

Australian weekly

week beginning 22 June 2009

- Westpac-ACCI Survey points to economic contraction.
- Australian data: motor vehicle sales.
- NZ data: Q1 GDP, Q1 current account, Q2 consumer confidence.
- US: FOMC decision, durable goods, housing update.
- Key economic & financial forecasts.

Information contained in this report was current as at 19 June 2009

Westpac-ACCI Survey points to economic contraction

The 191st Westpac-ACCI Survey of Industrial Trends was closed in the week ending 12 June, amidst a backdrop of encouraging 'green shoots' of a global recovery, relative resilience in the Australian economy with significant fiscal policy support, improved housing indicators and a reduction in the perceived difficulty of obtaining finance.

The Actual Composite Index rose 3.9pts to 38.3, partially reversing a 6.9pt fall previously, but remains well below 50 consistent with contracting activity in 2009Q2. It also remained at a level not consistently seen since the 1990/91 recession, below its decade average (52.3) for the fourth consecutive quarter, and was broadly in line with predictions in the prior survey's Expected Composite Index.

The less-bleak economic backdrop saw some improvement in expectations, driving the Expected Composite Index 12.3pts higher to 47.6 (highest since 2008Q3). However this level remains consistent with a further (albeit milder) contraction in Q3, below its decade average (52.8). General business sentiment surged 57pts (greatest improvement since 1975) to -4 (highest since 2007Q4).

Labour demand indicators improved moderately, but remained consistent with a sharp slowing in jobs growth through 2009H2 and a rise in the unemployment rate eventually beyond 8%. The Labour Market Composite net balance rose 8pts to -25, historically consistent with -1½%yr jobs growth. Perceptions of labour market tightness rose slightly but only to their second lowest level since 1992Q1.

Surprisingly, credit conditions eased, although the proportion seeing finance as a constraint remained at a 34 year high. However, an overwhelming majority continue to rate insufficient orders as the most significant constraint.

With improved business expectations, investment plans firmed somewhat, but remained historically weak, still consistent with falling investment through the year ahead.

Selling prices continued to fall and unit cost pressures are easing, but pressure on profit margins remained strong.

This survey is consistent with other surveys on business conditions we have seen recently both for Australia and the US. The Actual Composite Index, which provides a guide to the respondent's assessment of current business conditions, has improved from the depths of the March quarter but is still firmly in the "contractionary" territory. In turn, investment intentions and capacity utilisation have improved somewhat but still point to a heavy load of excess capacity.

The broader measure of Confidence (outlook for the general business situation) has improved dramatically but we are a little suspicious that it may be exaggerating the improvement. Respondents are probably only recognising that things are unlikely to get any worse than in the March quarter rather than declaring a robust future. We have always preferred the Composite Index to the "General Business situation" measure as a guide to the improvement in conditions.

This 'gradual improvement' theme is also apparent with the Labour Market Composite which has improved somewhat but is still pointing to a sharp slowing in the labour market and associated deterioration in the unemployment rate. Consistent with that is the

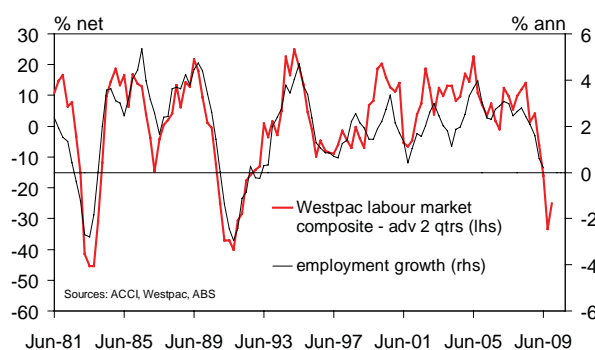
measure of labour availability which has improved a little but is still the second lowest measure since 1992.

Both prices and costs are expected to fall. Contrary to the commonly quoted inflation scare the greater risk is deflation as excess capacity and rising unemployment both domestically and offshore contain any inflation pressures.

