

## SUMMARY OF ECONOMIC FORECASTS

Calendar Years	Actual	Actual	Forecast				
	2005	2006	2007	2008	2009	2010	
Page 3	<b>NZ Growth and Employment (annual average percent changes)</b>						
	Real GDP	2.2	1.5	2.3	1.3	2.8	3.4
	Employment	2.8	2.1	1.3	0.2	0.9	1.6
	Unemployment Rate (Dec qtr)	3.6	3.7	4.1	4.3	4.5	4.5
Page 6	<b>Global Growth (annual average percent changes)</b>						
	US	3.2	3.3	2.2	3.0	3.2	3.2
	Australia	2.8	2.7	4.0	3.8	3.7	3.1
	Japan	1.9	2.2	2.4	1.9	2.1	1.9
	Trading Partners	3.3	3.7	3.7	3.6	3.7	3.5
Page 8	<b>NZ Inflation (annual percent changes)</b>						
	CPI Inflation	3.2	2.6	2.5	2.8	2.4	2.5
	Non-tradable Inflation	4.3	3.8	4.2	3.8	3.3	3.2
	Tradable Inflation	1.7	1.2	0.5	2.0	1.7	1.4
Page 9, 12	<b>NZ Financial Markets (December quarter averages)</b>						
	TWI	71.5	67.1	69.3	62.8	61.8	63.8
	NZD/USD	0.69	0.67	0.70	0.62	0.60	0.62
	Official Cash Rate	7.0	7.3	8.0	7.8	6.5	6.5
	90-day bank bill rate	7.5	7.6	8.2	7.8	6.7	6.7
	10-year bond rate	5.9	5.8	6.6	6.8	6.6	5.9
	<b>Other Information</b>						
	Current Account Balance (\$m)	-13,900	-14,500	-13,000	-13,100	-13,800	-14,800
	as % of GDP	-9.0	-9.0	-7.5	-7.3	-7.3	-7.4
Page 7	Govt. Operating Balance (\$m)*	6,200	11,500	6,300	6,000	5,500	5,500
	as % of GDP	4.1	7.3	3.8	3.4	3.0	2.8

Forecasts and text finalised 6 July 2007

\* June years

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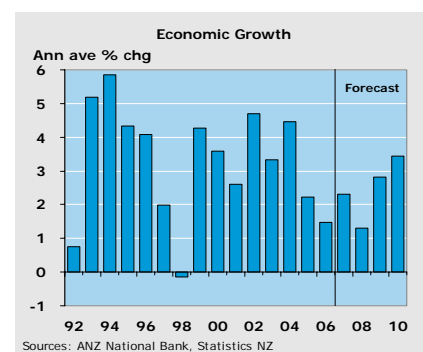
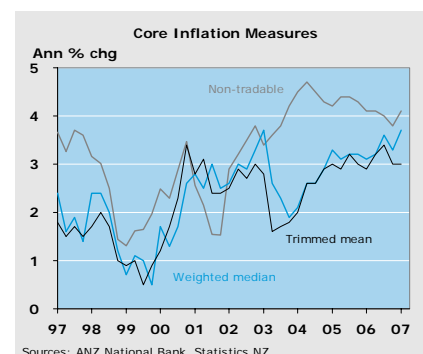
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## SUMMARY

- **Inflationary pressure remains the key theme shaping the business cycle**, necessitating a sustained period of slower growth. Two years of 2 percent growth has failed to alleviate inflation pressure, implying the next leg of the business cycle needs to be a step lower if inflation is going to recede.
- **We are in no doubt the Reserve Bank will engineer the required slowdown** despite countering impetus from the massive surge in the dairy payout and fiscal spending, with the latter likely to ramp up in the 2008 *Budget*. With core inflation measures running at around 3 percent, there is no inflation headroom to let the economy continue to run unchecked. Policymakers invariably win.
- **Financial conditions are now flagging a material slowdown in growth**. The Reserve Bank has raised the Official Cash Rate (OCR) three times, and the NZ dollar is at all time highs. While surging commodity prices are providing an offset, financial conditions are now consistent with growth of 1½ percent in 12 months.
- **The economy looks to be rolling gradually**. Consumer confidence has eased and migration flows have moderated. Business confidence is off its peak and retail spending is moderating. Countering this is considerable impetus from fiscal spending and exuberance associated with the uplift in the dairy payout that could elongate the cycle.
- **We expect two more years of below-trend growth performance in order to alleviate the imbalances facing the economy**. Economic growth is forecast to rise to 2.3 percent in calendar 2007, then ease to 1.4 percent in 2008 before rebounding thereafter.
- **The economic story at present is one of vulnerability**. Provided the global environment remains strong, a benign end to the business cycle can be expected. However, any change in global sentiment, and all bets are off.
- **Against this backdrop, we remain bullish on long-term prospects** given a structural uplift in commodity prices, which are expected to see New Zealand's terms of trade continue to increase over time.
- **Raising productivity growth is the major issue for the economy**. A sustained deterioration in productivity growth since 2000 is adding persistence to the inflationary undercurrent, necessitating higher interest rates for longer. It also threatens to undermine the economic opportunity being provided by a structural uplift in the terms of trade.
- **We do not expect to see interest rates head higher again**, despite potentially unwelcome inflation news over the coming month. The yield curve is now working more in the Reserve Bank's favour. Fixed lending rates are at 9 percent, and the NZD is undermining 70 percent of exporters not insulated by strong commodity prices. However, the risk profile for rates remains skewed to the upside.
- **We expect the easing cycle to take place from late 2008, and to be aggressive** as the longer lags in the monetary policy transmission channel works both ways.
- **We continue to look for an aggressive move in the NZD when the economy turns**, although a weaker USD and JPY continue to uplift the starting point. The NZD is defying forecasters in a similar fashion to 2000, when it was reciprocally weak. We struggle to see the economy remaining strong for another six months given where financial conditions reside and despite strong commodity prices. This errs us towards an earlier correction in the NZD relative to the consensus.



