

Weekly Commentary

11 February 2013

Confusion reigns

Last week's releases showed that the labour market continues to lag behind the upturn in other parts of the economy, although the messages were somewhat muddled. Wage growth remains subdued outside those directly involved in the post-quake Canterbury rebuild, while the Household Labour Force Survey (HLFS) continues to find new ways to baffle.

The HLFS delivered the expected correction in the unemployment rate, from the September quarter's surprisingly high 7.3% to a more reasonable 6.9%. But that was immediately followed by the news that the number of people employed fell by 1%, to be down 1.4% on a year ago. Falling employment is at odds with just about every other labour market indicator out there, and the divergence has dramatically increased over the last few quarters. (To be clear, the message from the other indicators is one of mild jobs growth at best.)

The drop in both employment and unemployment was a product of the labour force participation rate falling from 68.4% to 67.2% – the biggest quarterly drop on record going back to 1986. We've seen at least one estimate of "what the unemployment rate would've been if the participation rate had stayed constant". Frankly, this is a meaningless concept. The HLFS is a smallish survey that is subject to sampling error – which may have increased further as a result of the population movements in and out of Canterbury since the earthquakes. We suspect that the December quarter survey simply drew an unusually high number of people not participating in the labour force. But this has no bearing on what's going on within the labour force – our best indication is still that around 93% were employed and 7% were unemployed.

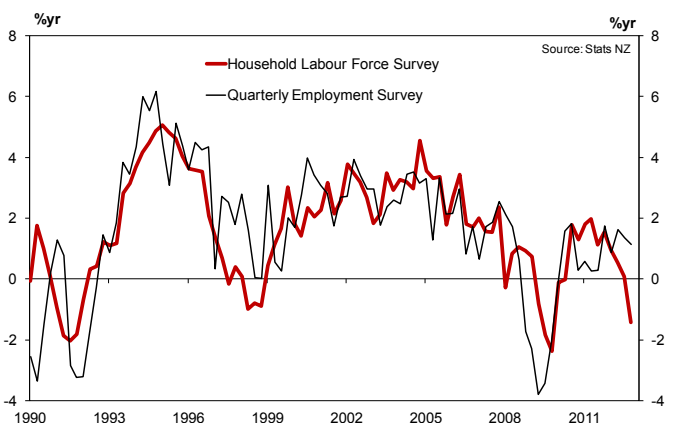
The HLFS does agree with the other evidence in one important respect: it shows a firmly two-speed labour market, with jobs growing and unemployment falling in Canterbury, but conditions much weaker in many other parts of the country. Eventually we'd expect high wages to attract more people to move to Canterbury (international migration to Canterbury has turned positive again). But for now this segmented labour market – where the people and the jobs are in different parts of the country – seems to be an important reason for the labour market's persistent weakness at the national level.

The breakdown by type of employment is also consistent with this two-speed story. There has been a big drop in the number of self-employed over the past year, more or less matched by an increase in employers. This suggests that a growing number of sole operators that sprang up in the aftermath of the Canterbury earthquakes are now expanding and taking on staff. Despite this, overall jobs growth among wage and salary earners has been weak – though the HLFS is much more downbeat on that score than the Quarterly Employment Survey (QES), which reported 1.5% growth over the last year.

The Labour Cost Index (LCI) rose 0.6% in the December quarter and was 2.0% higher than a year ago, a similar pace to the rest of 2012. Statistics New Zealand continued to report unusually high wage inflation in the Canterbury construction sector. But wage growth in other industries and parts of the country remains very subdued, suggesting that the pressures associated with the rebuild remain well-contained for now.

Stepping away from the labour market, there was strong market interest in last week's GlobalDairyTrade auction in light of the recent concerns about traces of dicyandiamide (DCD) found in some New Zealand milk products. In the event, there was no indication that buyers were fazed by this story, with prices rising 5.4% for whole milk powder and 2.4% for all dairy products. We expect further upward pressure on world prices

