

Weekly Commentary

9 November 2009

Labourled recovery

Last week's data confirmed the severe toll that the recent recession has taken on New Zealand's labour market.

The Household Labour Force Survey for the September quarter saw the unemployment rate jump a further half-percentage point to 6.5%, the highest level in nine years. Although the unemployment rate is much lower than the early-1990s recession, the rate of increase has been every bit as severe.

We always expected this data to reflect the recession just past, rather than the recent flush of stronger data, as the labour market tends to lag economic growth. Even so, we regard the overall survey as weaker than we expected. It was not so much the 0.8% fall in employment (16,000 jobs) - while weaker than our forecast of -0.2%, the error was neither here nor there in an economic sense. For the past two years, employment growth has been thrown around by movements in the surveyed participation rate, which has been extremely volatile and negatively autocorrelated (exhibiting a sawtooth pattern), and this quarter was no exception. We have found it more useful to focus on the unemployment rate, which was bang on our forecast.

The more important part was the 0.7% fall in hours worked, coming on top of a 1.9% fall in the June quarter. We had expected to see a lift in hours worked, as employers responded to early increases in economic

activity by increasing the hours of existing staff, rather than hiring new staff. We still expect this to happen in coming quarters, but the process is proving to be slower than we thought. It's possible that swine flu may have had an impact on the number of hours worked, as 'usual hours worked', which includes time spent on sick leave, fell by only 0.2%. But regardless of the cause, the drop in actual hours worked suggests that the economy may have grown by less than our 0.4% forecast for Q3.

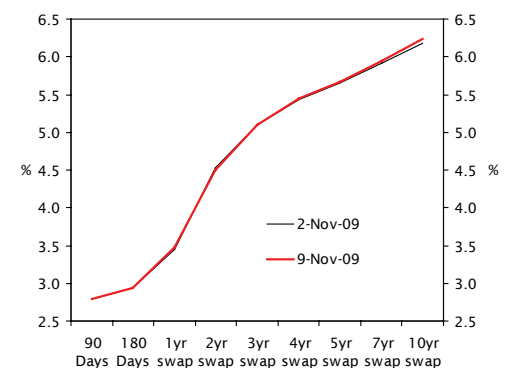
We anticipate that this was the last quarter of sharp increases in unemployment, though it will be a while longer before new hiring starts to outstrip the growth in the labour force. We expect the unemployment rate to peak at sub-7% early next year.

The wages data were also consistent with the sense that the labour market has reached the bottom of the cycle. The Labour Cost Index (LCI) registered a 0.4% rise in private sector pay in the September quarter, in line with our expectations. The slight acceleration from the 0.3% pace in June is illusory: most workers have their annual pay review in the second half of the year, so the index (which is not seasonally adjusted) tends to advance more in the final two quarters. Public sector pay rose 1.1%, partly due to the 4% pay increase given to primary and secondary teachers and principals on 1 July.

The LCI measures pay rates for given positions, experience levels etc, while the 'unadjusted' LCI includes pay rises given for promotions. Although it is not really a measure of wage inflation, it does tend to follow the labour market cycle more closely, and is therefore worth watching. As expected, it portrayed a labour market that has been battered over the past year, with the annual increase falling from 5.6% to 3.8%.

The Quarterly Employment Survey (QES) painted a more upbeat picture than the LCI, with private sector ordinary time earnings posting a stunning increase of 1.7% for the quarter to be 4.4% higher than a year ago. We suspect that the strength in the QES is down to its coverage of self-employed and commission-based workers, whose earnings are inherently cyclical but are not

NZ Interest Rates



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

covered by the LCI. As a result, the QES is better at registering the early stages of recovery. Backing this hypothesis, hourly earnings in the rental, hiring and real estate services industry (where many workers are on commission) were up 8.5% in the quarter.

