

# Weekly Commentary

18 January 2010

## Zeroing in

Last week was a busy one for second-tier data releases. Most prominent of the bunch was the NZIER's *Quarterly Survey of Business Opinion*, which gave us the first reliable guide to the state of economic activity and the labour market over the fourth quarter of 2009.

The survey was further confirmation that New Zealand is in a recovery phase following recession. Expectations of general business conditions over the next six months rose slightly from 22% to 23% (seasonally adjusted), the most optimistic businesses have been since September 1999. Firms' expectations of their own trading activity over the next three months were unchanged at 13%, which is roughly average and was consistent with our Q4 2009 GDP forecast of 1.1%.

The surprising element in the survey was the 2.5 percentage point jump in capacity utilisation – something that will worry the Reserve Bank. Historically, capacity utilisation has been one of the best guides to future non-tradables inflation, which lies at the heart of the Reserve Bank's inflation targeting schema. The data suggested that all of the spare capacity that built up during the recession has already been used up, which in turn suggests that general inflation could soon start to rise again. However, the size of the jump in capacity utilisation was completely out of kilter with the more modest improvements in other indicators, so it cannot be taken entirely at face value.

According to the QSBO the labour market

has well-and-truly turned, although it is still weak. Responses on employment intentions suggested that employment growth has resumed, and firms reported a marked fall in the ease of finding labour. The Westpac-McDermott Miller December quarter employment confidence survey, released the day after the *QSBO*, confirmed the picture of stabilisation in the labour market with its increase in current employment conditions. Unemployment appears to be close to its peak and will soon claw its way lower. We expect that the unemployment rate will peak at 6.7% in early 2010 before inching lower over the remainder of this year.

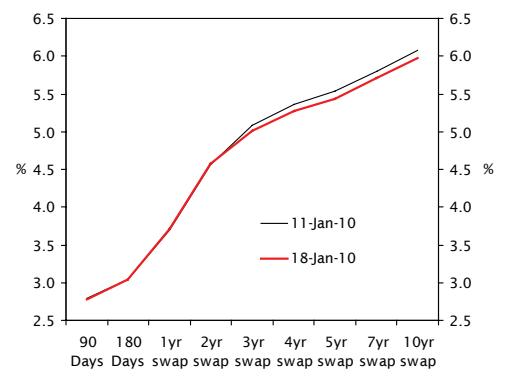
The ANZ Commodity Price Index showed that world prices for NZ commodities rose 2.6% in December, on the back of higher dairy, forestry and aluminium prices. The fall in the NZD that month extended the gain in local-currency commodity prices to 4.3%. The January Global Dairy Trade auction registered a 7% fall in prices, so we may be in for a pull-back in commodity prices. That should cap the upside for the exchange rate.

November dwelling consents were 1.2% higher than October, consolidating the 11% rise registered in that month. Low apartment consents meant that consents were a little weaker than we expected, but aside from monthly volatility we remain confident that our strong residential construction story for 2010 is on track. Total dwelling consents are now 48% higher than the low reached in January 2009 (s.a.).

As the busy week drew to a close the 0.7% increase in December retail electronic transactions gave us further confirmation that the NZ consumer is making a comeback. If anything, electronic transactions data are not doing justice to consumers, because they are not fully capturing strong growth in car sales. When the full retail trade report for December is released on Thursday we will be expecting 0.5% growth in sales, which will further challenge the RBNZ's notion that the link between rising house prices and consumption has weakened.

On that subject, the REINZ figures for December suggested that the housing market is finally starting to level out in response to higher term mortgage rates. Sales were down 4% in seasonally adjusted terms, following a 6% drop in November, and the new stratified house price index recorded its first monthly decline since last June.

### NZ Interest Rates



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

Wednesday's Consumer Price Index (CPI) will be the most important piece of data between now and the Reserve Bank's January 28 OCR review. Last quarter's 1.3% quarterly increase in the CPI was a huge upside surprise. If Q4 inflation surprises again on the upside, the RBNZ will have cause to worry that inflation is not going to moderate to the required degree, meaning monetary policy will have to be tightened more aggressively, and perhaps earlier, than currently planned. Fortunately we expect zero inflation for the quarter, which should be just enough to keep the RBNZ comfortable. The key drag on inflation will be food prices, which fell 3.3% from July to November. However, the December month Food Price Index (released at the same time as Dec quarter CPI) is expected to tick back up by 0.5%, owing to snow-damage

that hit vegetable crops a couple of months ago. Even so, the overall fall in food prices is expected to knock a whopping 0.4 percentage points off Q4 CPI.

