

# Australian weekly

## Week beginning 25 January 2010

- Australia: Uplift in economy's momentum: inflation print not important for near term rate outlook.
- Australian data: producer prices, consumer prices, Westpac-MI Leading Index and credit data previewed.
- New Zealand: RBNZ OCR Review – on hold for now, but an extended tightening cycle is on the cards.
- New Zealand data: trade deficit and building consents previewed.
- US FOMC: expect another on hold outcome and similar statement to Dec.
- US data focus: home sales, durable goods orders, Q4 GDP previewed.
- UK data: Q4 GDP previewed.
- Key economic & financial forecasts.

Information contained in this report was current as at 22 January 2010

# Uplift in economy's momentum: inflation print not important for near term rate outlook

There are times when the Westpac–Melbourne Institute Index of Consumer Sentiment sends out the earliest signal of a change in the economy's momentum.

For example, in June last year we saw a stunning 12.7% jump in the Index. It was largely ignored by the market. The market and most economists were still expecting further rate cuts with rate hikes not priced in before well into 2010.

While not as spectacular as last June the 5.6% jump in the Index which we announced last Wednesday is a stunning result. The Index has recovered all the ground it lost since the Reserve Bank began its record run of three consecutive rate hikes from October to December last year. It is likely to be signalling to the authorities that households are coping comfortably with higher rates.

Supporting that resilience are other aspects of the last Sentiment survey that tend to attract much less attention. Yesterday we released the latest measure of Unemployment Expectations. The Index indicates that households' confidence about their job security improved by 15.5% to reach its highest level of confidence since 1996. The stunning improvement in the jobs data and associated job prospects has been the most important driver of overall confidence.

Today we have released an associated survey on how households view house prices. As an adjunct to our Consumer Sentiment and Unemployment Expectations survey we also survey households' outlook for house prices.

In May last year when we first surveyed this topic only 33% of respondents expected house prices to rise over the next year. By October last year that proportion had increased to 74% and in the recent January survey 84% of respondents expect house prices to rise. Clearly, the exuberance associated with overall sentiment has spilled over to asset price expectations.

An important speech by RBA Deputy Governor Battellino on December 16 last year defined as clearly as one can expect from a central bank that the Bank's assessment of "neutral" has been lowered by 100 bp's. "With other interest rates in the economy having risen by at least 100 basis points relative to the cash rate over the past couple of years, they are now above their previous cyclical lows.....Taking these considerations into account it would be reasonable to conclude that the overall stance of monetary policy is now back in the normal range, though in the expansionary segment of the range".

We do not know how wide the "range" is assessed to be by the RBA but it is reasonable to assume that the "range" would have a minimum size of 100 bp's and a maximum of 200 bp's.

That would put the mid point of the "range" as 4.25% (minimum) and 4.75% (maximum). Previous assessments by RBA officials that neutral was around 5.5% fits neatly into a new neutral of 4.5% i.e. 100 bp's below the previous neutral and reflecting the increase of 100 bp's in the margin between the cash rate and private rates.

**The survey evidence set out above coupled with the ongoing positive news on the labour market suggests that the Bank will be keen to move the cash rate back to the new neutral fairly quickly – certainly by June this year.**

**We think markets are unnecessarily focussed on the inflation prints next week.**

**We believe that next week's inflation prints will be largely irrelevant to the near term prospects for rates.**

We expect underlying inflation to print 0.7% next week. That will push annual underlying inflation down from 3.5% to 3.4% – above the Bank's current forecast of 3.25% for underlying inflation in 2009. Such a result would, of its own right, support a rate hike on February 2.

However, our forecast might be on the 'high side' given that despite a 6.6% increase in the import weighted AUD TWI on average over the quarter we are only expecting price reductions across most of the imported goods sector (around 10% of the CPI in total) of 1–3%.

We may also be underestimating the indirect effects of the 3.4% fall in petrol prices.

However, we continue to see upside pressure from those large components which in addition to petrol tend to explain most major fluctuations in the CPI: housing costs (8% of CPI); rents (6% of CPI); motor vehicles (4% of CPI); and financial and insurance services (9% of CPI).

This general theme reflects our view that solid demand conditions will maintain pressure on prices – particularly services.

**If we did see a rogue low print on underlying inflation the RBA is still very likely raise rates on February 2.**

Recall that by the Bank's own admission rates are "in the normal range though in the expansionary segment of that range".

The Bank is likely to be currently giving much less emphasis to inflation than was the case in the last tightening cycle, particularly when rates are below neutral.

Arguably the Bank's most regrettable decision on rates in recent times was to be too influenced by what turned out to be two 'rogue' low CPI prints in December 2006 and March 2007.

Despite very strong data the Bank chose to keep rates on hold between November 2006 and August 2007. Strong lagged increases in underlying inflation over the next 9 months elicited another 75 bp's of rate increases to levels well above neutral (around 200 bp's above neutral) even as the global financial crisis was building (the last rate hike came in March 2008 – the same month that Bear Sterns collapsed into the 'government guaranteed' arms of JPMorgan.).

In retrospect it seems likely that the Bank would have preferred to have raised rates at a faster pace during 2007.