## ECONOMIC OUTLOOK – A GREATER GROWTH SACRIFICE REQUIRED

*Our forecasts have built in the fabled soft landing for the economy, although qualitatively we remain circumspect over how this business cycle will unfold. In an environment where inflation is persistent, it seems inevitable that growth will be sacrificed, and policymakers have only a blunt instrument at their fingertips.*

**The economy has picked up momentum after a soft patch in the middle of last year.** Growth rebounded in the final quarter of 2006, increasing by 0.8 percent. Activity accelerated further in the March 2007 quarter, expanding by 1.0 percent and lifting year-on-year growth to 2.5 percent. Partial data point to the momentum in economic activity continuing into the middle of this year, though not at the same pace as in previous quarters.

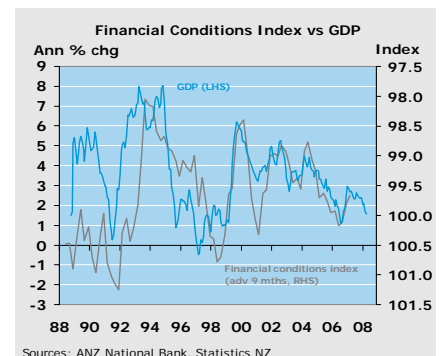
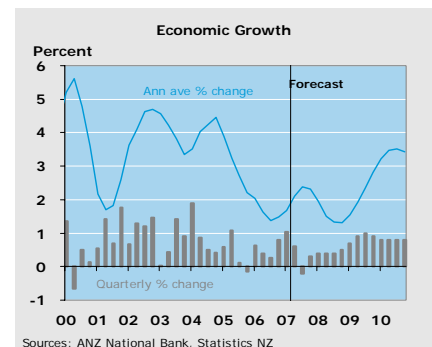
**Inflation pressure remains the key theme shaping the business cycle and necessitates a sustained period of slower growth.** Two years of 2 percent growth has so far failed to tame inflationary pressures. Recent economic momentum has placed more upward pressure on inflation. Non-tradable inflation accelerated to 1.2 percent in the March quarter from 0.8 percent previously, taking the annual rate back above 4 percent. Our travels around the country continue to highlight a worrying inflation undercurrent. Across the CPI regimen, price increases are becoming more prevalent, particularly in the services sectors, which have a high labour content.

**The economy remains capacity constrained,** with the unemployment rate residing at 3.8 percent, productivity growth weak, and capacity utilisation running high. Such forces are restraining the ability of the economy to expand strongly without generating more inflation pressure.

**Financial conditions have tightened considerably and are pointing towards a slowdown in growth.** This is courtesy of the three OCR hikes delivered by the Reserve Bank this year, increased mortgage lending rates and NZD at record high levels. While surging commodity prices and still elevated house price growth are providing an offset, financial conditions are consistent with growth of 1½ percent in 12 months time.

**Although it is early days, the momentum looks to be moderating gradually.** Consumer confidence has fallen and is no doubt a result of the recent increases in mortgage rates. Net migration inflows have eased further and will continue to provide less impetus to the housing market. Retail spending has slowed after a bumper March quarter. Business confidence fell dramatically, then rebounded but remains consistent with 1½ percent growth. Anecdotally, the nuances are starting to turn decidedly more bearish.

**Against this backdrop, there are strong forces that will support the economy.** Global demand remains strong across our trading partners, excluding housing related softness in the US. Rising world dairy prices have enabled Fonterra to revise up its 2007/08 season forecasted payout considerably, providing a significant boost to farmers' incomes. With dairy prices rising further, a payout in excess of \$6/kg of milk solid looks likely. In addition, there is a strong likelihood of more expansionary fiscal policy from the Government next year. The 2007 *Budget* revealed a larger fiscal impulse in 2007/08 than initially flagged late last year. Even if the cost of the KiwiSaver enhancements are excluded, there is still a sizeable fiscal impulse to the tune of 1.6 percent of GDP at a time when inflation is expected to head towards the upper range of the policy target band. With an election looming in 2008, the reality is that further fiscal stimulus will be on the cards, particularly if the Government finds itself behind in the political polls.