The RBNZ is forecasting -0.2% quarterly inflation. If inflation is that low or lower, the RBNZ will feel comfortable with its mid-2010 timing for hiking cycle to kick off, and our call for a March hike would start look unrealistic. We'd change our call to an April hike in such a scenario. If the CPI prints in line with our zero forecast or stronger, and especially if non-tradables inflation exceeds expectations, then it would be the Reserve Bank reassessing its monetary policy, while we maintain our call for a March hike.

**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.

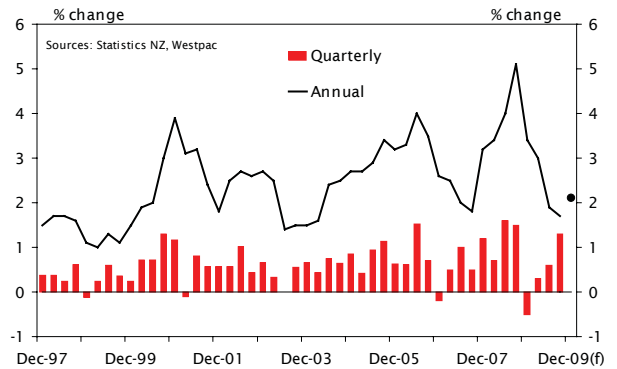
## Key Data Previews

### NZ Q4 CPI

Jan 20, Last: 1.3%, WBC f/c: 0.0%, Mkt f/c: 0.0%

- Last quarter's 1.3% quarterly CPI was a huge upside surprise. Non-tradables inflation, such as the price of construction and services, has not fallen nearly as far as expected. Having annual inflation in the middle of their target range despite a severe recession and a sharp currency appreciation is disconcerting for the RBNZ. A lot rides on whether the fourth quarter unwinds last quarter's surprise or not.
- Our forecast of zero quarterly inflation is mostly due to food prices, which fell sharply from September to November. A sharp fall in domestic airfares will also have an impact, although higher petrol is expected to add 0.2 ppts to total inflation.
- Outside of these special factors, generalised inflation was probably mildly positive. We are picking non-tradables inflation of just 0.1% quarterly, due to the fall in domestic airfares.

### CPI inflation

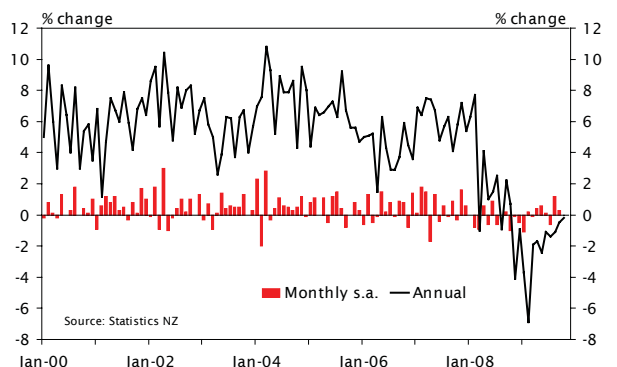


### NZ Nov retail sales

Jan 21, Last: 0.0%, WBC f/c: 0.5%, Mkt f/c: 0.5%

- Core retail sales growth has been averaging 0.4% per month over the past 8 months. Total sales have only averaged 0.1% growth, as the automotive categories have been in a funk.
- Electronic card transactions for core retail lifted 0.3% in the month of November. An increase in the price of petrol, and rising car registrations suggest that the automotive categories will be adding to retail sales growth in the month. We are picking 0.5% total retail growth in the month (2.7% annual).
- Judging by confidence surveys, consumers were still wary about the current conditions they faced in November – keeping their spending circumspect. However, rising house prices, a stabilised labour market, and buoyant future expectations will eventually result in a more robust consumer. We expect the 2010 sales rebound to be concentrated on durable goods categories.

