

Weekly Commentary

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A weekly outlook for New Zealand, Australia and US markets

22 June 2009

Spending less, making less

The sole piece of domestic data last week was a surprising 0.2% lift in manufacturing sales.

However, the rosy headline was entirely due to a 23% lift in sales of dairy, most probably reflecting inventory reduction. The rest of the survey implied dire falls in production for most industries, and an extremely weak quarter for manufacturing.

This week's data calendar is fairly full, starting with net migration today. Net migration has been rising sharply over the past few months, as the number of Kiwis crossing the Tasman has plunged. Annual total net migration for the year to May 2009 was a massive 11,200, compared to just 3,800 in the year to December 2008. Rising net migration is an important swing factor for the New Zealand economy, and has no doubt played an important role in the recent housing market pickup. The RBNZ will be taking careful note.

The perkier housing market, along with improved news from overseas, could see the Westpac June McDermott Miller Consumer Confidence Index rise a little when it is released on Wednesday. But the positive vibes will be tempered by confidence-sapping rises in long-term interest rates, rising fuel prices, rising unemployment, the axing of the 2010 and 2011 tax cuts, and now the outbreak of swine flu.

On Thursday one of New Zealand's most

reliably depressing pieces of data is released – the current account deficit (CAD). For a change we do expect the CAD to show a material improvement in Q1 2009, narrowing to 8.2% of GDP. The global credit crunch has finished off what monetary policy began several years ago – imports fell 14% as consumers spent less and saved more. In contrast, exports were down only slightly, with a sharp rise in dairy volumes partly offsetting lower prices. The investment income deficit is expected to narrow for the third straight quarter as interest and profits accruing to foreign lenders and owners are reduced.

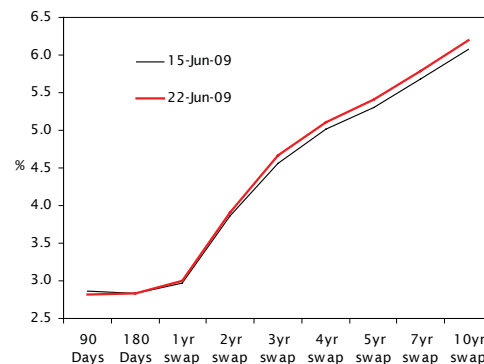
Finally, Q1 GDP is released on Friday. We expect GDP fell by 0.9%, completing five consecutive quarterly declines in economic activity. This would see economic activity 2.5% lower than a year ago and down 2.8% from its peak in the final quarter of 2007.

Consumer spending is expected to plunge 1.8%, in what would be the biggest quarterly fall since the 3.5% drop in Q3 1989 (after GST was hiked). The largest reductions have been in big-ticket durable items such as cars, furniture, floor coverings and appliances. We expect spending on durable goods was down 5.4% in Q1. We estimate business investment fell 7% over the quarter, led by marked reductions in plant, machinery and transport equipment investment. However, net trade will make a strong positive

contribution due to slumping imports and only a small fall in exports.

Most industries would have felt the backlash from the lack of demand, but none more so than the manufacturing sector. The 16% decline in cement production over the quarter is a telling indicator. The declines appear to have been widespread with very large falls in the manufacture of textiles, machinery and metals (the latter largely the result of a partial shutdown at the Tiwai Point aluminium smelter, which, incidentally, reduced electricity demand). Printing and publishing along with wood and paper and furniture manufacturing are also expected to show hefty falls. To top it off, the lack of lambs (following drought) and reduced slaughter of sheep and cattle is expected to see a pull back in meat processing. All up, we suspect that Q1 2009 was the worst decline for the manufacturing sector in more than 30 years.

NZ Interest Rates



*Yield curve is yields on bank bills to 180 days, fixed interest rate swaps for 1 year onwards.

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The slump in consumption should cause retail and wholesale trade to post their fifth consecutive quarterly declines. The construction sector is also expected to see its fifth consecutive quarterly decline on another, albeit smaller, decline in house building. Transport activity is expected to be down as a result of less freight given the generally lower sales and production environment, compounding a decline in air traffic. And distribution activity will reflect the large drop in imports.

