

## THE ADJUSTMENT

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### Page 2: Key economic forecasts

### Page 3: New Zealand economic outlook

- > The dynamics of a current account rebalancing process, driven in part by global developments, dominate the economic outlook. While natural shock absorbers, including a weaker currency, fiscal policy and lower interest rates, are responding – and will help cushion the adjustment – we must be realistic. The adjustment process will be a lengthy one, with a further contraction in 2009 before recovery takes hold.

### Page 8: Global outlook

- > The global economy is now reeling from the real economic consequences of the financial crisis. Policymakers have naturally swung into action. Nonetheless, we are looking at a protracted adjustment given the extent of financial malaise and weakness in household balance sheets across an array of Anglo-Saxon nations.

### Page 9: Fiscal policy

- > We expect a sizeable fiscal package pre-Xmas in response to economic conditions. Fiscal deficits, rising debt and large bond tenders will rapidly become the norm. While the correct policy response at present, this cannot continue unfettered. The long-term challenge remains to increase productivity growth.

### Page 10: Inflation

- > Inflation is set to return to the mid-point of the RBNZ's target band by early next year. A weaker currency and volatile commodity markets will result in some headline volatility over the coming years. But the stark reality is that weak growth and easing resource slack points to an easing trend in core inflation.

### Page 11: Exchange rate

- > The dynamics of rebalancing weigh heavily on our medium-term currency projections. A lower NZD is an inevitable part of the rebalancing process for the NZ economy. Abstracting from volatility, we see the NZD/USD pushing well below 50 cents, and continued weakness for an extended period against the other majors.

### Page 13: Interest rates

- > The big picture is that interest rates will continue to move lower given the downside risks to both the domestic and global economy. But once we get to the trough in the easing cycle by around mid-next year, attention will quickly turn to the policy normalisation that will inevitably follow.

### Page 15: Economic forecasts

### Page 16: New Zealand key economic indicators

## KEY ECONOMIC FORECASTS

Calendar years	2006	2007	2008(f)	2009(f)	2010(f)	2011(f)	2012(f)
<b>NZ Economy (annual average % change)</b>							
Real GDP	2.0	3.2	0.6	-1.1	2.2	4.0	3.1
Employment	2.1	1.8	0.2	-1.5	0.2	1.5	1.7
Unemployment Rate (Dec qtr)	3.8	3.4	4.7	6.2	6.8	6.4	6.1
Terms of Trade	-2.9	6.5	3.2	-4.4	0.7	2.8	2.2
<b>Global Growth (annual average % change)</b>							
United States	2.8	2.0	1.3	-1.1	1.3	2.6	2.9
Australia	2.9	4.0	2.3	0.5	2.1	3.1	3.5
Japan	2.0	2.4	0.1	-0.7	1.4	1.5	1.6
China	10.7	11.7	9.5	7.5	8.8	10.0	10.1
Trading Partner Growth	3.7	4.0	2.2	0.5	2.6	3.5	3.7
<b>NZ Inflation (annual % change)</b>							
CPI Inflation	2.6	3.2	3.6	2.8	2.7	2.5	2.4
Non-tradable Inflation	3.8	3.5	4.3	2.7	2.7	3.1	3.3
Tradable Inflation	1.2	2.8	2.8	2.8	2.2	1.4	1.5
<b>NZ Financial Markets (December quarter averages)</b>							
TWI	68.0	71.6	54.9	47.8	54.8	61.8	64.2
NZD/USD	0.69	0.77	0.54	0.44	0.50	0.58	0.62
NZD/AUD	0.88	0.88	0.82	0.81	0.83	0.83	0.82
Official Cash Rate	7.3	8.3	5.0	3.5	6.0	6.0	6.0
90-day bank bill rate	7.7	8.9	5.3	3.8	6.3	6.3	6.3
10-year bond rate	5.8	6.4	4.7	5.0	5.7	6.2	6.2
<b>Fiscal and External Balance</b>							
Current Account Balance (\$m)	-14,200	-14,300	-16,100	-11,600	-12,500	-11,500	-10,200
as % of GDP	-8.7	-8.2	-8.9	-6.5	-6.7	-5.8	-4.9
Govt. Operating Balance (\$m)*	9,500	8,000	2,400	-4,200	-5,600	-5,300	-5,400
as % of GDP	6.0	4.7	1.3	-2.3	-3.1	-2.8	-2.7

Forecasts and text finalised 12 December 2008.

\* June years

### Key forecast assumptions:

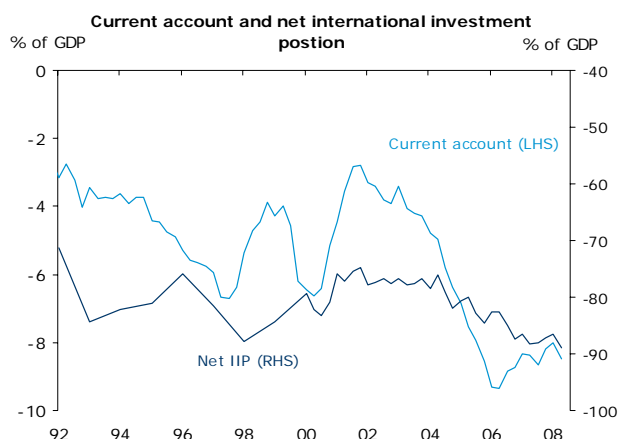
- > Dubai oil prices are expected to fall below US\$40 per barrel before gradually recovering to around US\$60 per barrel by 2011.
- > We expect the current financial market volatility to persist in the near-term but to not deteriorate further.
- > Net migration remains subdued for another 12 months, before increasing to around 10,000 by 2010.
- > 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 just under 4 percent.
- > Inflation expectations start to drift lower from current elevated levels.

## NZ ECONOMIC OUTLOOK

The dynamics of a current account rebalancing process, driven in part by global developments, dominate the economic outlook. While natural shock absorbers, including a weaker currency, fiscal policy and lower interest rates, are responding – and will help cushion the adjustment – we must be realistic. The adjustment process will be a lengthy one, with a further contraction in 2009 before recovery takes hold.

### The big story for NZ is dominated by its weak external position and the deteriorating global environment

**The external position is poor.** NZ's current account deficit – or the difference between what we save and what we invest as a nation – sits at 8.4 percent of GDP. This is one of the highest deficits in the developed world. Years of running these deficits have left NZ with a large stock of net foreign liabilities, which is currently just below 90 percent of GDP. This high dependency on offshore capital (which really stems from NZ's poor domestic savings and investment record) is a key area of vulnerability. Even prior to current global malaise, the unbalanced nature of growth always meant that the NZ economy was set for an "adjustment" where the composition of growth shifted away from the spending side of the economy towards the earnings sector. Typically we tend to think of the adjustment required as being sufficient to stabilise the ratio of net foreign liabilities to GDP. This broadly requires a current account deficit of around 4.5 to 5 percent of GDP. But against the current global (credit-centric and de-leveraging) backdrop, a question we are now asking ourselves is will a mere stabilisation of net foreign liabilities to GDP be enough? We suspect not. We've built in a fairly aggressive turn and improvement in the current account over 2009 (from -8.9 to -6.5 percent) and into the next few years. A lot of our macro forecasts are built around what we consider needs to happen. But our suspicion is that it could be more aggressive.



**We need to recognise the scale of global developments.** The global economy is in the midst of the worst financial crisis in 80 years. Asset prices are tumbling, major financial institutions have announced large write-downs and losses, some have failed or have been gobbled up, and others are crying out for capital. The credit decelerator is now in full force after being in "accelerator" mode over the preceding five years. Lending criteria is being tightened. While policymakers have been incredibly busy with unprecedented moves to try to stabilise and break the cycle of fear and mistrust that has developed, the global economy is still on the brink of a deep and synchronised recession – the worst since 1982, and deteriorating by the day. Financial markets are de-risking and de-leveraging, and it is something that will also be mirrored in real economies. Hence, the very nature of the current global shock exposes NZ's Achilles' heel, namely a huge reliance on offshore capital to fund a savings shortfall.

**When we roll the two together, it does not change the broad adjustment hypothesis, but it undoubtedly changes the magnitude.** As forecasters, we typically look for an orderly adjustment and benign correction for an economy over the forecast period, with an associated discussion around the risk profile. While our previous quarterly assessment painted a reasonably downbeat view of the economic outlook, the next 12-18 months looks like it could be anything but orderly. The downside risks for the domestic economy in particular, foreshadowed earlier in the year, are now reality. Moreover, in the current global environment, NZ can no longer look to the export sector in 2009 as a means of supporting growth.

