

Consumer confidence nose-dives

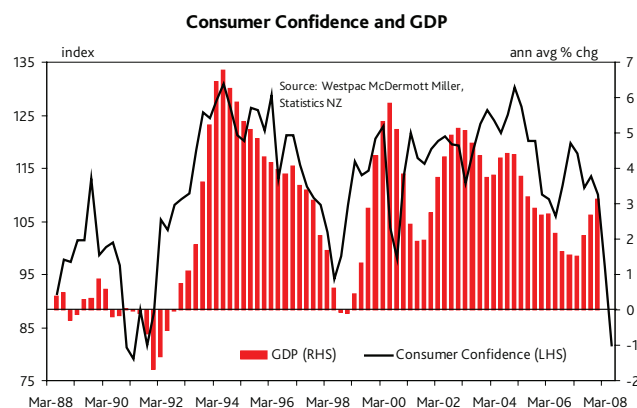
2008Q2 Westpac McDermott Miller Consumer Confidence Index: 81.7

- **Consumer confidence plunges to lowest level since 1991.**
- **A big deterioration in perceptions around current financial position and purchasing power leads the way.**
- **The result points to continued weakness in consumer spending in the months ahead, but on its own is unlikely to deliver a July rate cut by the RBNZ.**

Consumer confidence nose-dived in the June 2008 quarter, trumping even last quarter's jaw-dropping decline. The Westpac McDermott Miller Consumer Confidence Index fell 15 points to 81.7 in June – the third lowest level in the 20-year history of the survey. Confidence has not been this low since the 1991 recession. 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 pressure on consumers has intensified over the past few months as sharply higher prices for every day items such as food, fuel, and shelter, have continued to eat into disposable incomes. Of these, the highly publicised rise in fuel prices is likely to be the main culprit. Since the March quarter survey, oil prices have risen from around US\$100 per barrel to US\$136 per barrel currently. This has resulted in local pump prices rising to an all time high of \$2.109/litre for 91-Octane. For the average household, that translates into an extra \$430 per year, just on petrol (assuming no volume response and that prices remain at current levels for the remainder of the year).

To that we can add a further 2% increase in food prices, a 5% decline in the currency which is putting upward pressure on import prices, falling house prices, rising unemployment, and increased debt servicing costs as people on fixed mortgages roll off onto markedly higher rates. It's no wonder consumers are more than a little unhappy.



Consumer Confidence Indices

	Jun-08	Mar-08	change
Consumer Confidence Index	81.7	96.5	-14.8
Present Conditions Index	74.2	94.6	-20.4
Future Conditions Index	86.7	97.7	-11.0

There has been some good news. Fonterra lifted the dairy payout for the current season from \$7.30/kg milksolids to \$7.90. Moreover, Fonterra's initial forecast for the 2008/09 season is for \$7.00/kg milksolids – lower than the current season, but still well up on the average of the previous 5 years. In addition, the 2008 Government Budget delivered a tax cut package worth \$10.6bn over the next four years, as well as the earlier indexation of working for families' payments. Together these factors should provide some welcome relief to cash-constrained households later this year. But it seems for many that is too little too late. In any case, there is plenty for consumers to be grumpy about.

Key components

The fall in confidence was widespread this quarter, with all the components of the index significantly lower than in March. The biggest decline was in consumers assessment of their own financial circumstances now compared to a year ago. A net 40.8% of respondents said they felt worse off – down 21.9

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percentage points from the March quarter and the lowest response to this question since 1991. What's more, consumers don't expect the situation to improve over the coming year. A net 8.0% of consumers expect to be worse off financially in a year's time. Again this is the first time since 1991 that consumers on balance have been pessimistic about their future financial position and does not bode well for spending in the medium term.

Perceived purchasing power also took a hammering this quarter. A net 11% of respondents said now is a **bad** time to buy major household items – down 19 points from the March survey. This is only the second time in the history of the survey that the balance of consumers has said it is a bad time to buy! The last time the response was negative was in the December 2000 quarter. It seems consumers are acutely aware of the reduction in their living standards coming from higher prices staples, and discretionary spending is taking a hit as a result.

Regarding the economic outlook, consumers continue to remain extremely downbeat. A net 51.6% of respondents expect bad economic times over the next 12 months, down from a net 37.2% in March. This is the most negative response to this question in 10 years. On the whole, consumers still expect the downturn to be short lived, with a net 19.7% expecting better economic times over the next five years. However, this is down from the March quarter, when a net 28% expected better economic times in the medium term.