There will be a few offsetting positives. Real estate and finance may be boosted by snappier housing market activity.

Government spending is expected to make a positive contribution, adding to growth in the service sectors. And mining will increase with oil now flowing from the new Maari field, although the boost will be somewhat dampened by less output from the Tui field.

One benefit of the long delay before the national accounts are published is that the reference quarter has long passed. Thank goodness. International indicators have improved and the fear factor that appeared to spook all and sundry earlier in the year has diminished considerably. Still, an outcome on our expectations would point to an increase in economic

slack that ultimately points to interest rates remaining low for an extended period.

Fixed vs. floating: With the RBNZ nearing the end of its easing cycle, short-term rates are unlikely to fall significantly further, while long-term rates will continue to anticipate the next tightening cycle. For those borrowers currently on floating rates who have been looking to time their re-entry into fixed rates, we recommend fixing now for six months to one year, which are easily the most favourable rates on offer.

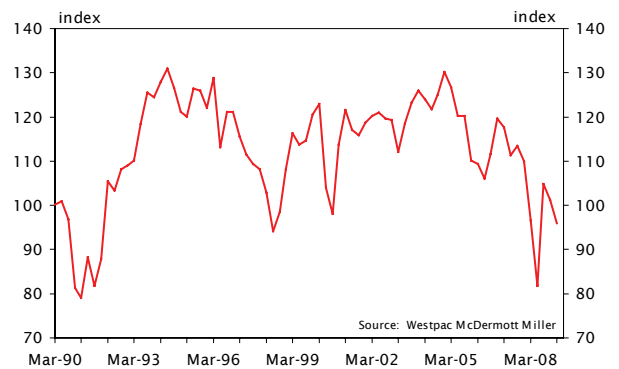
Key Data Previews

NZ Q2 consumer confidence

Jun 24, Last: 96.0

- Westpac McDermott Miller consumer confidence fell in the March 2009 quarter as consumers took on board the weight of negative economic news at the time. Top of the list was the rapid deterioration in global economic conditions.
- Since March, the news from offshore has still been bad, but not as bad. Australia has (so far) narrowly escaped recession, while in the US sentiment has clearly reached a turning point, as reflected in the sharp increases in equity and commodity markets. Europe remains the wildcard.
- Back home, news that the housing market has picked up is likely to have provided a fillip to confidence. But that needs to be set against the recent rise in longer term interest rates, rising fuel prices, rising unemployment, the axing of the 2010 and 2011 tax cuts, and now the outbreak of swine flu.

NZ Consumer Confidence

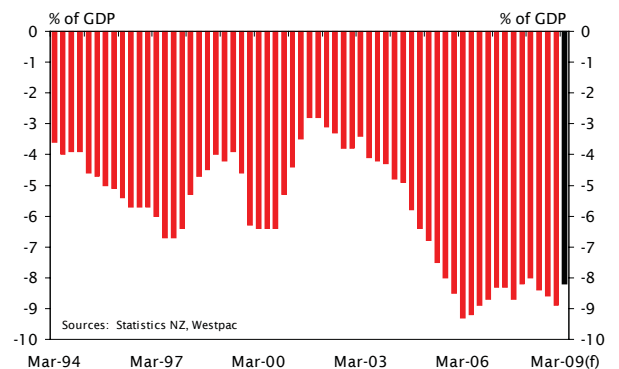


NZ Q1 current account deficit NZDm s.a.

Jun 25, Last: -3,764, WBC f/c: -2,110

- We estimate that the current account deficit fell to \$2.11bn in the March quarter. This would be the smallest quarterly deficit since June 2004.
- Imports were exceptionally weak in Q1, especially cars, while exports were steady with lower prices but higher volumes. Lower interest rates on overseas debt and falling profits for overseas-owned firms contributed to a further narrowing in the investment income deficit.
- We estimate that the deficit narrowed from 8.9% to 8.2% of GDP. The annual deficit remains high, due to the lingering impact of the spike in fuel prices last year. As this drops out of the equation, the deficit will narrow significantly over this year.

