

Weekly Commentary

19 April 2010

Household rules

Current data is painting a mixed picture of the consumer in the early part of this year – though nothing to shake our view that a normal recovery is taking place and that the RBNZ is set to begin raising rates soon.

The REINZ reported that house sales rose to 6,161 in March from 5,029 in February, while their stratified price index rose by 1.7%. March is typically the strongest month of the year for the housing market; we estimate that in seasonally adjusted terms, house sales were up 1.7% in March following a 7.6% rise in February. The average number of days to sell shortened from 39 to 38, and adjusted sale prices were 0.2% higher.

The housing market hasn't fully recovered from the plunge in January, which was probably due to fear of adverse tax changes following the recommendations of various working groups in late 2009 (although the most punitive measures were ruled out by the Prime Minister in February). Sales are still about 9% lower than last December, and the average time to sell is longer. But it appears that the housing market is stabilising at a lower level. Our current forecasts assume that house prices will track slightly lower over the course of this year, so while this is only one month of new information, we'll take it as a mild positive surprise.

Retail spending fell 0.6% in February, following a 0.7% rise in January. This was

weaker than market expectations for a small rise, but more in line with our forecast of -0.3%. Our forecast was based on a lack of price pressures in that month – food prices were down 1.3% and petrol prices were flat – and a 0.4% fall in debit and credit card transactions. The cards data suggested that food and durable goods were particularly soft in February, which proved to be the case.

We actually take this as a positive sign: it means that we can put more credence on the March card transactions report, which showed a 2.1% rise in retail spending (and a 2.2% rise in ex-auto spending). Consumables and durables, the weak points in February, bounced sharply in March, but the growth in transactions was fairly broad-based. A 4% rise in petrol prices failed to dampen spending in other areas.

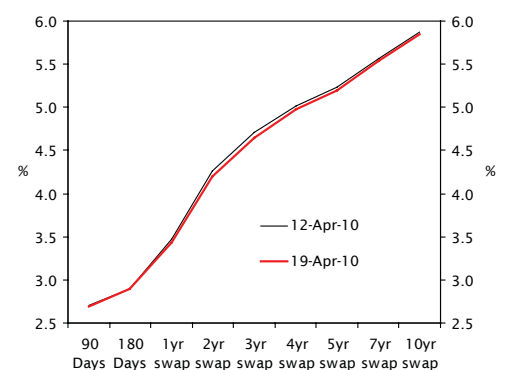
Depending on how the March month turns out, we estimate that nominal retail spending rose by 0.8% in the March quarter. That's not actually a bad outcome, comparable to the 0.7-1.0% growth in the three previous quarters. The difference this time is that most of that growth is likely to have been accounted for by higher prices.

Which brings us to the Q1 CPI, to be released Tuesday. We expect a 0.7% increase for the quarter, which would lift the annual inflation rate to 2.4%. That would be well ahead of 0.3% quarterly and 2.0% annual rates that

the RBNZ forecast in the March *Monetary Policy Statement*.

As usual, the main drivers for the quarter tell us more about specific price movements rather than the general inflation environment. We estimate that food prices were 1% higher for the quarter, and we know that petrol is up by around 6.5%. We put the annual round of education fee increases at 3.8%, which would be about average. And there has been a 0.6% increase in electricity and gas prices, compared to a 0.2% fall last quarter. International airfares are the biggest wildcard: we've have assumed an 8.5% decline, which is small by the standards of recent history (over the past five years the Q1 fall in international airfares has ranged from 8.1% to 18%). Our thinking is that rising oil prices and the improving global economy will outweigh the impact of the strong NZ dollar.

NZ Interest Rates



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

A surprise on any of these factors is unlikely to change anybody's view of the underlying trend in inflation. But there is one aspect of our forecast that is crucial. We estimate that the cost of new housing construction accelerated to 1%, after five subdued quarters that averaged just 0.1%. Construction cost inflation is a major focus for the RBNZ, and what's more, the evidence of a price jump only became apparent after it had finalised its March MPS forecasts. The March *QSBO* showed a sudden jump in the number of construction firms intending to raise prices, and this is supported by anecdotes from the industry.

