

Quarterly Economic Forecasts

New Zealand

February 2010

TRANSITION

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- > Momentum is building and our central scenario has the economy recovering progressively over 2010 and 2011. History shows that recoveries tend to surprise on the upside. Yet at the same time, we are mindful of structural forces at play as the economy adjusts to a "new normal" – voluntarily or not. In this environment, we encourage readers to focus on the underlying trends over a number of years, which is for modest growth, with upside being capped by the rebalancing process, de-leveraging and resource allocation shifts.

Page 8: Global outlook

- > The global economy is healing courtesy of aggressive steps taken by policymakers. Despite this a lot of tensions remain. We expect the recovery process to be gradual.

Page 9: Fiscal policy

- > Fiscal policy is set to become less expansionary over the coming years, as fiscal consolidation takes hold. However, it will be changes to the tax and regulatory systems that will be more important in getting a step-change in NZ's economic performance.

Page 10: Inflation

- > Medium-term inflation drivers are well contained at present. Despite a temporary push above the top of the policy band courtesy of government related charges, the outlook looks to be one of inflation remaining comfortably within the band. However, a key uncertainty in this regard is the supply-side capacity of the economy at present.

Page 11: Exchange rate

- > Support factors remain for the NZD but the uptrend for the NZD that has been in place since March 2009 looks to have been broken. An ongoing firmer USD – on a weaker EUR – is set to be the key feature of 2010. At this juncture we believe the NZD is biased lower over the year ahead, before structural forces support over the medium-term.

Page 13: Interest rates

- > Central banking looks easy in 2010, in theory at least. If credit growth picks up, remove liquidity. If not, maintain the status quo. We expect the RBNZ to begin the journey back to a more neutral policy setting from mid-year. Rather than a straight line, we envisage two stages. We also foresee a structural shift lower in the neutral OCR which should result in a lower peak.

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KEY ECONOMIC FORECASTS

Calendar years	2006	2007	2008	2009(e)	2010(f)	2011(f)	2012(f)
NZ Economy (annual average % change)							
Real GDP	1.0	2.9	-0.1	-1.5	2.2	3.3	2.0
Employment	2.4	1.9	0.6	-1.1	-0.2	1.7	1.7
Unemployment Rate (Dec qtr)	3.8	3.5	4.7	6.8	7.0	6.7	6.3
Terms of Trade	-2.9	5.9	2.3	-6.4	5.9	0.9	0.2
Global Growth (annual average % change)							
United States	2.7	2.1	0.4	-2.4	2.3	3.1	3.3
Australia	2.7	4.8	2.2	0.9	3.0	3.4	3.8
Japan	2.0	2.3	-1.2	-5.3	1.3	1.8	2.1
China	11.0	12.0	9.1	8.4	9.1	9.6	9.8
Trading Partner Growth	3.7	4.2	1.7	-1.1	3.2	3.7	4.0
NZ Inflation (annual % change)							
CPI Inflation	2.6	3.2	3.4	2.0	2.7	2.9	2.2
Non-tradable Inflation	3.8	3.5	4.3	2.3	2.4	3.4	3.1
Tradable Inflation	1.2	2.8	2.3	1.5	3.1	2.0	1.3
NZ Financial Markets (end of December quarter)							
TWI	68.0	71.6	55.1	64.6	62.2	61.0	64.6
NZD/USD	0.69	0.77	0.56	0.72	0.68	0.64	0.66
NZD/AUD	0.88	0.88	0.83	0.79	0.76	0.78	0.86
Official Cash Rate	7.3	8.3	5.0	2.5	4.0	5.3	5.5
90-day Bank Bill Rate	7.7	8.9	5.2	2.8	4.3	5.7	5.8
10-year Bond Rate	5.8	6.4	4.9	5.9	6.0	6.5	6.5
Fiscal and External Balance							
Current Account Balance (\$m)	-14,000	-14,200	-15,800	-3,300	-4,700	-6,700	-10,000
as % of GDP	-8.4	-8.0	-8.6	-1.8	-2.4	-3.3	-4.8
Government OBEGAL (\$m)*	7,100	5,900	5,600	-3,900	-6,900	-6,500	-5,800
as % of GDP	4.4	3.4	3.1	-2.1	-3.7	-3.3	-2.8

* Operating balance excluding gains and losses, June years

Forecasts and text finalised 1 February 2010.

Key forecast assumptions:

- > Dubai oil prices are expected to trade within a US\$70 to US\$80 per barrel range for the rest of this year, then rise towards US\$90 per barrel by 2011.
- > Annual net migration is nearing a peak, easing towards 14,000 by mid next year, with departures picking up as the global growth cycle recovers, particularly to Australia.
- > The longer-term potential growth rate is now seen in the 2 to 2½ percent range.
- > The neutral Official Cash Rate is closer to 5 percent.
- > Inflation expectations remain well anchored at a modest level and within the RBNZ's inflation target.

NZ ECONOMIC OUTLOOK

Momentum is building and our central scenario has the economy recovering progressively over 2010 and 2011. History shows that recoveries tend to surprise on the upside. Yet at the same time, we are mindful of structural forces at play as the economy adjusts to a “new normal” – voluntarily or not. In this environment, we encourage readers to focus on the underlying trends over a number of years, which is for modest growth, with upside being capped by the rebalancing process, de-leveraging and resource allocation shifts.

Out of recession but still some way to go

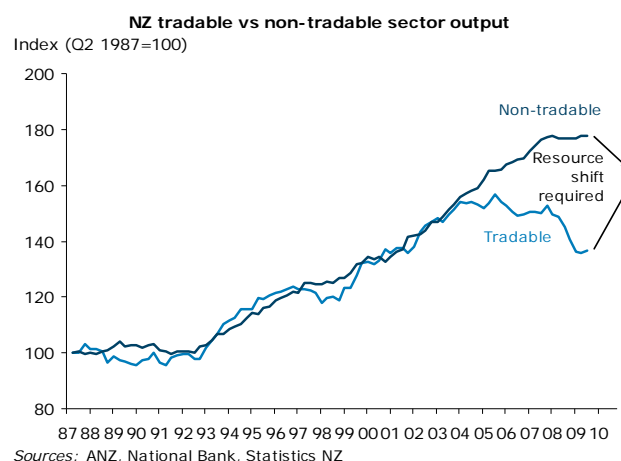
With the NZ economy out of recession in the second quarter of 2009, attention has focused on the shape of the recovery. There was a cumulative loss of output of 3.3 percent during the recession period, similar to the early 1990s recession. Judging by the strong rebounds seen in business and consumer confidence, the economy is certainly gaining momentum. As such, there are good reasons to anticipate a V-shaped recovery. This has, after all, been the traditional experience. After suffering a deep recession, the first legs of recovery tend to be consistent with a V. Upswings have historically been inversely proportional to downturns. We have seen year-on-year growth reaching 6 percent following the previous two recessions in NZ. Support is being provided via extraordinarily loose monetary policy. Pent-up demand is apparent in some areas, including residential construction, where a solution to the leaky home conundrum could unleash it further. Then there is the population growing at 1.2 percent annually, courtesy of strong net migration. Also providing support is a recovery in NZ’s major trading partner growth.

Our forecasts assume that the worst of the global financial crisis is past, and the global economy is on the road to recovery. This is not to be confused with saying that all is well: we fully expect more bumps and setbacks. But the key point is that the worst has past. However, profound adjustments and pending changes still need to be worked through in the global economy. A bathtub with waves captures the spirit of our global view, albeit a bath-tub rested on an upwards slope.

A critical judgement underpinning our forecasts is that debt-driven consumer behaviour of prior years has come to an end in NZ. While such pronouncements have proven premature in the past, we have reasonable confidence of this view this time. For one, we have the Reserve Bank Governor saying that it is untenable for NZ to go back to its borrow and

spend habits of old. And he has the means to make sure we don’t! In addition, policymakers globally are now taking note. The term “rebalancing” was used roughly 40 times in a 23 page communiqué from last September’s G20 summit (although we are not convinced they have a clear plan to achieve it). Credit is no longer abundant or cheap, despite record low official interest rates. There has been a material re-pricing of risk globally, and while short-term money markets have returned to pre-crisis levels, there is still a higher cost (premium) to raise long-term money. Policymakers require financial institutions to better match their claims and funding profile, and this has resulted in higher overall funding costs, which has been passed on to borrowers. Regulatory changes are coming thick and fast.

Given this, we struggle to see the NZ economy returning to its “old” ways. Growth needs to be driven by the earnings side of the economy (i.e. the tradable sector), and with less help from debt. This will result in a massive shift across investors’ mindsets towards yield and cash-flow, and away from capital gain. The latter was simply driven in prior years by the ability of subsequent purchasers to gain more leverage.

