

Weekly Commentary

19 December 2011

Party central

The temporary effects of the Rugby World Cup are likely to feature strongly in Thursday's September quarter GDP numbers, while the Balance of Payments data out a day before should show a current account deficit well within manageable levels. As such the RBNZ's attention will be focused on more timely matters such as Europe and overseas funding costs. Of potentially greater import will be December quarter consumer confidence. Meanwhile, the near-term inflation picture is looking increasingly benign, bolstering our view that the RBNZ can sit on its hands until late next year.

After reviewing the latest indicators we expect a solid 0.8% increase in GDP in the September quarter (in line with the market median). But in large part this strength reflects the start of the Rugby World Cup (RWC). Rugby aside, our GDP forecast is consistent with the modest pace of recovery seen over the last year. A strong increase in manufacturing is likely to reflect stock-building rather than a lift in demand, and construction will continue to be a drag on growth, with only a small degree of rebuilding in Canterbury and ongoing malaise in the rest of the country. Meanwhile agriculture will find it hard to top the superb growing conditions we saw over the past year.

The clearest evidence we've seen of the RWC effect to date has been in retail trade (up 2.6%). The impact on other sectors is harder to pin down, but based on Australia's experience in 2003 we're also likely to see a strong boost to cultural and recreational services (which includes the running of the tournament itself). The tournament should be an overall positive for the transport sector as well, though the net benefit probably won't be large, given disruption of business travel and overall long-distance flights. On the expenditure side, we expect a boost to household consumption (including RWC ticket sales that were purchased as early as last year but only just 'consumed' now), and a sharp rise in services exports, though this will only reverse the drop seen in Q2. Overseas visitor spending related to the RWC will probably see more of a lift in Q4 – spending is surveyed on departure, which for many visitors will have been in October.

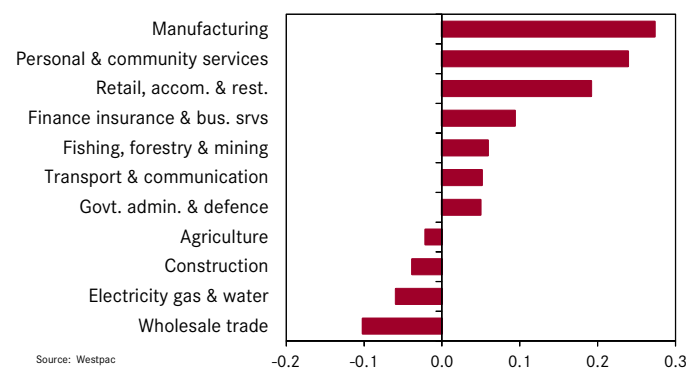
The RWC will also show up as an assortment of services flows on both sides of the ledger in Wednesday's current account figures – boosting travel and tourism exports, but also incurring the likes of payments to the International Rugby Board. Overall, we expect to see New Zealand's current account deficit widen in the September quarter, from 3.7% to 4% of GDP – still well within manageable

levels, and as such unlikely to attract much attention. Within that, we're likely to see a fall in the goods surplus, as softer export prices (particularly dairy) and flat volumes show through in the export data, an increase in the investment income deficit (largely reflecting improved company profits going offshore), and a smaller services deficit thanks to the RWC.

Of course, in ways not limited to the RWC, both the GDP and balance of payments data reflect a world that has already passed into history. In the year ahead the export climate is likely to be a lot tougher, while (mostly Christchurch quake-related) construction will increasingly become a driving force of growth. The RBNZ will therefore be keeping its focus on more timely and forward-looking indicators. This week, key among these will be today's Westpac McDermott Miller Consumer Confidence report, in view of the potential for global turmoil to hit confidence and spending locally. Consumer confidence held steady in the September quarter. Since then there's been another material deterioration in the global economic outlook – we'll see how confidence responds. Also of interest to us will be November migration figures, out Wednesday. Over the coming year we expect net migration to improve from current very weak levels over the as job prospects in the patchwork Australian economy continue to deteriorate – but it may be too soon to see that coming through just yet.