**Given the current level of rates and the strength of the current data series it is very hard to envision a CPI next week that would see rates being on hold.**

**Bill Evans**, Chief Economist

# Data wrap

## Dec TD–MI inflation gauge

- The TD–Melbourne Institute inflation gauge rose 0.3% in December following a 0.3% rise in November. Sources of higher prices noted included holiday travel and accommodation (seasonal), fruit and vegetables, and petrol prices. The monthly result also lifted annual growth in the gauge for the second consecutive month, taking it back above the mid-point of the RBA's 2% to 3% target band for the first time since March 2009. With a weaker result of –0.2%*mth* from December 2008 dropping out, annual growth in the inflation gauge rose to 2.6%*yr* from 2.1%*yr* previously and a trough of 1.2%*yr* in October 2009, the equal highest annual pace since March 2009. This affirms our view that annual headline inflation troughed in 3Q2009 at 1.3%*yr*.
- With back to back solid monthly increases in the Inflation Gauge, 3*mth* growth rose to +0.21% from –0.10% previously. However, this 3*mth* pace remains well below the end-Q3 September 3*mth* pace of +0.86% and the Q3 mid-month-of-the-quarter (August) pace of +1.29%, affirming our expectation for a markedly softer quarterly headline CPI pace in Q4 after Q3's 1.0%*qtr* result. Our Q4 headline CPI forecast fits this prognosis, with a forecast 0.4%*qtr* rise (which would still see annual headline inflation rise to 2.0%*yr* from 1.3%*yr* previously, returning to the target band similar to the inflation gauge).
- The detail of the December inflation gauge showed price pressures were more narrowly based in December than November, consistent with some easing in quarterly underlying inflation in Q4. Prices rose in 23 items (vs 28 *prev*), were unchanged in 48 items (vs 46 *prev*) and fell in 19 items (vs 16 *prev*). This gave a net balance of 4 price increases, down from a net 12 previously. This latest net balance was below its 6*mth* moving average (9.7) and 12*mth* average (11.9). Our underlying (avg of RBA measures) CPI forecast for Q4 is for an easing in the quarterly pace to 0.7%*qtr* from 0.8%*qtr* previously. However, while this would lower annual underlying inflation to 3.4%*yr* from 3.5%*yr* previously, it would remain above the top of the target band, stubbornly slow to fall at a time when the Australian economy is set to accelerate in 2010 with the labour market already re-tightening from a much better than expected starting position (with the unemployment rate having peaked below 6%).

## Dec merchandise imports

- Australian merchandise imports rose 0.6% unadjusted in December to \$17.662bn, following a 2.1% fall previously.
- The Statistician advised that after seasonal adjustment, the data is consistent with a jump in goods imports on a BoP basis of \$1156mn or +7.1%*mth*. This would more than reverse a 3.9%*mth* fall previously, allowing the volume-led (prices have been dented by AUD appreciation) uptrend in goods imports to accelerate to +0.5%*mth* (vs published +0.1%*mth* in November), the fastest pace since October 2008. The rise in seasonally adjusted December imports was heavily led by volatile components including fuels and lubricants (within intermediate and other merchandise goods) and non-monetary gold, although capital goods also recorded a further solid gain. Of the \$1156mn rise, fuels and lubricants rose \$535mn (26%) driving a \$760mn

(11%) rise in the intermediate and other merchandise goods category; non-monetary gold rose \$224mn (51%); and capital goods rose \$246mn (7%). Consumption goods eased \$74mn or 1%.

- With the AUD/USD falling 1.9% on a monthly average basis in December, a moderate rise in import prices would have supported total values in the month. However, the scale of the overall 7.1% rise in values easily surpasses any price boost, suggesting a strong rebound in volumes after an implied pullback previously (recall November's 3.9% fall in imports took place in a month when the AUD rose 1.3%, indicating a volumes pullback). The jump in December goods imports gives an average Q4 level 0.9% above the average Q3 level. But with the strong quarterly AUD appreciation driving prices lower (we expect around a 5% fall in the Q4 MPI), this backs out another strong quarter of import volumes growth for Q4 on top of Q3's 5.8%*qtr* surge.

## Jan Westpac–MI Consumer Sentiment

- The Westpac–Melbourne Institute Index of Consumer Sentiment increased by 5.6% in January from 113.8 in December to 120.1 in January.
- This is a very strong result. The Index is seasonally adjusted and therefore takes account of traditional January optimism. Nevertheless it is still above its level of last September prior to the Reserve Bank's record three consecutive rate increases over the three months from October to December.
- In other convincing evidence that households appear to have comfortably absorbed the higher interest rates we note that the confidence of those respondents who currently hold a mortgage has reached its highest level since 1994 when we first collected data using categories defined by home ownership.
- Clearly a major source of relief for households was the absence of a further rate increase. With no meeting of the Board of the Reserve Bank in January the record run of three consecutive monthly increases in interest rates was interrupted. The share market also supported confidence with a rise of 4.2%.
- However it is likely that the most important fillip to confidence in the month was the continuation of positive surprises on the employment situation.

## Jan MI consumer inflation expectations

- Consumers' inflation expectations eased back a notch in January to 3.5% after rising to 3.6% in December from 3.2% in November. This left their trend level unchanged at 3.49% for the third consecutive month, up from a March 2009 low of 2.25%. However, inflation expectations of managers and professionals (arguably a guide to business expectations of pricing power) spiked to 4.1% in January from 3.6% previously, the highest since October 2008. This continued the uptrend for this series, rising to 3.78% from 3.72% previously, also the highest since October 2008. Within consumer expectations, while the median expectations eased a touch, the detail as less encouraging. The proportion expecting prices to fall fell to 1.2% from 1.3% and the proportion expecting prices to rise rose to 81.3% from 78.2%. This saw the trend net balance expecting higher prices rise to 79.8% from 78.8% previously, the strongest since October 2005.

# Data wrap

Also, the proportion expecting inflation within the 2% to 3% target band fell to 16.2% from 17.7% previously (lowest since July 2009) and the proportion expecting inflation above the band rose to 65.6% from 60.8% previously, well above its twelve month average (53.7%) and the highest proportion since August 2008.

