BUSINESS NZ
PLANNING FORECAST

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BusinessNZ

Is the patient showing further signs of recovery?

Executive summary

Economy

If you spend some time checking out the large array of performance monitors hooked up to the patient called the world economy right now, you might find it slowly coming off life support, and starting to breathe on its own. Sure, there could be a bit of false hope going on here, as the patient may take another turn for the worse. However, you mustn't forget that this patient won't eventually die. It'll recover, it'll get on its two feet again, and it'll grow. Have we come to the point where the patient is beginning the road to recovery? The answer is a definite …… maybe. The signs are there – some green shoots and the 'R' word (yes, recovery) is being talked about. But the world economy is still shaky, and any upswings are often off a very low base, so we shouldn't get too optimistic yet.

Looking at New Zealand's case, there has certainly been a stream of more positive results to come out in recent weeks. The official unemployment rate was not as bad as many had expected (albeit still rising), the manufacturing sector (one of the sectors to first show changing fortunes) seems to show some turning points, while commodity prices for key New Zealand exports are improving. However, positive news is also sprinkled with those businesses struggling to make ends meet. The word 'patchy' best describes how activity is going, even within sectors. Tourism and hospitality are two such examples, where the market you've aimed your business at is heavily dictating your activity.

HIGHLIGHTS

New Zealand's growth is expected to bottom out at around -2 percent by mid 2009, before recovering somewhat to around -1 percent by 2010.

Inflation expected to remain well in the bottle for the next few years.

The unemployment rate may hit over 7.5% by 2010, but is unlikely to get near levels seen in other countries.

Business New Zealand's Economic Conditions Index shows improved conditions, although still in negative territory.

Part 1: The New Zealand Economy

1.1. Economic growth (GDP) – still going backwards

Most recent outcome: +0.2 per cent for the year to December 2008

Gross Domestic Product is a measure of a country's total economic activity over a given period. Since 2000, New Zealand's annual GDP growth has averaged more than 3 percent, indicating a relatively strongly performing economy with higher growth than in many other developed countries. However, in line with many other countries, New Zealand is currently in recession, and has been since the first quarter of 2008.

Economic activity decreased 0.9 percent in the December 2008 quarter, the fourth consecutive quarterly decrease in economic activity. On an annual basis, GDP was actually up 0.2 percent for the December 2008 year, despite four quarters of declining activity. This was because the economy grew at a faster pace in 2007 than it contracted in 2008.

The main drivers of the decline in the December 2008 quarter were the manufacturing and wholesale trade industries (which is consistent with the negative data from a number of surveys discussed later e.g. the BNZ Capital – Business NZ Performance of Manufacturing (PMI) and Performance of Services (PSI) Indexes).

Manufacturing activity declined 3.8 percent in the December 2008 quarter, with a reduction in activity broadly across most manufacturing sub-industries. Partly offsetting the decline in GDP was finance insurance and business services, which was up 2.2 percent in the December 2008 quarter. Activity in primary industries increased 1.6 percent in the December 2008 quarter, with agriculture being the main contributor (up 4.0 percent). Dairy production was the main driver in the agriculture industry.

Looking ahead, GDP is most likely to be negative on an annual basis for both the June years 2009 and 2010 as can be seen from the bank forecasts below. Looking out to 2011, there is expected to be a significant pick up in growth, with an average rate of close to 3.5%.

Continued negative growth over the next 2 or so years has to be put into context with the global situation, where things look much worse for other countries. The International Monetary Fund (IMF) is forecasting that the global economy will shrink by between 0.5 percent and 1 percent this year, which represents a sharp fall from the IMF forecasts of January 2009 which predicted that the global economy would grow 0.5 percent. The US economy is now forecast to contract by 2.6 percent this year with continuing flows of negative news in both the business and household sectors. New Zealand, thankfully, does not have many of the problems associated with toxic debt which the US and some other countries have. The difficultly for the global economy is that confidence has not only vaporized in the business sector, but also amongst households and consumers in general.

The Organization for Economic Cooperation (OECD) has revised its Economic Outlook for the OECD countries for the years 2009-10.

Some of the highlights include:

- OECD GDP will fall in 2009 by -4.3 percent followed by economic stagnation in 2010. World GDP will shrink in 2009 by 2.7 percent.
- OECD unemployment rates will rise sharply from 6 percent in 2008 to 8.4 percent this year and 9.9 percent in 2010.
- Amid the deepest and most widespread recession for more than 50 years, international trade is forecast to fall by more than 13 percent in 2009.
- The most important risk is that the weakening real economy will further undermine the health of financial institutions, which in turn will deepen the slump in economic activity.