Altogether, the labour data suggests the economy was coming from a slightly weaker point than previously thought in Q3. However, many forward-looking indicators are still powering ahead, especially with regard to the housing market and commodity prices. Most significantly, Fonterra unveiled a 95 cent increase in its payout forecast for the 2009/10 season, to \$6.05 per kilo of milksolids. A lift in the expected payout is not surprising, given the surge in world dairy prices in recent months, but for Fonterra to raise their forecast this far in one go suggests a high degree of confidence that these improved prices

can be achieved through the rest of the season. The increase in the payout would lift industry-wide revenue by around \$1.3bn, equivalent to 0.7% of GDP, and would mean a significant improvement in farm cashflows.

This week's data calendar turns the spotlight back onto the household. Retail sales for the September month are expected to push 0.6% higher, following a solid (possibly weather-assisted) 1.1% gain in August. However, this would still leave the value of sales up just 0.7% for the quarter, and with the retail components of the CPI exhibiting strong price increases, particularly for cars and petrol, we estimate that sales volumes were down by 0.3%. On that outcome, volumes would have fallen in eight of the last ten quarters.

We expect the nationwide housing figures for October to show a further

increase in sales and declining days to sell (in seasonally adjusted terms). Low interest rates, rising net migration and constrained supply ensure that house prices remain well-supported.

Fixed vs. floating: Six-month fixed mortgage rates have now risen – until now this was the only fixed term that had been left unscathed by rate increases. Now that it appears no point on the mortgage curve is 'safe', we could see borrowers rush to fix at whatever favourable rates are still on offer. 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.

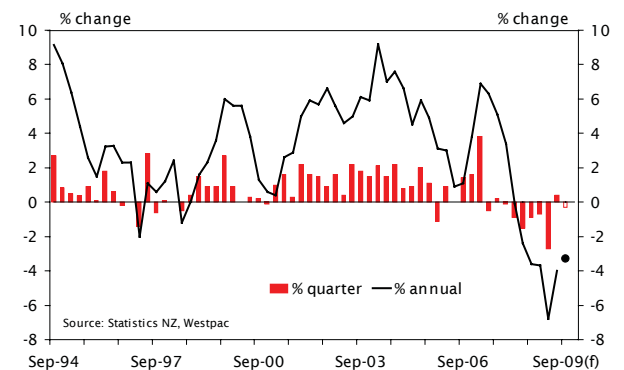
Key Data Previews

NZ Q3 real retail sales

Nov 12, Last: 0.4%, WBC f/c: -0.3%

- Total retail sales in the month of September are expected to push 0.6% higher following the strong gains in August. We expect a strong lift in car sales during September (given a strong lift in registrations) to boost overall sales, with the ex-auto sectors expected to post a 0.4% rise.
- Aggregate indicators paint a mixed picture. Credit card billings fell 1.0% in the month, while the broader electronic card transaction data for retailers rose 0.7%. Consumer confidence continued to soar during the month, despite hikes in retail interest rates.
- Over the quarter, we expect the volume of sales to fall. Details from the CPI tell us that retail prices (especially for cars and petrol) rose by more than the expected increase in the dollar value of sales. We expect total volumes dipped by 0.3%, while ex-auto volumes eked out a 0.1% gain.

NZ real retail sales

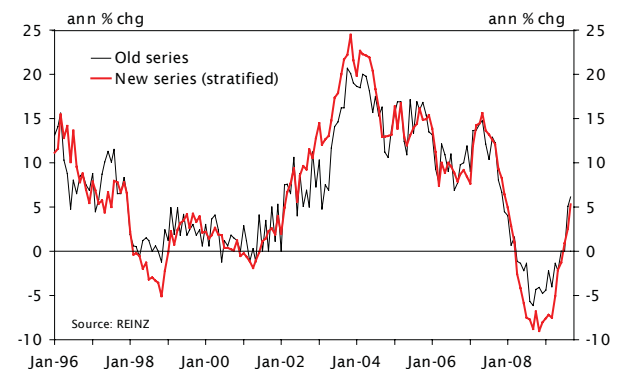


NZ Oct REINZ house sales and prices

Nov 13, Last: 5.3% yr

- Demand for housing has strong momentum, spurred on by still-low mortgage interest rates and rising net migration. Yet supply continues to be constrained by low listings and previous under-investment in new homes.
- The mismatch between demand and supply has become increasingly evident in falling days to sell and rising house prices. In the four months to September, the REINZ house price index rose 4%.
- We expect the October nationwide REINZ data to show a further increase in sales and declining days to sell. In this environment, we expect prices to remain well supported, with a further increase expected in the month.