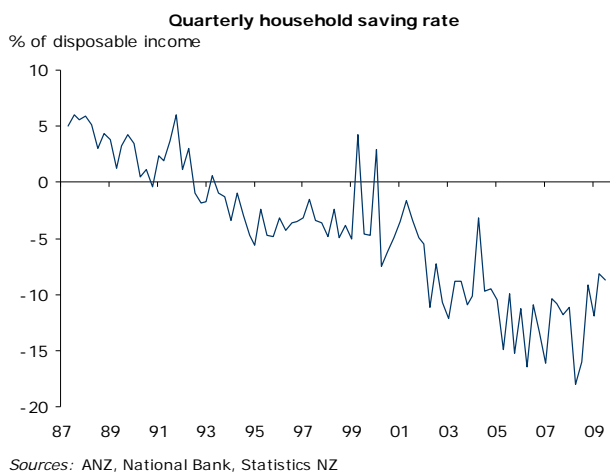


The economy is naturally going to push against this inevitability on a number of fronts. For one, the domestic economy is doing what it is supposed to do at present: that is, stabilising and reflating courtesy of low interest rates. This seems paradoxical at present given that we borrowed and spent our way into the jam in the first place. But such is the reality of stabilisation policy in response to exceptional circumstances. It will take time for resources to shift and reallocate, so the story is one that needs to be expressed over a number of years. Probably the most significant uncertainty at present surrounds the behavioural aspect that is inherent in every economic cycle. It will take time to shift investors to a yield mantra given the capital gain successes of the past. Similarly, it will take a while for consumers to arrest their Freddy Mercury “I want it all and I want

it now” attitudes. For most, the temptation is to return towards the way things were. The problem here is that the old normal (credit growth growing at 2 to 3 times the rate of nominal GDP and house prices the same) was abnormal and ultimately explosive in terms of the pressure it placed on the economy. Hence the purging process in 2008 and 2009, locally and globally.

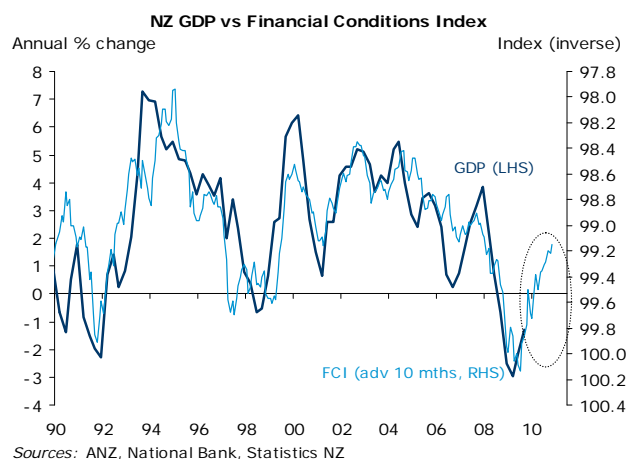
The NZ economy has made considerable progress towards rebalancing. The current account deficit has narrowed to 3.1 percent of GDP, having been as high as 9 percent in 2006. The country’s net external liability position has stabilised of late. Surging commodity prices (what we export) relative to manufactured goods (by-and-large what we import) are assisting the rebalancing process. Deleveraging is apparent when looking at anaemic credit growth (outright declines in the case of business credit).

There is still some way to go. The household saving rate is still overwhelmingly negative (although we question the statistics somewhat). Our net external liability position, at 94 percent of GDP, remains one of the highest in the OECD. These forces are natural handbrakes on the ability of the economy to expand rapidly.



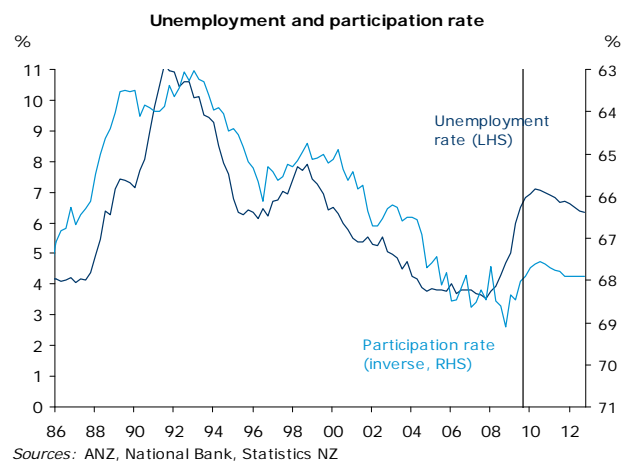
For now, the economic imperative for NZ.Inc is getting growth. Momentum is gradually building across the economy, although in a rather inconsistent fashion. Business and consumer confidence has recovered strongly and suggest 4 percent growth over the year ahead. Financial conditions point to a more muted 2 percent growth, but a recovery nonetheless. These have been reliable indicators historically. The housing market – courtesy of policy stimulus – has led the initial recovery process, assisted by rising net migration. This momentum is now starting to wane and the baton looks set to shift to residential investment, retailing and a modest stock-fillip. All will add to growth over 2010, but within a general de-leveraging backdrop, which means we won’t be setting the world on fire. Areas such as non-residential construction are expected to remain

weak into 2010. Incremental impetus from fiscal policy is waning as the spending reins are tightened.



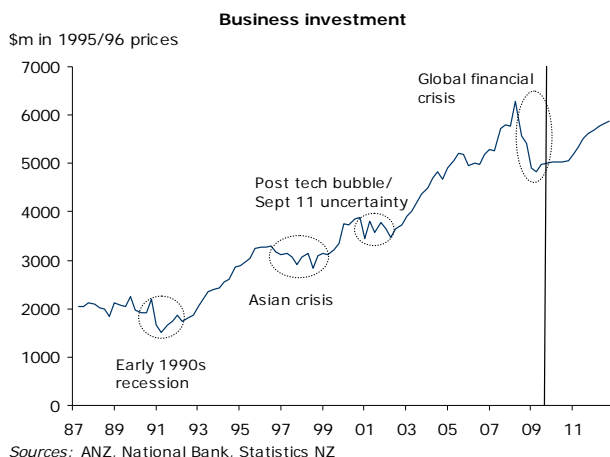
Looking for confidence to hire and invest

The missing ingredients towards a sustained recovery are employment and investment. We see both coming to the party over 2010, but with little euphoria, capping the potential for the typical pro-cyclical rebound. Hours worked took the brunt of the slowdown, and will naturally be the lever firms use when they have more confidence in the economic picture. This means an unemployment rate that remains higher than we have been used to over prior years. We forecast the unemployment rate to peak at just over 7 percent by mid-year, with most of the increase in labour demand being met via increased hours worked per person. This then gradually edges back towards 6.3 percent by the end of our forecast period, a far cry from the 3.5 percent low reached in 2007.



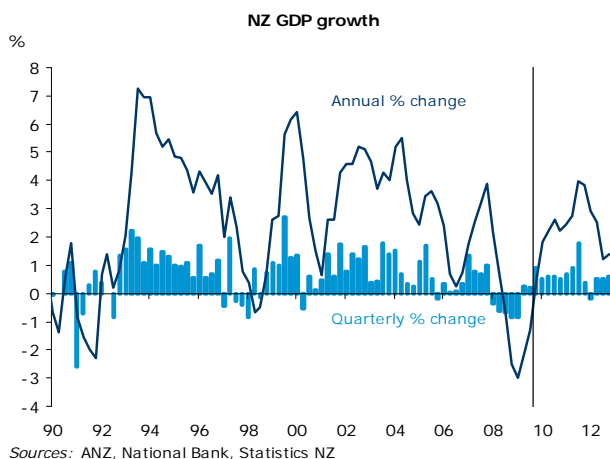
Business credit growth remains weak, a bad omen for investment ahead. Though investment intentions in business surveys have recovered, firms are not yet willing to commit the cash. The decline in business investment during the recession has been the steepest in over two decades. Historically, it has taken more than a year after the end of a recession before business investment

really starts to pick up. We expect this time to be no different, forecasting a pick-up later this year. The reduced investment over the past 18 months will affect the economy's near-term potential growth rate. The elevated capacity utilisation reading in the latest QSBO suggest the impact is already being felt.



Modest expansion but will we be surprised?

We are forecasting a modest rebound in GDP growth of 2.2 percent for this calendar year, as cyclical support is somewhat dampened by structural deleveraging headwinds. Residential investment will make a large contribution to growth this year, rising by 11.6 percent as it recovers off extreme lows. Inventories will also make a big 1.7 percentage point contribution, but this comes after shaving 2.6 percentage points off growth in 2009. We see public consumption growth being modest, as the Government seeks to rein in the deficit. Private consumption will recover this year, but will not have the benefit of a strong wealth effect to assist. Consumption growth will lag behind income growth as households rebuild their saving. For a lot of sectors, recovery is coming off deep declines, so 2010 will hardly be a year to cheer about.