In respect of construction, as we detail in our latest research bulletin 'The construction sector: past, present and future', recent

Percentage point contribution to Q3 GDP growth



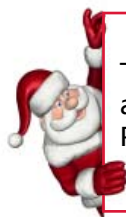
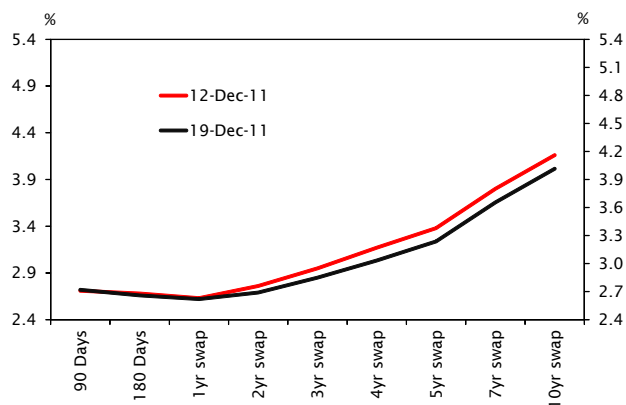
Source: Westpac

data suggests that there has already been around \$450m worth of quake-related activity in the sector over the last quarter of this year, most of this demolition and infrastructure repairs, some in the residential space as well. For example, 645 commercial buildings have already been demolished; work notices for infrastructure repairs in Christchurch have leapt up since around June; and there's been a 64% rise in the number of residential building consents (ex temporary housing) in greater Christchurch. Looking further ahead there's still a lot of uncertainty about the pace of rebuilding – but the magnitudes are such that even our assumption that only 10% of the residential building programme will be finished over 2012 makes up the major part of our forecast of 29% residential construction growth next year.

But for the time being global concerns are to the forefront, and it's becoming increasingly clear that the RBNZ can afford to sit tight with little in the way of a threat from the inflation data until further down the track. Following the latest outturn for food prices last week, we've further revised down our December quarter CPI forecast, from 0.2% to 0.1%. Food prices rose 0.2% in November, putting an end to three months of drops, but that's still weaker than we had been expecting. In large degree this was due to a seasonal drop in vegetable prices, but it's clear that food price pressures have eased significantly in the last few months as growing conditions have improved – vegetable prices are down nearly 9% on a year ago. After this latest revision our annual inflation forecast sits at 2.3% for the end of this year, and reaches a low point of 1.6% in mid-2012, making an undershoot of the RBNZ's target band a real possibility.

Fixed versus floating: Fixed mortgage rates are currently good value given where we think floating rates are heading over the next several years. With no satisfactory resolution to the European debt crisis in the offing, there is no immediate pressure on fixed rates to rise, so borrowers can afford to wait a little longer. But the RBNZ's latest *Monetary Policy Statement* made clear that there is limited scope for fixed rates to fall further. A situation where the RBNZ saw fit to cut rates would also probably be one where banks' funding spreads are increasing sharply.

NZ interest rates



This is the final Weekly Commentary for 2011. We wish you all a very Merry Christmas and a prosperous New Year. Publication of this document will resume on 16 January 2012.

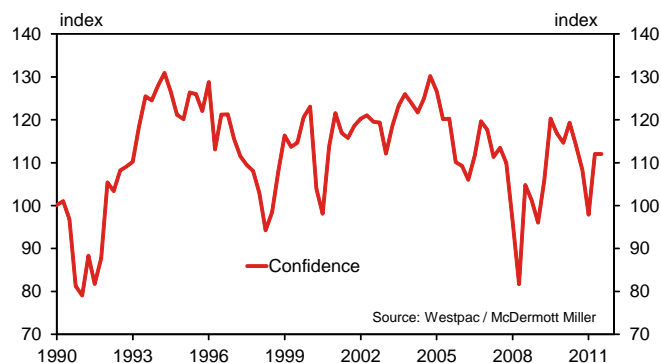
Key Data Previews

NZ Q4 consumer confidence

Dec 19, Last: 112.0

- Consumer confidence held steady in the September quarter: households' near-term economic confidence continued to improve (not doubt boosted both by the impending Rugby World Cup, and by prospects of reconstruction in Christchurch), but longer-term economic optimism started to sag.
- Next week's numbers will post-date both the Cup and a material deterioration in the global economic outlook. Confidence can matter materially for consumer spending, and remains one of the channels through which the European debt crisis could hit New Zealand.