REINZ house prices

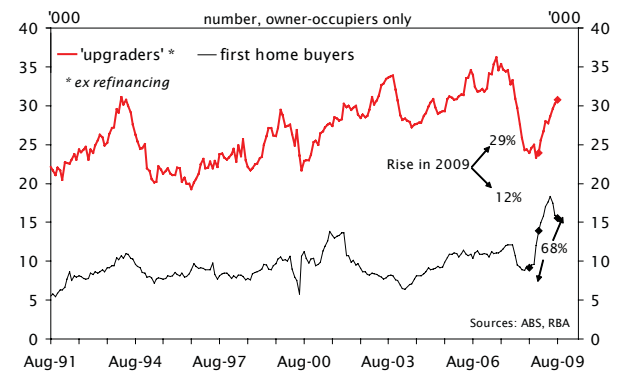


Aus Sep housing finance

Nov 9, Last: -0.6%, WBC f/c: 3.0%, Mkt f/c: 3.0%, Range: -1.0% to 4.5%

- Demand for housing finance from owner-occupiers has surged, with interest rates at a once in a generation low and additional government incentives for First Home Buyers (FHBs). New lending is up 39% over the last year and, within that, lending for the construction of new dwellings has jumped 69%.
- We're forecasting finance approval numbers for owner-occupiers to rise a further 3% in September. Expect a late burst of interest from FHBs ahead of the partial scaling back of the additional bonus from 1 October. That contrasts with the 15% drop in lending to this segment over the last three months. Going forward, lending to FHBs will lose altitude from current elevated levels.
- Lending to Upgraders continues to trend higher and is up 29% so far this calendar year.

Housing finance: smooth baton change

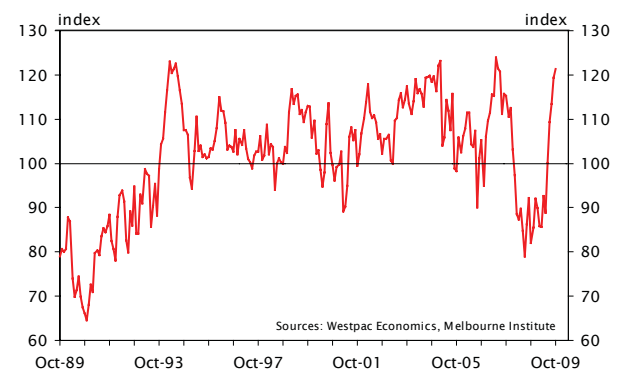


Aus Nov Westpac-MI Consumer Sentiment

Nov 11, Last: 121.4

- The Westpac-Melbourne Institute Index of Consumer Sentiment rose by 1.7% in Oct from 119.3 in Sep to 121.4. This followed a record surge between May and Sep and came in spite of a 25bp interest rate rise from the RBA and warnings of follow-on moves. That said, evidence from previous tightening cycles points to sentiment being resilient to initial rate rises.
- The Nov survey is in the field the week ended Nov 8. As such it will capture reactions to the RBA's follow-on 25bp rate hike at its Nov 3 meeting. Other likely influences include: further strong rises in house prices but a more mixed month for equities; weaker than expected retail sales, but another solid rise in dwelling approvals and stronger than expected trade data; GDP figures confirming the US economy moved out of recession in Q3; and upgrades to official growth forecasts by the RBA and the Government.

