

## REBALANCING

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### Page 2: Key economic forecasts

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- > The economy is in a delicate rebalancing phase. The economy does not have the capacity or productivity growth to perform strongly at this stage. A weak outlook for housing dominates the outlook. We've pencilled in a relatively benign period of soft growth, but this critically assumes Asia and Australia's prospects are not overly dented by current credit (US) dislocation. Global credit related malaise infecting New Zealand is a key risk.

### Page 7: Global outlook

- > The US economy is weak. While policymakers have been quick to respond via stimulus, credit dislocation leaves the outlook uncertain. With growth in Europe and Japan also slowing, we expect to see some modest spillover into Asia, but trading partner growth to remain reasonable.

### Page 8: Fiscal policy

- > Fiscal policy will invariably be more stimulatory than initially signalled. This will keep the RBNZ on alert, although the timing may prove lucky given the global backdrop. What is more important is that any further loosening of the fiscal reins is done within a medium-term framework aimed at raising living standards.

### Page 9: Inflation

- > Inflation is set to remain above the 1 to 3 percent policy band through 2008. While a number of one-offs represent inflation risks, we expect a weak domestic economy to dampen inflationary pressure over 2009.

### Page 10: Exchange rate

- > Given present uncertainties, our forecasts have the NZD/USD flat-lining in the near-term, but with a downside bias given our unease towards international malaise remaining US-centric. The NZD/AUD looks very extended given the diverging paths of the two economies and expected rate movements by the respective central banks.

### Page 12: Interest rates

- > We've pencilled in easings from late 2008, largely reflecting our wariness over house prices, and the (global led) credit cycle. The risk profile for rates looks unevenly distributed, with upside inflation risks suggesting another 50bps of tightening vs downside growth risks pointing to a potentially early and aggressive easing cycle.

### Page 14: Economic forecasts

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## KEY ECONOMIC FORECASTS

Calendar years	2005	2006	2007(e)	2008(f)	2009(f)	2010(f)	2011(f)
<b>NZ Economy (annual average % change)</b>							
Real GDP	2.8	1.6	3.0	1.5	2.4	3.5	3.2
Employment	2.8	2.1	1.7	1.2	0.7	1.0	1.4
Unemployment Rate (Dec qtr)	3.6	3.7	3.6	4.0	4.3	4.5	4.4
Terms of Trade	0.3	-2.8	5.9	3.0	-2.8	-0.6	0.4
<b>Global Growth (annual average % change)</b>							
US	3.1	2.9	2.2	1.5	2.7	3.4	3.3
Australia	2.8	2.8	3.9	3.6	3.3	3.0	3.2
Japan	1.9	2.4	1.8	0.7	1.8	1.9	0.9
China	10.4	10.7	11.4	10.2	9.1	8.9	8.7
Trading Partner Growth	3.3	3.7	3.9	3.2	3.4	3.4	3.3
<b>NZ Inflation (annual % change)</b>							
CPI Inflation	3.2	2.6	3.2	3.0	2.7	2.4	2.3
Non-tradable Inflation	4.3	3.8	3.5	3.9	3.4	3.2	3.2
Tradable Inflation	1.7	1.2	2.8	2.3	1.8	1.2	0.9
<b>NZ Financial Markets (December quarter averages)</b>							
TWI	71.5	67.1	71.0	64.8	61.8	60.9	62.5
NZD/USD	0.69	0.67	0.76	0.70	0.62	0.58	0.63
NZD/AUD	0.93	0.87	0.86	0.80	0.79	0.81	0.85
Official Cash Rate	7.0	7.3	8.3	7.7	6.8	6.8	6.8
90-day bank bill rate	7.5	7.6	8.8	7.7	7.0	7.0	7.0
10-year bond rate	5.9	5.8	6.4	5.7	5.9	6.8	6.8
<b>Fiscal and External Balance</b>							
Current Account Balance (\$m)	-13,300	-14,000	-13,900	-12,100	-12,600	-12,500	-13,300
as % of GDP	-8.6	-8.6	-8.0	-6.6	-6.7	-6.2	-6.3
Govt. Operating Balance (\$m)*	6,200	11,500	8,000	7,200	5,400	4,900	4,800
as % of GDP	4.1	7.3	4.8	4.0	2.9	2.5	2.3

Forecasts and text finalised 5 February 2008.

\* June years

### Key forecast assumptions:

- > Dubai oil prices remain above US\$80 per barrel in the near-term before gradually declining towards US\$60 per barrel.
- > The current volatile global financial market environment and US weakness does not trigger a substantial global slowdown.
- > Net migration remains subdued for another 18 months before increasing to around 10,000 over 2009.
- > Current cyclical potential growth is around 2 to 2½ percent, but longer term potential is still around 3 percent.
- > The neutral real interest rate is expected to be higher than in the past, at slightly over 4 percent.
- > Inflation expectations start to drift lower from current elevated levels.

## NZ ECONOMIC OUTLOOK

The economy is in a delicate rebalancing phase. The economy does not have the capacity or productivity growth to perform strongly at this stage. A weak outlook for housing dominates the outlook. We've pencilled in a relatively benign period of soft growth, but this critically assumes Asia and Australia's prospects are not overly dented by current credit (US) dislocation. Global credit related malaise infecting New Zealand is a key risk.

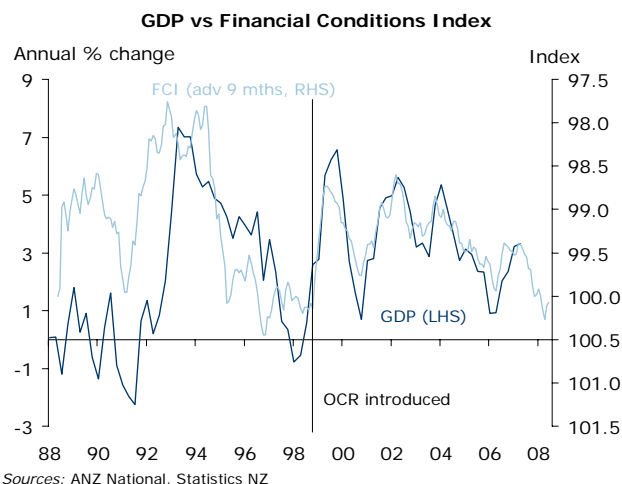
### The economy is in a delicate rebalancing phase

**Inflation. It's the number one influence on the economic cycle at present.** Inflationary pressures are stubbornly persistent with CPI inflation back above the top of the RBNZ's target band. Inflation has averaged 2.9 percent for the past four years. Too much inflation means less scope for growth. Financial conditions are tight as a consequence. This does not mean the RBNZ is anti-growth. Rather they are trying to support the economy's medium-term prospects. Sticky and elevated inflation pressures erode the value of savings, reduce discretionary income, lead to poor price signals, inefficient resource allocation, and ultimately weak growth.

**On top of this, other imbalances are prevalent.** Capacity constraints are rife, and firms continue to report difficulties in finding both skilled and unskilled labour. The current account deficit – at 8.3 percent of GDP – remains worrisome, despite New Zealand's terms of trade surging over 8 percent in the past year.

**The RBNZ has already assisted with the rebalancing.** The RBNZ has been on the inflation warpath and the four OCR increases last year look to be finally gaining a foothold. Domestic demand is looking soft. Retail sales have effectively flat-lined since March 2007 and are weaker once price effects are removed. The housing market has well and truly turned, with house sales off over 30 percent since the start of 2007. House prices are also starting to come under downward pressure and we expect this to continue over this year, falling in the vicinity of 5 percent. The softness in the housing market has now spread across all price brackets, after only being limited to lower-valued properties earlier.

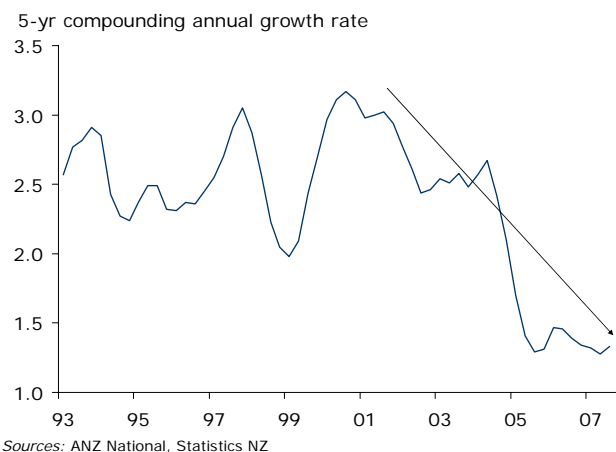
**After a strong H1 2007, economic momentum has now slowed.** GDP expanded by 0.5 percent in the September quarter, a step down from the 4 percent annualised growth over the first half of the year. In fact, growth would have been more subdued if it were not for the Tui oilfield (which sits off the Taranaki coast and began production in July 2007) adding 0.2 percentage points to growth in the September 2007 quarter and an estimated 0.1 percentage points to December quarter growth. Early indicators we monitor suggest activity has continued to moderate into 2008.



