ECONOMICS

29 Jun. 09

Business Weekly

Bad

This Week

The economy remained in bad shape in Q1, as GDP fell out of bed and hit the bedside table on the way down. The 1% decline over Q1 was weaker than the market and ourselves were expecting, with some very large declines in manufacturing, transport and communication contributing to a very weak picture. Retail and wholesale trade also declined sharply, as expected. Relative to our expectations there was a complete lack of any pick-up in pastoral processing activity to offset the dire weakness in other manufacturing sector activity. Furthermore, the extent to which the transportation and communications sectors were hit by domestic activity and travel weakness was considerable: the markedly fewer goods and people being transported around indicate the downturn is spreading its tentacles further through economy.

On an expenditure basis weakness showed through as expected in a marked drop in private consumption and non-residential fixed investment. Net exports made a strong contribution to growth through slumping imports while exports were relatively flat. Inventories were run down to meet export and consumer demand.

Prior to the release of the manufacturing survey we had been expecting a 0.9% fall in Q1 and a 0.6% fall in Q2, but effectively swapped those forecasts around in response to the manufacturing figures. We are now back to expecting a 0.5% decline in Q2, but just feel a little giddier. In other words our view of the first half of the year as a whole has changed little: we expected weakness to show through in overall manufacturing activity at some point but assumed primary processing would mask it in Q1.

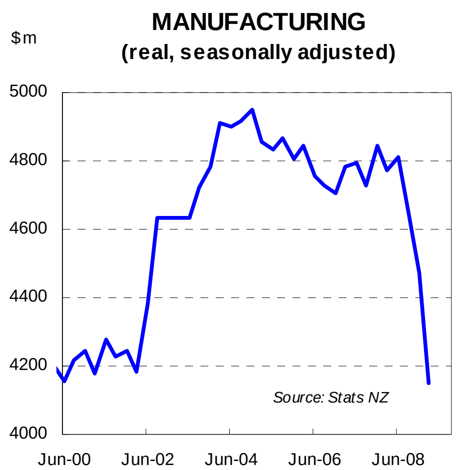
The RBNZ expected a 1% decline in its March MPS, prior to the release of robust construction figures and the weak underlying activity reported in the manufacturing sector. Nonetheless, the GDP report highlighted that the underlying momentum in GDP is very weak and downside risks remain to the economic and inflation outlook. We continue to expect further monetary policy stimulus later this year with two 25 basis point rate cuts pencilled in for September and October. Although green shoots may be appearing in the housing market, they are conspicuously absent in other sectors. At some stage down the track the RBNZ may want to deliver further monetary stimulus – or more correctly try and mitigate the lifts in the NZD and long-term interest rates. In expecting any further rate cuts we are distinctly in the minority, but the GDP figures still suggest to us that the RBNZ will keep open the door to that option.

The local data calendar is quiet now. Watch for the extent to which business confidence holds onto May's gains, and expect the RBNZ's lending figures to show continued moderation in annual growth rates.

Click here for:

Foreign Exchange	• NZD continues to lift on USD weakness.
Interest Rates	• Interest rates driven by offshore sentiment. Little reaction to GDP weakness.
Week Ahead	• June's NBNZ business Outlook survey the only main NZ release this week.
Week in Review	• Consumer confidence was up, but Q1 GDP was depressing.
Global Calendars	• US non-farm payrolls is the data highlight. ECB has a rate announcement.

Chart of the week



- Manufacturing production collapsed 7.2% over Q1, following hefty declines in the previous two quarters. Over the past year manufacturing production has fallen 13%.
- The adjacent chart highlights the extent of the weakness in the sector, with production returning to 2001 levels.
- The decline in manufacturing was broad based, reflective of the global fall in demand for manufactured goods in the wake of the credit crunch.
- The extent of the decline came as a large surprise to us. Following the release of the Q1 Manufacturing Survey we actually revised up our GDP forecast, as it had shown a 23% increase in dairy and meat sales volumes. However, according to StatsNZ, food-related manufacturing production actually fell 4.8%. The difference may be due to a large run down in stocks.

