

Weekly Commentary

29 April 2013

Still on the fence

The Reserve Bank is sitting on the fence. It reiterated as much in last week's Official Cash Rate review. Concerns are rising on both sides - the high exchange rate is pushing inflation ever lower. Meanwhile, the Canterbury rebuild and rising house prices are showing greater potential to stoke inflationary pressures. But these are pressures the RBNZ can deal with later. With that in mind, we have pushed out our call on the first interest rate hike to March 2014.

The RBNZ issued a very neutral Official Cash Rate review last week. The bottom line was a repeat from March:

"At this point we expect to keep the OCR unchanged through the end of the year."

This was very much as we expected. The RBNZ is currently caught between two opposing forces. Local growth has picked up considerably, driven by the post-earthquake Canterbury rebuild and rising house prices. However, inflation is below the RBNZ's target and could go lower from here, due to the inflation-suppressing effects of the high currency.

The RBNZ can't hike the OCR early for fear of exacerbating the high currency and pushing inflation even further below target in the short run; equally, it can't reduce the OCR or keep it unchanged forever, for fear of stoking the overvalued housing market and creating runaway inflation in the longer term. So the RBNZ has sensibly opted to continue sitting on the fence.

Eventually, one or the other of the opposing forces will win out, forcing the RBNZ to climb down from its current position on the fence. Our money is on rebuild- and housing-induced domestic inflation eventually proving the more pertinent long-run influence.

Over the course of New Zealand's history, construction booms have generated inflation pressures and rising house prices have provoked consumer spending. We believe that these themes will be repeated in the upcoming cycle – and we don't believe the RBNZ has taken sufficient account of that.

But the evolution from construction boom and rising house prices to widespread inflation pressures will be slow. For now, inflation is below the RBNZ's target. And the latest rise in the exchange rate, combined with falling petrol prices, could cause inflation to drop even further in the short run.

We agree with the RBNZ's assessment that inflation will remain close to 1% for the whole of this year. And therefore we agree that the best course of action this year is to keep the OCR on hold while waiting and seeing what happens to domestic inflation.

Westpac's OCR forecast

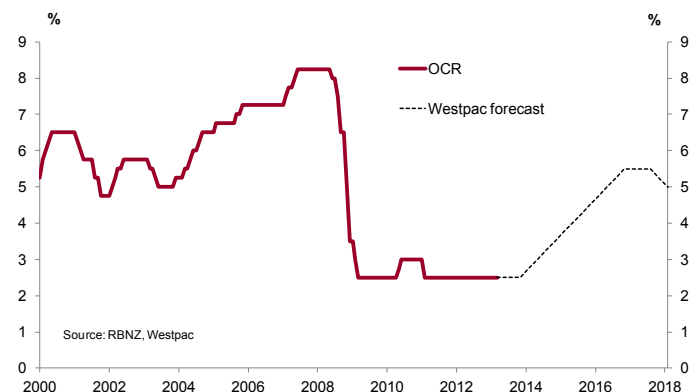
As the RBNZ has time on its side, we now expect the OCR will remain on hold at 2.5% until March 2014 (previously we were forecasting a hike in December 2013). This change in call is a consequence of persistently low near-term inflation, and brings us broadly into line with financial market pricing. While modest by historical standards, we expect this hiking cycle will be far greater in extent than financial markets are currently prepared for.

The conundrum isn't getting any easier

Net immigration data from last week surprised us, coming in at the highest level since January 2010. The numbers were boosted by a pickup in foreign migrants, while departures by New Zealanders to Australia fell to the lowest since early 2011.

An improving trend in Trans-Tasman migration is now clearly underway, in line with our view that labour market prospects in New Zealand are becoming more attractive relative to Australia – particularly as labour shortages associated with the Canterbury rebuild become more apparent.

Official Cash Rate





Along with low interest rates, accelerating net immigration is another reason to expect house prices to rise.

On Tuesday this week a triple-dose of data will be issued. We expect a continuation of the theme of strong growth versus low inflation.

First, building consents data is expected to continue the recent strong trend with a further 2% lift in the total number of dwellings consented. The domestic economy's buoyancy has been led by the burgeoning construction sector. Originally this was associated with the Canterbury region's post-quake recovery, but there are now increasing signs that construction activity is on the rise in Auckland too.