Consumer confidence

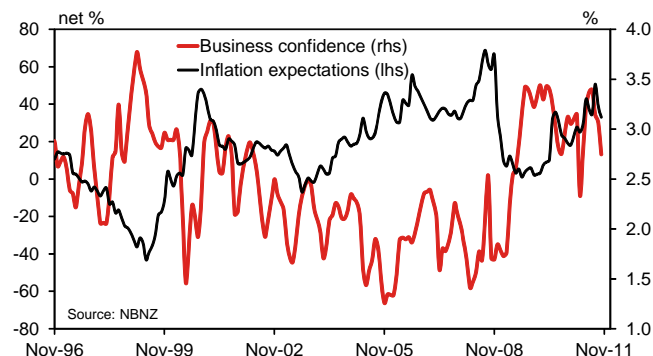


NZ Dec NBNZ business confidence

Dec 19, Last: 18.3

- There was a surprising uptick in business confidence in November, after three months of sharp declines. There may have been some post-Rugby World Cup rebound, given that the tournament had previously been cited as a disruptive factor on balance.
- The deepening European crisis has had only a modest impact on firms' own-activity expectations to date. However, there is a growing risk that the effects are felt more directly in this part of the world, as growth in Asia slows and credit becomes tighter.
- Inflation expectations for the next year remain above 3%, but should continue to moderate as the lack of pricing power pervades.

NZ Business confidence

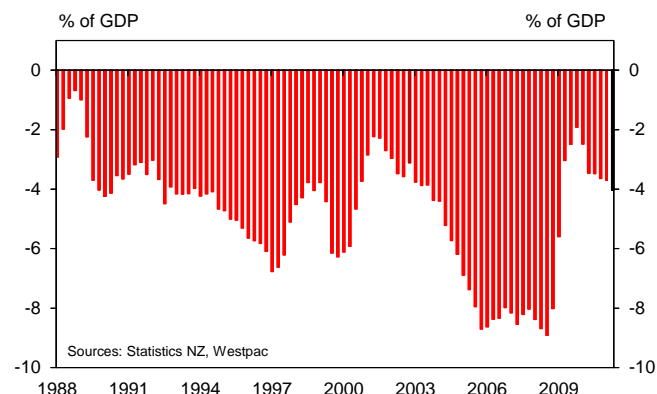


NZ Current account deficit

Dec 21, Last: -3.7%, Market: -3.9%, WBC f/c: -4.0%

- We expect New Zealand's current account deficit widened a little further in the September quarter to 4% of GDP (from -3% in the June quarter).
- Softer commodity prices will weigh on the goods balance yet it remains firmly in positive territory. In contrast, despite the boost to the tourism sector provided by the Rugby World Cup (which will permeate the current account data) we expect the services balance will remain in deficit. This is partly because the benefits of the event (held during September and October) will be spread over a couple of quarters.
- The investment income balance has been thrown around in recent quarters by earthquake-related flows. We expect that the deficit widened further in the September quarter in part due to improved quarterly profits accruing to foreign owned companies.