General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

Foreign Exchange Market

FX Rates	Current*	Week ago	Month ago	6 mths ago	Year ago	ST Bias	Support^	Resistance^
NZD/USD	0.6455	0.6395	0.6276	0.5759	0.7603	FLAT/UP	0.6350	0.6550
NZD/AUD	0.8004	0.7974	0.7956	0.8384	0.7929	FLAT	0.7900	0.8100
NZD/JPY	61.49	61.44	60.60	52.15	81.40	FLAT	60.50	62.50
NZD/EUR	0.4591	0.4597	0.4488	0.4069	0.4831	FLAT/UP	0.4550	0.4650
NZD/GBP	0.3913	0.3874	0.3929	0.3918	0.3826	FLAT	0.3850	0.4000
TWI	60.8	60.6	59.8	56.0	67.8	FLAT/UP	60.00	61.50

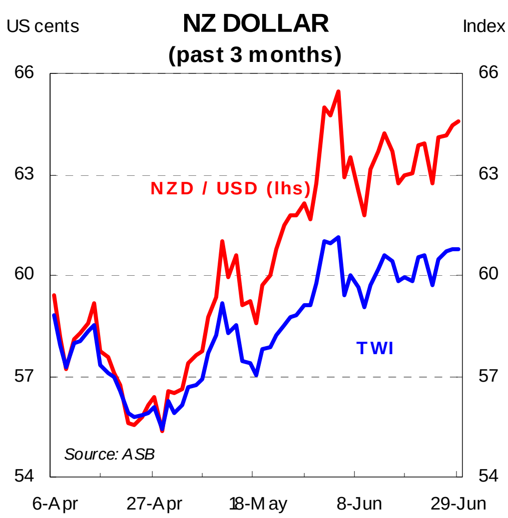
Weekly support and resistance levels * Current is as at 12pm Tuesday; week ago as at Monday 5pm

- NZD continues to lift against the still-weak USD, and GBP. The NZD was little changed against the JPY and EUR, but posted a small gain on the AUD.
- Over the week, the **NZD** traded in a two-cent range centred around the 0.635 level. The big data event of the week was the release of NZ Q1 GDP on Friday. The 1% contraction was weaker than expectations (ASB f/c -0.5%, market -0.8%). The NZD did dip on the number, but found support quickly, and recovered during London and New York trade on Friday. The pattern is a concern for those hoping for a lower kiwi - hard for the local unit to get too weak when everywhere else looks bad too, and Friday's support reflects that.
- The **US dollar** declined significantly against the euro on Friday and dropped versus the yen after China repeated its call for a new global currency. The People's Bank of China said the International Monetary Fund should manage more of members' foreign-exchange reserves. The Swiss franc also declined against the euro and dollar last week as the central bank was assumed to have intervened.
- The US ISM survey of manufacturing and non-farm payrolls report are likely to be the two key market movers this week.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
NBNZ Business Outlook (own activity)	30/6	3.00 pm	+3.8%

Potential currency movers from the US this week: Dallas Fed Manufacturing, Chicago Fed Index (30th) S&P Case Shiller House Price Index, Consumer Confidence (1st) ADP Employment Change, ISM Manufacturing, Pending Home Sales, Vehicle Sales (2nd), Non-farm payrolls, Factory Orders (3rd)



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 had shown countercyclical strength, is under pressure. The 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	2.50	FLAT
90-day bank bill	2.82	2.81	2.75	5.17	2.82	FLAT
2-year swap	3.88	3.94	3.55	4.52	3.88	FLAT
5-year swap	5.42	5.44	5.05	4.87	5.42	FLAT
11/11 gov't stock	4.87	4.90	4.55	4.53	4.87	FLAT
NZSX 50	2770	2795	2754	2678	2770	DOWN