Later in the day the ANZ Business Outlook (ANZBO) survey will provide an early assessment of how the summer drought has affected business confidence and domestic economic activity. It would be reasonable to anticipate a drop in confidence among firms in drought-affected regions, while confidence among firms in other regions marches on strong. However, this particular survey may not be robust enough to detect such subtleties, so we won't be taking the results too seriously.

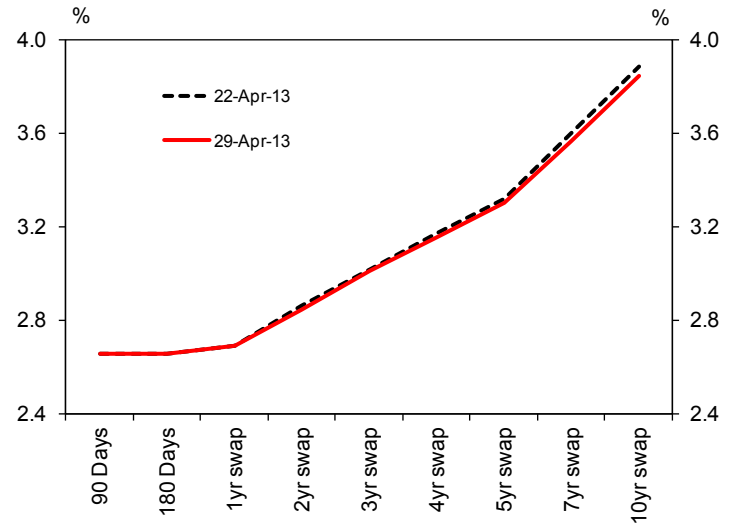
One theme that we do expect the ANZBO to reiterate is low inflation – intentions to raise prices and inflation expectations are sure to remain subdued.

Finally, late in the afternoon we get another instalment of the Reserve Bank's credit growth aggregates. Consumer credit has been expanding steadily alongside the buoyant housing market, and there is no reason to expect a perturbation to that trend.

Business credit growth has been low for most of the past year, reflecting subdued business investment. Last month business credit growth did pop higher – this month's data will help determine whether that was the start of a new trend (we doubt it).

Fixed vs floating for mortgages: At current mortgage rates we regard fixing as being 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. So staying on floating would only be the better option if the RBNZ actually cut the OCR – which we regard as unlikely.

NZ interest rates



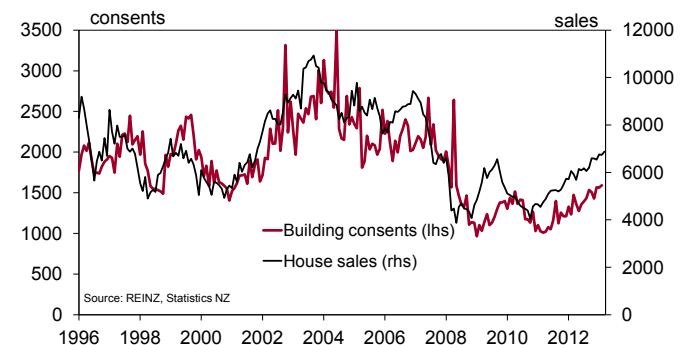
Key Data Previews

NZ Mar building consents

Apr 30, Last: 1.9%, WBC f/c: 2.0%

- The February consents data indicated that the building industry is still on track for substantial growth over the next year. Ex-apartment consents fell just 3.6% in February after a 9.5% jump in January.
- We have assumed 2% growth in total consents for March, a continuation of the recent trend rate of growth. Apartment consents were around average in February, so we have no expectation that they will skew the total one way or another.
- Growth in consents should continue to be led by Auckland and Canterbury, the regions where housing shortages are most apparent. The detailed consents data suggests that attention is shifting away from the outer regions of Canterbury and towards Christchurch proper, where there is much more work to come.