Annual current account deficit

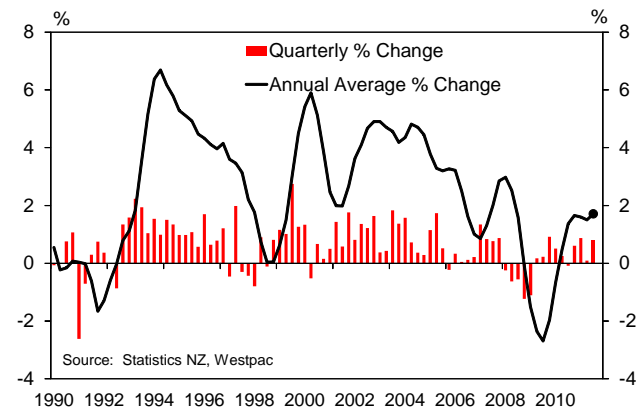


NZ Q3 GDP

Dec 22, Last: 0.1%, Mkt: 0.8%, WBC f/c: 0.8%

- Our forecast of a 0.8% rise in September quarter GDP partly reflects the temporary boost to activity from the Rugby World Cup, which was spread over September and October but will have had its greatest impact on growth rates in Q3.
- Ex-rugby, our forecast assumes a continued modest pace of recovery, broadly in line with the average of 0.5% growth in the last three quarters. Rebuilding in Canterbury is yet to make a substantial contribution to growth.
- The GDP figures should have little influence on the RBNZ, given the overriding concerns about the European crisis and increased offshore funding costs.

GDP growth

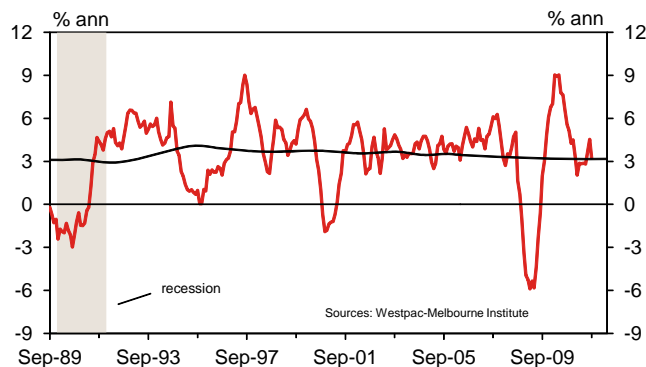


Aus Oct Westpac-MI Leading Index

Dec 21, Last: 3.3% annualised

- The annualised growth rate of the **Westpac-Melbourne Institute Leading Index** was 3.3% in September, basically in line with its long term trend and down from 4.5% in August.
- The October update will include: another very weak read on monthly dwelling approvals (-10.7%mt after a 14.2%mt drop in September); a resurgence in equity markets (ASX +7.1% after a 6.9% slump in the previous month) albeit one that was short-lived (ASX -4% in November); a rise in US industrial production (+0.7% after a flat September); and a milder 0.4% increase in money supply after September's 0.8% gain. The month will also incorporate updated quarterly data on commodity prices (up slightly in Q3 after strong gains in the first half of the year); overtime worked (slightly positive in Q3 after a flat Q2); productivity (slightly improved in Q3) and company profits (+5.7% in Q3 after a 10.9% jump in Q2).

Westpac-MI Leading index



US Nov housing starts/permits/sales updates

Dec 20, Starts: Last: -0.3%, WBC f/c: 1.5%

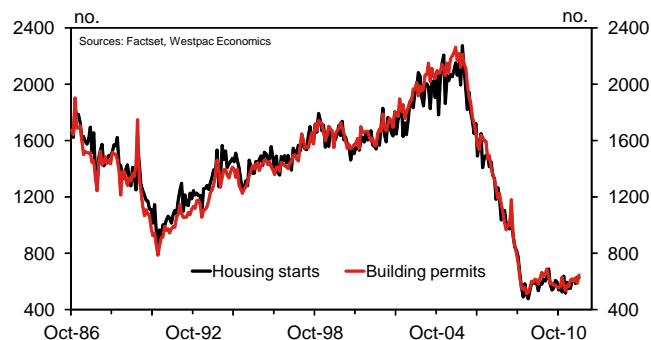
Dec 20, Permits: Last: 9.3%, WBC f/c: 0.0%

Dec 21, Existing home sales: Last: 1.4%, WBC f/c 3.0%

Dec 23, New home sales: Last: 1.3%, WBC f/c 2.0%

- Housing data were a little less weak on some Oct indicators, including the first rise in single family house starts for four months; an emerging uptrend in single family permits; and back to back gains in new home sales; existing home sales failed to reverse their Sep decline in Oct, but pending sales recovered 10%, suggesting contract closings could pick up later in Q4.
- With mortgage rates lower, homebuilder confidence less weak and recent US data tone a little more positive, we have a bias towards mostly positive housing data for Nov, subject to volatility in the multiples components of starts/permits. However prices might come under renewed downward pressure with foreclosures picking up again after a temporary lull.

