

Weekly Commentary

21 June 2010

Not a bad place to be

Recent and upcoming data should largely serve to confirm the story that the New Zealand economy was going through a rebalancing phase in the early part of this year, with subdued consumption but strong export-oriented production.

The housing market remained soft in May. We estimate that sales fell 2.8% in seasonally adjusted terms in May, while the average time to sell extended slightly to 43 days. The REINZ's stratified house price index fell 1.4% for the month. While the Budget delivered on 20 May has at least provided certainty about the tax treatment of property, the changes that were announced were a clear negative for housing (in particular the cut to the top income tax rate, which reduces the tax shelter provided by rental properties).

Despite the evidence of subdued consumer activity to date, the Q2 Westpac-McDermott Miller consumer confidence survey showed that households remain optimistic, with the overall index reaching its second-highest level since December 2006. On balance, households still see themselves as worse off than a year ago – although less so than in Q1 – but they continue to expect an improvement in the economy and in their own circumstances in the next year. The most notable improvement was in the category “good time to buy a major household item”, which will partly reflect an intention to buy big-ticket items before the GST increase on 1 October.

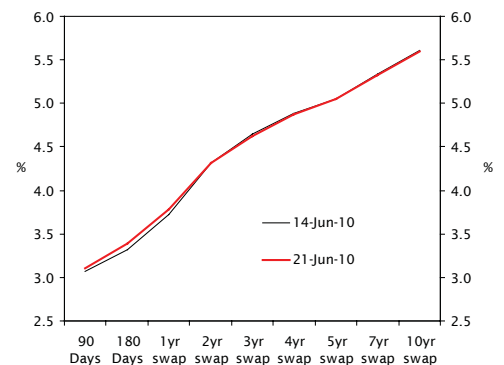
This week sees the last of the major indicators for the March quarter, starting with the current account (Wed). We expect a further narrowing in the annual deficit to a low point of 2.4% of GDP – a far cry from the high of 9.1% set in early 2006 or even the recent peak of 8.7% in December 2008.

The main feature for Q1 is an improvement in the trade balance – in fact, in seasonally adjusted terms we're anticipating the largest quarterly trade surplus on record. While prices (both exports and imports) are down about 8% on a year ago due to the rebound in the NZD, export volumes have been the star performer for the New Zealand economy in recent times. International prices and volume growth have been underpinned by strong demand from Australia and the fast-growing economies in developing Asia. That theme has continued into the June quarter – we expect Friday's merchandise trade balance for May to show a healthy surplus of \$600m (albeit not quite enough to keep the 12-month balance in surplus). Many of the debit items remain at a low point in the cycle, with the economy still in the early stages of recovery. Import demand is picking up again, but volumes are only 4% higher than a year ago. Investment income outflows have been pulled down by low interest rates and a fall in the profits of overseas-owned firms (although the latter item rose dramatically in Q4, a performance that we don't expect to be repeated).

While the narrowing in the current account deficit in the last year or so hasn't been for entirely positive reasons, it has come at just the right time. International markets are gunning for countries than run persistently ugly current account deficits – and a year ago NZ could well have been at the top of the hit list.

Finally, we have March quarter GDP (Thurs). By our reckoning, the pace of economic growth wobbled a bit in the first part of 2010 – we expect a 0.7% increase, compared to 0.8% growth in Q4 last year – but the recovery remains on track. The recovery has been distinctly export-led, thanks to skyrocketing commodity prices and strong demand from Australia and Asia. Business confidence has remained high enough for businesses to begin hiring, and unemployment has fallen sharply. However, the consumer sector fared poorly, and the housing market was

NZ Interest Rates



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

especially slow. This two-speed dynamic, combined with region-specific effects of drought, has created a very mixed economic picture.

For the production measure of GDP, the strongest contribution appears to have come from services (output is hard to measure in service sectors and is typically proxied by employment growth, which was notably strong in Q1). Wholesale trade and transport were likely to have benefited from the strong export performance over the quarter. Government administration and defence is also expected to make a positive contribution (again, based on employment growth). Finally, mining rose sharply as production began at the Kupe oil and gas field and the Pike River coal mine.