NZ Housing Activity



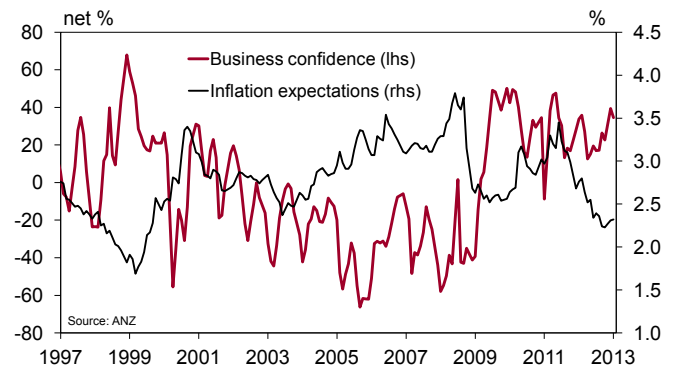


NZ Apr business confidence

Apr 30, Last: 34.6

- General business confidence dipped in March but remained at high levels. The largest decline was not surprisingly in the agricultural sector, as drought conditions spread over the country during the month.
- We suspect that the drought and its knock-on effects will be a further negative for the April survey. While the rains have returned recently, the timing of the survey (most responses are received in the first half of the month) suggests that we won't see a relief rally just yet.
- Drought aside, the high-frequency data were just as positive in March as they were in the previous six months. Nevertheless, we will be watching indicators such as business confidence to gauge the flow-on effects from the drought into other sectors.

NZ Business Confidence and Inflation Expectations



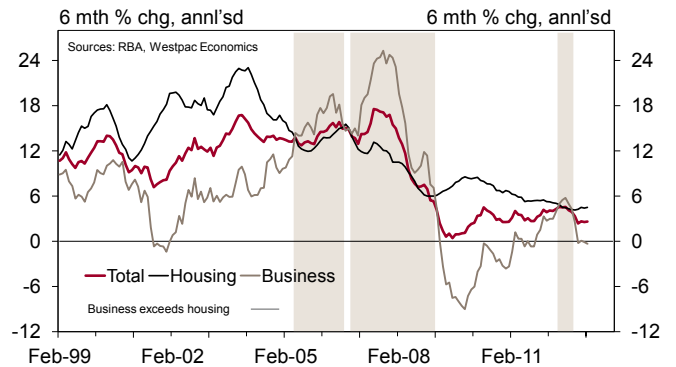
Aus Mar private credit

Apr 30, Last: 0.2%, WBC f/c: 0.2%

Mkt f/c: 0.3%, Range: 0.2% to 0.3%

- Credit growth lost momentum during the second half of 2012. Subdued growth has extended into early 2013.
- We expect credit to rise by 0.2% in March, a repeat of the January and February outcomes and matching the average monthly pace over the second half of 2012.
- Housing credit growth is soft, at 0.4%, 4.4%yr in February. Low interest rates will provide a boost to new lending in 2013. However, against this, existing mortgage holders are taking advantage of low rates to get ahead on repayments.
- Business credit, which is volatile month to month, stalled in mid 2012. A lack of confidence and mixed fundamentals, point to softness extending over the near-term.

Credit Momentum



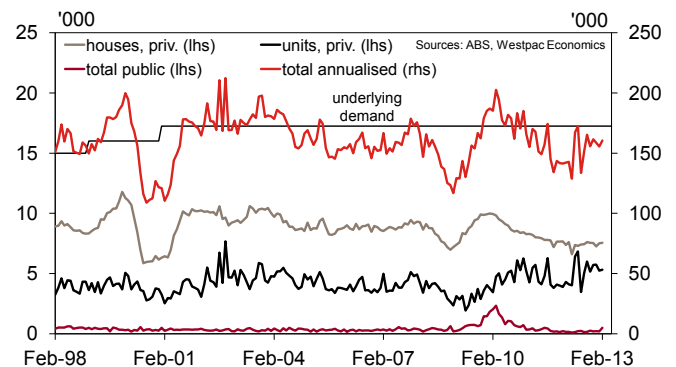
Aus Mar dwelling approvals

May 2, Last: 3.1%, WBC f/c: 1.5%

Mkt f/c: 1.5%, Range: -1.3% to 4.0%

- Dwelling approvals rose 3.1% in Feb after a 2% dip in Jan. Despite the gain, the detail remains mixed and underwhelming. A recovery is underway in most states, but does not look particularly strong and may or may have lost momentum in recent months depending on which way the data is interpreted.
- Finance approvals for the construction or purchase of newly built dwellings also suggest some flattening out in the uptrend since late last year. Against this, dwelling approvals have lagged this indicator a little in the upturn so far and housing markets more generally showed a notable quickening in early 2013 with both prices and auction activity improving. Sentiment also remains supportive. Overall we expect a further modest 1.5% gain in approvals in Mar.

