

# Weekly Commentary

22 March 2010

## Quartered

Quarterly indicators are the highlights of the data calendar right now, with our Q1 consumer confidence survey released last week and the final December quarter indicators due this week.

The Westpac McDermott Miller consumer confidence index fell slightly in March, to 114.7 from 116.9, largely driven by a drop in expected future conditions. While confidence has slipped from its peaks in the last six months, it remains comfortably above its long-run average.

The slight drop in consumer confidence was much as expected, given that not much went the consumer's way in late 2009 and early 2010. Interest rates rose, petrol prices rose, and unemployment worsened. The housing market experienced a jarring slowdown, which may have affected confidence among homeowners. Little wonder that consumers were more despondent about their personal financial situation, with a net 22% of respondents saying they were worse off than a year ago, compared to 21% last quarter. On the plus side, the stronger New Zealand dollar helped to keep prices down, especially for durables, and a higher number of respondents said that now is a good time to buy a major household item.

The overall level of the confidence measure is consistent with modest growth in consumer spending, just not as emphatic as in the latter part of 2009. That should help to ease the Reserve Bank's concern – raised again in March's *Monetary Policy Statement* – that the recovery in spending

could escalate into a return to the borrow-and-splurge behaviour seen in the last economic cycle.

Indeed, actual consumer spending may have moderated even further than the consumer confidence index suggests. Retail spending appears to have been subdued in the first two months of this year, and any increased willingness to spend may have been swallowed up by higher food and fuel prices.

Looking ahead to this week, the first of the major releases is the Q4 balance of payments (Wed). New Zealand's current account deficit has shrunk dramatically last year, from an eye-watering 8.7% of GDP at the end of 2008 to an estimated 2.3% a year later. Some one-off factors contributed to the decline, but it was mostly a product of the drawn-out recession that began in 2008. With the economy regaining momentum, the improvement in the deficit has now run its course – indeed, we expect to see a substantial rise in the underlying deficit in the December quarter.

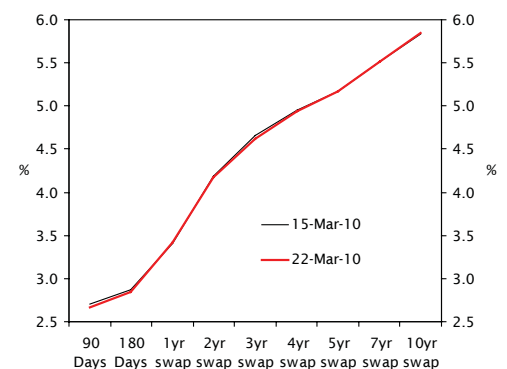
In seasonally adjusted terms, the trade balance remained strongly positive in Q4. Export volumes have held their ground through the global recession, and import volumes have only risen modestly to date (and remain about 20% below their mid-2008 peak). The services balance deteriorated slightly, with the stronger NZ dollar clawing back most of the benefits of a strong tourist season, while the modest growth in

goods imports also meant higher transport costs.

We expect to see a significant rise in the investment income deficit, specifically on the outflows side. The profits of overseas-owned firms, the largest component of the deficit, fell sharply during the most severe part of New Zealand's recession. However, our calculations suggest there was a substantial rebound in Q4, though normal quarterly variations may be overstating the improvement in the overall trend.

The final act of the bank tax saga is another factor behind the higher deficit. In December the major banks reached a settlement with the IRD, whereby they would pay 80% of the assessed amount of tax owed on structured finance transactions. In most cases this meant they had over-provisioned in Q2 and Q3, so 'writebacks' in Q4 added \$379m to their bottom line and hence to the income

**NZ Interest Rates**



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

deficit. In the final wash-up, these tax payments reduced the deficit by \$1.65bn last year, equal to 0.9% of nominal GDP.

It's likely that the annual deficit has now bottomed out, though at the moment we have a slight further narrowing pencilled in for Q1 this year. From there on the deficit will start to climb again – import spending is rising, company profits are improving, and banks' tax provisions will start to drop out of the annual balance in Q2. We expect the deficit to return to a more sustainable balance of 5% of GDP by the end of next year.