## Jan WBC-MI unemployment expectations

- Consumers' unemployment expectations fell sharply in January (survey period included last week's surprising strong labour force data), more than unwinding two consecutive moderate increases, allowing their rapid downtrend since peaking in February 2009. The unemployment expectations index plunged 15.5% in January to 100.55 after a 3.1% rise previously and 2.8% rise prior to that, taking the index 45.1% below its February peak. Their trend fell 4.1% mth to be 42.3% below their February trend peak. We prefer to assess this index via a smoothed trend deviation from its full history average as a guide for annual employment growth seven months ahead. This deviation measure continued to fall for the 10th consecutive month to -11.2% in January from -8.1% in December, the lowest since January 2008.
- The deviation measure of unemployment expectations peaked in March 2009, broadly consistent with the official employment data which has now revealed a trough in annual trend jobs growth in July 2009. However, just as jobs growth on the way down did not fall by the extent implied by the deviation measure's peak (its peak deviation of 44.6% historically would have been consistent with a trough in jobs growth as weak as -3.5%yr rather than the highly resilient -0.1%yr trough), we doubt jobs growth can accelerate as rapidly as the indicator's recovery is now suggesting in 2010H1. Still, we do expect a rapid uptrend in jobs growth through 2010H1 that is broadly in line with the rapid turn in this indicator. We expect annual jobs growth to rise to 2.1%yr (qly avg basis) in 2010Q2 from 0.6%yr in 2009Q4.

## Dec new motor vehicle sales

- New vehicle sales rose 3.3% in December. The monthly result was a touch below our expectation of a 5% rise but there were hefty upward revisions to the previous three months (Nov from +5.4% to +5.9%; Oct from +3.3% to +4.5%; and Sep from +3.7% to +4.3%).
- Business spending on vehicles surged strongly towards the year end as firms rushed to take advantage of the Government's temporary tax break for equipment investment before it ended

December 31. Although hard to verify, other indicators also suggest consumer spending on vehicles also turned up late in the year. All up, quarterly new vehicle sales surged 12.9% in the final quarter of 2009 to be up 12.2% on 2008Q4. Clearly this will give a big boost to Q4 business investment in the national accounts (spending on vehicles accounts for about 8% of all capex and over 25% of business spending on plant and machinery), and a smaller lift to Q4 consumer spending. However the net impact on headline GDP will likely be small as most vehicles are imported, and there will be a significant hangover decline in the first few months of 2010.

## Q4 international trade price indexes

- Export prices were more resilient than expected in Q4 at -1.7% (consensus -3.5%, prev -9.6%). Higher USD commodity prices were more than offset by the valuation drag from the 9.0%qtr AUD/USD rise. The fall was led by coal, coke and briquettes (-7.0%) and metalliferous ores and metal scrap (-1.9%), with partially offsetting rises in gas (16.5%) and non-monetary gold (6.2%).
- Import prices were -4.3%qtr in Q4 (consensus -2%, Westpac -5%, prev -3.0%), led by valuation effects of the stronger AUD, and lower prices in telecommunications and sound equipment (-7.5%) and road vehicles (-3.5%). Food and beverage prices fell again (-5.2%), while mineral fuels fell 0.5%. Abstracting from these non-core items, core import prices fell sharply by 4.9% as the import weighted AUD TWI jumped a further 6.6% in the quarter.
- With export prices more resilient than consensus but import prices weaker, the terms of trade improved unexpectedly. Consensus forecasts implied a ToT fall of 1.5%qtr, Westpac forecasts implied a rise of 0.5%qtr, but the outcome was a rise of 2.8%qtr.
- The data has no implications for our Q4 CPI forecast as the pass-through from lower import prices to consumers is often largely absorbed, especially at a time of firming consumer demand and strong confidence. However, with the smaller than expected fall in petroleum more than offset by weaker than expected food, we have nudged our Q4 PPI forecast lower to flat%qtr and -1.1%yr (from +0.1%qtr).

## Round-up of local data released last week

Date	Release	Previous	Latest	Mkt f/c
Mon 18	Dec TD-MI inflation gauge	0.3%	0.3%	-
Tue 19	Dec merchandise imports, nsa AUDbn	17.5	17.7	-
Wed 20	Jan Westpac-MI Consumer Sentiment	113.8	120.1	-
Thu 21	Jan MI consumer inflation expectations	3.6%	3.5%	-
	Jan WBC-MI unemployment expectations	3.1%	-15.5%	-
	Dec new motor vehicle sales	5.9%	3.3%	-
Fri 22	Q4 export price index %qtr	-9.6%	-1.7%	-3.5%
	Q4 import price index %qtr	-3.0%	-4.3%	-2.0%

Past performance is not a reliable indicator of future performance. The forecasts given above are predictive in character. Whilst every effort has been taken to ensure that the assumptions on which the forecasts are based are reasonable, the forecasts may be affected by incorrect assumptions or by known or unknown risks and uncertainties. The results ultimately achieved may differ substantially from these forecasts.

