

# Weekly Commentary

17 January 2011

## Hot and cold

The data calendar kicked off the year with a continuation of the mix of highlights and disappointments that characterised the economy through much of 2010.

The December *Quarterly Survey of Business Opinion* saw a welcome improvement in business sentiment, following the sharp downturn in the September quarter that foreshadowed a weak outcome in Q3 GDP. Own-activity in the past three months rose from -1.5% to -1%, the highest level in three years. The national result would've been even better were it not for the ongoing effects of the Canterbury earthquake, which saw activity for the region fall from -6% to -33%.

This series is the single best indicator of same-quarter GDP (though it's none too precise), and the latest reading is consistent with RBNZ's forecast of 0.4% growth in Q4 GDP, as well as our pick of 0.5%. The economy appears to have returned to a modest pace of growth after stalling in the midsection of last year.

Even with activity looking healthier, the degree of existing slack in the economy meant that price pressures were seen as more subdued in Q4. Capacity utilisation fell to its lowest in over a year, mostly led by the building industry. Skilled workers once again became harder to find (especially for

builders and retailers), but not so for unskilled labour. And pricing intentions eased back, particularly for retailers, now that the October GST increase is bedded down and the window of opportunity for raising prices has passed.

As always, there was a great deal of variation in performance across industries. Manufacturing, which bore the brunt of the economy's mid-year slump, appears to have fared better in Q4. Service industries were little changed on Q3. The building industry remains weak but showed some signs of promise, which would at least in part reflect the expected rebuilding activity following the Canterbury earthquake. Employment and sales both rose smartly and, helpfully, cost increases were the lowest since 2003.

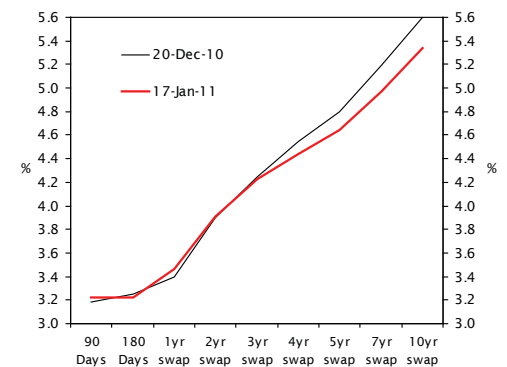
Retailers reported the biggest improvement in activity in the last three months – a little surprising, given that Q4 started out with a post-GST drop-off in spending and appears to have ended with a poor Christmas trading period. Retail electronic card transactions fell 0.9% in December, with a 1.6% drop in core sales that was spread across all of the broad industries. Fuel was the only category where spending rose, and that was in line with the 5% rise in petrol prices for the month. The cumulative 14% rise in prices since September – a mix of higher world oil prices, the GST hike and

an increase in excise duty – is one factor that is likely to be sapping purchasing power elsewhere.

Another factor is the continued malaise in the housing market; households are likely to remain cautious as long as the value of their most important asset remains flat or falling. Housing consents, excluding apartment units, fell a further 2.6% in November to their lowest level since mid-2009. While there were some positive signs in the form of a large lump of consents for retirement village units and a pickup in consents in Canterbury as post-quake reconstruction gears up, the overall level of activity remains muted.

House sales look a little more encouraging, though. Barfoot & Thompson figures for the Auckland region showed a 5% rise in sales in

**NZ Interest Rates**



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

December, following a 10% jump from record lows in November. Sale prices were softer, down 4% on a year ago, though these tend to lag the trend in house sales by a few months. Our tentative view is that the housing market has finished the bulk of its adjustment to the tax changes announced in the May Budget and is settling into a new, lower level of activity.

On the more positive side, export income continues to lead the NZ economy's recovery process. The trade deficit of \$186m was the best for a November month since 1997, and lifted the annual trade surplus to a 16-year high of \$1.35bn. Export receipts were up 19% on a year ago, as world prices for our main commodity exports have far outstripped gains in the NZ dollar. Indeed, world prices rose another 2% (and 4.5% in

NZD terms) to fresh record highs in December.

