

Weekly Commentary

10 May 2010

Trucking along

RBNZ Governor Bollard's speech on the economic recovery looked as though it would set the tone for the week. But overseas events have since taken the fore.

In his speech on Thursday last week, Dr Bollard noted that the worst of the financial crisis has passed, and the recovery now looks to be more assured. The rebound in New Zealand has been led by external forces – strong export demand from our key trading partners in Australia and Asia, and an improvement in the terms of trade – while the domestic sectors of the economy have been more subdued to date.

This recovery means that the RBNZ can begin removing monetary stimulus “over the coming months”. Dr Bollard emphasised that even the first few OCR hikes will still leave policy settings at very stimulatory levels: “Using a truck driver analogy, our foot is strongly on the accelerator. Over coming months we expect to reduce the pressure on this pedal, but in effect to keep some throttle going. Truck drivers know they must reduce acceleration long before the corner. We are not talking about tightening policy yet. We do not expect to have to touch the brake pedal for some time.”

These comments should not come as a surprise, largely reinforcing what was said in the OCR review and in the *Monetary Policy Statement* in March. A few forecasters may still be clinging to the good ship Double-Dip, but the general

sense is that the recovery is proving to be sustainable. Inflation is subdued at the moment, but as a forward-looking central bank, the RBNZ should be normalising interest rates well before the need to address inflation becomes urgent. Besides, lifting the cash rate back to its previous record low of 4.5% over the course of 18 months (on the RBNZ's projections) or even 12 months (on ours) hardly smacks of indecent haste.

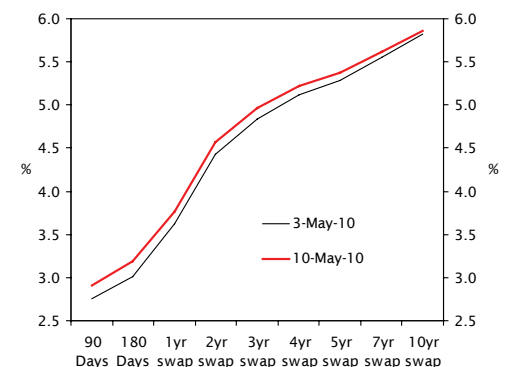
The speech ended by noting that “recovery so far has been full of surprises. There will be more to come.” While this was said as a note of caution – presumably referring to downside surprises – we should point out that there are major risks to the upside as well. The history of economic recoveries suggests there's a good chance that even our top-of-consensus growth forecasts could end up on the low side – peak growth rates of 6-7% are common.

Two such ‘surprises’ were quickly in evidence. Within an hour of Dr Bollard's speech, the Household Labour Force Survey showed a stunning improvement in the labour market in the March quarter. Less than 24 hours later, international markets were giving themselves a hernia over a perceived lack of willingness on the part of the European Central Bank to deal with concerns about sovereign debt default in Greece, and perhaps beyond. We won't add more to the screeds that have already been written about the international situation; instead we'll focus on the local developments.

The HLFS showed that the number of unemployed fell by 15,000 in Q1 – the first time on record that unemployment has fallen in a March quarter. In seasonally-adjusted terms the improvement was even more dramatic: the unemployment rate plunged to 6.0%, from a peak of 7.1% in the December quarter (revised down from the original 7.3% – a figure that at the time we felt was overstated).

We've been repeatedly asked whether this improvement is ‘genuine’, and there's been plenty of commentary about the impact of the seasonal correction. Seasonal adjustments can certainly be tricky, but in the end they are simply a tool to help us interpret the data; ultimately they don't drive the results. The bottom line is that the fall in the actual number of unemployed was huge, and unprecedented.

NZ Interest Rates



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

The detail of the survey was even stronger than the headlines. The 1.0% increase in employment was entirely in full-time jobs; part-time employment actually fell slightly. Hours worked rose 1.7%, confirming the picture given by the 1.0% increase in hours paid registered in last Tuesday's Quarterly Employment Survey. Underemployment and the number declaring themselves 'discouraged workers' fell.