Dwelling Approvals





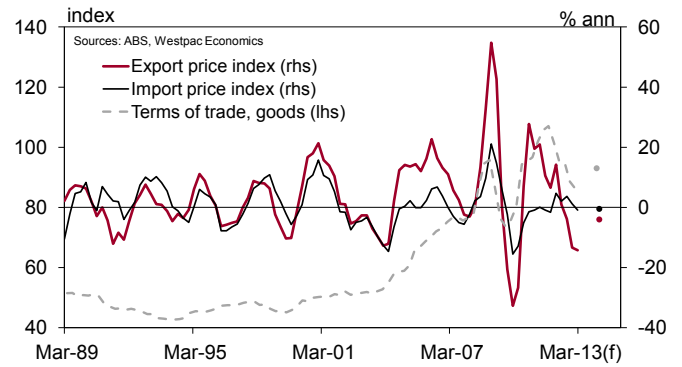
Aus Q1 import price index

May 2, Last: 0.3%, WBC f/c: -0.8%

Mkt f/c: -0.5%, Range: -1.5% to 2.0%

- The Import Price Index is expected to edge lower in the March quarter, down a forecast 0.8%, to be unchanged on a year earlier.
- The Australian dollar strengthened in the quarter on a TWI basis, appreciating 1.7%. This acted to lower the cost of imports. Although, against the US dollar, the currency was unchanged.
- A modest increase in global oil prices (+2%) acted to increase the cost of fuel imports.
- Note, the import price index covers goods but excludes services.

Import and Export Prices



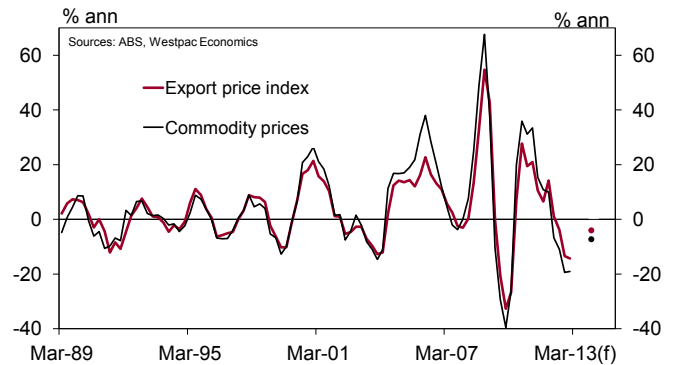
Aus Q1 export price index

May 2, Last: -2.4%, WBC f/c: 4.2%

Mkt f/c: 4.0%, Range: -2.0% to 7.0%

- The Export Price Index is expected to rise in the March quarter, increasing by a forecast 4.2%.
- This follows falls in four of the previous five quarters, with a cumulative decline over this period of 15%.
- Global commodity prices of Australian exports increased by about 6% in the quarter, a partial recovery from a 24% slump over the previous five quarters.
- Note, the export price index covers goods only.

Commodity Prices & Export Price Index

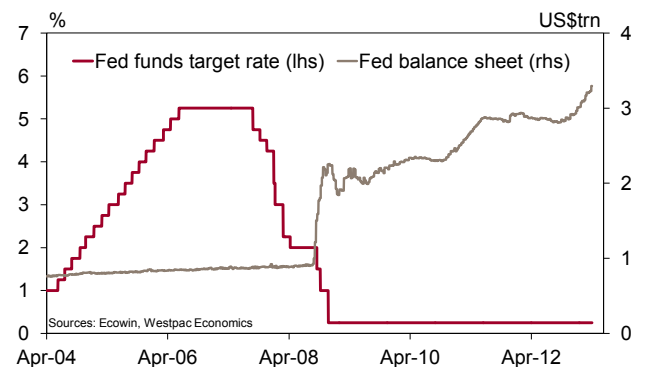


US FOMC policy decision

May 1

- At the March meeting, the FOMC maintained the pace of asset purchases at \$85bn per month. The Committee saw recent data as suggesting “a return to moderate economic growth following a pause late last year”. The labour market was seen as having shown signs of improvement; however, the unemployment rate remained elevated. Household spending and business fixed investment advanced, but fiscal policy had become somewhat more restrictive.
- Since the last meeting, the tone of US data has softened. This is particularly true of the all-important labour market data, with a further decline in the participation rate masking a deterioration in jobs growth. With the US economy still struggling to maintain momentum, and the impact of fiscal tightening to remain ever present, we expect Fed asset purchases to continue past the end of 2013.