### NZ nominal retail sales

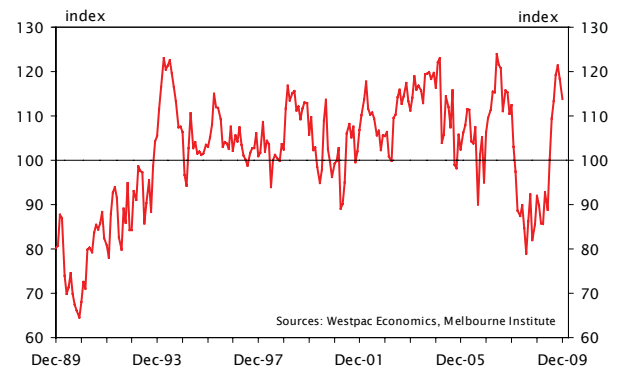


**Aus Jan Westpac-MI Consumer Sentiment**

Jan 20, Last: 113.8

- The Westpac-Melbourne Institute Index of Consumer Sentiment fell by 3.8% from 118.3 in November to 113.8 in December. Despite the drop, sentiment is actually holding up surprisingly well given interest rate developments. The RBA raised rates by 25bps in December – an unprecedented 3rd consecutive monthly rise. Moreover, this time most banks increased their variable mortgage rates by more than the official move. In the past, these sorts of developments have triggered double-digit falls in sentiment, suggesting that the low overall level of rates is still seeing a more muted impact from incremental rises.
- The January survey is in the field the week ended Jan 17. With no RBA meeting, sentiment is likely to be affected by: more strong Jobs data (up 35k in Dec, with the unemployment rate dropping to 5.5%); positive Nov reads on retail sales and dwelling approvals; and the rising ASX (up 3½% on Dec).

**Consumer Sentiment**

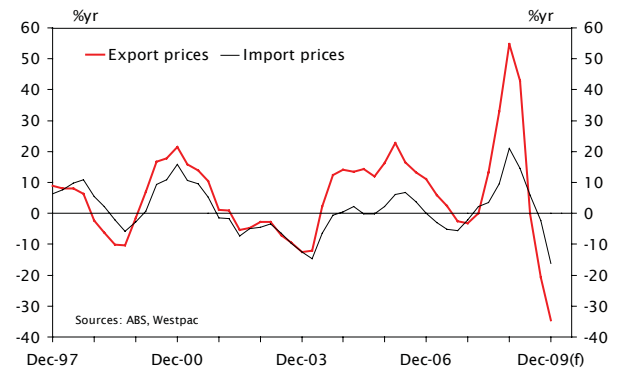


**Aus Q4 international trade price indexes**

Jan 22, Export: Last: -9.6%, WBC f/c: -4.5%, Mkt f/c: -3.5%  
 Import: Last: -3.0%, WBC f/c: -5.0%, Mkt f/c: -2.0%

- Q3 export prices fell 9.6%qtr after a 20.6%qtr plunge previously, cutting annual growth to -20.7%yr from -0.2%yr. A small rise in USD commodity prices led by base metals was outweighed by a valuation drag from the 9.7% AUD/USD appreciation. With the import weighted AUD TWI up 6.6%qtr, core import prices fell 5.4%qtr. With a 15.1% jump in mineral fuels only partially offset by a 5.3% fall in food and beverage prices, the total MPI fell a lesser 3.0%qtr, giving a weaker ToT.
- While the improving global economy saw higher USD commodity prices in Q4 (RBA index +5.5% led by base metals), a further 9% AUD/USD rise sees valuation effects more than offset, driving our -4.5%qtr XPI forecast. With the MTWI up 6.6%qtr, we expect a 5.2% fall in core import prices. A 4.1% fall in petroleum prices however tempers the total MPI forecast to -5.0%qtr.

**International trade price inflation**

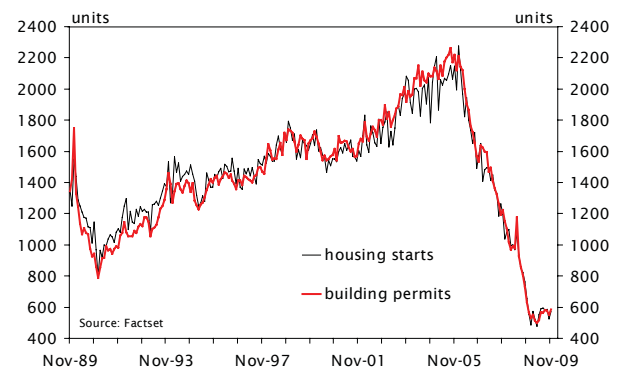


**US Dec housing starts and permits**

Jan 20, Starts: Last: 8.9%, WBC f/c: -10.0%  
 Jan 20, Permits: Last: 6.9%, WBC f/c: -3.5%