Westpac is surprised by current market pricing which is pointing to rate increases of around 150bp's by end 2010. It is far more likely that rates can fall further rather than rise in the current environment.

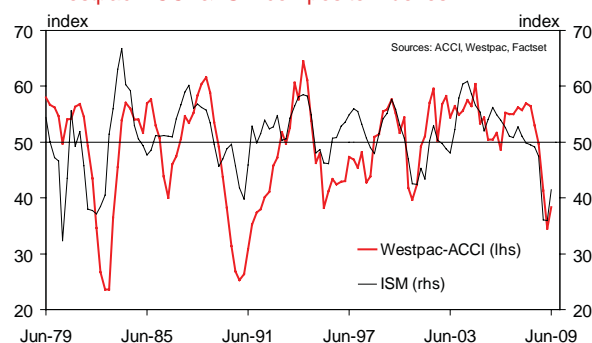
Bill Evans, Chief Economist

Jobs growth to deteriorate rapidly 2009H2



Australian & US manufacturing surveys

Westpac-ACCI & ISM composite indexes



Data wrap

Apr Westpac–MI Leading Index

- The annualised growth rate of the Westpac–Melbourne Institute Leading Index, which indicates the likely pace of economic activity three to nine months into the future, was –3.5% in April well below its long term trend of 2.8%.
- The annualised growth rate of the Coincident Index was –0.5%, also well below its long term trend of 3.0%.

Q1 dwelling commencements

- Dwelling commencements fell by 4.0% in the March quarter, taking the annual decline to 22.5%. That followed commencements falling by 8.6% in 2008Q3 and dropping by 11.5% in 2008Q4. Weakness in Q1 was broadly based - with private houses down 4.1%qtr, -16.3%yr and private units down 6.6%qtr, -34.9%yr.
- The commencement downturn has varied by state. The largest falls over the last year were in Qld -6.0%qtr, -43.5%yr and NSW -7.2%qtr, -33.3%yr. Victoria was the most resilient over this period, 0.1%qtr, -4.6%yr. For the other states, moderate declines over the year were evident: Tasmania -16.0%qtr, -9.2%yr; SA 3.5%qtr, -10.1%yr; and WA 5.8%qtr, -13.2%yr.

Q2 WBC–ACCI Survey of Industrial Trends

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- Surprisingly, credit conditions eased, although the proportion seeing finance as a constraint remained at a 34 year high. However, an overwhelming majority continue to rate insufficient orders as the most significant constraint.
- With improved business expectations, investment plans firmed somewhat, but remained historically weak, still consistent with falling investment through the year ahead.
- Selling prices continued to fall and unit cost pressures are easing, but pressure on profit margins remained strong.

Round-up of local data released last week

Date	Release	Previous	Latest	Mkt f/c
Tue 16	RBA minutes of June meeting	–	–	–
Wed 17	Apr Westpac–MI Leading Index	–5.1%	–3.5%	–
	Q1 dwelling commencements	–11.5%	–4.0%	–3.0%
Thu	Q2 WBC–ACCI Survey of Industrial Trends	34.5	38.3	–
	May merchandise imports, AUDbn	16.2	14.7	–
	RBA monthly bulletin	–	–	–

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

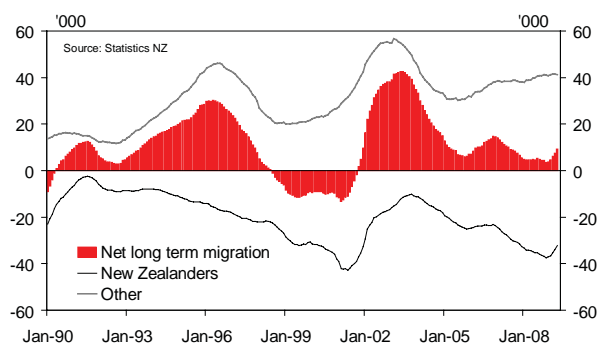
Data previews

NZ May external migration ann.