### Yes, there are some real positives...

**Tax relief and a mammoth dairy payout will continue to provide some support.** The forecast dairy payout for the current 2007/08 season of \$6.90/kg ms is a whopping \$2.44/kg ms higher than the previous season, an income boost of 2 percent of GDP into dairy farmers' pockets. It is being spent, and capitalised into farm values. The corporate tax rate falls to 30 percent from April 1. Roadwork cones are everywhere. In addition, there is the prospect of at least \$1.5b worth of tax cuts (0.9 percent of GDP) to be announced at this year's *Budget*, not to mention the strong likelihood of other spending promises to come as the election year progresses. Infrastructure spending will continue regardless of the economic cycle. NZ's largest trading partner, Australia, is booming. Everyone has a job, and income growth is solid.

### NZ private sector labour productivity growth (5-yr trend)



### ...but we need to be realistic

**The economy just does not have the capacity, inflationary scope or productivity performance to perform strongly at this juncture.** The unemployment rate sits at 3.5 percent – a positive for sure, but also a constraint on firm's ability to expand. Facing labour constraints, firms seem unable to extract

productivity improvements. Productivity growth across the market sector has averaged 1.3 percent since 2001. Recent data shows an improvement, although when we look at the surprising resilience of employment intentions relative to declining investment intentions (which runs counter to pricing signals), there seems little hope of a sustained turnaround.

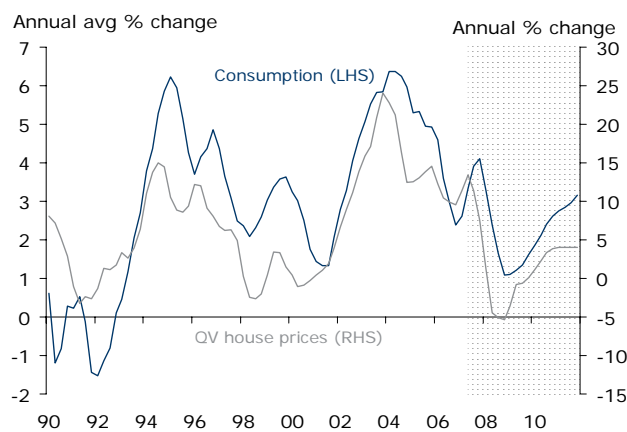
**The RBNZ has left us in no doubt it will not let the economy reflate at this juncture given the inflationary backdrop.** Financial conditions are at their tightest level since 1996 and indicative of 1 percent growth over the coming year.

**Housing dominates the balance sheet and is looking very vulnerable to a correction.** For one, New Zealand house prices are very expensive relative to income, and even in comparison to overseas norms. An average NZ house trades at 7½ times the average wage. Latest data shows the market is weak, with house prices starting to fall, and we have not yet seen the labour market turn. While there is a lot of speculation about the labour market holding house prices up, it doesn't explain why house price gains have more than doubled the rate of income growth in the past few years. The real story for housing is, and has been, about credit. Ripple effects from freely available credit dragged the market up. It became a circle of success where rising property prices supported the ability to borrow, driving property prices up, more leverage...and the spiral is in motion. This in turn kept the wealth effect supporting spending. Locally, we have seen a clear fallout from the global re-pricing of risk, with close to \$2 billion of investor funds at risk from finance company failures. These failures have seen the lending tap withdrawn as balance sheets are consolidated, and are acting to accentuate weakness in the market that the RBNZ and easing migration trends were already fostering. It's looking like the *coup-de-grâce* on a market that was already struggling. Section prices are looking particularly vulnerable given the degree of land-banking that has taken place. While small in magnitude, we are in no doubt the fallout from recent finance company distresses is, and will have, a major impact on property values as the ripple effect spreads.

**Headwinds to households are getting stronger.** There is no doubting income growth is still solid. Tax cuts are pending. But who cares about an extra \$20 per week in tax cuts if you are paying \$5 more for groceries, \$2 more for electricity, \$2 more for local authority rates, \$7 more for petrol, \$20 more for mortgage payments, and the real wild-card – house prices set to fall more than 5 percent?

We see such an adjustment in house prices as being relatively easily achievable. We wouldn't rule out something larger. For one, this housing boom has been far bigger than previous ones, and the valuation metrics are far more extended so previous "adjustments" (the 5 percent fall in 1997/98 or 1 percent easing in 2000) bare little resemblance. To put this in perspective, debt servicing to income was 10 percent in 2004. It is now more than 14 percent!

Private consumption vs house prices



Sources: ANZ National, Statistics NZ, Quotable Value

We strongly suspect there is a strong non-linear relationship where households are immune to developments (higher interest rates etc) up to a certain point. But the non-linearity emerges when households hit some "tipping point" from which developments cascade.

**We expect private consumption growth to remain subdued as households' disposable income get squeezed** from higher mortgage rates and increased costs for core staples such as food. Falling house prices will also weigh on spending as households will no longer be able to rely on associated wealth benefits. Spending fuelled by mortgage equity withdrawal will become more difficult. Although tax cuts and the strong dairy payout this year will provide some boost to spending, we struggle to see it as enough to keep the debt-fuelled spending cycle in motion in an environment where asset prices are under pressure. A period of de-leveraging and consolidation of the household balance sheet is more likely, and is in fact a positive dynamic. Rather than ignoring positives such as a booming rural sector, strong labour market and government spending, our judgement is that New Zealanders are by-and-large property-centric, and developments in that arena will dominate.

**It is at this juncture that global developments are adding a huge layer of uncertainty...**

**A key level of uncertainty at present is over how the global outlook will play out.** Booming growth in Asia supports strong commodity prices and tourism inflows. Conversely, unfavourable ends to NZ's economic cycle have typically coincided with a weak global backdrop. The NZ economy finds itself in a familiar position of having a high currency, tight monetary policy, and extended asset values at a time the global environment is looking very fragile. The global outlook continues to deteriorate, with the US economy widely tipped to head into recession, if it has not already done so. The spillover from the US is starting to be felt in the UK, Japan and Europe. Commodity prices have started to come under downward pressure and global equity markets have

sold off aggressively since the start of the year, a sign that markets are re-assessing the decoupling thesis.

**To date, the volatility in global financial markets have had limited effects on the NZ real economy.**

The re-pricing of risk has certainly resulted in higher wholesale funding costs for financial intermediaries, which have been, or eventually will be, passed on to borrowers. In addition, finance company failures over the second half of last year are further symptoms of the global risk aversion/liquidity theme. Credit and swap spreads have widened. The NZ equity market has been caught in the rip of fading global sentiment, although it was already on an easing path given the weaker growth-sticky inflation prognosis for earnings. Conversely, growth across our major trading partners (Asia and Australia) remains strong.

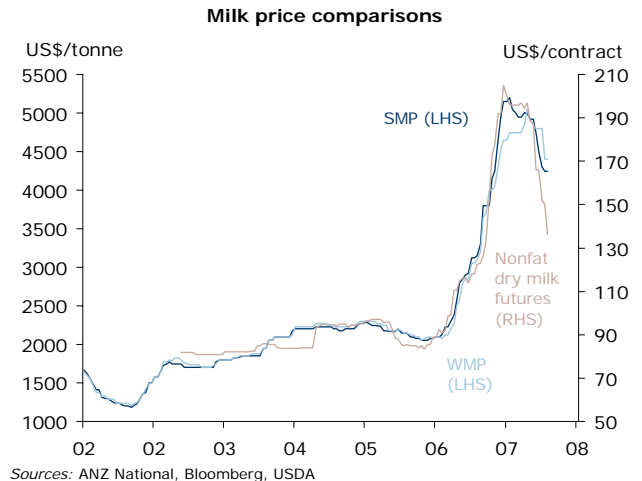
**But as a hugely indebted nation, we struggle to see New Zealand remaining immune to global (credit) developments.**

Credit resides at the heart of an economy's foundations. The first leg is the cost of capital and access to it. The former is moving up, while weakness in the global commercial paper and bond market is making corporates more reliant on domestic bank funding. Funding is still available (we're still open for business) but it is folly to say conditions have not changed. Facing altered credit conditions, weaker investment is pending. The inevitable final leg is less employment.

**Looking at the other channel from the global economy to New Zealand, we're big believers in a positive long-term outlook for soft commodity prices.** The blend of growing per capita incomes in Asia, support from biofuels and tight supply pointed to a reversal of the downward trend in real prices that had been apparent between 1960 and 2000. Just as NZ "transitioned" and suddenly started to feel rich in the mid 1980's and demand surged for upper-end goods, the same dynamic is expected to repeat in Asia, notably towards food staples. NZ is on to a winner. Admittedly it's been a dairy story to date, which is where the main focal point resides. But the broad principle also applies to beef, lamb, venison and other soft commodities. Long-term we maintain our bullish view.