The CPI will be a critical release as markets agonise over whether the RBNZ will stick to its plan of raising interest rates from around the middle of the year – and whether that means June or July. We remain comfortably in the June rate hike camp. For one, the track record of forecasting

errors on the CPI suggests that the odds of inflation coming in below the RBNZ's expectations are very low. Even an outturn slightly below our forecast (or the market consensus of 0.6%) would constitute an upside surprise to the RBNZ.

As for the retail spending figures, we don't see them as a threat to our GDP forecasts. Retail spending volumes won't be great, but non-retail spending has been quite strong (though we don't know how much of this was price-driven). Moreover, the household is not the entire economy. Private consumption accounts for 60% of GDP, and the quarterly correlation is only around 50%.

As we've noted elsewhere, the economy is going through a degree of rebalancing, where the growth is being generated in areas such as manufacturing, agriculture, housing construction, even mining exploration. It's not always prominent,

not always glamorous, but it's growth nonetheless.

Fixed vs. floating: The prospect of OCR hikes through the second half of the year and beyond 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.

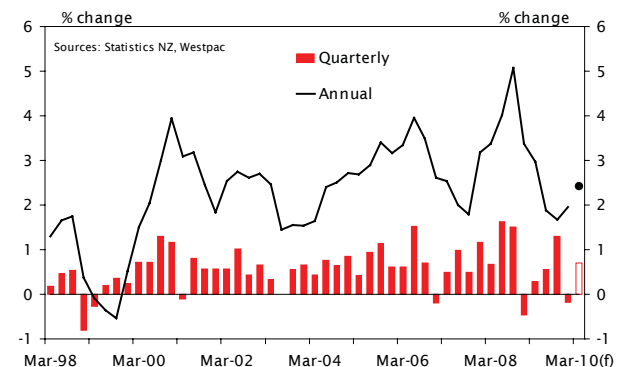
Key Data Previews

NZ Q1 CPI

Apr 20, Last: -0.2%, WBC f/c: 0.7%, Mkt f/c: 0.6%

- We think there is a high chance the RBNZ will receive an upside surprise on its 0.3% CPI forecast.
- Our bullish forecast is mostly down to inconsequential quarterly volatility in food and petrol prices. More important is our pick that construction cost inflation accelerated to 1%, after five quarters languishing around 0.1%.
- This data is critical for market pricing of a June OCR hike – we think a number on our forecasts would seal the deal.

NZ CPI inflation

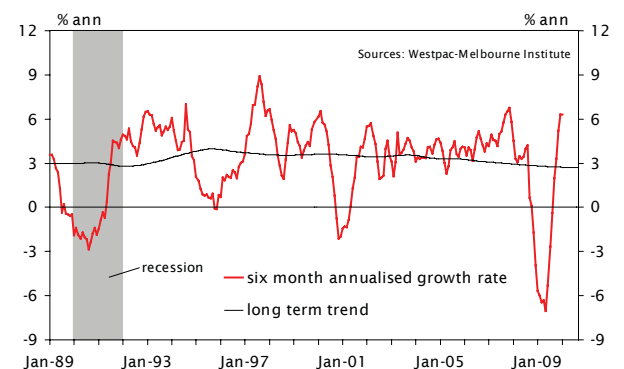


Aus Feb Westpac-MI Leading Index

Apr 21, Last: 6.3% annualised

- After rising sharply over the second half of 2009, the *Westpac-Melbourne Institute Leading Index* continued to point to strong momentum in January. The annualised growth rate, a guide to the likely pace of economic activity three to nine months ahead, was 6.3% well above its long run trend of 2.7%. Notably the annualised growth rate in the companion Coincident Index (a gauge of current conditions) also rose above its long term trend for the first time since September 2007.
- The Index's monthly components were mixed in February. Equity markets recovered from January's sell-off (ASX up 1.5%), and money supply growth rose edged higher but US industrial production stalled flat after seven strong monthly gains and dwelling approvals fell for a second month in a row (-3.3%).