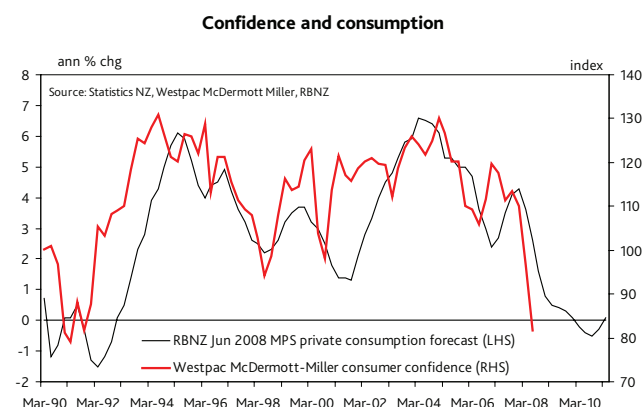
By region, the fall in confidence was equally widespread. Every region showed a deterioration (with 8 of the 11 regions registering falls in the double digits!), the sharpest falls occurring in Nelson/Marlborough/West Coast, Otago, Auckland, and Southland. With the exception of Auckland, the extent of the falls in these regions was surprising given their relatively strong commodity focus – particularly dairy. However, we suspect high profile job losses are likely to have contributed to the lower confidence, with companies such as Fisher and Paykel, ANZ, PPCS, Carter Holt Harvey, and Sealords all announcing significant layoffs during April and May.

Consumer Confidence Data

Region	Index		
	Jun-07	Mar-08	Jun-08
Northland	109.0	87.4	78.2
Auckland	112.6	99.8	80.8
Waikato	102.0	92.1	78.8
Bay of Plenty	114.2	95.7	86.9
Gisborne/Hawke's Bay	106.7	92.1	78.9
Taranaki/Manawatu-Wanganui	108.7	92.1	80.2
Wellington	118.6	96.3	92.8
Nelson-Marlborough/West Coast	108.4	101.5	77.5
Canterbury	117.5	98.7	81.7
Otago	103.0	96.2	76.4
Southland	100.8	91.6	72.8

Implications

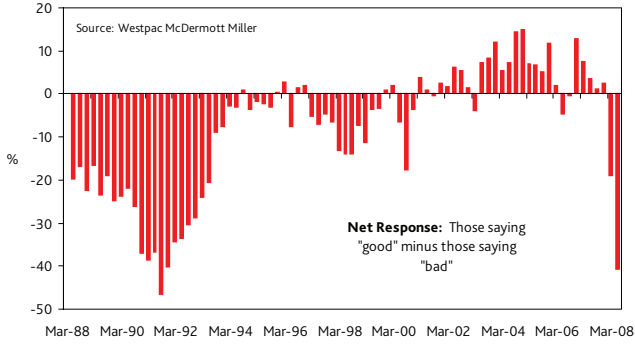
The RBNZ next meets on July 24. The sharp deterioration in confidence in the June quarter will inevitably see markets price in an increased probability of a cut in OCR at that time (prior to the release the market was pricing in around a 40% probability of a July cut). However, on its own, we don't believe the collapse in confidence will be enough to see a July cut eventuate. In the June *Monetary Policy Statement*, the RBNZ projected a deep retrenchment in consumer spending over the next few years: annual average consumption growth is forecast to be only 0.4% in the year to March 2009, -0.2% to March 2010, and still only 0.1% in the year to March 2011. As the chart below illustrates, the fall in confidence to date is broadly consistent with that pessimistic view. As such, we continue to favour September as the start of the easing cycle.



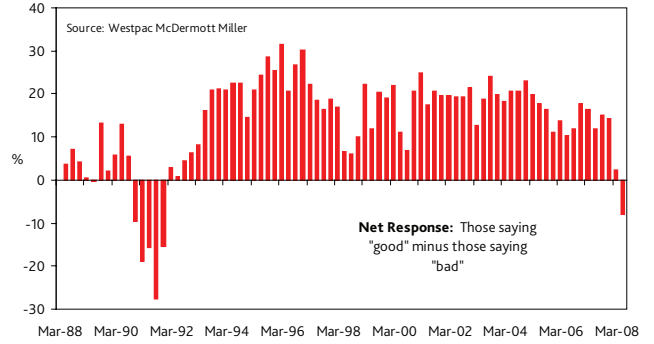
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**Q3 consumer confidence will be released on
 Wednesday 24 September 2008**