Consumer Sentiment

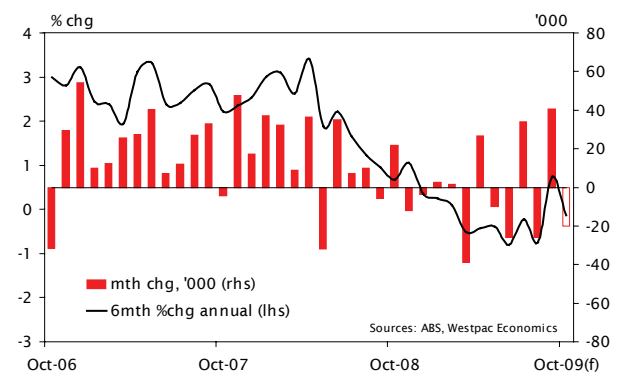


Aus Oct employment chg

Nov 12, Last: 40.6k, WBC f/c: -20k, Mkt f/c: -10k, Range: -20k to 25k

- Employment shocked on the upside in September with a 40.6k bounce, although this still saw trend growth slow to -0.15%yr, the weakest since Feb-93. Full-time jobs rose 35.4k, but following four straight falls, trend growth was -2.27%yr.
- The State split of the jobs bounce advocates caution, with South Australia explaining the majority of gains. This suggests statistical noise at play, raising risks of an October pullback.
- A partial retracement of recent gains in business survey employment indices also points to some pullback in October.
- We forecast a 20k fall in employment, which would temper the monthly uptrend to +2.0k (from +4.7k) but allow annual trend growth to continue easing gradually to -0.18%yr (from -0.15%yr), approaching a 2009Q4 low of around -0.3%yr.

Aust jobs: volatility to continue in October

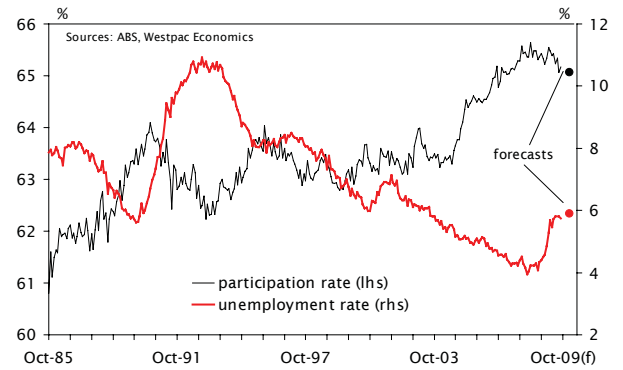


Aus Oct unemployment rate

Nov 12, Last: 5.7%, WBC f/c: 5.9%, Mkt f/c: 5.8%, Range: 5.7% to 6.0%

- The employment surge in September was only partially offset by a rise in the participation rate to 65.2% from 65.1%, allowing an unexpected dip in the unemployment rate to 5.7% from 5.8% (5.745% to three decimals).
- Historically, months of employment falls of the magnitude we expect, following prior rises in the participation rate and slight dips in the unemployment rate, have been accompanied by an average 0.2ppt fall in the participation rate. But this cycle has seen greater participation resilience, so we look for a lesser 0.1ppt dip to 65.1%. This results in a near steady labour force, but the jobs fall is enough to lift the unemployment rate to 5.9% from 5.7%. However, risks for the unemployment rate are to the downside from any greater pullback in participation more commensurate with history.

Unemployment and participation rates

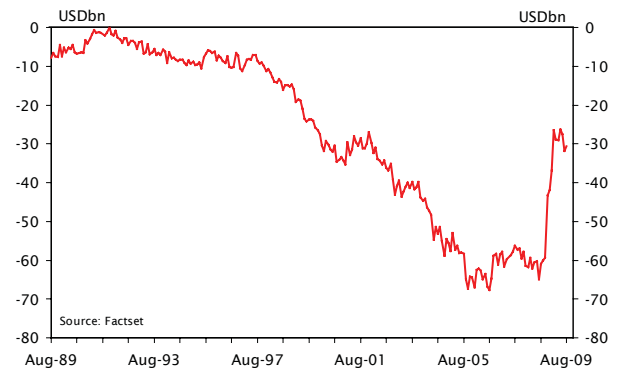


US September trade deficit to narrow slightly

Nov 13, Last: -\$30.7bn, WBC f/c: -\$30.5bn, Mkt f/c: -\$31.8bn

- The trade deficit narrowed dramatically earlier this year, from \$60+bn 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. Then in July, the deficit widened by \$4.4bn to back over \$30bn as roaring import growth far outpaced solid exports, although the deficit was little changed in August.
- In September, import prices were little changed, and auto imports should slow after three very strong months in June-Aug. Business surveys suggest recent export momentum is sustainable; shipments, especially of capital goods, rose; and Boeing had a better month, pointing to increased civilian aircraft deliveries to foreign buyers.
- Exports +1.2%, imports +0.8% = deficit narrows to \$30.5bn.

