

Economic Review

New Zealand

10 December 2009

RBNZ December *Monetary Policy Statement* Review

Key points

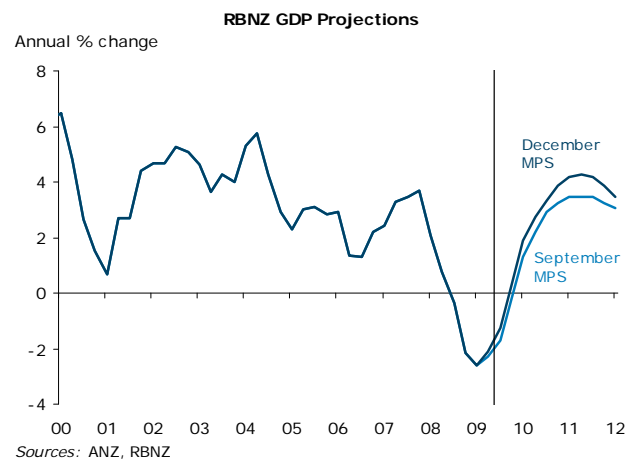
- > **The RBNZ left the OCR unchanged at 2.50 percent as widely expected, but flagged a *conditioned* mid-2010 start to the tightening cycle.**
- > **We've altered our September call to June in line with the RBNZ's view – a somewhat uncomfortably crowded fence to sit on.**
- > **While tempting to jump ahead of the market given how quickly developments are unfolding, we're not being spooked by the change in tone.**
- > **This largely reflects our view that fiscal policy is set to be very influential, and the recovery is narrowly based and very conditional on stimulus remaining in place.**

Assessment

The OCR was left unchanged at 2.50 percent as widely expected. We were anticipating a similar tone to the October *Review's* to be struck, and any material change in stance to occur in March 2010. But the RBNZ has now seen enough improvements to the outlook to flag rate hikes in the middle of 2010. This is conditional on the economy tracking in line with their upwardly revised growth forecasts (3 percent growth in calendar 2010 and 4.1 percent in calendar 2011).

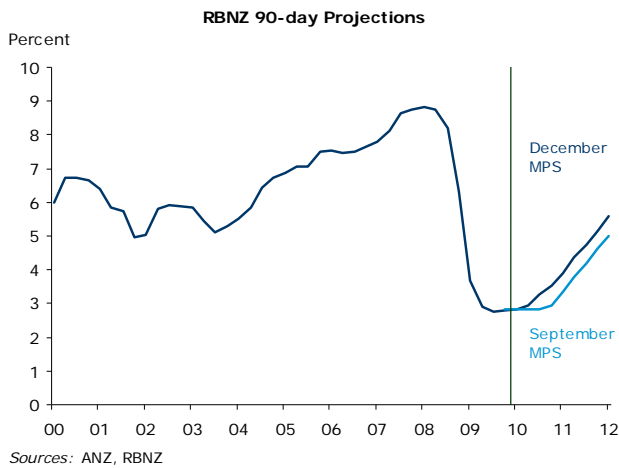
The RBNZ still remains somewhat cautious over the outlook. While acknowledging improvements in global growth, the Bank notes that medium-term risks remain. And the Bank does not expect the strong gains seen in NZ's main export commodity prices to continue going forward. Even so, the Bank views the improvements to the external outlook as being offset by recent gains in the NZD. It is the stronger rebound in the domestic economy that has resulted in most of the upward revision to the Bank's growth projections. Consumption growth is now forecast to grow by 2.7 percent in the year to March 2011 and 2.1 percent in the year to March 2012, compared to 1.7 percent and 0.3 percent, respectively, in the September *Monetary Policy Statement*.

Strong gains in house prices have the RBNZ somewhat concerned, with much discussion devoted to it in the *Statement*. While the Bank does not expect those gains to be sustained, it does see further increases in the near-term, which could result in a stronger rebound in consumer spending. The overall *Statement* is balanced in terms of the risks they see. Nonetheless, on the whole, the RBNZ now expects the economy to recover earlier and stronger compared to their *September* projections.