US housing starts and permits

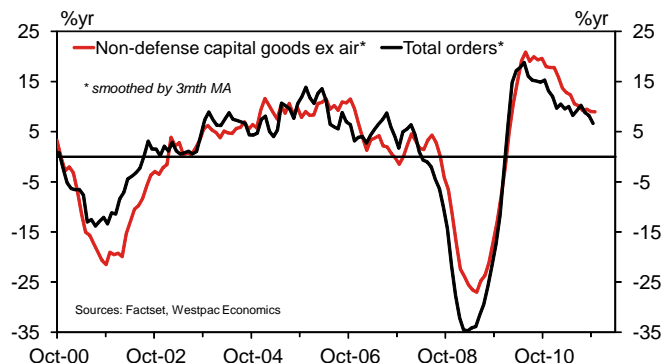


US Nov durable goods orders to rise across the board

Dec 23, Last: -0.5%, WBC f/c: -3.5%

- DGOs fell 0.5% in Oct. The breakdown was as expected, with core capital goods orders falling as they typically do in the first month of the quarter, this time by 1.8%; aircraft orders were down 16.4%, consistent with Boeing data; auto orders rose 6.2% in line with recent solid sales, and defence was down 19.8%. Ex transport orders rose 1.1% and ex defence by 0.2%.
- ISM factory new orders recovered further to a 7 month high in Nov after contraction through Q3. Boeing saw 96 new jet orders last month vs just 7 in Oct, which the seasonal factors may not dampen much. Core orders tend to rise in the second month of the quarter. Auto orders might hold up given sales have picked up in recent months although car production dipped last month. Most of this points to a robust orders gain in Nov, especially given the aircraft component.

US durable goods orders

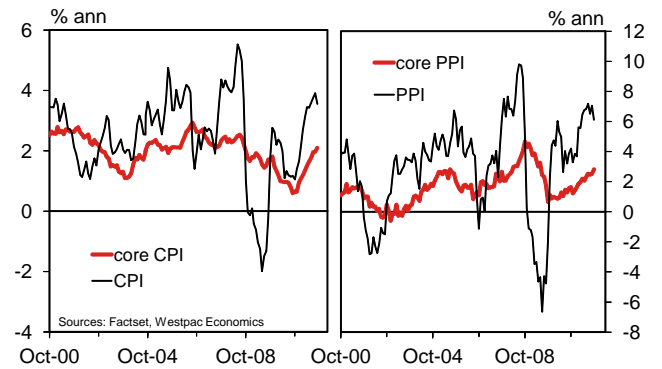


US Nov core PCE deflator to rise 0.1%

Dec 23, Last: 0.1%, WBC f/c: 0.1%

- The core PCE deflator was up 0.1% in Oct. This was the second consecutive month with a sub 0.1% outcome before rounding, so the three month annualised pace fell from 2.5% in July to 1.5% in Oct. The report also showed subdued personal spending growth, up just 0.1%, whereas personal income grew 0.4% in Oct.
- We expect another subdued 0.1% core CPI in Oct (data due 16/12) which in turn suggests another soft core PCE outcome is likely, consistent with the Fed's statement on 13/12 that inflation "has moderated" replacing "appears to have moderated" from six weeks earlier.
- The report should also include modest 0.2% gains for personal income and spending in Nov, given that hourly earnings rose but hours were down; and retail sales were sluggish.