Forecasts: Real GDP % Growth

	Years Ending		
	Jun 09	Jun 10	Jun 11
Highest	-1.7	0.1	4.6
Average	-1.9	-0.9	3.4
Lowest	-2.1	-1.4	2.6

Source: ANZ, ASB, BNZ, National, and Westpac

Business NZ believes key factors influencing GDP over the next two years will include:

Interest rates – falling, but easing on the rate of decline

The Reserve Bank continues to lower the official Cash rate (OCR) to levels not seen before during the time in which this mechanism has existed. However, this has only had minimal flow on effects in terms of retail rates so far

Since our last Business forecast, the Reserve Bank has twice lowered the OCR twice again. A 50 basis point cut to the OCR in March has been followed by another 50 basis points cut at the end of April, bringing the OCR down to 2.5 percent. Never before has the rate dived into the '2s', while the Reserve Bank Governor Alan Bollard made a rather forthright statement with the April cut, noting that *"We consider it appropriate to provide further policy stimulus to the economy. We expect to keep the OCR at or below the current level through until the latter part of 2010. The OCR could still move modestly lower over the coming quarters."*

Certainly, the Reserve Bank has the luxury that many other countries do not have as they have already expended the option of further cuts, with some commentators predicting another 25 basis point cut for the next OCR announcement on 11 June (further cuts beyond that will be measured against how the global situation continues to pan out). However, the Reserve Bank has been involved in some significant jaw-boning over recent weeks to try and get the retail banks to pass through the OCR cuts into the retail lending rates. This has only occurred at a minimal level, simply because the cost of borrowing offshore remains high.

Official Interest rates

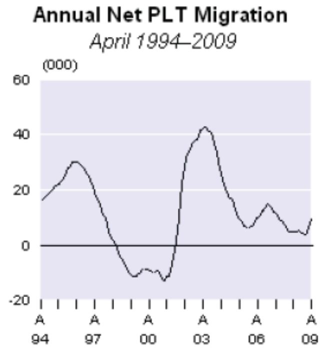
Central Bank	Current rate (%)	Previous rate (%)
Reserve Bank of Australia	3.00%	3.25%
US Federal Reserve	0.25%	0.25%
Bank of England	0.50%	1.00%
European Central Bank	1.00%	2.00%
Reserve Bank of NZ	2.50%	3.50%

The New Zealand Dollar – suddenly back in vogue?

There has been a general recovery of the New Zealand dollar since our last forecast, mainly due to the fact riskier currencies (yes, we're seen as one of those) have picked up demand.

Net migration flows – flows increasing, but make-up perhaps not as expected.

Net migration (which is a good leading indicator of general economic activity for the future) had been declining over the last few years, but there has been some recent upturn, although not from the countries many were anticipating. Seasonally adjusted net migration was 2,200 in April 2009, up from 1,700 in March, and 1,600 in February. The April result was the highest since January 2004, when it stood at 2,500. In addition, the equivalent figures for the last three months are all well above the average of 400 recorded for the 25-month period from January 2007-2009.



In terms of annual flows, net migration was 9,200 for the April 2009 year, up from 4,700 in the April 2008 year. While this is still below the average December year gains of 11,400 recorded between 1990-2008, the graph above does show a turn upwards.

The make-up of the gains is certainly interesting, and perhaps not what many have been expecting. The net gain was mainly driven by fewer New Zealanders leaving to live in Australia, as well as more people coming from India, the Philippines, Japan and China to live here for more than six months. Many thought the net gains may have come from New Zealanders returning from such places as Britain, and although numbers in this regard are slightly up, it is not a significant change. A combination of Kiwis failing to sell their house offshore, unable to find employment in New Zealand before moving and a general hesitancy regarding big decisions at present have probably all played a part in Kiwis staying 'over there'. Those in the property market will be watching this with close attention, as the number of cashed up Kiwis with pounds to spend on a house here looks to be far fewer than expected. However, we mustn't forget that we are still gaining people, who have to live somewhere. If net migration continues on its current trajectory, then some push demand is likely. However, how strong that will be is open for debate.

Commodity prices – some pick up after a hefty fall

There was a back-to-back monthly rise in commodity prices, with the ANZ Commodity Price Index standing at 153.5 in April 2009 (up 2.5 percent from the previous month), while the March result showed a 1 percent increase. However, the April results were still 29.5 percent down from the same period last year.

The April result saw a range of commodities increase in price, which meant the latest index result represented the strongest monthly rise in nearly two years, albeit coming off a low base. The biggest winners for April were aluminium (up 6.6 percent), followed by lamb (up 6.4 percent) that increased to a new high. Interestingly, world sheep meat prices have risen since mid-2007, despite the overall weakening of the other main commodities. This is mainly due to tightening in the global supply of sheep meat. While New Zealand accounts for around 40 percent of the worldwide market for sheep meat, it accounts for around 75 percent of world trade in lamb meat. This has meant New Zealand has benefited more than most when it comes to global supply shrinkages offshore.