Dairy products remain a key driver, with export receipts up 32% on a year ago. Prices received have actually dipped in the last two months, due to contracts that were signed during the short-lived drop in world prices in July-August. However, export volumes have recovered from the effects of last autumn's drought, and are set to make a healthy contribution to Q4 GDP growth. Renewed strength in auction prices for dairy products, and (weather permitting) an expected 3% rise in production over this season, bode well for export incomes in 2011.

December quarter CPI will be the main attention-grabber this week. We expect a 2.3% increase for the quarter, with a

1.7% contribution from the 1 October GST increase. However, a huge degree of uncertainty around the extent and timing of pass-through from the GST hike means that forecasts should be treated with even more caution than usual. A 6.4% rise in petrol prices will also add to the quarterly total. But the RBNZ will feel comfortable 'looking through' these two factors to the subdued inflation story underneath.

**Fixed vs. floating:** The RBNZ's more cautious stance suggests that floating rates will remain on hold for several more months. Fixed-term rates could rise in that time, but only if there is a substantial turnaround in sentiment on the global economy. As a result, there is no urgency to fix right now.

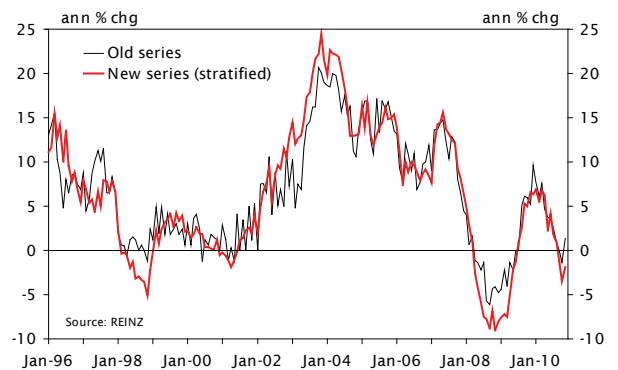
## Key Data Previews

### NZ Dec REINZ house price index

Jan 17-21, Last: -1.9% yr

- REINZ are no longer announcing a date for the release of their housing data. However, the release was previously scheduled for around the 14th of the month.
- Housing market activity softened throughout the course of 2010, and house prices remain weak. However, sales rebounded sharply in November, albeit off a low base and exaggerated by the impact of the Canterbury earthquakes.
- While careful not to read too much into one month's data, another solid month in December could signal changing sentiment in the housing market. Combined with improved net migration and lower fixed mortgage rates, this may bring stability in house prices in 2011 - a development that would be in contrast to the RBNZ's expectation of further house price declines in the first half of 2011.

### REINZ house prices

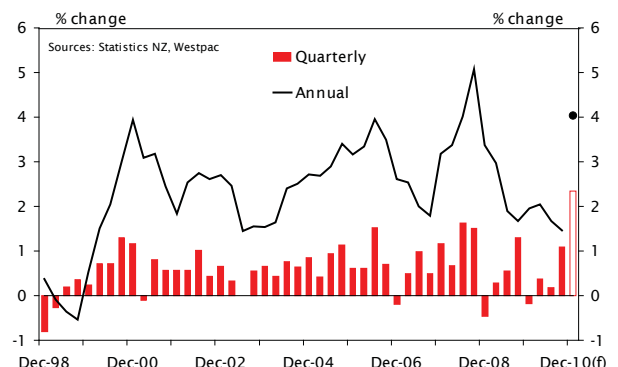


### NZ Q4 CPI

Jan 20, Last: 1.1%, WBC f/c: 2.3%

- GST and higher petrol prices are the big factors behind an expected 2.3% increase in Q4 consumer prices.
- Annual inflation will spike from a 7-year low of 1.5% in Q3 to 4.0% in Q4.
- Timing of GST pass-through is a significant uncertainty.
- The massive amount of spare capacity in the economy will leave the RBNZ comfortable accommodating a spike in headline inflation to around 5% this year.