**Our quantitative forecasts include a relatively benign soft landing for the economy,** before rebounding thereafter courtesy of a weaker currency. Households bare the brunt of the adjustment with consumption growth easing substantially courtesy of tighter monetary policy and moderating wealth gains from the property market. Part of the strong consumption growth in recent years has been debt-funded, backed by rising house prices. Going forward, we expect household appetite for further debt to wane in the face of higher servicing costs.

**The recent run-up in the currency is expected to weaken export performance, but the impact varies across the export sector.** The dairy sector is on fire and tourism numbers have so far held up well, although average spend is easing. Looking forward, we expect tourism numbers to show their normal six month response to the currency, which implies a subdued summer peak season. There is genuine stress in the meat industry, although strong balance sheets are providing support. Seafood and horticulture are struggling. Forestry sector activity is slowing after a good first half of the year.

**Manufacturing exporters are expected to bear the full brunt of the high currency.** Though imported raw materials are cheaper, the currency will further erode exporters' margins, which are already coming under pressure from rising domestic input costs – courtesy of higher wage and compliance costs. With a strong global backdrop, demand for New Zealand's manufacturing exports will remain firm. But increased third party competition and falling profits mean manufacturing exports will remain subdued for most of this year and part of next year, with a rebound only from late-2008 courtesy of the lagged effect of a depreciating currency. We expect the high currency to accelerate relocation plans to Asia.

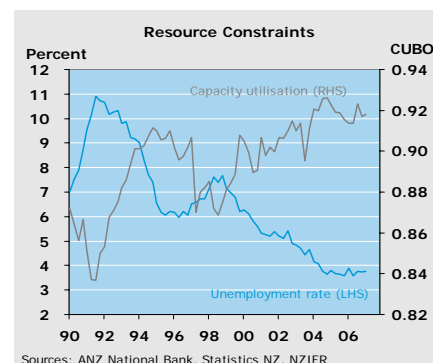
**With corporate profits coming under pressure (from costs), business investment will remain weak as firms shelve investment plans.** We are forecasting declining business investment over the second half of this year as the focus goes on cost containment across corporate New Zealand. We expect the cost focus to eventually shift to the labour market, resulting in the unemployment rate rising towards 4.5 percent.

**Our central forecasts depict a gradual and orderly adjustment in the economy, where the imbalances slowly unwind.**

**However, qualitatively, we harbour some concerns over how this business cycle will unfold.** Fabled soft landings do not curb inflation. We have already had two years of 2 percent growth! The Governor repeatedly refers to an adjustment that needs to happen in order to tame inflation and restore some balance to growth. Such adjustments are seldom voluntary, and seldom "soft". The Reserve Bank is clearly on the inflation warpath: this economy will slow, and touch-wood without having to hike rates again. If fiscal policy and dairy related exuberance look set to prolong the cycle, up will go rates again. Global investors – by bidding up the NZD – are bashing the export sector into submission. Have we become that much smarter over the past ten years that earnings multiples and leverage can be sustained at much greater levels? We suspect not and it all leaves us coy over how the fabled soft landing is to be achieved.

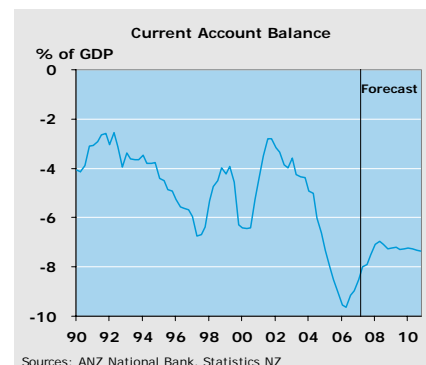
**Domestically, we remain wary of the housing market, which is the central bank's key focal point.** Household debt servicing as a share of income stands at 13.3 percent and continues to rise. To put this in perspective, it was 8.1 percent at the end of 1999 – the last time the property market was weak. There is now around 120 basis points of policy tightening in the pipeline for mortgages rolling off over the coming year. Of course, there are numerous positives supporting growth such as dairy prices, fiscal policy and infrastructure spending. But the additional impetus from such areas will merely intensify the adjustment necessary via the housing market and that blunt OCR instrument. A currency induced boost to the export sector did not stop a domestic recession in 2000.

**The real issue facing New Zealand at present is one of vulnerability.** The combination of a low savings rate, high housing leverage, mammoth



### Key Assumptions

- Oil prices (Dubai) remain stable at between US\$66 to US\$68 per barrel in the near term before declining towards US\$58.
- Trading-partner growth returns to trend of 3½ to 3¾ percent over the next few years.
- Net migration remains at current levels of 12,000 per annum.
- Current cyclical potential growth around 2 to 2½ percent, but longer term potential still around 3 percent.