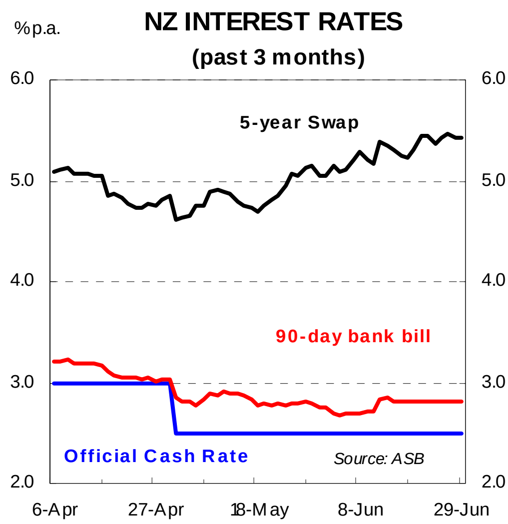
* Current is as at 12pm Monday; week ago as at Monday 5pm

- NZ markets remained very quiet last week, with the weaker than expected GDP result failing to provoke much reaction. Offshore sentiment remained the key driver, particularly in the early part of the week.
- Yield curve steepening took a break over the past week. Yields on government bonds have now returned to more enticing levels, with NZ 10-year bond yields over 6%.
- Last week's US Treasury bond auctions issued a massive US $104 billion of notes. The US Government has been selling bonds at an unprecedented pace to fund its rescue plan for the economy, pushing yields higher. However, with the recovery in yields over the past few months, this week's issuance was met by strong demand, particularly from offshore buyers (possibly central banks). Yields actually fell over the week, with US 10-year yields down by almost 25 points and US 2-year yields down 8.5 points.

Short-term outlook:

Key data	Date	Time (NZST)	Market expects
May Credit Aggregates	29/6	3.00 pm	-
June NBNZ Business Outlook	30/6	3.00 pm	-

Comment: NZ markets are 'range bound' and with the worse than expected GDP result failing to provoke a reaction this week's data are unlikely to gain much attention. Offshore sentiment remains dominant. With yields at current levels, last week's massive US government debt issuance was comfortably absorbed by demand, reducing the pressure on longer-term interest rates – for now.



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

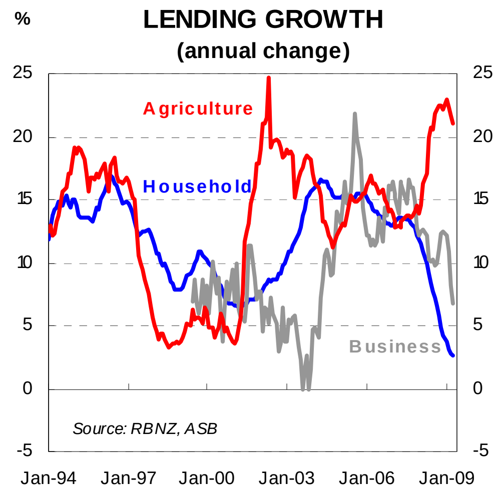
Data	Date	Time (NZST)	Previous	Market expects	ASB expects
May Credit Aggregates (yoy, household)	29/6	3.00 pm	+2.6%	-	-
NBNZ Business Outlook (own activity)	30/6	3.00 pm	+3.8%	-	-

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.