### NZ CPI inflation

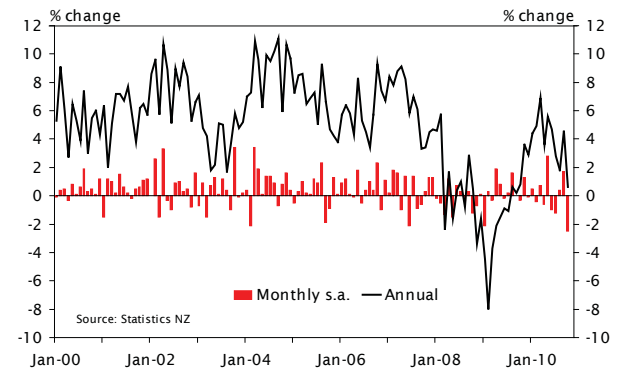


**NZ Nov retail sales**

Jan 21, Last: -2.5%, WBC f/c: 1.5%

- October retail sales were below trend as people brought purchases forward into September to beat the 1 October GST increase. Note that sales values in the retail trade survey are reported ex-GST.
- We expect a 1.5% rise in November as sales return to trend levels. The biggest increases are likely to be in big-ticket items such as furniture, appliances and vehicles, as well as a price-driven rise in fuel spending.
- Sales of vehicles and parts plunged 13% in October. We don't know whether this was due to teething problems with the recently redesigned survey, or a much larger GST effect than we had realised. We suspect the latter, and with the support of a sharp rebound in registrations in November, we're picking a 10% rise in car sales.

**NZ nominal retail sales**

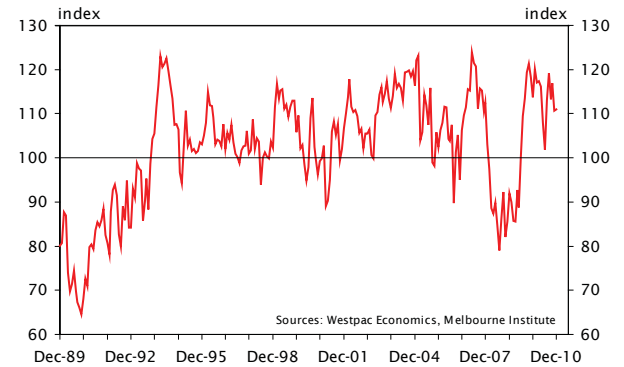


**Aus Jan Westpac-MI Consumer Sentiment**

Jan 19, Last: 111.0

- Sentiment edged up 0.2% in December after a surprisingly resilient reaction to November's rate rises the month before. While off the highs recorded in October and the first few months of last year, the Index remained in solidly optimistic territory in December comfortably above its long run average.
- The January survey is in the field the week ended January 16. With no RBA meeting, sentiment will be influenced by: mixed economic data (jobs flat) and financial markets (ASX +0.9% and AUD/USD +1.1% since the last survey). The severe flooding in Queensland may have a material impact as well.
- Note that the January sentiment reading is seasonally adjusted to remove a regular 'holiday bump' that adds about 5pts in the first month of the year - although Australia's poor showing in the Ashes may have removed one of the usual seasonal fillips to the consumer mood.

