Westpac InstitutionalBank

It's bad, but not that bad

Q1 Westpac McDermott Miller Consumer Confidence Index: 96.0

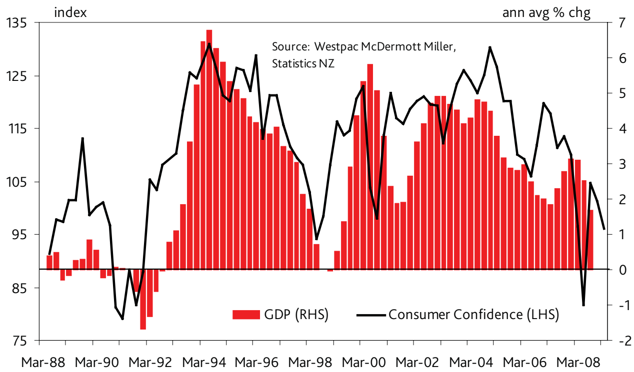
- **Consumer confidence slips back into pessimistic territory as worries around the short term economic outlook intensify. In contrast, confidence in the long-term economic outlook remains close to record highs.**
- **Consumers assessed their current and future financial position as worse than three months ago, and fewer believe now is a good time to buy a major household item.**
- **Consumer spending will moderate further. More monetary easing to come.**

Consumer confidence slipped back below the 100 level in the March 2009 quarter, as consumers took on board the weight of recent negative economic news. The Westpac McDermott Miller Consumer Confidence Index fell to 96.0 in March, from 101.3 in December. At current levels, confidence is still above the low reached in June last year (when the Index fell to 81.7), when high interest rates, petrol and other cost pressures were putting the squeeze on consumers. An index number over 100 indicates there are more optimists than pessimists, while a number under 100 indicates that pessimists outnumber optimists. The margin of error in the survey is 2.5% at a 95% confidence interval. The survey was conducted from 1-16 March.

The balance of economic news has been overwhelmingly negative since our last survey was conducted in early December 2008. Top of the list has been the rapid deterioration in global economic conditions. It has been almost impossible for consumers to escape the bad news from offshore, with nearly every day bringing another tale of woe from one of our major trading partners. Indeed for many of us it is hard to fathom job losses of 650,000 in one month, as was the case in the US in February. Nor is it easy to comprehend a 46% decline in exports in the space of a year, as experienced in Japan. Yet, at present it is these news stories we have to digest on an all too regular basis.

Back home, the economic news has been far less sensational, albeit still disturbing. Businesses are deeply pessimistic and expect to cut back sharply on investment and employment over

Consumer Confidence and GDP



Consumer Confidence Indices

	Mar-09	Dec-08	change
Consumer Confidence Index	96.0	101.3	-5.3
Present Conditions Index	90.7	95.0	-4.3
Future Conditions Index	99.6	105.5	-5.9

the coming year; unemployment is on the rise; house prices continue to fall albeit at a slower rate; and lower NZD is putting upward pressure on the price of imported goods, including petrol where prices have risen around 14% since the survey was last taken in December 2008.

Taking all of this on board, New Zealand consumers have remained remarkably resilient. Certainly, when we look at our international counterparts, New Zealand consumers appear to be less pessimistic than most. For example, confidence amongst US consumers is at a mind-bogglingly low 56.6 on their Index. In Australia, the consumer confidence Index is at 85.6. The divergence in confidence raises the questions as to whether NZ consumers are being staunch or whether they are in denial.

There are a number of plausible explanations as to why NZ consumers are not suffering such a bad case of depression. A key factor is the substantial stimulus coming to consumers via monetary and fiscal policy. Since December, the RBNZ has cut the OCR by 200bps, rounding out a full 525bps drop

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in the OCR since July last year (from 8.25% to 3% currently). Importantly, those cuts have largely been passed through to borrowers. This is in contrast to the US and the UK where despite massive easing by the Federal Reserve and the Bank of England, interest rates have taken a very long time to come down. In terms of fiscal policy, the second round of tax cuts commences on 1 April. That, in addition to the Government's recently announced initiatives on infrastructure spend, could be driving some of the optimism in the long term outlook for NZ (see below where a net 50% of respondents expect good economic times over the next 5 years).

Another explanation for our low level of pessimism possibly relates to the relatively low exposure NZ households have to financial assets (around 20% of total household assets). While from a long term perspective this is deemed a negative in terms of wealth generation, at present it is clearly working in our favour. With so few households owning shares, the massive declines in equity markets affect us less than some of our trading partners. Likewise, although New Zealanders have a substantial exposure to the housing market (80% of household assets), the correction to date has been mild relative to the experience in the US, UK and much of Europe. Moreover, NZ does not suffer from the over-supply of housing that has caused so much strife in the US. In fact, NZ is at risk of developing a shortage of housing in the coming few years. If that eventuates, that will provide some support to house prices.