Annual employment growth





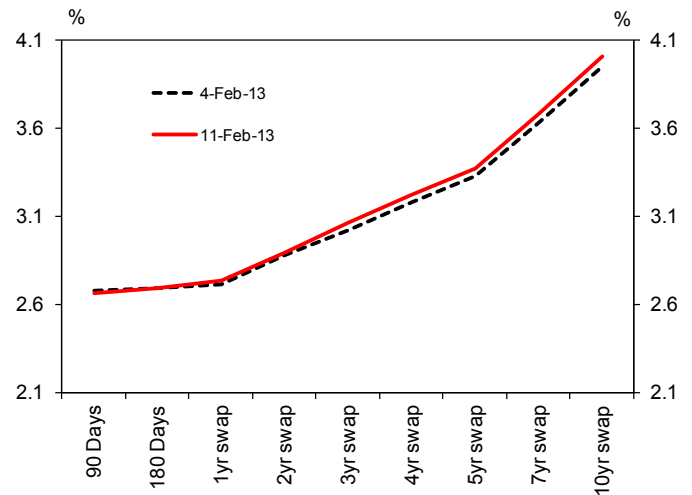
over the first half of this year, as improving Asian growth meets with constrained supply due to poor growing conditions in the Northern Hemisphere.

This week's data has a consumer-flavoured theme to it. The most likely headline-grabber will be retail sales for the December quarter – following a short but sharp downturn in the September quarter, we expect to see a 2% rebound back to around trend levels. Falling retail prices – largely a product of the strong New Zealand dollar – continue to pave the way for solid gains in real terms. While our pick is well above the market median forecast of 1.4%, it is consistent with the already-published figures on electronic card spending and consumer prices over the quarter.

National house sales and prices for January are also likely to be released sometime next week. Figures from a major Auckland agency suggested a drop in sales, although this data was perhaps more remarkable for the extremely low number of listings as at the start of the month – a constraint that may not apply at the nationwide level. Meanwhile, low interest rates have underpinned growth in house prices for some time, and that situation is not expected to change this year.

Fixed vs floating for mortgages: Fixing is likely to prove better value than floating over the next few years. Fixed-term rates out to two years are currently well below floating rates, while three-year and longer fixed rates are only slightly higher. Staying on floating would only be the better option if the RBNZ actually cut the OCR, and we regard that as fairly unlikely. Our view is that the OCR will stay on hold for now, and increase steadily from late 2013.

NZ interest rates



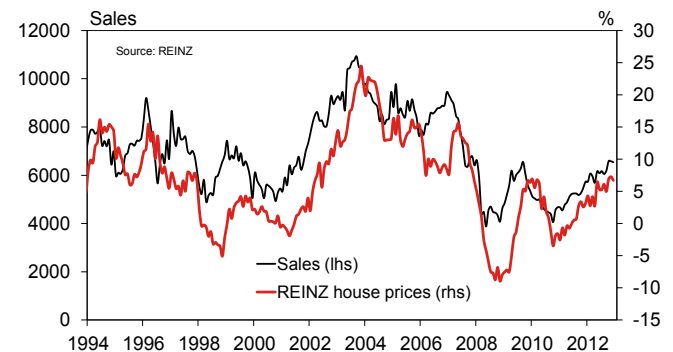
Key Data Previews

NZ Jan REINZ house prices and sales

Feb 11-15, Sales last: **-0.6%**, Prices last: **+0.2%**

- House sales rose around 7% higher over the December 2012 quarter, the highest in five years. The expectation of low mortgages rates for an extended period continues to underpin the market.
- Indicators for January sales are mixed. Mortgage approvals rose 11% s.a. in December, although this series includes refinancing activity. In contrast, the largest agency in the Auckland region reported a drop in sales in January, though they may have been constrained by an extremely low number of listings as at the start of the month.
- We expect house price inflation to accelerate further, from an estimated 6% pace in 2012 to 9% this year. Auckland and Christchurch continue to lead the way due to their respective supply shortages, but prices are now rising in all of the main centres.