US price inflation



Key Data and Events

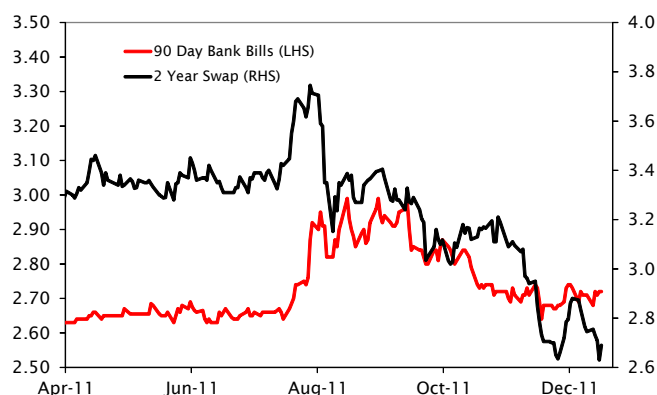
		Market Last	Westpac median	Westpac forecast	Risk/Comment
Mon 19					
NZ	Q4 Westpac MM Consumer Confidence	112.0	-	-	Will confidence hold up?
	Nov Performance Services Index	50.6	-	-	May soften along with manufacturing surveys.
	Dec NBNZ business confidence	18.3	-	-	Confidence at risk if the European crisis starts to hit closer to home.
Eur	Oct current account €bn sa	0.5	-	-	Sep saw first surplus since Jan 2010.
UK	Dec house prices %yr	-3.1%	-	-	Rightmove index.
US	Dec NAHB housing market index	20	20	19	Foreclosure gain and house price slippage to impact.
	Fedspk	-	-	-	Lacker in Charlotte
Can	Oct wholesale sales	0.3%	-	-	Up five months running.
Tue 20					
Aus	RBA minutes of December Board	-	-	-	Further detail around RBA decision to cut rates back-to-back.
Jpn	Oct all industry activity index %mth	-0.9%	-	-	Tertiary segment up 0.6%; IP up 2.2%.
Eur	Dec consumer confidence adv	-20.4	-21.0	-21.0	Austerity, euro debt / banking crisis continues.
Ger	Jan GfK consumer confidence	5.6	5.6	-	Labelled Jan but surveyed early Dec.
	Nov PPI %yr	5.3%	5.1%	-	Lower commodity prices but weaker euro driving factors.
	Dec IFO business climate index	106.6	106.0	106.0	Decline to resume after brief blip higher in Nov.
UK	Dec CBI retail survey	-19	-	-	Reported sales index.
	Dec consumer confidence	-31	-33	-	GfK index
	Nov consumer confidence	36	36	-	Nationwide index
US	Nov housing starts	-0.3%	0.3%	1.5%	Correction higher in multiples & flat single family starts to lift total
	Nov housing permits	9.3%	-1.8%	0.0%	starts but permits to be weighed down by multiples decline.
Can	Nov CPI %yr	2.9%	-	-	BoC core rate was 2.1% yr in Oct.
Wed 21					
NZ	Q3 current account balance	-3.7%	-3.9%	-4.0%	Deficit expected to widen slightly to 4.0% of GDP.
	November external migration s.a.	-150	-	-640	Trans-Tasman departures to remain high for now.
Aus	Oct Westpac-MI Leading Index	3.3%	-	-	At trend in Sep but which way is momentum moving in late 2011?
Jpn	Nov trade balance ¥bn sa	458	-	-	Complex picture of softer demand.
	Dec Bank of Japan decision	0.10%	0.10%	0.10%	Next asset purchase shift: reactive to either Fed or ECB.
Eur	Dec consumer confidence advance	-20.4	-	-21.0	Austerity measures impacting on growth and living standards.
UK	Nov BoE minutes	-	-	-	Case for further expansion of QE beyond Oct's £75k strengthened?
	Nov PSNCR £bn	-0.6	-	-	Public sector net credit requirement.
US	Nov existing home sales	1.4%	2.2%	3.0%	Pending home sales jumped 10% in Oct..
Can	Oct retail sales	1.0%	0.4%	-	Sep sales partly boosted by autos, though ex auto up 0.5%.
Thu 22					
NZ	Q3 GDP	0.1%	0.8%	0.8%	Rugby World Cup boost, modest underlying pace of recovery.
UK	Q3 GDP 2nd revision	0.5% a	0.5%	0.5%	Trade and IP data suggest downward revision likely.
	Q3 business investment final	-1.4% a	-	-	Measured on different basis to national accounts capital formation.
	Q3 current account £bn	-2.0	-	-	Subject to big revisions recently.
US	Q3 GDP 2nd revision	2.0% a	2.0%	2.0%	Partial data does not suggest much risk of revision.
	Nov Chicago Fed nat. activity index	-0.13	-	-	Based on previously released activity data, not itself a survey.
	Initial jobless claims w/e 16/12	366k	-	375k	Significant improvement (ie lower claims) over last month or so.
	Nov Uni of Mich consumer sentim't	67.7 a	68.0	68.0	Confidence has improved in Q4 relative to Q3.
	Nov leading index	0.9%	0.3%	-	Oct gain equal fastest for the year.
	Oct house prices	0.9%	0.2%	-	FHFA index.
Fri 23					
Chn	Dec MNI business conditions (flash)	-	-	-	Around an abrupt turning point survey data increases in value.
Ger	Oct import prices %yr	6.9%	-	-	Recent euro weakness to add upward pressure.
UK	Nov mortgages	35.3k	-	-	BBA data, number of new loans recovered Sep fall in Oct.
	Oct services index	0.1%	-	-	Clue to services component of quarterly GDP.
US	Nov durable goods orders	-0.5%	2.1%	3.5%	Most clues point to solid orders, esp Boeing data. See text box.
	Nov personal income	0.4%	0.3%	0.2%	Small fall in hours worked, hourly earnings higher.
	Nov personal spending	0.1%	0.3%	0.2%	Retail sales sluggish in Nov.
	Nov core PCE deflator	0.1%	0.1%	0.1%	Forecast assumes no upside surprise in core CPI.
	Nov new home sales	1.3%	2.0%	2.0%	Most housing data have improved modestly - but watch for revisions.
Can	Oct GDP	0.2%	-	-	Well past the soft patch earlier this year.