Jun 22, Last: 9,100, WBC f/c: 9,800

- In 2007 and 2008 hoards of New Zealanders moved to Australia, almost negating arrivals of foreign migrants. Net migration (arrivals less departures) was just 3,800 in 2008, the lowest annual total since 2000.
- But in the past few months the number of Kiwis crossing the Tasman has plunged, pushing the net migration figures up sharply. There were 5,500 net migrants in the first four months of this year (taking the annual total to 9,200).
- We expect the annual net inflow to lift to around 9,800 in May, before rising to total 20,000 people, or 0.5% of the population by the end of the year.

NZ net migration

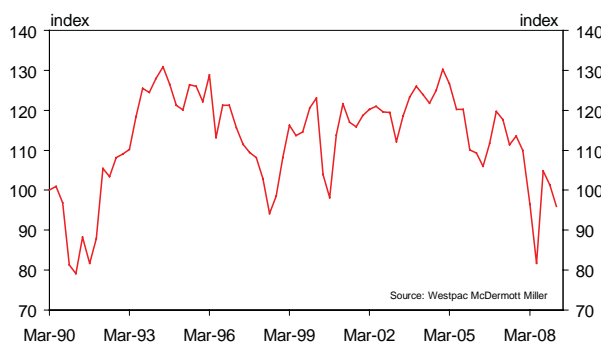


NZ Q2 consumer confidence

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

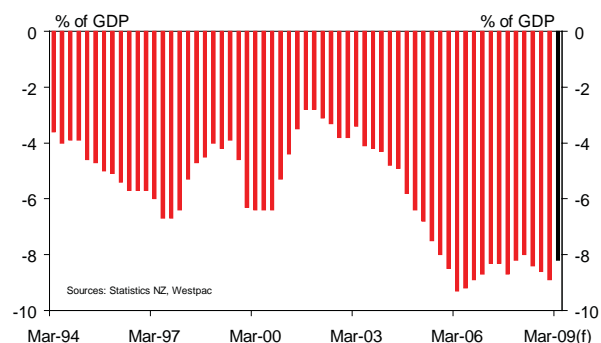


NZ Q1 current account deficit NZDm s.a.

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



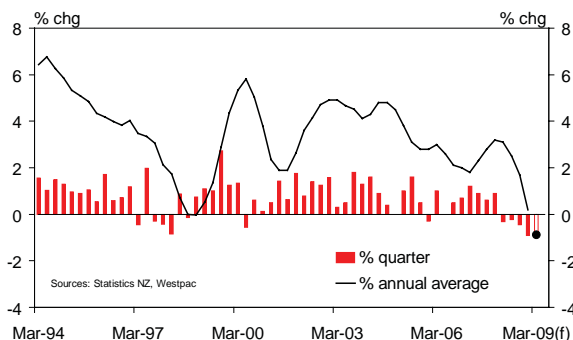
Data previews

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



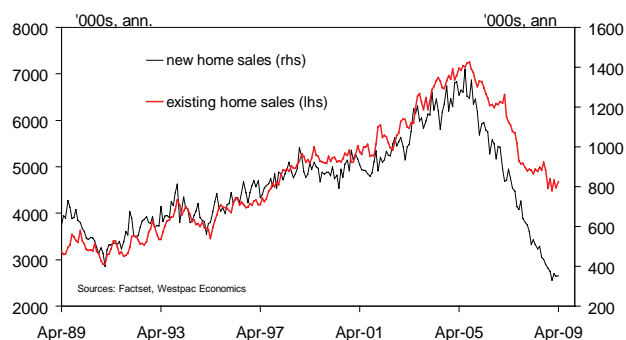
US May existing & new home sales to post gains