When converted into NZ dollars the ANZ NZ Dollar Commodity Price Index, the recent strength in the New Zealand dollar outstripped the rise in world commodity prices, which meant it went down in April 2009 (2.8 percent) to 140.1. On an annual basis commodity prices when converted into NZ dollars were down further at 7.7 percent.

	World Price Index	Monthly % Change	Annual % Change	NZ$ Index	Monthly % Change	Annual % Change
Apr 2004	140.9	2.7	17.8	117.7	5.7	4.3
Apr 2005	156.6	0.0	11.1	117.3	1.6	-0.3
Apr 2006	149.2	1.6	-4.7	128.1	3.9	9.2
Apr 2007	180.4	4.9	20.9	133.9	-0.1	4.5
Apr 2008	217.7	-0.3	20.7	151.8	1.1	13.4
Apr 2009	153.5	2.5	-29.5	140.1	-2.8	-7.7

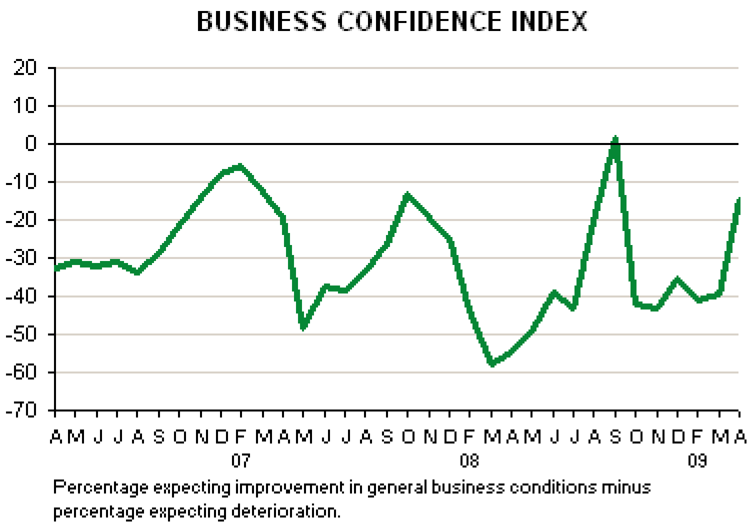
Source: ANZ Commodity Price Index NZ – 2 October 2008

Business confidence – green shoots?

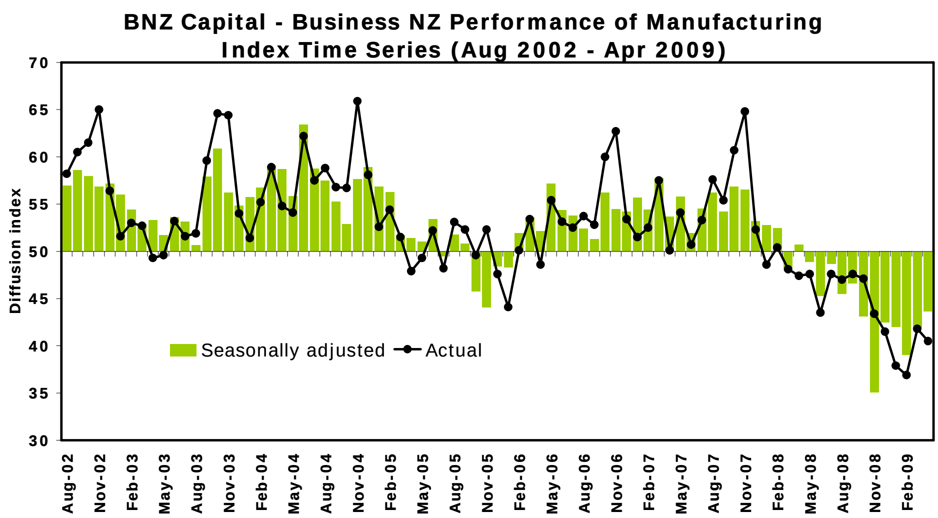
While both business and consumer confidence continues to be negative, there has been some improvement in sentiment over recent months. This pick up has been in the form of general confidence, as well as firms' own activity expectations. However, the figures gleamed from the surveys have many indicators at lows not seen for many years.

