Production	-1.9%	0.5%	flat	Orders data suggest IP might soon show signs of bottoming out.
UK	Jun Consumer Confidence	53	55	51	Nationwide index. Budget concerns, impact on tax, spending.
	Jun BRC Shop Price Index %yr	1.3%	-	-	Clue to part of the CPI basket.
<b>Thu 9 Jul</b>					
NZ	Jun Electronic Card Transactions	0.7%	-	-	Early indicator to retail sales in Jun, small rise expected.
Aus	Jun Employment chg	-1.7k	-20k	-30k	Leads still imply greater near-term weakness; takes annual trend -ve.
	Jun Unemployment Rate	5.7%	5.9%	5.9%	Jobs fall partially offset by 0.1ppt participation dip; but upside risk.
	Jul WBC-MI Unemployment Expect's	-7.9%	-	-	Trended down (improved) since Feb, implying Q4'08 low for jobs %yr.
	Jul MI Inflation Expectations	2.8%	-	-	Expectations bounced with surprise Q1 GDP rise; trend now 2.5%.
US	Initial Jobless Claims w/e 4/7	614k	-	605k	Distortion risk in coming weeks from auto shutdowns taking place early
	May Wholesale Inventories	-1.4%	-1.0%	-1.0%	Further clue to pace of inventory rundown in Q2.
	Jun Chain Store Sales %yr	-	-	-	Clue to official retail data, sometimes at odds with weekly retail figures.
	Fedspeak	-	-	-	Duke, subject TBA
Eur	Jul ECB Monthly Bulletin	-	-	-	May include more detail re covered bond purchases and latest rate call.
UK	May Visible Trade Balance, £bn	-7.0	-6.8	-	Exports and imports both falling sharply.
	BoE Rate Decision	0.50%	0.50%	0.50%	Firmly on hold; announcement re further QE more likely Aug than Jul.
Can	Jun Housing Starts	9.2%	2.0%	-	Volatile series, but trend downwards
	Jun Employment Change	-42k	-40k	-45k	April rise still needs to be corrected for.
<b>Fri 10 Jul</b>					
US	May Trade Balance \$bn	-29.2	-30.0	-30.5	Import prices up more than exports. More Boeing foreign deliveries.
	Jun Import Prices	1.3%	2.0%	1.5%	Energy price gains and weaker US dollar pushing import prices higher.
	Jul UoM Consumer Sentiment (Prelim)	70.8	70.6	67.5	CB confidence index sharply weaker in late June.
Jpn	Jun Corp. Goods Prices %yr	-5.4%	-6.4%	-	Stronger yen, lower commodity prices, excess supply in capital goods.
UK	Jun PPI %yr	1.2%	1.1%	-	Core output measure.
Can	May Trade Balance \$bn	-0.2	-0.6	-	Modest deficits now the norm after decades of surpluses.
	May New House Prices	-0.6%	-0.4%	-	Prices falling in line with weak housing market.

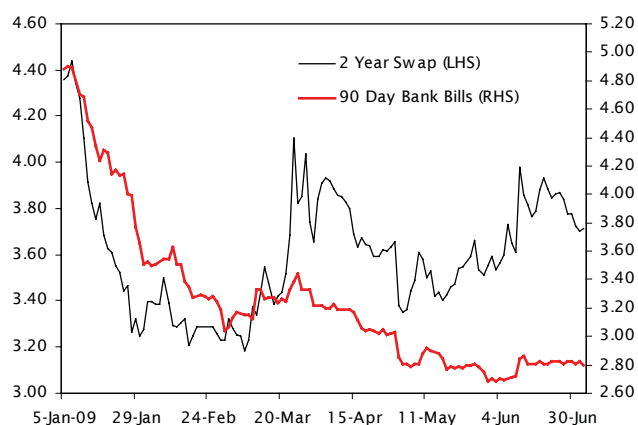
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## New Zealand Economic and Financial Forecasts

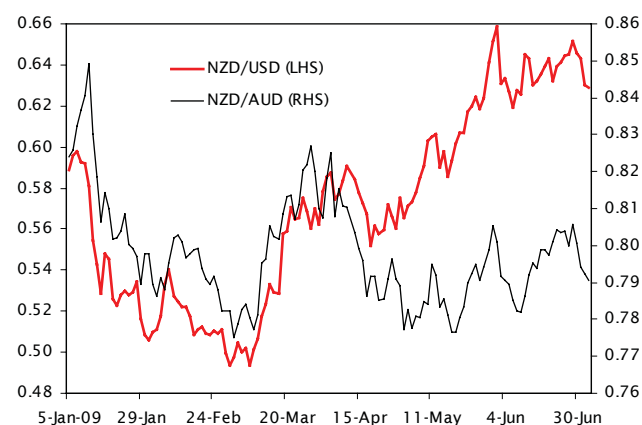
Economic Growth Forecasts	March years				Calendar years			
	2008	2009f	2010f	2011f	2008	2009f	2010f	2011f
% change								
GDP (Production) ann avg	3.1	-0.9	-2.3	2.2	0.2	-2.7	1.2	3.7
Employment	-0.3	0.8	-2.8	1.5	0.9	-3.8	0.8	2.2
Unemployment Rate % s.a.	3.8	5.0	7.5	6.4	4.7	7.4	6.8	5.3
CPI	3.4	3.0	1.5	1.3	3.4	1.3	1.1	1.3
Current Account Balance % of GDP	-8.0	-8.2	-5.3	-5.6	-8.9	-5.0	-5.6	-6.0