**But, there are now material risks.** Firstly, we may well be banking on too much of a good thing. Rural land values have surged, cows have close to tripled in price, and agri-inflation is rampant. Off a forecast dairy payout of \$6.90/kg ms, the return on assets for a dairy unit is roughly the same as what you get in the bank. And herd like behaviour in the dairy sector is giving the meat industry a caning. Admittedly, people are only responding to the price signals they are receiving. Here's hoping it's not another case of getting out of one at the bottom of the cycle, and into another at the top. Second, the risk profile on the international front has changed. Current US malaise has been brought about by risk being mispriced, or ignored. The "economic" story for the coming few years is about risk relative to return, and bringing attention back to the former, which was forgotten. Third, international dairy prices are easing. Whole-

milk and skim-milk powder prices are down 13 and 18 percent respectively. Non-fat dry milk futures suggest more falls are to come. After doubling in a year, the retreat needs to be put in context. We remain secular commodity bulls. But we are cautious of the potential cyclical pullbacks given the global backdrop. Finally, New Zealand once again finds itself engulfed in drought conditions.



**...but as always, our forecasts have a relatively benign adjustment**

**Our central economic forecasts portray a halfway house between a hard landing and a soft one,** with growth slowing from 3 percent in 2007 to 1.5 percent in 2008. NZ's macro framework dissuades us from putting in a weaker growth outlook (the currency would fall like a stone if growth looks to be sub 1 percent), while a stronger outcome looks inconsistent with contained inflation pressure.

Long-awaited consumer consolidation leads the way. Global uncertainty, higher financing costs, a nasty profit mix (slowing growth-sticky inflation) and increased difficulty in accessing capital due to the global re-pricing of risk will likely see business investment contract this year. Residential investment will also act as a drag on growth over the first half of this year as the housing market continues to correct.

**The external sector is not expected to fare much better, with demand likely to ease as global growth slows.** Luxury items and services such as tourism may be particularly vulnerable. The high NZD has already dented prospects for the majority of export sectors (with dairy the major exception) and therefore with global growth slowing, 2008 may be another challenging year for exporters. However, import growth is also expected to slow as domestic demand moderates and should contribute to an improvement in NZ's external trade balance. The current account deficit is expected to slowly reduce to around 6¼ percent of GDP by 2011, although further improvements are limited by the large level of debt servicing on NZ's stock of overseas liabilities.

**Bright spots on the landscape will include** ongoing infrastructure spending by central and local government. NZ has underinvested in this area over

the past decade, and is playing catch-up at present. But the large projects around the country should free up bottlenecks and help improve productivity performance down the track. Rebalancing will inevitably include a currency adjustment, and exporters to Australia look set to be big beneficiaries given very divergent paths for the two economies over 2008.

### But when all is said and done, the longer term prospects remain favourable

**The slowdown in growth we are forecasting should be seen in the context of the longest period of expansion the NZ economy has undergone since the 1960s.** Consolidation follows booms. Long-term we remain secular commodity bulls. NZ is rich in natural resources, and has clear

strategic advantages in industries such as tourism, agriculture and across pockets of manufacturing. There is a burgeoning IT industry (just look at film), and much across the economy to build a strong service platform around. However, we'd be a lot more comfortable with where NZ sits in the cycle if productivity growth was stronger as we navigate the inflationary waters, and current global fragility was not credit (NZ's achilles heel) centric. Achieving a higher trajectory for productivity is a prerequisite to better living standards, wages, and incomes. The alternative is a golden opportunity lost.

## NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years	2005	2006	2007(e)	2008(f)	2009(f)	2010(f)	2011(f)
<b>Total Consumption</b>	<b>4.8</b>	<b>3.0</b>	<b>4.1</b>	<b>2.0</b>	<b>2.1</b>	<b>2.8</b>	<b>3.2</b>
Private Consumption	4.9	2.4	4.1	1.1	1.6	2.6	3.2
Public Consumption	4.1	5.1	4.1	5.1	3.8	3.6	3.4
<b>Total Investment</b>	<b>4.1</b>	<b>-1.4</b>	<b>3.6</b>	<b>-2.1</b>	<b>2.8</b>	<b>6.5</b>	<b>6.2</b>
Residential investment	-4.0	-3.1	4.3	-9.4	-1.5	6.7	4.5
Other investment	6.5	-0.9	3.4	-0.1	3.8	6.5	6.6
<b>Stockbuilding<sup>1</sup></b>	<b>-0.3</b>	<b>-0.9</b>	<b>0.7</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>
<b>Gross National Expenditure</b>	<b>4.2</b>	<b>1.0</b>	<b>4.8</b>	<b>1.0</b>	<b>2.2</b>	<b>3.7</b>	<b>3.9</b>
<b>Total Exports</b>	<b>-0.4</b>	<b>1.8</b>	<b>2.2</b>	<b>1.6</b>	<b>4.2</b>	<b>4.9</b>	<b>4.4</b>
Goods	0.3	3.2	2.9	1.4	4.0	4.2	3.9
Services	-2.5	-1.8	0.0	1.4	5.0	7.3	6.0
<b>Total Imports</b>	<b>5.4</b>	<b>-2.7</b>	<b>7.6</b>	<b>1.3</b>	<b>3.3</b>	<b>5.4</b>	<b>6.2</b>
Goods	4.6	-2.0	7.9	1.2	4.3	5.8	6.3
Services	7.9	-5.0	6.5	0.1	-0.4	3.8	5.8
<b>Expenditure on GDP</b>	<b>2.8</b>	<b>2.2</b>	<b>3.3</b>	<b>1.2</b>	<b>2.5</b>	<b>3.4</b>	<b>3.2</b>
<b>GDP (production based)</b>	<b>2.8</b>	<b>1.6</b>	<b>3.0</b>	<b>1.5</b>	<b>2.4</b>	<b>3.5</b>	<b>3.2</b>

<sup>1</sup> Percentage point contribution to growth

## GLOBAL OUTLOOK

The US economy is weak. While policymakers have been quick to respond via stimulus, credit dislocation leaves the outlook uncertain. With growth in Europe and Japan also slowing, we expect to see some modest spillover into Asia, but trading partner growth to remain reasonable.

### A US story, but is it broadening?

**The US economy is weak.** Building permits have collapsed, house prices are falling, and there is close to a year of stock overhanging the housing market. Consumer confidence is soft, income growth has eased and employment has stalled. Recessionary fears are intensifying.

**Policymakers have swung into action.** The US Fed has cut interest rates by 225 basis points since September 2007, including a surprise 75bps intra-meeting move. Liquidity has been injected to encourage banks to lend. The Bush Administration has come up with a US\$157 billion stimulus package that is awaiting Congress approval and a rescue package for ailing bond insurers is being developed.

**Despite this, conditions remain fragile.** It's a case of monetary deflation versus credit dislocation. Losses from subprime are now cascading into other asset classes and into bond insurers. This in turn is placing increased pressure on financial intermediaries' balance sheets. The danger is that diminished appetites to lend sets off a chain of events where asset prices fall (correct from extended levels), consumers stop spending, delinquencies rise, financial conditions tighten again as lending standards tighten, asset prices fall... and the spiral is in motion.

**It is a broad process of de-leveraging as balance sheets are strengthened.** While subprime and US financial intermediaries were the initial catalyst, the prime focal point and real threat is that falling asset values and the process of de-leveraging knee-caps the US consumer. With the unemployment rate rising, house prices down 7 percent already, core staples (energy, oil and food) rising and lending standards tightening, the prognosis does not look good. The long-awaited period of US consumer retrenchment looks to be here. Unlike corporate de-leveraging, the process of de-leveraging for households tends to take time. The US economy is likely to be weak for a while as this process unfolds.

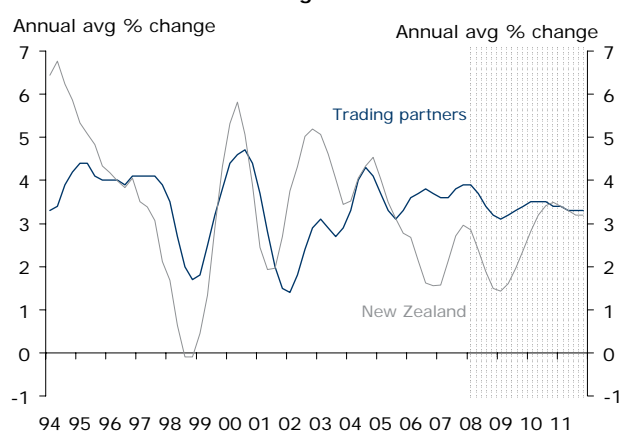
**The bigger picture is what is happening around the globe.** Whether the US goes into recession or not is a moot point. The bigger question is to what extent

it spreads. Europe is slowing, momentum in Japan is waning, and the UK is struggling. The European services PMI has fallen from 58.0 to 52.0 in the space of five months, and the ZEW economic sentiment survey is at its lowest level since 2002. Japanese exports have already softened in response to the yen's appreciation. In the UK, house prices have fallen in four of the past five months.

**Asia, emerging markets and commodity prices are prime focal points.** Has the global economy decoupled from the US, or set to recouple? Strong internal demand resides at the heart of Asian decoupling in the face of weak prospects for the US consumer. Yet, in the financial world, markets are coupled. The Chinese equity market has followed international sentiment, falling 23 percent since its October 2007 peak, although such a fall needs to be put in perspective following a 244 percent rise the preceding 12 months. But generally, "global growth" barometers are mixed. Oil remains high. Base metal prices have softened but look supported – for now. The Baltic Dry Index has halved since its peak in November last year. Lumber prices continue to ease. The AUD is range-trading.

