Business Weekly

Underlying weakness

This Week

This week we get a few chunky pieces of NZ data: Q1 GDP and current account and Q2 consumer confidence. Of the three it is Friday's GDP release that will hog the limelight.

We expect a 0.5% fall in quarterly GDP, a relatively mild fall compared to some forecasts. A fall of that magnitude would in one way be an improvement on the previous quarter's 0.9% decline (i.e. a slower pace of decline). However, in our view, the underlying momentum in GDP is weaker than a 0.5% fall implies, with some one-offs providing some temporary relief. In particular, the strength in agricultural production and related processing (mostly driven by a recovery in dairy) masks the underlying weakness in manufacturing production. In addition, the construction sector has maintained its level of activity despite a fall in consent issuance. The full extent of weakness in these two sectors will become apparent in Q2 if, as we suspect, these sectors held up in the first quarter.

Given the backdrop of the global financial crisis and the sudden shock to demand, NZ continues to fare comparatively well from an international perspective. The three economic regions directly implicated in the credit crunch, the US, UK and the Eurozone, have all experienced sharper declines in GDP over Q4 2008 and Q1 2009. Asian exporters have also been more adversely affected, exposed to the sharp drop in demand for durable manufactured goods. Japan's economic output contracted 3.8% in both Q1 and Q2, while Hong Kong and South Korea have also experienced extremely large and sudden declines.

Thursday's current account deficit will get some attention, though the immediate threat of a credit rating downgrade has diminished since May's Budget. The annual deficit should narrow to around 8.4% of GDP from 8.9%, helped by a lift in dairy exports and slumping import demand. The narrowing of the current account deficit will lose some momentum in the second half of the year. The spurt in dairy export volumes won't be sustained, wider export activity will remain subdued, and import contraction will also taper off.

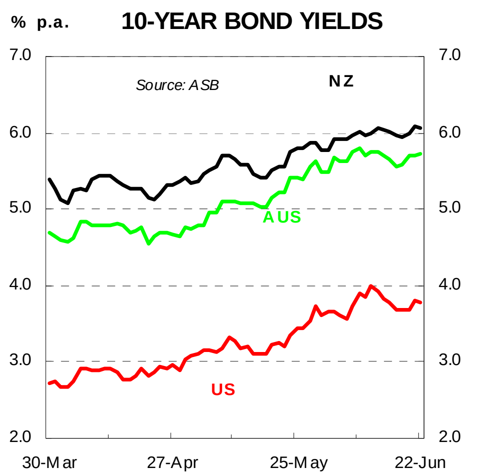
The Westpac McDermott Miller consumer confidence survey, out Wednesday, is likely to show some improvement in sentiment, though still show lingering caution amongst consumers. A relatively subdued lift in sentiment will be consistent with expectations that consumer spending growth will be muted this year.

In the US the Federal Reserve will make its next policy announcement Thursday morning NZ time. We expect no change to the Fed Funds target nor additional asset purchase plans, but the tone of the statement will indicate the extent to which the Fed sees green shoots sprouting.

Click here for:

Foreign Exchange	• NZD continues to lift on USD weakness.
Interest Rates	• Interest rate lift driven by offshore sentiment.
Week Ahead	• Q2 Consumer Confidence, and Q1 Current Account and GDP due.
Week in Review	• Manufacturing data was weak outside of Dairy and Meat
Global Calendars	• FOMC meet and US housing data due. OECD Economic Outlook released.

Chart of the week



- US bond yields dipped ahead of big week for the US bond market. 10-year bonds now yield 3.78%, below the 4% threshold touched last week, but well above the 2.05% low at the very end of 2008, and even the 2.53% low touched after the Fed announced it would buy government Bonds in March 2009.
- To try to hold down yields, the Fed has been buying up $300 billion of bonds (quantitative easing).
- But to put the enormity of the Fed's task into perspective, Treasury announced it will auction $104 billion worth of debt this week alone.
- The US Government has been selling bonds at an unprecedented pace to fund its rescue plan for the economy, pushing yields higher.