**Consumer Sentiment**

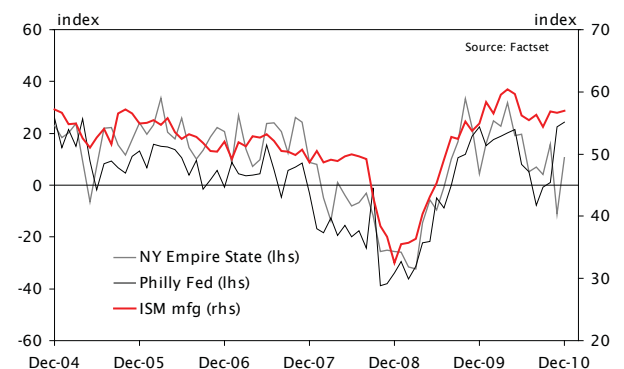


**US Jan NY and Philly Fed surveys**

Jan 18, New York Fed: Last: 10.6, WBC f/c: 11.0, Mkt f/c: 13.0  
 Jan 20, Philadelphia Fed: Last: 20.8, WBC f/c: 15.0, Mkt f/c: 20.4

- All the major and most minor business surveys, national and regional, pointed to renewed acceleration in industrial growth in late 2010, after the relatively short-lived mid year slowdown which saw some regional surveys point to contracting activity.
- In Dec, the NY Fed index bounced 21 pts after falling sharply in Nov to its first negative reading since mid 2009, suggesting that decline was an aberration. Meanwhile, the Philly Fed index held at multi-year highs in Dec.
- We expect the Jan regional Fed surveys to converge somewhat again, with most of the work to be done by the Philly Fed index, as it has been signalling a strength of economic performance that seems unrealistic. Indeed we remain concerned about the economic outlook in 2011 and these surveys should be among the first indicators to turn sharply lower in coming months.

**US manufacturing surveys**

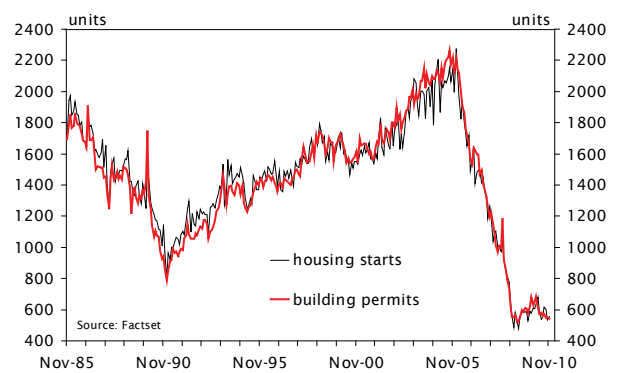


**US Dec housing starts/permits – bottoming out at best**

Jan 19, Starts: Last: 3.9%, WBC f/c: -2.0%, Mkt f/c: -0.9%

Jan 19, Permits: Last: -1.4%, WBC f/c: 1.5%, Mkt f/c: 2.0%

- Housing starts rose 3.9% in Nov to 555k annualised, reflecting a 7% rise in single family starts but a further 9% fall in multiples, which were down for the third month running (and by 50% in Q4). Building permits fell 1.4% to 544k in Dec, but the detail breakdown was similar to starts, with a 3% rise in the single family component offset by a further steep fall in multiples.
- The weakness on the multiples side essentially offsets the very tentative recovery in single family starts and means that overall housing activity is pretty much stagnant at rockbottom levels.
- Single family permits were running 48k below starts in Nov, and payrolls data showed construction jobs down for the second month running in Dec, which leads us to expect a further fall in starts, subject to some risk of a bounce in multiples.