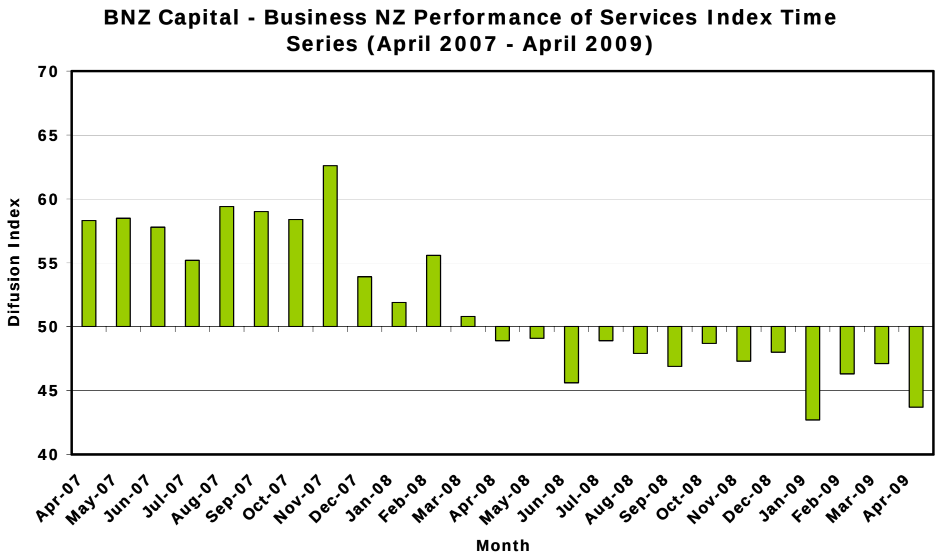
The National Bank's Business Outlook (April 2009) showed a negative picture, but there was a marked improvement with a net 15 percent expecting a deterioration in business conditions over the year ahead, compared with a net 39 percent in March. In fact, this was the biggest monthly improvement since December 2000.

National Bank Business Confidence Index



The continued negative outlook, but coupled with some steadying or improvement, can also be seen through Business NZ's own surveys such as the BNZ Capital – Business NZ Performance of Manufacturing (PMI) and Performance of Services (PSI) indexes. Both show activity continuing in decline with the key sub-indices of production, employment and new orders all in decline. However, the PMI has seen some relative improvement over recent months, while the PSI slipped back slightly in April after some relative improvements in the preceding two months.





Consumer confidence – bad but not the worst

Consumers remain pessimistic despite a number of factors which should arguably have impacted positively on consumption. Significant reductions in interest rates, reduced inflationary pressures including a major drop off in petrol prices, and rolling personal tax cuts have not been enough to offset consumer pessimism generated by a relatively bleak employment outlook and associated rises in unemployment.

Perhaps the big factor which is impacting most on consumer confidence is the cracks appearing in the labour market, resulting in redundancies and rising unemployment. In many respects, employment is the glue which keeps consumer confidence in positive territory. Now that glue is becoming unstuck although unemployment is still low compared with recent historical standards, as well as offshore results.

The Westpac McDermott Miller Consumer Confidence Index fell further to 96.0 in March, down 5.3 points on the previous quarter. Despite the positive factors mentioned above, the weight of other negative economic news meant short term confidence took a hit. This is not a complete surprise given the spate of stories offshore showing significant job layoffs and export results collapsing in certain parts of the world.

Retail stats for the March quarter were much weaker than many expected, as rising prices masked the significant fall in retail volumes. Discretionary items were particularly hit, with housing related or tourism associated volumes contracting sharply. While tax cuts were introduced at the beginning of April that may cause a pick up in sales, there is also the strong possibility that the current climate will lead many to either save or reduce debt with the extra disposable income in hand.

New Zealand's housing market remains an interesting picture, with debate raging about how far prices are yet to fall, or whether we've seen the worst and life is beginning to be breathed back into the sector. There is an old saying that a market is a market, but the housing market can suffer from bouts of 'stickiness', where vendors decide not to sell because of low offers, or a lack of offers means they withdraw their house completely. Certainly, there appears to be a drying up of houses available for sale, which can provide a false impression of where the housing market currently is. On face value, very low interest rates should provide a push for many to purchase, but increasing numbers of redundancies have meant the appetite for debt is not that strong.

In terms of the actual data, REINZ housing data for April showed some bounceback, with seasonally adjusted house sales rising 19.6 percent in the month. Also, the median number of days to sell a house is falling, now at 44 days, is getting closer to the historic average of 39 days.

Putting it all together – signs of recovery?