**We expect to see a modest downwards impact.** Compelling in our eyes is the broadening nature of the slowdown from the US to Japan and Europe, and the reality that de-leveraging for the US consumer will take time. The credit nature of the current event also leaves us circumspect. Stepping back, growth across Asia is expected to remain robust, just with less froth. We've pencilled in trading partner growth easing from 3.9 percent in 2007 to around 3¼ to 3½ percent per annum over the remainder of the forecast period, which is slightly below trend. At this juncture, the risk profile looks to have a clear downward bias.

NZ and Trading Partner Growth



Sources: ANZ National, Statistics NZ, Bloomberg

## GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2005	2006	2007(e)	2008(f)	2009(f)	2010(f)	2011(f)
United States	3.1	2.9	2.2	1.5	2.7	3.4	3.3
Australia	2.8	2.8	3.9	3.6	3.3	3.0	3.2
Japan	1.9	2.4	1.8	0.7	1.8	1.9	0.9
Euro Zone	1.6	2.9	2.7	2.0	2.1	2.0	2.3
China	10.4	10.7	11.4	10.2	9.1	8.9	8.7
<b>Trading Partner Growth</b>	<b>3.3</b>	<b>3.7</b>	<b>3.9</b>	<b>3.2</b>	<b>3.4</b>	<b>3.4</b>	<b>3.3</b>

## FISCAL POLICY

Fiscal policy will invariably be more stimulatory than initially signalled. This will keep the RBNZ on alert, although the timing may prove lucky given the global backdrop. What is more important is that any further loosening of the fiscal reins is done within a medium-term framework aimed at raising living standards.

### The cheque book's coming out!

**The ingredients for a large spend-up are all there:** a large fiscal war-chest (even with \$1.5b put aside for tax cuts), an election at the end of the year and the Government well behind in the political polls. There appears little doubt more money will be given away. Tax is being held out as the election sweetener, although we suspect housing affordability will also feature, and we wouldn't be surprised to see an election wild-card delivered in a similar fashion to the 2005 interest free student loan policy.

**The RBNZ will remain alert to the inflationary consequences of looser fiscal policy.** The RBNZ has correctly made reference to the impact fiscal policy is having on inflationary pressure. People tend to interpret this as warnings over spending and tax cuts. However it goes far beyond. Government (inflation) charges have previously been running at close to 5 percent per year. Employment growth within the public sector is rampant and wage growth has averaged 4.4 percent per year over the past five years, compared with 3.8 percent for the private sector. Compliance and regulation are adding to business costs.

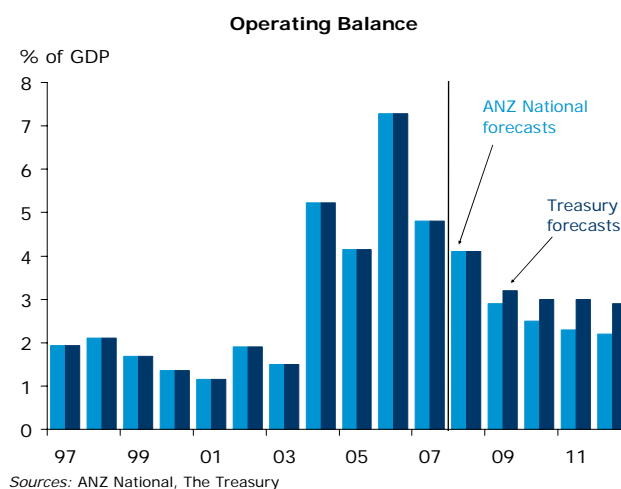
**The flipside to this debate is two-fold.** First, there is a deadweight cost of taking money out of people's pockets and leaving it on the Government's balance sheet, which is what is happening at present. Second, good policy should never be sacrificed for near-term considerations such as where interest rates could be headed. The key is to set policy within a medium-term context, aimed at delivering supply-side benefits and raising living standards.

**There is a lot of good work being done.** Research and development-based tax concessions, KiwiSaver, and increased infrastructure spending have been welcome steps. From April 1, the corporate tax rate reduces to 30 cents in the dollar. We support New Zealand's stance in the environment arena, although

we need to be realistic in terms of the economic cost. Official estimates massively understate the costs in our view. Fiscal policy will need to play a role addressing the transitional cost.

**However, more needs to be done.** It is late in the day so we'll throw in a couple of hand grenades; make KiwiSaver compulsory, reduce marginal tax rates, and re-prioritise spending away from the back office to the front-line. The real challenge to policymakers – irrespective of who gets into power – is to address New Zealand's poor productivity performance. Indeed, our economic synopsis on pages 3 to 6 would be more bullish regarding the adjustment required to bring some balance back to the economy if productivity growth was stronger. It is the missing link to higher incomes, living standards, strong growth, and less inflation. Recent trends suggest an improvement, so there may be cause for hope.

**Looking at the fiscal accounts, the overall position is still expected to remain strong** despite more fiscal expansion. Even with tax cuts and increased spending on other programmes, we forecast the operating balance to stay in a healthy shape. We wouldn't be surprised to see some erosion of the tax base from a softer economy over 2008 and 2009, but there certainly looks to be a good buffer at present to cope with this. For the 2008 fiscal year, we forecast an operating surplus equivalent to 4 percent of GDP. As spending is increased in further years, we forecast the operating surplus to decline towards 2¼ percent of GDP. Certainly, the low level of debt gives the Government room to do much more on the fiscal front, particularly on infrastructure spending.



## FISCAL FORECAST

June years	2006	2007	2008(f)	2009(f)	2010(f)	2011(f)
Operating Balance (\$m)	11,500	8,000	7,200	5,400	4,900	4,800
- as % of GDP	7.3	4.8	4.0	2.9	2.5	2.3
Net Crown debt (\$m)	7,700	4,400	2,000	2,400	2,900	3,300
- as % of GDP	4.9	2.6	1.1	1.3	1.5	1.6
Bond Tender Programme (\$m)	2,400	2,300	2,500	2,400	2,500	2,500

## INFLATION

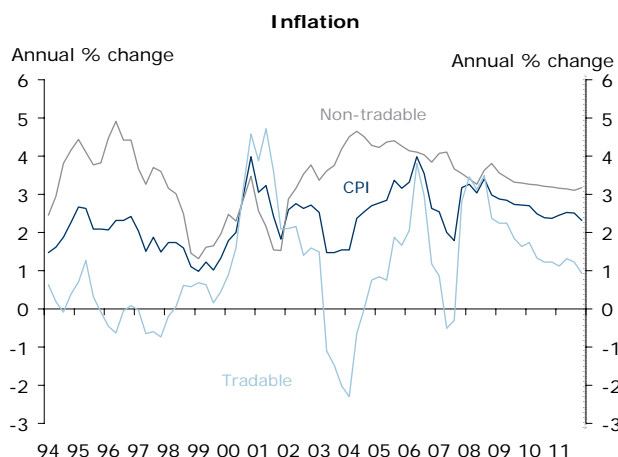
Inflation is set to remain above the 1 to 3 percent policy band through 2008. While a number of one-offs represent inflation risks, we expect a weak domestic economy to dampen inflationary pressure over 2009.

### High and persistent

**Inflationary pressure remains intense.** Capacity constraints and elevated pricing intentions suggest an undercurrent of inflationary pressures in the economy. A tight labour market also means cost-push inflation forces are present. Further rises in food prices, and the introduction of the Government's emissions trading scheme suggest the risks to inflation are all pointed one way. With the headline inflation rate now above 3 percent, the danger is that persistently sticky inflationary readings over the past four years become embedded in price and wage setting behaviour.

**Nonetheless, there are some encouraging signs.** Non-tradable (domestic) inflation has started to track lower with the annual rate easing to 3.5 percent. While one-off Government subsidies in the September quarter have helped pull the annual rate lower, we were encouraged by a softish read on non-tradable ex-housing inflation as well (which has eased to 2.8 percent annually). With Government-related inflation charges consistently running near 5 percent, it was about time some came the other way! Nevertheless, it is still too early to say the RBNZ has gotten on top of domestic inflationary pressure. In fact it's the opposite. Core inflation remains above 3 percent and 2-year inflation expectations at 2¾ percent.

**Inflation is forecast to remain above the RBNZ's target band in 2008.** Given our expectation that food and oil prices are expected to remain high over most of this year and the labour market will continue to remain tight and reinforce wage and cost-push pressures, inflation will remain stubbornly elevated and sticky in the near-term. A slowing non-tradable inflation profile, on the back of a slowdown in domestic demand is offset by higher tradable inflation, as sanity eventually returns to the currency market and the NZD declines.



Sources: ANZ National, Statistics NZ

**Looking at the medium-term trajectory, we've pencilled in a receding profile.** It is difficult to do otherwise given that this is what the RBNZ is mandated to deliver! The real issue are the judgements that deliver this profile. After all, the labour market shows no sign of abating thereby fuelling wage pressure, firms are sitting on compressed margins, and any signs of a weaker currency could see imported inflation through the roof. Is the inflationary genie about to be unleashed?