The second major release is GDP (Thurs), where we are forecasting 0.7% growth for the December quarter. The New Zealand economy is not yet firing on all cylinders, but there's no doubt that it has gained momentum compared to the 0.2% rate of growth in each of the two previous quarters.

We expect to see evidence of recovery in consumer spending and exports. Manufacturing clearly had a red-letter quarter as production was ramped up to replace depleted stocks, and demand from Australia was probably strong given the state of their economy and the low NZD/AUD exchange rate. Retail trade, wholesale trade and residential construction were other growth areas. The main point of weakness was in finance and real estate, with weak lending growth and falling house sales.

The RBNZ is forecasting 0.6% growth in Q4 GDP. A number on their expectations, or something stronger (which is certainly where top-down indicators such as business confidence are pointing), would help to provide the evidence they're looking for that the recovery is robust. That would leave them on track to begin raising rates in June as implied in the last MPS (we doubt that any number, no matter

how strong, would sway them towards an earlier move in April).

**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.

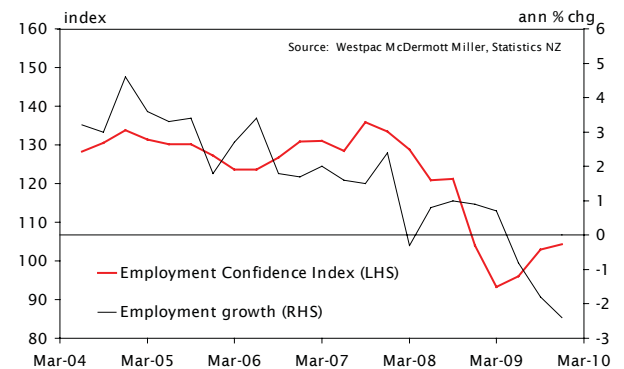
**Key Data Previews**

**NZ Q1 employment confidence index**

Mar 24, Last: 104.3

- Employment confidence rose modestly in the fourth quarter of 2009 as a result of a rise in perceptions around current employment conditions (the first rise in two years).
- Higher employment confidence is a positive sign for the emerging economic recovery. Generally speaking, the more confident people are in their employment situation, the greater their willingness to spend.
- We will be looking for further gains in employment confidence to support our view that consumer spending will continue to pick up pace in the early part of 2010. However, we note that the higher than expected rise in the unemployment rate in 2009Q4 (from 6.5% to 7.3%) may weigh on confidence this quarter.

**NZ employment and confidence**

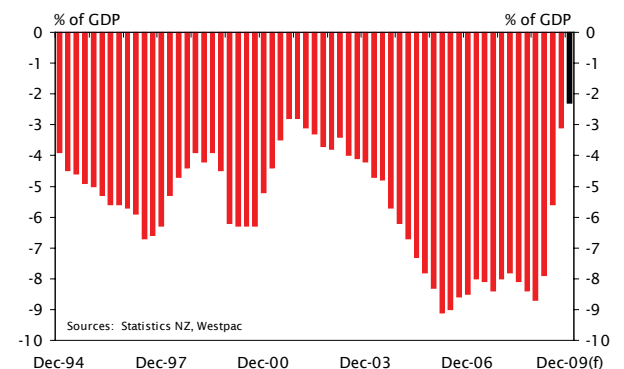


**NZ Q4 current account deficit NZDm s.a.**

Mar 24, Last: 340, WBC f/c: -2,310

- We estimate that the current account deficit narrowed to 2.3% of GDP by the end of 2009.
- The trade balance remained strongly positive, with exports holding up and import volumes growing only modestly.
- Improved company profits and a partial reversal of bank tax provisions mean a much larger income deficit than in recent quarters.
- The underlying deficit has turned the corner, and we expect the annual balance to be rising again by mid-year.