REINZ house prices and sales



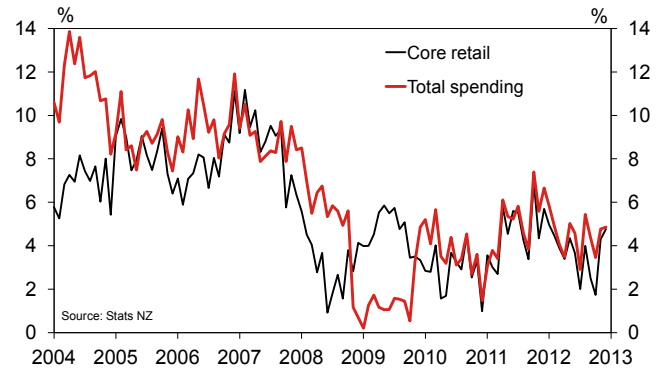


NZ Jan electronic card transactions

Feb 12, Last: 0.4%, WBC f/c: 0.5%

- After a September quarter soft patch, consumer spending seems to have settled back into the 5%-ish trend growth rate of the last few years. Card transactions rose 0.4% in December, with modest gains across all categories except fuel, which was at least partly price-led.
- Data from Paymark, the largest cards processor, showed a 0.6% rise in spending in January. With fuel prices down slightly for the month, that suggests some robust growth in the 'core' storetypes.
- Pressure on retail prices has generally been down in recent months due to the persistent strength of the NZ dollar. As a result, slow growth in nominal spending is still consistent with decent growth in real terms (see below).

Card transactions, annual % change

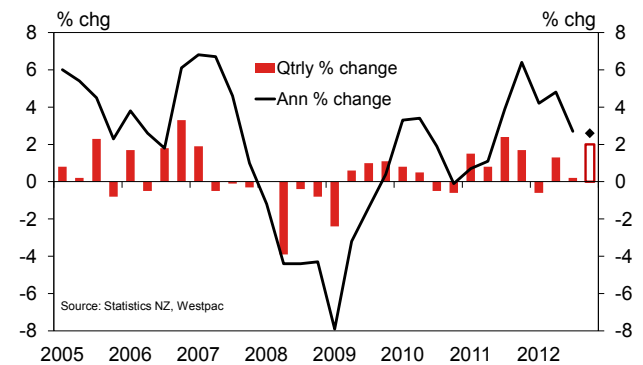


NZ Q4 real retail sales

Feb 15, Last: -0.4%, Mkt f/c: +1.4%, WBC f/c: +2.0%

- Like many domestic activity indicators, retail sales saw a short sharp drop in the September quarter. Our forecast of a 2% jump in the December quarter largely represents a return to trend, with growth averaging around 0.7% per quarter since the recession ended.
- We expect a 1.6% increase in the core measure, with particularly strong gains in durable goods (aided by falling prices). A rise in fuel spending (this component is not seasonally adjusted) should further boost the total.
- The retail price deflator has fallen in five of the last six quarters. While the CPI documents a rise in the incidence of 'discounting' over the last year, we think the overriding factor is the rising NZ dollar, which continues to depress the prices of imported and import-competing goods.

Real retail sales



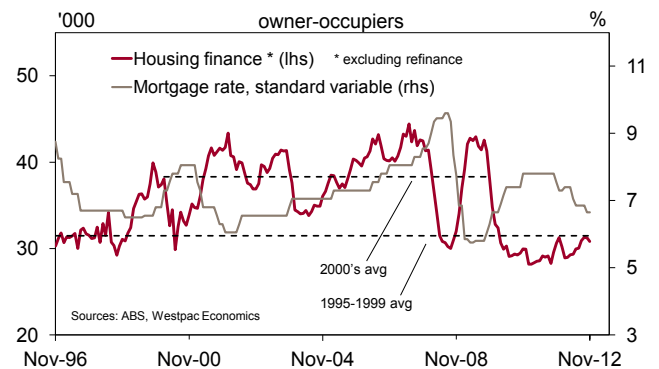
Aus Dec housing finance (no.)

Feb 11, Last: -0.5%, WBC f/c: -1.0%

Mkt f/c: flat, Range: -2.5% to 2.5%

- Housing finance to owner-occupiers edged 0.5% lower in Nov after a flat Oct. The result was driven by a sharp pull-back in the first home buyer (FHB) market, a reversal of an earlier bring-forward due to changes to incentives / stamp duty arrangements (in NSW in particular). In contrast, loans to upgraders and investors have continued to firm albeit with the latter mostly driven by strong gains in NSW.
- FHB demand will continue to be a drag in Dec with a Jan 1 increase in stamp duty concessions likely to see Vic buyers defer until 2013. The segment should stabilise in 2013 though as these factors wash out and in response to improved housing affordability. Upgrader and investor demand should also strengthen further. Overall we expect a 1% fall in finance approvals for Dec.