On the downside, the indicators for manufacturing are surprisingly weak

(although this follows a 4.5% rise in Q4). We expect zero growth overall, with a sharp decline in dairy production. Dry, mild weather is expected to have caused declines in agricultural production and electricity value-add. The finance and insurance sector is expected to show its first decline since June 2008, although we think the financial crisis had led to a mismeasurement of banks' margins, leaving them overstated during recession and understated during recovery. And retail, not surprisingly, is likely to be subdued.

Our forecast of 0.7% growth is above the market median of 0.5% but below the RBNZ's pick of 0.8% (which would put them at the top of the range). Still, we don't think that anything within the range of forecast outcomes would derail the RBNZ's plan to steadily return the OCR to normal levels.

Fixed vs. floating: This month, as was widely anticipated, the RBNZ kicked off what we expect to be an extended tightening cycle. Nevertheless the decision to fix or float remains finely balanced. Floating rates remain 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.

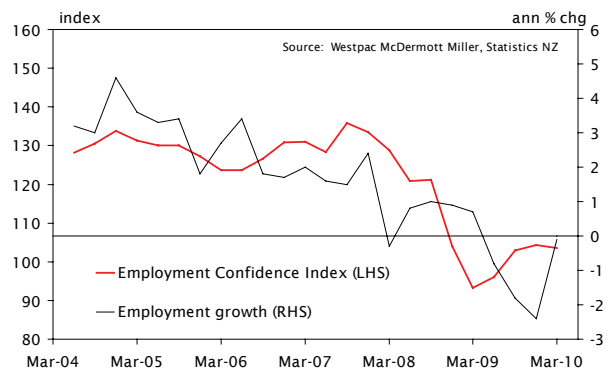
Key Data Previews

NZ Q2 employment confidence index

Jun 23, Last: 103.6

- Employment confidence registered a very small decline in the March 2010 quarter, as perceptions around both current and future conditions eased.
- Since March, data have confirmed a sharp decline in unemployment, while business confidence has continued to push higher. The latter bodes well for further improvements in the labour market.
- We will be looking for further gains in employment confidence to support our view that consumer spending will continue to pick up pace from the second half of 2010.

NZ employment and confidence

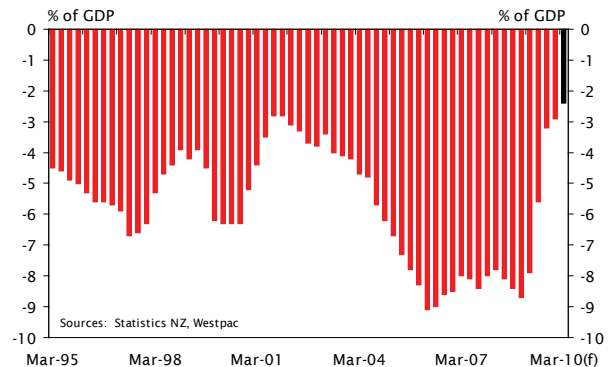


NZ Q1 current account deficit NZDm s.a.

Jun 23, Last: -3,110, WBC f/c: -1,030

- We estimate that the current account deficit (CAD) narrowed to 2.4% of GDP in the year to March.
- The trade balance has improved substantially, with exports boosted by strong demand from Asia while import demand is picking up only gradually.
- We expect a fall in the investment income deficit, with lower company profits, interest rates still low, and no distortions from banks' tax provisions.

