

# Weekly Commentary

8 February 2010

## We can work it out

Last week's wage and employment reports showed that the New Zealand labour market remains bogged down by the effects of the 2008-09 recession.

In the December 2009 quarter, wage growth slowed to a crawl, employment fell by 0.1%, and the unemployment rate jumped to 7.3%, the highest in ten years. We think that the latter overstates the degree of weakness, but the overall message is that the jobs creation machine has yet to kick into action.

Unemployment has hit the same groups as in previous recessions. Youth unemployment (15-24 years) has risen to 18.4%, from 12.0% a year ago. Unemployment among Maori and Pacific Islanders has risen from 9.0% to 14.9% in that same time. By industry, construction and manufacturing have been hit hardest during the downturn, though much of the weakness in the December quarter was found in the retail sector, where the usual seasonal increase in hiring was underwhelming.

For the last year or so we've advocated using the unemployment rate, rather than the number of people employed, as the better gauge of how the labour market is evolving. The employment figures have been unusually volatile in the past few years, due to recent changes to the seasonal pattern that are difficult for Statistics NZ to correct for.

But it seems that this issue is creeping

into other parts of the calculations as well. The seasonal adjustments for the various sub-groups normally add up to near-zero (as they should); this time, they 'created' almost 8,000 extra people in the working age population, some of whom went on to swell the ranks of the unemployed. Using the historic averages of the seasonal factors, we estimate the unemployment rate would have been more like 7.0% - admittedly still worse than the average forecast of 6.8%.

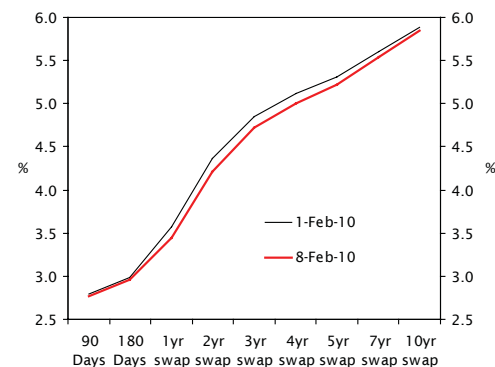
So for this time at least, we'll reverse our advice and suggest focusing on employment as the more meaningful measure. The fact remains that the labour market was weaker than we expected - just not quite as bad as a 7.3% unemployment rate would imply.

The 0.1% fall in employment, at a time when the aforementioned seasonal factors should have been pushing it higher, translates to a fairly weak outcome. Hours worked was also soft, although the 0.4% fall was an improvement on the 0.8% drop in September. We expected a lift in hours worked based on recent business indicators, where hiring intentions have picked up and overall activity measures have been consistent with Q4 GDP growth in the order of 1%. We also expected to see more people back at work after the increased absenteeism due to swine flu in Q3. Instead, the gap between actual and 'usual' hours worked widened further (in fact, usual hours worked were up 0.1% for the quarter).

The wages reports reinforced the message that labour market conditions remained soft at the end of last year. Private sector wages grew by just 0.3%, bringing the annual rate of growth down to 1.5%. Only 44% of workers have had a pay rise in the last year, the lowest proportion since June 2000. And for those who did get a raise, the average increase of 4.4% was down on the last few years.

Despite the apparent weakness in these figures, we don't think they will materially alter the RBNZ's view. Employment growth was in line with their forecasts; wages growth was a little softer than they expected; the unemployment rate was much worse than their 6.6% forecast but is problematic. The small drop in hours worked represents a downside risk to our forecast of 1.1% growth in Q4 GDP, but is consistent with the RBNZ's pick of 0.6%. So their expectation for rate hikes to begin "around the middle of 2010" should remain

NZ Interest Rates



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

intact. Market pricing has pushed out the expected timing of the first OCR hike to the June *Monetary Policy Statement*; a week ago the April review was seen as more likely.

We're leaving our cash rate forecasts unchanged for now – the soft employment data will need to be weighed against Friday's retail spending figures, which we expect will show that the consumer is back in a big way. To further complicate the mix, housing figures for January (also released on Friday) will be ugly. Weekly loan approvals, and figures from a major Auckland agency, suggest that sales were down 20-25% in seasonally adjusted terms, when compared to December. (Ignore any reports of the unadjusted figures or the year-on-year change, which will both still

be positive.) This may be due to buyers holding back until the uncertainty around changes to the tax treatment of housing is resolved.