Owner-occupier finance and the rate cycle



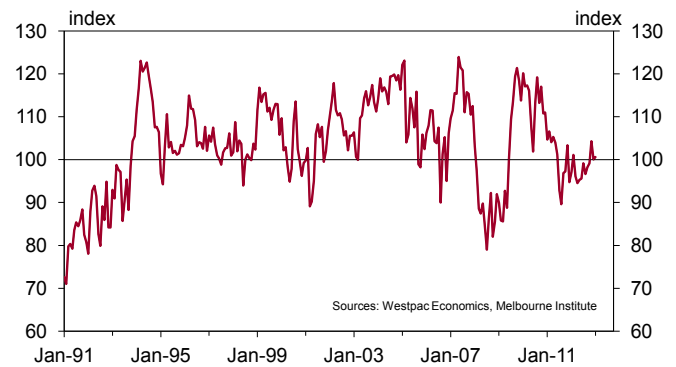


Aus Feb Westpac-MI Consumer Sentiment

Feb 13, Last: 100.6

- Consumer sentiment rose 0.6% in Jan, but continued to hold around neutral (100), a disappointing reading given the degree of monetary policy stimulus applied since May. The Index is seasonally adjusted to strip out a regular summer holiday 'feel-good' factor that occurs every January.
- The Feb survey is in the field from Feb 4 to 10. Factors that may influence sentiment include: the RBA's decision to leave rates on hold, albeit while signalling a clear inclination towards further cuts if necessary; 'mixed' economic data with the unemployment rate holding at 5.4% in Jan but the jobs detail soft and weak official data on dwelling approvals and retail sales; positive readings on house price growth; and a continued rally in financial markets (ASX up 4.8% between the Jan and Feb surveys and 13.8% from its mid-Nov low).

Consumer Sentiment

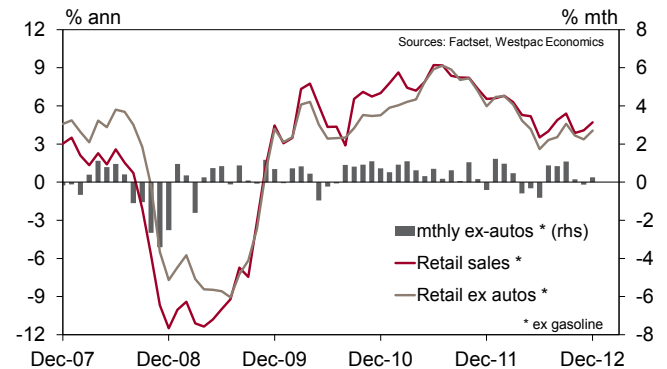


US Jan retail sales

Feb 13, Last: 0.5%, WBC 0.4%

- Retail sales rose 0.5% in Dec with autos continuing to rise following Oct superstorm writeoffs; furniture also posted back to back gains, perhaps for the same reason; strength also was seen in clothing, eating out and health/personal care. There were no especially weak storetypes; gasoline was held down by lower prices. Core retail ex autos/gas rose 0.6% in Dec, the same as in Nov.
- Personal income growth surged 2.6% in Dec as firms brought forward dividends and bonuses to beat tax hikes in the new year. That income gain will be reversed but retailing may feel the boost for a month or two yet.
- Auto sales were little changed in Jan and gasoline prices on average were little changed from Dec. We expect core and headline retailing to both post gains of around 0.4%.

US retail sales

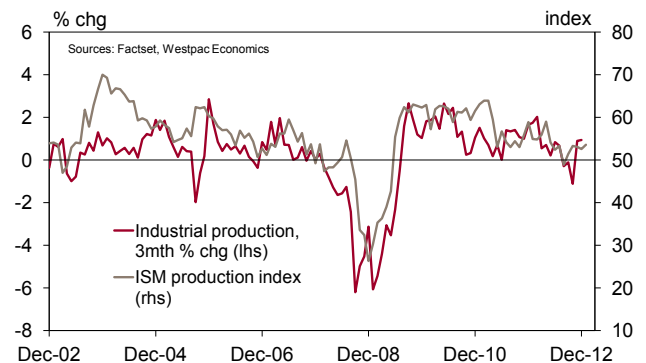


US Jan industrial production

Feb 15: Last: 0.3%, WBC f/c: 0.4%

- Industrial production rose 0.3% in Dec on top of Nov's 1.0% bounce from storm-disrupted Oct. Factory output rose a more impressive 0.8% after 1.1% in Nov with auto production solid for the second month running, but even ex auto factory output was up a decent 0.7%. A 4.8% utilities output decline explained the slower total IP growth rate in Dec.
- Factory hours worked fell 0.2% in Jan and orders data have been mixed lately, in the official Dec figures and the surveys for Jan. Manufacturing output was probably a modest positive in the month; we expect a 0.1% rise.
- The IP bottom line will be driven by the Fed's estimate of utility output. Very cold weather in Jan is likely to have seen a decent utilities bounce so we expect total IP rose 0.4%.