Activity associated with the Rugby World Cup (RWC) and improved export performance are

expected to be the key flag-bearers in 2011, where we expect growth of 3.3 percent. Infrastructure spending, a boost to tourism as visitors head to NZ and increased domestic consumption on the back of a feel-good factor of hosting the RWC will be key features. But we also expect the export sector to quietly perform well, helped by a lower exchange rate, historically high commodity prices, and trading partner growth that is back to trend.

Economists have a notorious track record of understating rebounds, and it may well be the case this time around over the coming two years. The bulls have a strong case when looking at history, policy stimulus and migration. We'd counter that by saying that history has never seen a necessary period of household deleveraging (apart from the 1930s depression). But the reason booms and busts are under or over estimated is simple: economists bank on the rational, and most of the models they rely on assume linear relationships. In reality, the world can at times be irrational, and variables can and do interact in non-linear ways. There are tipping points at which behaviour (in the form of investment and employment decisions) stops and starts. Probably the most difficult task ahead of us at present is trying to predict the "behavioural aspect" within the economic cycle. Economic trends are about combinations of economics, finance and human behaviour. The difficulty in the current instance is that you have an economy undergoing a deep structural change as we adjust to a new normal. Human nature however, wants to go back and grasp the "old", as in the way things were pre-crisis. The problem is that the period in the lead-up to the global financial crisis was abnormal, characterised by excesses in risk taking, credit growth and double-digit asset prices, and is unlikely to be repeated again.

We see such behavioural tensions every day. One scribe notes the process of learning as similar to watching a teenager learn from a mistake: faced with two choices, the path chosen is likely to be the one that is most fun and least painful. And so it applies to the general economy in terms of how we "learn". Across the corporate world we see business leaders recognising that a step-change is required if NZ's medium-term positive potential is to be unlocked. But that requires a sacrifice up front in terms of earnings, and we all know how conditioned the market, and hence CEO behaviour, can become to hitting those near-term benchmarks. The existing level of government services is unsustainable given the income (tax) base. But where is the hurry to forge ahead with the hard decisions when you are judged in the court of public opinion? Is farming or investing in residential property for capital gains going to change overnight? Of course not. **Hence, the tendency**

to push against the inevitable or take the easy solution.

So if the economy does surprise with strong growth over 2010, and momentum associated with the Rugby World Cup carries us through into 2011, then we'd put strong odds on a double-dip style recession, with the second dip in 2012. And when you eye history, there has been a tendency for such a dynamic to occur. Certainly the 1987 crash took until 1991 to completely flush out (although there were more serious structural issues impeding the NZ economy then than there is now).

We prefer to focus on the spirit of our economic view, rather than the exact numbers. We envisage growth, but of a modest variety. That is, two to two and a half percent growth on average over the coming three to four years. The economy simply does not have the same degree of excess capacity of prior years to justify a boom, nor the ability across balance sheets to debt-fund consumption. Structural changes such as higher deposit rates and longer-term borrowing rates are working against a return to housing excesses.

At some stage in the coming two years, the NZ and global economy will enter a stage we refer to as the transition. For now, the imperative across policymakers is about ensuring a recovery. As noted earlier, employment and investment are the missing links. Credit growth is a key gauge for both. While we are not there yet, we expect a pick-up in credit demand by mid-year. As confidence in the recovery grows, attention will shift towards the process of change, and what we call transition. We expect the transition phase to be characterised by four things:

- > **Policy stimulus will be removed or dampened.** This of course will be conditional on the recovery being strong enough to withstand it in theory. In practice we have some reservations about fiscal policy and monetary policy getting the exit strategy (the OCR to five percent and fiscal position to balance) right in terms of unexpected potential impacts on the economy. This is particularly so globally where some nations have fiscal deficits in excess of 10 percent of GDP. You cannot reduce this without higher taxes or deep sending cuts.
- > **We are going to see more structural changes being introduced,** implicitly aimed at ensuring the new normal for credit growth is more in line with GDP growth and not twice that. In other words, ensuring that the economy does not resume its *"borrow and*

spend habits" of old that RBNZ Governor Bollard warned against. Locally, the RBNZ has bought in new liquidity rules which will temper activity at the top of the cycle (and potentially prevent another housing boom). These new rules have made significant changes to the shape of the yield curve and shifted the advantage to investors as opposed to borrowers. Some changes to other regulatory mechanisms appear imminent on the global stage: *"we will not allow a return to banking as usual"* (G20 Communiqué). Put simply, if credit is not driving the capital gains excesses of prior years, then spending needs to be derived from incomes alone.

- > **The economy's supply side potential will be capped for a few years simply because it will take the economy, behaviour and resources time to shift.** The period 1984 to 1990 was an extreme period of huge structural change in NZ, with the economy turned on its head. It took time for resources to adjust, and for six years we went nowhere. That period is extreme in so far as zero growth over 6 years is concerned, but it provided important lessons: facing structural changes, it will take time for resources to shift to different price signals. Across a lot of industries, there will be consolidation as it becomes apparent that we will not be returning to the levels or growth rates of the past. Such a dynamic will take a while to play out, as the realisation of a new normal takes time to sink in.
- > **Decisions taken in the transition phase will determine the supply-side capacity of NZ over the subsequent decade.** This is where we are going to see tensions between leadership and populism. The former is needed, the latter not. NZ is sitting on a winning ticket in terms of what we produce, the areas of strategic advantage and the shifts around the globe in favour of Asia – which sit on our doorstep. This makes us tremendously bullish on NZ.Inc beyond our existing forecast horizon. We just have a few hurdles (i.e. deleveraging) to jump through first. But you don't achieve a *"step-change in economic performance"* (Minister of Finance Bill English in his *Budget Policy Statement*) by maintaining the status quo. The recession of 2008/09 was probably of the half flush variety. We needed the full-flush to get the process of change gathering a head of steam. We're hopeful the tough decision will be made, but are also not holding our breath.

NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual percent change)	2006	2007	2008	2009(e)	2010(f)	2011(f)	2012(f)
Total Consumption	2.8	4.0	0.8	-0.3	2.1	2.0	1.6
Private Consumption	2.2	3.9	-0.3	-0.7	2.3	2.0	1.5
Public Consumption	5.3	4.1	4.8	1.2	1.6	2.0	2.1
Total Investment	-0.9	5.4	-1.2	-12.2	3.3	8.4	6.1
Residential investment	-2.1	4.7	-16.3	-19.8	11.6	18.3	8.6
Other investment	-0.6	5.5	2.6	-10.6	1.7	6.4	5.6
Stockbuilding¹	-0.8	0.4	0.2	-2.6	1.7	0.5	0.0
Gross National Expenditure	1.2	4.8	0.3	-5.5	4.2	3.9	2.7
Total Exports	1.7	3.8	-1.2	0.2	3.3	5.2	4.4
Goods	3.3	5.5	0.3	1.7	2.7	4.0	4.7
Services	-2.3	-0.4	-5.7	-5.9	4.3	9.9	3.3
Total Imports	-2.5	8.7	2.5	-16.1	8.3	8.3	7.7
Goods	-1.9	8.9	3.1	-17.4	7.3	10.9	8.9
Services	-4.3	8.1	0.6	-12.2	10.4	0.0	3.5
Expenditure on GDP	2.3	3.1	-0.7	-0.2	2.5	3.0	1.8
GDP (production based)	1.0	2.9	-0.1	-1.5	2.2	3.3	2.0

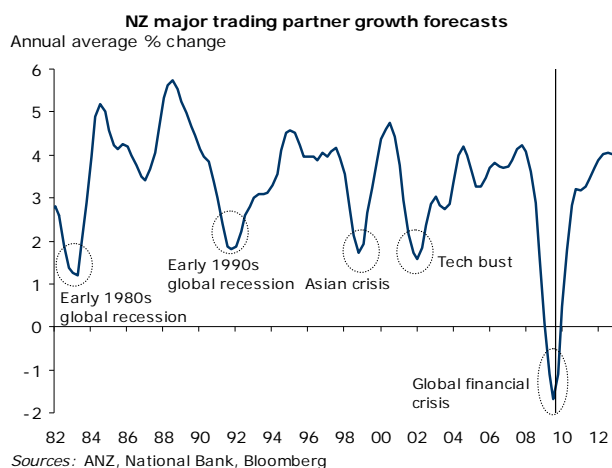
¹ Percentage point contribution to growth

GLOBAL BACKDROP

The global economy is healing courtesy of aggressive steps taken by policymakers. Despite this a lot of tensions remain. We expect the recovery process to be gradual.