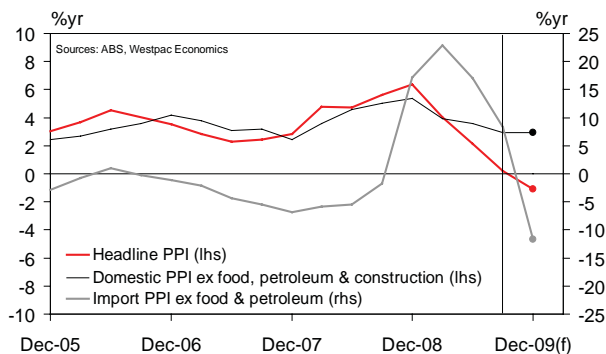
# Data previews

## Aus Q4 PPI

Jan 25, Last: 0.1%, WBC f/c: 0.0%  
Mkt f/c: 0.1%, Range: -0.5% to 0.7%

- The Q3 PPI was weak at 0.1%qtr, 0.2%yr. Non-core items added 0.27ppts to the qtrly rate (food +0.8%, petroleum +5.9%). Core import prices fell 5.7% with the AUD import weighted TWI up 6.6%, combining with weakness in the domestic core ex-construction & utilities (-0.5%), & flat building construction prices to give a weak total core PPI of -0.2%, despite a seasonal 12.2% spike in utilities.
- The core PPI is f/c to remain weak in Q4 at -0.1%qtr. While we f/c a 0.9% rise in the domestic core ex-construction & utilities with stronger demand, & higher building prices (+0.5%), utilities seasonally revert to stability (+0.1%) & we expect another offsetting fall in core import prices (-4.7%) from the higher AUD (+6.6%). Food prices (+0.8%) & petroleum (-0.4%) give a small net addition, allowing the total PPI to be flat%qtr, cutting the annual rate to -1.1%yr.

## PPI: firm domestic core, but core M weak

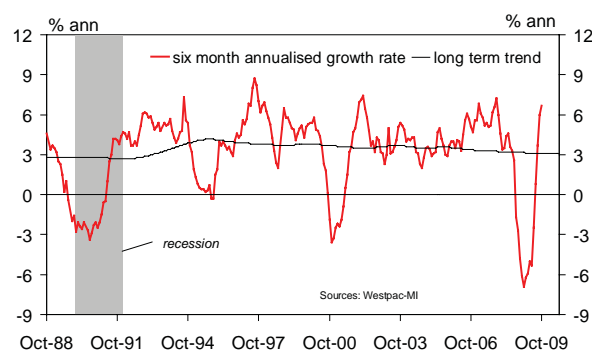


## Aus Nov Westpac-MI Leading Index

Jan 27, Last: 6.7% annualised

- The annualised growth rate of the *Westpac-Melbourne Institute Leading Index*, which indicates the likely pace of economic activity three to nine months into the future, continued to surge in October, rising to 6.7%, well above its long term trend of 3.1%. The extraordinary rebound – the index was contracting at a -5.3% annual pace in May – is easily the fastest turnaround since the mid 1970's.
- All monthly components improved in November. Equity markets regained ground, the ASX rising 1.3% after slipping 2.1% in October; dwelling approvals surged strongly, up 5.9% after a 1.8% fall previously; and although the money supply continued to contract, the pace of decline moderated slightly. US industrial production rose 0.6%, a fourth successive monthly rise and a step up on the 0.2% gain in October.

## Westpac-MI Leading Index

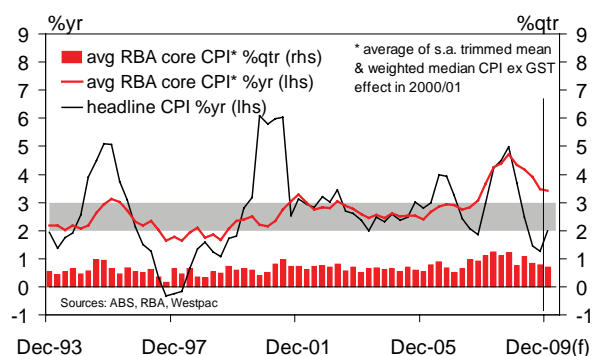


## Aus Q4 CPI

Jan 27, Last: 1.0%, WBC f/c: 0.4%  
Mkt f/c: 0.4%, Range: 0.0% to 0.7%

- Our Q4 headline CPI f/c is weaker than Q3, but sees the annual rate rise to 2.0% from 1.3%. Lowering the qtrly rate are rents (f/c 1.1% v 1.2%), a 3.4% fall in petrol (-0.13ppt cont), pharmaceuticals (f/c -5.2%, PBS effect), & weakness in discretionary items (AV & PC, h/hld goods, clothing & footwear) from deeper pre-Xmas discounting than usual. Preventing a greater slowing are depo & loan facilities (f/c 3.0%), stronger house purchase costs (f/c 1.3% v 1.1% with FHOB cut \$7k), domestic holidays (airfares up) & a food rebound.
- Our avg RBA underlying CPI f/c is 0.7%qtr, 3.4%yr (vs 0.8%qtr, 3.5%yr prev), reduced by pre-Xmas sales, petrol & rents. The slowing is tempered by higher house purchase inflation & strong SAdj rises in areas that spiked in raw terms in Q3 & Q1 (property rates, utilities & education). Downside risk is limited to 0.6%qtr, requiring a surprise +0.4% or lower for D&L facilities.

## Inflation: sticky core CPI, higher annual h/l



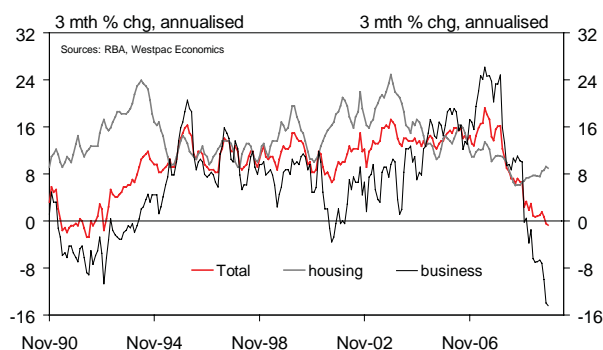
# Data previews

## Aus Dec private sector credit

Jan 29, Last: 0.1%, WBC f/c: 0.1%  
Mkt f/c: 0.1%, Range: 0.0% to 0.3%

- Credit growth was anaemic in 2009 as business responded to weaker profitability, looked to strengthen balance sheets and raised funds via the equity market. Annual total credit growth was just 0.8% in November, the weakest since post the 1990s recession. That's down from a peak of 16% through 2007.
- We expect credit to rise by just 0.1% in December, as weakness looks set to persist for a little while longer.
- Business credit (-1.0%*mth*, -8.2%*yr* in Nov) will contract further. With business investment to turn the corner in 2010, the rate of decline should moderate at some stage soon.
- Housing credit growth, which has stepped up from the lows of last 2008, was 0.7% in November. While strength in new lending points to a sharper acceleration, households with existing mortgages have paid down debt more quickly.