For us, the timing of the first rate hike is less critical than the extent and speed of the tightening cycle over the next couple of years. Our profile of 25bp hikes at each review still adds up to less by year-end than what the market is currently pricing. RBNZ Governor Bollard recently noted that they may need to increase the cash rate in "meaty chunks" – the key condition being if they see inflation pressures re-emerging. The subdued tone to the labour market suggests no immediate pressure to step up the pace.

**Fixed vs. floating:** The growing prospect

of OCR hikes in the first half of the year will eventually flow through to short-term fixed rates, which have only seen small increases to date and remain at historically low levels. As a result we could see more borrowers moving to fix at the favourable rates still on offer – and the experience of March/April last year shows that these types of flows can put a great deal of upward pressure on mortgage rates. With floating and one-year fixed rates around similar levels, there may not seem to be much advantage in fixing right now, but those who wait until they see the whites of the RBNZ's eyes before fixing are likely to face much less attractive options. Repaying more than the minimum amount and spreading the loan over a mix of terms can help to reduce overall risk regarding uncertain future interest rate changes.

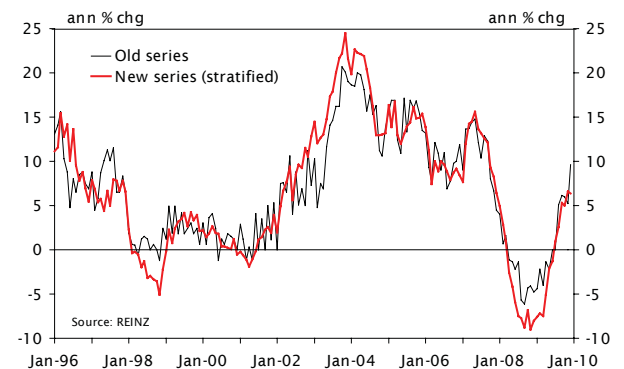
Key Data Previews

NZ Jan REINZ house sales and prices

Feb 12, Last: 6.4%

- The housing market held steady in the face of rising mortgage rates through the second half of 2009, but caved in January. Weekly mortgage approvals are down about 20% on a year ago, and a major Auckland real estate agency reported a 25% drop in sales for the month (s.a.). We expect a similar outcome in the nationwide figures.
- Slowing sales will ease the recent upward pressure on prices. In December, the REINZ's new stratified house price index fell for the first time since June.
- As well as rising interest rates, buyers may be concerned by potential tax changes aimed at reducing the appeal of housing as an investment, with several groups making recommendations in December. PM John Key is due to outline the Government's thinking on tax reform on Tuesday.

REINZ house prices

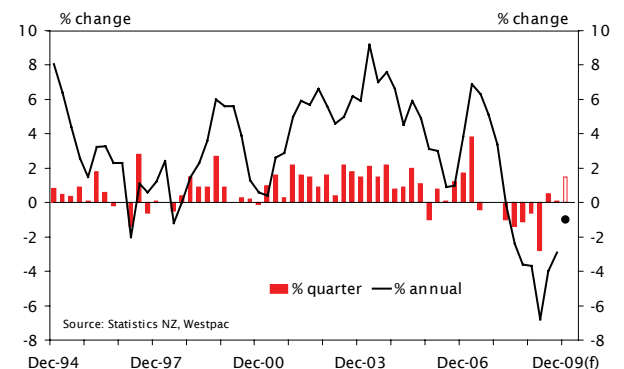


NZ Q4 real retail sales

Feb 12, Last: 0.1%, WBC f/c: 1.5%

- Total retail sales in the month of December are expected to push 0.6% higher (seas adj). We expect core retail sales to be up 0.4% and stronger car sales to add to the total.
- Nominal sales excluding auto will be up around 1.7% in the December quarter. There was price weakness (particularly food) and discounting across a wide range of retail goods in the December quarter. A negative deflator of 0.3% will make for core retail volume growth of 2.0%. This would be the strongest quarterly growth outturn in almost three years.