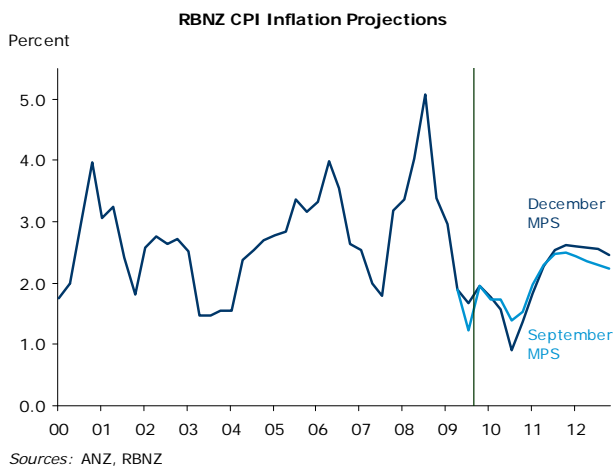


Overall, the RBNZ has seen enough improvements to flag a removal of policy stimulus by mid-2010. The RBNZ sees no need for earlier moves than that given; (a) the upward sloping interest rate curve, (b) more people on shorter term mortgages, reducing the transmission lags of monetary policy, (c) elevated bank funding costs, and (d) market pricing that is helping to do some of the RBNZ's work. In the absence of these, we would be putting in a rate hike for Q1. But the above developments give the RBNZ the luxury of a little bit more time to stay on hold.

Reading between the lines, the RBNZ has still given itself a lot of flexibility in terms of when they tighten. By signalling the middle of 2010, this effectively means the RBNZ could move anytime between April and September, subject to whether the economy evolves in line with their view. The 90-day track rises from June 2010, going to 3.5 percent by December 2010 and 5.6 percent by March 2012. **But developments are unfolding quickly and so too, no doubt, could the RBNZ's view. The next two quarterly CPI outturns in particular will be significant.**



Key gauges to watch going forward are: (a) credit growth, (b) house prices and the flow-on to consumer spending, (c) pick-up in corporate spending, (d) fiscal policy, and (e) the global scene and steps other policymakers are taking. The removal (or progressive unwind) of extraordinary policy stimulus would be a clear sign that policymakers believe the recovery is becoming self sustaining. Policymakers continue to take a cautious stance at present but clearly conditions are changing rapidly.



Inflation is expected to remain within the target band, though some concerns have been expressed. The fact that non-tradable inflation had not eased by more than it has, given the severity of the recession, was a puzzle for the RBNZ, noting that *“it seems the recession simply took the heat out of inflation, rather than driving it to an especially low rate.”* In addition, the recent uptick in inflation expectations has not gone unnoticed by the RBNZ. They see non-tradable inflation remaining sticky throughout the forecast horizon, with a high currency helping to suppress tradable inflation. Rather ironically, the RBNZ now needs a higher currency to keep the inflation track in check given the sticky non-tradable inflation backdrop they see. The recently introduced Emissions Trading Scheme (ETS) was not factored into the RBNZ’s projections, though the Bank does

not expect it to have much impact on monetary policy. In their view, the ETS is more akin to a consumption tax, and any direct impact on the CPI can be looked through, though they will be alert to any second round effects and what they may do to inflation expectations.

The interaction between fiscal (including tax) and monetary policy was again mentioned, with a box in the *Statement* devoted to it. The upshot is that greater fiscal consolidation and any changes to the tax system that helps increase saving will mean less pressure for monetary policy to do more work (and likely result in a lower NZD). This means close attention needs to be paid to the government’s *Half-year Economic and Fiscal Update* and *Budget Policy Statement* due out next week.

Strictly speaking, we believe there is a greater than even chance that we see tax changes in relation to property being introduced at some stage that will materially influence the market in 2010. Such dynamics would certainly take some urgency off monetary policy (if you could consider mid-2010 urgent!). Then there is the continued elevated bank funding costs and the widening in basis swaps, not to mention potential regulatory changes that are pending for the banking sector. However, upside risks are also apparent with the global economy rebounding (recent concerns over Dubai and sovereign debt aside), the Australian economy accelerating and migration trends remaining strong.

Implications

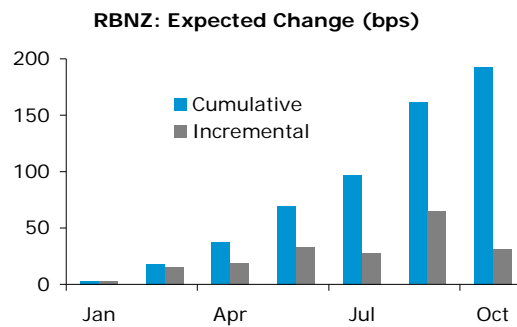
We have nudged our rate hike view slightly, pulling it forward from September to June.