Foreign Exchange Market

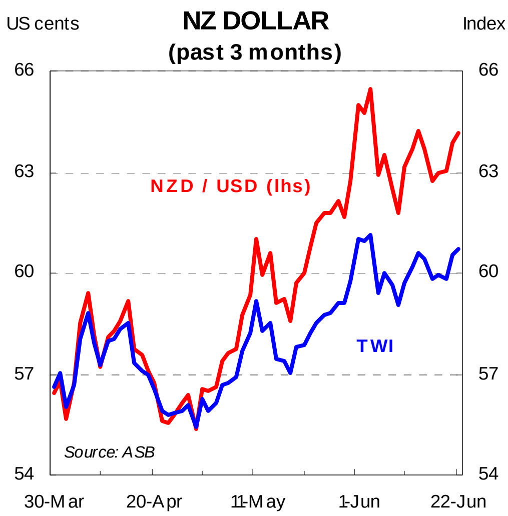
FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6416	0.6369	0.6146	0.5760	0.7612	UP	0.6350	0.6500
NZD/AUD	0.7996	0.7888	0.7890	0.8453	0.8003	DOWN	0.7850	0.8050
NZD/JPY	61.73	62.67	57.86	51.91	82.15	FLAT	60.00	64.00
NZD/EUR	0.4606	0.4566	0.4413	0.4119	0.4908	FLAT	0.4550	0.4650
NZD/GBP	0.3897	0.3889	0.3873	0.3862	0.3860	FLAT	0.3850	0.3950
TWI	60.7	60.4	58.5	56.2	68.3	UP	60.00	65.50

Weekly support and resistance levels * Current is as at 12pm Tuesday; week ago as at Monday 5pm

- NZD continues to lift against the still-weak USD, and GBP. The NZD was also up on the AUD, and EUR, but lost some ground on the JPY. The local currency lifted 0.5% on a trade-weighted basis.
- With little in the way of data in New Zealand, the currency movements were largely influenced by offshore themes. However, a host of releases brings some focus for markets back on shore this week, and reinforce the weakness in the economy. In particular, the GDP report should show a fifth consecutive quarter of contraction in the economy. In addition, confirmation that New Zealand's current account deficit has only improved to 8.4% of GDP may weigh somewhat on the NZD. Consumer Confidence data will also provide an important update on the mood of shoppers.
- Last week the Fed's Beige book indicated that the US economy remained soft, despite some signs of stabilisation. We suspect the US FOMC minutes this week will reflect this caution and may serve to assist a further pushing out of markets' expectations for Fed rate hikes. The USD may come under pressure. Should the OECD's economic outlook be reflective of a slightly less severe state of the global economy, the USD could be sold further as US investors increase their amount of offshore investments.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q2 WMM Consumer Confidence	24/6	3.00 pm	-
Q1 Current Account	25/6	10.45 am	8.4%
Q1 GDP	26/6	10.45 am	-0.8%
May Trade Balance	29/6	10.45 am	+$375m
May Building Consents	29/6	10.45 am	-



Potential currency movers from the US this week: existing home sales and OECD economic outlook (23rd), Durable goods orders, new home sales and FOMC (24th), GDP (25th), personal income, personal spending, PCE and UoM confidence (26th). Speakers: Bernanke (26th), Fisher (27th).

Medium term outlook: [Last Quarterly Economic Forecasts]

- As a consequence of the financial market turmoil centred in the United States, USD weakness was expected in early 2009. Although this weakness was initially offset in part by concerns about other regions, improved sentiment in financial markets has seen risk appetites improve and the USD weaken.
- Right now, the USD, which has shown countercyclical strength, is under pressure. USD is weakening for the following reasons:
  - US residents increase their offshore investment, encouraged by improvement in the global economy.
  - USD liquidity demand and safe-haven buying of the USD reverses is easing.
  - Diversification out of USD is expected to occur due to concerns about US government debt.
- The arguments for buying EUR, GBP and JPY are strong enough to engineer a reasonable depreciation in the USD, but we do not expect to revisit fresh US TWI lows.
- We are also comfortable with our current forecast that the NZD and AUD have bottomed and will appreciate over the course of 2009, rather than revisit and break through the lows seen in early 2009. Since the Budget the threat of a credit rating downgrade has subsided.
- We expect the NZD to firm noticeably against the USD and yen as those currencies remain under sustained pressure. Against other key currencies the NZD is likely to appreciate but to a more modest extent: the NZD will leverage off the global recovery and NZ is in a relatively good position compared to a number of economies.
- The likelihood of the RBNZ intervening to try and weaken the NZD remains very low given the RBNZ's acknowledgement that global factors have much to do with the NZD's lift.