Out of the starting blocks

The global economy is recovering. H2 2009 GDP came in positive and leading indicators suggest this has been maintained into early 2010. The rebound has been especially pronounced in the Asian region, with a strong performing Chinese economy a key feature. Policymakers remain committed to keeping extraordinary policy stimulus in place until the recovery becomes self-fulfilling. Key in this regard is investment and jobs. These legs are stabilising, but yet to turn positive, which is looking a mid-year story. While we view the recovery to date as largely “statistical” and coming off a low base, and one that is missing key aspects such as final demand, net-on-net momentum is building - gradually.



A lot of tension remains within the global economy. Final demand remains absent, commercial property is still under pressure, de-leveraging remains a dominant theme, credit growth in key nations remains anaemic as the credit channel of monetary policy works against conventional policy stimulus, changes in US consumer spending behaviour presents huge challenges for the likes of Japan, and the euro zone is facing internal pressure from precarious fiscal situations in the likes of Greece. Suffice to say that despite a recovery beginning, considerable

GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2006	2007	2008	2009(e)	2010(f)	2011(f)	2012(f)
United States	2.7	2.1	0.4	-2.4	2.3	3.1	3.3
Australia	2.7	4.8	2.2	0.9	3.0	3.4	3.8
Japan	2.0	2.3	-1.2	-5.3	1.3	1.8	2.1
Euro Zone	3.1	2.7	0.5	-4.0	1.0	1.5	1.9
China	11.0	12.0	9.1	8.4	9.1	9.6	9.8
Trading Partner Growth	3.7	4.2	1.7	-1.1	3.2	3.7	4.0

challenges remain. We are in no doubt we'll see both bouts of euphoria and despair over 2010.

Trading partner growth is nonetheless expected to rebound sharply over 2010. This by-and-large reflects “statistical” bounce in trading partners such as the US off recessionary lows in 2008 and 2009. However, key trading partners such as Australia and China are performing well. Both these nations are facing tightening monetary conditions to ensure the expansion does not overheat (a delicate balancing act for policymakers), but are nonetheless expected to remain beacons of economic prosperity relative to others around the globe.

The spirit of our view remains cautious. There are simply too many variables and tensions within the system for us to accept that the deepest financial crisis in 80 years can pass in the space of 12-18 months. Our greatest concerns centre on Europe and Japan, which simply do not have the economic flexibility to respond to structural changes that are occurring around the globe. As noted, we remain bullish on China's prospects (and hence Australia) but likewise acknowledge that with an investment share of GDP at around 45 percent, poor demographics and inflation challenges in 2010, risks remain. Navigating this could prove a tall order for the Chinese economy, at a time when other global economic engines are not yet showing self-fulfilling recoveries. For now we view such China risks as more than matched by the basic maths behind rapidly growing per capita incomes and huge foreign reserves to absorb any near-term blips. For NZ this represents a huge medium-term opportunity.

NZ stands to benefit hugely from China's increasing demand for high-quality agricultural products. China is facing serious water shortage problems in its northern plains. This means it will become difficult for China to maintain the current scale of agricultural production in the future. Meanwhile, China's affluent middle and upper class, with a per capita income of US\$7,000 and above, is emerging rapidly. Our estimates put the number at about 130 million, larger than the Japanese population. This income group will demand more proteins and high quality agricultural and fishery products, which will help keep soft commodity prices elevated.

FISCAL POLICY

Fiscal policy is set to become less expansionary over the coming years, as fiscal consolidation takes hold. However, it will be changes to the tax and regulatory systems that will be more important in getting a step-change in NZ's economic performance.

Looking for leadership

The fiscal position is slowly improving as the economic recovery takes hold. We forecast the underlying operating deficit falling from a peak of 3.7 percent this fiscal year towards 2.5 percent by 2013. The threat of a credit rating downgrade may have passed, but much hard work still lies ahead to get the fiscal position back into surplus.

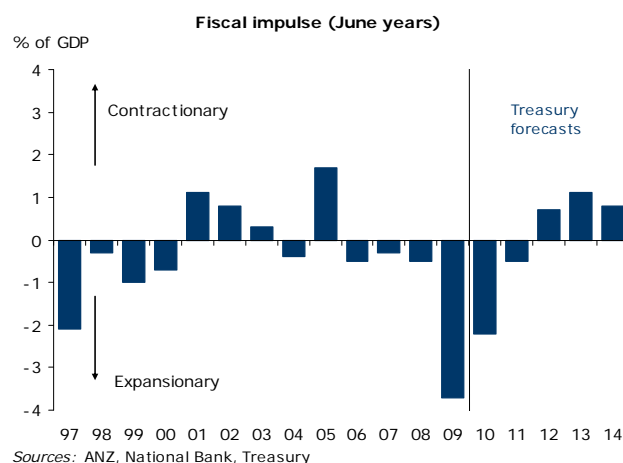
2010 is shaping up as one of the most critical years in NZ's economic history. The scene has been set with the Government talking about aspirations to catch up with Australia, and about laying the groundwork for a step-change in economic performance. The various working groups and taskforces that have been set up have largely reported back with their recommendations. The analysis has been done. The time has now come for decisions to be made and implemented.

Tough decisions lie ahead. You can't talk about a step-change in growth and then rule out the recommendations of the Productivity Taskforce as being too radical. If we see "popular" decisions being made, then we cannot expect to see meaningful improvements. But if we see the tough decisions being made, then we will have more confidence about NZ's future prospects.

There are four key areas to watch.

- > **The process of fiscal consolidation.** We estimate that around half the fiscal deficit is structural in nature. That means getting back into sustained surpluses requires addressing some areas of government spending. Increasingly, this will involve shifting the burden to households, which will still be de-leveraging themselves. Fiscal policy will almost certainly move into contractionary mode next year.

- > **The balance between monetary policy and fiscal policy.** We fully expect monetary policy to get some assistance from fiscal policy over the coming cycle. Fiscal consolidation and changes to the tax and regulatory system should take some of the burden of adjustment off monetary policy. The big uncertainty is the extent of fiscal policy changes.
- > **Look for further progress in unlocking NZ's mineral wealth (reputedly worth \$170 billion) and other growth-wins such as oil exploration.** Strong growth over the past decade led to touchy-feely style initiatives supplanting economic priorities. This has changed given the growth outlook. The economic imperative for any government at present is growth and jobs: these are the benchmarks they will be judged on the court of public opinion. Hence, we expect substantial progress in some key areas, despite obvious concerns from some pockets.
- > **Foresight versus populism.** The Government is committed to delivering a step-change in NZ's economic performance. Some change is inevitable, and indeed needed. The May *Budget* will be critical in setting out the policies that will achieve this step-change. The risk is that tough choices are avoided, opting instead for tinkering at the side.



FISCAL FORECAST

June years	2007	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
Operating Balance (\$m)	8,000	2,400	-10,500	-4,500	-4,600	-3,700	-3,500
- as % of GDP	4.7	1.3	-5.7	-2.4	-2.3	-1.8	-1.6
OBEGAL (\$m)	5,900	5,600	-3,900	-6,900	-6,500	-5,800	-5,400
- as % of GDP	3.4	3.1	-2.1	-3.7	-3.3	-2.8	-2.5
Net Core Crown Debt (\$m)	13,400	10,300	17,100	26,900	37,000	48,000	56,000
- as % of GDP	7.8	5.7	9.3	14.3	18.7	23.1	25.9
Core Crown residual cash (\$m)	2,900	2,100	-8,600	-9,500	-10,000	-9,700	-8,000
Bond Tender Programme (\$m)	2,300	1,900	5,800	10,500	10,500	12,500	12,500

INFLATION

Medium-term inflation drivers are well contained at present. Despite a temporary push above the top of the policy band courtesy of government related charges, the outlook looks to be one of inflation remaining comfortably within the band. However, a key uncertainty in this regard is the supply-side capacity of the economy at present.

Well behaved

Inflation pressures have eased considerably over the past year. Non-tradable inflation has fallen from a peak of 4.3 percent in the December 2008 quarter to 2.3 percent in December 2009. Other core inflation measures have also fallen. This has helped to bring headline CPI inflation down from a peak of 5 percent in 2008 to 2 percent. Despite the severity of the downturn, inflation has hardly been crushed. But it certainly is contained. With the economy now recovering from recession, there does not appear to be much evidence of broad-based price pressures.