**US housing starts and permits**

## Key Data and Events

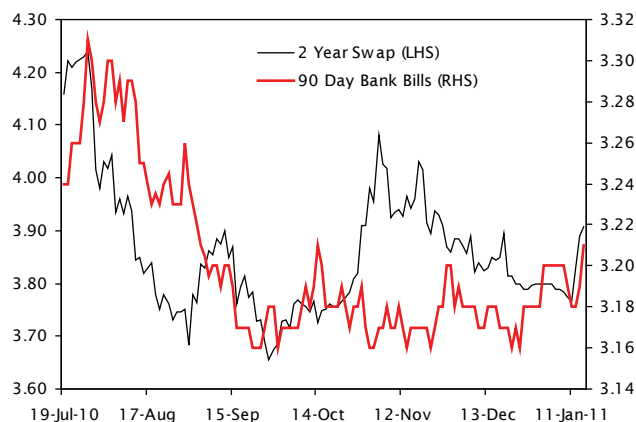
		Last	Market Median	Westpac Forecast	Comments
<b>Mon 17 Jan</b>					
NZ	Dec REINZ House Prices %yr	-1.9%	-	-	Tentative date. Will November's improvement be carried forward?
Aus	Dec TD-MI Inflation Gauge	0.4%	-	-	Nov gauge hinted at pickup in inflation in Q4 pre any flood impact.
US	Martin Luther King Jr. Day	-	-	-	Markets closed.
	Fedspeak	-	-	-	Plosser on scope of monetary policy, in Chile.
UK	Jan House Prices %yr	0.4%	-	-	Rightmove index. Annual pace is about to turn negative again.
<b>Tue 18 Jan</b>					
US	Jan NY Fed Empire State Index	10.6	13.0	11.0	Business confidence holding up at start of 2011.
	Nov TIC Flows \$bn	27.6	40.0	-	Net long term TIC flows.
	Jan NAHB Housing Market Index	16	17	16	Housing market at best bouncing along the bottom.
Ger	Jan ZEW Analysts' Survey	4.3	7.0	-	Expectations improved in late 2010 after trend decline since 2009.
UK	Dec Consumer Confidence	45	44	-	Nationwide index. Down 3 mths running. Snow may be a Dec factor.
	Dec RICS House Prices %yr	-44%	-44%	-	Net balance of surveyors reporting prices - very negative message.
	Nov House Prices %yr	5.5%	-	-	DCLG measure.
	Dec CPI %yr	3.3%	3.4%	3.3%	BRC shop price index suggests prices, if anything, edged higher.
Can	BoC Rate Decision	1.00%	1.00%	1.00%	Retightening on hold until US eco outlook clarifies.
<b>Wed 19 Jan</b>					
Aus	Jan Westpac-MI Consumer Sentiment	111.0	-	-	Held up well in late 2010. Impact from Queensland floods?
US	Dec Housing Starts	3.9%	-0.9%	-2.0%	Permits data point to downside risk ahead for single family starts but as always data can be pushed around by volatility in multiples.
	Dec Housing Permits	-1.4%	2.0%	1.5%	
Jpn	Nov Tertiary Activity Index	0.5%	0.5%	-	Non-mfg Tankan was OK, but cons related firms to struggle thru Q4.
Eur	Nov Current Account Balance €bn	-9.8	-	-	Has not been in surplus since Jan 2010.
UK	Dec Unemployment Change	-1.2k	0.0k	0.0k	Job market stalling again?
Can	Nov Manufacturing Sales	1.7%	0.3%	-	Oil and autos drove recent strength.
	BoC Monetary Policy Report	-	-	-	More on the economy and policy outlook.
<b>Thu 20 Jan</b>					
NZ	Q4 CPI %qtr	1.1%	2.3%	2.3%	The big quarterly increase is mainly due to higher GST and petrol.
Aus	Jan Westpac-MI Inflation Expectations	2.8%	-	-	Inflation expectations have moderated in recent months.
	Jan MI Unemployment Expectations	-1.1%	-	-	Will likely provide further evidence of robust labour market.
US	Initial Jobless Claims w/e 15/1	445k	425k	440k	Latest jump suggests claims were distorted lower by the holidays.
	Dec Existing Home Sales	5.6%	3.8%	1.0%	Pending home sales gains suggest little immediate upside ahead.
	Dec Leading Index	1.1%	0.6%	0.6%	Trend has accelerated since mid 2010.
	Jan Philadelphia Fed Index	20.8	20.4	15.0	Late 2010 readings look excessively high give economic headwinds.
Ger	Dec PPI %yr	4.4%	4.9%	-	Producer price inflation levelling off in 4-5% range.
UK	Jan CBI Industrial Trends	-3	-1	-	New orders index jumped sharply in late 2010 on back of exports.
Can	Dec Leading Index	0.3%	0.3%	-	Trend slowed from 0.9% per month in Q1 to 0.1% in latest 3 months.
	Nov Wholesale Sales	0.0%	0.3%	-	Have not declined since June.
<b>Fri 21 Jan</b>					
NZ	Nov Retail Sales	-2.5%	1.2%	1.5%	Back towards normal after GST distortions; trend growth remains weak.
Aus	Q4 Export Prices	7.8%	-	-	Commodity prices have risen in Q4; stronger AUD partial offset.
	Q4 Import Prices	0.7%	-	-	Stronger AUD to help dampen import price growth.
Jpn	Nov All-Industry Activity	-0.2%	0.2%	-	Provides new info on construction and public sector activity.
Ger	Jan IFO Business Climate Index	109.9	109.9	-	IFO ended 2010 at all time high!
UK	Dec Retail Sales Volumes	0.3%	-0.2%	0.0%	Snowstorm impact, some offset from pre VAT hike buying.
Can	Nov Retail Sales	0.8%	0.4%	-	Higher gasoline prices masked weakness in other retailing in Oct.