US industrial sector



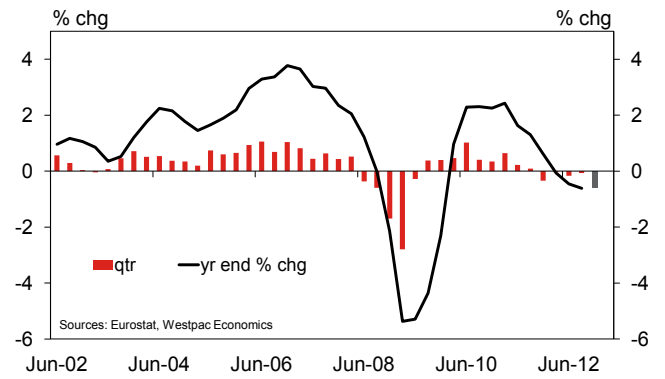


Euroland Q4 GDP

Feb 14: Last: **-0.2%**, WBC f/c: **-0.6%**

- Euroland GDP has fallen for four consecutive quarters from Q4 2011, although Q1 2012 rounded up to flat.
- Most business surveys were running at new cycle lows in late 2012, around levels they last fell to in 2008 when the economy was contracting at a moderate pace prior to the collapse in global trade at the end of that year.
- A preliminary estimate for German GDP of “up to a half percent decline”, means no offset to ongoing weakness elsewhere; Spain has already been reported down 0.7% in Q4, the sixth and steepest quarterly decline of the ongoing Spanish recession. French industrial production and consumer spending point to a 0.2% decline in Q4. The quarterly pace of decline in the overall Euroland economy is likely to be around 0.6%, the steepest yet of the recession which on our forecasts will stretch into 2014.