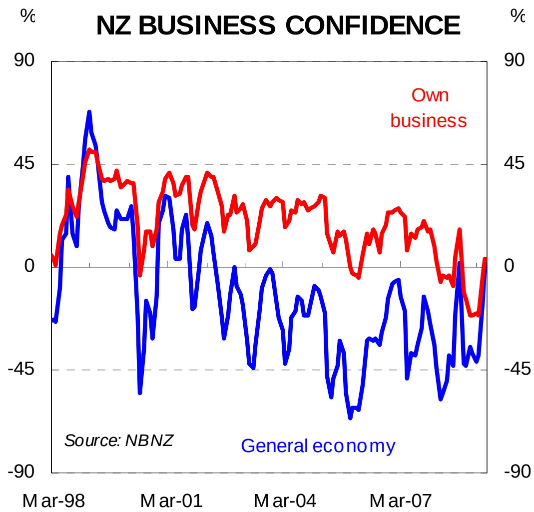


June NBNZ Business Confidence

Previous: Own activity outlook +3.8%

Business optimists outnumbered pessimists for the first time since September 2008 last month in the National Bank's Business Outlook Survey. Both the overall outlook and own activity indicators within the survey have moved into positive territory. In May a net 2% expected general business conditions to improve over the next 12 months, and firms' expectations of their own activity is back in positive territory with a net 4% of firms expect better times ahead. If own activity expectations continue to improve that would signal a likely return to weak growth in the second half of 2009.

Last month confidence lifted across all sectors, with retail being the notable sector where pessimists still outnumber optimists in terms of their own activity expectations. Profit, investment and employment intentions all remain negative, below Asian crisis levels, but did improve in the last survey. Pricing intentions remain weak, and point to lower inflation in the year ahead. This survey can be volatile from month to month, but we are looking for further consolidation on last month's strong result in June.



NZ Data Review: weekly recap

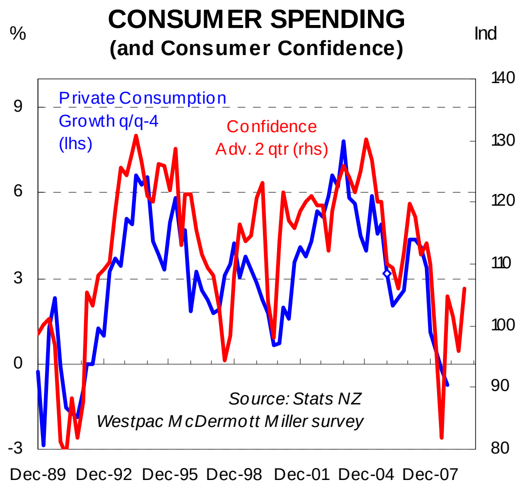
Q2 WMM Consumer Confidence Survey

The quarterly Westpac McDermott Miller consumer confidence survey showed a slight recovery in consumer optimism over Q2, as foreshadowed by the fortnightly Roy Morgan survey. Much of the lift in the headline index came from reduced anxiety on the general economic outlook over the next year. Questions relating to individuals' own outlook showed less improvement, suggesting this lift is less likely to translate to a lift in spending.

All regions showed an improvement in consumer confidence, except for the Waikato – possibly impacted by the reduced dairy payout forecast.

Over the past 3 quarters confidence has picked up off its June 2008 low (which coincided with the peak in petrol prices). Since then households have benefited from lower petrol prices, falling interest rates and tax cuts. However, this pick up in cash flow has been greeted with a muted recovery in confidence as households remain cautious on the employment outlook.

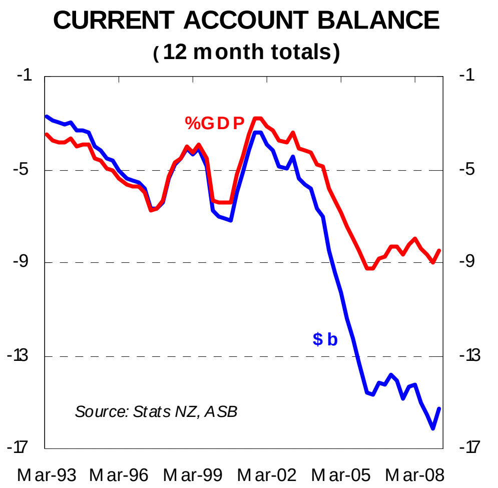
This consumer confidence survey points to, at best, a mild recovery in spending over Q2. We expect spending growth to remain muted for some time, with the peak effect of rising unemployment yet to be felt.