## New Zealand Economic and Financial Forecasts

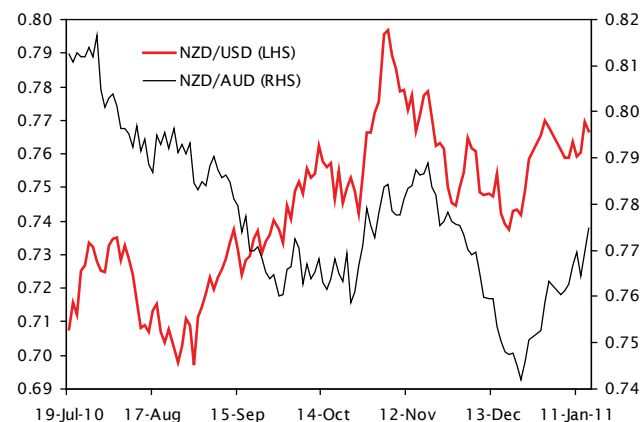
Economic Growth Forecasts	March years				Calendar years			
	2010	2011f	2012f	2013f	2009	2010f	2011f	2012f
% change								
GDP (Production) ann avg	-0.5	1.6	4.0	3.1	-1.7	1.5	3.5	3.2
Employment	-0.1	1.8	2.2	1.4	-2.4	2.3	2.5	1.2
Unemployment Rate % s.a.	6.0	5.9	4.8	4.7	7.1	6.2	4.8	4.8
CPI	2.0	4.6	1.6	2.4	2.0	4.0	2.2	2.1
Current Account Balance % of GDP	-2.4	-3.2	-4.6	-4.5	-2.8	-2.7	-4.6	-4.7

Financial Forecasts	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12
Cash	3.00	3.00	3.25	3.50	3.75	4.00	4.50
90 Day bill	3.20	3.20	3.50	3.80	4.00	4.30	4.80
2 Year Swap	4.00	4.30	4.60	4.90	5.10	5.30	5.50
5 Year Swap	4.90	5.10	5.40	5.60	5.70	5.80	5.90
10 Year Bond	5.70	5.70	5.70	5.80	5.90	6.00	6.00
NZD/USD	0.76	0.79	0.78	0.77	0.76	0.75	0.74
NZD/AUD	0.76	0.77	0.79	0.80	0.80	0.81	0.81
NZD/JPY	63.1	65.6	70.2	73.2	73.7	74.3	74.7
NZD/EUR	0.56	0.57	0.59	0.59	0.59	0.59	0.58
NZD/GBP	0.48	0.49	0.49	0.48	0.47	0.45	0.44
TWI	68.0	69.9	71.0	71.6	71.2	70.8	70.2