**NZ annual current account deficit**

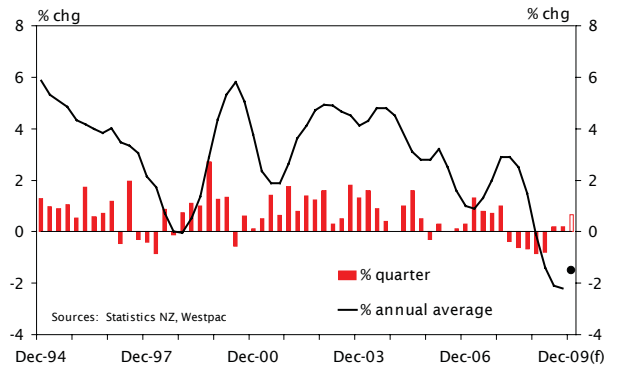


**NZ Q4 GDP**

Mar 25, Last: 0.2%, WBC f/c: 0.7%

- Survey indicators for Q4 last year were sky-high, but not all of the hard data on activity has matched those lofty expectations. We do expect to see evidence of recovery in household spending and exports. Retail trade, wholesale trade, and manufacturing have all done well. But these areas of growth were offset by a sharp fall in commercial construction, and a slump in house sales which will hit the real estate and finance industries.
- Similarly, the expenditure breakdown will show decent growth in consumption and exports, offset by declining business investment and rising imports (which is a negative for GDP). It is highly likely that stocks will make a huge positive contribution to GDP growth. No doubt some will use this to cast doubt upon the sustainability of recovery. We will simply note that restocking is the first phase of every recovery.

**NZ GDP growth**

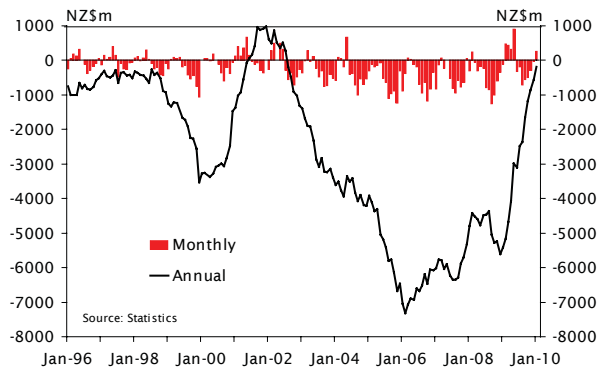


**NZ Feb merchandise trade NZDm**

Mar 26, Last: +269, WBC f/c: +480

- The trade balance has been trending towards surplus over the past year as exports have recovered faster than imports.
- Seasonality alone argues for a substantial surplus, since Feb is normally just a little shy of the peak export season, and is the low-point of the year for imports.
- Exports will be further boosted by a good growing season, sky-high dairy product prices, and the ongoing ramp-up of the Kupe oil field. And we know that car imports were weaker in Feb than in late-2009.

**NZ merchandise trade balance**



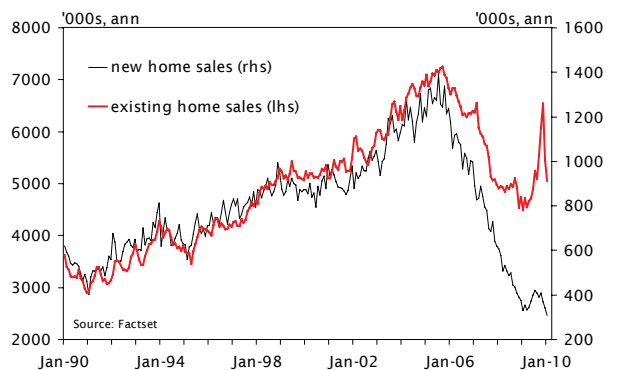
**US Feb new and existing home sales**

Mar 23, Existing home sales: Last: -7.2%, WBC f/c: flat, Mkt f/c: -1.4%

Mar 24, New home sales: Last: -11.2%, WBC f/c: 4.0%, Mkt f/c: 1.9%

- For nearly six months up until late Q3, 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 momentum, including some steep falls for both these sale measures in late 2009 and Jan.
- Existing home sales reflect transactions agreed in months prior, but the 22% collapse in Dec-Jan was greater than the 20% fall in pending home sales since early Q4. That suggests less scope for an immediate further existing home sales decline in Feb, though a significant rise is not likely either.
- New home sales tend to be volatile and revisions can be severe. They hit a new cycle low in Jan. Some sort of bounce, in part due to the extended tax credit, is likely, though the size of the gain may be muted by Feb's snow-storms.