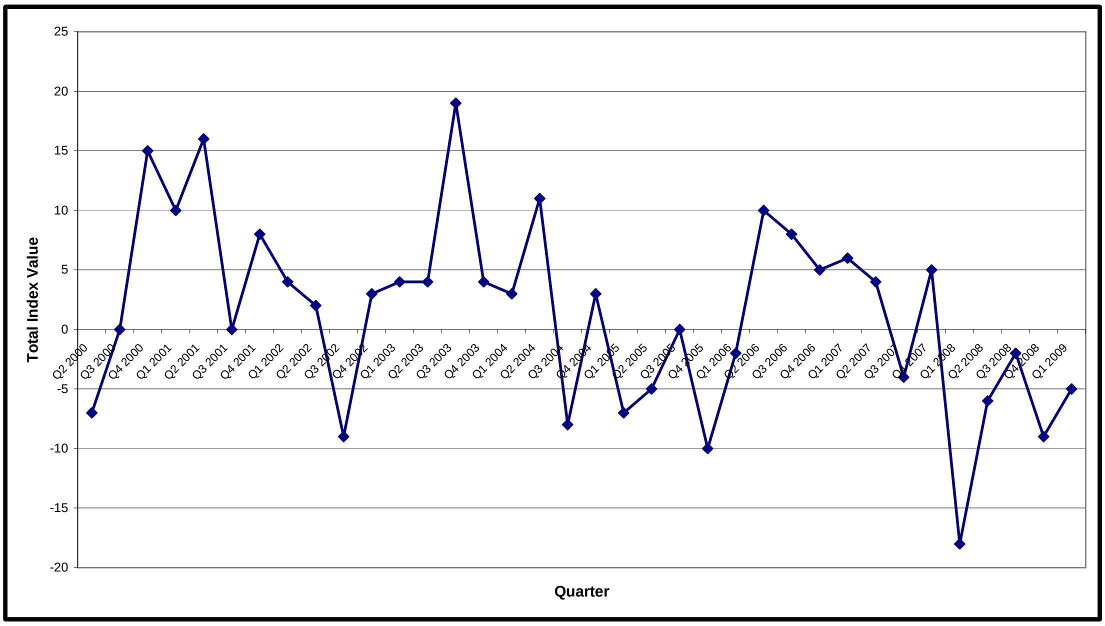
Business NZ Economic Conditions Index (ECI)

The overall Business Conditions Index (a measure of the major economic indicators) sat at -5 for the March 2009 quarter, an improvement of 4 from the -9 recorded for the December 2008 quarter.

Data is broken into four key sub-groups:

- Economic growth/performance indicators
- Monetary policy/pricing indicators
- Business/consumer confidence indicators
- Labour market indicators

The overall ECI has been in negative territory since March 2008, although tentative signs of improvement are evident in some sectors.



Inflation - no longer the main concern

Most recent outcome: +3.0 percent, year-ended March 2009

The rate of inflation as measured by the Consumer Price Index (CPI) indicates increases in price levels and provides an indirect benchmark for wage demands. It is also the key reference point for monetary policy.

The March quarter 2009 CPI rose 0.3 percent after a fall of 0.5 percent in the December quarter. However, annual inflation returned to within the RBNZ's target band of 1 to 3 percent for the first time since June 2007, albeit at the top of the range of 3 percent for the March 2009 year.

The food group made the biggest contribution to the March increase (a 0.2 percentage point contribution), and has been the biggest element to New Zealand's inflation over the past year or so giving the booming global demand for food. The alcoholic beverages and tobacco group made the second largest contribution (0.1 percentage points) mainly due to the annual indexation of excise taxes. However, offsetting these increases were falls for the transport group (international airfares down a significant 16.5 percent) and further retail discounting.

The Reserve Bank will be very confident that annual inflation will remain well within the target band going forward, especially once the June and September quarter results (1.6 and 1.5 percent respectively) have moved out of the annual calculations, and are replaced with only minimal increases in quarterly inflation to come.

Given the expected improvement in inflation figures, forecasts below show inflation continuing to drop through to 2011, with some predicting an annual inflation result as low as 0.8 percent.

Forecasts: % Change in Inflation (CPI)

	Years Ending		
	Jun 09	Jun 10	Jun 11
Highest	2.4	2.2	2.6
Average	2.1	1.6	1.4
Lowest	1.9	1.1	0.8

Source: ANZ, ASB, BNZ, National, and Westpac

Labour costs – further signs of trending down

Most recent outcome: +3.3% -- year-ended March 2009

The general pessimism about future labour market conditions is continuing to impact on wage and salary rates. By historical standards, wage and salary rates achieved for the March quarter 2009 were still robust, although down substantially on the last two quarters of 2008.

The Labour Cost Index (LCI) recorded an increase of 0.6 per cent in salary and wage rates (including overtime) for the March 2009 quarter, down from a 0.7 percent and record 1.1 percent increase in the December and September 2008 quarters respectively. On an annual basis the LCI showed that salary and wage rates (including overtime) were 3.3 percent higher in the March 2009 quarter than in the March 2008 quarter. This increase is down from a 3.5 percent annual rise for the December 2008 quarter, and a 4 percent annual rise for the September 2008 quarter (the largest since the series began in the December 1992 quarter).

The Quarterly Employment Survey (QES) recorded that seasonally-adjusted total gross earnings increased by 3.3 percent in the year to March 2009, and 0.7 percent for the March 2009 quarter. Private sector ordinary time wages remained resilient, up 5.1 percent year on year. However, the QES survey is the least reliable of the two main wage measures produced.