We have long been the cheerleaders of the economic recovery, but we hadn't expected to see jobs growth of this magnitude until mid-year. The evidence confirming a normal recovery had, until this week, mainly been of the soft variety - ballistic business confidence, surveys reporting sharply rising sales, high consumer confidence, and so on. We now have hard evidence that the economy has embarked upon the long road to recovery. Indeed, our forecast of 0.8% growth in March quarter GDP may be a tad low.

That may seem odd in the context of a weak housing market, slow credit growth, and lackadaisical retail sales. Friday's retail report is likely to show a slowdown from the rapid pace seen in Q4 last year. We estimate that the value of sales was up just 0.4% in the March quarter, with higher prices accounting for all of the gains. We're actually sceptical that these figures tell the full story; they certainly don't square with other activity and confidence measures for the retail sector. For instance, credit and debit card transactions have been well ahead of the wider retail figures up to February, and recorded a sizeable 2.1% gain in March. But even if that gap in the level of sales remains, we wouldn't use this to extrapolate weakness in spending growth from here onward.

Financial markets have read the employment survey as confirmation that the RBNZ will begin raising rates in June,

with hikes at each subsequent review date. All the ducks are in a row for the domestic economy; the only obstacle now is the ugly duckling that is Europe. Like everyone else, we can only wait and watch how the authorities deal with this situation.

Fixed vs. floating: Stronger data and a more confident tone from the RBNZ have cleared the path for a series of rate hikes, with June the most likely starting date. The decision to fix or float is finely balanced - floating rates are lower than short-term fixed rates at the moment, but they are likely to rise faster as the RBNZ increases the OCR. Fixing, if even for a short term, has the advantage of greater certainty around cash flows, at a time when floating rates could be rising rapidly. Repaying more than the minimum amount, and spreading the loan over a mix of terms, can also help to reduce the overall risk around uncertain future interest rate changes.

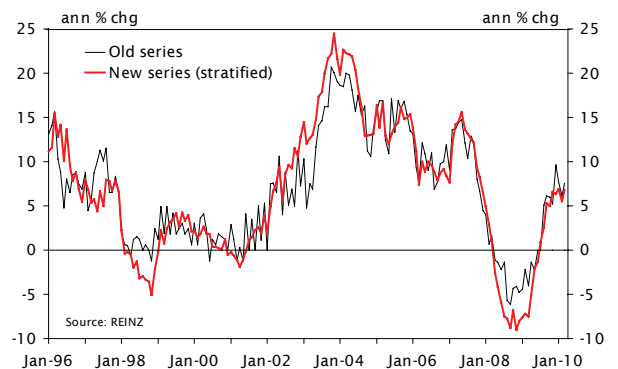
Key Data Previews

NZ Apr REINZ house sales and prices

May 14, Last: 6.8%

- Housing market conditions improved slightly in March, building on the rebound experienced in February. However, the two solid months combined did not make up for the sudden drop in sales that occurred in January. On all metrics, the housing market in March was still weaker than in was in December 2009.
- Recent data from a major real estate agency in the Auckland region suggests that the housing market stabilised through the month of April, albeit at a lower level of activity than late last year.
- REINZ prices in annual terms were up 6.8% in March. Anecdotes suggest that prices remained around a similar pace of growth in April.

REINZ house prices

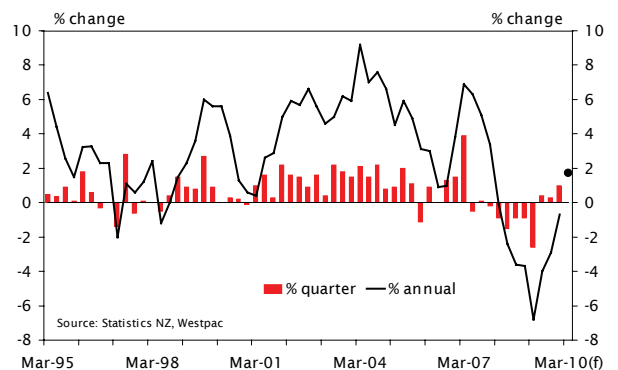


NZ Q1 real retail sales

May 14, Last: 1.0%, WBC f/c: 0.0%

- Retail sales picked up in the March month, judging by the 2.1% rise in credit and debit card transactions, which account for about 70% of retail spending. Allowing for seasonal differences in the two measures, we think this translates to 0.8% growth in total retail sales - though with risks to the upside.
- Retail sales appeared to take a leg lower in December, so even with subsequent gains, we estimate that total sales in Q1 were just 0.4% higher than in Q4. With the CPI indicating a 0.4% rise in retail prices, that implies flat sales volumes for the quarter.
- We're actually sceptical that the retail figures are telling the full story. For instance, card transactions have not shown the same degree of weakness since December. We're not sure how to account for this, but the risk to our retail forecasts is for a sharp closing of the gap at some point.