Interest Rate Market

Wholesale interest rates	Current	Week ago	Month ago	6 mths ago	Year ago	ST Bias
Cash rate	2.50	2.50	2.50	5.00	8.25	FLAT
90-day bank bill	2.82	2.81	2.78	5.02	8.68	FLAT
2-year swap	3.91	3.87	3.59	4.61	7.94	UP
5-year swap	3.41	5.31	4.96	4.97	7.61	UP
11/11 gov't stock	4.90	4.81	4.57	4.58	6.41	UP
NZSX 50	2791	2821	2763	2680	3288	DOWN

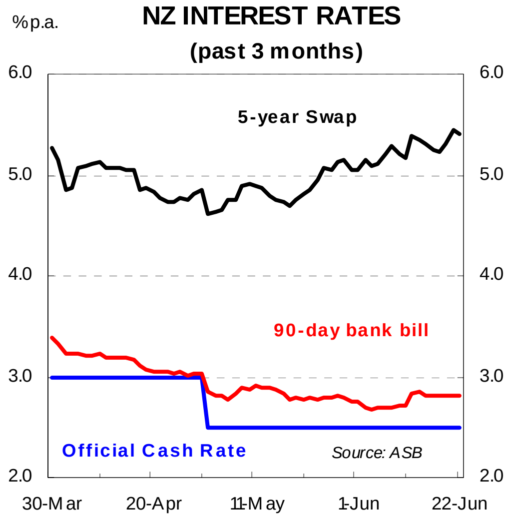
* Current is as at 12pm Monday; week ago as at Monday 5pm

- With the local data calendar remaining quiet, last week's sell-off in interest rate markets was driven by offshore sentiment, in particular movements across the Tasman. The trend of yield curve steepening continued, with the 3-5 year part of the curve lifting 20 basis points, 1-year rates nudging higher by 5bp and 90 days remaining unchanged. Swap rates in the mid part of the curve (i.e. 3-5 years) have returned to their post-MPS peaks.
- The market has dismissed the RBNZ's dovish tone, with only has a 1 in 4 chance of a rate cut priced in for the next meeting and rate hikes priced in for early 2010. In contrast, we continue to see downside risks to the inflation outlook and expect that the RBNZ will have to deliver further monetary stimulus down the track. We have two 25 bp cuts scheduled in for September and October.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
Q2 WMM Consumer Confidence	24/6	3.00 pm	-
Q1 Current Account	25/6	10.45 am	8.4%
Q1 GDP	26/6	10.45 am	-0.8%
May Trade Balance	29/6	10.45 am	+$375m
May Building Consents	29/6	10.45 am	-

Comment: NZ data calendar heats up this week. The focus will be on the Current Account on Thursday and GDP Friday. With the market expectation centred on a relatively weak GDP outturn, the risk is activity turns out better than expected (ASB forecasts -0.5%, compared to market -0.8%) and further spurs the recent lift in interest rates.



Medium term outlook: [Last Quarterly Economic Forecasts]