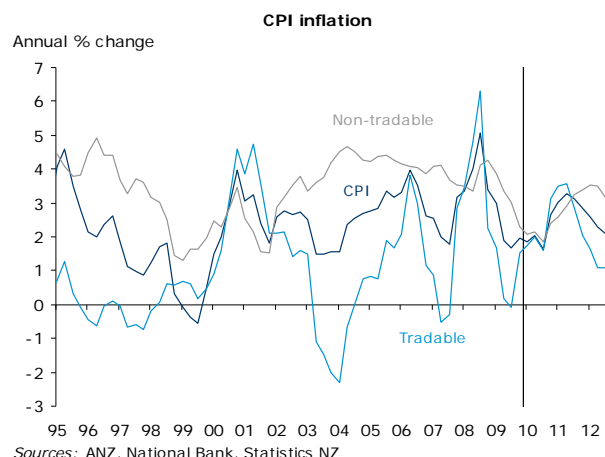
For now we remain relaxed over the outlook for inflation. Housing related inflation, a long-standing bugbear at the RBNZ, remains subdued although forward indicators are pointing to a pick-up later this year. With wage pressures subdued and the unemployment rate still set to move higher, there should not be much cost-push inflation pressure for some time. Inflation expectations remain contained. A sizeable negative output gap exists, although considerable uncertainty surrounds the magnitude. So long as deleveraging dominates as a global theme, we find it difficult to paint a strong case for the inflationary genie leaping out of the bottle.

The inflation outlook will be volatile due to government related charges clouding the picture. Given financial pressures on local governments, council rate increases will continue to outpace overall CPI. Increases in levies (such as ACC), the potential for further tobacco tax increases and the introduction of emissions trading scheme (ETS) related charges from July this year will all put upward pressure on the CPI. The ETS alone is estimated to increase annual CPI inflation by 0.4 percentage points. Changes to the NZD, not to mention global commodity prices and the possibility of increases in the GST rate, will add a further layer of volatility to the inflation outlook.

We expect inflation to remain comfortably within the RBNZ's target band over the forecast horizon. We forecast inflation to temporarily exceed the top of the target band mid-next year (3.3 percent by mid-2011 quarter), as the full effects of the first round of ETS changes flow through. And while we expect the NZD to fall,

resulting in a rise in tradable inflation, some of this is expected to be offset by ongoing declines in the price of global manufacturing goods given the excess of global capacity. We forecast inflation to ease back towards 2¼ percent by 2012.

A key question regarding the inflation outlook at present is how much spare capacity the economy has. Conventional output gap measures suggest a lot. The unemployment rate peaking at 7 percent relative to a NAIRU of around 5½ suggests likewise. But the failure of a long recession to crush inflation has us perplexed over how fast this economy can grow without generating inflation. Obviously, persistent rises in Government related charges "inflates" the inflation picture somewhat. Then there is the reality that with duopoly dominating in several key sectors, there is still some pricing leverage. But the real uncertainty is regarding the economy's supply-side capacity. If the supply side is constrained, inflation pressure could pick up more sharply. At present we do not have a huge demand side picture. But given our subdued assessment of potential growth, it is the supply side that we are doing the most thinking about and where some inflation risks lie.



CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Mar-09	0.3	3.0
Jun-09	0.6	1.9
Sep-09	1.3	1.7
Dec-09	-0.2	2.0
Mar-10 (f)	0.2	1.9
Jun-10 (f)	0.7	2.0
Sep-10 (f)	0.9	1.6
Dec-10 (f)	0.8	2.7
Mar-11 (f)	0.5	3.0
Jun-11 (f)	1.0	3.3
Sep-11 (f)	0.8	3.1
Dec-11 (f)	0.5	2.9
Mar-12 (f)	0.3	2.6
Jun-12 (f)	0.7	2.3
Sep-12 (f)	0.6	2.1
Dec-12 (f)	0.6	2.2

EXCHANGE RATE

Support factors remain for the NZD but the uptrend for the NZD that has been in place since March 2009 looks to have been broken. An ongoing firmer USD – on a weaker EUR – is set to be the key feature of 2010. At this juncture we believe the NZD is biased lower over the year ahead, before structural forces support over the medium-term.

Still supportive but for how long?

Support factors remain for the NZD. World prices for soft commodities have risen sharply. NZ interest rates, whilst low, remain favourable relative to global peers. NZ's external position has improved considerably, the government is pulling together a credible fiscal consolidation strategy and a booming Australian economy is hoisting the AUD (and hence NZD) courtesy of associated rises in interest rates. Momentum within the economy is improving and we fully expect the RBNZ to start the long journey of taking interest rates back to a more neutral setting from mid-year. All else equal, this suggests a positive outlook for the NZD.

Nonetheless, the uptrend for the NZD since March 2009 looks to have been broken.

- > **The USD is emerging from a bear market.** The US Federal Reserve has confirmed that quantitative easing will be completed by the end of March. Hence, the market is becoming increasingly constructive on the USD relative to other currencies including the JPY, GBP and EUR. We expect this trend to continue.
- > **Authorities are moving to cool the Chinese economy.** Reserve requirements have been raised, directives to limit new lending have been issued to banks, and formal interest rate increases look likely sooner rather than later. If this is as good as it gets for the Chinese economy, the same implication can be drawn for the AUD and NZD. Prospects for tighter monetary policy also carry the implication of a strong Renminbi, which should lessen downward pressure on the USD against other currencies.
- > **The global economy is moving into a different stage in the cycle.** We noted on page 8 about the tensions that still exist. This is equally apparent across the currency market. 2009 was about recovery and hence hi-beta currency plays. Elements of this will persist in 2010. But as the year progresses, attention will turn increasingly to points of differentiation as the transition stage is navigated.

The EUR has been the standout underperformer of late and we expect this to continue. Greece's fiscal problems (deficits of 9

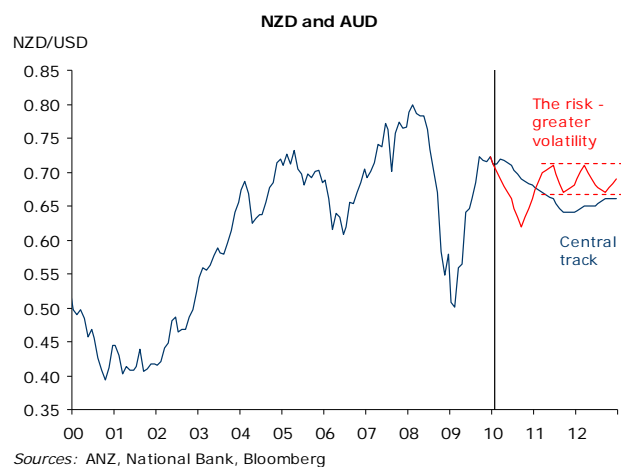
percent of GDP) have seen credit default swap spreads widen to 377bps. Question marks surround who is next, with Portugal, Ireland and Spain being mentioned.

The US economy and dollar faces clear challenges. Portfolio diversification away from the USD will continue in some areas. Material fiscal deficits (9.2 percent of GDP in FY2010) are problematic and need to be addressed. **But relative to the EUR and JPY, the USD looks the tallest pygmy.** The US bond market remains the most liquid and will continue to benefit from nervousness across risk appetites. The US economy has considerably more flexibility across goods and product markets to respond to change and challenges. Such flexibility is absent in Europe and Japan, and carries the implication that the adjustment period will likely be more elongated. That means weaker growth relative to the US.

Beware of the cycle

We have laid out a fairly safe central track for the NZDUSD over the forecast period.

Technically, the NZDUSD is already below our February 2010 forecast. But the danger with currency forecasting is in chasing trends. We prefer to focus on the spirit of the forecasts, rather than on the precise numbers. Our NZD view is somewhat tempered by the house view for the major currencies. We have the NZD gradually declining from current levels towards the low to mid-0.60s area by the second half of next year, as NZ's relative growth underperformance relative to other countries become apparent and the USD firms slowly. During that period, the interest rate differential that the NZD currently enjoys will have narrowed. The NZD then recovers towards our estimate of structural fair value of around 0.66 by the end of the forecast period.



Our bias, however, is towards a much bigger cycle, with an earlier move towards the low to mid-0.60s by the second half of this year as recent global jitters extend, and risk assets are repriced as major economies around the globe embark on their

exit strategies. A shakeout of the EURUSD towards 1.20 is a key feature. This is followed by a rebound in the NZDUSD towards the 0.70 area once again, as points of differentiation are sought by the currency market. In this respect, the NZD will stand out amongst other currencies, a large net external liability position notwithstanding.

While we do not foresee the kind of big swings in currency markets like the one seen during the global financial crisis, we still expect the NZD to be wobbly, particularly as the NZ economy navigates its way through the transition stage.

We expect the NZD to underperform the AUD in the year ahead, given relative growth and interest rate differentials. We forecast the NZDAUD to head towards 0.75 sometime this year.