NZ real retail sales



Aus 2010 Federal Budget

May 11

- Treasurer Swan will focus on the strategy to return the fiscal balance to surplus by 2013/14 when announcing the Budget this Tuesday night. The run-up in net debt will be manageable and much smaller than expected in MYEFO. The gross borrowing requirement for 2010/11 is likely to be around \$55bn.
- Sharply higher commodity prices and the expectation that the terms of trade will remain elevated for the next four years is central to this fiscal outlook.
- Key themes will be: fiscal austerity, health, the new national broadband network, a shake-up of the defence forces and tax reform (including the Government's initial response to the Henry Tax Review and an agenda for the second term).

Underlying cash balance, \$bn

	MYEFO		Budget*	
	\$bn	% GDP	\$bn	% GDP
2008/09(a)	-27.1	-2.3	-27.1	-2.3
2009/10	-57.7	-4.7	-56	-4.3
2010/11	-46.6	-3.6	-33	-2.4
2011/12	-31.2	-2.3	-12	-0.8
2012/13	-15.9	-1.1	0	0.0
2013/14**	-10.0	-0.7	5	0.3

* Westpac's expectation of Government forecasts to appear in 2009 Budget

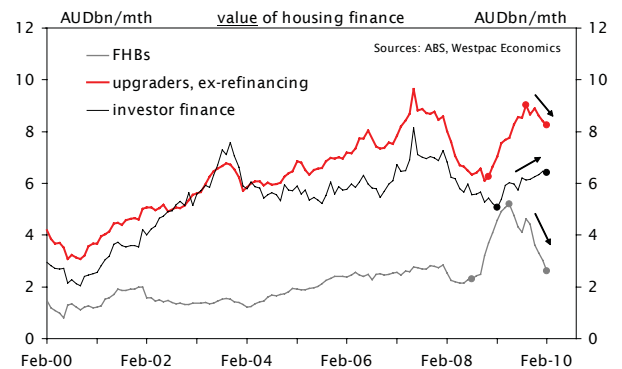
** MYEFO estimates were to 2012/2013. This is our estimate of what MYEFO would have forecast for 2013/14 given its forecast starting point in 2012/13. Next week's Budget will include 2013/14 projections and, based on our numbers, the Government will be forecasting a return to surplus in 2013/14 assisted partly by the initiatives announced in the tax package.

Aus Mar housing finance

May 12, Last: -1.8%, WBC f/c: -3.0%, Mkt f/c: -3.0%, Range: -4.4% to 1.0%

- Housing finance demand is moderating, following a strong upswing for much of 2009, as policy stimulus is unwound (monetary, as well as fiscal incentives for first home buyers).
- We're forecasting a fall of 3.0% in March, after a 22% drop in finance to owner-occupiers over the last five months.
- Finance to first home buyers has trended lower since May, dropping 51% since then. That returns lending to this segment to the low of August 2008 that preceded the temporary increase in the Government's FHB bonus. The Upgrader segment is also down, -12% in five months, as the heat comes out of the FHB market and as interest rates rise.
- By contrast, investors are returning, a trend that is likely to continue. The value of finance to investors is up 26% from the low of February 2009, with a 5% rise over the last 5 months.