- The RBNZ left the cash rate unchanged at 2.5% at the June OCR announcement. The RBNZ has cut the cash rate 575 basis points in less than a year in response to the financial crisis offshore. The RBNZ has previously expressed reluctance to cut the OCR below 2%, which leaves just 50 bp of rate cuts up its sleeve.
- The RBNZ's June statement was dovish, playing down green shoots optimism and highlighting the downside risks to the economic outlook. The RBNZ maintained an explicit easing bias, mentioning the potential for the OCR to move lower and restated it continues to expect to hold the OCR at current levels until the latter part of 2010.
- The RBNZ revised down its growth outlook in June, and as a result inflation pressures are considerably weaker. The RBNZ forecasts CPI inflation to briefly fall through the bottom of the target band later this year, then recover to remain 'comfortably' in the middle of the target band.
- The RBNZ's export-led recovery is heavily dependent on the trade weighted exchange rate remaining below average for an extended period. In our view, the RBNZ's exchange rate assumption is reasonably heroic, and differs from our own view of US dollar weakness remaining a dominant driver of the NZ dollar. The assumption leaves the RBNZ vulnerable to the risk inflation falls uncomfortably low. There remains large downside risk to the economic outlook, and the RBNZ is likely to want to deliver further monetary policy stimulus.
- The market has underestimated the RBNZ's willingness to cut further, with market pricing implying the easing cycle is over – and that the OCR will increase as early as the start of 2010. The RBNZ is disappointed with this reaction. The longer that interest rates and the NZ dollar remain above the RBNZ's assumptions, the more pressure the RBNZ will feel for further cuts to remind the markets of its position. We have pencilled in two 25 basis point cuts for September and October, although the timing of these are partly dependent on the NZ dollar. Currently, risks are pointing to a cut in July should the market continue to doubt the RBNZ's easing bias.
- The OCR remains the RBNZ's primary tool, although it has started to lose traction at very low levels. While the RBNZ has investigated other options, it remains very reluctant to use them while there is potential to cut the OCR further.

NZ Data Preview: a look at the week ahead

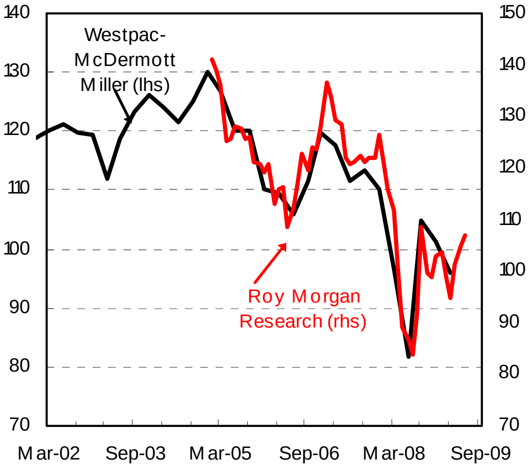
Data	Date	Time (NZST)	Previous	Market expects	ASB expects
May Credit Card Spending	22/6	3.00 pm	+2.3%	-	-
Q2 WMM Consumer Confidence	24/6	3.00 pm	96.0	-	100
Q1 Current Account	25/6	10.45 am	-8.9%	-8.4%	-8.4%
Q1 GDP	26/6	10.45 am	-0.9%	-0.8%	-0.5%
May Trade Balance	29/6	10.45 am	+ $276	+ $375	+ $150
May Building Consents	29/6	10.45 am	+11.2%	-	
May Credit Aggregates (yoy, household)	29/6	3.00 pm	+2.6%	-	-

Q2 Westpac McDermott Miller Consumer Confidence.

Consumer confidence made a surprisingly solid recovery in Q3 2008, rising from a 17-year low. Since then, confidence has dipped as the recession dampens the mood.

The fortnightly Roy Morgan Survey has historically provided a reasonable guide to the higher profile quarterly Westpac survey, and is pointing to an improvement in confidence in the second quarter of 2009. Behind the recovery in optimism from the lows of 2008 was the decline in petrol prices, tax cuts in October, and the outlook for lower borrowing costs as the RBNZ slashed the cash rate and mortgages fell. Households feel more positive on their financial outlook based on the relief on these fronts, but providing significant offsets are falling house prices and job insecurity in the face of the recession and global turmoil. We do not expect to revisit the lows seen in 2008, and the Roy Morgan Survey is suggesting the headline confidence figure will lift back above 100, from last quarter's 96. However, capping any strong rebound in confidence is a backdrop of rising unemployment, rising long-term mortgage rates, and increasing petrol prices.

NZ CONSUMER CONFIDENCE SURVEYS



Q1 Current Account.