NZ annual current account deficit

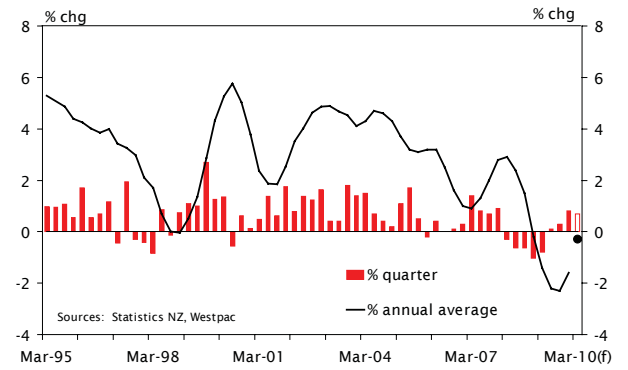


NZ Q1 GDP

Jun 24, Last: 0.8%, WBC f/c: 0.7%, Mkt f/c: 0.5%

- NZ's economic recovery was tepid at first, but growth accelerated to 0.8% in Q4 2010. Our forecasts suggests that the recovery remains on track, but the pace of growth slowed slightly in the first quarter of 2010.
- The recovery is distinctly export-led, while consumers and housing-related activity has been pretty miserable. Mining, government and personal/community services all had very strong runs, while finance, manufacturing, and retailing were more subdued.
- It would take a huge surprise to generate a significant market reaction to this data. Now that it is in train, the RBNZ is unlikely to change it's well-signalled plan to steadily hike the OCR.

NZ GDP growth

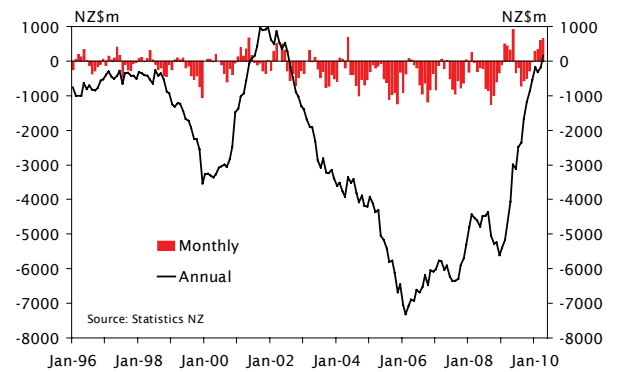


NZ May merchandise trade NZDm

Jun 25, Last: 656, WBC f/c: 600, Mkt f/c: 767

- New Zealand has been running firm trade surpluses for most of 2010, as exporters receive record prices for their product and consumer reluctance keeps imports low.
- We have seen evidence of a slight increase in import values. We are picking higher import values for consumption, investment and intermediate goods. By contrast, exports may be coming off their early-2010 highs, as prices stabilise and drought begins to affect volumes.
- This won't be enough to return us to deficit. The forecast surplus is smaller than last year's but still large by historical standards.

NZ merchandise trade balance

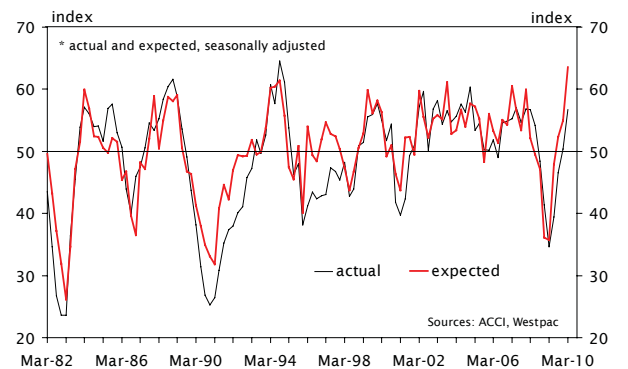


Aus Q2 Westpac-ACCI Survey of Industrial Trends

Jun 24, Last: Actual Composite Index: 56.7

- The Q1 Westpac-ACCI Survey saw a 6.3pt jump in the Actual Composite Index to 56.7 (highest since 2007Q4), its fourth consecutive rise. The result exceeded predictions from the prior Survey's Expected Composite Index (55.0) and significantly, surpassed its decade average (52.0) for the first time since 2008Q2, indicative of above-trend manufacturing growth. The Labour Market Composite Index net balance rose 9pts to +8, historically consistent with jobs growth accelerating to 3%yr in 2010H2. The investment outlook improved substantially, with strong gains in capacity utilisation, profit expectations and 12mth month investment plans.
- Expectations for Q2 were strong. The Expected Composite Index rose 8.6pts to a record high of 63.6, implying predictions of accelerating, above-trend growth (decade average is 52.9).
- The Q2 Survey was conducted from 7 May to 11 June.