Regardless of how we compare with our international friends, at current levels the Index points to continued weak consumer spending over the next few months at least. We estimate that real spending was flat through the March quarter, following a 0.4% decline in the December 2008 quarter and these data suggest little improvement in the near term. In fact, when consumers were asked what they would do with a $10,000 cash windfall, 58.3% said they would pay off debt or save it. That compares with 53.1 % in the December quarter, and 50.5% at the same time last year. It seems NZ consumers' newfound conservatism toward spending will be here for a while yet.

Survey components

The fall in confidence was widespread, with all the components of the index lower than in December. However, apprehension around the short term economic outlook continues to drive the decline. A net 57% of respondents expect bad economic times over the next 12 months, up from 45% in December last year. This is the most negative response to this question since June 1998. Fortunately, consumers still believe that the downturn will be short lived – a net 50% expect better economic times over the next five years, down only marginally from the record high of a net 51% reached in December. The long term average for this component is a net 30%. The above average result is likely to be reflecting where we are in the current economic cycle – i.e., it seems reasonable that during a recession the majority of consumers would expect better times over the medium to long term.

Consumers' assessment of their finances worsened over the quarter. A net 28% of respondents said they felt worse off now compared to a year ago – from a net 21% in the December quarter. Still, that is better than the 41% of respondents saying they felt worse off in June last year when cost increases were at their peak. A net 6% of respondents expect to be better of in a year's time, although that is down from a net 10% in December.

Perceived purchasing power fell further this quarter, despite the massive drop in interest rates since the last survey was taken. Only a net 10% of respondents said now is a good time to buy major household items – down 1 point from the December survey. Clearly, cheaper credit is not enough to offset the negatives of falling job security and a lower currency (making imported items more expensive).

Regional and demographic split

By region, the fall in confidence was also widespread, with nine of the eleven regions showing a deterioration, and all regions once again in pessimistic territory. The sharpest falls were in the Bay of Plenty and Otago, although the prize of most pessimistic consumers goes to the Northland region. The only areas to experience a lift in confidence from the December quarter were Waikato and Canterbury. Overall, however, rural consumers are still the most pessimistic, followed by the secondary centres, with metropolitan centres bringing up the rear.

By demographic grouping, the 50+ age group is the most pessimistic – not surprising given they arguably have the most to lose in this environment. The 18-29 age group is the only group where the index is still over 100 (i.e. the optimists outweigh the pessimists). Males are less pessimistic than females, albeit only by a very small margin.

Consumer Confidence Data

Region		Index	
	Mar-08	Dec-08	Mar-09
Northland	87.4	98.8	91.8
Auckland	99.8	102.3	95.4
Waikato	92.1	96.0	98.2
Bay of Plenty	95.7	105.7	93.4
Gisborne/Hawke's Bay	92.1	104.5	98.3
Taranaki/Manawatu-Wanganui	92.1	102.0	93.9
Wellington	96.3	103.2	97.8
Nelson-Marlborough/West Coast	101.5	105.6	96.9
Canterbury	98.7	95.7	98.7
Otago	96.2	104.2	93.4
Southland	91.6	102.6	93.8

Implications

The RBNZ's latest *Monetary Policy Statement* forecast very weak consumer spending through 2009. These data are broadly consistent with that view. As such it is unlikely to change their current stance on future monetary policy settings.

Nevertheless, we continue to believe that the domestic data will disappoint the RBNZ over the next few months, thus failing to support their story of a recovery in growth in the second half of this year. Moreover, the recent strength in the NZ dollar, if sustained, implies more work on the interest rate front if the RBNZ is to achieve easier monetary conditions. We remain of the view that the OCR will reach 2% by the middle of this year.

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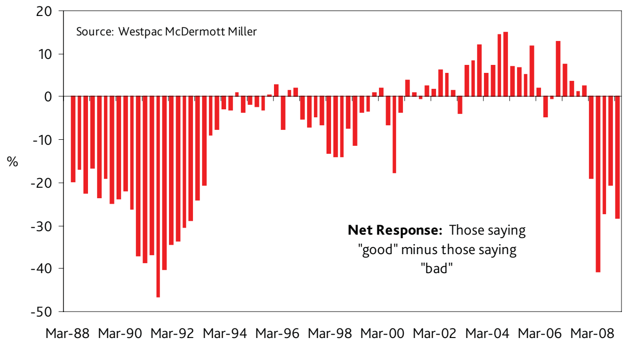
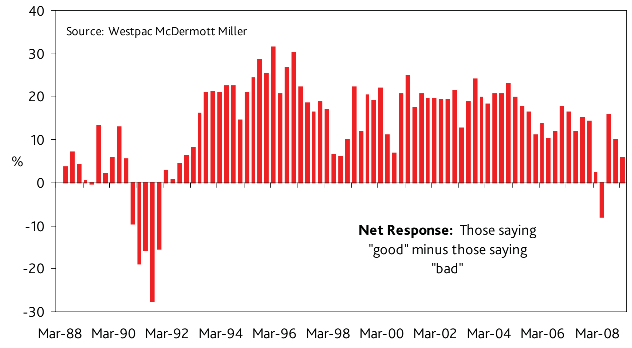
Q2 consumer confidence will be released on Wednesday 24 June 2009