New Zealand Economic and Financial Forecasts

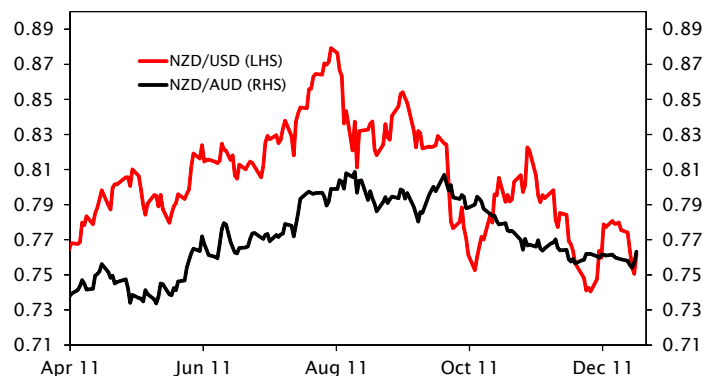
Economic Growth Forecasts	March years				Calendar years			
	2010	2011e	2012f	2013f	2010	2011f	2012f	2013f
% change								
GDP (Production) ann avg	-0.7	1.6	2.2	3.5	1.6	2.1	3.1	3.8
Employment	-0.1	1.8	1.2	2.3	1.3	1.9	2.1	2.5
Unemployment Rate % s.a.	6.1	6.5	6.2	5.6	6.7	6.4	5.7	5.0
CPI	2.0	4.5	2.0	2.5	4.0	2.3	2.3	2.8
Current Account Balance % of GDP	-1.9	-3.6	-4.6	-6.4	-3.5	-4.0	-6.3	-5.6