Westpac-ACCI composite indexes*

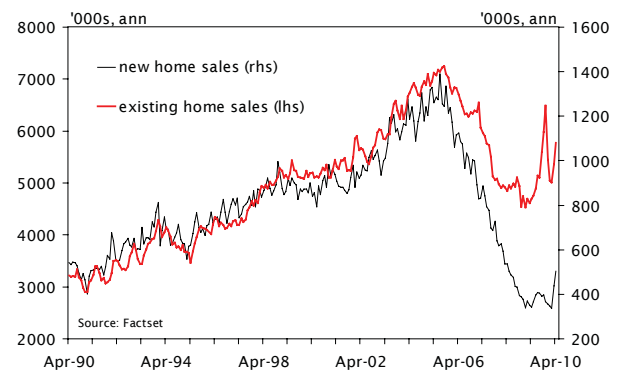


US May existing and new home sales

Jun 22, Existing home sales: Last: 7.6%, WBC f/c: 5.0%, Mkt f/c: 6.5%
 Jun 23, New home sales: Last: 14.8%, WBC f/c: -25.0%, Mkt f/c: -18.7%

- Housing data have turned extremely positive in the past month or two, with a weather-related activity rebound and a scramble by buyers to take advantage of the tax credit that expired on April 30 supporting sales, starts and homebuilder sentiment.
- Existing home sales reflect transactions agreed in months prior, but the separate pending home sales series provides an early lead. Its 20+% rise in Feb-Apr suggests that existing home sales should build upon their 15% March-April gain, with a further 5% in May. In H2 2010, sales will fall back again.
- New home sales hit a new cycle low in Feb, jumped 29% in March, due to the extended tax credit and normalising weather, then surged a further 15% in April. But May will suffer from the tax credit pull-forward, and a fall of 20-40% is likely; anything smaller, and it just means June will fall steeply.

US housing sales

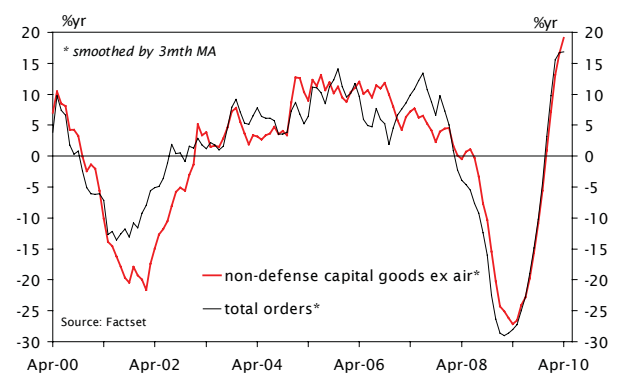


US May durable goods orders to fall, due to aircraft

Jun 24, Last: 2.8%, WBC f/c: -2.2%, Mkt f/c: -1.3%

- Durables orders posted a near 3% jump in April and back revisions meant that March's fall was revised away, so April was the fifth straight month without an orders decline. The detail showed a 228% surge in civilian aircraft orders that explained all of the gain; ex transport orders fell 1%. Core capital good orders were down 2.4% in April but that followed a cumulative rise of around 10% over the prior two months.
- The aircraft component will again dominate in May: Boeing saw 34 '777' orders in April vs just 4 in May, plus a lone '737'. Boeing data don't always track Commerce Dept figures but that points to a fall of 50-80%. Elsewhere, signals are favourable: the ISM factory survey new orders index held at a very strong 65.7; and industrial production rose 1.2% in May. So ex transport orders are expected to rise 2%; core capital goods orders 4%; but total durable orders should be down 2.2%.