Housing finance: segments diverge

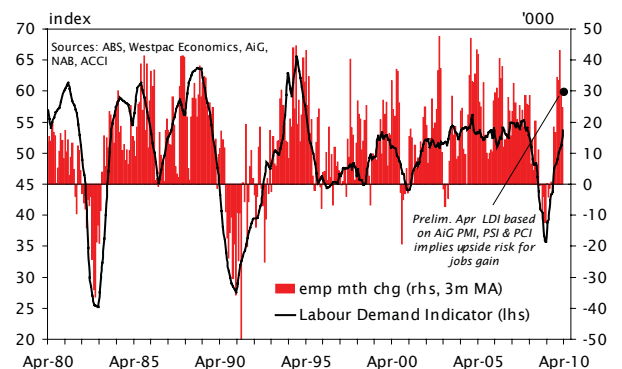


Aus Apr employment chg

May 13, Last: 19.6k, WBC f/c: 27k, Mkt f/c: 22.5k, Range: 5k to 35k

- After bursting out of the blocks in the five months to Jan with a cumulative 200k jump in employment, jobs growth has consolidated in Feb/Mar with a net 15k rise. Still, the trend growth rate has continued to accelerate in line with lead indicators pointing to jobs growth reaching 3%yr in 2010H2, with growth rising to 2.0%yr in Mar from 1.7%yr in Feb.
- The trend level of average hours worked remains 2.6% below its mid-2008 peak indicating spare capacity in the existing workforce that should keep monthly jobs growth on a more moderate path. The recent 'softer' outcomes have also slowed smoothed jobs growth to a pace more in line with our composite of business survey employment indices (the LDI). On this basis, we look for a 27k rise in Apr jobs. However, the prelim. Apr LDI read (narrowly based on the three AiG surveys) was strong, suggesting upside risks to our Apr forecast.

Westpac Australian Labour Demand Indicator

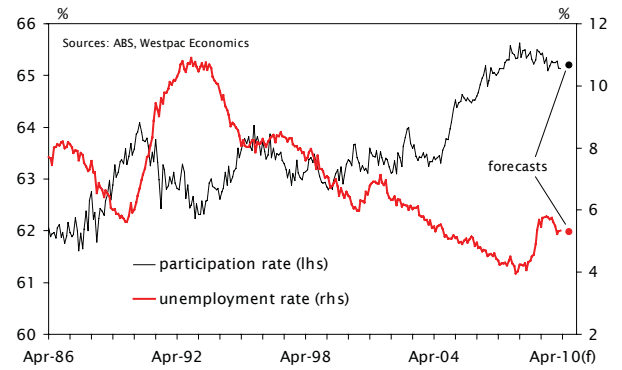


Aus Apr unemployment rate

May 13, Last: 5.3%, WBC f/c: 5.3%, Mkt f/c: 5.3%, Range: 5.1% to 5.4%

- The participation rate fell to 65.1% in Mar from 65.2%, but only just (65.14% vs 65.15% to two decimals). Consequently, labour force growth remained strong, with the 19.6k rise in employment only managing to hold the unemployment rate steady at 5.3%. The trend unemployment rate was also steady at 5.3%, consistent with our view that a further strengthening in labour force growth will keep the unemployment rate downtrend on a slower track through 2010.
- Months of jobs growth similar to what we expect for Apr (with steady unemployment and participation rates prior) have historically seen rises in participation of 0.1ppts on avg (participation also usually rises with interest rates), and we expect 65.2%. This offsets the 27k jobs rise leaving unemployment steady at 5.3%. But, risks are to the downside from a stronger jobs gain and/or steady participation rate.

Unemployment and participation rates

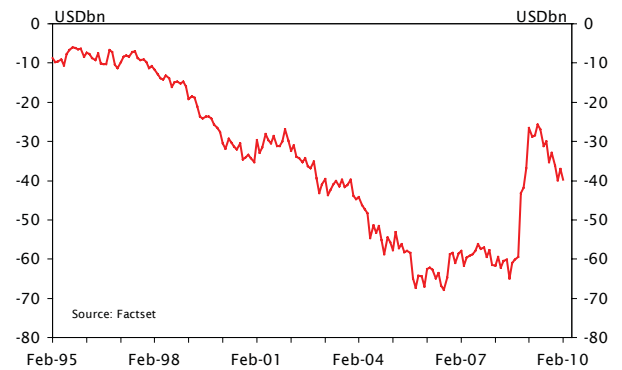


US Mar trade balance \$bn

May 12, Last: -39.7, WBC f/c: -39.0, Mkt f/c: -40.0

- The trade deficit widened by nearly \$3bn in Feb. This reflected about flat exports for the second month running, but a 1.7% rebound in imports which had fallen a similar amount in Jan. Exports were constrained by a further decline in civilian aircraft deliveries to foreign customers, while imports showed broad-based gains outside of apparel, autos and food. A one off factor was a surge in royalty and licence fees which boosted the import side.
- Factory shipments were very solid in March, as was the export component of the ISM manufacturing index. Import prices rose by the same amount as exports (rather than faster as has been the case when oil prices surge), and that royalty one-off drops out.
- A 2% exports gain and 1.2% for imports delivers a \$39bn deficit.