Westpac-MI Leading Index

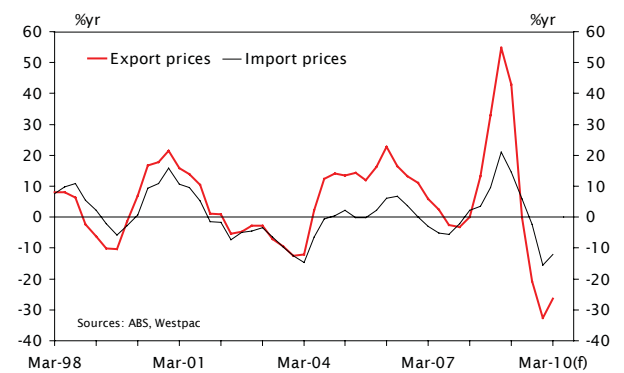


Aus Q1 international trade price indexes

Apr 23, Export: Last: -1.7%, WBC f/c: 4.3%, Mkt f/c: 3.7%
 Import: Last: -4.3%, WBC f/c: 1.2%, Mkt f/c: -1.5%

- Q4 export prices fell 1.7%qtr, their 4th consecutive fall, taking annual growth to -32.7%yr from -20.7%yr previously. While USD commodity prices rose 7.2% led by base metals, this was more than offset by the valuation drag from a 9.0% AUD/USD rise. With the import weighted AUD TWI up 6.6%qtr, core import prices fell 4.9%qtr. Food & beverage prices fell 5.2% but with a lesser 0.5% fall in mineral fuels, the total MPI fall was tempered to 4.3%qtr, giving a higher terms of trade.
- USD commodity prices continued to rise in Q1 (RBA index +3.9% led by base metals) and with a 0.5% AUD/USD dip providing valuation support, we look for a solid 4.3%qtr rise in the XPI. While the MTWI rose 0.1%qtr, recent core MPI moves have exceeded those implied by straight MTWI moves - we expect a 1.1%qtr core MPI rise. An expected 1.5%qtr rise in mineral fuels lifts the total MPI forecast to +1.2%qtr.

International trade price inflation

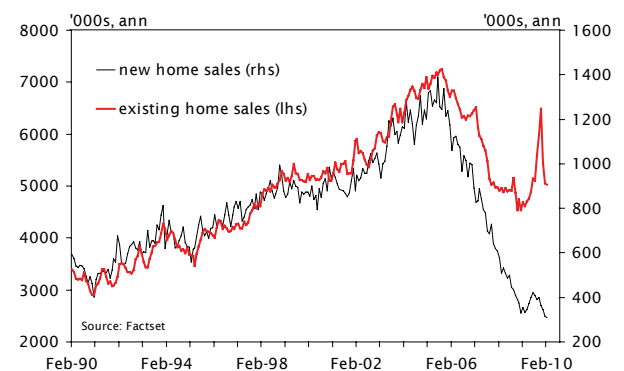


US Mar existing and new home sales

Apr 22, Existing home sales: Last: -0.6%, WBC f/c: 5.0%, Mkt f/c: 5.6%
 Apr 23, New home sales: Last: -2.2%, WBC f/c: 8.0%, Mkt f/c: 5.5%

- For six months up until early Q4, US housing showed signs of strengthening on all indicators: starts, permits, prices, homebuilder sentiment and of course sales. But more recently, most sector indicators have lost this momentum, including some steep falls for both of these sale measures since late 2009. Poor weather may have been a factor at play.
- Existing home sales reflect transactions agreed in months prior, but the separate pending home sales series posted a solid 8% rise in February, suggesting that the recent dramatic downswing in existing home sales should turn around in March.
- New home sales are volatile and revisions can be severe. They hit a new cycle low in Feb. A solid March bounce, due to the extended tax credit and normalising weather, is likely. We expect an 8% gain; a double digit rise would not surprise.