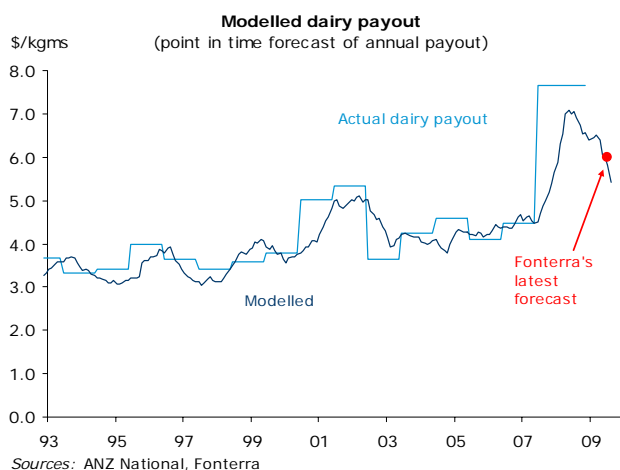
**The obvious channels include the cost of funds and funding of the deficit itself.** A higher international cost of funds is mitigating the reflationary impact of monetary policy. There is no doubt we are also set to see a switch in the funding of NZ's current account deficit from the private "growth" sector to the public sector. Typically we'd call this neutral, although we need to appreciate that private sector funding gets distributed into asset prices (and hence drives the wealth effect for spending) whereas public sector funding is directed into other areas, such as infrastructure. Hence, a dollar of government investment does not completely offset a dollar of private sector investment. More worrying are the trends in sovereign credit default swap spreads (a measure of default risk), which suggest that some sovereigns are finding it more difficult to raise capital in the current environment. In this type of setting everyone is naturally looking domestically for cash and funding. To fully appreciate the significance of what is going on, people's attention needs to be directed at deposit interest rates.

Everyone is competing aggressively for cash. The problem in NZ's case is that we always end up going back to the same issue: a limited pool of domestic savings.

**There is also a strong credit channel of monetary policy at work within the economy.**

The credit channel boosted the economy (and asset prices) beyond expectations at the top of the cycle. The spiral of rising asset prices, spending, profits, employment, confidence (exuberance), exceptional appetites for risk, rising asset prices...and so on took hold. Of course it's easy to see the reverse spiral take hold when asset prices move the other way. But generally the credit channel operates via two means. The first is the balance sheet channel, which involves deteriorating financial conditions which affects borrowers' net worth, either reducing current cash flows or securable assets, thereby influencing their external finance premium. The second is the bank (or any financial intermediary) channel influencing investment behaviour via the cost and availability of credit. Domestically we can see this not only via tightened lending standards but also through the outright withdrawal of credit in some areas by foreign players, with motor vehicle financing being a clear example.

**The real economic consequences are also starting to be noticed.** NZ is already seeing the real economic flow-on from global malaise via a reduction in tourism numbers and poor forward bookings. Commodity prices are falling with reports of aggressive contract "repricing". In some cases buyers are now simply disappearing in a similar manner to what we saw in 1997 and 1998. Global dairy prices have fallen 43 percent from their November 2007 peak and the risks are clearly for further moves lower. While dairy prices are still around average levels historically, such a price is simply not sufficient to justify what has recently been factored into land prices, or to offset the creep that has been appearing across costs.



**Bottom line is that we should not underestimate the flow-on impact from the global scene, given our external position.**

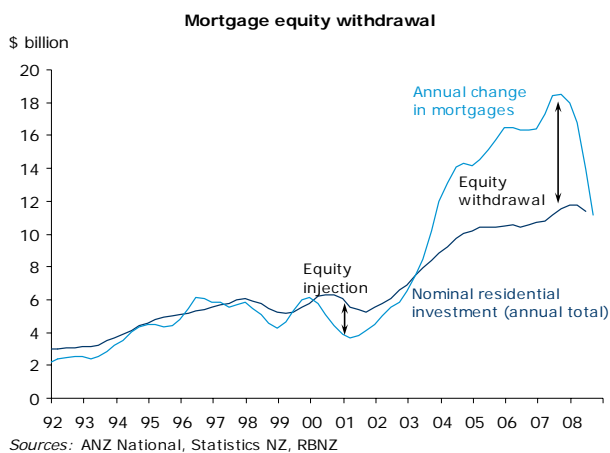
**The economy has yet to find a base.** After contracting over the first half of 2008, the outlook is subdued to say the least. Firms' activity expectations, investment and employment intentions are at, or close to, historical lows. Residential building consents have collapsed to early 1980s lows – a remarkable feat considering the economy is now close to twice as large! Consumer confidence looks perkier, but the disconnect between businesses and consumers appears to reside in the still low unemployment rate, which going by forward indicators and anecdotes, is set to rise rapidly in the New Year. This means 'round two' for the housing market, that for the past couple of months did look like it was finding a base of sorts.

**The economy is being adjusted**

**Given our big picture view towards the external position and global environment, we expect the economy to remain weak through 2009.** We expect a protracted period of subdued growth, and believe 2009 will be weaker than 2008. Previous economic slowdowns in NZ have shown that the economy remains choppy and wobbly at the trough, with no clear trend. This cycle will be no different, as NZ navigates through uncertain times. While there is likely to be bounces and rebounds due to technical factors, we actually expect the economy to experience further consecutive quarters of negative GDP growth over 2009. At this juncture, and courtesy of global events, it's fair to say there is more downside risk than up.

**A few specific themes dominate our thinking on the adjustment process**

- > **The piper will be paid.** When we analyse historical current account alignment experiences around the globe, there are two key dynamics that are common. Firstly, the currency depreciates significantly, stimulating the export sector and reducing the burden of offshore funding. Second, the economy experiences a period of very weak domestic demand. Both are critical legs of the inevitable rebalancing process. While a number of other commentators are looking at consumption and spending to drag the economy out of the current predicament over 2009, this fails a basic litmus test: overspending was how we got into this position in the first place, so it would be truly ironic if it was indeed the saviour! Moreover, if the financial system is de-leveraging courtesy of the global environment, the same must ultimately manifest within the real economy.

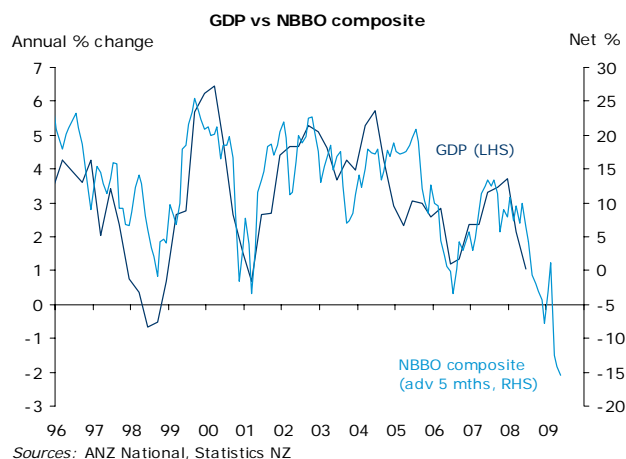


> **This is primarily a household realignment process.** Household balance sheets enter this cycle looking the most extended, whereas corporate balance sheets look robust, a major difference compared with previous cycles. Households have already begun a consolidation process as a result, with retail spending volumes (particularly for discretionary items) heading backwards over the first nine months of the year. Unlike businesses and corporates, households have limited levers (effectively only one – reduced discretionary spending) to restore balance sheet health. Hence, household de-leveraging tends to be a more elongated process.

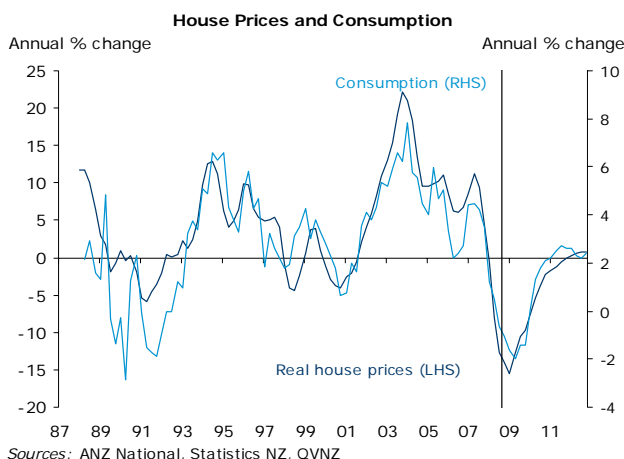
> **NZ cannot look to robust domestic demand as a mechanism for “rolling” through the crisis, such as Australia experienced during the Asia crisis.** Despite a bigger exposure to Asia than NZ had, the Australian economy outperformed NZ’s over the 1997/98 period. To be fair, NZ experienced two consecutive years of droughts and then there was the MCI shenanigans that had a big impact. But domestic demand came to the party for Australia over this period. This doesn’t look likely to be the case for NZ this time around with the economy already in recession of the “lite” variety in early 2008.

**Businesses are responding to the altered economic environment.** While this slowdown has, and will likely continue to centre on households, businesses will not be immune. The fact that own activity expectations from the National Bank *Business Outlook* – a key forward indicator of economic activity – have been in negative territory for seven of the past nine months (unprecedented in the history of the survey), shows that businesses are also feeling the pinch. It is this weak demand environment and growing pressure on profits that is seeing many being forced to respond, and this is increasingly turning the focus to costs (especially staffing levels). The unemployment rate rose to a 5-year high of 4.2

percent in the September quarter and is expected to continue to deteriorate rapidly reaching 6.2 percent by the end of 2009 and 6.8 percent over 2010. Ironically, the way businesses are responding at present by looking closely at costs and efficiency is actually a positive for productivity – a factor that always leads the inevitable recovery. But investment plans are also likely to be shelved given the cost pressures and the possibility of it being more difficult to access funding for this investment. Business investment is forecast to retreat by 7.3 percent over 2009. This does not bode well for the supply side potential of the economy in future years.



