Economic Research
J.P. Morgan Securities Inc.
June 26, 2009

New Zealand Economic Update

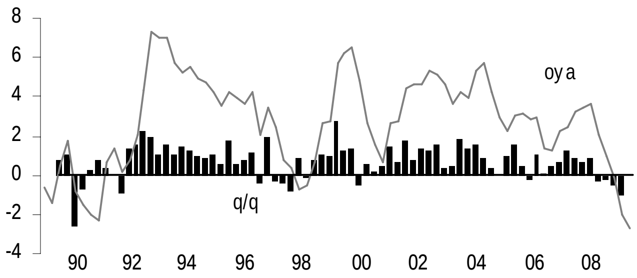
GDP

- **Economy contracted for fifth straight quarter**
- **Business investment tumbled in 1Q**
- **Expect further policy easing from RBNZ**

The New Zealand economy contracted 1.0%q/q in the March quarter (J.P.Morgan -0.4%, consensus -0.7%), marking the fifth straight quarterly decline. The contraction in output matched that recorded in 4Q (which was revised slightly lower from -0.9%q/q) and is likely to be the first of three straight negative GDP prints in 2009 although, on our forecasts, this will be the deepest contraction in GDP this year.

New Zealand: GDP growth

%, chain volume



Weaker business investment was the main drag on economic growth in 1Q, a trend we expect will continue throughout 2009 due to low confidence, reduced credit availability, and tighter lending standards. Business investment in fixed assets tanked 7%q/q, with investment in plant and machinery down 5% and investment in transport equipment slumping 37%. Gross fixed capital formation fell 6%q/q, owing to less investment in non-residential buildings, transport equipment, and plant, machinery and equipment. But, residential investment held up as expected, though the 0.3% fall did mark the seventh straight quarterly decline in what has been a prolonged downturn in Kiwi the housing market.

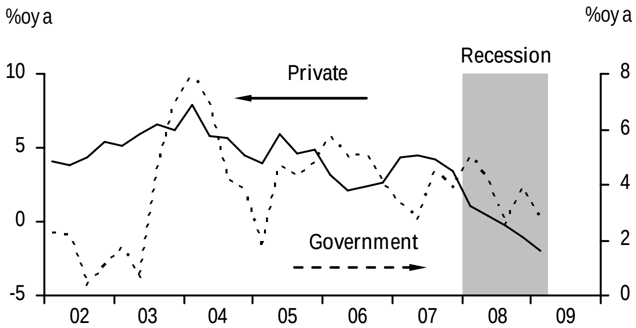
Household consumption expenditure fell, unsurprisingly, after the release of earlier data showing a record fall in retail sales volumes in 1Q. Consumers continue to save rather than spend, mainly owing to increased anxiety about job security, leading to a 1.3%q/q fall in private consumption in 1Q, the largest fall since 1991. We expect further falls in private consumption given ongoing wealth destruction in the household sector and the deleveraging process underway. Government consumption was surprisingly weak in the March quarter, rising just 0.4%q/q, following a 1.5% spike in 4Q.

Net exports made a solid, positive contribution to GDP growth, thanks mainly to a slump in imports (-8.6%q/q). The bad news is that the fall in imports is a symptom of firms slashing investment which, of course, has negative consequences for the employment outlook, supporting our view that the unemployment rate will venture significantly higher in coming quarters. Export volumes were up slightly (+0.6%q/q), mainly owing to an increase in exports of dairy products (+12%).

We forecast that the economy will contract again in the second and third quarters of 2009, before expanding modestly in 4Q. The significant monetary and fiscal policy easing that has been delivered should help New Zealand eventually recover from this prolonged recession, but growth will remain below trend for some time. Indeed, the forecast recovery will be milder than those experienced after previous recessions, where growth averaged 5%. This time, an extended period of weak investment and household deleveraging will delay to return to trend growth.

The main risk to the recovery we forecast to commence later this year is the strengthening NZ dollar. RBNZ Government Bollard recently acknowledged that recent NZD appreciation had added to the broader tightening in financial market conditions. For this reason, it has become even more important that fiscal and monetary policy operate effectively. We believe that if monetary conditions continue to tighten, further monetary policy support will be delivered in 2H09. Indeed, the RBNZ has left the door open to further policy easing, and we maintain our call for a terminal cash rate of 2.25%. We acknowledge, though, the significant possibility that the RBNZ's easing cycle may already have ended.

New Zealand: government and private consumption



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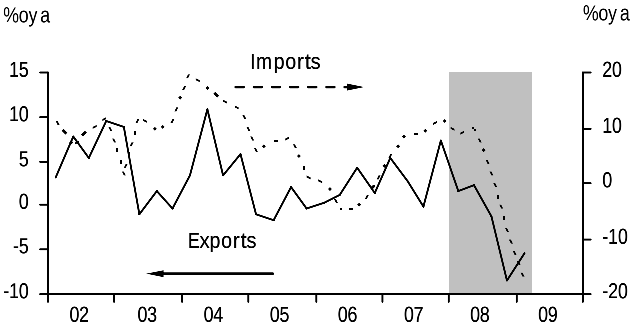
New Zealand: imports and exports



	%q/q	Contribution to GDP growth
Final consumption expenditure		
Private	-1.3	-0.8
General government	0.4	0.1
Gross fixed capital formation		
Residential buildings	-0.3	0.0
Other fixed assets	-7.3	-1.3
Exports of goods and services	0.6	0.2
Imports of goods and services	-8.6	2.7
Change in inventories	...	-1.6
Expenditure on GDP	-0.7	-0.7

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