NZ real retail sales

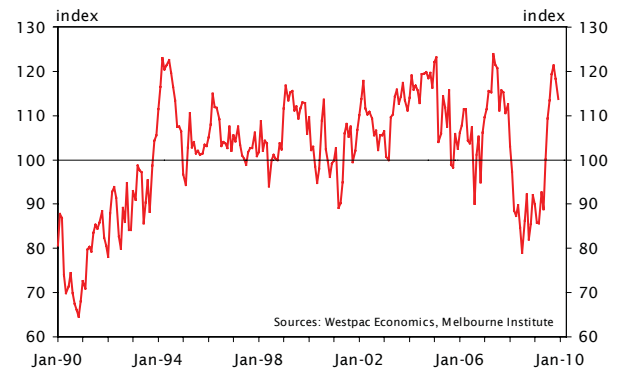


**Aus Feb Westpac-MI Consumer Sentiment**

Feb 10, Last: 120.1

- The *Westpac-Melbourne Institute Index of Consumer Sentiment* showed surprising strength in January, rising 5.6% and recovering all the ground lost since the RBA began raising rates in October. At 120.1, the index moved back into strongly optimistic territory.
- The February survey is in the field the week ended Feb 7. As such, it will capture the reaction to the RBA's surprise decision to leave rates unchanged at its Feb meeting. Sentiment may also be impacted by news of more strong gains in house prices; surging dwelling approvals; but mixed retail sales figures. Although probably off the radar for Australian consumers, the US economy also posted strong Q4 growth figures. Financial markets have been much shakier though, the ASX sliding over 8% and the AUD down 5½c against the USD since the Jan survey.

**Consumer Sentiment**

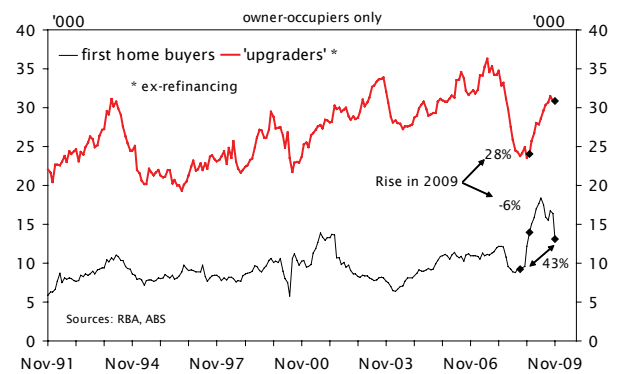


**Aus Dec housing finance**

Feb 10, Last: -5.6%, WBC f/c: -6.0%, Mkt f/c: -5.0%, Range: -7.0% to 4.0%

- Housing finance is in a temporary adjustment phase, as the first home buyer segment corrects with the removal of the additional bonus from the Commonwealth.
- We're forecasting the number of approvals to owner-occupiers to fall by 6.0% in December, following a 5.6% drop in November and a near 2% decline in October.
- Interest rate rises by the RBA in the final three months of the year are also a headwind. Although, the Upgrader segment has so far been reasonably resilient, with only a 2% fall in October and a flat result in November. That contrasts with a 31% rise over the first nine months of 2009.
- If the RBA does enter a more extended pause later in 2010 and the labour market continues to firm, as we anticipate, we could see a second wind for housing finance.

**Housing finance: FHBs losing altitude**

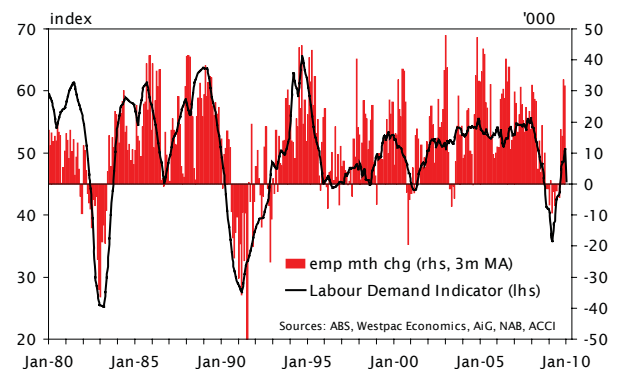


**Aus Jan employment chg**

Feb 11, Last: 35.2k, WBC f/c: 15k, Mkt f/c: 15k, Range: -5k to 30k

- December saw the 4th consecutive upside surprise in jobs, up 35.2k for a cumulative 135.7k rise in four months. Since troughing in July at a highly resilient -0.1%yr, annual trend jobs growth has accelerated to +0.8%yr in December. Trend average hours worked have been rising for five months, although are still 2.0% below their Jun-08 peak (spare capacity that should be tempering the upswing in jobs).
- While our composite of business survey employment indices was up solidly to December, its 50.6 level was historically consistent with a slower uptrend in jobs around 11k/mth, suggesting consolidation near-term. Also, partial inputs for January for the composite (PMI & PSI) suggest a setback this month. We continue to expect an acceleration in jobs growth to 2½%yr in 2010, but expect a softer 15k rise this month, taking annual trend growth to +1.1%yr (highest since Dec-08).