- Housing starts and permits both collapsed in Oct, due to very wet weather in the northeast and uncertainty about the tax credit for first home buyers (which has since been extended). The subsequent Nov rebound, especially for single family starts, did not fully recover the Oct losses.
- Signals ahead of the Dec report are almost universally weak. These include a softer homebuilder sentiment index; the 11% plunge in new home sales in Nov; poor weather in the mid-west; construction job losses twice Nov's pace in Dec and falling hours worked. Also, multiple starts jumped 67% in Nov so a correction lower there will add to the headline starts downside.
- Housing permits are also likely to correct lower although the weather and multiples factors noted for starts are less relevant for permits whose decline should be less dramatic.

**US housing starts and permits**



## Key Data and Events

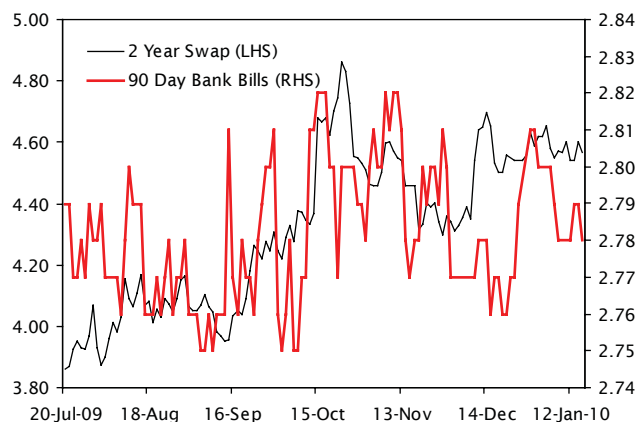
	Last	Market Median	Westpac Forecast	Comments
<b>Mon 18 Jan</b>				
Aus	Dec TD-MI Inflation Gauge	0.3%	-	- 3mth pace of -0.10% vs 1.29% in Aug implies weak Q4 headline CPI.
US	Martin Luther King Jr Day Holiday	-	-	- Markets closed
UK	Jan House Prices %yr	1.7%	-	- Real estate group Rightmove's index of asking prices.
<b>Tue 19 Jan</b>				
Aus	Dec Merchandise Imports, nsa AUDbn	17.5	-	- -2.3% in Nov = -3.9% sa with vols slightly weaker after recent surge.
US	Nov Net Long Term TIC Flows \$bn	20.7	27.5	- TIC data record the extent/source of current account deficit funding.
	Jan NAHB Housing Market Index	16	17	16 Little impact from extended home-buyer tax credit. Snowstorms in Jan
Eur	Nov Construction Output	-0.6%	-	- Has not posted a gain since March.
Ger	Jan ZEW Survey	50.4	50.0	50.0 Slipped since Sep; prospect of stalled Q4 GDP could see further fall.
UK	Dec CPI %yr	1.9%	2.6%	2.6% Last year's VAT cut dropping out of annual calc. Will jump to 3.5% in Jan.
Can	Dec Leading Index	1.3%	1.0%	- Nov saw 6th consecutive (and strongest so far) monthly gain.
	BoC Rate Decision	0.25%	0.25%	0.25% Some hint re dropping on hold commitment till mid year unlikely.
<b>Wed 20 Jan</b>				
NZ	Q4 CPI %qtr	1.3%	flat	flat Lower food prices over qtr combined with subdued general inflation.
	Dec Food Prices	-0.3%	-	0.5% Vegetable prices to rise following crop damage from October snow.
Aus	Jan Westpac-MI Consumer Sentiment	113.8	-	- Holding up well in face of rate rises. Strong job numbers helping.
US	Dec PPI	1.8%	flat	0.1% Gasoline and truck prices spiked in Nov lifting both headline & core rate
	Dec PPI Core	0.5%	0.1%	0.1% but steadier prices for both (not falls) in Dec will see flatter PPI.
	Dec Housing Starts	8.9%	-0.2%	-10.0% Poor Dec weather, plunging Nov new home sales and a correction
	Dec Housing Permits	6.9%	-0.7%	-3.5% lower in the multiples component will all pull starts down sharply.
Ger	Dec PPI %yr	-5.9%	-5.1%	-5.0% Base effects alone will add 0.8 ppts to annual rate.
UK	Jan BoE MPC Minutes	-	-	- On hold rates and unchanged QE program decision likely unanimous.