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
Dec-08	0.58	0.82	52.5	0.40	0.41	56.2
Mar-09	0.56	0.81	55.4	0.39	0.42	57.3
Jun-09	0.65	0.80	62.2	0.39	0.46	61.3
Sep-09	0.72	0.82	64.9	0.45	0.49	65.4
Dec-09	0.72	0.81	67.2	0.45	0.50	66.3
Mar-10 (f)	0.72	0.78	66.2	0.44	0.51	65.5
Jun-10 (f)	0.71	0.76	63.9	0.43	0.49	63.8
Sep-10 (f)	0.69	0.75	62.8	0.42	0.48	62.5
Dec-10 (f)	0.68	0.76	62.6	0.41	0.48	62.2
Mar-11 (f)	0.67	0.77	63.0	0.40	0.48	62.1
Jun-11 (f)	0.66	0.78	62.7	0.40	0.48	61.8
Sep-11 (f)	0.64	0.76	62.1	0.38	0.47	60.4
Dec-11 (f)	0.64	0.78	63.4	0.38	0.47	61.0
Mar-12 (f)	0.65	0.81	65.0	0.38	0.48	62.3
Jun-12 (f)	0.65	0.83	65.0	0.38	0.49	62.9
Sep-12 (f)	0.66	0.86	66.7	0.38	0.50	64.3
Dec-12 (f)	0.66	0.86	67.3	0.38	0.51	64.6

INTEREST RATES

Central banking looks easy in 2010, in theory at least. If credit growth picks up, remove liquidity. If not, maintain the status quo. We expect the RBNZ to begin the journey back to a more neutral policy setting from mid-year. Rather than a straight line, we envisage two stages. We also foresee a structural shift lower in the neutral OCR which should result in a lower peak.

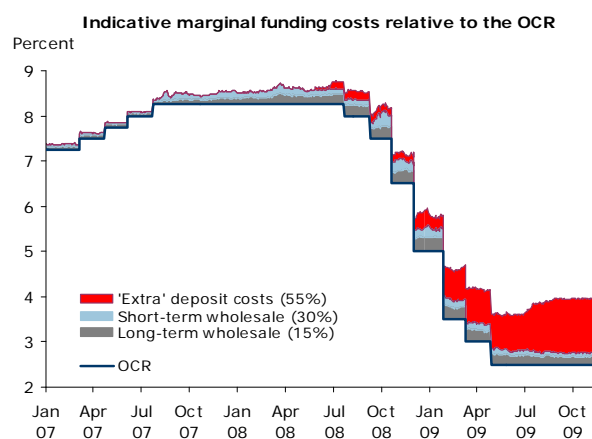
Back to neutral but how quickly?

With the economy out of recession, the need for record low interest rates has passed. The RBNZ flagged rate hikes from mid-2010, conditional on the economy continuing to recover. We believe this to be the case, although not in a straight line. We concur with the spirit although the market is divided on timing, magnitude and the endgame. There are three issues regarding the upcoming tightening cycle.

- > **In terms of the timing, we continue to favour a mid-year start.** The RBNZ has a balancing act in weighing up structural aspects of the recovery against soft leading indicators and hard actual data. Clearly the economy has less spare capacity than initially thought, judging by the elevated capacity utilisation reading from the latest QSBO. However, the recovery to date remains patchy and narrow. Retail spending looks to be picking up, but housing market activity is starting to turn the other way. Credit growth remains subdued, with no sign that business spending is starting to pick up. We're paying particular attention to labour market and credit growth trends and believe there will not be sufficient information from either to justify a move by April. For sure it's a risk, but not our central view. At present we wouldn't rule out a latter start to the cycle either (which no one is talking about in terms of tail risk) given global unease of late.
- > **There is a need to be assertive when you need to move.** For credibility as much as for other reasons, we believe the RBNZ needs to deliver at least one 50 basis points move and it's hard to fathom it happening latter on in the cycle. If the Bank was prepared to cut in 100 and 150 basis point clips on the way down, it has to show a willingness to deliver stern messages in the other direction. Of course, we are not advocating 100 basis point rate hikes. But with the starting point of the OCR well south of neutral, the strategy is to start strong, with a view of getting conditions back to more conventional levels. To do otherwise would appear to go against the lessons of 2 of the preceding 3 upswings when monetary policy

ended up behind the curve (the early 1990's and 2004, with 2000 the exception).

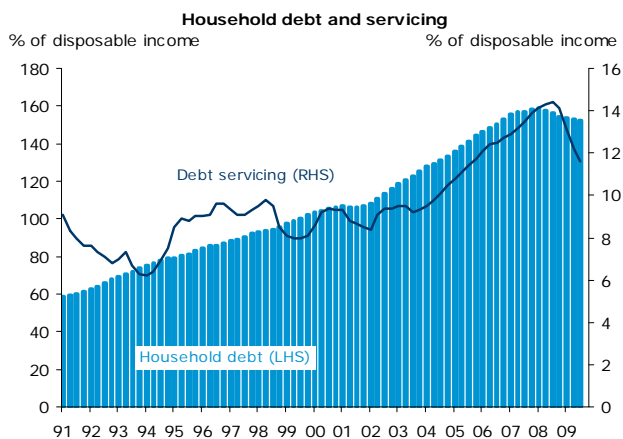
- > **The neutral OCR is lower, reflecting a structural shift in the pricing of risk around the globe which increases the cost of funds and keeps the yield curve steep.** Structural changes that will keep the spread between the OCR and lending rates wide include the RBNZ's new liquidity rules, as well as a reversal of the downward trend in lending margins to offset slower volume growth. At present we see the neutral OCR being closer to 5 percent as opposed to the commonly perceived or talked about 6 percent.



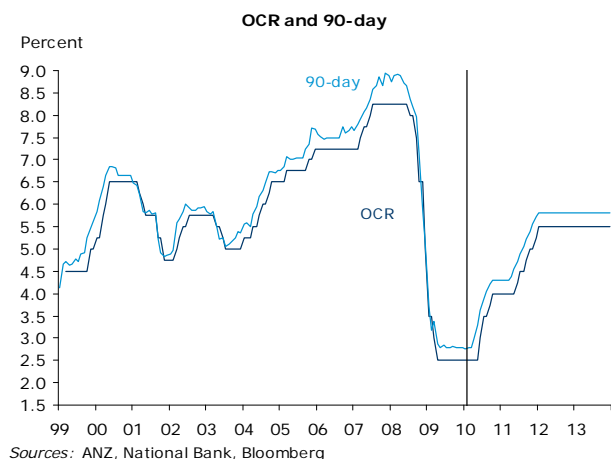
We are forecasting a staggered tightening cycle. We see the RBNZ kicking off with a couple of 50 basis point increase in June and July, thereafter moving in more measured 25 basis point increments towards 4 percent. We envisage a pause thereafter to assess the impact of the rate hikes, before embarking on another tightening cycle in mid-2011. Our staggered approach is based on the following view:

- > We doubt the economy can sustain a successive 250 basis points of tightening (taking the OCR to neutral straight away). The mortgage curve is steep, meaning there is nowhere for households to run. Despite a record low OCR, household debt servicing is still above historical averages. Policy tightenings will have a more immediate impact on household cashflows this time around, sending debt servicing higher.
- > In our view you don't want monetary policy to be too far away from neutral when structural changes are occurring which are pending from the Government. This doesn't mean you should rush to get there quickly either. Furthermore, any policy measures directed at curbing housing investment (which seems inevitable) are set to assist monetary policy somewhat. As the December *Monetary Policy Statement* noted, what policy action the Government takes "will affect how hard monetary policy has to

work to achieve price stability and potentially where the burden of adjustment falls."



- > Specific recommendations relating to residential investment property (such as removing tax depreciation on buildings, taxing returns based on a deemed risk-free rate, and imposing a low-rate land tax) have been put on the table by the Tax Working Group. As these have not been rejected outright by the Government, we may see some behavioural response occur, even if final decisions are still some way off. This will make it difficult for us (not to mention the RBNZ) to get our heads around the data as structural and cyclical forces interact over the coming years.



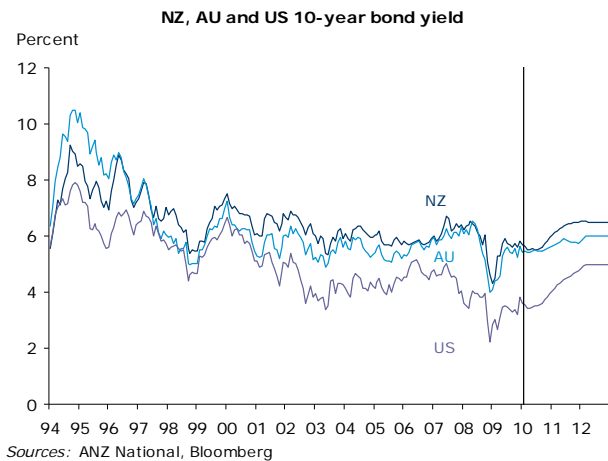
Internationally, we see this year as the year of the exit strategy. We'd couch central banks' reaction functions as one of simply watching credit growth. If it picks up, you can afford to drain liquidity. If not, you maintain supportive policy settings. Such is the reality of the interaction between the credit channel of monetary policy and traditional monetary channel in so far as prospects for recovery are concerned. You can't remove the latter without the former picking up the slack.