US trade balance

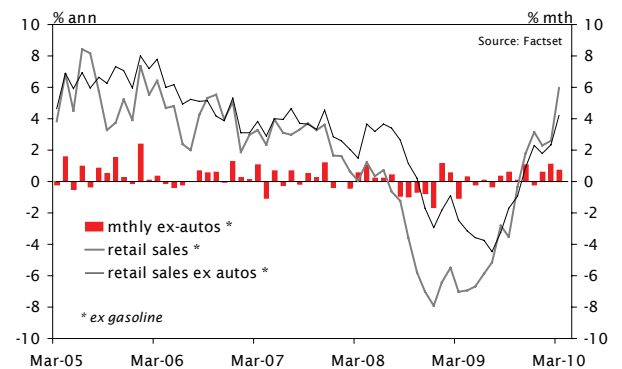


US Apr retail sales

May 14, Last: 1.9%, WBC f/c: flat, Mkt f/c: 0.2%

- Retail sales jumped 1.9% in March. Auto sales surged 6.7% as Toyota resumed selling after the suspension of sales of some models earlier in the year. But most storetypes saw gains in March, with especially strong building materials and clothing sales a function of the warmer weather after February's snowstorms.
- Industry data showed a 5% pull-back in April auto sales, which has the potential to completely offset modest sales gains elsewhere. Also those storetypes that bounced in March due to the weather may post partial pull-backs in April. Weekly chain store reports during the month were mixed to weaker. But gasoline prices rose a little. On our estimates that adds up to a modest 0.5% rise in ex auto sales (0.4% ex autos & gas) but flat total sales due to the autos decline.

US retail sales

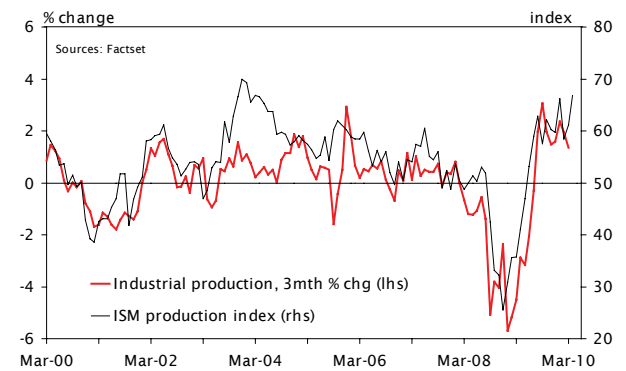


US Apr industrial production

May 14, Last: 0.1%, WBC f/c: 0.6%, Mkt f/c: 0.6%

- US industrial production rose just 0.1% in March, but factory output was up a much stronger 0.9% – the difference due to a 6% contraction in utility output following the very cold weather earlier in the year.
- The factory ISM for April included a steep rise in the production index, consistent with most of the regional factory surveys. Together they point to the industrial upswing continuing into the second quarter. March orders data were decent, which should lead to April production gains, although auto sales were down in April. Very warm weather early in April may have seen utility output recover somewhat due to increased air conditioning use.
- These factors point to a 0.6% rise in industrial production, but note we may revise the forecast after we see the factory hours worked data from the payrolls report on May 7.