**We struggle with this in a couple of areas.** First, businesses can only recover margins when consumers are buying, and prospects for the domestic economy are subdued, with downside risk. There'll be a lot of screaming about imported inflation when the NZD falls, but the first stage will be margin liposuction like it has always been. And second, given our subdued views over global growth and inclinations towards recoupling, we expect less commodity price inflation, continued downward pressure on consumption and manufacturing good prices, and downside pressure on the USD to ease (thereby dampening USD denominated commodity inflation). The biofuels debate – which has driven a lot of soft commodities skyward – also looks more hype than substance. The numbers look questionable, and it is based on a cost-plus paradigm (the ability to pass on cost increases willy-nilly), which goes against the whole thrust of central banks' monetary policy frameworks.

This doesn't mean to say there won't be a fair degree of inflation stickiness – there will be. But we have confidence in the whole monetary policy framework. It has worked well for NZ over the past 15 years and we expect it to continue doing so over the next 15.

A lot of this confidence in the monetary policy framework stems from our belief the property market is in the midst of a decent correction.

## CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Sep-07	0.5	1.8
<b>Dec-07</b>	<b>1.2</b>	<b>3.2</b>
Mar-08 (f)	0.6	3.3
Jun-08 (f)	0.8	3.0
Sep-08 (f)	0.9	3.4
<b>Dec-08 (f)</b>	<b>0.8</b>	<b>3.0</b>
Mar-09 (f)	0.5	2.9
Jun-09 (f)	0.7	2.9
Sep-09 (f)	0.7	2.7
<b>Dec-09 (f)</b>	<b>0.7</b>	<b>2.7</b>
Mar-10 (f)	0.5	2.7
Jun-10 (f)	0.5	2.5
Sep-10 (f)	0.6	2.4
<b>Dec-10 (f)</b>	<b>0.7</b>	<b>2.4</b>
Mar-11 (f)	0.5	2.5
Jun-11 (f)	0.6	2.5
Sep-11 (f)	0.6	2.5
<b>Dec-11 (f)</b>	<b>0.5</b>	<b>2.3</b>

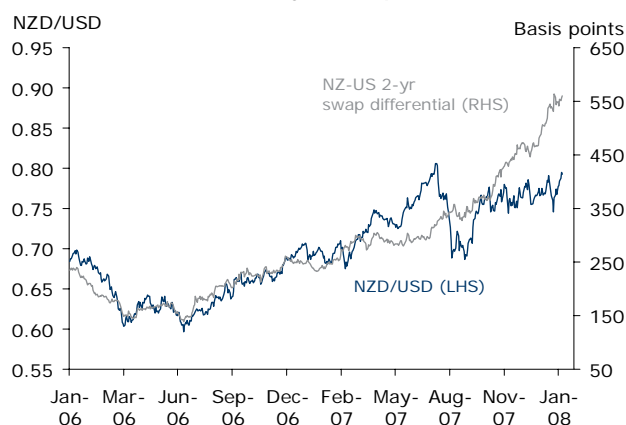
## EXCHANGE RATE

Given present uncertainties, our forecasts have the NZD/USD flat-lining in the near-term, but with a downside bias given our unease towards international malaise remaining US-centric. The NZD/AUD looks very extended given the diverging paths of the two economies and expected rate movements by the respective central banks.

### Pick-your driver

**The NZD continues to face a tug-of-war between risk appetites and yield.** The NZ-US 2-year swap differential has blown out to around 560 basis points as a result of aggressive US Federal Reserve interest rate cuts (225 basis points since September last year) and expectations of further cuts to come. At the other end of the spectrum, sentiment remains flaky and equity markets volatile, with 2 cent moves in the NZD in the space of a few hours becoming common. Capital preservation as opposed to yield enhancement continues to feature. Bonds, currencies and commodities are all taking their cues from US equities, and we expect this pattern to continue. For so long as credit markets continue to worry over pending losses, write-downs, and ripple effects into other areas, equities – dominated by financials – will remain volatile. While the Fed is trying to restore sanity and confidence to markets, sentiment will remain precarious until exposures are declared and worked through. It's a process that continues to take time.

**NZD vs US-NZ 2-year swap differential**



Sources: ANZ National, Bloomberg

**The real issue is whether weak growth remains US-centric, or broadens.** The former will see attention concentrated on the massive yield differential on the assumption there is enough momentum across peripheral and emerging markets to keep global growth on a respectable footing, thereby keeping commodity prices high, and our own RBNZ on the disinflationary brake. Brace for a push to 0.80 to 0.85 cents against the greenback. Conversely, any signs of dislocation extending will see pressure come on commodity prices and the market quickly looking for an early easing from the RBNZ. While Asia remains the critical benchmark for the latter, it could well be the Euro area's growth prospects, and EUR/USD as the

early warning barometer, that acts as the trigger. A strong Asian region is one thing in the face of a soft US economy. But holding up against the US, Japan and Europe is another. The Euro area has a more inflation-phobic central bank, has suffered from a high currency, and has little fiscal latitude to stabilise growth. We expect a growth pothole for Europe at some stage in 2008, with the by-product a stronger USD. Looking at global growth indicators, commodity markets are oscillating, and inconsistent. Metals are still elevated but have eased. Bulks remain supported, but the Baltic Dry Index is down 45 percent from its peak. Bottom line is that the peak in the growth cycle looks to have been reached, but no-one is sure what's on the other side.

**There are numerous inconsistencies across the currency market at present.** Yield and a wider yield gap have pushed the NZD/USD up. Yet a narrower NZ-Aus 2-year differential (which has fallen sub 100 basis points) has not pushed the NZD/AUD down. By-and-large it has been the AUD leg that has struggled, which tells us that global growth concerns remain.

The AUD is being perceived as more growth sensitive and hence heavy, which while true to a degree, runs counter to trends we are already seeing in commodity markets, with dairy prices now down 7 percent from their peak, but various bulks (coal and iron ore) continuing to surge. While commodities may be second-order currency drivers, they directly influence primary focal points such as the path for interest rates. The RBA and AUD look to have further interest rate adjustments pending. In the absence of global unease, we'd be calling parity for the AUD/USD.

**Given the current uncertainties present, any potential currency forecast needs to be associated with wide confidence bands.** Like with our economic forecasts, we have taken a "middle of the road" approach to our currency projections. Our forecasts have the NZD/USD effectively flat-lining in the mid-to-high 70's until we see how the decoupling/recoupling – yield/risk debate unfolds. About the safest thing we can say at present is that volatility will stay high. History also tells us that when the currency does move, it moves quickly. Just think back to July/August last year. The NZD/USD fell 18 percent in the space of three weeks. We suspect we could be in for a repeat when we look at credit dislocation, all the negative sentiment factored into the USD (often a contrarian indicator), signs that international dairy prices are easing, and housing related weakness domestically. The average NZ house sells for around 30 percent more than its US equivalent, when expressed in USD terms. It makes us wonder what sort of housing adjustment NZ could be facing.

**Further out, we remain comfortable in sticking with a bearish view of the NZD.** The long-run anchor for our NZD/USD view remains south of 70 cents, with the terms of trade boost capped by relative productivity under-performance. We didn't buy into the sub-50 cent fair value hype in 2000 and we're happy holding a more circumspect position in 2008.

For now short-term cyclical gauges (yield, strong AUD, commodity prices) certainly suggest the NZD will remain high for the time being. The key remains when the market re-prices any pending easing cycle from the RBNZ, and our expectations of lower rates from September 2008 (on housing woes) should see the NZD start to track lower from late Q2.

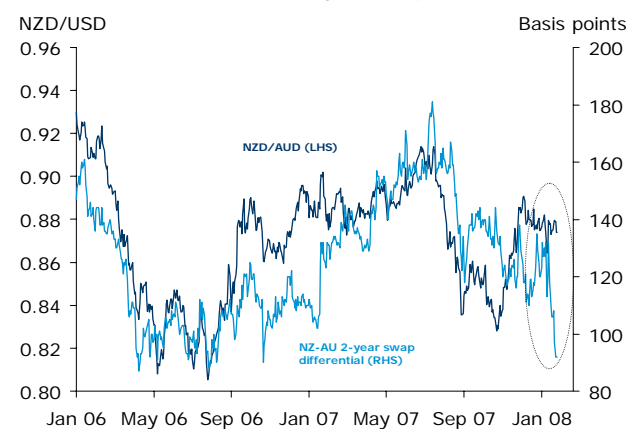
**Part of the inevitable rebalancing the economy is facing will involve a weaker currency, although like most things, it continues to take time.**

Growth and housing remain key directional barometers for the currency and while both are on a softening path, the market requires more before interest rate markets will start to re-price the RBNZ. Commodity prices may well hold the key in this regard, not only for their traditional link with the NZD, but the indirect impact on the RBNZ's stance. The message on this front is to watch for potential signs of strength in the USD (with most commodities expressed in USD's and having close to a 20 percent speculative element), and the whole decoupling/recoupling debate.