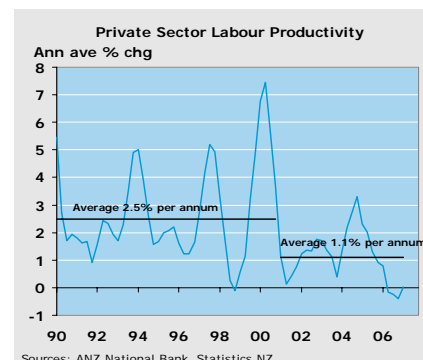
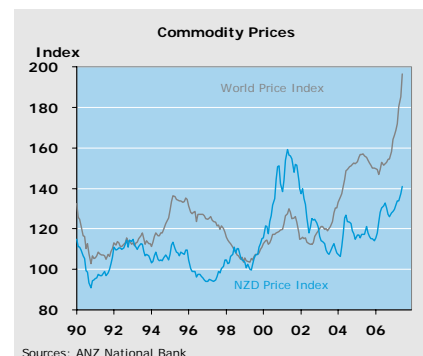
current account deficit and high asset valuations leave the economy vulnerable to a change in sentiment or some sort of event. As forecasters we find it difficult to include an “event” in our core view (although we can identify some candidates such as derivative leverage and the US subprime market). However, as history buffs, we know they tend to occur, and roughly every 8 years. **From a business planning perspective, it’s a message of being prudent and conservative.**

**Against this backdrop, we remain bullish on long-term prospects.**

Rising per capita incomes in Asia will underpin soft commodity demand, and a surfeit of manufacturing capacity will cap the price we pay for imported products. Watch for a baby-boomer and Asia related boost to tourism. Let’s not forget about the rugby world cup in 2011, lower taxes (touchwood), and huge amounts of domestic oil and gas exploration activity. A positive spin can be placed on the pending cyclical downturn given that it is already forcing consolidation across some industries, including finance companies and potentially the meat industry. Businesses will respond to moderating growth by focusing more on productivity growth.

**This optimism comes with a caveat.** There are some signs of difficulty with the supply side of the economy that could restrain New Zealand’s ability to either take advantage of favourable medium-term trends or remain a strong performing economy. Productivity growth in the market sector has dropped from an average of 2.5 percent in the 1990’s to 1.1 percent since 2001. Business investment, which declined throughout late 2005 and most of 2006, has not responded to capacity constraints as expected, nor has the relative demand for labour and capital to changes in the price of both. Put simply, there seem to be frictions that are restraining the free-flow of labour and capital to pricing signals. Moreover, they are playing a role in keeping inflation elevated, necessitating tighter monetary policy for longer, and of course the stronger currency in the near-term, and a greater growth sacrifice. Everyone loses. It is easy to identify candidates for such frictions including the massive growth in regulation, changes to labour market legislation and the role uncertainty is having on business investment decisions (via the time value of waiting option).

Such issues need to be critically addressed and debated, and should be a key part of discussions at the upcoming inquiry of the monetary policy framework by the Finance and Expenditure Committee.



## THE NATIONAL ACCOUNTS

Annual average % change Calendar Years	Actual 2005	Actual 2006	Forecast			
			2007	2008	2009	2010
<b>Total Consumption</b>	<b>4.6</b>	<b>2.8</b>	<b>3.7</b>	<b>1.3</b>	<b>1.9</b>	<b>2.6</b>
Private Consumption	4.7	2.3	3.7	0.5	1.3	2.3
Public Consumption	4.2	4.8	3.7	4.4	3.6	3.4
<b>Total Investment</b>	<b>3.6</b>	<b>-2.5</b>	<b>4.9</b>	<b>2.0</b>	<b>5.4</b>	<b>6.1</b>
Residential investment	-4.2	-2.7	1.6	-1.1	1.5	3.4
Other investment	6.0	-2.4	5.8	2.8	6.4	6.7
<b>Stockbuilding<sup>1</sup></b>	<b>-0.3</b>	<b>-0.8</b>	<b>0.4</b>	<b>0.2</b>	<b>0.0</b>	<b>0.0</b>
<b>Gross National Expenditure</b>	<b>4.1</b>	<b>0.7</b>	<b>4.2</b>	<b>1.7</b>	<b>2.7</b>	<b>3.5</b>
<b>Total Exports</b>	<b>-0.5</b>	<b>1.9</b>	<b>2.1</b>	<b>3.0</b>	<b>5.2</b>	<b>6.1</b>
Goods	0.2	3.1	2.3	1.9	4.0	5.7
Services	-2.7	-1.2	2.0	5.9	8.9	7.1
<b>Total Imports</b>	<b>5.5</b>	<b>-2.5</b>	<b>8.1</b>	<b>3.9</b>	<b>4.7</b>	<b>5.8</b>
Goods	4.8	-1.7	8.4	4.5	5.9	6.1
Services	7.7	-5.2	5.7	1.1	0.1	4.5
<b>Expenditure on GDP</b>	<b>2.6</b>	<b>1.9</b>	<b>2.3</b>	<b>1.3</b>	<b>2.8</b>	<b>3.4</b>
<b>GDP (production based)</b>	<b>2.2</b>	<b>1.5</b>	<b>2.3</b>	<b>1.3</b>	<b>2.8</b>	<b>3.4</b>

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

## GLOBAL OUTLOOK – THE US HAS SLOWED BUT ELSEWHERE LOOKING SOLID

*Despite a slowing in the US economy, the outlook for trading partner growth remains solid courtesy of the Asian region. Strong global demand is expected to maintain central banks' bias towards higher interest rates.*

**Trading partner growth remains solid, despite a housing market led slowdown in the US.** Trading partner growth is expected to remain at 3.7 percent in 2007, following similarly strong growth in 2006. Beyond that, we expect growth of between 3½ to 3¾ percent, which will underpin firm demand for New Zealand's exports.