## Credit momentum

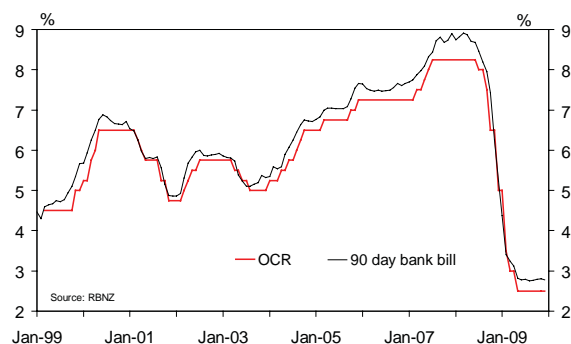


## NZ RBNZ OCR review

Jan 28, Last: 2.50%, WBC f/c: 2.50%, Mkt f/c: 2.50%

- The RBNZ will reiterate that they expect the tightening cycle to begin around the middle of this year.
- Recent economic data has been broadly in line with the RBNZ's December forecasts, although consumers are proving to be more responsive to a resurgent housing market than the RBNZ hoped.
- The timing of the first hike is less significant than the extent of tightening required in the next couple of years. The economy has clearly moved into a recovery phase and short-term interest rates are a long way from normal.

## NZ OCR and 90 day rate

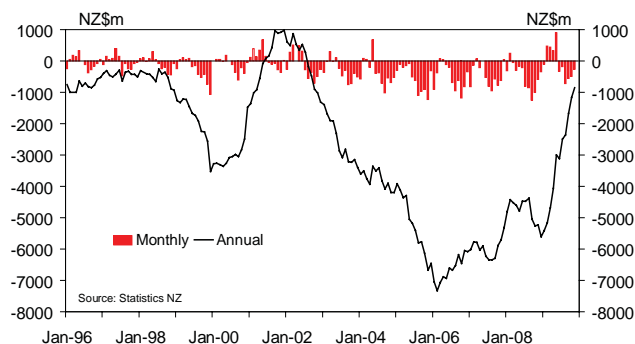


## NZ Dec merchandise trade NZDm

Jan 29, Last: -269, WBC f/c: -170

- The merchandise trade balance ran high for the whole of 2009. Although exports were weak, imports were much weaker. However, over the year imports have been growing more rapidly than exports, meaning the balance has been slipping back towards deficit.
- For December, a dip in car imports will interrupt the strong import theme for a month. Meanwhile, the huge rise in dairy prices over 2009 should finally be reflected in export receipts.
- The deficit we are forecasting is small – in fact, it is the smallest December deficit since 2001.

## NZ merchandise trade balance



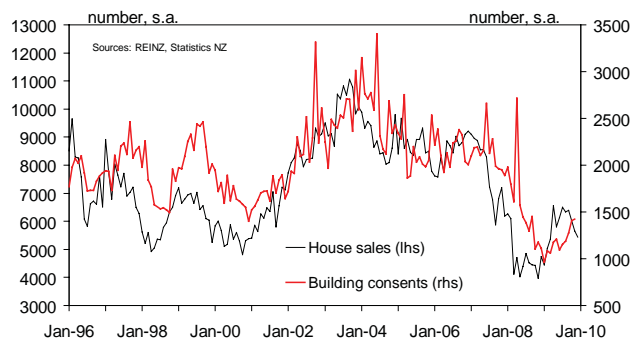
# Data previews

## NZ Dec building consents s.a.

Jan 29, Last: 1.2%, WBC f/c: 4.0%

- Dwelling consent issuance has picked up pace in recent months, reflecting an improving housing market and better credit conditions.
- We expect a 4% increase in dwelling consents this month, as ex-apartment consents maintain a solid upward trend. Apartment consents remain the wildcard. We have factored in 85 apartment consents in Dec (average over the past six months), but a lower/higher outturn risks a softer/stronger outcome.
- Non-residential consents continue to be weak, reflecting poor profitability and still ample spare capacity following the recession. We do not anticipate a sustained pick up in non-residential investment until mid-2010.

## NZ housing activity



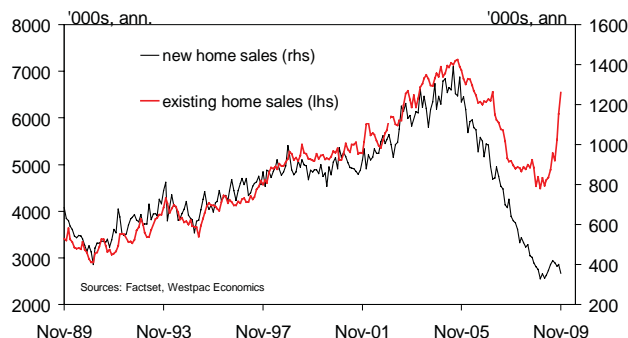
## US Dec existing & new home sales

Jan 25, Existing home sales: Last: 7.4%, WBC f/c: -10.0%

Jan 27, New home sales: Last: -11.3%, WBC f/c: 7.0%

- For nearly six months up until late Q3, US housing was showing signs of strengthening on all indicators: starts, permits, prices, homebuilder sentiment and of course sales of both existing and new dwellings. However over the past month or two, most sector indicators have lost momentum, including sentiment, new sales and starts, though permits remain solid.
- Existing home sales reflect transactions agreed months prior, but the 17% collapse in pending home sales in Nov warns of an imminent fall in existing home sales, 10 pts of which we expect to show up in Dec.
- New home sales tend to be volatile (and revisions can be severe), but given the scale of the weakness in recent starts and pending home sales figures, we suspect the Dec bounce won't fully recover the Nov loss, hence our 7% forecast rise.