Fed Funds Target Rate and Balance Sheet





US Apr ISM surveys

May 1, Manuf Last: 51.3, WBC f/c: 51.0

May 3, Non-manuf Last: 54.4, WBC f/c: 54.0

- The manufacturing ISM fell 2.9 pts to 51.3 in Mar. Production fell from 57.6 to 52.2 and new orders declined from 57.8 to 51.4. Backlog In contrast, employment edged higher, from 52.6 to 54.2. The regional Fed surveys to hand have been weak: orders, shipments and jobs all showing slower growth in Richmond and two of the three weaker in NY/Philly. The seasonal factors impart an upward bias in Q4-Q1 so we now expect a run of offsetting weaker outcomes through mid-year.
- The ISM non-manufacturing slipped from 56.0 to 54.4 in March, mirroring the loss of altitude seen in 2011 and 2012 as early year spikes in the index soon gave way to more subdued outcomes. This is distorted seasonal adjustment factors at play rather than underlying swings in economic activity. Expect further weaker outcomes in coming months, above 50 though.

US ISMs



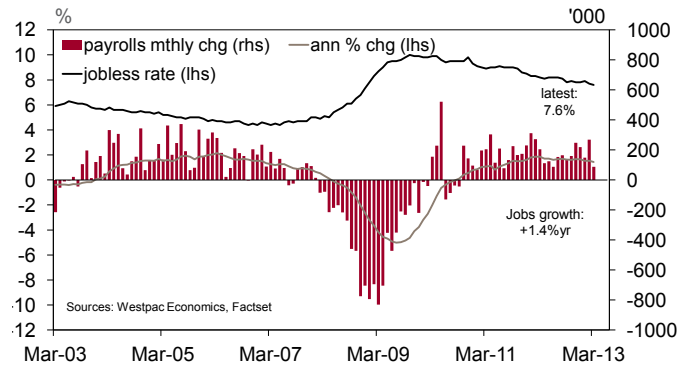
US non-farm payrolls

May 3, Payrolls ch Last: 88k, WBC f/c: 120k

May 3, Unemployment rate Last: 7.6%, WBC f/c: 7.7%

- The labour market is not as weak as it appeared in March; it was not as strong as it looked in Feb when jobs reportedly rose 248k. The seasonality distortion that seems to be impacting the ISM surveys (both of which weakened in March) also seems to be at play in the payrolls data too. Employment grew at 0.9% yr, on both the household and payroll survey measures in Mar. Neither is impressive given the degree of policy accommodation that the Fed has had in place for some years. The jobless rate decline is mostly due to declining participation in the labour market.
- March's weak payrolls gain occurred earlier than we expected (by a month) but is likely to be followed by similarly weak reports in Q2. The jobless rate might correct higher in April if the labour force partially reverses its steep declines in Feb-Mar.

US Payrolls

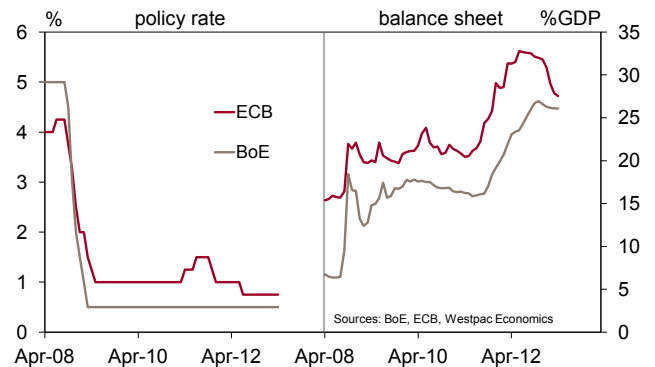


ECB policy decision

May 2, ECB Last: 0.75%, WBC f/c: 0.75%

- At the April meeting, the ECB left the stance of policy unchanged as expected. However, there were clear signs ECB chief Draghi was cognisant of crystallising risks across much of Europe. He emphasised downside risks to the outlook from the outset in his introductory statement, and also said the Council was "monitoring closely" the situation. Policy settings were appropriate "for the time being", but a rate cut was discussed extensively.
- We assess Draghi is signalling an upcoming (but not immediate) policy announcement. Further, fragmentation has clearly impaired the transmission of monetary policy and tightened credit, so further action may not be limited to a rate cut. All of the above was clearly on the Council's radar last month, and will be again this month. We'll look to the Q&A for further guidance on the likely timing of the ECB's next step.