**US housing sales**

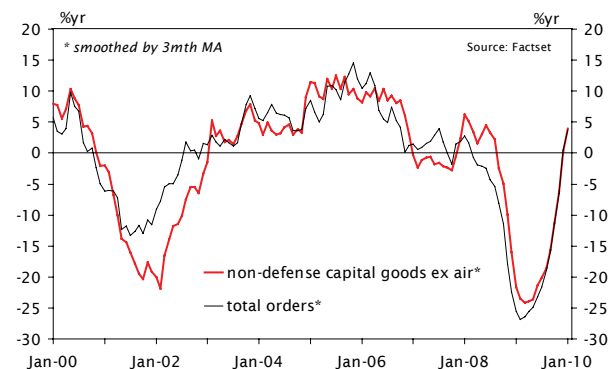


## US Feb durable goods orders to post a modest gain

Mar 24, Last: 2.6%, WBC f/c: 0.8%, Mkt f/c: 0.5%

- Durables orders posted solid gains in Dec and Jan, although the strength in the latest month was concentrated in aircraft orders and defence, with core capital goods orders down for the first month in three.
- Feb orders are forecast to post another gain, which would mean the first string of three monthly rises since late 2007. However we expect a relatively subdued 0.8% rise.
- Feb ISM factory orders fell more than 6 pts from their Jan cycle high but at 59.5 remain positive; Feb industrial production showed a steep fall in autos but a further modest gain in business equipment and defence was up again. Although Boeing Feb data revealed a steep rise (47 aircraft vs 10 in Jan), these figures are currently out of synch with the Census Bureau data but suggest some upward risk to our forecast.