## US housing sales

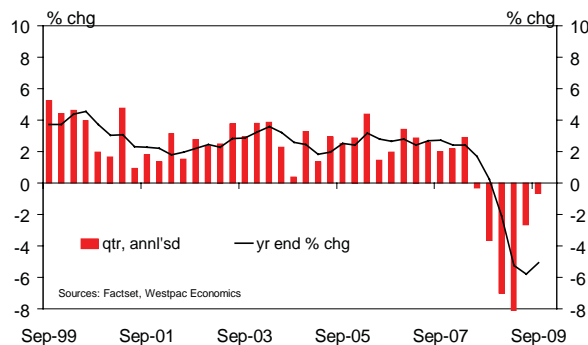


## UK Q4 GDP advance

Jan 26, Last: -0.2%, WBC f/c: 0.2%

- The jury is still out on whether the UK economy remained in recession in Q4 2009. Q3's GDP contraction was progressively revised from -0.4% to -0.3% to -0.2% in late 2009, somewhat undermining the prospect of a Q4 bounce, but Westpac is still cautiously forecasting a 0.2% rise in Q4 GDP.
- However spending to beat the restoration of the 17.5% VAT rate in early January will be part of that growth story, which could mean the economy stalls again in early 2010.
- Certainly, after elections which must be held by May, the incoming government will be under considerable pressure to tighten fiscal policy and that will weigh against the economy in the second half of 2010, offsetting any benefit from the weaker pound. The UK economy shrank almost 5% in 2009 and is forecast to grow less than half a per cent in 2010.

## UK GDP growth



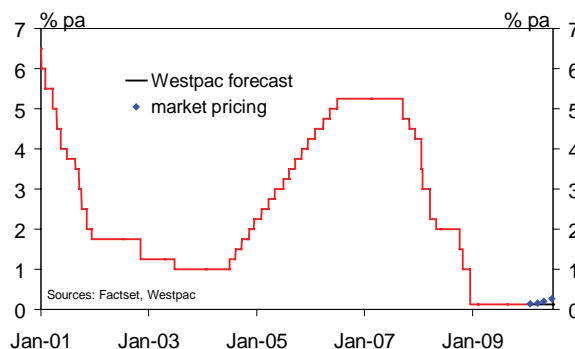
# Data previews

## US FOMC rate decision

Jan 27, Last: 0-0.25%, WBC f/c: 0-0.25%

- Rates were left on hold at 0-0.25% at the Dec 16 window and the committee assessed once again that "economic conditions... are likely to warrant exceptionally low levels of the federal funds rate for an extended period."
- Also in the statement there was a modestly upgraded economic assessment (previously business was "cutting back on staffing", now it is "reluctant" to hire) and renewed emphasis that with financial markets freeing up, the special measures to maintain liquidity will be gradually withdrawn from early 2010.
- Not too much has changed since the Dec meeting. Housing and jobs data have, if anything, been a bit softer, though expectations regarding Q4 GDP growth have firmed into the 4-5% annualised range (data due 2 days after the FOMC). We expect another on hold outcome and similar statement.

## Fed funds target rate

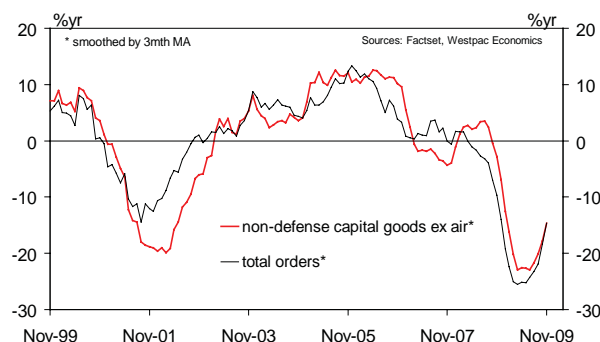


## US Dec durable goods orders to post a stronger gain.

Jan 28, Last: 0.2%, WBC f/c: 2.5%

- Durable goods orders have see-sawed of late, with the dips in June and August mostly due to volatility in the lumpy civilian aircraft component. However Oct's 0.6% fall was despite a 39% jump in aircraft orders, and reflected a fall in core capital goods orders and defence, whereas in Nov, those two categories bounced delivering a 0.2% orders rise despite a 33% fall in aircraft orders.
- Dec orders are forecast to post the first back to back gain since April-May. Dec ISM factory orders rose to a new cycle high above 65; Dec industrial production recorded gains in the key business equipment and machinery categories; and Boeing Dec data revealed a 500+% jump (59 orders vs just 9 in Nov).
- These factors point to decent 2.5% gain; the gains in defence and core capital goods in Nov might prevent a bigger bounce.