**We likewise retain a bearish view towards the NZD/AUD.** While the AUD and cross looks hostage to wider global gyrations at present, we find it difficult to go past the divergent economic picture. Momentum in Australia is building at a time New Zealand's is waning. Core inflation reads are stronger across the Tasman. 4.1 percent non-tradable inflation versus 3.5 percent

here. Weighted median inflation is 3.8 percent in Australia versus 3.4 percent in NZ. The interest rate market has been quick to re-price the two economies via a narrowing yield differential. Why this is not flowing through to the cross remains a mystery. We expect to see some catch-up.

**NZD/AUD vs NZ-AU 2-year swap differential**



Sources: ANZ National, Bloomberg

**NEW ZEALAND DOLLAR FORECAST (average for the quarter)**

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
<b>Dec-04</b>	<b>0.70</b>	<b>0.92</b>	<b>74.0</b>	<b>0.38</b>	<b>0.54</b>	<b>67.6</b>
<b>Dec-05</b>	<b>0.69</b>	<b>0.93</b>	<b>81.4</b>	<b>0.40</b>	<b>0.58</b>	<b>71.5</b>
<b>Dec-06</b>	<b>0.67</b>	<b>0.87</b>	<b>79.2</b>	<b>0.35</b>	<b>0.52</b>	<b>67.1</b>
Mar-07	0.70	0.89	83.1	0.36	0.53	68.8
Jun-07	0.74	0.89	89.5	0.37	0.55	72.0
Sep-07	0.74	0.88	87.9	0.37	0.54	71.4
<b>Dec-07</b>	<b>0.76</b>	<b>0.86</b>	<b>86.4</b>	<b>0.37</b>	<b>0.53</b>	<b>71.0</b>
Mar-08 (f)	0.78	0.87	84.5	0.39	0.52	71.4
Jun-08 (f)	0.77	0.86	84.0	0.40	0.52	70.9
Sep-08 (f)	0.74	0.84	79.3	0.38	0.50	68.5
<b>Dec-08 (f)</b>	<b>0.70</b>	<b>0.80</b>	<b>72.9</b>	<b>0.36</b>	<b>0.49</b>	<b>64.8</b>
Mar-09 (f)	0.67	0.79	69.8	0.35	0.48	62.8
Jun-09 (f)	0.65	0.78	69.2	0.35	0.48	61.9
Sep-09 (f)	0.63	0.79	69.2	0.34	0.48	61.7
<b>Dec-09 (f)</b>	<b>0.62</b>	<b>0.79</b>	<b>69.8</b>	<b>0.34</b>	<b>0.49</b>	<b>61.8</b>
Mar-10 (f)	0.61	0.79	69.8	0.34	0.49	61.2
Jun-10 (f)	0.59	0.79	69.6	0.33	0.50	60.9
Sep-10 (f)	0.58	0.80	69.6	0.33	0.50	60.9
<b>Dec-10 (f)</b>	<b>0.58</b>	<b>0.81</b>	<b>69.6</b>	<b>0.33</b>	<b>0.50</b>	<b>60.9</b>
Mar-11 (f)	0.59	0.81	69.9	0.33	0.51	61.1
Jun-11 (f)	0.60	0.81	70.4	0.34	0.51	61.5
Sep-11 (f)	0.61	0.83	71.2	0.34	0.52	62.1
<b>Dec-11 (f)</b>	<b>0.63</b>	<b>0.85</b>	<b>71.7</b>	<b>0.34</b>	<b>0.52</b>	<b>62.5</b>

## INTEREST RATES

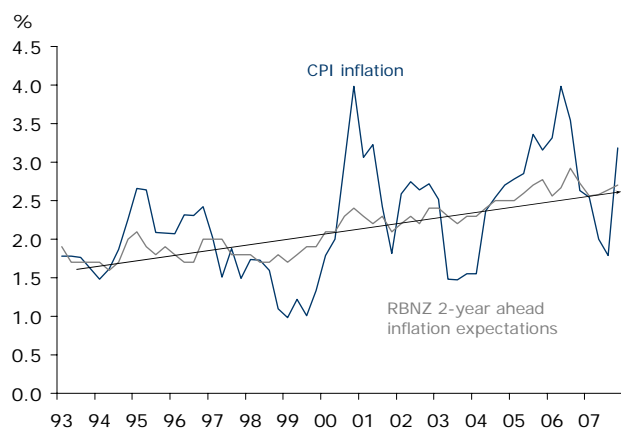
We've pencilled in easings from late 2008, largely reflecting our wariness over house prices, and the (global led) credit cycle. The risk profile for rates looks unevenly distributed, with upside inflation risks suggesting another 50bps of tightening vs downside growth risks pointing to a potentially early and aggressive easing cycle.

### Upside vs downside

As noted by the RBNZ in their January *OCR Review*, the interest rate outlook contains a wider degree of uncertainty than normal. The two scenarios painted in their September 2007 *Monetary Policy Statement* – one containing more inflation pressure resulting in further policy tightening, and the other an extension of global unease leading to earlier rate cuts – appear to be unfolding. Economic growth is likely to undershoot the RBNZ's latest forecasts, with the risks tilted further to the downside given the deteriorating outlook in the US. However, the risks to inflation remain firmly to the upside stemming from food price inflation, further potential cost-push pressure from a tight labour market and the cost of meeting the Government's proposed emissions trading scheme.

Based purely on domestic considerations, it is conceivable that the RBNZ could remain on hold until well into 2009. With headline inflation not expected to return to the RBNZ's target band until early 2009, the risk profile is tilted towards higher rates, particularly if global conditions stabilise and commodity prices continue to rise. The RBNZ simply has no headroom to absorb further upside inflation surprises. While it has finally managed to get on top of the housing market (an understatement in our view) and there are early signs that non-tradable inflation might be starting to turn, it is too early to say that the RBNZ have gotten completely on top of domestic inflation pressure given resource pressure, especially a very tight labour market.

CPI inflation vs expectations



Sources: ANZ National, Statistics NZ, RBNZ

Getting inflation expectations down appear to be the new battlefield. Over recent years, inflation expectations have moved higher. While part of this upward drift is to be expected given the changes to the policy target band, at 2½ percent, inflation

expectations have moved to a level where they are increasingly difficult for the RBNZ to get CPI inflation towards the mid-point of the target band over the medium-term. This is particularly so when actual inflation is above 3 percent. As the RBNZ noted in their December *Statement*, "it is well recognised that reversing an increase in inflation expectations can be difficult and costly."

Near-term, the Reserve Bank looks to be in a holding pattern, with the talk remaining tough ensuring that they maintain the current pipeline tightening through the mortgage curve, and also an implicit stick waving exercise at inflation expectations.

### A more challenging environment for central banks

Other central banks are facing similar inflation pressures to the RBNZ. Surging food and oil prices are a global phenomenon. The headline inflation rate in the US has risen to 4.1 percent. Globally, unemployment rates are low with labour scarce, commodity prices have been high now for a number of years (adding inflation persistence) and 1990's inflation suppressants are less active.

The presence of lower core inflation has given the Fed, BoC, and BoE capacity to respond already to emerging economic risks. However, such central bank "puts" do not come risk free. A successful navigation of the current mess may ultimately come with an inflation cost down the track, if liquidity and stimulus manage to avert a US downturn. Long-term rates look biased higher from late 2008. While inflationary pressures are foremost determined by the state of demand, and hence looking capped for now (in the US at least), the global economy is entering a period of inflationary unease, where central banks will rightly be concerned over any deteriorating path for inflation expectations.

### An easing catalyst?

Domestically, the housing market is weak, and we expect such weakness to diffuse through the broader economy, and into the path for inflation. However, by itself, and given more widespread inflation pressure, we'd be coy about anchoring rate moves off this alone. Fiscal largesse is pending and the NZD is likely to be a key release valve through which monetary conditions ease.

The wildcard and key looks to be how global developments unfold. While (in New Zealand) the upside inflation risks (fiscal policy, food and energy prices, Government's emissions trading scheme) are known and quantifiable to a certain extent, the big uncertainty at present is how the global environment will play out. While policymakers always face a degree of uncertainty in setting policy, the current global growth gyrations suggests a wide confidence interval should surround the range of possible outcomes. The standard approach to policy in an uncertain environment is to adopt a "middle of the road approach", which is what the RBNZ appears to be doing by holding, watching and waiting. However, some potential shocks do have greater consequences

than others (even if they are no more or even less likely to occur), and in such instances the distribution of outcomes can become heavily skewed to one side. The bottom line is that there looks to be 50bps of upside interest rate risk, versus a potential downside of 200bps.

In New Zealand, we need to be realistic (humble) about what our analysis can add to the international growth debate. Certainly, our instincts are more drawn to recoupling as opposed to the decoupling view. However, we can add value on the nature of the event NZ is facing. First, it's a credit event, as opposed to a trade related event that has typically impacted on the economy. Second, NZ is one of the most heavily indebted nations around the globe, with a huge current account deficit. This makes NZ very reliant on offshore capital. Third, while offshore capital is still available, it's nonetheless coming at a cost, both in price, and at investors' discretion. Fourth, while NZ doesn't have a pocket called subprime, it does have a mini equivalent via dislocation across finance companies, which has yet to fully unfold. This combination leaves us scratching our heads not over the impact, but to what degree.