**A weaker labour market represents the next leg of vulnerability for the domestic economy.** The weakness that has occurred in the housing market to date has come at a time when the labour market was still strong and wage growth at record highs. A rapid deterioration in job security and the likelihood of smaller wage increases over the coming year represents another leg of domestic economic weakness to come. We continue to look for real house prices to go through a 20-30 percent peak-to-trough contraction, as affordability measures “adjust” to more appropriate levels. Of course this does not take into account the potential for an undershoot, just as prices overshot on the other side. Private consumption growth is expected to slow to be flat by the end of 2008, and in fact contract over 2009. Residential investment also goes through a pronounced cyclical adjustment, contracting by 17 percent over 2008 and another 23 percent over 2009.



**There will be winners and losers.** Unfortunately NZ will be a 'loser' in an international sense and it is unlikely that any sector will escape totally unscathed. But there will be pockets that will outperform. Sectors with non-cyclical revenues and those which have already experienced a recent crisis of confidence over their ability to allocate capital to productive enterprises (i.e. they have been "stress-tested" and have been actively deleveraging already) are likely to be in a better position over the coming months.

### Shock absorbers are kicking in

**NZ's macro framework is responding rapidly.** Policymakers around the world cannot be accused of sitting idly by as the global situation deteriorates. There have been unprecedented measures taken by officials in response to this crisis. The same can be said for our own RBNZ who have cut interest rates aggressively, and signalled more to come. There have also been non-monetary policy type measures introduced by the RBNZ and government such as liquidity injections into money markets and the guarantee of bank retail and wholesale deposits. Exceptional times call for exceptional responses and in the environment we are in at the moment, the lines between monetary policy and financial stability have become very blurred. The NZD too is also adjusting, having fallen a long way against the USD already, and it looks set to remain in a medium-term downward trend.

**Inflation pressures are dissipating.** Rapidly retreating commodity prices around the globe provide central banks with the headroom to "front-load" easing cycles. Easing inflationary pressure and falling commodity prices are also providing an explicit income boost to the spending side of the economy, although the net effect for the aggregate economy in NZ, via the terms of trade, is actually negative.

**Fiscal policy looks likely to step up to the plate.** Tax cuts have already been delivered and another round will be rolled out from April next

year. There are plans for more transitional assistance for those who lose their jobs as a result of the current turmoil. Infrastructure spending will also be brought forward though details and costings are sketchy at the time of writing. For now, it is a case of watching and waiting for concrete details to emerge.

### But these will stabilise rather than reflate

**Monetary policy's potency will be seriously diluted over the coming year as the credit channel provides an offset.** A weaker currency is irrelevant if there is limited global demand for NZ's exports in the first place. Fiscal policy will assist, but timing wise is likely to be too late. Net on net we continue to see the global backdrop, and stark reality of an inevitable current account rebalancing process, as dominating. Natural shock absorbers are welcome, but they merely act to mitigate some of the extreme downside risks.

### The seeds of recovery are being sown

**The economy is reflating,** both via aggressive loosening in financial conditions such as interest rates and the currency, but also – and critically – through a much stronger focus on productivity growth across the business sector. A stronger global economy is a critical part of any recovery, with the holy grail of economics for the economy to be built around earning as opposed to spending our way to growth. This is looking like a late 2010 story. The Rugby World Cup is also around the corner, and a weaker global scene looks set to turn New Zealanders back home (or at least keep a few from departing!). When combined with a degree of pent up demand – which is typical when the economy wraps itself in cotton wool in response to global developments – we fully expect 2011 to be a boomer of a year with 4 percent growth.

### Looking past the turbulence

**All the bad news can become overpowering but we need to be mindful of the trend.**

Stepping beyond the business cycle, we need to appreciate the strong medium-term story for the economy. The massive wealth shift occurring around the globe that is seeing Asia grow in importance, can only be good news for NZ. While commodity prices are going through a corrective phase at present, we remain long-term commodity bulls. Asia looks set to remain a key engine for global growth over the next decade and given NZ's close proximity (and an exporter of products that Asia is increasingly demanding) we stand to benefit. Throw in water's ever increasing importance, a natural resource base, and there is huge potential for NZ to leverage; just not in our usual borrow and spend sense.

**NEW ZEALAND NATIONAL ACCOUNTS FORECAST**

<b>Calendar years</b>	<b>2006</b>	<b>2007</b>	<b>2008(f)</b>	<b>2009(f)</b>	<b>2010(f)</b>	<b>2011(f)</b>	<b>2012(f)</b>
<b>Total Consumption</b>	<b>3.2</b>	<b>4.0</b>	<b>0.9</b>	<b>-0.6</b>	<b>1.6</b>	<b>2.7</b>	<b>2.5</b>
Private Consumption	2.6	4.1	0.0	-0.7	-1.2	1.9	2.4
Public Consumption	5.0	3.3	3.9	3.4	2.8	2.8	3.0
<b>Total Investment</b>	<b>-1.1</b>	<b>4.3</b>	<b>0.4</b>	<b>-2.0</b>	<b>-6.1</b>	<b>5.1</b>	<b>5.4</b>
Residential investment	-3.3	4.4	-16.6	-22.7	-16.0	3.3	14.7
Other investment	-0.5	4.3	4.7	3.2	-4.2	5.4	3.8
<b>Stockbuilding<sup>1</sup></b>	<b>-0.8</b>	<b>0.5</b>	<b>0.3</b>	<b>-2.7</b>	<b>-0.3</b>	<b>0.4</b>	<b>0.1</b>
<b>Gross National Expenditure</b>	<b>1.3</b>	<b>4.6</b>	<b>1.1</b>	<b>-0.6</b>	<b>-3.2</b>	<b>4.5</b>	<b>3.3</b>
<b>Total Exports</b>	<b>1.8</b>	<b>3.2</b>	<b>0.4</b>	<b>-0.4</b>	<b>-0.5</b>	<b>4.8</b>	<b>5.7</b>
Goods	3.2	4.8	1.2	-0.2	1.6	4.2	4.7
Services	-1.9	-0.8	-2.7	-3.5	-7.8	7.2	9.0
<b>Total Imports</b>	<b>-2.6</b>	<b>8.6</b>	<b>5.1</b>	<b>0.4</b>	<b>-9.0</b>	<b>8.4</b>	<b>6.0</b>
Goods	-2.0	9.0	5.5	0.3	-8.9	9.6	6.1
Services	-4.4	7.3	3.0	-0.5	-9.9	4.0	5.3
<b>Expenditure on GDP</b>	<b>2.5</b>	<b>3.0</b>	<b>-0.5</b>	<b>-1.0</b>	<b>2.4</b>	<b>3.8</b>	<b>3.1</b>
<b>GDP (production based)</b>	<b>2.0</b>	<b>3.2</b>	<b>0.6</b>	<b>-1.1</b>	<b>2.2</b>	<b>4.0</b>	<b>3.1</b>

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

## GLOBAL BACKDROP

The global economy is now reeling from the real economic consequences of the financial crisis. Policymakers have naturally swung into action. Nonetheless, we are looking at a protracted adjustment given the extent of financial malaise and weakness in household balance sheets across an array of Anglo-Saxon nations.

### A deep and synchronised slowdown

**The financial crisis has gone global.** Equity markets have tumbled, key barometers such as the Baltic Dry Freight Index have collapsed and commodity prices are falling. Activity indicators across most nations are either at, or close to, historical lows. The world economy is staring down the barrel of the deepest and most synchronised global recession since the early 1980s.

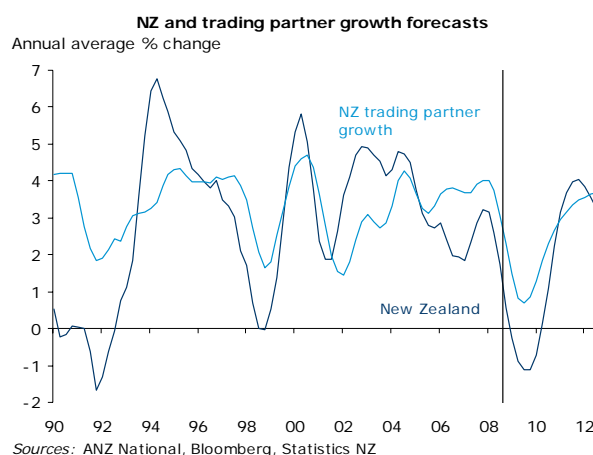
**It's all a question of trust.** Trust underpins the entire economic system: the free-flow of credit, doing a job, getting paid and so on. The collapse of some major institutions has now dented the circle of trust that underpins billions and billions of dollars changing hands. Suddenly no one is too big to fail. While we typically focus on the big-time examples, it is as simple as imagining a small business that unexpectedly finds that a major debtor cannot pay. Suddenly your attention is drawn to everyone you deal with and who owes you money. It is happening on a massive scale around the globe as de-risking and de-leveraging takes hold. Lacking "trust", cash is held tightly and money is not put to work, leaving less for consumption and investment. The global economy grinds to a halt as a result.

**Policymakers are taking critical steps to restore "trust" and confidence within the global financial system.** In the past few months we have seen a barrage of responses from policymakers. In the US there is TARP (Troubled Assets Relief Programme) and then TALF (Term Asset-Backed Securities Loan Facility). There is also the Primary Dealer Credit Facility (PDCF), the Asset-Backed Commercial Paper Money Market Fund Liquidity Facility (AMLF), the Term Securities Lending Facility (TSLF), the Commercial Paper Funding Facility (CPFF), and the Money Market Investor Funding Facility (MMIFF)! Government

guarantees and bailouts have been widespread. Central banks are in the process of moving interest rates to historical lows, and naturally fiscal policy is being looked upon to assist.