**Westpac Australian Labour Demand Indicator**

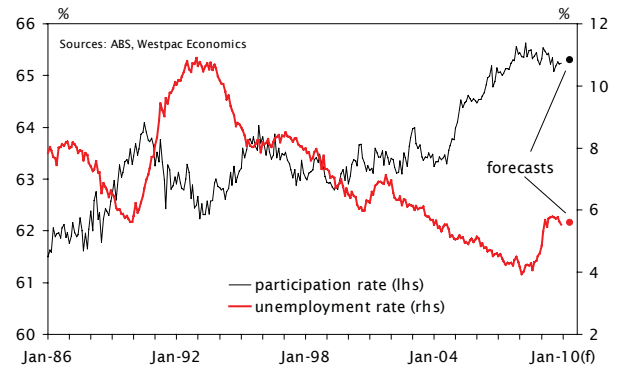


**Aus Jan unemployment rate**

Feb 11, Last: 5.5%, WBC f/c: 5.6%, Mkt f/c: 5.6%, Range: 5.5% to 5.7%

- With the December jobs jump accompanied by a steady participation rate (65.2%), the unemployment rate fell from a downwardly revised 5.6% to 5.5%. This has confirmed a much lower and earlier peak in the rate than had been expected, at just 5.8% in October. However, while we expect an acceleration in annual jobs growth through 2010, accelerating working aged population growth and prospects for rising participation rates are lifting the monthly jobs requirement to hold the unemployment rate steady, so we expect the recent downtrend in the unemployment rate to flatten in 2010.
- Historically, months of around 15k jobs growth following 0.1ppt dips in the unemployment rate have been accompanied by slightly higher participation rates. We expect a 0.02ppt rise in participation to a rounded 65.3%, which would nudge the unemployment rate 0.03ppts higher to a rounded 5.6%.

**Unemployment and participation rates**



**US Dec trade deficit to narrow as exports jump**

Feb 10, Last: -\$36.4bn, WBC f/c: -\$34.9bn, Mkt f/c: -\$35.5bn

- The trade deficit widened sharply in Nov, by \$3.2bn, due to imports rising at three times the pace of exports. Both were strong – the 0.9% rise in exports followed 2+% gains in four of the previous five months. But imports surged 2.6%, building upon 5+% gains in July and September, a further indication that the US economy is back in business.
- Improving global trade, the lagged impact of the weaker US dollar through most of 2009, a 0.6% rise in export prices and a 58% jump in Boeing deliveries to foreign customers should see a return to 2+% export growth in Dec (we are forecasting 3%). Flat prices will constrain the import side but we still expect a solid 1.5% rise, in part due to higher oil import volumes.
- Those dynamics should drive a \$1.5bn narrowing in the trade deficit to \$34.9bn in Dec.

**US trade balance**

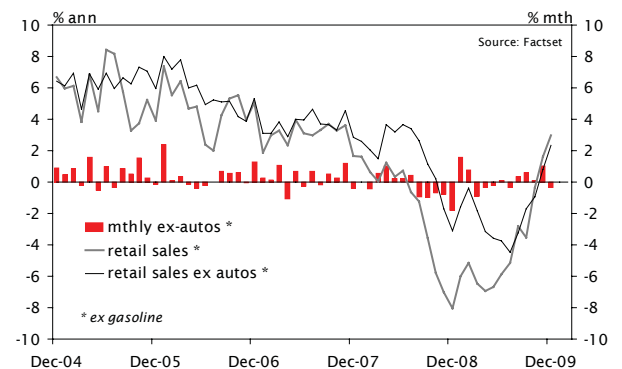


**US Jan retail sales to fall on autos, weather**

Feb 11, Last: -0.3%, WBC f/c: -1.0%, Mkt f/c: 0.3%

- Retail sales posted unexpected declines across all key measures in Dec (though Nov was revised higher). An increasing tendency for holiday season shopping to start earlier than in previous years probably weighed against Dec and helped boost Nov.
- Jan data to hand include a 4% fall in unit auto sales, weighed down by “unexpected acceleration” problems that saw Toyota suspend sales late Jan, and weather disruption. Indeed snowstorms impacted sharply on weekly retail figures mid month. Gasoline prices rose slightly but reports suggest there was less driving than usual due to the weather.
- These factors should deliver an even steeper retail fall in Jan, but they are largely one-offs and should not be over-interpreted as signs of economic weakness.