ASB(f) -$1,065mn (qtr), -8.4% of GDP (annual total)

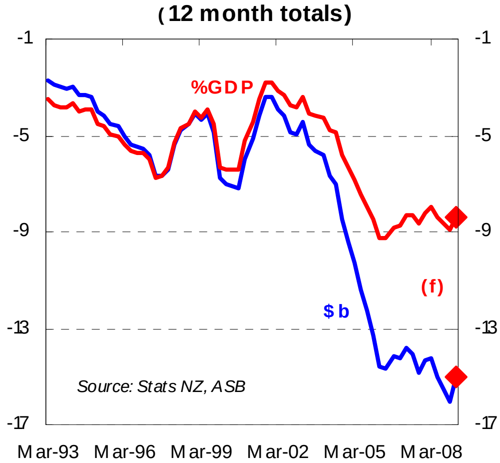
After narrowing steadily through to March 2008, the annual current account deficit widened through the rest of 2008. We expect the annual deficit to narrow to around 8.4% of GDP, down from 8.9% in Q4. For Q1 itself we expect an unadjusted deficit of $1,065mn.

A larger goods trade surplus is likely compared to a year ago as exports lift and imports decline.

Services trade was affected by a tapering off in tourism earnings. In contrast, the investment income deficit should be constrained by reduced profit and debt-servicing outflows, notwithstanding weaker earnings inflows.

We expect the deficit to continue shrinking through 2009 as declining domestic demand and profitability rein in outflows. However, the price will slow down in the second half of the year as the rise in goods balance tapers off.

CURRENT ACCOUNT BALANCE
(12 month totals)

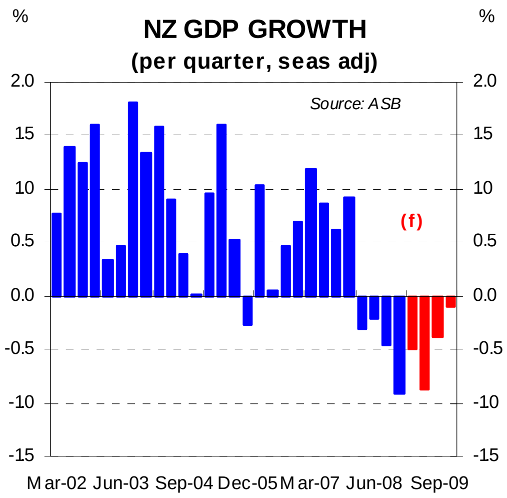


Q1 GDP

ASB (f): -0.5% qoq. Last -0.9 qoq.

We estimate that New Zealand's Gross Domestic Product (GDP) contracted 0.5% over Q1, compared to the market expectation of a 0.8% decline. This follows Q4's 0.9% decline and marks the 5th quarter of recession. We expect that NZ will remain in recession until the end of 2009.

Q1's decline is likely to be centred on sharp contractions in retail and wholesale volumes, as well as weakness in electricity and transport sectors. Our GDP forecast would have been considerably weaker. However, some early indicators suggest a number of key sectors showed surprising resilience, including manufacturing and construction. Some one-offs are likely to be masking underlying weakness in these sectors, which will become more apparent over Q2.

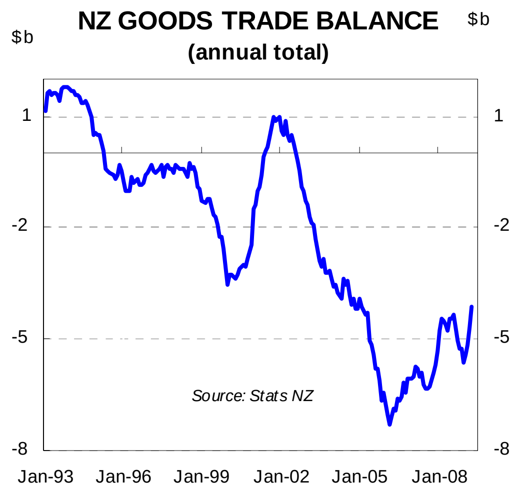


May Trade Balance

ASB (f): +150 million

We expect a trade surplus of $150 million. May will be the 4th consecutive surplus as import demand has fallen sharply while exports remain supported by strong agricultural production.