**There are three conditions before the macro environment will stabilise.** First, the "credit wheels" need to turn. Encouragingly we have seen inter-bank lending rates (a "trust" proxy) fall, but off panic driven extremes. Credit markets remain tight, but perhaps not as gridlocked as a month ago. Second, asset prices need to stop falling, thereby encouraging credit to flow. The US housing market is the major barometer on this front, and it is looking a late 2009 story. Third, "losses" need to be disclosed. So far we have seen close to a trillion dollars of write-offs, and they keep coming. One clear season of zero downside earnings surprises is required. Once that occurs, markets can then start to price instruments and firms more efficiently.

**This "credit" event is also different.** Credit events have typically been business sector-centric. In the past, the resulting "corporate" response by aggressively focusing on costs to repair balance sheets, reallocation of capital by financial intermediaries towards the low beta asset (housing), and lower interest rates (stimulating domestic demand) has dragged the economy clear. This time around we see two differences. First, it is a global event. Second, across Anglo-Saxon nations it is household balance sheets that are most extended and in need of repair. Hence, we foresee a far more protracted adjustment. NZ's trading partner growth is expected to be the weakest we have records for, and we see downside risks to this given the ongoing deterioration in the dataflow.



## GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2006	2007	2008(f)	2009(f)	2010(f)	2011(f)	2012(f)
United States	2.8	2.0	1.3	-1.1	1.3	2.6	2.9
Australia	2.9	4.0	2.3	0.5	2.1	3.1	3.5
Japan	2.0	2.4	0.1	-0.7	1.4	1.5	1.6
Euro Zone	3.0	2.6	1.0	-0.8	1.5	2.3	2.4
China	10.7	11.7	9.5	7.5	8.8	10.0	10.1
<b>Trading Partner Growth</b>	<b>3.7</b>	<b>4.0</b>	<b>2.2</b>	<b>0.5</b>	<b>2.6</b>	<b>3.5</b>	<b>3.7</b>

## FISCAL POLICY

We expect a sizeable fiscal package pre-Xmas in response to economic conditions. Fiscal deficits, rising debt and large bond tenders will rapidly become the norm. While the correct policy response at present, this cannot continue unfettered. The long-term challenge remains to increase productivity growth.

### To the rescue

#### The new Government faces two challenges.

The first is a policy response to economic developments. The second is how it goes about lifting the economy's long-term productivity growth performance – the elixir of living standards.

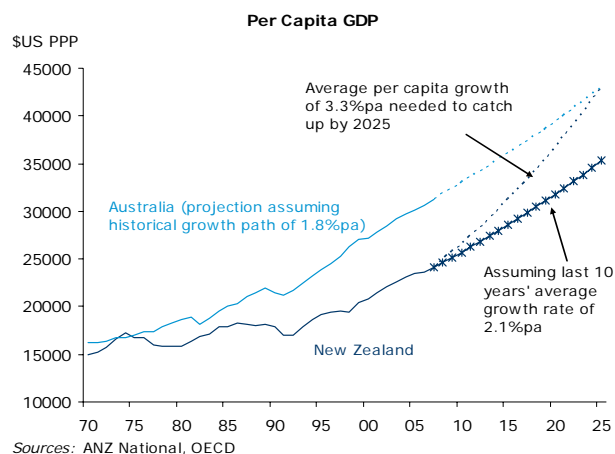
**Pragmatism needs to prevail when formulating policy.** Typically we look to monetary policy as the economy's saviour in challenging times. But fiscal policy is not impotent in this regard, particularly as the government has the largest balance sheet to work with. Credit also needs to be given to the preceding Finance Minister. While projecting cash deficits in the 2008 *Pre-Election Update*, net debt was also effectively zero. The latter gives the new Government ample room to respond to the challenging economic times.

**Fiscal policy is set to become even more expansionary.** An April 1 tax package and bringing forward infrastructure spending (with a focus on new roading, public transport, upgrading of schools and accelerated roll-out of broadband across NZ), will form the core of the Government's policy response. Given the typically long lags in getting infrastructure spending to impact on activity, focus is on approved projects and speeding up the approval process. Collectively, we envisage policy being expansionary to the tune of around 2 percent of GDP over the coming two years. While helpful, we see fiscal policy as providing a floor as opposed to stimulating growth. One way to think about the impact of expansionary fiscal policy versus the private sector is via the current account deficit. This is normally funded by the private sector and banks. Money is primarily directed into asset prices, which in turn delivers strong multiplier effects. While the government may now fill the current account funding void, realistically we are

not set to see anywhere near the same degree of multiplier effects, given the absence of a strong wealth channel.

**Deficits, debt and high bond tender programmes will become the norm.** We forecast underlying operating deficits of near 4 percent of GDP, with cash deficits in excess of \$10b. As such, **we will see a return of sizeable bond tender programmes in the order of \$14b per year**, a far cry from the \$2-\$2.5b bond tenders of the past few years. At present, our working assumption is that the market will be able to absorb this "switch" in the composition of current account funding from the private sector to the sovereign. Yet we are also acutely aware that government credit default swaps (the cost of insuring against sovereign default) around the globe are widening as investors fret about the size and scale of government rescue programmes. For now, we see NZ's credit rating as remaining immune. Indeed, if the US can have its rating endorsed given the combination of banking collapses and twin deficits, then it would be truly incredible if a different stance was taken towards other nations!

**The long-term challenge remains to lift productivity growth.** The new Government has signed up to the goal of closing the income gap with Australia by 2025. In per capita terms, the current GDP gap is around 23 percent. Closing that gap requires per capita growth rates of 3.3 percent per annum (assuming Australian growth at its average 1.8 percent rate), a step change from the what was achieved over the past decade.



## FISCAL FORECAST

June years	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)	2013(f)
Operating Balance (\$m)	8,000	2,400	-4,200	-5,600	-5,300	-5,400	-5,200
- as % of GDP	4.7	1.3	-2.3	-3.1	-2.8	-2.7	-2.4
OBEGAL (\$m)	5,900	5,600	-3,200	-7,100	-6,800	-6,900	-6,700
- as % of GDP	3.5	3.1	-1.8	-3.9	-3.5	-3.4	-3.1
Gross Debt (\$m)	30,600	31,400	36,100	45,000	55,500	67,000	78,500
- as % of GDP	18.2	17.5	20.1	24.7	28.8	33.0	36.8
Core Crown residual cash (\$m)	2,900	2,100	-9,100	-10,700	-11,000	-10,600	-10,600
Bond Tender Programme (\$m)	2,300	1,800	7,200	11,400	13,000	14,000	14,000

## INFLATION

Inflation is set to return to the mid-point of the RBNZ’s target band by early next year. A weaker currency and volatile commodity markets will result in some headline volatility over the coming years. But the stark reality is that weak growth and easing resource slack points to an easing trend in core inflation.

### From inflation to dis-inflation

**What a difference six months makes!** At the start of the year all commentators were fretting about inflation remaining high for three years. Now some are worrying about it moving below the bottom of the RBNZ’s 1-3 percent target band!

**Headline inflation is set to fall rapidly.** After peaking at 5.1 percent in the September quarter, annual headline inflation will return to the RBNZ’s target band by early next year. Most of this will be driven by the sharp declines in petrol prices, alongside massive discounting in the retail sector, resulting in quarterly declines in the CPI for this quarter and next. Further falls in commodity prices could see headline inflation temporarily fall towards the bottom or even below the target band.

**We need to step back from commodity and currency “noise”,** which we are seeing at present, and will no doubt see over the forecast horizon. Indeed, we fully expect to see the headline rate rise back temporarily through 3 percent in 2010 as a weaker currency pushes up tradable inflation.

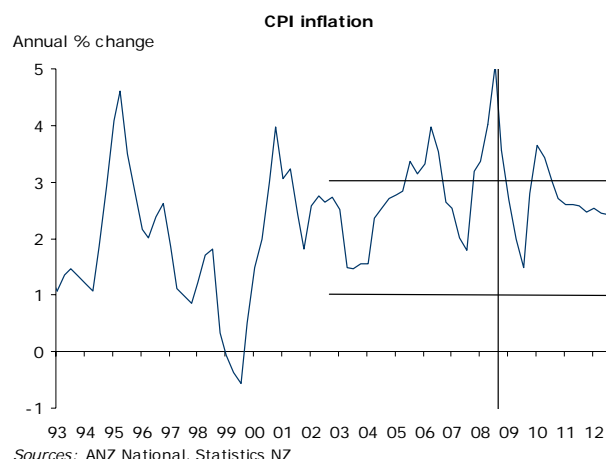
**There are still elements of domestic inflation pressure, a key focus for the RBNZ.** Services inflation remains high and construction costs are yet to follow the way of the housing market. Margins continue to come under intense pressure, and the non-contestable parts of the economy are still putting through sizeable price increases. Electricity prices and local authority rates are two cases in point.