US trade balance



Key Data and Events

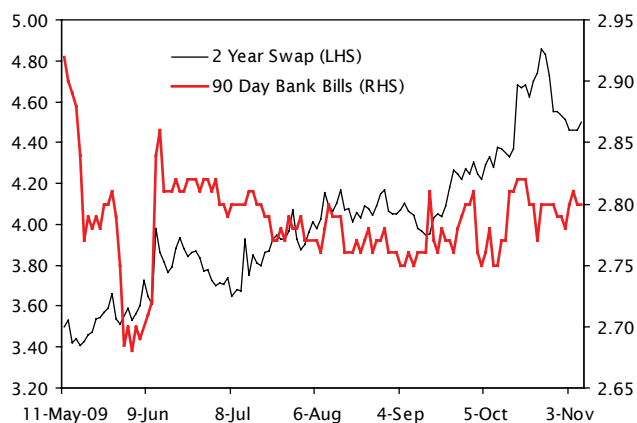
		Last	Market Median	Westpac Forecast	Comments
Mon 9 Nov					
Aus	Sep Housing Finance	-0.6%	3.0%	3.0%	After 2mths of decline, FHBs getting in ahead of bonus wind down.
	Oct ANZ Job Ads	4.4%	-	-	Consecutive gains & trough in deviation = Jan-10 low for jobs%yr.
	RBA Assistant Governor Lowe Speaking	-	-	-	On panel at UWA "In the Zone" conference, Perth (14:20AEDT)
Eur	Nov Sentix Investor Sentiment	-12.6	-12.0	-12.0	Pace of improvement is levelling off - see ZEW comment below.
Ger	Sep Industrial Production	1.7%	1.0%	1.0%	Auto production strong due scrappage schemes in many countries.
Can	Oct Housing Starts	-4.6%	5.0%	-	Volatile series but trend clearly rising.
Tue 10 Nov					
NZ	Oct Electronic Card Transactions	0.4%	-	-	Expect strong lift in transactions on higher consumer confidence.
Aus	RBA Head of Domestic Markets Speaking	-	-	-	"Reconnecting Corporate Aust. with Frozen Credit Markets..."
	Oct NAB Business Survey	7.0	-	-	Conditions index (+1pt in Sep, +14pt since May) implies robust growth.
US	Nov IDB/TIPP Economic Optimism	48.7	49.5	50.0	Confidence fell in Oct but small bounce expected in Nov.
	Fedspeak	-	-	-	Lockhart and Yellen (seen by some as Bernanke mouthpiece).
Jpn	Sep Current Account ¥bn s.a.	1234	1320	-	Exports continue to improve, income surplus slowly rebuilding.
	Oct Bank Lending %yr	1.6%	1.5%	-	Capex demand is non-existent, working capital consolidating.
Ger	Nov ZEW Analysts' Survey	56.0	55.0	56.0	Uptrend since late 2008 has now stalled.
UK	Oct BRC Retail Sales Monitor %yr	2.8%	-	-	Same store sales measure strong in Sep but official retail sales flat.
	Oct RICS House Prices net balance %	22%	28%	-	Surveyors have been calling prices higher since Aug.
	Sep Visible Trade Balance £bn	-6.2	-6.1	-	Deficit narrowing thanks to weaker £ and weak domestic demand.
	Sep House Prices %yr	-5.6%	-4.9%	-	Lesser watched DCLG index.
Wed 11 Nov					
NZ	Oct Food Prices	-0.7%	-	0.5%	Higher meat and grocery prices to drive food prices up.
Aus	Nov Westpac-MI Consumer Sentiment	121.4	-	-	Consumers barely flinched after Oct's rate hike. How about Nov?
US	Fedspeak	-	-	-	Dallas Fed's Fisher.
Jpn	Sep Machinery Orders	0.5%	4.1%	-	Machinery orders rebound the missing link in IP rally.
UK	Oct Unemployment Change	21k	20k	20k	With economy still shrinking in Q3, joblessness is still rising.
	BoE Quarterly Inflation Report	-	-	-	More detail behind Nov rate/QE decision.
Thu 12 Nov					
NZ	Q3 Real Retail Sales	0.4%	-0.1%	-0.3%	Sales volumes to turn down again.
	Sep Retail Sales	1.1%	0.4%	0.6%	Sales to push higher from strong gains in August.
Aus	Oct Employment chg	40.6k	-10k	-20k	Payback for noisy Sep jump, but ann. growth approaching Q4 trough.
	Oct Unemployment Rate	5.7%	5.8%	5.9%	Jobs pullback partially offset by 0.1ppt PR dip to 65.1%; downside risk.
	Nov WBC-MI Unemployment Expect's	-14.6%	-	-	Trended down 33% from Feb peak implying Q4 trough for jobs%yr.
	Nov MI Inflation Expectations	3.5%	-	-	Steady last 3 mths, although in uptrend since Mar to 3.63%.
US	Initial Jobless Claims w/e 31/10	512k	510k	520k	Downtrend continuing but not yet indicative of jobs growth.
	Oct Federal Budget Statement \$bn	-	-	-	Too early for stronger activity to drive significant revenue recovery.
Jpn	Oct Corporate Goods Prices %yr	-7.9%	-6.0%	-	Supply glut remains, yen strength mitigating bounce in raw materials.
Eur	Sep Industrial Production	0.9%	0.5%	1.0%	Orders upswing now translating into steady IP growth, much of it cars.
Can	Sep New House Prices	0.1%	0.2%	-	On the rise again after falling for nine months.
Fri 13 Nov					
NZ	Oct REINZ House Prices %yr	5.3%	-	-	Prices well supported by strong demand, low supply.
US	Sep Trade Balance \$bn	-30.7	-32.0	-30.5	Steady oil prices, recovering exports, fewer auto imports.
	Oct Import Price Index	0.1%	1.0%	1.2%	Oil prices on the rise again.
	Nov UoM Consumer Sentiment (Prelim)	70.6	71.0	72.0	Bounce in confidence continues in Nov after Oct revised higher.
	Fedspeak	-	-	-	Chicago Fed's Evans in Paris.
Jpn	Sep Capacity Utilisation	2.3%	-	-	Factory use well up from the trough, but well down from the peak.
Eur	Q3 GDP Adv	-0.2%	0.5%	0.5%	Boost from exports and auto scrappage schemes in US, UK, Europe.
Ger	Q3 GDP	0.3%	0.8%	0.7%	Boost from auto output due scrappage schemes at home and US, UK.
Can	Sep Trade Balance C\$bn	-2.0	-1.7	-	Swinging between surplus and deficit.
	Sep Auto Sales	-0.3%	0.0%	0.0%	StatCan guidance for Sep was "relatively unchanged".