Exports are likely to lift again in May, on the back of seasonal strength in agricultural production, in particular dairy, meat and fruit. However, the gain in exports has been tempered by the falling dairy prices and lower slaughter volumes. Meanwhile imports are set to increase, albeit modestly as the underlying trend remains weak. Weak domestic demand has seen import volumes fall dramatically, which has been compounded by falling oil prices. Excluding oil, prices have actually lifted, although looking ahead the recent pick up in the NZ dollar should help contain further price increases on imports. We are close to a turning point in monthly trade data, as exports slip into their seasonally weak months the extent of underlying weakness for export demand will become more apparent.

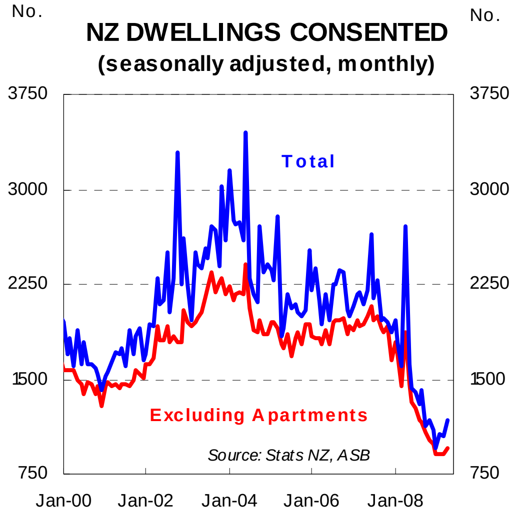


May Building Consents

Previous: +11.2% mom

Residential building consents lifted over April, with a recovery in both apartment and core consents. Consent issuance is likely to have reached a bottom. Low interest rates and a turnaround in net migration have lifted underlying housing demand. The recent pick up in housing turnover also points to a recovery in construction demand, and core consent issuance (i.e. excluding apartments) is likely to increase. Ex-apartment consents picked up almost 4% over April and further gains over May are likely. Apartment consent issuance tends be lumpy, and following a surge in issuance over April, some correction is possible during May. A fall in apartment consent issuance is likely to dampen the increase in overall consents.

Non-residential consent issuance surged in April due to the Christchurch International Airport development, and is likely to fall over May.



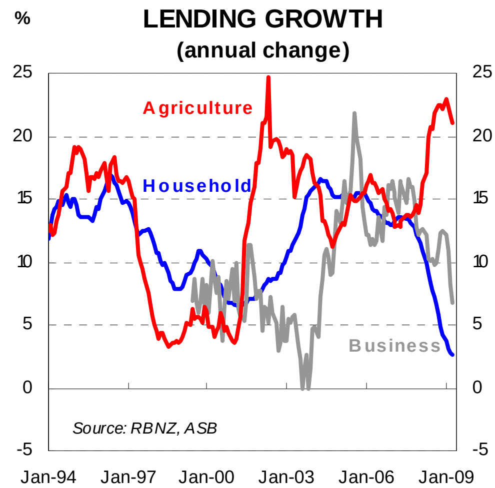
May Credit Aggregates

Previous: Household Lending +0.2% s.a. mom

Mortgage lending had another relatively robust month in April, with net lending up $488mn. Ongoing strength in house sales over May suggests that lending growth is likely to remain firm. In contrast, consumer lending continued to contract slightly on an annual basis, and weakness in retail sales of durable goods suggests these declines are likely to continue. Growth in household lending is likely to remain muted as households focus more on saving.

Business lending growth has started to slow more noticeably in recent months and moderation in growth is likely to continue. Customer demand is weak, profits are under pressure, and capital investment is consequently being pared back.

Agricultural lending growth remains surprisingly resilient. Nevertheless, lending growth in this sector is likely to slow noticeably. In particular, the low dairy payout for the upcoming section reinforces that on-farm investment is likely to be muted.