	Dec Unemployment chg	-6.3k	-4.6k	flat Nov saw first fall since Feb 2008 suggesting economy growing again.
Can	Dec CPI %yr	1.0%	1.6%	1.7% Headline rate rising due to energy-related base effects from late 2008
	Dec CPI Boc Core %yr	1.5%	1.7%	1.6% while core rate continues to hover below 1-3% target mid-point.
	Nov Manufacturing Sales	2.0%	0.6%	- Up-trend has emerged since mid-year.
<b>Thu 21 Jan</b>				
NZ	Nov Retail Sales	flat	0.5%	0.5% Core growth of 0.3%, with vehicles adding to total.
Aus	Jan MI Consumer Inflation Expect's	3.6%	-	- +0.4ppts in Dec to highest since Oct-08, but uptrend since Mar stalled.
	Jan WBC-MI Unemployment Expect's	3.1%	-	- Despite Nov & Dec rises, rapid 39% downtrend since Feb-09 peak cont'd.
	Dec New Motor Vehicle Sales	5.5%	-	5.0% FCAI figs show strong Dec sales on tax-break-boosted business demand.
US	Initial Jobless Claims w/e 16/1	444k	440k	435k Downtrend resuming after correction higher from holidays distortion.
	Jan Philadelphia Fed Index	20.4	19.4	10.0 Snow disruption, weaker NY Fed in recent months, point to downside.
	Dec Leading Index	0.9%	0.7%	0.8% Claims, equities, yield spread, permits and more to drive further gain.
Eur	Jan ECB Bulletin	-	-	- More detail behind Jan rate decision.
	Jan PMI Factory Advance	51.6 a	51.9	51.4 The upswing in these indices through Q4 looks inconsistent with the
	Jan PMI Services Advance	53.7a	53.8	53.0 apparent slowdown in Q4 GDP growth so we expect dip lower in Jan.
UK	Dec Major Bank Mortgage Approvals	63k	65k	65k The no. of bank mortgages approved has almost doubled since Jan.
	Dec PSNCR £bn	14.7	25.5	- Govt budget blowout is dramatic but won't be addressed till next FY.
	Dec Money Supply M4 %yr	9.3%	8.9%	- Growth has plunged from 18.7% yr since QE began in March.
	Jan CBI Industrial Trends Survey	-	-	- First look at factory sector in early 2010. Some weather disruption?
Can	Nov Wholesale Sales	0.3%	0.5%	- Trending modestly higher since mid year.
<b>Fri 22 Jan</b>				
Aus	Q4 Export Price Index %qtr	-9.6%	-3.5%	-4.5% 5.5% USD commodity price rise more than offset by 9% AUD/USD jump.
	Q4 Import Price Index %qtr	-3.0%	-2.0%	-5.0% Core prices -5.2% with MTWI up 6.6%; petroleum (-4.1%) also a drag.
Eur	Nov Industrial Orders	-2.2%	0.5%	0.0% German data up just 0.2% after falling 1.9% in Oct, so good guide.
UK	Dec Retail Sales	-0.3%	1.1%	1.6% Shoppers seeking to beat the VAT hike should deliver retail spike.
Can	Nov Retail Sales	0.8%	-0.2%	-0.5% Likely to be weighed down by falling auto sales.

## New Zealand Economic and Financial Forecasts

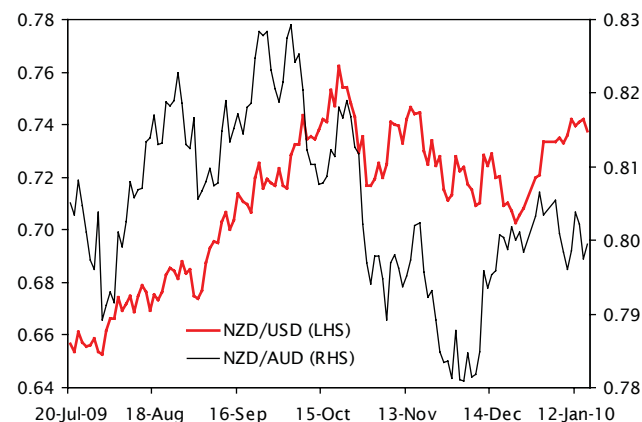
Economic Growth Forecasts	March years				Calendar years			
	2008	2009	2010f	2011f	2008	2009f	2010f	2011f
% change								
GDP (Production) ann avg	2.9	-1.4	-0.1	4.1	-0.1	-1.4	3.7	4.3
Employment	-0.3	0.7	-0.9	2.1	0.9	-2.2	1.1	2.1
Unemployment Rate % s.a.	3.8	5.0	6.7	5.1	4.7	6.7	6.1	5.3
CPI	3.4	3.0	2.5	3.0	3.4	2.1	2.6	2.8
Current Account Balance % of GDP	-7.8	-7.9	-1.9	-5.0	-8.7	-1.9	-4.7	-5.1