Financial Forecasts	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
Cash	2.50	2.50	2.50	2.75	3.00	3.25
90 Day bill	2.70	2.70	2.80	3.00	3.30	3.60
2 Year Swap	2.80	3.00	3.30	3.70	4.10	4.40
5 Year Swap	3.50	3.70	4.10	4.40	4.70	4.90
10 Year Bond	4.10	4.10	4.20	4.30	4.60	4.80
NZD/USD	0.78	0.73	0.71	0.75	0.78	0.80
NZD/AUD	0.77	0.76	0.76	0.77	0.77	0.78
NZD/JPY	60.0	56.2	54.7	58.5	63.2	67.2
NZD/EUR	0.57	0.58	0.59	0.61	0.61	0.63
NZD/GBP	0.49	0.49	0.49	0.50	0.51	0.50
TWI	68.6	66.7	66.3	69.0	70.7	72.5

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 19 December 2011

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.64%	2.67%	2.69%
60 Days	2.70%	2.67%	2.66%
90 Days	2.72%	2.73%	2.68%
2 Year Swap	2.69%	2.88%	2.71%
5 Year Swap	3.24%	3.60%	3.84%

NZ foreign currency mid-rates as at Monday 19 December 2011

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.7623	0.5808	0.7566
NZD/EUR	0.5849	0.5808	0.5604
NZD/GBP	0.4906	0.6544	0.4791
NZD/JPY	59.296	60.631	58.092
NZD/AUD	0.7640	0.7608	0.7576
TWI	68.320	68.840	66.950

Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2008	2009	2010	2011f	2012f	2013f
Australia						
Real GDP % yr	2.5	1.4	-2.6	-2.0	3.0	3.5
CPI inflation % annual	3.7	2.1	2.7	3.5	3.3	1.9
Unemployment %	4.3	5.6	5.2	5.1	5.6	5.4
Current Account % GDP	-4.5	-4.2	-2.9	-2.2	-4.5	-3.3
United States						
Real GDP %yr	-0.3	-3.5	3.0	1.7	1.7	2.1
Consumer Prices %yr	3.8	-0.3	1.6	3.2	2.0	2.0
Unemployment Rate %	5.8	9.3	9.6	9.0	9.1	9.1
Current Account %GDP	-4.7	-2.7	-3.2	-3.3	-2.9	-1.8
Japan						
Real GDP %yr	-1.5	-6.7	4.4	0.1	2.0	1.9
Consumer Prices %yr	1.4	-1.3	-0.7	-0.2	-0.5	-0.3
Unemployment Rate %	4.0	5.1	5.1	4.4	4.2	4.5
Current Account %GDP	3.3	2.8	3.6	2.2	2.7	3.4
Euroland						
Real GDP %yr	0.3	-4.0	1.7	1.6	-1.5	0.1
Consumer Prices %yr	3.3	0.3	1.7	2.5	1.0	0.8
Unemployment Rate %	7.5	9.5	10.0	10.3	11.0	11.5
Current Account %GDP	-0.8	-0.7	-0.5	-0.5	0.0	0.0
United Kingdom						
Real GDP %yr	-0.1	-4.9	1.4	0.9	-0.1	0.6
Consumer Prices %yr	3.6	2.2	3.2	4.0	2.2	1.5
Unemployment Rate %	5.6	7.6	7.8	8.3	9.0	9.2
Current Account %GDP	-1.6	-1.3	-2.4	-2.0	-1.5	-1.5

Forecasts finalised 16 December 2011

Interest Rate Forecasts	Latest (Dec 19)	Mar-12	Jun-12	Sep 12	Dec 12	Mar 13
Australia						
Cash	4.25	4.00	3.75	3.75	3.75	3.75
90 Day Bill	4.45	4.25	4.00	4.00	3.90	3.90
10 Year Bond	3.76	4.20	4.40	4.50	4.70	4.90
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.91	2.20	2.40	2.50	2.60	2.70
ECB Repo Rate	1.00	0.75	0.75	0.75	0.75	0.75

Exchange Rate Forecasts	Latest (Dec 19)	Mar-12	Jun-12	Sep 12	Dec 12	Mar 13
AUD/USD	0.9978	0.96	0.93	0.97	1.01	1.02
USD/JPY	77.783	77	77	78	81	84
EUR/USD	1.3032	1.26	1.20	1.23	1.27	1.28
AUD/NZD	1.3089	1.32	1.31	1.29	1.29	1.28

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