Q1 Current Account Balance

The current account deficit, at 8.5% of GDP for the March 2009 year, was close to expectations. The key component balances were all close to our expectations, leaving no surprises in the composition of the deficit. The quarterly deficit has narrowed, both relative to March 2008 and also in seasonally-adjusted terms relative to December 2008. The main drivers were the collapse in goods import demand (particularly of vehicles), with strength in dairy export volumes some offset to weak export prices. Given the weak domestic economy, profits attributable to foreign owners also fell over the past year.

We expect the current account deficit to continue narrowing steadily over the next 2 quarters. Beyond that the momentum will slow: the lift in dairy exports is not sustainable and the contraction in imports will taper off. But for now the deficit is moving in the right direction – albeit still very large.

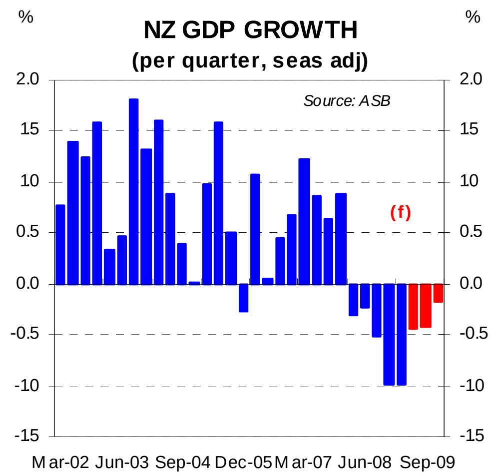


Q1 GDP

The economy remains in bad shape, as GDP fell out of bed and hit the bedside table on the way down. The 1% decline over Q1 was weaker than the market and ourselves were expecting, with some very large declines in manufacturing, transport and communication.

Manufacturing production collapsed a shocking 7.2% over Q1, following hefty declines in the previous two quarters. The decline in manufacturing was broad based, reflective of the global fall in demand in manufactured goods in the wake of the credit crunch. Retail and wholesale trade also declined sharply, as expected.

Adding insult to injury, the previous quarter's GDP was also revised down, to give NZ two consecutive 1% quarterly contractions. The result confirms NZ's 5th consecutive quarter of decline as New Zealand's recession enters its second year. The outlook remains challenging: we expect a further decline in Q2, led by weakness in construction activity. However, an improvement in business confidence suggests activity will start to stabilise over the second half of 2009.

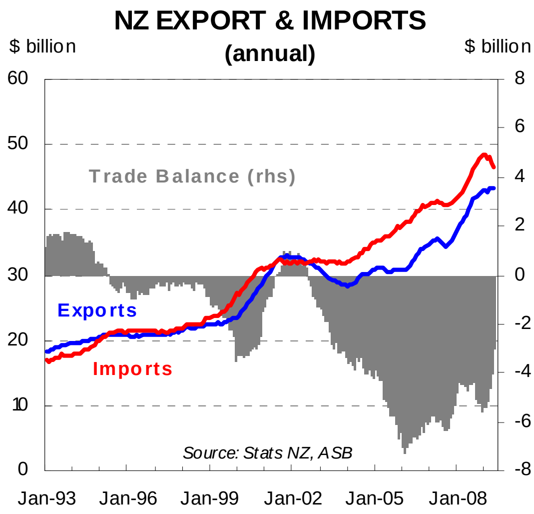


May Trade Balance

The trade balance posted another very healthy trade surplus ($858 million) over May, once again buoyed by strong export revenues and weak imports. This strong result follows a string of surpluses since February, aided by seasonal strength in agricultural exports whilst import demand has dropped dramatically as a result of NZ's recession. May's surplus was much bigger than the market's (already strong) expectation of $350 million surplus. The direction of surprise was evenly split between exports and imports: exports proving much stronger than expected and imports much weaker.