US durable goods orders

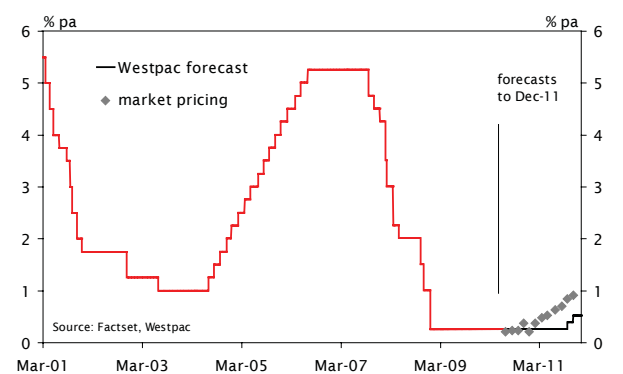


US FOMC still on hold despite minority agitation

Jun 23, Last: 0-0.25%, WBC f/c: 0-0.25%, Mkt f/c: 0-0.25%

- There is an increasingly vocal body of opinion on the FOMC that thinks the time is fast approaching when it will be appropriate to unwind some of the emergency stance of policy, to mitigate against the risk of higher future inflation.
- But the majority, including Chairman Bernanke ("significant restraints" on pace of recovery; inflation "likely to remain subdued") feel the current stance is still appropriate. Indeed speeches from FOMC members indicate there are differences of opinion about how to tighten policy: will the 'exit strategy' start with a higher Fed funds rate, or sales of the assets the Fed accumulated on its balance sheet during the crisis?
- Whatever... it is not a pressing question; heightened military tensions in Korea and the Middle East, and uncertainty about the fall-out from the European sovereign debt crisis provide peripheral but valid further reasons for the on hold stance.