**But core inflation is set to ease rapidly.** All the medium-term drivers of inflation, excluding non-contestable pockets, are looking favourable. Growth is weak and set to be sub-trend for another 18 months. Resource slack is opening up in the labour market, rapidly. Inflation expectations have begun to nudge lower and pricing intentions surveys are consistent with headline inflation returning to the RBNZ’s target band. In regard to non-contestable pockets, we expect a bit of political reality to bite, particularly in the local government arena as it becomes difficult to push through large rate increases in the current economic climate.

**We expect inflation to remain comfortably within the target band throughout the forecast horizon,** though there will be some volatility due to commodity price movements. After

falling towards 1½ percent by the second half of 2009, inflation will rise past 3 percent temporarily as the negative CPI quarters “drop out” of the annual calculation. But underlying inflation by that stage will have eased, as weak growth chokes off domestic inflation pressure, leading to inflation settling around 2½ percent.

**Near-term inflation risks are lower, but higher over the medium-term.** Tumbling commodity prices are resulting in falling headline inflation rates all over the world. But it is the fall-off in global demand leading to large excess capacity in global manufacturing that could yet see deflation emerge as a threat next year. Beyond the current malaise, we must also be mindful of the aggressive reflationary steps being pursued around the globe. Subject to current global weakness not turning into a rout, it portends of more inflation as opposed to less – an issue policymakers will no doubt be alert to going forward.



## CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Mar-08	0.7	3.4
Jun-08	1.6	4.0
Sep-08	1.5	5.1
<b>Dec-08 (f)</b>	<b>-0.3</b>	<b>3.6</b>
Mar-09 (f)	-0.2	2.7
Jun-09 (f)	0.9	2.0
Sep-09 (f)	1.0	1.5
<b>Dec-09 (f)</b>	<b>1.0</b>	<b>2.8</b>
Mar-10 (f)	0.6	3.6
Jun-10 (f)	0.7	3.4
Sep-10 (f)	0.6	3.0
<b>Dec-10 (f)</b>	<b>0.7</b>	<b>2.7</b>
Mar-11 (f)	0.5	2.6
Jun-11 (f)	0.7	2.6
Sep-11 (f)	0.6	2.6
<b>Dec-11 (f)</b>	<b>0.6</b>	<b>2.5</b>
Mar-12 (f)	0.6	2.5
Jun-12 (f)	0.6	2.4
Sep-12 (f)	0.6	2.4
<b>Dec-12 (f)</b>	<b>0.6</b>	<b>2.4</b>

## EXCHANGE RATE

The dynamics of rebalancing weigh heavily on our medium-term currency projections. A lower NZD is an inevitable part of the rebalancing process for the NZ economy. Abstracting from volatility, we see the NZD/USD pushing well below 50 cents, and continued weakness for an extended period against the other majors.

### De-leveraging

The currency market has not been immune to wider global developments. Facing the biggest financial crisis in 80 years, it is only natural that one of the world's most liquid markets, namely the currency, should see some incredible movements. The kiwi has fallen from over 80 cents against the USD in March to around 0.55 currently. This represents one of, if not, the largest and steepest falls the NZD has experienced in its post-float history. The EUR, GBP and AUD, along with many emerging market currencies, have all been battered. Stepping back, capital preservation has replaced yield as de-leveraging and de-risking take hold. While initially contained to more heavily speculative and hence 'VAR' driven accounts, there is now no doubting that risk metrics are increasingly being reassessed across all participants, including real money accounts. Stepping aside from "noise" we wouldn't be surprised to see an aggressive bounce, but our focus is on the big picture.

**Fundamentals switch.** Yield, growth, equities, and commodities are all heavily quoted drivers or focal points for currency market participants. They all have a role to play as indicators, as they are reflective of the wider environment, and hence have to be respected. Some lag (such as commodities) while others can lead. Yet, we also know that models based on combinations or individual aspects tend to be notoriously volatile. They also tend to "switch" from month to month or year to year, and typically leave people grasping when that does occur.

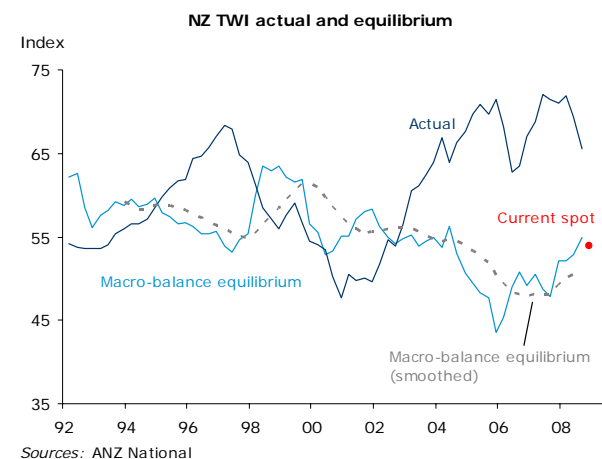
### A question of balance

We are increasingly being drawn to macro-balance type measures when it comes to assessing the currency outlook within a medium-term context. Macro balance measures of exchange rate equilibrium derive the level of the exchange rate (or real exchange rate) that is consistent with simultaneous internal and external equilibrium. In other words, they give us a level of the exchange rate that results in a sustainable level of the capital account (or current account). We are drawn to these sorts of measures for three reasons:

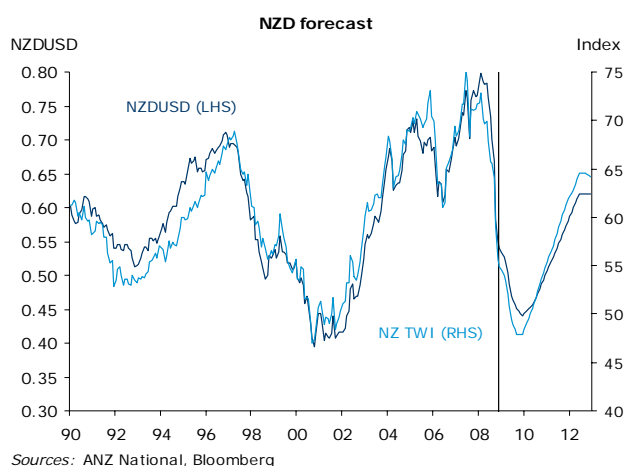
- > This is a global credit event, which means traditional fundamentals are more paramount;
- > the financial system is de-leveraging; and
- > it's a process that we believe will take time.

**Such models imply an extended currency correction.** Whether you look at the starting position for the current account deficit (8.4 percent of GDP), low trade balance elasticity with respect to the currency (-0.4), or high net external liability position (90 percent of GDP) which requires a 4.5 percent current account deficit just to stabilise, (and we would argue that the liabilities position will need to improve), the inevitable conclusion is that the currency needs to undergo a material correction.

**NZ's large current account deficit means the nation as a whole face a serious savings shortfall.** As the adjustment process unfolds, the current account deficit will need to be reduced, but it's going to take time. In the meantime, we still need to borrow to close the gap, and in an environment where money is short, there are two ways we can do it - either by paying more for it (higher interest rates), or discounting it (a lower exchange rate). The economy can't handle higher interest rates at present, but it can handle a lower exchange rate, which will ultimately accelerate the economic recovery as imports slow, exports pick up, and offshore funding becomes less of a burden.



**The situation is complicated somewhat by the US economic predicament.** The deteriorating US economy and the US Treasury's issuance of substantial debt to finance the fiscal deficit would ordinarily result in a weaker USD. But in the current synchronised downturn, most major sovereigns are set for a large issuance of bonds. The USD still remains the world's reserve currency, and in such an environment, the USD is rising by default rather than by merit. But should the USD come under another wave of selling pressure, as occurred last year, then it will increasingly fall on the other NZD crosses to carry the burden of the NZD currency adjustment.



**Our currency forecasts see the NZD head towards 0.44 against the USD in the second half of 2009.** It will not be a smooth ride down, with expected bouts of technical rebounds and short-squeezes along the way. But the big picture points to the need for the NZD to fall further and stay lower for longer to allow the external imbalances in the economy to adjust. On a trade weighted index (TWI) basis, we are forecasting a period where it goes below 50, undershooting what

our macro-balance model suggests is needed. This reflects the reality that currency cycles tend to undershoot, as well as overshoot, at the extremes. A key risk we see is that the NZD ends up going much lower than anyone envisages, in a similar manner to how much higher it went on the up.

**The NZD/AUD cross could also be set for another move south of 0.80,** even though we are not explicitly forecasting it. The AUD has been singled out for punishment by the currency markets, as a play on the global commodity and growth story. Yet, the weakening in the AUD has been more than sufficient to date to offset the falls in their major export commodity prices. This has resulted in the Australian trade balance turning into huge surpluses in recent months. In contrast, NZ has been running sizeable trade deficits. In addition, the NZ economy is already in recession, and not expected to get out of it until mid-next year. By comparison, the Australian economy could yet avoid heading into one. The NZD/AUD will come under downward pressure as the contrasts between the two economies continue to mount in favour of Australia.