## US durable goods orders

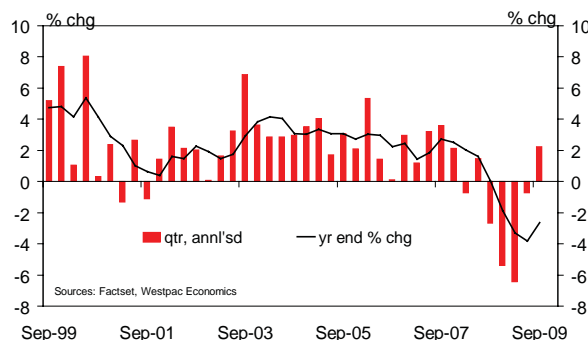


## US Q4 GDP advance

Jan 29, Last: 2.2% annualised, WBC f/c: 4.0% annualised

- The US economy bounced out of recession in Q3 although the advance 3.5% estimate has been revised back to 2.2%, within a whisker of Westpac's 2.3% forecast back in Oct. Consumer spending (much on autos) accounted for two thirds of growth, slower inventory rundown one third. Housing and govt gains were offset by declining business investment and net exports.
- We expect growth accelerated further to 4% annualised in Q4. By far the biggest contribution will come from inventories, which partial data suggest were not run down at all in the quarter, enough to explain the full 4 ppts of growth. Elsewhere, slower growth in consumer spending, housing and government will be offset by smaller drags from business and net exports.
- Q4's reliance on inventory building and the tail end of fiscal stimulus will rightly call into question the sustainability of growth later in 2010, when we expect renewed GDP declines.

## US GDP growth



# Key data & event risk for the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
<b>Mon 25</b>					
Aus	Q4 PPI %qtr	0.1%	0.1%	0.0%	Bounce in domestic core, higher construction, offset by weak M core.
NZ	Wellington Anniversary Day	-	-	-	Public holiday. Although markets remain open.
Ger	Feb GfK consumer confidence	3.3	3.2	-	Labelled Feb but surveyed early Jan.
US	Dec existing home sales	7.4%	-8.3%	-10.0%	Pending home sales collapse in Nov to show up here in Dec-Jan.
	Jan Dallas Fed factory index	3.8	-	6.0	Last survey to rise >0 so may not reflect recent NY/Richm'd jitters yet.
<b>Tue 26</b>					
Aus	Australia Day	-	-	-	Public holiday. Markets closed.
NZ	Dec credit card transactions	0.8%	-	-	Expect evidence of consumer recovery.
Jpn	Bank of Japan decision	0.1%	0.1%	0.1%	Volatile items improving CPI trends, but core deflation is entrenched.
Sing	Dec industrial production %yr	-8.2%	4.5%	-	Ex-biomedical output is yet to reclaim July 2008 peak level.
Myr	BNM policy decision	2.00%	2.00%	2.00%	Never renowned for hawkishness, now is hardly the time to start.
Eur	Nov current account €bn sa	-4.6	-	-	Back into deficit in Sep-Oct after brief return to surplus in Jul-Aug.
Ger	Jan Ifo business climate index	94.7	95.2	95.0	Slower pace of gain on recognition economy losing some momentum.
UK	Jan house prices %yr	5.9%	-	-	Tentative date (due 26-29/1) for Nationwide index.
	Q4 GDP advance	-0.2%	0.4%	0.2%	Q4 will confirm recession over though growth drivers temporary.
	Dec mortgage approvals	44.7	-	-	BBA data, so not comprehensive but includes 12 of 15 largest lenders.
US	Nov house prices %yr	-7.3%	-5.0%	-	S&P-Case Shiller index for 20 cities.
	Jan Conference Board consumer confidence	52.9	53.5	52.0	Confidence on this measure has stalled since May last year.
	Nov house prices	0.6%	-	-	Lesser watched FHFA series.
	Jan Richmond Fed factory index	-4	0	0	Turned negative in Dec after 7 months above 0.
<b>Wed 27</b>					
Aus	Nov Westpac-MI Leading Index	6.7%	-	-	All monthly components improved in November.
	Q4 headline CPI %qtr	1.0%	0.4%	0.4%	D&L up, house costs stronger, but petrol fell & deeper pre-Xmas discounting.
	Q4 avg RBA underlying CPI %qtr	0.8%	0.6%	0.7%	Qly slowing tempered by house costs & still strong SAdj utilities, education.
Ger	Jan CPI %yr	0.8%	0.9%	1.0%	Base effects add 0.5 ppts but Jan CPI to fall 0.3 %.
UK	Jan CBI distributive trades survey	-	-	-	Early guide to impact of VAT hike though survey may include late Dec.
US	Dec new home sales	-11.3%	4.2%	7.0%	Decent bounce but not enough to recover fully from Nov plunge in sales.
	FOMC rate decision	0-0.25%	0-0.25%	0-0.25%	Firmly on hold despite renewed eco growth. See text box.
<b>Thu 28</b>					
NZ	RBNZ OCR review	2.50%	2.50%	2.50%	On hold for now, but an extended tightening cycle is on the cards.
Jpn	Dec retail sales %yr	-1.0%	0.4%	-	Income levels are down on a year ago, dragging spending lower.
Eur	Jan business climate index	-1.22	-1.10	-	In contrast to some of the private sector surveys of confidence, and the recent hard activity data flow which points to slower economic
	Jan consumer confidence	-16	-15	-	growth in Q4, these surveys have continued to improve uninterrupted.
	Jan economic confidence	91.3	92.5	-	Short-working scheme and statistical issues driving apparent falls.
Ger	Jan unemployment chg	-3k	18k	-	Index based on 80 previously published activity indicators.
US	Dec Chicago Fed national activity index	-0.32	-	-0.50	Boeing orders up nearly 800! ISM factory orders index very strong.
	Dec durable goods orders	0.2%	2.0%	2.5%	Latest jump due to catch-up from weather, holiday-delayed claims.
	Initial jobless claims w/e 23/1	482k	452k	450k	
<b>Fri 29</b>					
Aus	Dec private credit	0.1%	0.1%	0.1%	Anaemic (up just 0.8%yr in Nov) as business credit contracts (-8%yr).
NZ	Dec merchandise trade NZDm	-269	-	-170	Smallest December deficit since 2001.
	Dec building consents s.a.	1.2%	3.8%	4.0%	Upward trend becoming more entrenched.
Jpn	Dec unemployment rate	5.2%	5.3%	-	Participation down, retirees outnumber new entrants.
	Dec nationwide CPI %yr	-1.9%	-1.6%	-	Headline will improve on volatile items, core deflation to be sticky.
	Dec industrial production	2.2%	2.5%	-	What lies beyond fiscal stimulus and inventory adjustment?
	Dec household spending %yr	2.2%	1.6%	-	Real measure. Some evidence of consumption smoothing via savings.
	Jan Nomura PMI	53.8	-	-	Will be the first to indicate inventory rebalancing is over.
Inr	RBI policy decision (repo)	4.75%	4.75%	4.75%	Many tools at disposal. Will be one of the first Asian CBs to move.
Eur	Dec money supply M3 %yr	-0.2%	-0.6%	-	Nov saw first ever annual contraction in M3 growth.
	Dec unemployment rate %	10.0%	10.1%	10.0%	European and US jobless rates are both exactly on 10%!
	Jan CPI flash %yr	0.9%	1.2%	1.3%	Base effects will add 0.8 ppts but CPI usually falls in Jan.
UK	Jan GfK consumer confidence	-19	-	-	Confidence partially unwound recent gains in Nov-Dec.
US	Q4 GDP % annualised	2.2%	4.5%	4.0%	Big cont'n from inventories but consumer/housing spending slower.
	Q4 employment cost index	0.4%	0.4%	0.4%	Weak job market keeping downward pressure on employment costs.
	Jan Chicago PMI	58.7	57.0	55.0	NY/Richmond surveys suggest some downside risk.
	Jan Milwaukee NAPM	52.0	-	-	One of the lesser watched PMIs.
	Fedspeak	-	-	-	Fed vice-chair Kohn on interest rate exposure.
Can	Dec industrial product prices	1.0%	-	-	Nov gain reversed declines in Sep-Oct.
	Nov GDP	0.2%	0.3%	-	Sep-Oct saw first back to back gains since late 2007.