Already, we have seen rate hikes from the RBA last year, and more central banks are expected to follow suit. The People's Bank of China has already

moved to reduce stimulus by raising reserve requirements, raising the 1-year bill rate and directing certain banks to restrict new lending. And while the US Federal Reserve still intends to keep the fed funds rate at exceptionally low levels for an extended period, their quantitative easing policy is set to expire at the end of March and unlikely to be extended. Various other non-traditional measures the Fed employed are also being wound down.

The fiscal and regulatory side will also be crucial, particularly for long bonds. Central banks' inflation fighting credentials have not been severely dented despite record low interest rates and an unprecedented expansion of some of their balance sheets. Deteriorating fiscal positions around the world have not resulted in the re-emergence of the bond vigilantes, though attention is starting to turn to a few heavily indebted countries of late (Dubai, Greece). Eventually, ballooning public debt needs to be reined in. Credit rating agencies are starting to react, with S&P putting Japan's AA sovereign credit rating to "negative". The US is also seeking to start reining in their ballooning deficit, with proposals to freeze non-military discretionary spending for three years starting from FY2011. Yet, tighter regulation of the global financial system, while inevitable, risks going too far. In the G20's quest to ensure that we do not go back to "banking as usual", there is the potential for the goose that lays the golden egg to get cooked in the process, impeding the efficient allocation of capital and resulting in higher risk premiums.

In terms of our forecast of the long end, we see a gradual move higher as monetary policy globally returns towards normality. A key judgement is that major sovereigns will continue to be able to fund their deficits despite the end to quantitative easing, and that investors do not suddenly withdraw their appetite for bonds when interest rates start to rise. We expect NZ bonds to continue attracting strong interest, especially given the favourable fiscal position relative to other countries. However, the NZ-US bond spread is expected to remain wide, reflecting the global repricing of risk.



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	7.25	7.7	7.1	6.7	5.7	4.4	5.2
Dec-06	7.25	7.7	7.6	7.2	5.9	4.7	5.9
Dec-07	8.25	8.9	8.7	8.2	6.4	4.0	6.3
Dec-08	5.00	5.1	4.3	4.7	4.6	2.2	4.0
Mar-09	3.00	3.4	3.7	4.9	5.3	2.7	4.4
Jun-09	2.50	2.8	3.8	5.3	5.9	3.5	5.5
Sep-09	2.50	2.8	4.3	5.5	5.6	3.3	5.4
Dec-09	2.50	2.8	4.6	5.6	5.8	3.8	5.6
Mar-10 (f)	2.50	2.8	4.5	5.4	5.5	3.4	5.4
Jun-10 (f)	3.00	3.6	4.7	5.5	5.5	3.5	5.5
Sep-10 (f)	3.75	4.2	5.0	5.6	5.6	3.6	5.5
Dec-10 (f)	4.00	4.3	5.2	5.9	6.0	4.0	5.6
Mar-11 (f)	4.00	4.3	5.3	6.1	6.2	4.3	5.8
Jun-11 (f)	4.25	4.7	5.6	6.4	6.4	4.5	5.9
Sep-11 (f)	4.75	5.2	6.0	6.6	6.5	4.6	5.8
Dec-11 (f)	5.25	5.7	6.2	6.7	6.5	4.8	5.8
Mar-12 (f)	5.50	5.8	6.3	6.7	6.6	5.0	6.0
Jun-12 (f)	5.50	5.8	6.3	6.7	6.5	5.0	6.0
Sep-12 (f)	5.50	5.8	6.3	6.7	6.5	5.0	6.0
Dec-12 (f)	5.50	5.8	6.3	6.7	6.5	5.0	6.0

ECONOMIC FORECASTS

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Real Gross Domestic Product												
Total GDP, QPC	-0.9	0.2	0.2	0.9	0.5	0.6	0.6	0.5	0.7	0.9	1.8	0.4
Total GDP, APC	-3.0	-2.1	-1.3	0.5	1.8	2.2	2.6	2.2	2.4	2.7	4.0	3.9
Total GDP, AAPC	-1.4	-2.1	-2.2	-1.5	-0.3	0.8	1.8	2.2	2.4	2.5	2.8	3.3
Real GDP Components												
Private Consumption, QPC	-1.2	0.4	0.7	0.9	0.5	0.5	0.3	0.3	0.4	0.5	1.2	0.3
Private Consumption, AAPC	-1.1	-1.4	-1.3	-0.7	0.5	1.4	2.1	2.3	2.0	1.7	1.8	2.0
Public Consumption, QPC	0.4	-1.5	0.4	0.5	0.6	0.6	0.6	0.3	0.4	0.4	1.0	0.5
Public Consumption, AAPC	4.2	3.0	2.4	1.2	0.4	0.7	1.0	1.6	2.1	2.0	2.0	2.0
Residential Investment, QPC	-0.5	-2.3	-5.0	1.5	5.0	6.0	6.0	3.0	4.0	4.0	6.0	2.0
Residential Investment, AAPC	-22.7	-24.9	-25.3	-19.8	-13.2	-5.7	4.7	11.6	17.2	19.9	19.4	18.3
Other Investment, QPC	-6.5	-0.4	-0.9	1.3	0.9	0.3	0.3	0.5	2.1	3.3	1.4	1.6
Other Investment, AAPC	-0.9	-7.5	-10.1	-10.6	-8.2	-3.8	-0.5	1.7	2.3	3.5	4.7	6.4
Gross National Expenditure, QPC	-2.9	-1.9	0.5	2.4	1.5	0.8	0.7	0.6	1.0	1.3	1.5	0.5
Gross National Expenditure, AAPC	-1.9	-4.3	-5.7	-5.5	-3.5	-0.2	2.8	4.2	4.4	4.0	3.7	3.9
Exports, QPC	0.8	4.7	0.0	-0.2	1.0	0.9	0.9	0.9	1.0	1.4	2.8	1.1
Exports, AAPC	-3.1	-3.7	-3.2	0.2	3.1	3.6	3.7	3.3	2.9	3.5	4.5	5.2
Imports, QPC	-8.2	-2.4	0.7	3.0	3.9	1.6	1.3	1.4	1.9	3.2	2.5	1.7
Imports, AAPC	-4.6	-12.6	-16.5	-16.1	-10.8	-2.7	4.1	8.3	8.6	8.2	8.0	8.3
Prices												
Headline CPI, QPC	0.3	0.6	1.3	-0.2	0.2	0.7	0.9	0.8	0.5	1.0	0.8	0.5
Headline CPI, APC	3.0	1.9	1.7	2.0	1.9	2.0	1.6	2.7	3.0	3.3	3.1	2.9
Non-tradable CPI, QPC	0.7	0.5	1.0	0.1	0.5	0.5	0.7	0.6	0.7	0.9	1.0	0.8
Non-tradable CPI, APC	3.8	3.3	3.0	2.3	2.1	2.2	1.9	2.4	2.6	2.9	3.2	3.4
Tradable CPI, QPC	-0.4	0.8	1.6	-0.5	-0.2	1.0	1.2	1.0	0.2	1.1	0.5	0.2
Tradable CPI, APC	1.7	0.2	-0.1	1.5	1.7	2.0	1.6	3.1	3.5	3.6	2.9	2.0
External Accounts												
Annual Balance on Goods, % of GDP	-0.7	0.4	1.2	1.7	1.7	1.8	1.9	1.9	1.9	1.6	1.2	0.8
Annual Balance on Services, % of GDP	-0.6	-0.5	-0.4	-0.1	0.0	0.0	0.0	0.0	0.0	0.1	0.4	0.6
Annual Balance on Invisibles, % of GDP	-6.6	-5.4	-4.0	-3.3	-3.0	-3.4	-4.2	-4.3	-4.3	-4.4	-4.6	-4.7
Annual Current Account Balance, % of GDP	-7.8	-5.5	-3.2	-1.8	-1.3	-1.7	-2.4	-2.4	-2.4	-2.7	-2.9	-3.3
Net International Invt Position, % of GDP	-94.5	-93.3	-93.7	-92.8	-92.1	-90.9	-89.8	-88.8	-88.2	-87.8	-87.2	-86.7
Terms of Trade (SNA basis)												
Export Prices, QPC	-3.9	-9.5	-5.3	1.9	3.8	3.2	3.0	1.8	0.9	0.9	1.8	0.4
Export Prices, APC	8.2	-4.1	-13.2	-15.9	-9.3	3.4	12.4	12.3	9.2	6.8	5.5	4.1
Import Prices, QPC	-2.4	-4.1	-7.3	-1.4	1.7	1.6	2.5	1.4	0.8	0.9	1.9	0.5
Import Prices, APC	17.9	6.2	-7.9	-14.5	-10.9	-5.6	4.4	7.4	6.5	5.7	5.1	4.1
Terms of Trade, QPC	-1.5	-5.6	2.2	3.3	2.1	1.6	0.5	0.4	0.1	0.1	-0.1	-0.1
Terms of Trade, APC	-8.2	-9.7	-5.8	-1.7	1.8	9.6	7.7	4.6	2.5	1.0	0.4	0.0
Labour Market												
Employment, QPC	-1.4	-0.4	-0.7	-0.1	0.0	0.1	0.3	0.4	0.5	0.5	0.5	0.4
Employment, APC	0.7	-0.9	-1.8	-2.5	-1.2	-0.7	0.3	0.8	1.3	1.7	1.9	1.9
Labour Force, QPC	-1.0	0.7	-0.2	0.3	0.1	0.3	0.2	0.3	0.4	0.4	0.3	0.5
Labour Force, APC	2.0	1.2	0.6	-0.3	0.9	0.5	0.9	1.0	1.3	1.4	1.5	1.6
Unemployment Rate, sa	5.0	6.0	6.5	6.8	7.0	7.1	7.1	7.0	6.9	6.8	6.7	6.7
Participation Rate, sa	68.3	68.4	68.0	67.9	67.7	67.6	67.6	67.6	67.7	67.8	67.8	67.9
Private Sector Wages (apc)	5.1	3.7	4.4	4.0	3.2	2.7	1.4	1.4	1.6	1.8	2.0	2.2
Public Sector Wages (apc)	4.2	5.6	5.9	5.6	3.8	3.6	1.7	1.8	1.5	1.5	1.4	1.5