### NEW ZEALAND DOLLAR FORECAST (end of quarter)

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
Dec-05	0.68	0.93	80.4	0.40	0.58	70.4
Dec-06	0.70	0.89	83.8	0.36	0.53	69.4
Dec-07	0.77	0.88	85.6	0.39	0.53	71.8
Mar-08	0.79	0.86	78.4	0.40	0.50	70.1
Jun-08	0.76	0.80	81.0	0.38	0.48	67.8
Sep-08	0.67	0.85	71.1	0.38	0.48	64.1
<b>Dec-08 (f)</b>	<b>0.54</b>	<b>0.82</b>	<b>51.3</b>	<b>0.36</b>	<b>0.43</b>	<b>54.9</b>
Mar-09 (f)	0.52	0.83	47.8	0.35	0.43	53.5
Jun-09 (f)	0.47	0.81	43.2	0.32	0.39	49.4
Sep-09 (f)	0.45	0.80	41.4	0.31	0.38	47.9
<b>Dec-09 (f)</b>	<b>0.44</b>	<b>0.81</b>	<b>41.4</b>	<b>0.31</b>	<b>0.39</b>	<b>47.8</b>
Mar-10 (f)	0.45	0.83	43.2	0.32	0.41	49.6
Jun-10 (f)	0.46	0.82	45.1	0.33	0.44	51.1
Sep-10 (f)	0.48	0.83	48.0	0.34	0.46	53.1
<b>Dec-10 (f)</b>	<b>0.50</b>	<b>0.83</b>	<b>50.0</b>	<b>0.34</b>	<b>0.48</b>	<b>54.8</b>
Mar-11 (f)	0.52	0.81	53.0	0.35	0.50	56.4
Jun-11 (f)	0.54	0.82	56.2	0.36	0.51	58.4
Sep-11 (f)	0.56	0.82	58.8	0.37	0.53	60.2
<b>Dec-11 (f)</b>	<b>0.58</b>	<b>0.83</b>	<b>60.9</b>	<b>0.37</b>	<b>0.55</b>	<b>61.8</b>
Mar-12 (f)	0.60	0.83	63.0	0.38	0.55	62.8
Jun-12 (f)	0.62	0.84	65.1	0.39	0.56	64.6
Sep-12 (f)	0.62	0.84	65.1	0.39	0.56	64.6
<b>Dec-12 (f)</b>	<b>0.62</b>	<b>0.82</b>	<b>65.1</b>	<b>0.39</b>	<b>0.56</b>	<b>64.2</b>

## INTEREST RATES

The big picture is that interest rates will continue to move lower given the downside risks to both the domestic and global economy. But once we get to the trough in the easing cycle by around mid-next year, attention will quickly turn to the policy normalisation that will inevitably follow.

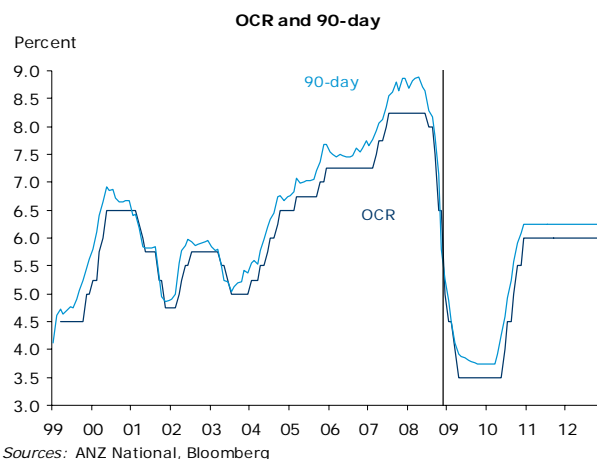
### Into the expansionary zone

**Monetary policy has moved to a stimulatory stance at rapid pace.** The RBNZ delivered a 25bp cut in July, 50bps in September, 100bps in October and 150bps in December; for a cumulative reduction of 325bps so far this cycle. Despite this unprecedented move, the RBNZ is still far from done. Policy has gone from highly contractionary to just a little south of neutral, in our view. Typically we see the 6 percent rate as neutral. At present “credit” dislocation knocks at least 50bps off that. Hence, while the RBNZ may characterise the current OCR of 5 percent as being “*expansionary*”, it is not significantly so.

**There is more work ahead for the RBNZ.** We are increasingly drawn to the OCR printing with a ‘three-handle’. Dominating at present are three key issues:

- > The global backdrop, with the deepest and most synchronised global downturn since the 1980s, and we have yet to hit a trough.
- > The increasing importance the credit channel of monetary policy, via the availability and price of credit, is playing in this economic cycle. This channel is leaning heavily against the traditional monetary transmission mechanism and the steps being taken by the RBNZ to stimulate and support the economy.
- > The exceptionally weak NZ economy heading into the current period of global dislocation.

**Some degree of uncertainty will still surround the timing and potential magnitude of further cuts.** We’ve pencilled in a series of 50bps moves from here taking the OCR to 3.5 percent. But we are being drawn to more front loading in January. If rates need to be lower, there is a lot to be said for just getting the job done, quickly.

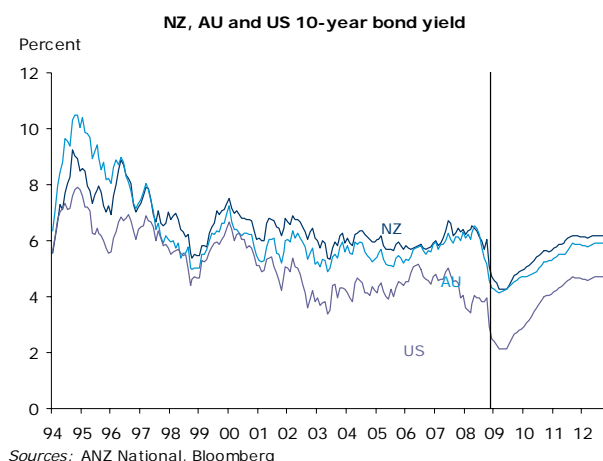


**We also need to keep an eye on the big picture when it comes to inflation.** One danger we are acutely wary of at present is the risk of being hyped-up in terms of interest rate cuts as a consequence of an awful economic environment, and ignoring some wider considerations. Around the globe there is a huge amount of reflationary stimulus being thrown at the international economy. The RBNZ (in a similar fashion to the RBA) acknowledge the “*substantial support to demand over the period ahead*” that is set to hit the NZ economy. Certainly, this stimulus is currently required given the international scene. Yet, at the danger of responding to one crisis (and policymakers can only manage one at a time), another risks being created down the track, namely inflation. This seems a tall ask at present given the dis-inflationary (deflationary?) forces that are dominating, including collapsing demand, falling commodity prices and easing inflation expectations. We are certainly of the view that rates will move lower from here. But we must not lose sight of the bigger picture: consumer driven excess resides at the heart of global imbalances, and there is of course the risk that by stimulating the spending tap via monetary and fiscal policy, we create a further problem down the track. It would be truly ironic if we managed to spend our way out of a binge spending driven jam in the first place!

**So while we continue to look for rate cuts near-term, we are also mindful as to when the potential turning point could be.** One thing seems for sure. Interest rates, when they start to move back up, will not rise in the 25bp increments that was the trajectory during the previous RBNZ tightening cycle. Yes, we know the global scene is facing an elongated adjustment as households de-leverage. Yet we also know NZ has the Rugby World Cup around the corner, there are flow-on effects from the current crisis translating into less supply side capacity for the global economy, the market is focusing too much on demand when it comes to assessing inflation risks, and there is a historical tendency for pent-up demand to take hold

as soon as confidence returns. Hence we have rates moving back up in 2010.

**It's back to basics for bonds.** We expect traditional bond market fundamentals, including inflation expectations, debt issuance and various risk metrics, to increasingly come back into play for bonds over the coming years. Short-term rates and expectations for monetary policy will still have a huge say anchoring the curve to a degree, but the rally has almost run its course. Collectively we expect the fundamentals to progressively result in some upward drift in bond yields over time. We have NZ longer-dated yields heading to 6¼ percent, but the risk is that it could go higher should a larger risk premium be attached to NZ sovereign debt. With a huge current account deficit to be funded and an altered global environment for credit, this is now a key risk in our view.



### INTEREST RATE FORECAST (end of quarter)

Quarter	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
Dec-05	7.3	7.7	7.1	6.7	5.7	4.4	5.2
Dec-06	7.3	7.7	7.6	7.2	5.9	4.7	5.9
Dec-07	8.3	8.9	8.7	8.2	6.4	4.0	6.3
Mar-08	8.3	8.9	8.1	7.8	6.4	3.4	6.1
Jun-08	8.3	8.6	7.8	7.5	6.3	4.0	6.4
Sep-08	7.5	7.8	6.8	6.7	5.7	3.8	5.4
<b>Dec-08 (f)</b>	<b>5.0</b>	<b>5.3</b>	<b>4.8</b>	<b>5.1</b>	<b>4.7</b>	<b>2.5</b>	<b>4.3</b>
Mar-09 (f)	4.0	4.1	4.4	4.7	4.3	2.2	4.2
Jun-09 (f)	3.5	3.8	4.4	4.7	4.3	2.2	4.3
Sep-09 (f)	3.5	3.8	4.5	5.1	4.8	2.7	4.6
<b>Dec-09 (f)</b>	<b>3.5</b>	<b>3.8</b>	<b>4.6</b>	<b>5.2</b>	<b>5.0</b>	<b>2.9</b>	<b>4.7</b>
Mar-10 (f)	3.5	3.8	4.7	5.4	5.1	3.2	4.8
Jun-10 (f)	4.0	4.6	5.3	5.7	5.4	3.6	4.9
Sep-10 (f)	5.0	5.6	5.9	6.1	5.7	4.0	5.3
<b>Dec-10 (f)</b>	<b>6.0</b>	<b>6.3</b>	<b>6.2</b>	<b>6.2</b>	<b>5.7</b>	<b>4.1</b>	<b>5.3</b>
Mar-11 (f)	6.0	6.3	6.3	6.3	5.9	4.3	5.5
Jun-11 (f)	6.0	6.3	6.3	6.4	6.0	4.5	5.5
Sep-11 (f)	6.0	6.3	6.4	6.6	6.2	4.7	5.9
<b>Dec-11 (f)</b>	<b>6.0</b>	<b>6.3</b>	<b>6.4</b>	<b>6.5</b>	<b>6.2</b>	<b>4.7</b>	<b>5.9</b>
Mar-12 (f)	6.0	6.3	6.3	6.5	6.1	4.6	5.8
Jun-12 (f)	6.0	6.3	6.4	6.6	6.2	4.7	5.9
Sep-12 (f)	6.0	6.3	6.4	6.6	6.2	4.7	5.9
<b>Dec-12 (f)</b>	<b>6.0</b>	<b>6.3</b>	<b>6.4</b>	<b>6.6</b>	<b>6.2</b>	<b>4.7</b>	<b>5.9</b>