US housing sales

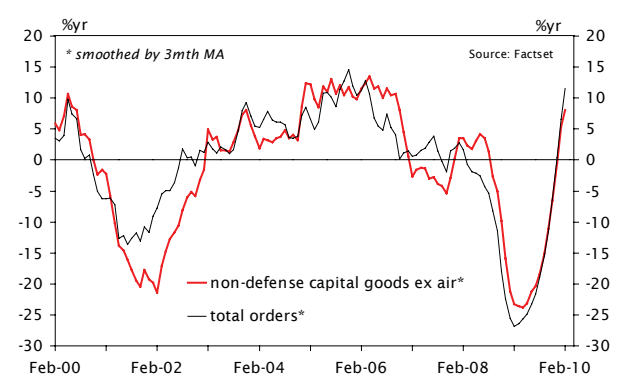


US Mar durable goods orders to post a modest gain

Apr 23, Last: 0.9%, WBC f/c: 1.0%, Mkt f/c: 0.2%

- Durables goods orders rose 0.9% in Feb, supported by a modest bounce in core capital goods orders and a further rise in civilian aircraft orders, offset by weakness in defense, autos and elsewhere. Orders have now posted three consecutive monthly gains for the first time since late 2007 but some loss of momentum is becoming apparent despite mostly upbeat business surveys
- Mar orders are forecast to post another gain, which would mean the first string of four monthly rises since late 2005. However we expect a relatively subdued 1.0% rise.
- Mar ISM factory orders rose 2 pts to back above 60 - very solid. Mar factory production up 0.9% - also solid. Boeing Mar data suggest steady orders growth but these figures are currently out of synch with the Census Bureau data.