NZ annual current account deficit



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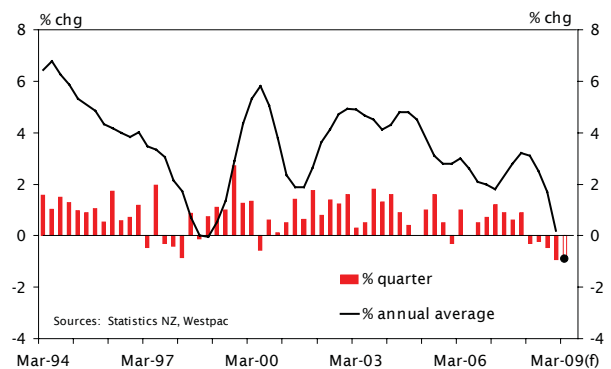
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NZ Q1 GDP

Jun 26, Last: -0.9%, WBC f/c: -0.9%, mkt f/c: -0.7%

- The expected 0.9% drop in Q1 GDP will be the fifth consecutive quarterly decline. Consumer spending is expected to show its biggest quarterly fall since 1989, driven by a sharp cut back in spending on durable goods. Business investment will also be well down, reflecting the extremely gloomy mood of business at the time.
- Manufacturing production is expected to show its biggest drop since 1977, slammed by the slump in demand. Weak demand will also see declines in retail and wholesale trade, construction and transport activity.
- More house sales along with increases in mining (thanks to oil flowing from the new Maari field) and rising government spending will be among the few bright spots.

NZ GDP growth



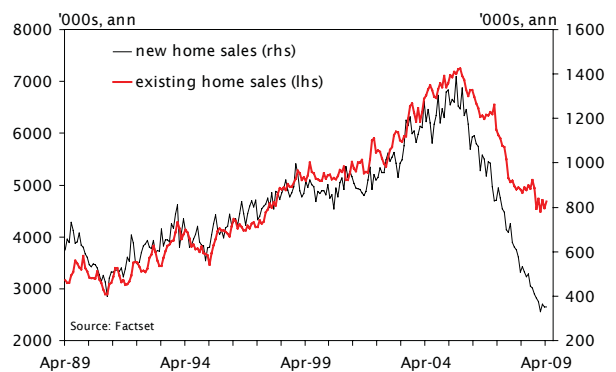
US May existing and new home sales to post gains

Jun 23, Existing home sales: Last: 2.9%, WBC f/c: 6.0%

Jun 24, New home sales: Last: 0.3%, WBC f/c: 4.0%

- Most housing indicators point to activity in the sector bottoming out at very weak levels. Existing home sales have see-sawed with a tight range since November last year, about 35% below their 2004 peak; new home sales have also levelled off since the start of this year, about 75% below their 2005 peak.
- Pending sales of existing homes rose 12% in the three months to April, way stronger than the recent profile for finalised existing home sales. Sharply lower prices, distressed sales of foreclosed homes and (temporarily) lower mortgage rates have boosted sales, and should lift the May existing outcome by 6% or more.
- Housing starts and permits have trended higher, and homebuilder sentiment has been less negative. We expect a 4% jump in new home sales, but given the volatility and propensity for revision of this series, a substantially stronger result would not surprise.