## US durable goods orders



## Key Data and Events

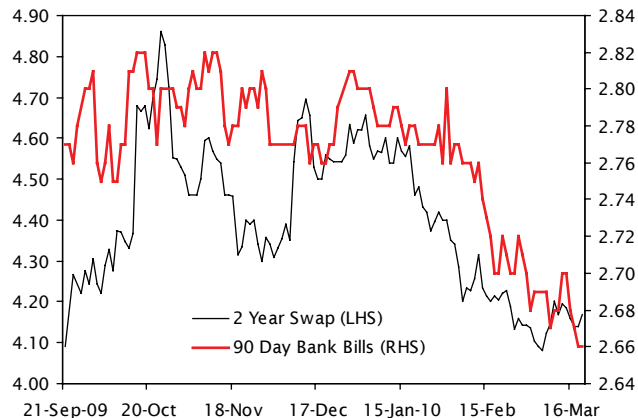
		Last	Market Median	Westpac Forecast	Comments
<b>Mon 22 Mar</b>					
Aus	Feb Motor Vehicle Sales	-3.4%	-	-2.0%	Unwind of tax break induced surge in bus spend. Cons dem firming.
US	Feb Chicago Fed National Activity Index	0.02	-	-	Based on 80+ previously released data points.
	Fedspeak	-	-	-	Atlanta Fed president Lockhart (two speeches).
Eur	Mar Consumer Confidence Adv	-17	-17	-	Now released ahead of other EC confidence indicators.
<b>Tue 23 Mar</b>					
US	Feb Existing Home Sales	-7.2%	-1.4%	flat	Likely weather constrained; pending sales trend soft recently.
	Jan House Prices	-1.6%	-0.9%	-	Lesser watched FHFA index.
	Mar Richmond Fed Factory Index	2	5	5	Lagging behind other regional indices, after leading higher in mid 09.
	Fedspeak	-	-	-	San Fran Fed president Yellen; Philly Fed president Plosser.
Jpn	Bank of Japan Meeting Minutes (Feb)	-	-	-	The meeting before the doubling of the liquidity facility. Ho hum.
UK	Feb CPI %yr	3.5%	3.1%	3.2%	Base affects favourable but weak pound, VAT tail end impact.
	Feb BBA Loans for House Purchase	35k	37k	-	Sharp fall in Jan - one off or new trend?
	Mar CBI Distributive Trades Survey	23	-	-	Reported sales jumped from 31 pts in Feb following snow, VAT impact.
Can	Feb Leading Index	0.9%	0.8%	-	Has not recorded a decline since April last year.
<b>Wed 24 Mar</b>					
NZ	Q1 Employment Confidence Index	104.3	-	-	Higher than expected unemploy' in Q4 may weigh on confidence.
	Q4 Current Account NZDm s.a	340	-	-2,310	Goods balance remained strong, big jump in income deficit.
US	Feb Durable Goods Orders	2.6%	0.5%	0.8%	Slower core factory activity but Boeing orders solid.
	Feb New Home Sales	-11.2%	1.9%	4.0%	At cycle low in Jan, snowy Feb weather likely to prevent steep bounce.
	Fedspeak	-	-	-	Dissenting Kansas Fed president Hoenig.
Jpn	Feb Trade Balance ¥bn s.adj	728	389	-	Growth in neighbours to outweigh ¥ strength to = widening surplus.
Eur	Mar PMI Services Adv	51.8	52.0	51.5	Will Jan-Feb slippage continue in Mar?
	Mar PMI Factory Adv	54.2	54.0	54.0	Uptrend still intact but slight correction from Feb gain.
	Jan Industrial Orders	1.1%	1.8%	2.0%	German orders surged 4.3% in Jan.
Ger	Mar IFO Business Climate Index	95.2	95.8	95.0	Feb saw first decline in eleven months.
UK	2010 Budget	-	-	-	Chancellor Darling's pre-election budget.
<b>Thu 25 Mar</b>					
NZ	Q4 GDP	0.2%	0.8%	0.7%	While only an "average" pace, would be the best outcome for 2 years.
Aus	RBA Financial Stability Review	-	-	-	Half yrly update on banking system. Greater focus on balance sheets.
	RBA Assist Gov (Economic) Philip Lowe	-	-	-	AIC's Economic Forum, Sydney 10:40am
US	Initial Jobless Claims W/E 20/3	457k	450k	435k	Claims should fall as economy posts genuine jobs growth, for a bit.
	Fed Chair Bernanke	-	-	-	Speaking on exit strategy, rescheduled from 10/2. Also Pianalto.
Jpn	Feb Corporate Services Prices %yr	-1.0%	-1.2%	-	Firms mired in cost minimisation mode leads to zero pricing power.
Eur	Feb Money Supply M3 %yr	0.1%	-0.1%	0.0%	Hovering around zero annual growth.
Ger	Apr GfK Consumer Confidence	3.2	3.1	-	Labelled April but surveyed early March.
UK	Feb Retail Sales Total	-1.8%	0.8%	0.8%	Partial bounceback but not as strong as private sector surveys.
<b>Fri 26 Mar</b>					
NZ	Feb Merchandise Trade NZDm	+269	-	+480	Weak imports + strong dairy prices + good growing season = surplus.
Aus	RBA Governor Stevens	-	-	-	ACI World Congress, Sydney 9:15am
US	Q4 GDP % ann'lsd (F)	5.9%a	5.9%	6.0%	Partial data suggest minimal revision but 6-handle possible.
	Mar UoM Consumer Sentiment (F)	72.5a	73.0	71.0	Sticking with our bottom of the range prelim forecast.
	Fedspeak	-	-	-	Warsh, Bullard, Tarullo.
UK	Q4 Business Investment (F)	-5.8%a	-5.8%	-	Q4 saw renewed steep drop after smaller Q3 decline.