We continue to see a 50 basis point hike at some stage in the mix (likely early) to cement the RBNZ’s credibility. However, we also believe there has been a substantial fall in the neutral OCR rate (from 6 percent to 5 percent), which means the eventual tightening cycle needs to be less aggressive over the business cycle. This is especially so if fiscal and tax policy comes to the party and gives monetary policy some help. **So while we are mindful of the start to the cycle, we are equally cognisant as to how high rates will eventually need to push up.**

The market sold off today and the NZD gained over a cent on the back of today’s more hawkish than expected tone – a modest tightening in financial conditions. This looks like an over-reaction given the tone of the overall *Statement* itself. But in the current environment the market will no doubt continue to push for an earlier as opposed to later move, simply on the historical experience that the RBNZ’s nemesis (housing) is once again front and centre.

Market Pricing

New Zealand	Rate	Change
<i>Current Rate</i>	2.50	from current
Jan 10	2.53	0.03
Mar 10	2.68	0.18
Apr 10	2.87	0.37
Jun 10	3.19	0.69
Jul 10	3.47	0.97
Sep 10	4.12	1.62
Oct 10	4.43	1.93



Source: ANZ, Bloomberg

RBNZ Projections for December MPS (September 2009 MPS Projections in brackets)					
Quarter average	90-day	TWI	March years	CPI (ann % chg)	GDP (ann ave % chg)
Q1 2010	2.8 (2.8)	66.5 (62.3)	2009 (a)	3.0	-1.1
Q2 2010	2.9 (2.8)	66.6 (62.3)	2010	1.8 (1.7)	-0.3 (-0.9)
Q3 2010	3.3 (2.8)	66.2 (62.3)	2011	1.8 (2.0)	3.6 (3.1)
Q4 2010	3.5 (2.9)	65.5 (61.7)	2012	2.6 (2.4)	3.9 (3.4)
Q1 2011	3.9 (3.3)	64.5 (61.2)			
Q2 2011	4.4 (3.8)	63.4 (60.5)			
Q3 2011	4.7 (4.2)	62.2 (59.6)			
Q4 2011	5.1 (4.6)	61.2 (59.0)			
Q1 2012	5.6 (4.0)	60.5 (58.6)			

Text of the policy assessment:

The Official Cash Rate (OCR) remains unchanged at 2.5 percent.

Reserve Bank Governor Alan Bollard said: "The New Zealand economy continues to recover but there remains considerable uncertainty about the durability of the expansion.

"Global activity has continued to rebound. Most obviously, activity in Australia, China and emerging Asia continues to increase and solid growth is expected over the next few years.

"The picture is more mixed in the major developed economies. While activity is expanding, sustained growth is not assured. Financial sectors are still impaired in a number of economies and economic activity is still heavily dependent on policy support.

"In New Zealand, the economy continues to recover, reflecting improved world growth, higher export commodity prices, increased government spending and housing strength. A key uncertainty is the extent to which higher house prices are eventually reflected in increased consumer spending. At this point credit growth remains subdued suggesting households are being relatively cautious.

"While business confidence has improved, actual business spending remains weak. In addition, the high level of the New Zealand dollar has limited the scope for exports to contribute to the recovery. After some short-term correction the current account deficit is expected to widen in the future.

"Annual CPI inflation is expected to remain below 2 percent until early 2011 and track within the target range over the medium term.

"The economy is being assisted by both monetary and fiscal policy support. As growth becomes self sustaining, fiscal consolidation would help reduce the work that monetary policy might otherwise need to do.

"If the economy continues to recover, conditions may support beginning to remove monetary stimulus around the middle of 2010. Recent tightening in financial conditions, driven by a higher exchange rate, increased long-term interest rates and a wider gap between the OCR and bank funding costs, reduces the need for more immediate action."

NEW ZEALAND DISCLOSURE INFORMATION

The Bank (in respect of itself and its principal officers) makes the following investment adviser disclosure to you pursuant to section 41A of the Securities Markets Act 1988.

The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

Qualifications, experience and professional standing

Experience

The Bank is a registered bank and, through its staff, is experienced in providing investment advice about its own securities and, where applicable, the securities of other issuers. The Bank has been selling securities, and providing investment advice on those securities, to customers as a core part of its business for many years, drawing on the extensive research undertaken by the Bank and its related companies and the skills of specialised staff employed by the Bank. The Bank is represented on many bank, finance and investment related organisations and keeps abreast of relevant issues by running seminars and workshops for relevant staff and having its investment adviser staff attend external seminars where appropriate. The Bank subscribes to relevant industry publications and, where appropriate, its investment advisers will monitor the financial markets.