US housing sales

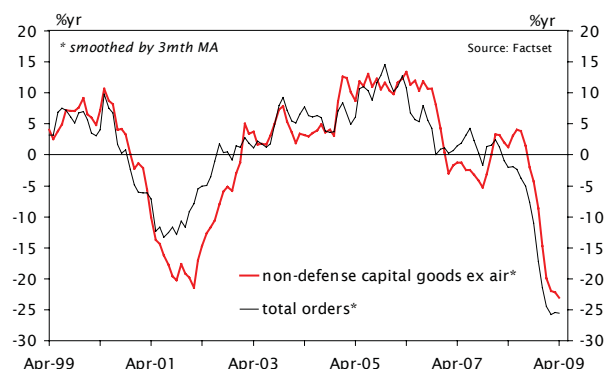


US May durable goods orders to slip away further

Jun 24, Last: 1.9%, WBC f/c: -2.0%

- Durable orders posted close to a 2% gain in Apr but this failed to fully reverse the March fall. April's gain was driven by a one-off 3% jump in auto orders (the first this year) and a 23% jump in defence procurement but core capital goods orders fell for the second month running.
- Business surveys for May showed orders still falling but at a slower pace than earlier this year. Industrial production of business equipment continued to fall away in May, but also not as steeply. The bankruptcies of Chrysler and GM hit auto production sharply, so orders likely off too. Boeing saw a modest increase in aircraft orders, but for mostly smaller craft, so the value would not have increased much if it all.
- Putting all this together, we expect a 2% fall in total orders including a further decline in core orders ex defence & aircraft.

US durable goods orders



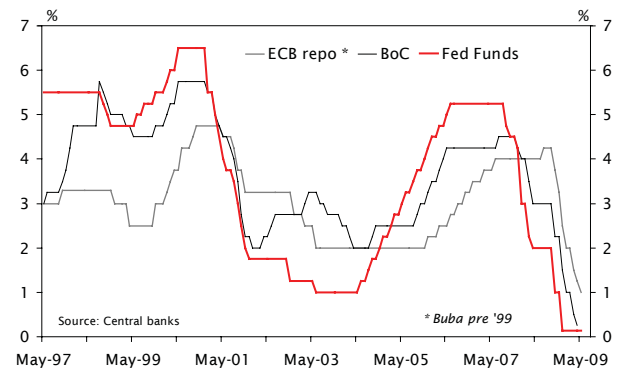
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US FOMC rate decision

Jun 24, Last: 0.25%, WBC f/c: 0.25%

- The Fed Funds target has been at 0-0.25% since Dec 16 last year. Following the April 29 meeting, the FOMC statement sounded a little less downbeat, noting that “the economy has continued to contract, though the pace of contraction appears to be somewhat slower”, but insufficiently so to warrant an altered policy position.
- In the June 24 statement, the FOMC will acknowledge that the economic data tone has improved considerably further. However, depending on whether or not the recent pull-back in yields is sustained, there is likely to also be some discussion about the impact of rising bond yields on the nascent housing and broader economic recovery. In an effort to constrain yields, the FOMC may see fit to clarify how long the “extended period” that rates will remain low might be.

Official rates

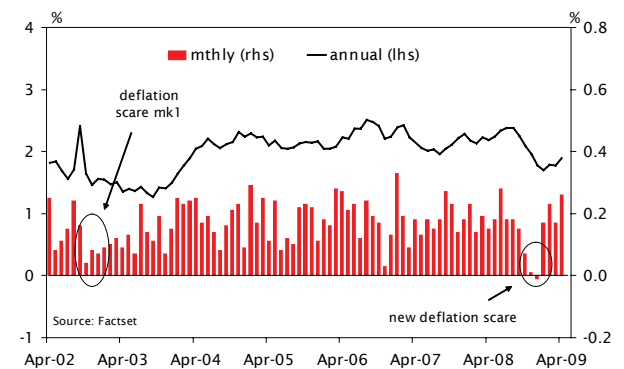


US May core PCE deflator and spending/income

Jun 26, Last: 0.3%, WBC f/c: 0.1%

- The core PCE deflator rounded up to 0.3% in April (as did the core CPI) and its annual pace lifted from 1.8% yr to 1.9% yr, adding weight to the view that the US economy is not on the brink of a deflationary meltdown.
- However in May, the core CPI rounded down to 0.1%, and given that it is rare for the monthly core PCE to be stronger than the CPI, we expect a similar 0.1% outcome for the May core PCE deflator.
- The report will also include details of May personal income (and spending). In April, income was boosted to a 0.5% rise by higher unemployment and increased transfer payments to job losers, despite underlying weakness in hours worked and earnings. In May, a one-off payment to welfare recipients (part of the fiscal package) should contribute to a 0.8% income gain.