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



## NZ interest rates as at market open on Monday 17 January 2011

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	3.00%	3.00%	3.00%
30 Days	3.11%	3.12%	3.13%
60 Days	3.15%	3.16%	3.16%
90 Days	3.23%	3.21%	3.19%
2 Year Swap	3.91%	3.80%	3.90%
5 Year Swap	4.64%	4.73%	4.80%

## NZ foreign currency midrates as at Monday 17 January 2011

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7679	0.7734	0.7373
NZD/EUR	0.5739	0.5788	0.5596
NZD/GBP	0.4840	0.4993	0.4747
NZD/JPY	63.580	63.200	61.910
NZD/AUD	0.7754	0.7606	0.7475
TWI	69.110	69.480	66.810

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2006	2007	2008	2009	2010e	2011f	2012f
<b>Australia</b>							
Real GDP % yr	2.9	4.0	2.2	1.3	2.7	3.5	3.5
CPI inflation % annual	3.3	3.0	3.7	2.1	2.7	3.2	2.7
Unemployment %	4.8	4.4	4.3	5.6	5.3	4.9	4.9
Current Account % GDP	-5.3	-6.3	-4.5	-4.2	-2.9	-3.0	-3.2
<b>United States</b>							
Real GDP %yr	2.7	2.1	0.0	-2.6	2.7	1.1	2.4
Consumer Prices %yr	3.2	2.9	3.8	-0.3	1.6	2.3	3.3
Unemployment Rate %	4.6	5.8	5.8	9.3	9.7	10.0	10.2
Current Account %GDP	-6.0	-5.3	-4.7	-2.7	-3.3	-3.1	-2.4
<b>Japan</b>							
Real GDP %yr	2.8	2.2	-1.5	-6.6	4.5	1.8	2.3
Consumer Prices %yr	0.2	0.1	1.4	-1.3	-0.8	-0.4	-0.1
Unemployment Rate %	4.1	3.9	4.0	5.1	5.1	5.0	4.9
Current Account %GDP	3.9	4.8	3.3	2.8	3.3	3.4	3.6
<b>Euroland</b>							
Real GDP %yr	3.2	2.9	0.3	-4.0	1.7	1.3	1.5
Consumer Prices %yr	2.0	3.1	1.6	0.9	1.5	1.6	1.5
Unemployment Rate %	7.9	7.3	7.8	10.0	10.5	10.5	10.5
Current Account %GDP	-0.1	0.1	-1.1	-1.0	-0.5	0.0	0.0
<b>United Kingdom</b>							
Real GDP %yr	2.8	2.7	-0.1	-5.0	1.8	1.3	1.5
Consumer Prices %yr	3.0	2.1	3.5	2.9	3.0	2.8	1.5
Unemployment Rate %	3.0	2.5	3.1	5.0	4.5	5.0	5.5
Current Account %GDP	-3.3	-2.7	-1.6	-2.4	-2.0	-1.5	-1.0

Forecasts finalised 10 December 2010

Interest Rate Forecasts	Latest (Jan 17)	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
<b>Australia</b>						
Cash	4.75	4.75	5.00	5.00	5.00	5.25
90 Day Bill	4.96	5.10	5.25	5.25	5.25	5.40
10 Year Bond	5.58	5.70	5.60	5.60	5.60	6.00
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.32	3.30	3.00	2.80	3.00	3.50
ECB Repo Rate	1.00	1.00	1.00	1.00	1.00	1.00
<b>Exchange Rate Forecasts</b>						
AUD/USD	0.9903	1.00	1.02	0.99	0.96	0.95
USD/JPY	82.80	83	83	90	95	97
EUR/USD	1.3380	1.35	1.38	1.33	1.30	1.29
AUD/NZD	1.2896	1.32	1.29	1.27	1.25	1.24

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