US durable goods orders



Key Data and Events

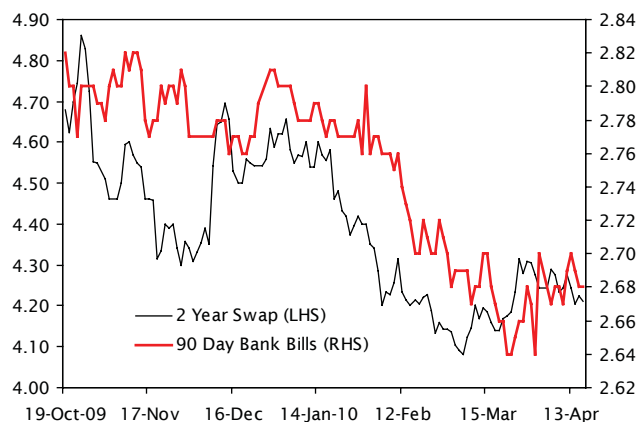
	Last	Market Median	Westpac Forecast	Comments
Mon 19 Apr				
US Mar Leading Index	0.1%	1.0%	1.0%	March rise would make it twelve in a row.
Tue 20 Apr				
NZ Q1 CPI %qtr	-0.2%	0.6%	0.7%	The RBNZ is likely to get a large upside surprise on its 0.3% forecast.
Mar Food Prices	-1.3%	-	flat	Fruit and veg fall offset by grocery rise.
Aus Apr RBA Board Meeting Minutes	-	-	-	What motivated the Board to drop its 'gradual' approach to rate rises?
Eur Feb Current Account sa €bn	-8.1	-	-	Fairly persistently in deficit despite trade surplus.
Ger Apr ZEW Economic Sentiment	44.5	45.1	40.0	Greece and GDP concerns to see downtrend since last Oct steepen.
Mar Producer Prices %yr	-2.9%	-1.8%	-1.7%	Base effects and weaker euro to lift annual pace closer to flat.
UK Mar CPI	3.0%	3.1%	3.2%	Sticking above 3% for the time being but likely to fall later in Q2.
Can BoC Rate Decision	0.25%	0.25%	0.25%	Domestic data suggest hike is just round the corner, but not quite yet.
Wed 21 Apr				
Aus Feb WBC-MI Leading Index	6.3%	-	-	Tracking well above long run average rate of 2.7%.
UK Apr BoE Minutes	-	-	-	April on hold decision almost certainly unanimous.
Mar Unemployment chg	-32k	-10k	5k	Benefit claimant count fall in Feb looks overdone.
Can Feb Wholesale Sales	3.0%	0.8%	-	Up five months running, and Jan rise the fastest in three years.
Thu 22 Apr				
Aus Mar New Vehicle Sales	-1.9%	3.0%	3.0%	Raw data showed rise on firming cons & jump in rental fleet sales.
US Mar Producer Price Index	-0.6%	0.5%	0.5%	Early month survey timing will capture sharp energy price gain but
Mar PPI Core	0.1%	0.1%	0.1%	auto/light truck price discounting could constrain core rate.
Initial Jobless Claims w/e 17/4	484k	450k	449k	Latest spike in claims due to statistical issues according to Labor Dept.
Feb House Prices	-0.6%	-0.2%	-	Lesser watched FHFA index.
Mar Existing Home Sales	-0.6%	5.6%	5.0%	Feb pending home sales point to decent gain in March.
Eur Apr Consumer Confidence Advance	-17	-17	-18	Headlines about the economy and Greece have not been favourable.
Apr PMI Factory Adv	56.6	56.7	56.0	March saw outsized gains inconsistent with likely economic prospects
Apr PMI Services Adv	54.1	54.4	53.5	so a correction lower in both expected.
UK Mar Major Bank Mortgage Approvals	48k	50k	-	Down 3 months running from recent peak of 62k in Nov.
Mar Money Supply M4 %yr	3.9%	-	-	Slowed sharply from 17.7%yr since the start of QE early last year.
Mar PSNCR £bn	7.7	31.3	-	Public sector net credit requirement - a measure of the budget deficit.
Apr CBI Industrial Trends Survey	-	-	-	Will include quarterly business optimism survey results.
Mar Retail Sales Volumes	2.1%	0.6%	0.6%	Total including fuel. Mild weather late month may have boosted sales.
Can Mar Leading Index	0.8%	0.8%	-	Has not posted a decline for ten months.
Fri 23 Apr				
NZ Mar External Migration ann.	21,620	-	21,540	The tide is turning for net migration.
Mar Credit Card Transactions	-0.3%	-	-	Strong spending growth in March, though credit card share down.
Aus Q1 Export Price Index %qtr	-1.7%	3.7%	4.3%	1st rise since Q408; 3.9% USD commodity price rise & 0.5% A\$ dip.
Q1 Import Price Index %qtr	-4.3%	-1.5%	1.2%	Core prices +1.1% with MTWI near flat (+0.1%) & mineral fuels +1.5%.
RBA Governor Stevens speech	-	-	-	Toowoomba, topic: Economic Conditions (12.50pm AEST)
US Mar Durable Goods Orders	0.9%	0.2%	1.0%	Strong ISM and IP in March suggest orders gain.
Mar New Home Sales	-2.2%	5.5%	8.0%	March weather-related bounce from Feb's cyclical low.
G20 Washington Meeting	-	-	-	Finance officials meet to discuss global economy.
Fedspeak	-	-	-	Kohn in Europe on economic/financial statistics.
Eur Feb Industrial Orders	-1.6%	1.0%	0.3%	German orders were flat in Feb.
Ger Apr Ifo Business Climate Index	98.1	98.7	97.5	Sharp March rise looks overdone.
UK Q1 GDP Advance	0.4%	0.4%	0.2%	Latest partial data suggest our previous flat forecast too pessimistic.
Can Mar Consumer Price Index %yr	1.6%	1.6%	-	Strength of domestic data, recent acceleration in headline CPI and
Mar Boc CPI Core %yr	2.1%	1.9%	-	core CPI back above 1-3% target midpoint point to BoC hike in H2 10.
Feb Retail Sales	1.8%	1.0%	1.2%	Strong auto sales to boost headline retail value.