**US retail sales**



## Key Data and Events

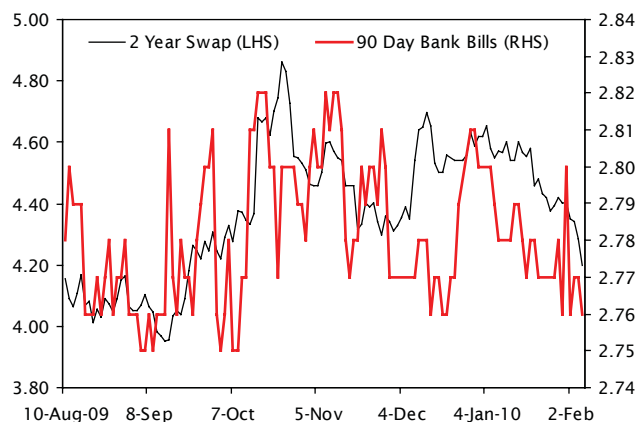
		Last	Market Median	Westpac Forecast	Comments
<b>Mon 8 Feb</b>					
Jpn	Dec Current Account ¥bn sa	1305	1250	-	Big widening awaits recovery in global yields & durables demand.
	Jan Bank Lending %yr	-1.0%	-	-	Weak flows and high base effects will hit year-ended pace hard.
Eur	Feb Sentix Investor Sentiment	-3.7	-2.7	-5.0	ZEW survey suggests recent Sentix upswing unsustainable.
Can	Jan Housing Starts	3.9%	2.6%	-	Single family urban starts solid, multiples weaker of late.
<b>Tue 9 Feb</b>					
NZ	PM John Key State of Nation speech	-	-	-	Expect announcements on economic policy and tax changes
Aus	Jan NAB Business Survey	10	-	-	Conditions steady in Dec at an above trend level.
US	Jan NFIB Small Business Optimism	88.0	-	-	Stalled between 86.5 to 89.0 since April last year.
	Dec Wholesale Inventories	1.5%	0.5%	-	Guide to direction of Q4 GDP revisions.
	Feb IBD/TIPP Economic Optimism	48.8	-	53.0	Conf Brd index hit new cycle high in Jan; UoM did too.
UK	Jan RICS House Prices % Balance	30%	27%	-	Surveyors have been reporting higher prices since Aug.
	Jan BRC Retail Sales Monitor %yr	4.2%	-	0.0%	Sharply lower sales due VAT hike and snow disruption.
	Dec Visible Trade Balance £bn	-6.8	-6.7	-	Deficit off recent lows around £6.2bn.
<b>Wed 10 Feb</b>					
NZ	Jan Electronic Card Transactions	0.3%	-	-	Could be affected by poor post-Christmas spending.
Aus	Feb Westpac-MI Consumer Sentiment	120.1	-	-	Will capture reaction to RBA's surprise reprieve on rates.
	Dec Housing Finance (no.)	-5.6%	-5.0%	-6.0%	Pull-back: First Home Buyers losing altitude & rate rises a headwind.
US	Dec Trade Balance \$bn	-36.4	-35.5	-34.9	Flat import prices, higher exp prices, improving trade to narrow deficit.
	Jan Federal Budget \$bn	-63.5	-50.0	-	Watch these numbers blow out to \$1.6trn per year!
	Fedspeak	-	-	-	Plosser on financial crisis.
Jpn	Dec Machinery Orders	-11.3%	8.0%	-	Investment outlook is still bleak, but external demand is improving.
	Jan Corp. Goods Prices %yr	-3.9%	-2.3%	-	Commodity prices are rising again; durables still face supply glut.
UK	Dec Industrial Production	0.4%	0.2%	1.0%	Utility consumption during cold snap major boost to IP.
	BoE Quarterly Inflation Report	-	-	-	More guidance re outlook for inflation, rates and QE program.
Can	Dec Trade Balance \$bn	-0.3	-0.1	-	Switching between small deficit/surplus each month.
<b>Thu 11 Feb</b>					
NZ	Jan Food Prices	-0.3%	-	0.8%	Dairy price increases plus effect of Oct snow.
Aus	Feb WBC-MI Unemploy Expectations	-15.5%	-	-	Jan fall more than unwound two prev rises, continuing rapid downtrend.
	Feb MI Inflation Expectations	3.5%	-	-	Consumer uptrend has stalled, but rising for managers/professionals.
	Jan Employment chg	35.2k	15k	15k	Business surveys imply slower uptrend, some suggesting softer Jan.
	Jan Unemployment Rate	5.5%	5.6%	5.6%	Softer jobs gain, slightly higher participation (65.3%) to nudge U higher.
US	Jan Retail Sales	-0.3%	0.3%	-1.0%	Auto sales known down nearly 4% and snowstorm disruption to
	Jan Retail Sales ex Autos	-0.2%	0.5%	-0.5%	weigh on Jan retailing but expect a Feb bounce.
	Initial Jobless Claims w/e 6/2	480k	465k	-	Recent volatility due to late 2009 backlog processing ... until last week?
	Dec Business Inventories	0.4%	0.3%	-	Further clue to direction of Q4 GDP revisions.
Can	Dec New House Prices	0.4%	0.4%	-	Up for five months running July-Nov after falling from Q4 2008.
<b>Fri 12 Feb</b>					
NZ	Jan REINZ House Prices %yr	6.4%	-	-	Sales dropped off a cliff in January.
	Q4 Real Retail Sales	0.1%	1.4%	1.5%	Lower prices result in volume growth being above revenue growth.
	Dec Retail Sales	0.8%	0.6%	0.6%	Core growth of 0.4%, and more vehicle sales add to total.
US	Feb UoM Consumer Sentiment Prelim	74.4	75.0	75.0	Gasoline prices lower in Feb; good news on economy, Wall St steadier.
Eur	Dec Industrial Production	1.0%	0.1%	0.8%	German data due 5/2 will provide further clue.
	Q4 GDP Advance	0.4%	0.3%	0.2%	Partial data less solid in Q4 compared to Q3.
Ger	Q4 GDP Prelim	0.7%	0.2%	0.1%	Somewhere between 0-0.5% according to official sources.
Can	Dec Auto Sales	-6.0%	2.0%	2.0%	StatCan guidance for Dec is 2% gain.