NZ Data Review: weekly recap

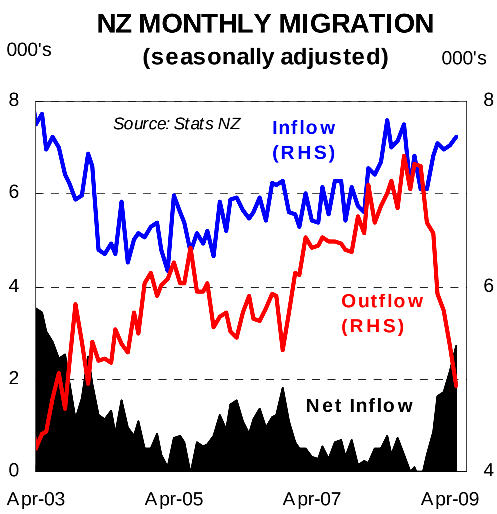
May International Travel and Migration

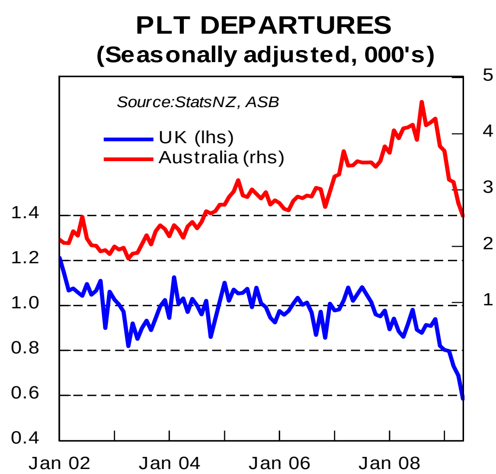
Net migration increased strongly again over May, adding almost 2,700 net new migrants to NZ's population (an annualised rate of 26,400 over the past 3 months). Net migration has turned swiftly over the past six months, and as a result the pace of annual net migration has doubled, lifting from around 5000 per annum to 11,200 in May. If current trends continue, net migration is well on track to reach almost 20,000 per annum, if not stronger. We estimate that 20,000 new migrants would be consistent with working age population growth of around 1.6% by mid-2010, which is a small increase by historical standards. Nonetheless, the increase in population base will help provide timely support to retailing and the housing market, which are currently at cyclical lows.

The turn around in the migration pattern comes as less New Zealanders head across the Tasman. Departures to the UK have also slowed considerably, suggesting the financial crisis has curbed the number of young kiwis heading off on their OE. New Zealanders are playing it safe and opting to stay put.

Permanent arrivals remain reasonably steady, lifting 1.2% over the month. Asia remains the main source of arrivals and on a trend basis inflows from India and China continue to grow.

Short-term arrivals remain very resilient, up 1% on year-ago levels, with the rising number of Australian visitors offsetting the decline in visitors from longer-haul destinations. The annual number of Australian visitors exceeded 1 million for the first time in May. According to Stats NZ, 40% come for a holiday, 38% to visit friends or relatives and 15% on business. While Australians continue to visit in growing numbers, the credit crunch has seen a sharp drop in visitors from the US, UK and Asia. Longer-haul visitors tend to spend more per visit, as they often stay longer. Indeed, the decline in revenue stemming from less of these tourists has already been apparent with exports of services dropping sharply over the past year.





Global Data Calendars

Note: Calendar 2 is in UK times. Add 11 hours for NZ times.