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

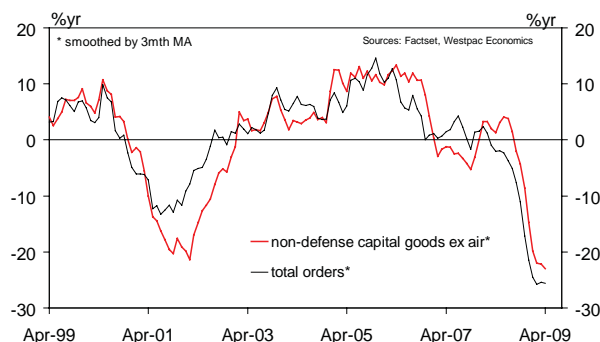


US May durable goods orders to slip away further

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



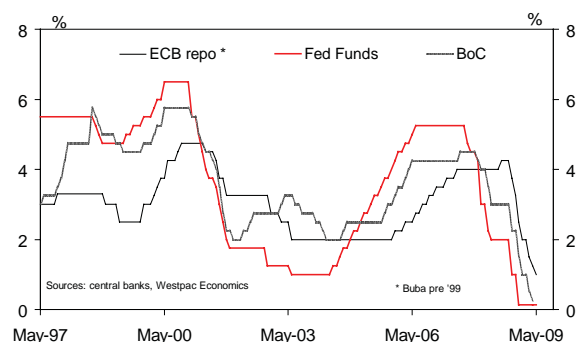
Data previews

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

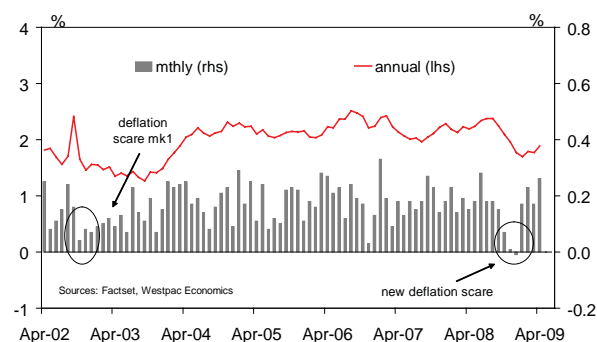


US May core PCE deflator and spending/income

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 & event risk for the week ahead

		Last	Market median	Westpac forecast	Risk/Comment
Mon 22					
Aus	May motor vehicle sales	-1.4%	-	4.0%	Industry figs showed strong uptick on tax break boost to business.
NZ	May external migration ann.	9,100	-	9,800	Kiwis likely to remain happy to stay at home for a while yet.
	May credit card transactions	2.3%	-	-	A moderate increase in transactions expected in May.
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%	-	-	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.
	Jun house prices %yr	-11.3%	-	-	Nationwide index, tentative date - prices up in 2 of last 3 months.
Tue 23					
Twn	May industrial production %yr	-19.9%	-	-	Showing some improvement at the margin as de-stocking slows.
	May export orders %yr	-20.9%	-	-	Revival of Mainland demand helping to crimp rate of contraction.
Eur	Jun PMI factory advance	40.7	42.0	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	-	-	Up from £18bn low point in Nov last year.
US	Jun Richmond Fed factory index	4	-	-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%	2.6%	6.0%	Pending sales up 12% in three months, suggesting existing to jump.
Wed 24					
NZ	Q2 consumer confidence	96.0	-	-	Still reason for caution, but overall tone should be more positive.
Jpn	May trade balance ¥bn sa	-52	-	-	Commodity prices are rising faster than exports are improving.
	May corp. services prices %yr	-2.4%	-	-	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.
US	May durable goods orders	1.9%	-0.9%	-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 and 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.
Thu 25					
NZ	Q1 current account deficit NZDm s.a.	-3,764	-	-2,110	Weak import demand and falling investment income outflows.
Twn	CBC policy decision	1.25%	1.25%	1.25%	No compelling need to cut further with activity consolidating.
Eur	Apr industrial orders	-0.8%	0.0%	0.0%	German orders known flat in April.
US	Q1 GDP final % annualised	-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	Claims point to slower pace of job shedding.
Fri 26					
NZ	Q1 GDP %qtr	-0.9%	-0.7%	-0.9%	Less consumer spending & less investment equals lower production.
Jpn	Apr all-industry activity index	-2.4%	-	-	Will be helped by a large jump in IP as inventory rundown concluded.
	May national CPI %yr	-0.1%	-	-	Immense output gap, slack labour market, deflation ensues.
	Jun Tokyo CPI %yr	-0.8%	-	-	One month ahead snapshot of trends in nationwide figure.
Chn	May industrial profits %ytd	-37.3%	-	-	Sales volumes off, leaving excess capacity/weak margins exposed.
Sing	May industrial production %yr	-0.5%	-	-	April boosted by pharma jump. Underlying more like high -ive teens.
Ger	Jun CPI prelim %yr	0.0%	-0.1%	-0.3%	Base effects to push annual CPI below zero for first time ever.
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%	0.4%	0.3%	
	May core PCE deflator	0.3%	0.1%	0.1%	Core CPI was 0.1% in May.
	Jun UoM consumer sentiment final	69.0	69.0	68.8	Continued gasoline price upswing, equity pull-back may be factors.
	Fedspeak	-	-	-	Dallas Fed president Fisher. Topic tba.