## ECONOMIC FORECASTS

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
<b>Real Gross Domestic Product</b>												
Total GDP, QPC	0.9	0.6	0.9	-0.3	-0.2	<b>-0.5</b>	<b>0.1</b>	<b>-0.6</b>	<b>-0.5</b>	<b>0.0</b>	<b>0.3</b>	<b>0.6</b>
Total GDP, APC	3.3	3.5	3.7	2.2	1.1	<b>-0.1</b>	<b>-0.9</b>	<b>-1.2</b>	<b>-1.5</b>	<b>-1.0</b>	<b>-0.8</b>	<b>0.4</b>
Total GDP, AAPC	2.4	2.9	3.2	3.2	2.6	<b>1.7</b>	<b>0.6</b>	<b>-0.3</b>	<b>-0.9</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-0.7</b>
<b>Real GDP Components</b>												
Private Consumption, QPC	0.5	0.5	0.6	-0.4	-0.3	<b>-0.6</b>	<b>0.2</b>	<b>-1.0</b>	<b>-0.6</b>	<b>0.0</b>	<b>0.2</b>	<b>0.5</b>
Private Consumption, AAPC	3.5	3.9	4.1	3.3	2.3	<b>1.1</b>	<b>0.0</b>	<b>-0.7</b>	<b>-1.3</b>	<b>-1.5</b>	<b>-1.6</b>	<b>-1.2</b>
Public Consumption, QPC	1.3	1.5	0.5	1.5	0.5	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>	<b>0.5</b>	<b>0.6</b>	<b>0.5</b>
Public Consumption, AAPC	3.7	3.4	3.3	3.8	4.1	<b>3.9</b>	<b>3.9</b>	<b>3.4</b>	<b>3.3</b>	<b>3.2</b>	<b>2.9</b>	<b>2.8</b>
Residential Investment, QPC	4.6	0.5	-2.3	-5.2	-8.1	<b>-8.5</b>	<b>-8.0</b>	<b>-7.0</b>	<b>-4.0</b>	<b>-2.0</b>	<b>0.5</b>	<b>0.5</b>
Residential Investment, AAPC	1.8	3.5	4.4	4.1	-2.0	<b>-9.3</b>	<b>-16.6</b>	<b>-22.7</b>	<b>-25.4</b>	<b>-25.0</b>	<b>-21.7</b>	<b>-16.0</b>
Other Investment, QPC	-1.3	0.1	4.8	-0.5	6.1	<b>-3.7</b>	<b>-2.9</b>	<b>-2.0</b>	<b>-0.3</b>	<b>-0.2</b>	<b>-0.3</b>	<b>1.0</b>
Other Investment, AAPC	0.5	1.9	4.3	4.4	6.0	<b>6.9</b>	<b>4.7</b>	<b>3.2</b>	<b>-1.7</b>	<b>-4.5</b>	<b>-4.9</b>	<b>-4.2</b>
Gross National Expenditure, QPC	1.7	0.4	0.6	0.4	0.4	<b>-3.7</b>	<b>-2.9</b>	<b>-2.0</b>	<b>-0.3</b>	<b>-0.2</b>	<b>-0.3</b>	<b>1.0</b>
Gross National Expenditure, AAPC	2.8	4.4	4.6	4.6	3.6	<b>2.4</b>	<b>1.1</b>	<b>-0.6</b>	<b>-2.3</b>	<b>-3.7</b>	<b>-4.2</b>	<b>-3.2</b>
Exports, QPC	-0.8	-0.4	4.5	-1.8	-0.2	<b>0.1</b>	<b>-2.0</b>	<b>0.2</b>	<b>-0.6</b>	<b>0.4</b>	<b>0.8</b>	<b>1.3</b>
Exports, AAPC	3.3	2.0	3.2	2.2	2.1	<b>3.0</b>	<b>0.4</b>	<b>-0.4</b>	<b>-1.5</b>	<b>-2.6</b>	<b>-1.4</b>	<b>-0.5</b>
Imports, QPC	2.5	0.7	4.0	1.4	3.3	<b>-2.4</b>	<b>-5.8</b>	<b>-4.8</b>	<b>-3.1</b>	<b>-0.8</b>	<b>1.8</b>	<b>3.3</b>
Imports, AAPC	1.9	5.4	8.6	9.6	9.8	<b>9.1</b>	<b>5.1</b>	<b>0.4</b>	<b>-5.8</b>	<b>-10.6</b>	<b>-11.5</b>	<b>-9.0</b>
<b>Prices</b>												
Headline CPI, QPC	1.0	0.5	1.2	0.7	1.6	1.5	<b>-0.3</b>	<b>-0.2</b>	<b>0.9</b>	<b>1.0</b>	<b>1.0</b>	<b>0.6</b>
Headline CPI, APC	2.0	1.8	3.2	3.4	4.0	5.1	<b>3.6</b>	<b>2.7</b>	<b>2.0</b>	<b>1.5</b>	<b>2.8</b>	<b>3.6</b>
Non-tradable CPI, QPC	1.1	0.6	0.7	1.1	0.9	1.3	<b>0.8</b>	<b>0.7</b>	<b>0.7</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>
Non-tradable CPI, APC	4.1	3.7	3.5	3.5	3.4	4.1	<b>4.3</b>	<b>3.8</b>	<b>3.6</b>	<b>2.9</b>	<b>2.7</b>	<b>2.6</b>
Tradable CPI, QPC	0.9	0.5	1.8	0.2	2.3	1.9	<b>-1.5</b>	<b>-1.3</b>	<b>1.2</b>	<b>1.5</b>	<b>1.4</b>	<b>0.5</b>
Tradable CPI, APC	-0.5	-0.3	2.8	3.4	4.8	6.3	<b>2.8</b>	<b>1.3</b>	<b>0.2</b>	<b>-0.2</b>	<b>2.8</b>	<b>4.6</b>
<b>External Accounts</b>												
Annual Balance on Goods, % of GDP	-1.8	-1.8	-1.4	-1.0	-1.1	<b>-1.3</b>	<b>-1.6</b>	<b>-1.4</b>	<b>-0.4</b>	<b>0.5</b>	<b>1.1</b>	<b>1.1</b>
Annual Balance on Services, % of GDP	0.2	0.3	0.2	0.1	0.0	<b>-0.1</b>	<b>-0.2</b>	<b>-0.4</b>	<b>-0.6</b>	<b>-0.8</b>	<b>-0.9</b>	<b>-0.8</b>
Annual Balance on Invisibles, % of GDP	-6.8	-7.1	-7.0	-7.1	-7.3	<b>-7.2</b>	<b>-7.1</b>	<b>-7.0</b>	<b>-6.8</b>	<b>-6.8</b>	<b>-6.7</b>	<b>-6.7</b>
Annual Current Account Balance, % of GDP	-8.4	-8.7	-8.2	-8.0	-8.5	<b>-8.6</b>	<b>-8.9</b>	<b>-8.8</b>	<b>-7.7</b>	<b>-7.0</b>	<b>-6.5</b>	<b>-6.5</b>
Net International Invnt Position, % of GDP	-88.2	-88.1	-87.3	-86.6	-88.8	<b>-89.3</b>	<b>-90.4</b>	<b>-91.4</b>	<b>-92.0</b>	<b>-92.7</b>	<b>-93.2</b>	<b>-93.2</b>
<b>Terms of Trade (SNA basis)</b>												
Export Prices, QPC	-0.5	1.9	7.6	3.2	0.8	<b>7.2</b>	<b>3.9</b>	<b>2.4</b>	<b>2.6</b>	<b>2.1</b>	<b>-0.2</b>	<b>-2.4</b>
Export Prices, APC	-3.2	-1.6	8.8	12.6	14.1	<b>20.1</b>	<b>15.9</b>	<b>15.0</b>	<b>17.0</b>	<b>11.3</b>	<b>7.0</b>	<b>2.0</b>
Import Prices, QPC	-2.6	-1.5	4.4	0.6	5.1	<b>7.7</b>	<b>6.1</b>	<b>3.0</b>	<b>3.4</b>	<b>2.7</b>	<b>-0.1</b>	<b>-2.8</b>
Import Prices, APC	-8.1	-9.2	-1.8	0.8	8.7	<b>18.8</b>	<b>20.9</b>	<b>23.8</b>	<b>21.8</b>	<b>16.2</b>	<b>9.3</b>	<b>3.1</b>
Terms of Trade, QPC	2.2	3.4	3.1	2.5	-4.1	<b>-0.4</b>	<b>-2.1</b>	<b>-0.7</b>	<b>-0.8</b>	<b>-0.7</b>	<b>0.0</b>	<b>0.4</b>
Terms of Trade, APC	5.3	8.3	10.8	11.8	4.9	<b>1.0</b>	<b>-4.1</b>	<b>-7.1</b>	<b>-3.9</b>	<b>-4.2</b>	<b>-2.1</b>	<b>-1.0</b>
<b>Labour Market</b>												
Employment, QPC	0.3	-0.2	0.9	-1.3	1.3	0.1	<b>-0.9</b>	<b>-0.7</b>	<b>-0.6</b>	<b>0.0</b>	<b>0.0</b>	<b>0.1</b>
Employment, APC	1.5	1.5	2.5	-0.2	0.7	1.0	<b>-0.8</b>	<b>-0.2</b>	<b>-2.1</b>	<b>-2.2</b>	<b>-1.3</b>	<b>-0.5</b>
Labour Force, QPC	0.2	-0.2	0.8	-1.0	1.5	0.4	<b>-0.3</b>	<b>-0.4</b>	<b>0.0</b>	<b>0.2</b>	<b>0.5</b>	<b>0.3</b>
Labour Force, APC	1.5	1.3	2.1	-0.3	1.1	1.7	<b>0.5</b>	<b>1.2</b>	<b>-0.4</b>	<b>-0.5</b>	<b>0.3</b>	<b>0.9</b>
Unemployment Rate, sa	3.6	3.5	3.4	3.7	3.9	4.2	<b>4.7</b>	<b>5.0</b>	<b>5.6</b>	<b>5.8</b>	<b>6.2</b>	<b>6.4</b>
Participation Rate, sa	68.7	68.3	68.7	67.7	68.6	68.7	<b>68.3</b>	<b>67.9</b>	<b>67.7</b>	<b>67.7</b>	<b>67.8</b>	<b>67.8</b>
Private Sector Wages (apc)	4.2	3.7	4.0	4.4	5.4	5.2	<b>5.1</b>	<b>5.0</b>	<b>3.7</b>	<b>3.4</b>	<b>3.2</b>	<b>3.0</b>
Public Sector Wages (apc)	4.6	4.9	5.0	5.4	4.8	6.4	<b>5.6</b>	<b>4.1</b>	<b>5.2</b>	<b>3.5</b>	<b>3.5</b>	<b>3.5</b>