Fed funds target rate



Key Data and Events

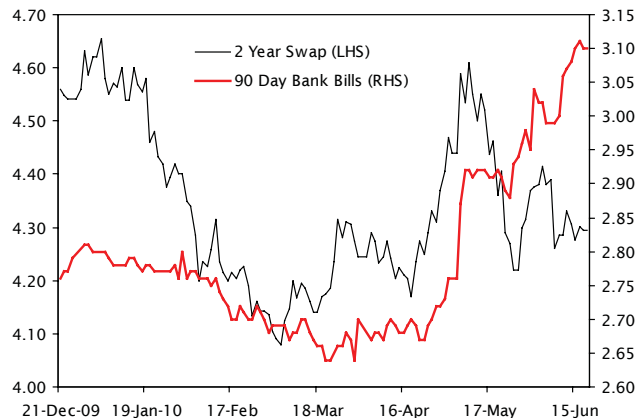
		Last	Market Median	Westpac Forecast	Comments
Mon 21 Jun					
Aus	May Motor Vehicle Sales	8.4%	-	-2.0%	FCAI figs showed highest May sales on record but still imply dip on Apr.
Jpn	Apr All-Industry Activity Index	-0.8%	2.0%	-	Construction still weak, IP decelerating, services subdued.
UK	Jun House Prices %yr	4.3%	-	-	Rightmove index.
Tue 22 Jun					
NZ	May Credit Card Transactions	-1.2%	-	-	Small pickup seen in May, despite lower food and fuel prices.
US	Jun Richmond Fed Factory Index	26	20	15	We expect US business surveys to soften heading into H2 2010.
	May Existing Home Sales	7.6%	6.5%	5.0%	Expired tax credit to impact positively on this measure till June.
	Apr House Prices	0.3%	0.3%	0.3%	Lesser watched FHFA index.
Eur	Apr Current Account Balance €bn	1.7	-	-	Mar saw first surplus since July last year.
	Jun Consumer Confidence Adv	-18	-19	-20	Germans hate bailing out those profligate southerners (also worried).
Ger	Jun IFO Business Climate Index	101.5	101.2	100.0	Extension of marginal May decline expected.
UK	Emergency Budget	-	-	-	Chancellor Osborne to announce "lifechanging" spend and tax reforms
Can	May CPI %yr	1.8%	1.3%	-	Core rate was 1.9%yr in Apr.
Wed 23 Jun					
NZ	Q2 Employment Confidence Index	103.6	-	-	Labour market improvement point to stronger confidence.
	Q1 Current Acct Deficit NZDmn s.a.	-3,110	-	-1,030	Strong trade surplus and a 'normal' quarter for the income deficit.
US	May New Home Sales	14.8%	-18.7%	-25.0%	Tax credit pull-forward means sales to slump 20-40% in May-June.
	FOMC Rate Decision	0-0.25%	0-0.25%	0-0.25%	Firmly on hold despite some regional agitation for tightening.
Eur	Jun PMI Factory Advance	55.8	55.3	55.0	Business surveys are starting to reflect concerns about sovereign debt,
	Jun PMI Services Advance	56.2	55.9	55.5	fiscal tightening and banking sector risk, so PMI's due to correct lower
Ger	Jul GfK Consumer Confidence	3.5	3.3	-	Labelled Jul but surveyed in early June.
UK	Jun BoE Policy Meeting Minutes	-	-	-	Another unanimous vote 9:0 to maintain rates/QE on hold expected.
	May Bank Mortgage Lending £bn	35.7	36.0	-	BBA data covering most banks; BoE will publish broader data 29/6.
	Jun CBI Distributive Trades Survey	-18	-	-	In May reported sales slumped 31 pts to -18.
Can	Apr Retail Sales	2.1%	-0.4%	-0.8%	Auto sales fell nearly 5% in April.
Thu 24 Jun					
NZ	Q1 GDP	0.8%	0.5%	0.7%	A mixture of growth performances across industries.
Aus	Q2 WBC-ACCI Survey of Indust Trends	56.7	-	-	+6.3pts in Q1 to above decade avg = mfg expansion at above-trend pace.
US	May Durable Goods Orders	2.8%	-1.3%	-2.2%	Forecast fall mainly a volatile aircraft component story.
	Initial Jobless Claims w/e 19/6	472k	460k	-	Claims downtrend seem to have stalled.
Jpn	May Corporate Services Prices %yr	-1.1%	-	-	With cost pressure rising elsewhere, there is no pricing power in services.
	May Trade Balance ¥bn sa	729	627	-	Shipments to Asia relatively healthy, price volatility on the import side.
Eur	Apr Industrial Orders	5.7%	1.6%	-2.0%	March saw biggest % jump since 2004 so modest correction possible.
Fri 25 Jun					
NZ	May Merchandise Trade NZDmn	656	767	600	Smaller surplus than last May, but still very strong.
US	Q1 GDP (F)	3.0%a	3.0%	3.1%	Marginal upward revision possible due inventories, other minor stuff.
	Jun UoM Consumer Sentiment (F)	75.5a	75.5	76.0	Modest sentiment upswing in May-June to highest since Jan 2008.
Jpn	May National CPI %yr	-1.2%	-1.1%	-	Output gap has narrowed in the ytd, but remains canyonesque.
Can	G8/G20 World Leaders' Summits	-	-	-	In Huntsville and Toronto this weekend.

New Zealand Economic and Financial Forecasts

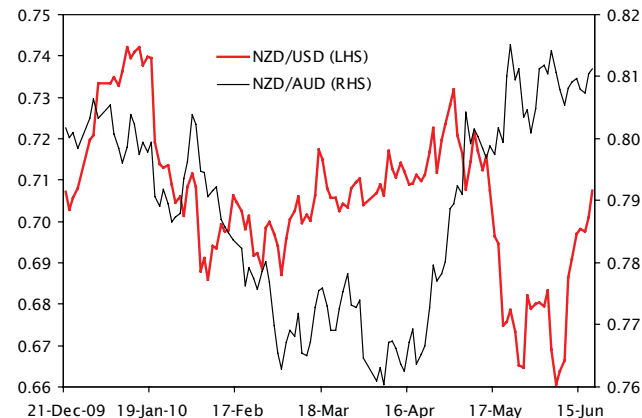
Economic Growth Forecasts	March years				Calendar years			
	2009	2010f	2011f	2012f	2009	2010f	2011f	2012f
% change								
GDP (Production) ann avg	-1.4	-0.3	4.1	4.2	-1.6	3.4	4.4	3.4
Employment	0.7	-0.1	2.1	1.8	-2.4	2.7	1.8	1.3
Unemployment Rate % s.a.	5.1	6.0	5.3	5.0	7.1	5.5	5.0	4.9
CPI	3.0	2.0	5.1	2.7	2.0	4.9	2.6	3.1
Current Account Balance % of GDP	-7.9	-2.6	-3.3	-4.4	-2.9	-3.0	-4.4	-4.4