Financial Forecasts	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Cash	2.50	2.50	2.50	2.50	3.00	4.00	5.00
90 Day bill	2.80	2.80	2.80	2.90	3.60	4.60	5.50
2 Year Swap	3.90	4.10	4.30	4.60	5.00	5.40	5.85
5 Year Swap	5.30	5.40	5.50	5.60	5.80	6.00	6.30
10 Year Bond	5.80	5.90	6.00	6.10	6.20	6.30	6.40
NZD/USD	0.60	0.59	0.62	0.65	0.68	0.70	0.71
NZD/AUD	0.79	0.80	0.81	0.81	0.83	0.84	0.85
NZD/JPY	57.0	54.3	59.5	64.4	70.0	72.1	75.3
NZD/EUR	0.43	0.43	0.45	0.46	0.47	0.48	0.48
NZD/GBP	0.38	0.37	0.38	0.38	0.39	0.39	0.38
TWI	57.7	57.0	59.3	61.6	64.0	65.6	66.3

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 6 July 2009

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.81%	2.80%	2.76%
60 Days	2.80%	2.82%	2.74%
90 Days	2.81%	2.81%	2.69%
2 Year Swap	3.73%	3.89%	3.60%
5 Year Swap	5.22%	5.37%	5.17%

NZ foreign currency midrates as at Monday 6 July 2009

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.6287	0.6321	0.6268
NZD/EUR	0.4504	0.4559	0.4488
NZD/GBP	0.3858	0.3865	0.3930
NZD/JPY	60.370	60.690	61.840
NZD/AUD	0.7910	0.8009	0.7893
TWI	59.610	60.110	59.780

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## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2004	2005	2006	2007	2008	2009f	2010f
<b>Australia</b>							
Real GDP % yr	3.8	2.8	2.9	4.0	2.3	-0.6	1.0
CPI inflation % annual	2.6	2.8	3.3	3.0	3.7	1.8	2.4
Unemployment %	5.4	5.1	4.8	4.4	4.2	6.3	8.5
Current Account % GDP	-6.1	-5.8	-5.3	-6.2	-4.3	-3.9	-5.7
<b>United States</b>							
Real GDP %yr	3.9	3.1	2.8	2.0	1.1	-3.1	0.7
Consumer Prices %yr	2.6	3.4	3.2	2.9	3.8	-1.4	1.1
Unemployment Rate %	5.5	5.1	4.6	4.6	5.8	9.3	10.6
Current Account %GDP	-5.7	-6.1	-6.0	-5.3	-4.7	-2.7	-2.9
<b>Japan</b>							
Real GDP %yr	2.3	1.9	2.8	2.3	-0.8	-7.5	1.1
Consumer Prices %yr	-0.1	-0.3	0.2	0.1	1.4	-1.1	-0.6
Unemployment Rate %	4.5	4.4	4.1	3.9	4.0	5.1	6.6
Current Account %GDP	3.3	3.6	3.9	4.8	3.2	2.5	2.4
<b>Euroland</b>							
Real GDP %yr	1.9	1.8	3.0	2.6	0.7	-4.7	-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
<b>United Kingdom</b>							
Real GDP %yr	2.8	2.1	2.8	3.0	0.7	-4.5	-0.1
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	-6.0	-5.5

Forecasts finalised 5 June 2009

Interest Rate Forecasts	Latest (Jul 6)	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
<b>Australia</b>						
Cash	3.00	2.75	2.50	2.50	2.50	2.50
90 Day Bill	3.13	3.00	2.75	2.75	2.75	2.75
10 Year Bond	5.43	5.00	4.75	5.00	5.50	5.75
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.50	3.50	3.25	3.75	4.25	4.75
ECB Repo Rate	1.00	1.00	1.00	1.00	1.00	1.00
<b>Exchange Rate Forecasts</b>						
AUD/USD	0.7948	0.76	0.74	0.77	0.80	0.82
USD/JPY	96.02	95	92	96	99	103
EUR/USD	1.3960	1.38	1.36	1.39	1.42	1.45
AUD/NZD	1.2642	1.27	1.25	1.24	1.23	1.21

This publication has been prepared by the Wellington, Sydney and London Economic Departments

Published by Westpac, PO Box 691, Wellington, ph: (04) 381 1413

For further information contact Brendan O'Donovan, Michael Gordon, Doug Steel, Donna Purdue, Dominick Stephens or Sharon Zollner

For email address changes contact natalie\_denne@westpac.co.nz



Past performance is not a reliable indicator of future performance. The forecasts given in this document are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The ultimate outcomes may differ substantially from these forecasts.