ECB & BoE





Key Data and Events

		Last	Market median	Westpac forecast	Risk/Comment
Mon 29					
Eur	Apr business climate indicator	-0.86	-	-1.20	Business outlook surveys have had a weaker bias so far in April ...
	Apr economic confidence	90.0	-	89.0	... although consumer confidence is well off its lows.
Ger	Apr CPI prelim %yr	1.4%	-	-	Mar CPI lowest since late 2010.
UK	Apr house prices %yr	0.0%	-	-	Hometrack index. Nationwide index also due 29/4-3/5 (last 0.8%yr).
US	Mar core PCE deflator	0.1%	0.1%	0.2%	Core CPI was 0.1% in Mar
	Mar personal income	1.1%	0.4%	0.3%	Quarterly totals will be known from GDP release on 29/4. Earnings ...
	Mar personal spending	0.7%	0.1%	0.1%	... were flat in Mar, retail sales weak.
	Mar pending home sales	-0.4%	1.6%	0.0%	Sales constrained by lack of quality homes for sale.
Tue 30					
NZ	Mar building consents	1.9%	2.0%	2.0%	Trending higher, led by Canterbury and Auckland.
	Apr ANZ business confidence	3.64%	-	-	Watch for risk of drought impact extending to other sectors.
	Mar private sector credit %yr	3.8%	-	-	Housing lending growing steadily in line with rising housing market.
Aus	Mar private sector credit	0.2%	0.3%	0.2%	Subdued. Housing soft ahead of rate cut boost. Business flat.
Jpn	Apr Markit/JMMA manufacturing PMI	50.4	-	-	Enjoying its first run of multiple outcomes above 50 in a year.
	Mar industrial production %mth	0.6%	-	-	Cars and auto parts up 17% over three months. Time for a breather?
Eur	Apr CPI flash %yr	1.7%	-	1.6%	Inflation is slipping further away from "close to but below 2%".
	Mar unemployment rate %	12.0%	-	12.1%	Steady German jobless rate no longer offsets rises elsewhere.
Ger	Apr unemployment ch	13k	-	-	German joblessness risen in 11 of last 12 months.
	May GfK consumer confidence	5.9	-	-	Surveyed early Apr but labelled May
UK	Mar net mortgage lending £bn	0.9	-	-	BoE/Treasury FLS credited with modest rise in household loan ...
	Mar net consumer credit £bn	0.6	-	-	... outstandings, though demand for credit remains weak.
	Mar M4 money supply %yr	0.5%	-	-	M4 ex IOFCs up 3.1% yr in Feb (from 7.9% yr in Aug).
US	Q1 employment cost index	0.5%	0.5%	0.5%	Cost remain subdued with job market still weak.
	Apr Chicago PMI	52.4	53.0	52.0	Way down on 60 a yr ago and 65 two yrs ago.
	Feb house prices %yr	8.1%	9.0%	-	S&P Case Shiller 20 city index.
	Apr Conf. Board consumer confidence	59.7	60.3	61.0	Weekly data suggest confidence firmed later in April.
Can	Feb GDP	0.2%	-	-	Jan rise reversed Dec fall.
Wed 1					
Aus	Apr AiG PMI	44.4	-	-	Manufacturing index -1.2pts in Mar. Sub 50 in 27 of past 31 months
	Apr RP Data-Rismark home price index	1.3%	-	-0.4%	Daily measure shows softer month, mostly a seasonal variation (+2.6%yr).
	RBA Assist Gov Edey speaking	-	-	-	Thomson Reuters Regulatory Summit, Sydney, 1.25 pm AEST.
Chn	Apr NBS manufacturing PMI	50.9	51.1	-	Weak flash reading from private survey preaches caution.
UK	Apr manufacturing PMI	48.3	-	48.3	If European surveys are a guide, expect little change in Mar
	BoE Governor in waiting Carney	-	-	-	Speaking in Canada.
US	Apr ADP private payrolls	158k	160k	140k	140k would be consistent with out 120k payrolls forecast.
	Apr manufacturing ISM	51.3	51.1	51.0	Softer regional survey detail so far for April.
	Mar construction spending	1.2%	0.6%	0.4%	Housing spending momentum may be softening in early 2013.
	FOMC policy decision	0.25%	-	0.25%	Softer data tone unlikely to see any nuanced shift in language.
	Apr auto sales mn annualised	15.2	15.3	-	Guide to extent of consumer spending momentum in early Q2.
Thu 2					
Aus	Mar dwelling approvals	3.1%	1.5%	1.5%	Trend recovery tracking at +12%yr but flattened out a little since Oct?
	Q1 import price index	0.3%	-0.5%	-0.8%	Currency up 1.7% on a TWI basis, but flat against USD & oil prices rose.
	Q1 export price index	-2.4%	4.0%	4.2%	Up on a partial rebound in global commodity prices.
Chn	Apr HSBC manufacturing PMI - final	51.6	50.7	-	Tentative date: Weak flash estimate caught most on the hop.
Eur	Apr PMI factory final	46.5 a	-	46.4	Sub 50 since Aug 2011. Note France/Germany differential.
	ECB policy decision	0.75%	0.75%	0.75%	Draghi could signal June rate cut and we do not rule out a May move.
UK	Apr PMI construction	47.2	-	47.0	Sector in doldrums since middle of 2012.
US	Initial jobless claims w/e Apr 26	-	-	-	Claims trending lower but latest week not yet available
	Mar trade balance \$bn	-43.0	-41.9	-44.0	In Feb imports were flat, and exports rose 0.8%.
	Q1 productivity % ann	-1.9%	1.8%	1.3%	Forecasts prepared ahead of Q1 GDP release.
Fri 3					
Aus	Q1 PPI	0.2%	-	-	Now released post-CPI and thus of more limited interest.
Chn	Apr NBS services PMI	55.6	-	-	Quarterly PBoC survey looks similar: growth, albeit modest.
Eur	Mar PPI %yr	1.3%	-	1.6%	German PPI dropped from 1.2% yr to 0.4% in Mar
	EU Spring economic forecasts	1.4%	-	-	2014 GDP. Westpac expects ongoing Eurozone recession at -0.5%.
UK	Apr PMI services	52.4	-	51.0	Dec saw weakest reading since 2009 recession, back above 50 in Q1
US	Apr non-farm payrolls ch'	88k	155k	120k	Seasonals artificially boosted payrolls in Q4-Q1 but offsetting
	Apr jobless rate	7.6%	7.6%	7.7%	mid-year jobs slowdown now underway. See text box.
	Mar factory goods orders	3.0%	-1.0%	-4.5%	Durables due 24/4 will provide early clue.
	Apr ISM non-manufacturing	54.4	54.5	54.0	New year seasonal upswing as in 2010, 2011, 2012 unwinding.
	Fedspeak	-	-	-	Lacker.