New Zealand Economic and Financial Forecasts

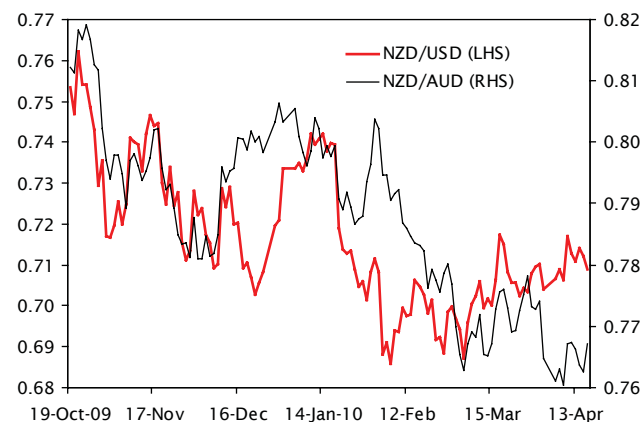
Economic Growth Forecasts	March years				Calendar years			
	2008	2009	2010f	2011f	2008	2009	2010f	2011f
% change								
GDP (Production) ann avg	2.9	-1.4	-0.3	4.1	-0.2	-1.6	3.4	4.4
Employment	-0.3	0.7	-1.2	1.8	0.9	-2.4	1.6	2.1
Unemployment Rate % s.a.	3.8	5.0	7.4	6.3	4.7	7.3	6.2	5.5
CPI	3.4	3.0	2.4	2.1	3.4	2.0	2.4	2.7
Current Account Balance % of GDP	-7.8	-7.9	-2.6	-3.3	-8.7	-2.9	-3.0	-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 19 April 2010

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.64%	2.60%	2.62%
60 Days	2.67%	2.63%	2.63%
90 Days	2.69%	2.67%	2.66%
2 Year Swap	4.20%	4.25%	4.17%
5 Year Swap	5.20%	5.22%	5.16%

NZ foreign currency midrates as at Monday 19 April 2010

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7077	0.7068	0.7082
NZD/EUR	0.5246	0.5276	0.5234
NZD/GBP	0.4627	0.4626	0.4717
NZD/JPY	65.090	66.300	64.060
NZD/AUD	0.7677	0.7610	0.7730
TWI	65.570	65.700	65.570

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	3.2	3.6
CPI inflation % annual	2.8	3.3	3.0	3.7	2.1	2.6	2.8
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	-4.2	-3.1
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	0.7	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	0.3	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 8 April 2010

Interest Rate Forecasts	Latest (Apr 19)	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
Australia						
Cash	4.25	4.50	4.50	4.50	4.50	5.00
90 Day Bill	4.51	4.50	4.60	4.75	4.75	5.25
10 Year Bond	5.76	5.90	6.00	6.00	6.10	6.75
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.50
US 10 Year Bond	3.77	3.70	3.75	4.00	4.50	5.25
ECB Repo Rate	1.00	1.00	1.00	1.00	1.25	1.50
Exchange Rate Forecasts						
AUD/USD	0.9218	0.94	0.94	0.95	0.93	0.90
USD/JPY	91.98	93	95	98	102	106
EUR/USD	1.3491	1.34	1.36	1.38	1.36	1.32
AUD/NZD	1.3025	1.31	1.25	1.22	1.22	1.20

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