Economic & financial forecasts

Interest rate forecasts

	Latest (Jun 19)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
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
3 Year Swap	4.92	4.25	4.00	4.00	4.50	5.00
10 Year Bond	5.77	5.00	4.75	5.00	5.50	5.75
10 Year Spread to US (bps)	197	150	150	125	125	100

International

Fed Funds	0.125	0.125	0.125	0.125	0.125	0.125
US 10 Year Bond	3.80	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

New Zealand

Cash	2.50	2.25	2.00	2.00	2.00	2.00
90 day bill	2.82	2.50	2.30	2.30	2.30	2.30
2 year swap	3.90	3.60	3.70	3.90	3.90	4.30
10 Year Bond	6.03	5.40	5.50	5.60	5.60	5.80
10 Year spread to US	223	240	195	185	185	240

Exchange rate forecasts

	Latest (Jun 19)	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10
AUD/USD	0.8020	0.76	0.74	0.77	0.80	0.82
NZD/USD	0.6390	0.60	0.59	0.62	0.65	0.68
USD/JPY	96.90	95	92	96	99	103
EUR/USD	1.3920	1.38	1.36	1.39	1.42	1.45
AUD/NZD	1.2550	1.27	1.25	1.24	1.23	1.21

Australian economic growth forecasts

	2008		2009				2010		Calendar years			
	Q3	Q4	Q1	Q2f	Q3f	Q4f	Q1f	2007	2008	2009f	2010f	
% change												
GDP	0.2	-0.6	0.4	-0.6	-0.5	-0.3	0.4	4.0	2.3	-0.6	1.0	
ann chg	2.2	0.8	0.4	-0.6	-1.3	-1.0	-1.0	-	-	-	-	
Unemployment rate	4.3	4.5	5.3	5.8	6.6	7.5	8.1	4.4	4.2	6.3	8.5	
CPI headline	1.2	-0.3	0.1	0.7	0.4	0.6	0.6	-	-	-	-	
ann chg	5.0	3.7	2.5	1.7	0.9	1.8	2.3	3.0	3.7	1.8	2.4	
CPI core	1.2	0.7	1.1	0.7	0.7	0.6	0.5	-	-	-	-	
ann chg	4.7	4.3	4.2	3.8	3.2	3.1	2.5	3.6	4.3	3.1	2.0	

New Zealand economic growth forecasts

	2008		2009				Calendar years					
	Q2	Q3	Q4	Q1f	Q2f	Q3f	Q4f	2007	2008	2009f	2010f	
GDP % qtr	-0.2	-0.5	-0.9	-0.9	-1.0	-0.5	0.2	-	-	-	-	
Annual avg change	2.5	1.7	0.2	-0.9	-1.9	-2.7	-2.7	3.2	0.2	-2.7	1.2	
Unemployment rate %	4.0	4.3	4.7	5.0	6.2	6.9	7.4	3.5	4.7	7.4	6.8	
CPI %qtr	1.6	1.5	-0.5	0.3	0.6	0.3	0.2	-	-	-	-	
Annual change	4.0	5.1	3.4	3.0	1.9	0.6	1.3	3.2	3.4	1.3	1.1	

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