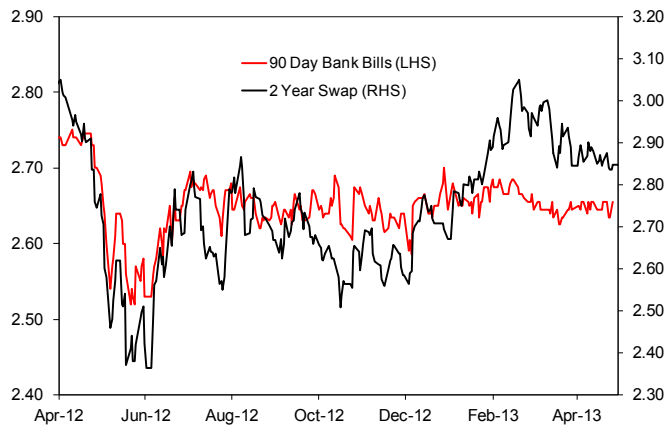


New Zealand Economic and Financial Forecasts

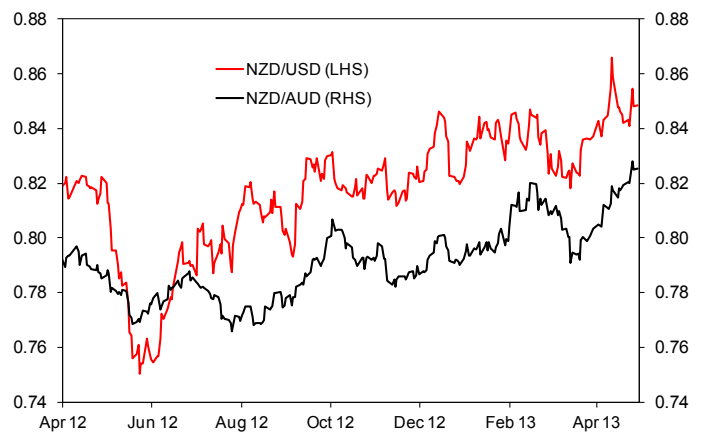
Economic Growth Forecasts	March years				Calendar years			
	2012	2013f	2014f	2015f	2011	2012	2013f	2014f
% change								
GDP (Production) ann avg	1.9	2.5	3.0	3.4	1.4	2.5	3.0	3.2
Employment	1.0	0.0	2.6	2.5	1.5	-1.4	3.7	2.6
Unemployment Rate % s.a.	6.7	7.0	6.1	5.1	6.4	6.9	6.3	5.3
CPI	1.6	0.9	1.4	2.5	1.8	0.9	1.3	2.3
Current Account Balance % of GDP	-4.4	-4.9	-5.0	-6.0	-4.0	-5.0	-4.8	-5.8