## New Zealand Economic and Financial Forecasts

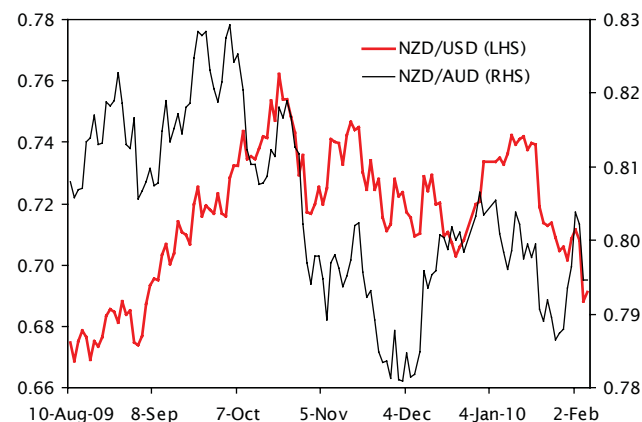
Economic Growth Forecasts	March years				Calendar years			
	2008	2009	2010f	2011f	2008	2009e	2010f	2011f
% change								
GDP (Production) ann avg	2.9	-1.4	-0.1	4.2	-0.1	-1.4	3.7	4.3
Employment	-0.3	0.7	-0.9	1.7	0.9	-2.4	1.1	2.1
Unemployment Rate % s.a.	3.8	5.0	7.1	6.1	4.7	7.3	6.4	5.3
CPI	3.4	3.0	2.3	2.8	3.4	2.0	2.7	2.8
Current Account Balance % of GDP	-7.8	-7.9	-2.1	-4.9	-8.7	-2.1	-4.7	-5.1