Given the declining labour market outlook, it is likely that restraint will be placed on wage demands as individuals and businesses adjust to tighter economic conditions. This includes elements in the public sector which have tended to lead the drive for increased salaries over recent years.

Forecasts below show that total labour cost inflation is expected to decline over the next two years which is consistent with expectations of negative employment growth, rising unemployment, and reduced capacity utilisation.

Forecasts: Labour cost index percentage change (wages & salaries)

	Years ending		
	Jun 09	Jun 10	Jun 11
Highest	3.2	2.3	2.0
Average	3.0	2.1	1.8
Lowest	2.8	1.8	1.5

Source: ANZ, ASB, BNZ, National, and Westpac

Employment – unemployment increasing, but not at the rate many expected

Most recent outcome: +0.8% -- year-ended March 2009

After a number of years of strong employment growth and reducing levels of unemployment, the tables have recently turned with expectations of negative employment growth out to 2011 and bank forecasts of unemployment to possibly reach above 7 percent looking ahead to 2010 (see table below).

Given the number of pessimistic business surveys on employment intentions, and the increased number of redundancies in the news, the latest official statistics on employment and unemployment provided somewhat of a nice surprise, although the core result still showed a deteriorating labour market.

Statistics NZ's Household Labour Force Survey (HLFS) for the March 2009 quarter showed that the unemployment rate has risen from 4.7 percent to 5.0 percent. However, many were predicting a result around 5.3 percent, so the more moderate increase, given the adverse conditions many businesses have felt over recent months, was a relatively positive result. However, one shouldn't be too optimistic that this will mean only minimal future increases in unemployment. There was also a pick-up of those not in the labour force (rising 2.3 percent over the quarter), which may mean many who have lost their jobs have decided to take a break from working, or have decided to enrol for some form of qualification.

It is also important to point out that businesses have been spending a lot of time (literally years in some cases) trying to acquire the right people with certain skill sets to be employed in their business. After getting them, suddenly having to let them go because of cutting back may feel like the very last thing they want to do. Therefore, many businesses may choose to cut back in other areas of their business, and view staff reductions as a last resort. No doubt for many, worsening activity may lead to the inevitable, so this could be one of the lagged effects to come through in terms of rising unemployment.

Forecasts: Unemployment % (HLFS)

	Quarter		
	Jun 09	Jun 10	Jun 11
Highest	6.2	7.7	7.5
Average	5.9	7.7	7.0
Lowest	5.6	7.6	6.0

Source: ANZ, ASB, BNZ, National, and Westpac

Interest Rates (90-day bill rate) – continuing to slip lower

Most recent outcome: 2.8 percent as at 19 May 2009

Overdraft and mortgage interest rates generally move in line with the 90-day bill rate, which is in turn heavily influenced by the Reserve Bank's OCR (although these may be at variance if the market prices in future increases or decreases in the OCR).

Unsurprisingly, the 90 day bill rate has continued to fall since the last business forecast. Forecasts below point to further reductions in interest rates to hit a low of around 2.5 percent by June, and staying at that level through to 2010. However, there is expected to be a significant upswing by 2011.

The Reserve Bank may make further cuts in the OCR (currently 2.5 percent) over the next few months, although these are likely to involve cuts around the 25 basis point mark. However, as mentioned earlier, further drops in the OCR will not necessarily flow through to an equivalent drop in the cost of capital to businesses given risk factors and the cost of banks borrowing on international wholesale markets.

Forecasts: Interest Rates (90 day bills)

	As at end of		
	Jun 09	Jun 10	Jun 11
Highest	2.9	2.8	5.7
Average	2.5	2.5	5.1
Lowest	2.3	2.3	4.4

Source: ANZ, ASB, BNZ, National, and Westpac

Exchange Rates – bottoming out?

Most recent outcome: NZD = US$0.6017 as at May 21 2009

NZD = AU$0.7770 as at May 21 2009

TWI = 58.0 as at May 21 2009

The NZ dollar has spent the last three months recovering against most of the major currencies monitored. As discussed above, this has primarily been due to an increased appetite for riskier currencies, of which New Zealand's is one.

Forecasts below show a mixed bag in the short term, with the New Zealand dollar against the Australian expected to hover around current levels, while a drop is expected against the USA currency. Against the TWI, the New Zealand dollar is also expected to lose some ground by mid-2009. Looking into 2010-11, improved economic conditions are expected to see similar improvements in the New Zealand dollar across the board.