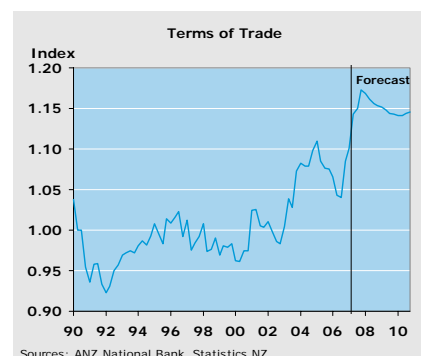
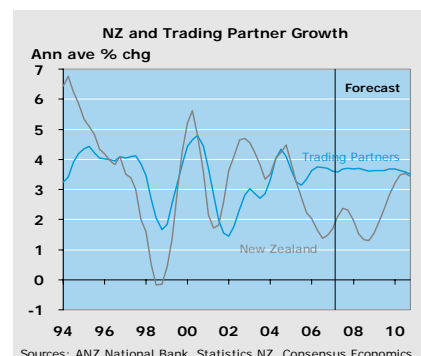
**Australian growth is expected to rebound strongly in 2008, once the drought effect has worked its way through.** The outlook for the Euro-Zone economy remains positive, and UK growth has surprised on the upside. Even Japan is expected to post reasonable growth this year.

### The US economy has slowed, but inflation pressures persist.

Annualised GDP growth in the March quarter slowed to its lowest level in four years. A considerable slump in the housing market is clearly weighing, with residential investment contracting strongly. However, growth looks likely to rebound in the June quarter as business investment recovers and consumers show little signs of cutting back spending in the face of slowing house price growth. Despite the slowing in economic growth, inflationary pressures remain elevated due to high capacity utilisation and a tight labour market. The Federal Reserve has stated that inflation remains their predominant concern and the market now appears to be reassessing their expectation of the next interest rate move. After having as much as three interest rate cuts priced in before the end of the year at one stage, the market now believe rates will remain on hold for the rest of this year.

**A strong Chinese economy continues to fuel growth in the Asian region.** However, rising inflationary pressures are raising concerns that the Chinese economy may be overheating. The Chinese authorities have increased interest rates, allowed the Yuan to appreciate further and used more administrative controls in an attempt to prevent over-investment. Strong demand out of China for commodities will continue to provide support for prices of New Zealand's main export commodities. Continued supply disruptions in other key markets mean that the favourable demand-supply balance will continue to favour higher prices over the near-term.

**Although global imbalances remain, persistent inflation and rising protectionism are the biggest risks going forward.** The reluctance of many of the surplus economies to allow their currencies to appreciate has allowed the global imbalances to fester for longer. As a result, the threat of growing protectionist policies is posing a risk to global growth. Persistent inflationary pressures among developed economies, courtesy of tight labour markets, high capacity utilisation and rising commodity prices, mean that the global tightening cycle still has some way to run. This is likely to see some heightened volatility across financial markets over the year.



## GLOBAL ECONOMIC GROWTH

Annual average % change Calendar Years	Actual	Actual	Forecast			
	2005	2006	2007	2008	2009	2010
United States	3.2	3.3	2.2	3.0	3.2	3.2
Australia	2.8	2.7	4.0	3.8	3.7	3.1
Japan	1.9	2.2	2.4	1.9	2.1	1.9
Euro Zone	1.5	2.8	2.3	2.1	2.1	2.1
China	10.2	10.7	10.2	9.6	9.0	8.5
<b>Trading Partner Growth</b>	<b>3.3</b>	<b>3.7</b>	<b>3.7</b>	<b>3.6</b>	<b>3.7</b>	<b>3.5</b>

## FISCAL POLICY – NO REAL SURPRISES IN 2007, BUT JUST WAIT FOR 2008

*Dr Cullen continues to run a prudent fiscal line. With 2008 being an election year, the risk of a more expansionary fiscal policy is large, which will have the Reserve Bank on notice, although short-term monetary policy considerations should never stand in the way of good policy. The overall fiscal position is expected to remain healthy.*

**The Government's accounts continue to show a state of strength.** Strong economic performance continues to fill the Government's coffers, with the Government hoarding an operating surplus of around 3.8 percent of GDP for 2006/07 and flagging strong surpluses over the next few years in the 2007 *Budget*. Strong surpluses are giving the Government considerable flexibility to meet policy objectives and deliver on priority areas including health, assisting families, savings and infrastructure.