**We continue to pencil in a late 2008 start to the easing cycle.** With the housing market already in retreat (and vulnerable to more downside), the New Zealand economy finds itself very reliant on global growth and commodity prices. Don't expect a \$20 per week tax cut to be a saving grace if asset values are down more than 5 percent. International dairy prices have fallen 7 percent in the space of 2 months.

While this simply unwinds a portion of the 100 percent plus gain seen over the preceding year, which has been quickly capitalised into (dairy) farm values, farm sentiment and values look vulnerable. As a net borrower hugely reliant on offshore capital, the credit nature of current global unease reinforces the economy's Achilles heel, namely leverage.

**The easing cycle we've pencilled in is relatively modest,** with the cash rate troughing at 6.75 percent. We'd consider this at the topside of where we see the neutral cash rate, but consistent with a sticky inflationary tone in the upper quadrant of the 1 to 3 percent policy band. To take a more bullish stance towards rates would imply house prices were set for a 10 percent plus correction. It certainly looks feasible given the run-up but we'll bide our time for now.

**Central bank policy actions overseas late last year highlight how quickly events can turn.** The US Federal Reserve was hawkish on inflation for most of last year, only to find itself behind the curve and cutting 225bps between September 2007 and now, with further easings likely. Both the BoC and BoE hiked in July 2007, only to ease in December. Market pricing has the ECB and BoE easing in 2008, owing to slower growth but also concerns over the financial system. The RBA may well find Australia as the lucky country once again, although this will likely be matched by successive hikes early this year in the face of accelerating core inflation and a strong domestic economy. A 40 percent jump in their terms of trade suggests the consumer could be hard to rein in, even if dislocation spreads.

## INTEREST RATE FORECAST (average for the quarter)

Quarter	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
Dec-04	6.4	6.7	6.6	6.6	6.0	4.2	5.4
Dec-05	7.0	7.5	7.2	6.9	5.9	4.5	5.4
Dec-06	7.3	7.6	7.5	7.1	5.8	4.6	5.7
Mar-07	7.4	7.8	7.7	7.4	5.9	4.7	5.8
Jun-07	7.9	8.1	8.1	7.8	6.3	4.8	6.0
Sep-07	8.3	8.7	8.3	7.9	6.5	4.7	6.0
<b>Dec-07</b>	<b>8.3</b>	<b>8.8</b>	<b>8.6</b>	<b>8.1</b>	<b>6.4</b>	<b>4.3</b>	<b>6.1</b>
Mar-08 (f)	8.3	8.7	8.5	8.0	6.3	3.7	6.2
Jun-08 (f)	8.3	8.6	8.4	7.8	6.2	3.8	6.1
Sep-08 (f)	8.2	8.2	8.0	7.5	6.0	3.8	5.8
<b>Dec-08 (f)</b>	<b>7.7</b>	<b>7.7</b>	<b>7.5</b>	<b>7.0</b>	<b>5.7</b>	<b>3.6</b>	<b>5.3</b>
Mar-09 (f)	7.2	7.2	7.1	6.7	5.4	3.6	4.9
Jun-09 (f)	6.8	7.0	6.9	6.7	5.6	3.9	5.0
Sep-09 (f)	6.8	7.0	7.0	6.8	5.7	4.2	5.2
<b>Dec-09 (f)</b>	<b>6.8</b>	<b>7.0</b>	<b>7.0</b>	<b>6.9</b>	<b>5.9</b>	<b>4.5</b>	<b>5.4</b>
Mar-10 (f)	6.8	7.0	7.1	7.1	6.3	5.0	5.9
Jun-10 (f)	6.8	7.0	7.1	7.5	6.8	5.7	6.6
Sep-10 (f)	6.8	7.0	7.2	7.6	7.0	5.9	7.0
<b>Dec-10 (f)</b>	<b>6.8</b>	<b>7.0</b>	<b>7.1</b>	<b>7.5</b>	<b>6.8</b>	<b>5.6</b>	<b>6.9</b>
Mar-11 (f)	6.8	7.0	7.1	7.5	6.8	5.6	6.9
Jun-11 (f)	6.8	7.0	7.1	7.5	6.8	5.6	6.9
Sep-11 (f)	6.8	7.0	7.1	7.5	6.8	5.6	6.9
<b>Dec-11 (f)</b>	<b>6.8</b>	<b>7.0</b>	<b>7.1</b>	<b>7.5</b>	<b>6.8</b>	<b>5.6</b>	<b>6.9</b>

## ECONOMIC FORECASTS

	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
<b>Real Gross Domestic Product</b>												
Total GDP, QPC	0.4	0.7	1.2	0.8	0.5	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	0.5	0.6	0.7
Total GDP, APC	0.9	2.0	2.4	3.2	3.3	2.9	1.9	1.4	1.2	1.4	1.7	2.1
Total GDP, AAPC	1.6	1.6	1.6	2.1	2.7	3.0	2.8	2.4	1.9	1.5	1.4	1.6
<b>Real GDP Components</b>												
Private Consumption, QPC	0.9	1.3	2.1	0.4	0.3	<b>0.3</b>	<b>0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.4</b>	<b>0.5</b>
Private Consumption, AAPC	2.9	2.4	2.7	3.4	3.9	4.1	3.4	2.4	1.6	1.1	1.1	1.2
Public Consumption, QPC	0.8	0.7	0.6	1.0	2.1	1.2	1.2	1.1	1.0	0.9	0.9	0.9
Public Consumption, AAPC	5.3	5.1	4.7	4.2	4.0	4.1	4.6	5.2	5.2	5.1	4.6	4.1
Residential Investment, QPC	3.8	1.5	-0.2	3.5	1.9	-2.0	-5.0	-4.2	-3.0	-1.5	0.5	1.0
Residential Investment, AAPC	-3.5	-3.1	-2.7	1.6	3.4	4.3	4.2	-0.3	-5.5	-9.4	-11.0	-9.6
Other Investment, QPC	1.7	1.1	3.6	-1.1	-0.8	2.2	-1.1	-0.5	0.3	0.7	1.1	1.2
Other Investment, AAPC	2.0	-0.9	-2.0	0.2	1.7	3.4	2.7	1.4	0.9	-0.1	0.5	1.3
Gross National Expenditure, QPC	0.8	2.4	1.4	1.7	0.2	0.5	-0.1	0.0	0.3	0.4	0.6	0.7
Gross National Expenditure, AAPC	1.1	1.0	1.0	2.9	4.6	4.8	4.6	3.1	1.8	1.0	0.8	1.1
Exports, QPC	2.5	-1.3	2.2	-0.8	-0.6	0.6	0.5	0.7	0.7	1.0	1.1	1.1
Exports, AAPC	1.3	1.8	3.1	3.5	2.2	2.2	0.7	0.4	1.2	1.6	2.6	3.3
Imports, QPC	0.7	1.5	4.1	2.6	0.2	1.0	-0.4	-0.3	0.5	0.7	1.0	0.9
Imports, AAPC	-2.3	-2.7	-1.6	1.9	5.4	7.6	7.3	5.1	3.1	1.3	1.0	1.6
<b>Prices</b>												
Headline CPI, QPC	0.7	-0.2	0.5	1.0	0.5	1.2	0.6	0.8	0.9	0.8	0.5	0.7
Headline CPI, APC	3.5	2.6	2.5	2.0	1.8	3.2	3.3	3.0	3.4	3.0	2.9	2.9
Non-tradable CPI, QPC	1.0	0.8	1.2	1.1	0.6	0.7	1.0	0.9	0.9	0.9	0.9	0.8
Non-tradable CPI, APC	4.0	3.8	4.1	4.1	3.7	3.5	3.4	3.3	3.6	3.9	3.8	3.6
Tradable CPI, QPC	0.3	-1.3	-0.4	0.9	0.5	1.8	0.2	0.6	0.8	0.7	0.1	0.6
Tradable CPI, APC	3.0	1.2	0.9	-0.5	-0.3	2.8	3.4	3.1	3.4	2.3	2.2	2.1
<b>External Accounts</b>												
Annual Balance on Goods, % of GDP	-2.0	-1.9	-1.7	-1.8	-1.8	-1.8	-1.5	-1.1	-1.0	-1.0	-1.1	-1.2
Annual Balance on Services, % of GDP	0.2	0.3	0.3	0.3	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.4
Annual Balance on Invisibles, % of GDP	-7.0	-7.0	-6.8	-6.7	-6.8	-6.6	-6.5	-6.3	-6.1	-6.1	-6.1	-5.9
Annual Current Account Balance, % of GDP	-8.8	-8.6	-8.2	-8.1	-8.3	-8.0	-7.5	-6.9	-6.6	-6.6	-6.8	-6.8
Net International Invnt Position, % of GDP	-85.3	-87.9	-86.9	-88.5	-88.4	-87.6	-85.6	-84.1	-84.3	-84.1	-82.9	-81.8
<b>Terms of Trade (SNA basis)</b>												
Export Prices, QPC	-0.2	-0.7	-0.3	-2.1	1.3	3.7	1.3	0.5	1.0	3.5	2.1	1.0
Export Prices, APC	8.8	5.8	2.8	-3.3	-1.8	2.5	4.2	6.9	6.5	6.3	7.2	7.7
Import Prices, QPC	-0.4	-3.3	-1.8	-3.1	-1.3	0.9	0.0	1.4	3.0	4.6	2.7	1.4
Import Prices, APC	12.1	6.3	0.8	-8.3	-9.2	-5.3	-3.6	0.9	5.3	9.3	12.2	12.2
Terms of Trade, QPC	0.2	2.7	1.5	1.1	2.7	2.8	1.3	-0.9	-2.0	-1.1	-0.6	-0.4
Terms of Trade, APC	-3.0	-0.4	1.9	5.5	8.1	8.2	8.0	5.9	1.1	-2.7	-4.5	-4.0
<b>Labour Market</b>												
Employment, QPC	-0.3	0.0	1.2	0.6	-0.3	0.5	0.4	0.3	0.2	0.3	0.1	0.1
Employment, APC	1.5	1.4	1.7	1.6	1.5	2.0	1.2	0.9	1.4	1.2	0.9	0.7
Labour Force, QPC	-0.1	0.0	1.2	0.5	-0.4	0.6	0.5	0.4	0.3	0.4	0.2	0.2
Labour Force, APC	1.6	1.6	1.6	1.5	1.3	1.9	1.2	1.1	1.7	1.6	1.3	1.1
Unemployment Rate, sa	3.8	3.7	3.7	3.6	3.5	3.6	3.7	3.8	3.8	4.0	4.1	4.2
Participation Rate, sa	68.3	68.1	68.6	68.8	68.3	68.5	68.6	68.7	68.7	68.7	68.7	68.6
Private Sector Wages (apc)	5.4	5.5	5.5	4.2	3.7	4.0	4.4	4.6	4.3	4.7	4.6	4.5
Public Sector Wages (apc)	3.2	4.1	1.9	4.6	4.9	5.0	2.1	4.5	4.9	5.1	5.0	4.8