Financial Forecasts	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Cash	2.50	3.00	3.50	4.00	4.50	5.00	5.50
90 Day bill	2.90	3.40	4.00	4.50	5.00	5.50	6.00
2 Year Swap	4.60	4.90	5.20	5.50	5.80	6.30	6.10
5 Year Swap	5.60	5.70	5.90	6.10	6.25	6.40	6.55
10 Year Bond	5.90	6.00	6.00	6.10	6.20	6.30	6.30
NZD/USD	0.68	0.68	0.74	0.79	0.78	0.75	0.72
NZD/AUD	0.79	0.80	0.82	0.83	0.84	0.83	0.84
NZD/JPY	59.8	61.9	71.0	79.0	82.7	81.8	80.6
NZD/EUR	0.49	0.50	0.53	0.55	0.53	0.51	0.49
NZD/GBP	0.43	0.42	0.44	0.46	0.43	0.40	0.38
TWI	63.0	63.6	68.2	71.9	71.3	69.0	67.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



## NZ interest rates as at market open on Monday 8 February 2010

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.74%	2.71%	2.73%
60 Days	2.76%	2.75%	2.75%
90 Days	2.77%	2.77%	2.78%
2 Year Swap	4.22%	4.42%	4.57%
5 Year Swap	5.22%	5.33%	5.53%

## NZ foreign currency midrates as at Monday 8 February 2010

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.6907	0.7136	0.7362
NZD/EUR	0.5039	0.5042	0.5111
NZD/GBP	0.4412	0.4396	0.4595
NZD/JPY	61.730	64.450	68.220
NZD/AUD	0.7925	0.7896	0.7962
TWI	63.890	65.070	66.790

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2005	2006	2007	2008	2009e	2010f	2011f
<b>Australia</b>							
Real GDP % yr	2.8	2.9	4.0	2.3	1.0	3.0	3.2
CPI inflation % annual	2.8	3.3	3.0	3.7	2.1	2.5	2.7
Unemployment %	5.1	4.8	4.4	4.3	5.6	5.5	5.3
Current Account % GDP	-5.8	-5.3	-6.3	-4.4	-4.2	-5.3	-4.7
<b>United States</b>							
Real GDP %yr	3.1	2.7	2.1	0.4	-2.4	1.8	3.0
Consumer Prices %yr	3.4	3.2	2.9	3.8	-0.5	1.3	2.4
Unemployment Rate %	5.1	4.6	5.8	5.8	9.3	10.7	10.6
Current Account %GDP	-6.1	-6.0	-5.3	-4.9	-3.0	-3.0	-2.2
<b>Japan</b>							
Real GDP %yr	1.9	2.8	2.2	-1.5	-5.6	1.5	1.8
Consumer Prices %yr	-0.3	0.2	0.1	1.4	-1.2	-0.7	0.3
Unemployment Rate %	4.4	4.1	3.9	4.0	5.1	5.2	5.1
Current Account %GDP	3.6	3.9	4.8	3.2	2.9	4.0	4.8
<b>Euroland</b>							
Real GDP %yr	1.7	2.9	2.7	0.6	-4.0	0.7	1.1
Consumer Prices %yr	2.5	2.0	3.1	1.6	0.9	0.7	1.2
Unemployment Rate %	8.8	7.9	7.3	7.8	10.0	11.5	10.8
Current Account %GDP	-0.2	-0.1	0.1	-1.1	-1.0	-0.5	0.0
<b>United Kingdom</b>							
Real GDP %yr	2.2	2.9	2.6	0.7	-4.7	0.4	1.2
Consumer Prices %yr	2.1	3.0	2.1	3.5	2.9	2.0	1.5
Unemployment Rate %	2.8	3.0	2.5	3.1	5.5	7.0	7.3
Current Account %GDP	-2.6	-3.3	-2.7	-1.6	-2.4	-2.0	-1.5

Forecasts finalised 5 February 2010

Interest Rate Forecasts	Latest (Feb 8)	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
<b>Australia</b>						
Cash	3.75	4.00	4.25	4.50	4.50	4.50
90 Day Bill	4.11	4.20	4.50	4.60	4.75	4.75
10 Year Bond	5.39	5.60	5.90	6.00	6.00	6.10
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.57	3.60	3.40	3.75	4.00	4.50
ECB Repo Rate	1.00	1.00	1.00	1.00	1.25	2.00
<b>Exchange Rate Forecasts</b>						
AUD/USD	0.8716	0.86	0.85	0.90	0.95	0.93
USD/JPY	89.38	88	91	96	100	106
EUR/USD	1.3707	1.38	1.36	1.40	1.43	1.46
AUD/NZD	1.2619	1.26	1.25	1.22	1.20	1.19

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