Forecast in bold

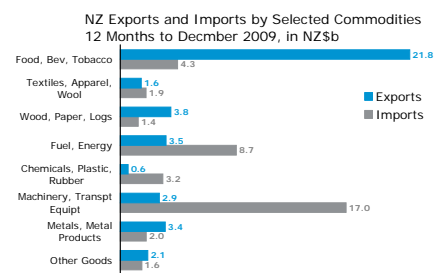
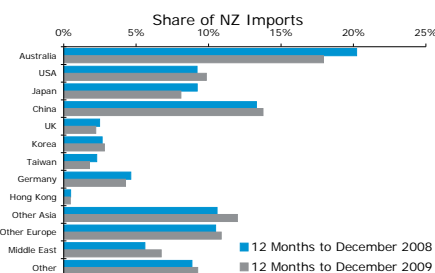
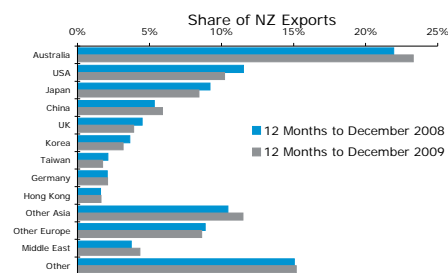
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

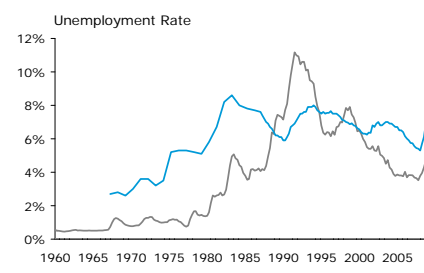
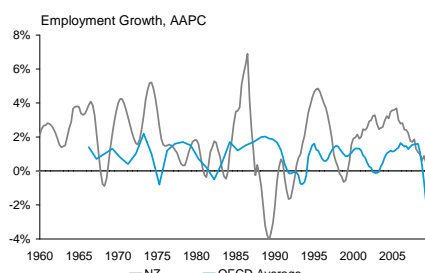
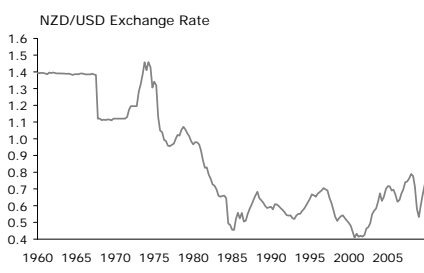
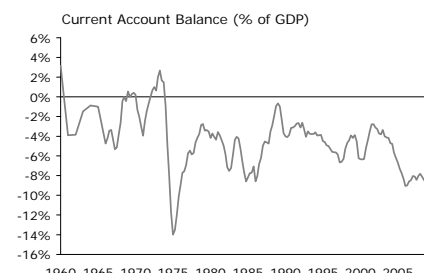
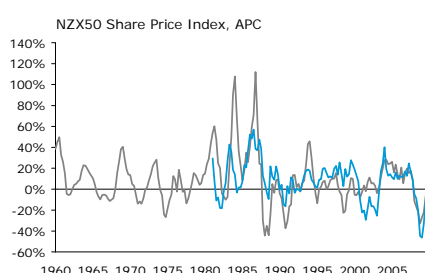
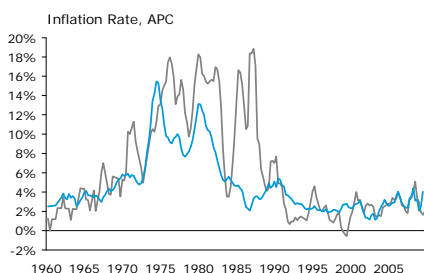
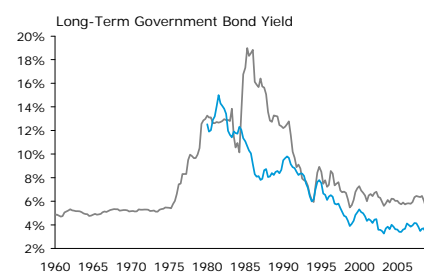
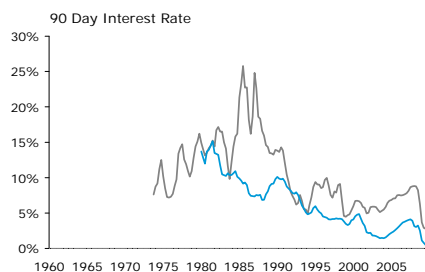
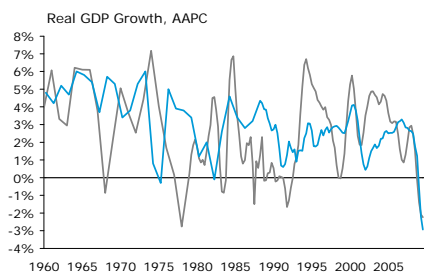
sa – seasonally adjusted

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	4.3	22.1	308.6	127.7	61.3	1,368	82.1	51.4	22.9	25.7	7.1	4.6	257.7
Area in 1,000 km ²	271	7,713	9,373	378	244	9,561	357	92	36	330	1	1	1,905
Inhabitants per km ²	15.7	2.9	32.9	338.0	251.1	143.1	230.2	557.5	636.1	77.9	7,130	4,600	135.3
GDP, in billion NZ\$	185	1,573	21,951	7,497	4,129	6,937	5,619	1,458	601	342	330	276	807
Change in real terms (year-on-year %)	-2.2	0.6	-2.9	-5.9	-4.5	7.5	-4.8	-2.3	-6.1	-2.8	-4.1	-4.2	4.5
Nominal GDP per capita in NZ\$	43,326	67,425	68,943	50,113	68,361	4,145	59,722	30,364	24,345	10,499	44,306	52,308	3,124
NZ exports to ..., in million NZ\$ (FOB)	n/a	9,995	4,382	3,613	1,672	2,534	895	1,358	752	949	700	863	1,006
Share of NZ Exports (%)	n/a	23.3	10.2	8.4	3.9	5.9	2.1	3.2	1.8	2.2	1.6	2.0	2.3
NZ imports to ..., in million NZ\$ (VFD)	n/a	8,098	4,449	3,653	1,002	6,214	1,931	1,269	806	1,696	203	2,260	1,048
Share of NZ Imports (%)	n/a	17.9	9.8	8.1	2.2	13.8	4.3	2.8	1.8	3.8	0.4	5.0	2.3
Current Account balance as a % of GDP	-3.1	-2.9	-3.8	2.4	-2.0	8.2	4.4	2.9	8.2	18.4	14.8	12.0	0.8



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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