The strength in exports relates to strong seasonal production, particularly with dairy production recovering from the previous year's drought. The value of milk powder, butter and cheese exports are up almost 20% compared to year-ago levels. The rise has been underpinned by stronger volumes, as export prices for dairy products have declined. Logs and wood have also increased strongly compared to year-ago levels, with exports of logs to China in particular. A strong start to the kiwifruit season and an increase in prices has seen the value of fruit exports up 20% on year-ago levels.

The weakness in imports remains fairly broad-based, consistent with weak demand and falling aggregate output in NZ. On an annual basis, the declines are centred on vehicles, capital and intermediate goods.

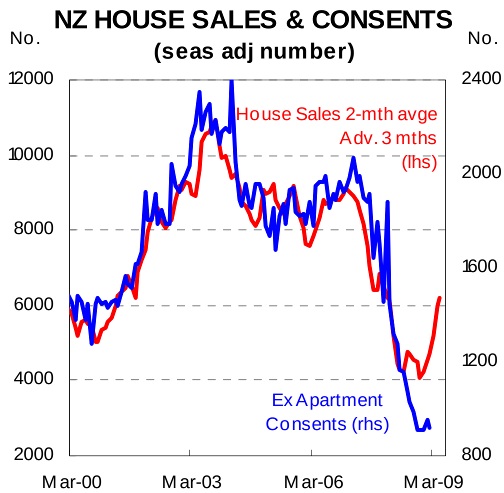


May Building Consents.

Overall dwelling consents rose slightly through a lift in apartment consents that was concentrated in Auckland (223 of 275 units authorised). Statistics NZ noted that more than a third of all apartment units consented in 2009 to date are assisted living apartments in retirement villages. Although no corresponding figures for last year were given, the inference is that mainstream apartment consents remain subdued. Over 2008 apartments averaged 192 per month: to date in 2009 apartment consents have averaged a lower 168 per month with presumably a higher proportion of retirement village units.

Ex-apartment consents fell slightly, largely reversing April's lift. To date ex-apartment consents have lifted very little in response to strengthening house sales turnover and reduced real estate listings. We would expect consent issuance to start picking up as house sales turnover grinds up and house prices stabilise.

Non-residential consents were given a boost over the month by consents for sports stadiums. The value of consents for the 3 months ending May was up 19% from the immediately preceding 3 months.



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 29 Jun	11.50	JP	Industrial production	May	m%ch	5.9	~	~
					y%ch	-30.7	~	~
	11.50	JP	Large retailers' sales	May	%	-6.7	~	~
	11.50	JP	Retail trade	May	m%ch	0.7	~	~
					y%ch	-2.8	~	~
	15.00	NZ	Credit Aggregates	May	~	~	~	~
	16.00	JP	Vehicle production	May	y%ch	-47.1	~	~
Tue 30 Jun	11.15	JP	Nomura/JMMA manuf. PMI	Jun	Index	46.6	~	~
	11.30	JP	Jobless rate	May	%	5.0	~	~
	11.30	JP	Job-to-applicant ratio	May	Ratio	0.5	~	~
	11.30	JP	Household spending	May	y%ch	-1.3	~	~
	13.00	AU	HIA new home sales	May	m%ch	0.5	~	~
	13.30	AU	Private sector credit	May	m%ch	0.1	~	0.2
					y%ch	4.6	~	4.3
	13.30	JP	Labor cash earnings	May	y%ch	-2.7	~	~
	15.00	NZ	NBNZ business confidence	May	Index	1.9	~	~
	17.00	JP	Small business confidence	Jun	Index	34.1	~	~
	17.00	JP	Housing starts	May	y%ch	-32.4	~	~
	17.00	JP	Annualised housing starts	May	¥mn	0.8	~	~
	17.00	JP	Construction orders	May	y%ch	-25.9	~	~
Wed 1 Jul	11.50	JP	Tankan large manuf. index	QII	Index	-58.0	-43.0	~
	11.50	JP	Tankan non-manufacturing	QII	Index	-31.0	-27.0	~
	11.50	JP	Vehicle sales	Jun	y%ch	-19.4	~	~
	13.00	CH	PMI manufacturing	Jun	Index	53.1	~	~
	14.30	CH	CLSA manufacturing PMI	Jun	Index	51.2	~	~
	11.30	AU	PWC/Ai-Group PMI	Jun	Index	37.5	~	~
	13.00	AU	DEWR skilled vacancies	Jun	m%ch	-7.0	~	~
	13.30	AU	Retail sales	May	m%ch	0.3	~	0.4
	13.30	AU	Building approvals	May	m%ch	5.1	~	7.0
						-16.0	~	-3.4
Thu 2 Jul	13.30	AU	Trade balance	May	$mn	-91.0	~	-100
Fri 3 Jul	11.30	AU	CBA-Ai Group PSI	Jun	Index	39.9	~	~