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# Economic & financial forecasts

## Interest rate forecasts

	Latest (Jan 22)	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11
Cash	3.75	4.00	4.50	4.50	4.50	4.75
90 Day Bill	4.25	4.30	4.70	4.60	4.75	5.00
3 Year Swap	5.34	6.40	6.50	6.25	6.50	6.75
10 Year Bond	5.43	5.70	6.20	6.50	6.50	6.50
10 Year Spread to US (bps)	184	250	245	225	200	150

## International

Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.58	3.20	3.75	4.25	4.50	5.00
ECB Repo Rate	1.00	1.00	1.00	1.00	1.25	2.00

## New Zealand

Cash	2.50	2.50	3.00	3.50	4.00	4.50
90 day bill	2.78	2.90	3.40	4.00	4.50	5.00
2 year swap	4.43	5.10	5.40	5.70	5.90	6.10
10 Year Bond	5.64	6.10	6.20	6.30	6.30	6.40
10 Year spread to US	206	290	245	205	180	140

## Exchange rate forecasts

	Latest (Jan 22)	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11
AUD/USD	0.9024	0.96	0.90	0.93	0.95	0.93
NZD/USD	0.7126	0.77	0.73	0.76	0.78	0.77
USD/JPY	89.99	88	93	96	100	106
EUR/USD	1.4118	1.51	1.47	1.50	1.51	1.47
AUD/NZD	1.2664	1.25	1.23	1.22	1.22	1.21

## Australian economic growth forecasts

% change	2009			2010				Calendar years			
	Q2	Q3	Q4f	Q1f	Q2f	Q3f	Q4f	2008	2009f	2010f	2011f
GDP	0.6	0.2	0.7	1.0	0.8	0.9	0.6	2.2	1.0	3.0	3.2
ann chg	0.4	0.5	2.1	2.6	2.8	3.5	3.4	-	-	-	-
Unemployment rate	5.7	5.8	5.7	5.5	5.4	5.5	5.5	4.3	5.6	5.5	5.3
CPI headline	0.5	1.0	0.4	0.4	0.5	0.8	0.5	-	-	-	-
ann chg	1.5	1.3	2.0	2.3	2.3	2.1	2.2	3.7	2.0	2.2	2.7
CPI underlying	0.8	0.8	0.7	0.6	0.6	0.7	0.6	-	-	-	-
ann chg	3.9	3.5	3.4	2.9	2.7	2.6	2.5	4.3	3.4	2.5	3.0

## New Zealand economic growth forecasts

	2009			2010				Calendar years			
	Q1	Q2	Q3	Q4e	Q1f	Q2f	Q3f	2008	2009e	2010f	2011f
GDP % qtr	-0.8	0.2	0.2	1.1	1.0	1.2	1.0	-	-	-	-
Annual avg change	-1.4	-2.1	-2.2	-1.4	-0.1	1.3	2.7	-0.1	-1.4	3.7	4.3
Unemployment rate %	5.0	6.0	6.5	6.7	6.7	6.7	6.5	4.7	6.7	6.1	5.3
CPI % qtr	0.3	0.6	1.3	-0.2	0.6	0.6	0.9	-	-	-	-
Annual change	3.0	1.9	1.7	2.0	2.3	2.4	2.0	3.4	2.0	2.7	2.9

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