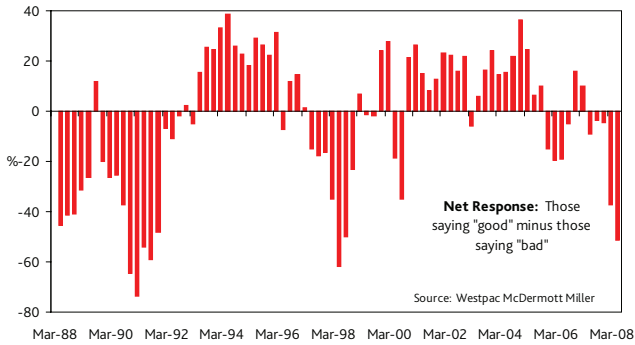
Are you better or worse off financially now than a year ago?



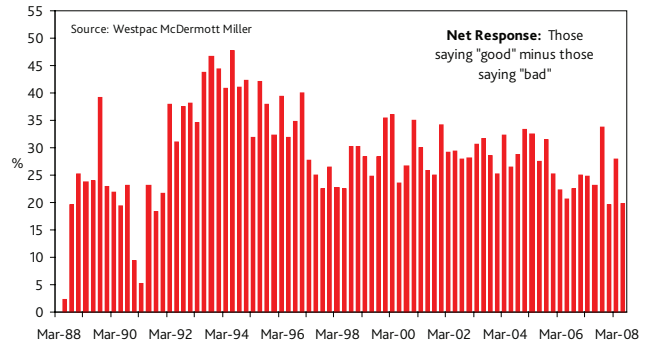
Do you expect to be better or worse off financially this time next year?



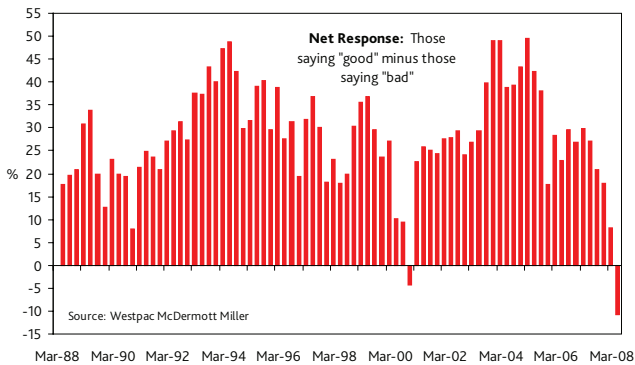
Do you expect good or bad economic times over the next 12 months in NZ?



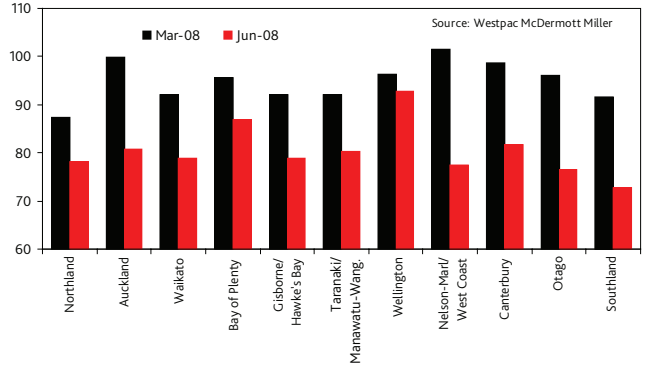
Do you expect good or bad economic times over the next 5 years in NZ?



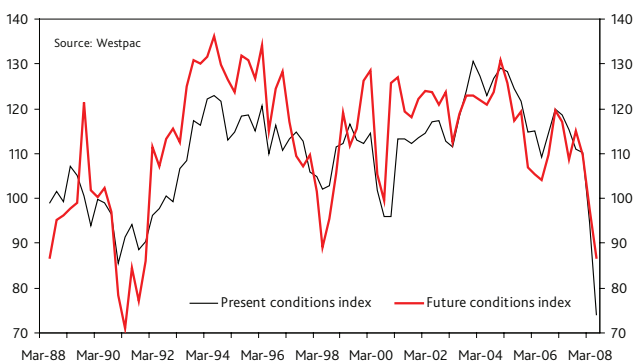
Is this a good or bad time to buy a major household item?



Regional Confidence



Present and Future Conditions Index



Consumer Confidence Data

Quarter	Index
Mar-06	109.3
Jun-06	106.0
Sep-06	111.7
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