AUD (cents)			
	Jun 09	Jun 10	Jun 11
Highest	0.791	0.844	0.844
Average	0.775	0.800	0.817
Lowest	0.760	0.760	0.790

USD (cents)			
	Jun 09	Jun 10	Jun 11
Highest	0.550	0.650	0.650
Average	0.538	0.575	0.603
Lowest	0.530	0.470	0.510

TWI			
	Jun 09	Jun 10	Jun 11
Highest	54.9	65.4	66.1
Average	54.1	58.2	60.8
Lowest	53.4	50.6	53.6

Part 2: The Australian Economy

Monitoring the performance of the Australian economy is critical in the first instance because Australia's performance provides a measure of how well New Zealand exporters are likely to fare; a stronger Australian economy will generally 'suck in' imports. Monitoring also provides an indication of the likely strength of competition from Australian-sourced products on the domestic market.

Like New Zealand, the Australian economy now faces some challenging times, which has been shown through the recent Federal Budget. However, the Australian economy looks better than most to weather the storm (if forecasts looking out to 2011-13 are close to being accurate).

The Budget showed a cash deficit of $57.6b (4.9 percent of GDP) in 2009-10, and $57.1b (4.7 percent of GDP) in 2010-11. This was the biggest budget deficit in both dollars and as a percentage of GDP since WWII. A relatively mild recession is expected for the Australian economy (down 0.5 percent in 2009-10), but then a recovery to 2.25 percent in 2010-11. In 2011-12 and 2012-13 the government is projecting GDP growth to rebound to well above trend of 4.5 percent

2.1 Economic Growth (GDP)

Most recent outcome: +0.3% for the year ended December 2008.

Forecast 2009: -0.5%

Source: *The Economist*

Australia's annual GDP is now close to negligible, and is expected to experience a somewhat shallow negative result for the current year.

Some key recent economic statistics:

- New motor vehicle sales down 20.2 percent for March 2009 compared with March 2008.
- Dwelling unit approvals down 25.6 percent for March 2009 compared with March 2008.
- Employment up 0.3 percent for April 2009 compared with April 2008.
- Unemployment rate of 5.5 percent as at April 2009, up from 4.1 percent in April 2008.
- Participation rate of 65.5 percent as at April 2009, the same as April 2008.

The Australian PMI is well below New Zealand's at 30.1, while their service sector index at 39.8 has also remained below New Zealand's for some months.

2.2 Headline Inflation

Most recent outcome: +2.5 percent for the year ended March 2009

After an initial decrease of 25 basis points in early September (the first decrease in the cash rate in Australia since December 2001) the credit crisis that hit later that month caused the Australian Reserve Bank Board to lower cash slash interest rates and currently the benchmark interest rate is 3.00 percent. However, in its latest announcement in early May, the Australian Board decided to leave the cash rate unchanged, given some stability in the global sector. As well, the current stance of monetary policy, together with the substantial fiscal initiatives, should provide significant support to domestic demand over the period ahead,

Part 3: Rest of the World (as seen by the European central Bank* 'Monthly Bulletin'*)

Although the global economy continues to face a severe downturn, recent indicators point to a deceleration in the pace of the decline in economic activity. In March, the Global PMI pointed to slower rates of contraction for manufacturing production and services sector activity. Overall, the average output index reading for the first quarter of 2009 was slightly above the record low of the previous quarter. Rates of contraction in manufacturing output eased further in April.

Global inflationary pressures have been diminishing rapidly, owing to base effects stemming from lower commodity prices, weaker labour market conditions and greater global economic slack. Headline CPI inflation in OECD countries rose by 0.9 percent in the year to March 2009, compared with 1.3 percent for the year to February 2009.

Excluding food and energy, annual CPI inflation rose by 1.8 percent in March. The global PMI overall input prices index fell further in March, signalling a further deterioration in cost conditions. In April, the global manufacturing input prices index rose, but remained at a historically low level, suggesting further declines in manufacturing costs.

United States

In the United States, economic activity remained weak. The economy continued to contract in the first quarter of 2009, although recent evidence points to a deceleration in the pace of the decline. According to advance estimates, real GDP decreased by 6.1 percent in annualised terms in the first quarter of 2009, after 6.3 percent in the preceding quarter. While stronger than anticipated personal consumption limited this decline, the contraction in private fixed investment and trade flows accelerated.

Furthermore, the rapid pace of inventory liquidation reduced GDP growth by 2.8 percentage points. Looking forward, the outlook for consumer spending is clouded by the sharp deterioration in labour market conditions and negative wealth effects. Export performance has also been weak due to a downturn in global trade flows and declines in foreign economic activity.

Against this background, lower commodity prices combined with the sizeable policy stimulus measures underway should provide some support for economic activity. In addition, looking ahead, the sharp downward correction in stockpiles can be seen as a positive sign for the prospects of a gradual recovery.