New Zealand Economic and Financial Forecasts

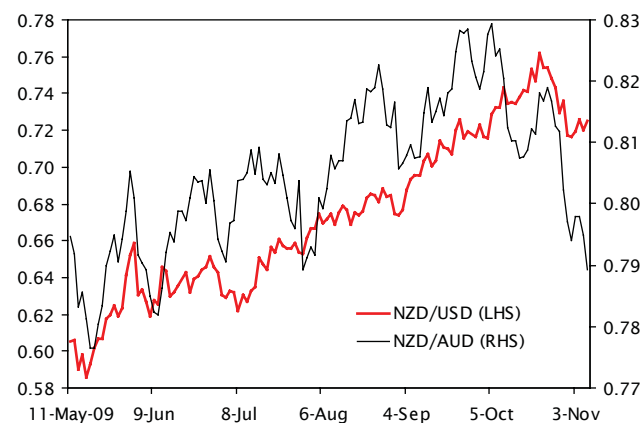
Economic Growth Forecasts	March years				Calendar years			
	2008	2009	2010f	2011f	2008	2009f	2010f	2011f
% change								
GDP (Production) ann avg	3.1	-1.1	0.0	3.8	0.0	-1.3	3.5	3.8
Employment	-0.3	0.7	-0.8	1.6	0.9	-2.1	1.0	1.8
Unemployment Rate % s.a.	3.8	5.0	6.7	5.3	4.7	6.7	6.3	5.5
CPI	3.4	3.0	2.4	2.8	3.4	2.5	2.4	2.8
Current Account Balance % of GDP	-7.9	-8.1	-2.5	-5.3	-8.9	-2.6	-4.0	-5.2