Relevant professional body

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

Professional indemnity insurance

The Bank (and its subsidiaries), through its ultimate parent company Australia and New Zealand Banking Group Limited, has professional indemnity insurance which covers its activities including those of investment advisers it employs.

This insurance covers issues (including 'prior acts') arising from staff fraud, electronic crime, documentary fraud and physical loss of property. The scope of the insurance also extends to third party civil claims, including those for negligence. The level of cover is of an amount commensurate with the size and scale of the Bank.

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

The Bank has a process in place for resolving disputes. Should a problem arise, you can contact any branch of the Bank for more information on the Bank's procedures or refer to any of the Bank's websites.

Unresolved complaints may ultimately be referred to the Banking Ombudsman, whose contact address is PO Box 10-573, Wellington.

Criminal convictions

In the five years before the relevant investment advice is given none of the Bank (in its capacity as an investment adviser and where applicable an investment broker) or any principal officer of the Bank has been:

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;

- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

Fees

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

Other interests and relationships

When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

- ANZ Investment Services (New Zealand) Limited (ANZIS), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ANZIS may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- The Bank has a joint venture relationship with ING (NZ) Holdings Limited (ING). ING and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.

Securities about which investment advice is given

The Bank provides investment advice on the following types of securities:

- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

If you wish to pay investment money to the Bank you can do this in several ways such as by:

- Providing cash;
- Providing a cheque payable to the relevant product or service provider and crossed 'not transferable'; or
- Making an automatic payment or payment through another electronic delivery mechanism operated by the Bank.

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third

parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

Record Keeping

The Bank will keep adequate records of the deposit of investment moneys or property and all withdrawals and dealings with such money or property, using the account/investment number allocated to your investment. You may have access to those records upon request.

Auditing

The Bank's systems and operations are internally audited on a regular basis. The financial statements of the Bank and its subsidiaries are audited annually by KPMG. However, this does not involve an external audit of the receipt, holding and disbursement of the money and other property.

Use of Money and Property

Money or property held by the Bank for a specific purpose communicated to the Bank (e.g. the purchase of an interest in a security) may not be used by the Bank for its own purposes and will be applied for your stated purpose. No member of the Bank's staff may use any money or property deposited with the Bank, for their own purposes or for the benefit of any other person. In the absence of such instructions, money deposited with the Bank may be used by the Bank for its own purposes, provided it repays the money to you upon demand (or where applicable, on maturity), together with interest, where payable.

NEW ZEALAND DISCLAIMER

The Bank does not provide investment advice tailored to an investor's personal circumstances. It is the investor's responsibility to understand the nature of the security subscribed for, and the risks associated with that security. To the maximum extent permitted by law, the Bank excludes liability for, and shall not be responsible for, any loss suffered by the investor resulting from the Bank's investment advice.

Each security (including the principal, interest or other returns of any security) the subject of investment advice given to the investor by the Bank or otherwise, is not guaranteed, secured or underwritten in any way by the Bank or any associated or related party except to the extent expressly agreed in the terms of the relevant security.

This document is provided for informational purposes only and does not constitute an offer to sell or solicitation to buy any security or other financial instrument. No part of this document can be reproduced, altered, transmitted to, copied to or distributed to any other person without the prior express permission of the Bank.

This document is a necessarily brief and general summary of the subjects covered and does not constitute advice. You should obtain professional advice before acting on the basis of This document has been prepared by ANZ National Bank Limited.

ANZ (part of ANZ National Bank Limited), Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-496 8639 <http://www.anz.co.nz> e-mail ecnmcs@anz.com

any opinions or information contained in it. The information contained in this document is given in good faith, has been derived from sources perceived by it to be reliable and accurate and the Bank shall not be obliged to update any such information after the date of this document. Neither the Bank nor any other person involved in the preparation of this document accepts any liability for any opinions or information (including the accuracy or completeness thereof) contained in it, or for any consequences flowing from its use.

UNITED STATES DISCLAIMER

This document is being distributed in the United States by ANZ Securities, Inc. (Member of FINRA [www.finra.org] and SEC) ("ANZ S") (an affiliated company of Australia and New Zealand Banking Group Limited ("ANZBG") and the Bank), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this document and wishing to effect transactions in any fixed income securities referred to herein should contact ANZ S 1177 Avenue of the Americas, New York, NY 10036 USA, Tel: 1-212-801-9160, Fax: 1-212-801-9163, not its affiliates.

This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy.

In addition, from time to time ANZBG, the Bank, ANZ S, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZBG, the Bank, ANZ S or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will be directly or indirectly related to specific recommendations or views expressed in this document. ANZBG, the Bank, ANZ S, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.