## New Zealand Economic and Financial Forecasts

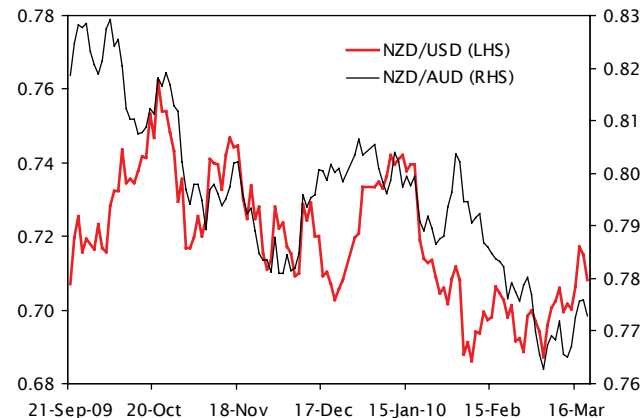
Economic Growth Forecasts	March years				Calendar years			
	2008	2009	2010f	2011f	2008	2009e	2010f	2011f
% change								
GDP (Production) ann avg	2.9	-1.4	-0.3	4.1	-0.1	-1.5	3.4	4.4
Employment	-0.3	0.7	-1.3	1.8	0.9	-2.4	1.2	2.1
Unemployment Rate % s.a.	3.8	5.0	7.1	6.3	4.7	7.3	6.5	5.7
CPI	3.4	3.0	2.4	1.5	3.4	2.0	2.0	2.4
Current Account Balance % of GDP	-7.8	-7.9	-2.2	-4.7	-8.7	-2.3	-4.5	-5.1

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	4.70	5.00	5.30	5.60	5.90	6.20	6.40
5 Year Swap	5.60	5.70	5.90	6.10	6.30	6.45	6.60
10 Year Bond	5.90	5.90	6.00	6.10	6.20	6.20	6.30
NZD/USD	0.67	0.72	0.77	0.76	0.74	0.72	0.71
NZD/AUD	0.79	0.80	0.81	0.82	0.82	0.84	0.84
NZD/JPY	61.0	67.0	73.9	77.5	78.4	78.5	79.5
NZD/EUR	0.50	0.53	0.56	0.56	0.56	0.56	0.57
NZD/GBP	0.46	0.48	0.50	0.48	0.47	0.46	0.46
TWI	63.3	67.1	70.8	71.1	70.7	70.4	70.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



## NZ interest rates as at market open on Monday 22 March 2010

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.63%	2.67%	2.67%
60 Days	2.64%	2.69%	2.70%
90 Days	2.67%	2.69%	2.71%
2 Year Swap	4.18%	4.13%	4.23%
5 Year Swap	5.17%	5.10%	5.22%

## NZ foreign currency midrates as at Monday 22 March 2010

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7066	0.7004	0.6860
NZD/EUR	0.5219	0.5136	0.5011
NZD/GBP	0.4703	0.4643	0.4388
NZD/JPY	63.940	63.320	61.260
NZD/AUD	0.7725	0.7692	0.7906
TWI	65.530	64.750	63.740

## Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2005	2006	2007	2008	2009	2010f	2011f
<b>Australia</b>							
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	5.2	4.9
Current Account % GDP	-5.8	-5.3	-6.3	-4.4	-4.1	-4.7	-4.1
<b>United States</b>							
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	9.6	9.1
Current Account %GDP	-6.1	-6.0	-5.3	-4.9	-3.1	-3.0	-2.3
<b>Japan</b>							
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
<b>Euroland</b>							
Real GDP %yr	1.8	3.1	2.8	0.5	-4.0	0.6	1.1
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	11.5	10.8
Current Account %GDP	-0.2	-0.1	0.1	-1.1	-1.0	-0.5	0.0
<b>United Kingdom</b>							
Real GDP %yr	2.2	2.9	2.6	0.5	-5.0	0.2	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	5.5	7.0	7.3
Current Account %GDP	-2.6	-3.3	-2.7	-1.6	-2.4	-2.0	-1.5

Forecasts finalised 12 March 2010

Interest Rate Forecasts	Latest (Mar 22)	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
<b>Australia</b>						
Cash	4.00	4.25	4.50	4.50	4.50	5.00
90 Day Bill	4.29	4.50	4.60	4.75	4.75	5.25
10 Year Bond	5.67	5.90	6.00	6.00	6.10	6.75
<b>International</b>						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.50
US 10 Year Bond	3.69	3.40	3.75	4.00	4.50	5.25
ECB Repo Rate	1.00	1.00	1.00	1.00	1.25	1.50
<b>Exchange Rate Forecasts</b>						
AUD/USD	0.9147	0.85	0.90	0.95	0.93	0.90
USD/JPY	90.50	91	93	96	102	106
EUR/USD	1.3539	1.34	1.36	1.38	1.36	1.32
AUD/NZD	1.2945	1.27	1.25	1.23	1.22	1.20

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