US industrial sector: expansion mode



Key Data and Events

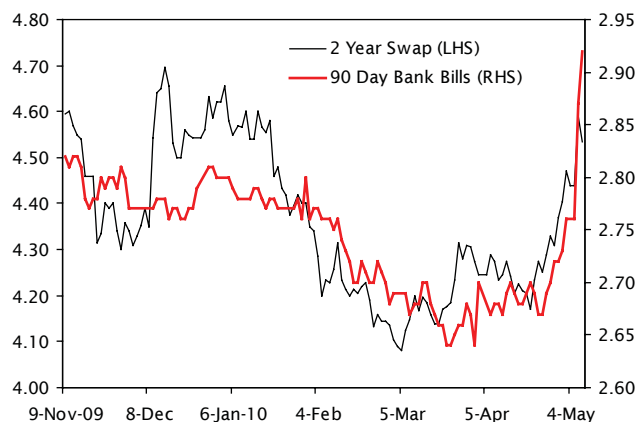
		Last	Market Median	Westpac Forecast	Comments
Mon 10 May					
Aus	Apr ANZ Job Ads	1.8%	-	-	Strong uptrend for 8 months pointing to 3%yr jobs growth in 2010.
	Apr NAB Business Survey	12.6	-	-	Conditions rebounded 5pts in March, & compares with 11 over Q4.
Jpn	BoJ Minutes From April Meeting	-	-	-	Provide further insights into current thinking at the BoJ
Eur	May Sentix Investor Confidence	2.5	-1.0	-4.0	Surely much of April's bounce must be reversed due to Greek crisis?
UK	May BoE Policy Meeting	0.50%	0.50%	0.50%	No rate/QE change at this stage; awaiting incoming govt's fiscal plan.
	Apr BRC Retail Sales Monitor %yr	4.4%	-	-	Same store sales measure jumped in Mar.
	Apr RICS House Price Balance	9%	-	-	Surveyors are less upbeat on house prices once again.
Can	Apr Housing Starts	200.9	200.0	-	Housing market still in recovery mode on back of cheap mortgages.
Tue 11 May					
NZ	Apr Electronic Card Transactions	1.2%	-	-0.9%	Expected to reverse most of the sharp rise in March.
Aus	2010 Federal Budget	-	-	-	Expect return to surplus in 2013/14 (2yrs ahead of schedule)
US	Apr NFIB Small Business Survey	86.8	87.0	-	Intention to hire component useful guide to May payrolls.
	Mar Wholesale Inventories	0.6%	0.5%	-	Guide to Q1 GDP revision.
	May IBD/TIPP Economic Optimism	48.4	48.4	46.5	Equity market losses may weigh on confidence.
	Fedspeak	-	-	-	Lacker, Lockhart and Plosser in Atlanta.
UK	Mar Industrial Production	1.0%	0.3%	0.2%	Feb bounced from weather impacted Jan, Mar to be more subdued.
Wed 12 May					
Aus	Mar Housing Finance (no.)	-1.8%	-3.0%	-3.0%	-22% last 5mths as rate rises & winding back FHBs grant impact.
US	Mar Trade Balance \$bn	-39.7	-40.0	-39.0	Shipments data suggest exports growth may beat imports this month.
	Apr Federal Budget \$bn	-20.9	-20.0	-	April used to be the biggest surplus month, now in deficit.
	Fedspeak	-	-	-	Rosengren, Lockhart in Atlanta; Bullard in Nashville.
Eur	Mar Industrial Production	0.7%	1.0%	0.8%	German production up 1.5% but recent French IP strength may falter.
	Q1 GDP Advance	0.0%	0.1%	0.1%	Meagre growth, entirely export driven.
Ger	Q1 GDP Advance	0.0%	0.0%	0.2%	Meagre export driven growth.
UK	Apr Unemployment Change	-33k	-20k	-20k	Claimant count unemployment is falling despite nil jobs growth.
	BoE Quarterly Inflation Report	-	-	-	Heightened uncertainties from election and European drama.
	Apr Consumer Confidence	72	73	69	Election uncertainty, air travel disruption, some Greece impact.
Can	Mar New House Prices	0.1%	0.3%	-	Up for eight months running.
	Mar Trade Balance C\$bn	1.4	1.6	-	Back in surplus now but small deficits still a risk.
Thu 13 May					
NZ	Apr Food Prices	0.2%	-	0.2%	Seasonal decline in fruit and vege vs rising prices for dairy and meat.
Aus	RBA Assist. Governor (Economic) Lowe	-	-	-	Speaking to Investment Forum, Sydney, 11am AEST.
	Apr Employment chg	19.6k	22.5k	27k	Strong prelim. composite of survey emp indices implies upside risk.
	Apr Unemployment Rate	5.3%	5.3%	5.3%	LF growth to offset jobs gain; downside risk from stronger jobs rise.
US	Apr Import Prices	0.7%	0.8%	1.2%	Oil prices higher in April.
	Initial Jobless Claims w/e 8/5	444k	440k	435k	A downtrend has resumed, but claims still above Feb-Mar lows.
	Fedspeak	-	-	-	Kohn, Kocherlakota and Lockhart.
Jpn	Mar Current Account ¥bn	1,119	1,482	-	Current account narrowed more than expected in Feb (exports down).
Eur	ECB Monthly Bulletin	-	-	-	Not usually a market mover but this issue should be scrutinised.
UK	Mar Visible Trade Balance £bn	-6.2	-6.4	-	Can Feb's export bounce be sustained?
	Mar House Prices %yr	7.4%	-	-	Lesser watched DCLG (govt) index.
Fri 14 May					
NZ	Apr REINZ House Prices %yr	6.8%	-	-	Indicators point to stabilising market.
	Q1 Real Retail Sales	1.0%	0.3%	0.0%	Volumes flat, but not a sign of ongoing consumer weakness.
	Mar Retail Sales	-0.6%	1.1%	0.8%	Solid rebound, led by food and durable goods.
US	Apr Retail Sales	1.9%	0.2%	0.0%	Unit auto sales fell 4.8% in April, and the weather-related bounce in
	Apr Retail Sales ex auto	0.9%	0.4%	0.5%	March spending won't be repeated.
	Apr Industrial Production	0.1%	0.6%	0.6%	Mar constrained by steep utilities fall which won't be repeated.
	May Uni of Mich Consumer Sent Prelim	72.2	73.5	71.5	Upward rev'n to Apr may not be fully sustained in May as equities fell
	Mar Business Inventories	0.5%	0.4%	-	Guide to Q1 GDP revision.
	Fedspeak	-	-	-	Evans in Illinois.
Can	Mar Auto Sales	8.1%	-4.0%	-4.0%	StatCan guidance is for a 4% fall.
	Mar Manufacturing Sales	0.1%	1.0%	-	Up for six months running but Feb constrained by autos, energy.