US core PCE deflator



Key Data and Events

		Last	Market Median	Westpac Forecast	Comments
Mon 22 Jun					
NZ	May Credit Card Transactions	2.3%	-	-	A moderate increase in transactions expected in May.
Aus	May Motor Vehicle Sales	-1.4%	-	4.0%	Industry figs showed strong uptick on tax break boost to business.
Jpn	Q2 BSI Large All-Industry Conditions	-51.3	-	-	Services embattled as domestic demand tumbles.
	Q2 BSI Manufacturing Conditions	-66.0	-	-	Manufacturers assisted by the advance of the de-stocking process.
	Apr Tertiary Activity Index	-4.0%	2.3%	-	Rate of decline should diminish, but no quick rebound for services.
Ger	Jun IFO Business Climate Index	84.2	85.0	85.5	Even in Germany, optimism is emerging about the outlook.
UK	Jun House Prices %yr	-6.2%	-	-	Rightmove index - monthly prices up in Feb, Mar, Apr and May.
Tue 23 Jun					
US	Jun Richmond Fed Factory Index	4	5	-6	Some of the regional factory surveys jumped too far in May.
	May House Prices	-1.1%	-0.3%	-	Lesser watched and recently volatile FHFA index.
	May Existing Home Sales	2.9%	3.0%	6.0%	Pending sales up 12% in three months, suggesting existing to jump.
Eur	Jun PMI Factory Advance	40.7	42.1	41.0	Still very weak, no recovery but activity falling at slower pace.
	Jun PMI Services Advance	44.8	45.6	45.0	Still very weak, no recovery but activity falling at slower pace.
Ger	Jul GfK Consumer Confidence	2.5	2.5	-	Surveyed early June but labelled July.
UK	May BBA Mortgage Approvals £bn	27.7	29.0	-	Up from £18bn low point in Nov last year.
	Jun House Prices %yr	-11.3%	-10.8%	-	Due 23-30 Jun. Nationwide index, prices up in 2 of last 3 months.
Wed 24 Jun					
NZ	Q2 Consumer Confidence	96.0	-	-	Still reason for caution, but overall tone should be more positive.
US	May Durable Goods Orders	1.9%	-0.8%	-2.0%	Business surveys suggest orders still falling. Autos, defence to slip.
	May New Home Sales	0.3%	2.3%	4.0%	Recent strength in housing starts & permits suggests new sales lifting.
	FOMC Rate Decision	0.25%	0.25%	0.25%	Rates on hold, Fed to address rising mortgage rates in statement.
Jpn	May Trade Balance ¥bn sa	-52	204	-	Commodity prices are rising faster than exports are improving.
	May Corp. Services Prices %yr	-2.4%	-2.8%	-	Corporate cost cutting is on in earnest.
Eur	Apr Current Account Balance €bn sa	-6.5	-	-	Consistently in deficit since Feb last year.
UK	Jun CBI Distributive Trades Survey	-17	-	-	Recently volatile due Easter, warm weather, but sales trend less weak,
Thu 25 Jun					
NZ	Q1 Current Account Deficit NZDm sa	-3,764	-	-2,110	Weak import demand and falling investment income outflows.
US	Q1 GDP (F) % ann'lsd	-5.7%	-5.7%	-5.8%	Minor revisions only, mainly due to a lower inventory estimate.
	Initial Jobless Claims w/e 20/6	608k	600k	600k	Claims point to slower pace of job shedding.
Eur	Apr Industrial Orders	-0.8%	0.0%	0.0%	German orders known flat in April.
Fri 26 Jun					
NZ	Q1 GDP %qtr	-0.9%	-0.7%	-0.9%	Less consumer spending & less investment equals lower production.
US	May Personal Income	0.5%	0.3%	0.8%	Subdued earnings and falling hours to constrain income but watch for transfer payment, taxation impact. Retail sales suggest spending gain.
	May Personal Spending	-0.1%	0.3%	0.3%	
	May Core PCE Deflator	0.3%	0.1%	0.1%	Core CPI was 0.1% in May.
	Jun UoM Consumer Sentiment (F)	69.0	69.0	68.8	Continued gasoline price upswing, equity pull-back may be factors.
	Fedspeak	-	-	-	Dallas Fed president Fisher. Topic tba.
Jpn	Apr All-Industry Activity Index	-2.4%	2.3%	-	Will be helped by a large jump in IP as inventory rundown concluded.
	May National CPI %yr	-0.1%	-1.0%	-	Immense output gap, slack labour market, deflation ensues.
	Jun Tokyo CPI %yr	-0.8%	-1.3%	-	One month ahead snapshot of trends in nationwide figure.
Ger	Jun CPI Prelim %yr	0.0%	-0.1%	-0.3%	Base effects to push annual CPI below zero for first time ever.