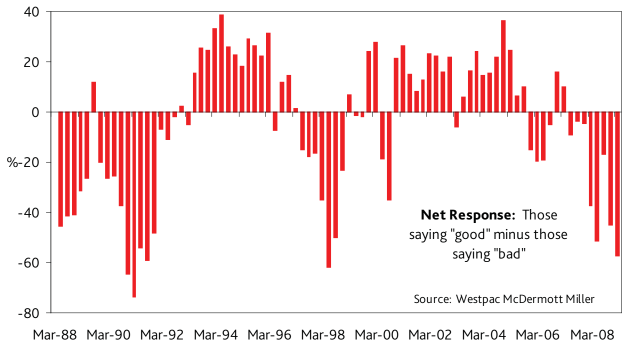
Are you better or worse off financially now than a year ago?



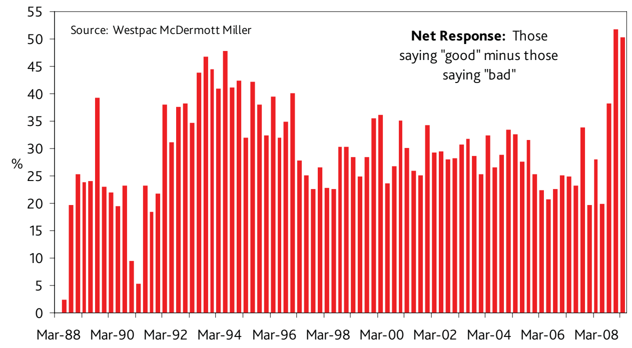
Do you expect to be better or worse off financially this time next year?



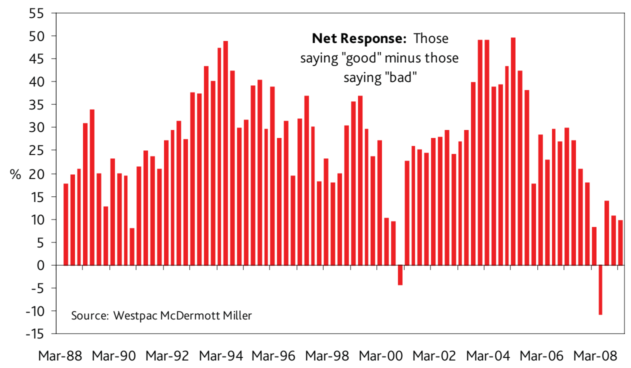
Do you expect good or bad economic times over the next 12 months in NZ?



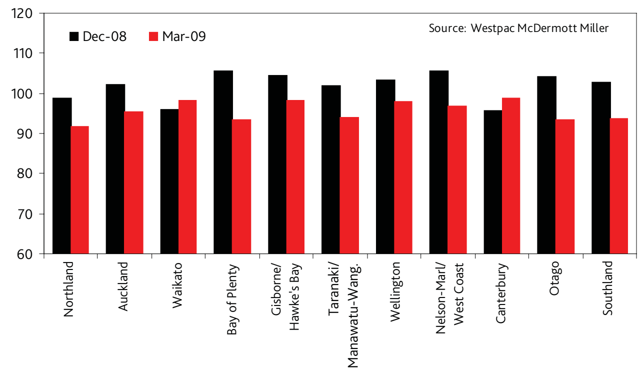
Do you expect good or bad economic times over the next 5 years in NZ?



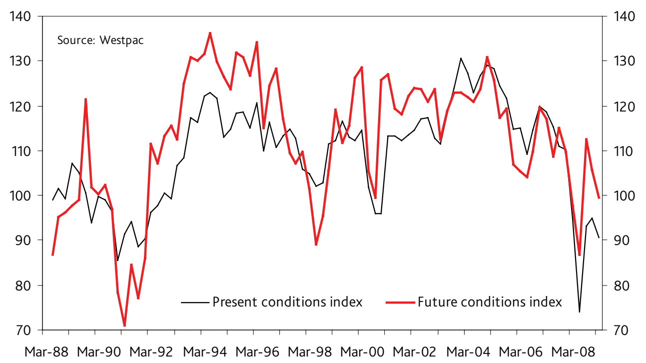
Is this a good or bad time to buy a major household item?



Regional Confidence



Present and Future Conditions Index



Consumer Confidence Data

Quarter	Index
Dec-06	119.7
Mar-07	117.7
Jun-07	111.4
Sep-07	113.5
Dec-07	110.0
Mar-08	96.5
Jun-08	81.7
Sep-08	104.8
Dec-08	101.3
Mar-09	96.0