New Zealand Economic and Financial Forecasts

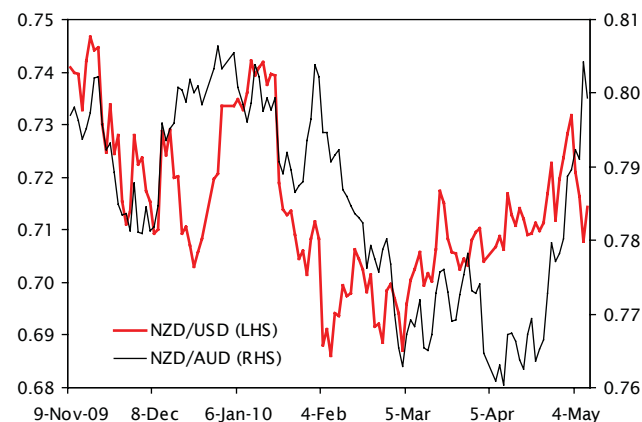
Economic Growth Forecasts	March years				Calendar years			
	2009	2010f	2011f	2012f	2009	2010f	2011f	2012f
% change								
GDP (Production) ann avg	-1.4	-0.3	4.1	4.2	-1.6	3.4	4.4	3.4
Employment	0.7	-0.1	2.1	1.8	-2.4	2.7	1.8	1.3
Unemployment Rate % s.a.	5.1	6.0	5.3	5.0	7.1	5.5	5.0	4.9
CPI	3.0	2.0	2.6	2.8	2.0	2.5	2.7	2.9
Current Account Balance % of GDP	-7.9	-2.6	-3.3	-4.4	-2.9	-3.0	-4.4	-4.4