Euro zone GDP growth





Key Data and Events

		Market Last	Westpac median	forecast	Risk/Comment
Mon 11					
NZ	Jan REINZ house sales	-0.6%	-	-	Due this week. Low interest rates remain the bottom line.
	Jan REINZ house price index	0.2%	-	-	Prices expected to accelerate further this year.
Aus	Dec housing finance	-0.5%	flat	-1.0%	First home buyers likely to be weak due to state govt policy changes.
Eur	Eurozone Fin-Min meeting	-	-	-	Regular meeting in Brussels
US	Q4 mortgage delinquencies	7.4%	-	-	Down from 10% peak in Q1 2010. Data due any day this week.
Tue 12					
NZ	Jan electronic card transactions	0.4%	0.3%	0.5%	Trending up again after a September quarter soft patch.
Aus	Jan NAB business survey	-4	-	-	Conditions index weak, albeit up 2pts. Confidence rebound 12pts to +3.
UK	Dec house prices %yr	2.1%	-	-	ONS index of selling prices.
	Jan house prices net %	0%	-	-	RICS surveyors neutral on house prices for first time since mid 2010.
	Jan PPI %yr	1.5%	-	-	Core output measure.
	Jan CPI %yr	2.7%	2.7%	2.5%	Oct CPI jump on education fees has yet to reverse.
US	Jan NFIB small business optimism	88.0	-	-	Nov's steep fall sustained in Dec, but Jan hiring intentions rose.
	Jan federal budget \$bn	-	-	-	Impact of fiscal compromise to show up here.
	Fedspeak	-	-	-	George
Wed 13					
Aus	Feb Westpac-MI Consumer Sentiment	100.6	-	-	Lacklustre response to lower rates as other concerns dominate.
Eur	Dec industrial production	-0.3%	-0.1%	0.2%	German IP rose 0.3% in Dec.
UK	Bank of England inflation report	-	-	-	Unusually detailed statement set the agenda.
US	Jan advance retail sales	0.5%	0.1%	0.4%	Auto sales and gasoline prices were not big factors in Jan.
	Jan retail sales ex & auto, gas	0.6%	0.3%	0.4%	The surge in incomes growth in Jan Dec may still be supporting sales.
	Jan import prices	-0.1%	0.9%	0.9%	Oil prices on rise again in Jan.
	Dec business inventories	0.3%	0.3%	0.2%	Inventories being kept tight.
	Fedspeak	-	-	-	Lacker, Plosser, Bullard
Thu 14					
NZ	Jan food price index	-0.2%	-	1.0%	Seasonal uptick in produce prices; annual inflation still near zero.
	Jan manufacturing PMI	50.1	-	-	Stronger NZD vs improving domestic demand.
Aus	Feb WBC-MI unemploy expect' %yr	7.1%	-	-	Trend improved last 5 months. Even so, still points to a higher un' rate.
	Feb MI consumer inflation expect.	2.0%	-	-	Inflation expectations have moved lower, around lowest since 1998.
Eur	Q4 GDP	-0.1%	-0.4%	-0.6%	Germany down 0.5%, Spain down 0.7%. See text box.
Ger	Q4 GDP	0.2%	-0.5%	-0.5%	Stats office warned of decline of up to half a per cent.
US	Initial jobless claims w/e 10/2	366k	360k	370k	Week prior to payrolls survey week.
	Fedspeak	-	-	-	Bullard
Fri 15					
NZ	Q4 real retail sales	-0.4%	1.4%	2.0%	Recovering from a weak Q3; falling prices support volume growth.
Eur	Dec trade balance sa €bn	11.0	-	-	In surplus since late 2011.
UK	Jan retail sales volume inc fuel	-0.1%	0.5%	0.5%	Retailing in Q4 was sluggish; did Jan cold snap deter or encourage?
US	Feb NY Fed factory survey	-7.8	-3.0	2.0	Nov-Dec constrained by superstorm/fiscal cliff, Jan failed to bounce.
	Jan industrial production	0.3%	0.2%	0.4%	Factory hours down 0.2%, but utilities up on cold weather. See box.
	Feb UoM consumer sentiment final	73.8	74.5	73.5	300 responses in prelim, 500 in final.
	Dec TIC data, \$bn	52.3	-	-	Net long term TIC flows.
	Fedspeak	-	-	-	Pianalto
Can	Dec manufacturing sales	1.7%	-0.5%	-	Aircraft and autos behind Nov rebound.
	Jan existing home sales	-0.5%	-	-	New data series, only posted a rise in Sep, otherwise falls since Jun.

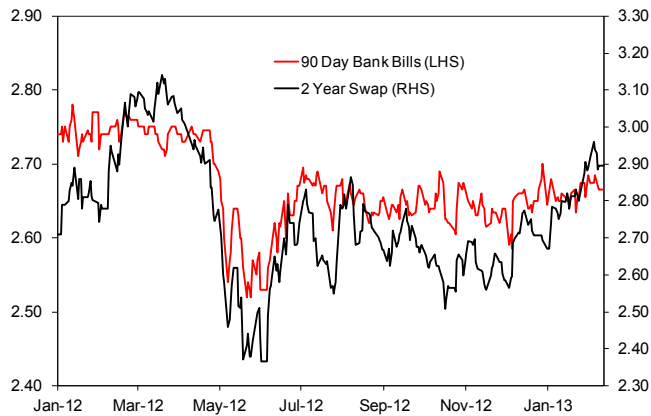


New Zealand Economic and Financial Forecasts

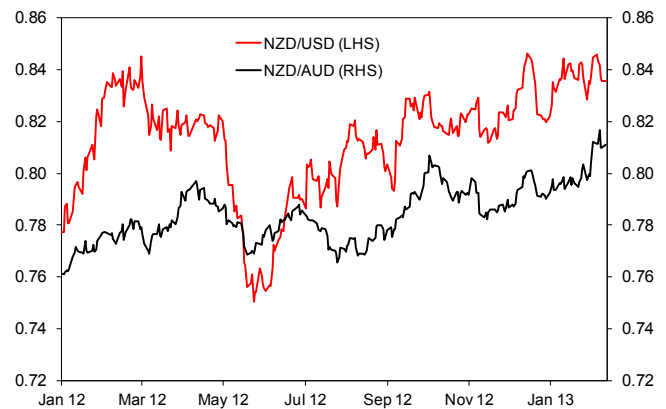
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012e	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.2	3.3	3.1	1.5	2.4	3.0	3.2
Employment	1.0	0.1	2.8	2.5	1.5	-1.4	4.1	2.6
Unemployment Rate % s.a.	6.7	6.8	5.8	4.8	6.4	6.9	6.0	5.0
CPI	1.6	1.0	1.9	2.4	1.8	0.9	1.9	2.4
Current Account Balance % of GDP	-4.4	-4.9	-5.0	-6.3	-4.0	-5.0	-4.8	-6.1