Financial Forecasts	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-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	5.10	5.40	5.70	5.90	6.10	6.30	6.20
5 Year Swap	6.00	6.10	6.20	6.30	6.40	6.50	6.50
10 Year Bond	6.10	6.20	6.30	6.30	6.40	6.50	6.50
NZD/USD	0.77	0.73	0.76	0.78	0.77	0.75	0.72
NZD/AUD	0.80	0.81	0.82	0.82	0.83	0.83	0.84
NZD/JPY	67.8	67.9	73.0	78.0	81.6	81.8	80.6
NZD/EUR	0.51	0.50	0.51	0.52	0.52	0.51	0.49
NZD/GBP	0.43	0.42	0.42	0.43	0.43	0.40	0.38
TWI	67.4	65.9	67.9	69.6	70.2	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 18 January 2010

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.77%	2.73%	2.76%
60 Days	2.77%	2.75%	2.76%
90 Days	2.78%	2.80%	2.76%
2 Year Swap	4.57%	4.66%	4.50%
5 Year Swap	5.43%	5.64%	5.49%

## NZ foreign currency midrates as at Monday 18 January 2010

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7364	0.7335	0.7105
NZD/EUR	0.5129	0.5099	0.4956
NZD/GBP	0.4531	0.4585	0.4403
NZD/JPY	66.850	66.990	64.250
NZD/AUD	0.7990	0.8055	0.7988
TWI	66.700	66.730	64.820

## 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	2.4	1.0	3.0	3.2
CPI inflation % annual	2.8	3.3	3.0	3.7	2.0	2.2	2.7
Unemployment %	5.1	4.8	4.4	4.3	5.6	6.0	5.9
Current Account % GDP	-5.8	-5.3	-6.3	-4.6	-4.1	-5.1	-5.4
<b>United States</b>							
Real GDP %yr	3.1	2.7	2.1	0.4	-2.5	1.5	3.1
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	-2.6	-1.8
<b>Japan</b>							
Real GDP %yr	1.9	2.8	2.2	-0.9	-5.8	1.6	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	5.3	5.2
Current Account %GDP	3.6	3.9	4.8	3.2	2.6	3.1	3.9
<b>Euroland</b>							
Real GDP %yr	1.7	2.9	2.7	0.6	-4.0	0.6	1.2
Consumer Prices %yr	2.5	2.0	3.1	1.6	0.3	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	-0.5	0.0	-0.2	0.0	0.4	0.4
<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	1.5	2.8	1.5
Unemployment Rate %	2.8	3.0	2.5	3.1	5.5	7.0	7.3
Current Account %GDP	-2.6	-3.0	-2.8	-2.3	-3.0	-3.0	-2.0

Forecasts finalised 9 December 2009

Interest Rate Forecasts	Latest (Jan 18)	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
<b>Australia</b>						
Cash	3.75	4.00	4.50	4.50	4.50	4.75
90 Day Bill	4.20	4.30	4.70	4.60	4.75	5.00
10 Year Bond	5.59	5.70	6.20	6.50	6.50	6.50
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.67	3.50	3.20	3.75	4.25	4.50
ECB Repo Rate	1.00	1.00	1.00	1.00	1.25	2.00
<b>Exchange Rate Forecasts</b>						
AUD/USD	0.9216	0.96	0.90	0.93	0.95	0.93
USD/JPY	90.79	88	93	96	100	106
EUR/USD	1.4358	1.51	1.47	1.50	1.51	1.47
AUD/NZD	1.2515	1.25	1.23	1.22	1.22	1.21

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