Financial Forecasts	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Cash	2.50	2.75	3.25	3.75	4.25	4.75	5.25
90 Day bill	2.90	3.20	3.70	4.20	4.70	5.20	5.70
2 Year Swap	4.70	5.10	5.40	5.70	5.90	6.10	6.20
5 Year Swap	5.80	6.00	6.10	6.20	6.30	6.40	6.50
10 Year Bond	6.00	6.10	6.20	6.30	6.30	6.40	6.50
NZD/USD	0.77	0.77	0.73	0.76	0.78	0.77	0.75
NZD/AUD	0.80	0.80	0.81	0.82	0.82	0.83	0.83
NZD/JPY	67.8	67.8	67.9	73.0	78.0	81.6	81.8
NZD/EUR	0.51	0.51	0.50	0.51	0.52	0.52	0.51
NZD/GBP	0.44	0.43	0.42	0.42	0.43	0.43	0.40
TWI	67.5	67.4	65.9	67.9	69.6	70.2	69.0

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 9 November 2009

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.79%	2.79%	2.78%
60 Days	2.79%	2.79%	2.78%
90 Days	2.80%	2.80%	2.77%
2 Year Swap	4.50%	4.83%	4.37%
5 Year Swap	5.67%	5.82%	5.45%

NZ foreign currency midrates as at Monday 9 November 2009

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7346	0.7484	0.7344
NZD/EUR	0.4935	0.5034	0.4987
NZD/GBP	0.4408	0.4582	0.4632
NZD/JPY	66.120	68.970	65.910
NZD/AUD	0.7960	0.7484	0.8124
TWI	65.630	67.310	66.280

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	1.0	2.8
CPI inflation % annual	2.6	2.8	3.3	3.0	3.7	2.0	2.2
Unemployment %	5.4	5.1	4.8	4.4	4.3	5.7	6.4
Current Account % GDP	-6.1	-5.8	-5.3	-6.3	-4.6	-4.1	-4.7
United States							
Real GDP %yr	3.6	3.1	2.7	2.1	0.4	-2.5	1.6
Consumer Prices %yr	2.6	3.4	3.2	2.9	3.8	-0.5	1.3
Unemployment Rate %	5.5	5.1	4.6	5.8	9.2	10.5	10.8
Current Account %GDP	-5.7	-6.1	-6.0	-5.3	-4.9	-2.9	-2.5
Japan							
Real GDP %yr	2.3	1.9	2.8	2.2	-1.0	-6.0	1.1
Consumer Prices %yr	-0.1	-0.3	0.2	0.1	1.4	-1.2	-0.6
Unemployment Rate %	4.5	4.4	4.1	3.9	4.0	5.2	5.9
Current Account %GDP	3.3	3.6	3.9	4.8	3.2	2.6	3.0
Euroland							
Real GDP %yr	2.2	1.7	2.9	2.7	0.6	-4.0	0.7
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	-4.7	0.3
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 6 November 2009

Interest Rate Forecasts	Latest (Nov 9)	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Australia						
Cash	3.50	3.75	4.00	4.50	4.50	4.50
90 Day Bill	3.95	4.00	4.30	4.70	4.60	4.75
10 Year Bond	5.62	6.00	5.70	6.20	6.50	6.50
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.50	3.50	3.20	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	0.9229	0.96	0.96	0.90	0.93	0.95
USD/JPY	90.01	88	88	93	96	100
EUR/USD	1.4885	1.51	1.51	1.47	1.50	1.51
AUD/NZD	1.2563	1.25	1.25	1.23	1.22	1.22

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