Financial Forecasts	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14
Cash	2.50	2.50	2.50	2.75	3.25	3.50
90 Day bill	2.70	2.70	2.75	3.20	3.50	3.75
2 Year Swap	2.90	3.00	3.10	3.30	3.60	3.90
5 Year Swap	3.40	3.50	3.60	3.80	4.00	4.30
10 Year Bond	3.70	3.80	3.90	4.10	4.30	4.40
NZD/USD	0.85	0.86	0.87	0.87	0.85	0.83
NZD/AUD	0.80	0.80	0.83	0.84	0.84	0.84
NZD/JPY	72.3	71.4	70.5	69.3	66.3	65.6
NZD/EUR	0.64	0.64	0.66	0.67	0.67	0.67
NZD/GBP	0.52	0.51	0.52	0.52	0.52	0.49
TWI	75.7	75.7	77.0	77.2	76.4	75.4

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 11 February 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.66%	2.66%	2.65%
60 Days	2.68%	2.67%	2.65%
90 Days	2.67%	2.68%	2.66%
2 Year Swap	2.90%	2.88%	2.79%
5 Year Swap	3.37%	3.33%	3.22%

NZ foreign currency mid-rates as at Monday 11 February 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8356	0.8323	0.8380
NZD/EUR	0.6261	0.6186	0.6275
NZD/GBP	0.5290	0.5303	0.5196
NZD/JPY	77.494	75.477	74.829
NZD/AUD	0.8109	0.7991	0.7949
TWI	75.890	75.010	75.150



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012e	2013f	2014f
Australia						
Real GDP % yr	1.4	2.5	2.4	3.5	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.3	2.8
Unemployment %	5.6	5.2	5.2	5.3	6.0	6.2
Current Account % GDP	-4.2	-2.9	-2.3	-3.8	-3.3	-4.0
United States						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.6	1.5
Consumer Prices %yr	-0.3	1.6	3.1	2.0	2.0	2.0
Unemployment Rate %	9.3	9.6	8.9	8.1	8.0	7.9
Current Account %GDP	-2.7	-3.0	-3.1	-3.3	-3.5	-3.5
Japan						
Real GDP %yr	-5.7	4.9	-0.4	2.1	1.4	1.9
Consumer Prices %yr	-1.3	-0.7	-0.3	0.0	-0.2	0.1
Unemployment Rate %	5.2	5.1	4.5	4.3	4.3	4.3
Current Account %GDP	2.8	3.6	2.0	2.1	2.0	2.0
Euroland						
Real GDP %yr	-4.4	1.9	1.5	-0.5	-0.4	-0.5
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.4
Unemployment Rate %	9.5	10.0	10.1	11.7	12.0	12.5
Current Account %GDP	-0.2	-0.1	0.0	0.9	1.0	1.0
United Kingdom						
Real GDP %yr	-4.0	1.8	0.9	0.0	0.7	0.2
Consumer Prices %yr	2.2	3.2	4.0	2.7	1.8	1.5
Unemployment Rate %	7.6	7.8	8.4	8.0	8.5	8.5
Current Account %GDP	-1.3	-2.4	-1.9	-3.8	-2.0	-1.5

Forecasts finalised 11 February 2013

Interest Rate Forecasts	Latest	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14
Australia						
Cash	3.00	2.75	2.75	2.75	2.75	2.75
90 Day Bill	2.95	2.85	3.00	3.10	3.10	3.00
10 Year Bond	3.48	3.25	3.60	3.50	3.30	3.10
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.96	1.85	2.20	2.30	2.10	2.00
ECB Repo Rate	0.75	0.75	0.75	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Mar 13	Jun 13	Sep 13	Dec 13	Mar 14
AUD/USD	1.0286	1.06	1.07	1.05	1.03	1.01
USD/JPY	93.49	91	89	87	85	83
EUR/USD	1.3411	1.34	1.36	1.32	1.29	1.25
AUD/NZD	1.2313	1.25	1.24	1.21	1.18	1.19

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