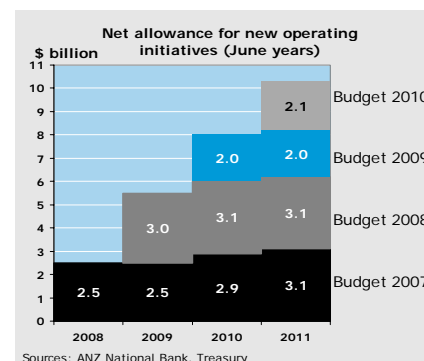
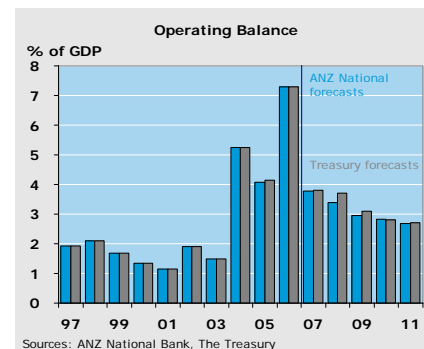
**The Reserve Bank is wary of additional government spending** with recent rhetoric highlighting fiscal policy as a key risk to the medium-term inflation outlook. The Government faces a difficult trade-off in avoiding putting more pressure on monetary policy but at the same time not be seen to be hoarding a large fiscal surplus.

**But short-term monetary policy considerations should never stand in the way of good policy.** We were encouraged by the strong focus on savings in the 2007 *Budget*, a cut to the corporate tax rate, and tax based initiatives for Research and Development expenditure. We view KiwiSaver-based incentives as a welcome move. The Government also committed an additional \$0.6 billion to capital spending. Against this backdrop, there was a disconcerting lack of substance in regard to improving productivity growth. There was certainly a lot of talk, but we struggled to find anything concrete. As noted on page 5, current inflationary difficulties look to be supply as opposed to demand induced, requiring policymakers' attention.

**Odds of a large election year lolly scramble in 2008 are rising.** The election may be over a year away, but with the Government behind in the polls, the pressure is building. If the KiwiSaver and Business Tax Reform packages in this year's *Budget* do nothing to improve the Government's popularity, then it seems inevitable we are set for a large fiscal stimulus next year, particularly with tax shaping up as a key election issue. Prospects for additional loosening of the fiscal reins will be one factor keeping the Reserve Bank biased towards higher interest rates.

**Despite more spending, stronger than expected forecast tax revenues see the fiscal accounts still in strong shape,** with an operating surplus of 3.4 percent of GDP expected for 2007/08 and 3.0 percent of GDP in 2008/09. We expect operating surpluses in the vicinity of 2¾ to 3 percent of GDP to continue over the forecast period.

**The Government accounts continue to be a saving grace for New Zealand's credit rating.** Given the level of imbalances facing the economy and the period of slower economic growth ahead, the healthy state of the fiscal accounts continues to be the one major factor supporting the country's current strong credit rating.



### BALANCING THE BOOKS

June Years	Actual			Forecast		
	2006	2007	2008	2009	2010	2011
Operating Balance (\$m)	11,500	6,300	6,000	5,500	5,500	5,500
- as % of GDP	7.3	3.8	3.4	3.0	2.8	2.7
Net Crown debt (\$m)	7,700	5,000	4,500	5,500	6,600	6,600
- as % of GDP	4.9	3.0	2.6	3.0	3.4	3.2
Bond Tender Programme (\$m)	2,400	2,500	2,500	2,500	2,500	2,500

## INFLATION – A WORRYING UNDERCURRENT

*Inflation is becoming broader-based. Non-tradable inflation has accelerated while other core inflation measures remain elevated. We expect softer demand to dampen inflation pressure, although a degree of stickiness will persist in response to traditional cost-push forces.*

**The latest data highlights that inflation is becoming broader based and more than purely a housing phenomenon.** Annual headline inflation eased to 2.5 percent in the March quarter, the lowest level since September 2004. However, non-tradable inflation accelerated back over 4 percent. This increase was not due to a single or few items recording large price increases. Rather, it was the upward creep in the price of most items. This portends of a clear inflationary undercurrent and confirms that the housing market can no longer be the sole scapegoat for high inflation.

#### Other core measures of inflation remain stubbornly elevated.

The weighted median inflation measure rose to 3.7 percent in the March quarter, the highest since 2002. Capacity pressures remain prevalent throughout the economy. More alarmingly, cost-push inflation appears to be re-exerting itself in the services sector, as unit labour costs continue to surge higher.

**The higher NZD is providing some short-term inflation relief.** Petrol price falls over 2006 resulted in annual headline inflation falling to below 3 percent. The decline in headline inflation also helped keep inflation expectations steady. Further pass-through from the higher currency is expected to result in inflation approaching 1¾ percent by the middle of this year.

#### However, inflation is expected to quickly re-accelerate towards the top of the Reserve Bank's target band.

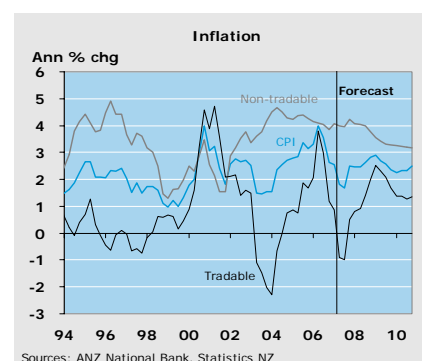
Sticky domestic inflation at elevated levels, coupled with an expected

depreciation in the NZD later this year, will see headline inflation quickly approach 3 percent over late 2008. This inflation profile gives the Reserve Bank very little headroom to absorb upside inflation surprises.