Forecast in bold

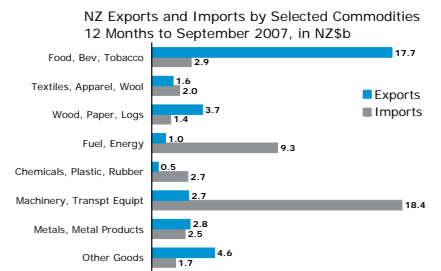
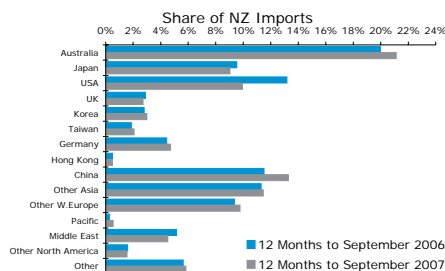
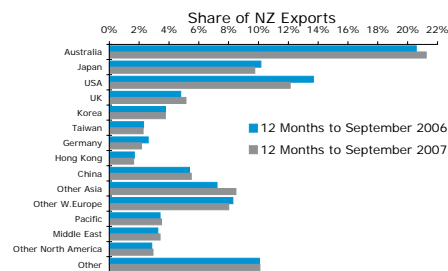
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

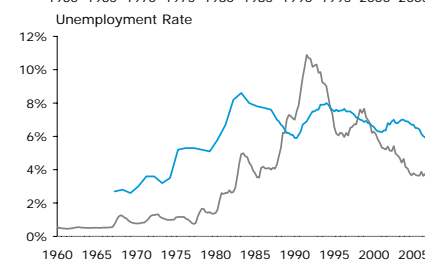
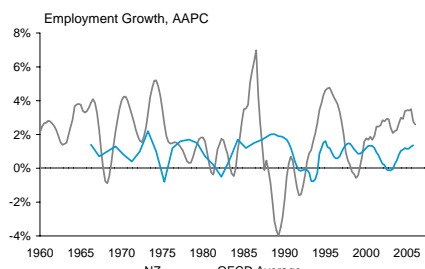
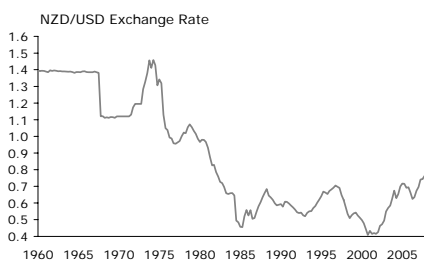
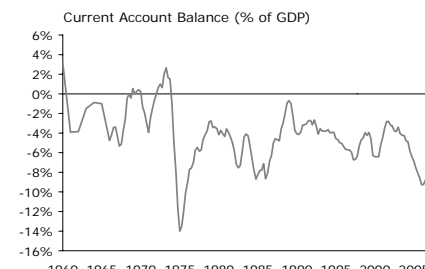
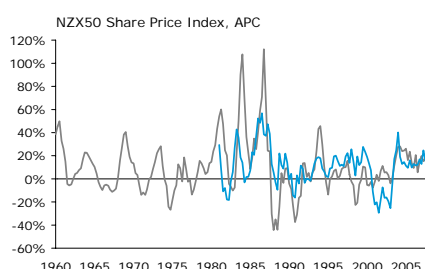
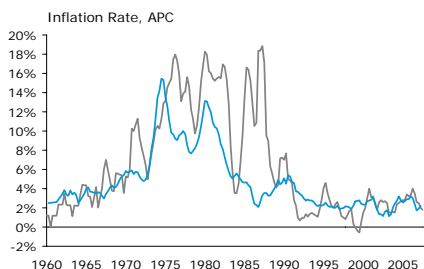
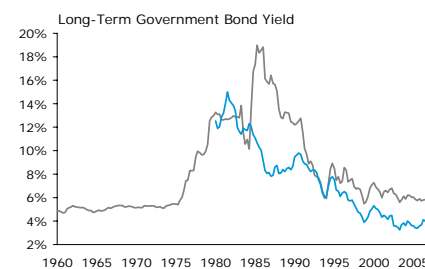
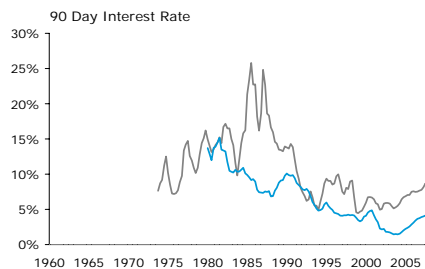
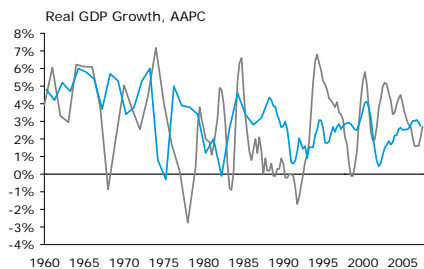
sa – seasonally adjusted

## NEW ZEALAND KEY ECONOMIC INDICATORS



## New Zealand Compared to Main Trading Partners (latest available figures)

	NZ	Aust	USA	Japan	UK	China	Gmany	SKorea	Taiwan	Malaysia	H/kong	S/pore	Indonesia
Population, in millions	4.1	20.4	301.1	127.4	60.8	1320.9	82.4	49.0	22.9	24.8	6.9	4.6	234.7
Area in 1,000 km2	271	7713	9373	378	244	9561	357	92	36	330	1	1	1905
Inhabitants per km2	15.0	2.6	32.1	337.2	249.1	138.2	231.0	531.5	636.1	75.2	6900.0	4600.0	123.2
GDP, in billion NZ\$	171.0	1095.8	17269	5886.9	3424.7	3697.7	4401.9	1185.5	409.9	213.1	246.0	188.6	465.0
Change in real terms (%)	2.7	4.3	2.8	1.9	2.9	11.2	2.5	5.2	6.9	5.7	6.2	6.0	6.5
Nominal GDP per capita in NZ\$	42,095	53,718	57,354	46,208	56,327	2,799	53,421	24,194	17,901	8,591	35,659	40,992	1,981
NZ exports to ..., in million NZ\$ (FOB)	n/a	7366	4205	3383	1784	1905	748	1301	788	585	568	568	678
Share of NZ Exports (%)	n/a	21.2	12.1	9.8	5.1	5.5	2.2	3.8	2.3	1.7	1.6	1.6	2.0
NZ imports to ..., in million NZ\$ (VFD)	n/a	8123	3825	3477	1043	5108	1815	1150	794	955	188	1811	600
Share of NZ Imports (%)	n/a	21.1	9.9	9.0	2.7	13.3	4.7	3.0	2.1	2.5	0.5	4.7	1.6
Current Account balance as a % of GDP	-8.3	-5.8	-5.7	4.7	-4.9	8.8	6.4	0.8	9.0	17.5	14.2	32.0	2.9



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