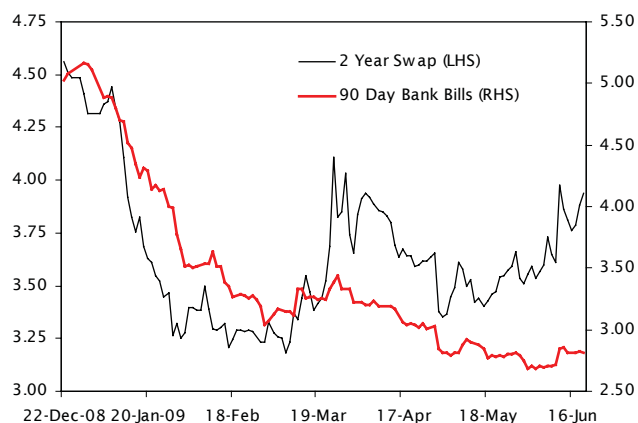
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New Zealand Economic and Financial Forecasts

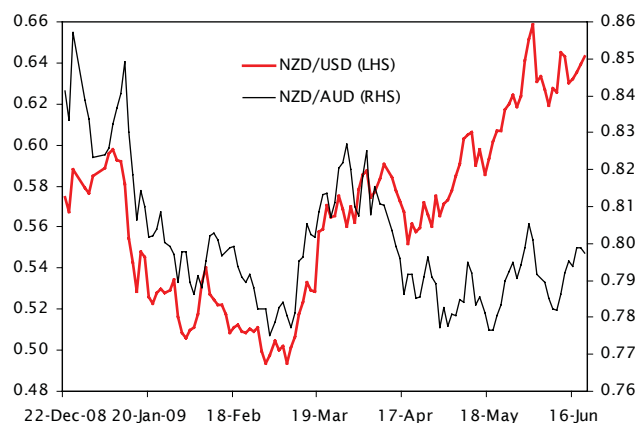
Economic Growth Forecasts	March years				Calendar years			
	2008	2009f	2010f	2011f	2008	2009f	2010f	2011f
% change								
GDP (Production) ann avg	3.1	-0.9	-2.3	2.2	0.2	-2.7	1.2	3.7
Employment	-0.3	0.8	-2.8	1.5	0.9	-3.8	0.8	2.2
Unemployment Rate % s.a.	3.8	5.0	7.5	6.4	4.7	7.4	6.8	5.3
CPI	3.4	3.0	1.5	1.3	3.4	1.3	1.1	1.3
Current Account Balance % of GDP	-8.0	-8.2	-5.3	-5.6	-8.9	-5.0	-5.6	-6.0

Financial Forecasts	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Cash	2.25	2.00	2.00	2.00	2.00	2.00	3.00
90 Day bill	2.50	2.30	2.30	2.30	2.30	2.50	3.40
2 Year Swap	3.60	3.70	3.90	4.10	4.30	4.50	4.70
5 Year Swap	4.50	4.60	4.70	4.80	5.00	5.20	5.40
10 Year Bond	5.40	5.50	5.60	5.70	5.80	5.90	6.10
NZD/USD	0.60	0.59	0.62	0.65	0.68	0.70	0.70
NZD/AUD	0.79	0.80	0.81	0.81	0.83	0.84	0.83
NZD/JPY	57.0	54.3	59.5	64.4	70.0	72.1	74.2
NZD/EUR	0.43	0.43	0.45	0.46	0.47	0.48	0.48
NZD/GBP	0.38	0.37	0.38	0.38	0.39	0.39	0.38
TWI	57.7	57.0	59.3	61.6	64.0	65.6	65.3