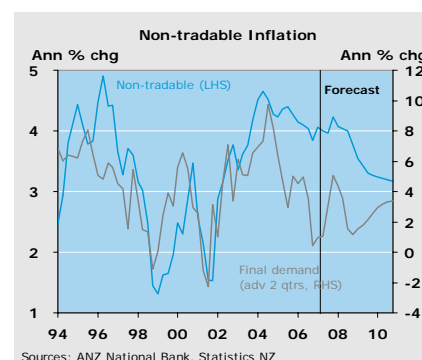
**Ultimately, a prolonged period of sub-trend growth is required for inflation pressure to ease.** The slowdown in growth over the past two years has not been sufficient to alleviate inflation pressure. This suggests a further period of sub-trend growth is required to dampen inflation pressure. But given the more broad-based nature of the current inflation dynamic, any easing in inflation pressure will be a slow and drawn-out affair.

#### Our forecasts assume slower growth caps cost-push inflation forces.

This critically assumes the recent slow grind up in inflation expectations does not extend into pricing behaviour. However, with firm's margins being squeezed over the past few years, and considerable pipeline cost-pressure, there looks set to be a solid element of traditional mark-up inflation that will result in inflation being sticky for a while.



	Quarterly	Annual
<b>Dec-03</b>	<b>0.7</b>	<b>1.6</b>
<b>Dec-04</b>	<b>0.9</b>	<b>2.7</b>
<b>Dec-05</b>	<b>0.7</b>	<b>3.2</b>
Mar-06	0.6	3.3
Jun-06	1.5	4.0
Sep-06	0.7	3.5
<b>Dec-06</b>	<b>-0.2</b>	<b>2.6</b>
Mar-07	0.5	2.5
Jun-07	0.8	1.8
Sep-07	0.6	1.7
<b>Dec-07</b>	<b>0.6</b>	<b>2.5</b>
Mar-08	0.5	2.5
Jun-08	0.8	2.5
Sep-08	0.8	2.6
<b>Dec-08</b>	<b>0.8</b>	<b>2.8</b>
Mar-09	0.6	2.9
Jun-09	0.6	2.7
Sep-09	0.7	2.6
<b>Dec-09</b>	<b>0.6</b>	<b>2.4</b>
Mar-10	0.5	2.3
Jun-10	0.6	2.3
Sep-10	0.6	2.3
<b>Dec-10</b>	<b>0.7</b>	<b>2.5</b>



## EXCHANGE RATE – STILL LOOKING FOR THE TURN

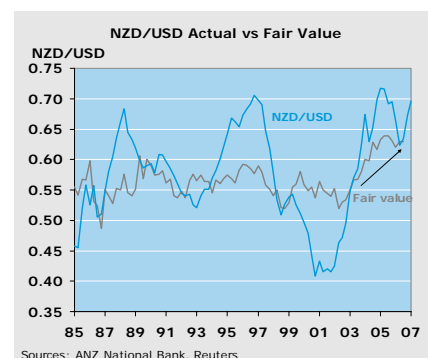
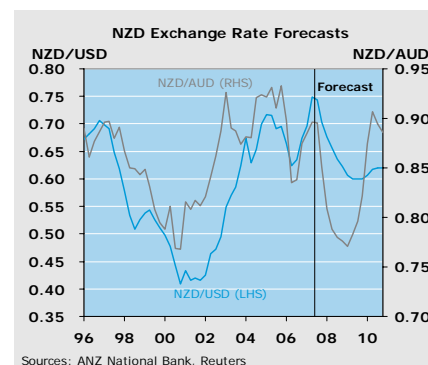
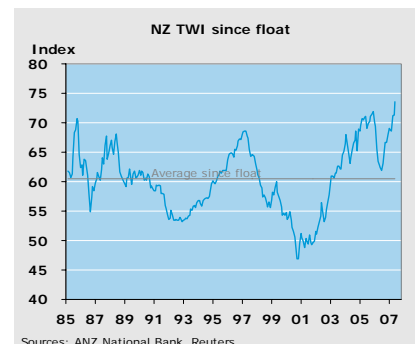
We continue to look for an aggressive move in the NZD when the economy turns, although a weaker USD and JPY continue to uplift the starting point. The NZD is defying forecasters in a similar fashion to 2000, when it was reciprocally weak. We struggle to see the economy remaining strong for another six months given where financial conditions reside. This errs us towards an earlier correction in the NZD relative to consensus expectations.

**New post float highs for the NZD continue to be reached.** Interest rate differentials remain well and truly in favour of the NZD. Expectations of New Zealand interest rates remaining elevated for some time, strong risk appetites, an economic slowdown in the US leading to weakness in the USD, and a strong AUD have all contributed to the recent strength in the kiwi. Commodity prices are also clearly playing a role in supporting the kiwi with dairy prices in particular surging to new record highs and vilifying the stronger for longer economic and interest rate view.