Calendar – Australasia, Japan and China

Date	Time NZT	Econ	Event	Period	Unit	Last	Forecast Market	Forecast ASB/CBA
Mon 22 Jun	13.30	AU	New motor vehicle sales	May	m%ch	0.9	~	~
					y%ch	-20.3	~	~
	15.00	NZ	Credit card spending	May	y%ch	-1.6	~	~
Tue 23 Jun	17.00	JP	Leading index CI	Apr	Index	76.5	~	~
	17.00	JP	Coincident index CI	Apr	Index	85.8	~	~
Wed 24 Jun	11.50	JP	Merchandise trade balance	May	¥bn	67.7	220.0	~
	11.50	JP	Adj merch trade balance	May	¥bn	-52.2	250.0	~
	11.50	JP	Merchandise trade exports	May	y%ch	-39.1	-39.2	~
	11.50	JP	Merchandise trade Imports	May	y%ch	-35.8	-41.0	~
	11.50	JP	Corp service price	May	y%ch	-2.4	-2.8	~
	14.00	NZ	NZ consumer confidence	QII	Index	96.0	~	~
Thu 25 Jun	10.45	NZ	Current account balance	QI	$bn	-4.0	~	~
	10.45	NZ	Account deficit-GDP ratio	QI	%	-8.9	~	-8.4
	12.00	AU	CB leading index	Apr	%	0.4	~	~
Fri 26 Jun	10.45	NZ	GDP	QI	q%ch	-0.9	~	-0.5
					y%ch	-1.9	~	-0.8
	11.30	JP	National CPI	Jun	y%ch	-0.1	-1.1	~
	11.30	JP	National CPI ex-fresh food	Jun	y%ch	-0.1	-1.1	~
	11.30	JP	National CPI ex food, energy	Jun	y%ch	-0.4	-0.5	~
	11.50	JP	All industry activity index	Apr	m%ch	-2.4	2.1	~
	14.00	CH	Industrial profits	May	ytd y%ch	-37.3	~	~

Calendar – North America & Europe

Please note all days and times are UK time, not local release day/times

Date	UK time	Econ	Event	Period	Unit	Last	Forecast Market	Forecast CBA
Mon 22 Jun	00.01	UK	Rightmove house prices	Jun	m%ch	2.4	~	~
					y%ch	-6.2	~	~
	09.00	GE	IFO – business climate	Jun	Index	84.2	85.0	~
	09.00	GE	IFO – current assessment	Jun	Index	82.5	83.1	~
	09.00	GE	IFO – expectations	Jun	Index	85.9	87.0	~

Date	time	Econ	Event	Period	Unit	Last	Market	CBA
Tue 23 Jun	07.10	GE	GfK consumer confidence	Jul	Index	2.5	2.5	~
	08.30	GE	PMI manufacturing	Jun	Index	39.6	40.9	~
	08.30	GE	PMI services	Jun	Index	45.2	46.0	~
	09.00	EZ	PMI manufacturing	Jun	Index	40.7	42.0	~
	09.00	EZ	PMI services	Jun	Index	44.8	~45.6	~
	09.00	EZ	PMI composite	Jun	Index	44.0	~	~
	10.00	~	OECD Forum 2009					
	15.00	US	Richmond Fed manufacturing	Jun	Index	4.0	~	~
	15.00	US	House price index	May	m%ch	-1.1	-0.3	~
	15.00	US	Existing home sales	May	£mn	4.7	4.8	~
	15.00	US	Existing home sales	May	m%ch	2.9	2.6	~
Wed 24 Jun	~	~	OECD Economic Outlook					
	09.00	EZ	ECB Current Account SA	Apr	€bn	-6.5	~	~
	13.30	US	Durable goods orders	May	%	1.9	-0.9	~
	13.30	US	Durables ex transportation	May	%	0.8	-0.5	~
	15.00	US	New home sales	May	'000	352	360	~
	15.00	US	New home sales	May	m%ch	0.3	2.3	~
	19.15	US	FOMC rate decision	Jun	%	0.25	0.25	0.25
Thu 25 Jun	10.00	EZ	Industrial new orders	Apr	m%ch	-0.8	0.0	~
					y%ch	-26.9	-33.9	~
	13.30	US	GDP (annalised)	QI	q%ch	-5.7	-5.7	~
	13.30	US	Personal consumption	QI	%	1.5	1.5	~
	13.30	US	GDP price index	QI	%	2.8	2.8	~
	13.30	US	Core PCE	QI	q%ch	1.5	~	~
	13.30	US	Initial jobless and continuing claims					
Fri 26 Jun	~	GE	CPI – EU harmonised	Jun	y%ch	0.0	-0.1	~
	13.30	US	Personal income	May	%	0.5	0.3	~
	13.30	US	Personal spending	May	%	-0.1	0.4	~
	13.30	US	PCE deflator	May	y%ch	0.4	~	~
	13.30	US	PCE core	May	m%ch	0.3	0.1	~
					y%ch	1.9	1.8	~
	15.00	US	Uni of Michigan confidence	Jun	Index	69.0	69.0	~

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