Forecast in bold

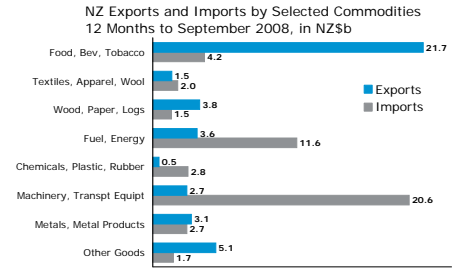
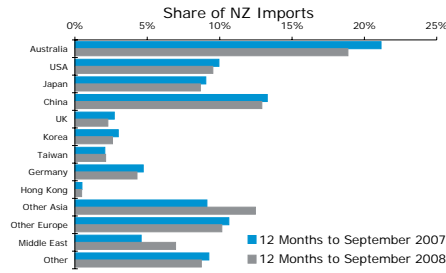
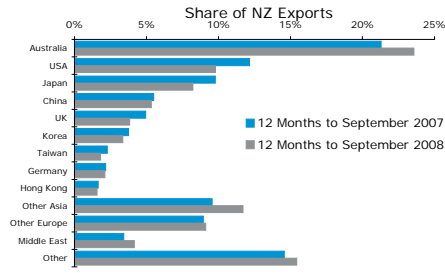
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

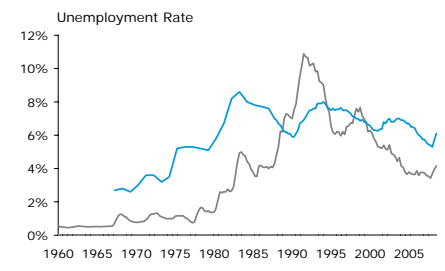
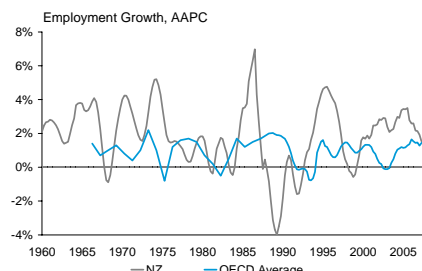
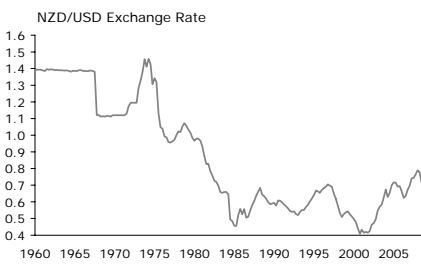
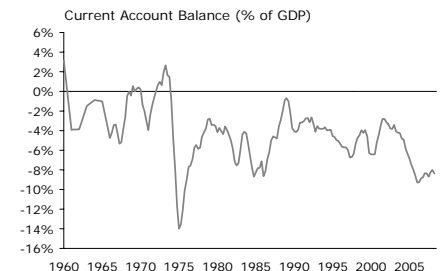
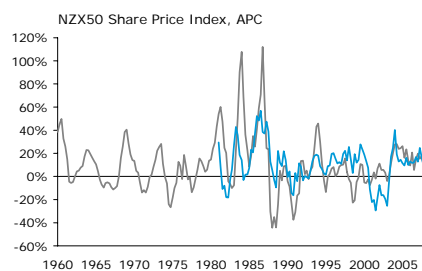
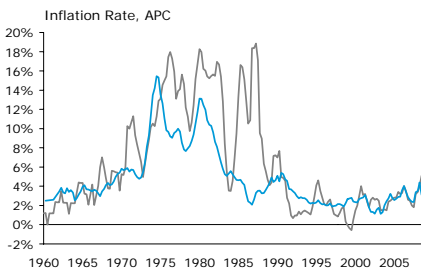
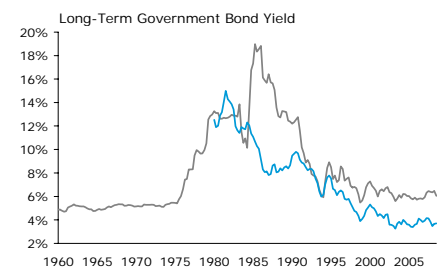
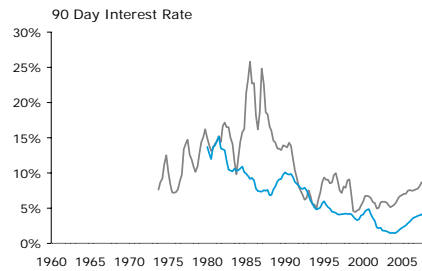
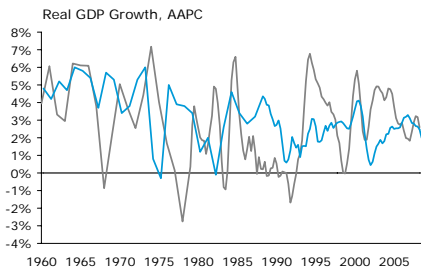
sa – seasonally adjusted

## 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	20.5	302.8	127.9	60.5	1320.9	82.6	48.1	22.9	26.1	7.1	4.6	228.9
Area in 1,000 km2	271	7713	9373	378	244	9561	357	92	36	330	1	1	1905
Inhabitants per km2	15.0	2.7	32.3	338.5	247.8	138.2	231.7	521.1	636.1	79.1	7130.0	4600.0	120.1
GDP, in billion NZ\$	179.0	1330	20443	6426	4110	5237	4925	1462	588	282	321	239	680
Change in real terms (%)	1.1	3.6	1.8	1.0	1.6	10.1	1.7	4.8	6.1	7.1	4.2	1.9	6.4
Nominal GDP per capita in NZ\$	44079	64859	67515	50241	67934	3965	59594	30423	25695	10805	44968	51971	2971
NZ exports to ..., in million NZ\$ (FOB)	n/a	9896	4108	3454	1611	2239	889	1407	759	915	660	912	1023
Share of NZ Exports (%)	n/a	23.6	9.8	8.2	3.8	5.3	2.1	3.4	1.8	2.2	1.6	2.2	2.4
NZ imports to ..., in million NZ\$ (VFD)	n/a	8356	4223	3838	1009	5723	1900	1150	942	1811	205	2210	1060
Share of NZ Imports (%)	n/a	18.9	9.5	8.7	2.3	12.9	4.3	2.6	2.1	4.1	0.5	5.0	2.4
Current Account balance as a % of GDP	-8.4	-5.5	-4.5	3.8	-3.0	10.5	6.6	-2.3	5.8	12.8	10.3	17.4	0.4



## 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.

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