Financial Forecasts	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
Cash	3.25	3.75	4.25	4.75	5.25	5.75	6.00
90 Day bill	3.70	4.20	4.70	5.20	5.70	6.10	6.20
2 Year Swap	4.80	5.20	5.50	5.90	6.20	6.40	6.50
5 Year Swap	5.70	5.90	6.10	6.30	6.50	6.60	6.70
10 Year Bond	6.00	6.10	6.20	6.30	6.30	6.40	6.50
NZD/USD	0.72	0.74	0.76	0.75	0.74	0.73	0.72
NZD/AUD	0.82	0.82	0.83	0.83	0.83	0.84	0.84
NZD/JPY	65.5	70.3	74.5	76.5	78.4	79.6	80.6
NZD/EUR	0.58	0.60	0.63	0.64	0.64	0.63	0.62
NZD/GBP	0.50	0.51	0.53	0.53	0.53	0.52	0.51
TWI	69.1	71.2	73.8	74.0	74.0	73.9	73.1

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 21 June 2010

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.75%	2.50%	2.50%
30 Days	2.96%	2.79%	2.70%
60 Days	3.02%	2.95%	2.79%
90 Days	3.11%	2.99%	2.89%
2 Year Swap	4.31%	4.39%	4.29%
5 Year Swap	5.05%	5.15%	5.18%

NZ foreign currency midrates as at Monday 21 June 2010

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7118	0.6607	0.6786
NZD/EUR	0.5728	0.5532	0.5404
NZD/GBP	0.4790	0.4562	0.4690
NZD/JPY	64.400	60.600	61.090
NZD/AUD	0.8083	0.8107	0.8151
TWI	68.090	65.250	65.590

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	2.3	1.3	3.0	3.5
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	-3.4	-3.0
United States							
Real GDP %yr	3.1	2.7	2.1	0.4	-2.4	2.7	2.8
Consumer Prices %yr	3.4	3.2	2.9	3.8	-0.2	1.3	2.4
Unemployment Rate %	5.1	4.6	5.8	5.8	9.3	9.7	9.9
Current Account %GDP	-6.1	-6.0	-5.3	-4.9	-2.9	-3.2	-2.4
Japan							
Real GDP %yr	1.9	2.8	2.2	-1.5	-5.8	3.3	2.0
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	3.3	2.8	4.0	4.3
Euroland							
Real GDP %yr	1.8	3.1	2.8	0.5	-4.0	0.8	1.2
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	0.7	1.4
Consumer Prices %yr	2.1	3.0	2.1	3.5	2.9	2.5	2.0
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 4 June 2010

Interest Rate Forecasts	Latest (Jun 21)	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
Australia						
Cash	4.50	4.75	5.00	5.00	5.25	5.50
90 Day Bill	4.93	5.00	5.20	5.20	5.50	5.75
10 Year Bond	5.36	5.60	5.90	5.90	6.00	6.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.375
US 10 Year Bond	3.22	3.40	3.50	4.00	4.20	4.50
ECB Repo Rate	1.00	1.00	1.00	1.00	1.00	1.00
Exchange Rate Forecasts						
AUD/USD	0.8806	0.88	0.90	0.92	0.90	0.88
USD/JPY	90.47	92	95	98	102	105
EUR/USD	1.2427	1.22	1.22	1.18	1.18	1.16
AUD/NZD	1.2371	1.22	1.22	1.21	1.20	1.19

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