2 Year Swap and 90 Day Bank Bills



NZD/USD and NZD/AUD



NZ interest rates as at market open on Monday 22 June 2009

Interest Rates	Current	Two Weeks Ago	One Month Ago
Cash	2.50%	2.50%	2.50%
30 Days	2.83%	2.75%	2.76%
60 Days	2.84%	2.74%	2.78%
90 Days	2.82%	2.70%	2.78%
2 Year Swap	3.92%	3.73%	3.55%
5 Year Swap	5.42%	5.27%	4.93%

NZ foreign currency midrates as at Monday 22 June 2009

Exchange Rates	Current	Two Weeks Ago	One Month Ago
NZD/USD	0.6423	0.6193	0.6175
NZD/EUR	0.4610	0.4455	0.4411
NZD/GBP	0.3899	0.3858	0.3879
NZD/JPY	61.800	60.980	58.500
NZD/AUD	0.7998	0.7850	0.7898
TWI	60.770	59.190	58.690

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Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2004	2005	2006	2007	2008	2009f	2010f
Australia							
Real GDP % yr	3.8	2.8	2.9	4.0	2.3	-0.6	1.0
CPI inflation % annual	2.6	2.8	3.3	3.0	3.7	1.8	2.4
Unemployment %	5.4	5.1	4.8	4.4	4.2	6.3	8.5
Current Account % GDP	-6.1	-5.8	-5.3	-6.2	-4.3	-3.9	-5.7
United States							
Real GDP %yr	3.9	3.1	2.8	2.0	1.1	-3.1	0.7
Consumer Prices %yr	2.6	3.4	3.2	2.9	3.8	-1.4	1.1
Unemployment Rate %	5.5	5.1	4.6	4.6	5.8	9.3	10.6
Current Account %GDP	-5.7	-6.1	-6.0	-5.3	-4.7	-2.7	-2.9
Japan							
Real GDP %yr	2.3	1.9	2.8	2.3	-0.8	-7.5	1.1
Consumer Prices %yr	-0.1	-0.3	0.2	0.1	1.4	-1.1	-0.6
Unemployment Rate %	4.5	4.4	4.1	3.9	4.0	5.1	6.6
Current Account %GDP	3.3	3.6	3.9	4.8	3.2	2.5	2.4
Euroland							
Real GDP %yr	1.9	1.8	3.0	2.6	0.7	-4.7	-0.2
Consumer Prices %yr	2.1	2.5	2.0	3.1	1.6	0.3	0.7
Unemployment Rate %	9.0	8.8	7.9	7.3	7.8	10.0	11.5
Current Account %GDP	0.0	-0.2	-0.5	0.0	-0.2	0.0	0.4
United Kingdom							
Real GDP %yr	2.8	2.1	2.8	3.0	0.7	-4.5	-0.1
Consumer Prices %yr	1.3	2.1	3.0	2.1	3.5	1.0	1.2
Unemployment Rate %	2.8	2.8	3.0	2.5	3.1	5.5	7.0
Current Account %GDP	-1.9	-2.6	-3.0	-2.8	-2.3	-6.0	-5.5

Forecasts finalised 5 June 2009

Interest Rate Forecasts	Latest (Jun 22)	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
Australia						
Cash	3.00	2.50	2.00	2.00	2.00	2.00
90 Day Bill	3.24	2.60	2.30	2.30	2.30	2.30
10 Year Bond	5.76	4.25	4.00	4.00	4.50	5.00
International						
Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.78	3.50	3.25	3.75	4.25	4.75
ECB Repo Rate	1.00	1.00	1.00	1.00	1.00	1.00
Exchange Rate Forecasts						
AUD/USD	0.8031	0.76	0.74	0.77	0.80	0.82
USD/JPY	96.22	95	92	96	99	103
EUR/USD	1.3932	1.38	1.36	1.39	1.42	1.45
AUD/NZD	1.2504	1.27	1.25	1.24	1.23	1.21

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