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	CBA
Mon 29 Jun	09.30	UK	Net consumer credit	May	£bn	0.3	~	~
	10.00	EZ	Business climate indicator	Jun	Index	-3.2	~	~
	10.00	EZ	Consumer confidence	Jun	Index	-31.0	~	~
Tue 30 Jun	00.01	UK	GfK cons. confidence survey	Jun	Index	-27.0	~	~
	07.05	GE	Retail sales	May	m%ch	0.5	~	~
	08.55	GE	Unemployment rate	Jun	%	8.2	~	~
	09.30	UK	GDP	QI	q%ch	-1.9	~	~
					y%ch	-4.1	~	~
	09.30	UK	Current account	QI	£bn	-7.6	~	~
	10.00	EZ	CPI estimate	Jun	y%ch	0.0	~	~
	13.30	CA	GDP	Apr	m%ch	-0.3	-0.1	~
	14.00	US	S&P/CaseShiller comp.-20	Apr	%	-18.7	-18.6	~
	14.45	US	Chicago PMI	Jun	Index	34.9	~	~
	15.00	US	Consumer confidence	Jun	Index	54.9	55.4	~
	15.00	US	NAPM-Milwaukee	Jun	Index	43.0	~	~
Wed 1 Jul	~	US	Total vehicle sales	Jun	$mn	9.9	9.7	~
	08.55	GE	PMI manufacturing	Jun	Index	40.5	~	~
	08.55	GE	PMI services	Jun	Index	44.3	~	~
	09.00	EZ	PMI manufacturing	Jun	Index	42.4	~	~
	09.30	UK	PMI manufacturing	Jun	Index	45.4	~	~
	09.30	UK	Index of services (3mth/3mth)	Apr	%	-1.2	~	~
	13.15	US	ADP employment change	Jun	'000	-532	-410	~
	15.00	US	ISM manufacturing	Jun	Index	42.8	44.0	~
	15.00	US	Construction spending	May	m%ch	0.8	-0.5	~
	15.00	US	Pending home sales	May	m%ch	6.7	1.1	~
Thu 2 Jul	09.30	UK	PMI construction	Jun	Index	45.9	~	~
	10.00	EZ	Unemployment rate	May	%	9.2	~	~
	10.00	EZ	PPI	May	m%ch	-1.0	~	~
					y%ch	-4.6	~	~
	12.45	EZ	ECB announces interest rates	Jul	%	1.0	~	1.0
	13.30	US	Change in non-farm payrolls	Jun	'000	-345	-363	~
	13.30	US	Unemployment rate	Jun	%	9.4	9.6	~
	15.00	US	Factory orders	May	%	0.7	0.0	~
Fri 3 Jul	09.00	EZ	PMI composite	Jun	Index	44.4	~	~
	09.30	UK	PMI services	Jun	Index	51.7	~	~
	09.30	UK	BoE hous. equity withdrawal.	QI	£bn	8.0	~	~
	10.00	EZ	Retail sales	May	m%ch	0.2	~	~

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