Euro zone

In the United Kingdom, the latest indicators confirm the current expectation of a pronounced recession in 2009. According to the preliminary estimate, real GDP contracted by 1.9 percent (quarter on quarter) in the first quarter of 2009, exceeding the consensus expectation of 1.5 percent. The decline was especially pronounced in manufacturing activity, which fell by 6.2 percent over the same period. In recent months, confidence has fallen both in the services and industrial sectors, while consumer and retail confidence rose slightly in February and March. The Halifax House Price Index remained on a downward trend, falling by 17.5 percent year on year in March. The protracted decline in property prices, along with weaker aggregate demand and increasing difficulties in accessing external financing, is expected to curtail business investment. Net exports are expected to contribute positively to GDP growth, reflecting the substantial depreciation of the pound sterling. Annual HICP inflation declined in March to 2.9 percent and is expected to fall below the 2 percent target in the course of 2009. On 7 May the Bank of England's Monetary Policy Committee decided to keep the official Bank Rate unchanged at 0.5 percent and to increase the size of its asset purchase programme by GBP $50b to a total of GBP $125b.

In most other non-euro area EU countries, economic activity was weak in the first quarter of 2009. Inflation decreased in most countries in March. In Sweden, GDP contracted by 2.4 percent quarter on quarter in the fourth quarter of 2008, owing to tighter financial conditions, weaker external demand and more cautious households. These factors are also dampening economic activity in Denmark, where output contracted by 2.0 percent in the fourth quarter of 2008.

In Hungary, the economy contracted by 1.2 percent quarter on quarter in the fourth quarter of 2008. In the same period real GDP growth in the Czech Republic also declined by 0.9 percent quarter on quarter. Similarly, economic activity in Romania declined markedly, to 2.9 percent year on year in the fourth quarter of 2008, reflecting a very sharp quarter-on-quarter decline. Economic activity held up best in Poland, where quarter-on-quarter growth was still positive at 0.3 percent in the fourth quarter of 2008. This was because domestic demand continued to grow more strongly than in other countries in the region. Short-term indicators point to continued weakness in economic activity in all countries.

Asia

According to preliminary data, economic activity was weak in most emerging Asian economies during the first months of 2009. However, very recent indicators show that in those countries that had already experienced a drop in 2008, the economic decline has started to slow down and, in some cases, activity even seems to have rebounded. In particular, foreign trade seems to have stabilised, albeit at low levels. Nevertheless, the negative second-round effects from the global financial crisis, such as rising unemployment and negative wealth effects, are expected to hamper recovery in the coming months. Consumer price inflation has moderated further in most countries.

In China, annual real GDP growth dropped to 6.1 percent in the first quarter of 2009, from 6.8 percent in the last quarter of 2008. However, according to unofficial estimates, growth accelerated slightly in quarter-on-quarter terms during the first months of this year. While external demand is still weak, the government's stimulus policies have boosted investment growth considerably. Fixed asset investment in urban areas increased by 30 percent year on year in the first quarter of 2009. In addition, the available figures suggest that domestic consumption has held up surprisingly well thus far.

In March, annual CPI inflation remained negative at -1.2 percent, compared with -1.6 percent in February. The accommodative monetary policy and fiscal measures have been reflected in very fast credit growth. At the end of March, the loan stock was 30 percent larger than a year earlier.

Japan

In Japan, economic conditions continued to deteriorate. The Bank of Japan's March 2009 Tankan survey of business sentiment hit an all-time low for large manufacturers, reflecting the collapse in exports and spillovers to the domestic economy. However, consumer confidence rose in March for the first time since hitting its record low in December 2008. Meanwhile, the contraction in trade has decelerated somewhat, with exports falling by 45.6 percent year on year in March 2009, compared with 49.4 percent in February, and imports falling by 36.7 percent year on year in March, compared with 43 percent in the previous month.

Consumer price inflation continued to decline in March, driven by the greater economic slack. Overall annual CPI inflation declined to -0.3 percent in March, compared with -0.1 percent in February. Excluding food and energy, annual CPI inflation remained negative at -0.3 percent in March, while CPI inflation excluding fresh food turned negative to -0.1 percent in March. At its meeting on 30 April 2009, the Bank of Japan decided to leave its target for the uncollateralized overnight call rate unchanged at around 0.1 percent.

Forecasts: World GDP Growth (Selected Trading Partners)

Country	*Latest*	*2009*	*2010*
Australia	0.3	-0.7	1.6
Canada	-0.7	-2.3	1.6
Japan	-4.3	-6.4	0.6
United Kingdom	-4.1	-3.7	0.3
United States	-2.6	-2.9	1.4
Euro Area	-1.5	-3.7	0.3

Source: Economist

Forecasts: World Consumer Price Inflation (Selected Trading Partners)

Country	*2009*
Australia	2.0
Canada	0.5
Japan	-1.1
United Kingdom	1.5
United States	-0.8
Euro Area	0.4

Source: Economist