Financial Forecasts	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14
Cash	2.50	2.50	2.50	2.75	3.00	3.25
90 Day bill	2.65	2.70	2.75	3.00	3.25	3.50
2 Year Swap	2.90	3.00	3.10	3.30	3.50	3.70
5 Year Swap	3.40	3.45	3.50	3.60	3.70	3.85
10 Year Bond	3.40	3.40	3.45	3.50	3.55	3.60
NZD/USD	0.85	0.85	0.85	0.84	0.83	0.82
NZD/AUD	0.82	0.83	0.84	0.85	0.86	0.85
NZD/JPY	81.6	80.8	79.1	77.3	74.7	72.2
NZD/EUR	0.65	0.66	0.68	0.69	0.70	0.70
NZD/GBP	0.56	0.56	0.56	0.56	0.56	0.54
TWI	78.1	78.5	79.1	79.0	78.7	77.9

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 15 April 2013

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.64%	2.64%	2.64%
60 Days	2.64%	2.65%	2.65%
90 Days	2.66%	2.66%	2.66%
2 Year Swap	2.85%	2.86%	2.86%
5 Year Swap	3.30%	3.32%	3.38%

NZ foreign currency mid-rates as at Monday 15 April 2013

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.8482	0.8579	0.8369
NZD/EUR	0.6500	0.6546	0.6517
NZD/GBP	0.5473	0.5590	0.5496
NZD/JPY	83.09	84.52	78.10
NZD/AUD	0.8251	0.8162	0.8030
TWI	78.23	78.73	76.79



Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2009	2010	2011	2012	2013f	2014f
Australia						
Real GDP % yr	1.4	2.5	2.4	3.6	2.5	2.3
CPI inflation % annual	2.1	2.8	3.0	2.2	2.5	2.8
Unemployment %	5.6	5.2	5.2	5.3	5.9	5.8
Current Account % GDP	-4.2	-2.9	-2.3	-3.7	-2.8	-3.6
United States						
Real GDP %yr	-3.1	2.4	1.8	2.2	1.7	1.6
Consumer Prices %yr	-0.3	1.6	3.1	2.1	2.0	2.0
Unemployment Rate %	9.3	9.6	8.9	8.1	7.7	7.7
Current Account %GDP	-2.7	-3.0	-3.1	-3.1	-2.9	-2.9
Japan						
Real GDP %yr	-5.7	4.9	-0.4	1.9	1.3	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	-0.5	-0.5
Consumer Prices %yr	0.3	1.7	2.7	2.2	1.4	1.2
Unemployment Rate %	9.5	10.0	10.1	11.7	12.4	13.0
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	0.3	0.7	0.2
Consumer Prices %yr	2.2	3.2	4.0	2.7	2.3	1.8
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	-2.5	-1.5

Forecasts finalised 8 April 2013

Interest Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
Australia						
Cash	3.00	2.75	2.75	2.75	2.75	2.75
90 Day Bill	2.95	3.00	3.10	3.10	3.00	3.00
10 Year Bond	3.15	3.50	3.50	3.30	3.20	3.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	1.71	2.00	2.20	2.10	2.00	1.80
ECB Repo Rate	0.75	0.75	0.75	0.50	0.50	0.50

Exchange Rate Forecasts	Latest	Jun 13	Sep 13	Dec 13	Mar 14	Jun 14
AUD/USD	102.41	1.04	1.03	1.01	0.99	0.97
USD/JPY	99.66	96	95	93	92	90
EUR/USD	1.2999	1.30	1.28	1.25	1.22	1.19
AUD/NZD	1.2125	1.22	1.21	1.19	1.18	1.17

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