Financial Forecasts	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Cash	2.75	3.25	3.75	4.25	4.75	5.25	5.75
90 Day bill	3.20	3.70	4.20	4.70	5.20	5.70	6.10
2 Year Swap	4.50	4.80	5.20	5.50	5.90	6.20	6.40
5 Year Swap	5.50	5.70	5.90	6.10	6.30	6.50	6.60
10 Year Bond	6.00	6.00	6.10	6.20	6.30	6.30	6.40
NZD/USD	0.72	0.75	0.78	0.76	0.75	0.74	0.73
NZD/AUD	0.78	0.80	0.81	0.82	0.82	0.83	0.84
NZD/JPY	65.5	69.8	74.9	75.2	76.5	78.4	79.6
NZD/EUR	0.52	0.54	0.56	0.55	0.55	0.56	0.56
NZD/GBP	0.46	0.47	0.48	0.47	0.47	0.47	0.46
TWI	66.1	68.5	71.1	70.3	70.4	70.8	70.8

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 10 May 2010

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.69%	2.60%	2.60%
60 Days	2.80%	2.65%	2.64%
90 Days	2.91%	2.69%	2.67%
2 Year Swap	4.57%	4.29%	4.25%
5 Year Swap	5.37%	5.26%	5.22%

NZ foreign currency midrates as at Monday 10 May 2010

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7193	0.7227	0.7170
NZD/EUR	0.5581	0.5407	0.5297
NZD/GBP	0.4856	0.4674	0.4659
NZD/JPY	66.230	67.930	66.800
NZD/AUD	0.8015	0.7797	0.7672
TWI	68.050	67.210	66.160

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2005	2006	2007	2008	2009	2010f	2011f
Australia							
Real GDP % yr	2.8	2.9	4.0	2.4	1.3	3.0	3.8
CPI inflation % annual	2.8	3.3	3.0	3.7	2.1	3.3	3.1
Unemployment %	5.1	4.8	4.4	4.2	5.6	5.1	4.8
Current Account % GDP	-5.8	-5.3	-6.3	-4.4	-4.1	-4.0	-2.6
United States							
Real GDP %yr	3.1	2.7	2.1	0.4	-2.4	2.4	3.0
Consumer Prices %yr	3.4	3.2	2.9	3.8	-0.4	1.3	2.4
Unemployment Rate %	5.1	4.6	5.8	5.8	9.3	9.5	9.2
Current Account %GDP	-6.1	-6.0	-5.3	-4.9	-2.9	-3.1	-2.3
Japan							
Real GDP %yr	1.9	2.8	2.2	-1.5	-5.8	2.3	1.8
Consumer Prices %yr	-0.3	0.2	0.1	1.4	-1.3	-1.1	-0.2
Unemployment Rate %	4.4	4.1	3.9	4.0	5.1	4.8	4.5
Current Account %GDP	3.6	3.9	4.8	3.2	2.8	4.1	4.3
Euroland							
Real GDP %yr	1.8	3.1	2.8	0.5	-4.0	0.6	1.3
Consumer Prices %yr	2.5	2.0	3.1	1.6	0.9	1.0	1.2
Unemployment Rate %	8.8	7.9	7.3	7.8	10.0	10.5	10.5
Current Account %GDP	-0.2	-0.1	0.1	-1.1	-1.0	-0.5	0.0
United Kingdom							
Real GDP %yr	2.2	2.9	2.6	0.5	-4.9	0.5	1.3
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	5.0	5.0	5.0
Current Account %GDP	-2.6	-3.3	-2.7	-1.6	-2.4	-2.0	-1.5

Forecasts finalised 7 May 2010

Interest Rate Forecasts	Latest (May 10)	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Australia						
Cash	4.50	4.50	4.75	5.00	5.25	5.50
90 Day Bill	4.85	4.70	5.00	5.20	5.50	5.70
10 Year Bond	5.47	5.70	5.85	5.90	6.00	6.25
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.50
US 10 Year Bond	3.43	3.50	3.60	3.70	4.00	4.75
ECB Repo Rate	1.00	1.00	1.00	1.00	1.25	1.50
Exchange Rate Forecasts						
AUD/USD	0.8974	0.90	0.94	0.95	0.92	0.90
USD/JPY	92.08	89	91	95	98	102
EUR/USD	1.2889	1.24	1.24	1.24	1.20	1.18
AUD/NZD	1.2476	1.25	1.25	1.22	1.21	1.20

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