**The NZD looks hostage to wider global sentiment in the near-term,** with strong risk appetites around the globe, a weak USD and JPY, and strong AUD still suggesting upside prodding. The entire commodity bloc continues to perform well given the global growth backdrop, with only the US economy looking soggy courtesy of the housing market. The currency market is on a trend, and these do tend to extend further than what all and sundry expect.

**Beyond the next month, we're more bearish on the outlook for the NZD over the coming year relative to consensus, and are mindful of the following themes.**

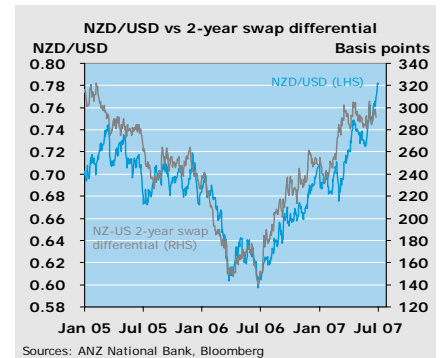
- **We are not buying into the new range or equilibrium level for the NZD.** A structural uplift in commodity prices underpins this view, and we certainly concur that fair value for the NZD/USD has risen from somewhere in the order of 0.60 to 0.65.<sup>1</sup> However, the sustained uplift hypothesis overlooks a massive deterioration in productivity growth and rising unit labour costs relative to our trading partners that has capped the magnitude of the improvement. At current levels, the fair value rubber band is still taut, and we agree with the Reserve Bank that the NZD is unjustifiably high when productivity performance is taken into account.
- **Growth holds the key, and our formal economic forecasts now include a negative quarter for GDP,** which is what typically occurs when financial conditions tighten aggressively in a short space of time. The cheque-book and credit card disappear for 3-months. When the market gets a sustained picture of slowing growth and consistent weakness across the partial indicators (a string of data pointing the one way), we struggle to see the NZD remaining elevated. Just look at early 2006 – GDP data was released showing the economy barely expanded at the end of 2005, and the NZD fell from 0.71 to 0.60 within three months! Ironically, a strong currency will be one of the mechanisms that bring about the economy's, and eventually, the currency's downfall.
- **Historically the NZD does turn aggressively from the top.** The NZD/USD has had two 10 cent moves lower over three months in the past three years. We expect the same again, but like most forecasters, have averaged this out over a range of quarters with it nigh on impossible to pick the exact timing.
- **Stepping back it feels eerily like 2000, only in reverse fashion.** Back then, a strong USD was forcing the NZD down. Growth as



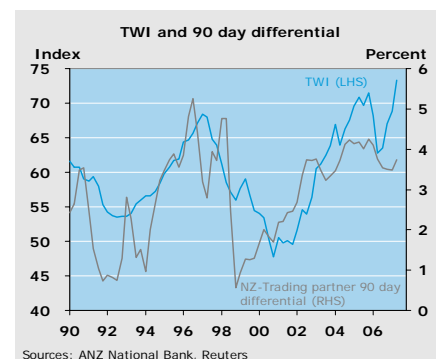
<sup>1</sup> We use an average of four alternate specifications to determine fair value for the NZD/USD. Inputs include combinations of relative inflation, unit labour costs, terms of trade, short and long-term interest rates, GDP growth relative to trend, and current account balances. An average across these specifications point to fair value being around US0.65 cents.

opposed to yield mattered. Commodity currencies were shunned, despite commodity prices being strong over the year. The NZD was expected to stay weak, and forecasters were chastised for presenting “unreasonable” forecasts showing it going back through 0.50. By implication, the stronger for longer NZD over the past few years, particularly the recent push up, implies that the eventual correction will only be deeper in magnitude.

- **The NZD is tracking well ahead of short-term support drivers, including the yield differential and risk gauges.** The yield differential is actually narrower than 18 months ago, and correlations with risk gauges have broken down. This all suggests the recent “kiwi” related buying is more hype than substance.
- **Perceptions towards the carry trade remain vulnerable to a major reversal.** It’s on everyone’s radar with policymakers repeatedly warning as to the risks of an unwind. In our view, the consistency of the messages across these circles (BIS, BoE, BoJ, IMF, and other officials) should be respected. Despite these risks, global investors’ (the herd) see little to be wary of with global risk aversion measures remain healthy (although off historical lows) despite some concerns surrounding US subprime woes. The reality is that speculators are forced to play the carry game if they are to out-perform. The real uncertainty at present is the degree of positioning, which is thought to be large, and what drives the turn? Candidates include a massive turn in USD/JPY, or emerging spillover from US subprime woes into a more widespread credit event.
- **Strategically, we remain attuned to the New Zealand experience when looking at the prospective path for global interest rates.** The same fundamental inflation drivers New Zealand is experiencing (tight labour market, high capacity utilisation, strong commodity prices) are apparent around the globe. The US economy and USD looks distinctly like the New Zealand economy in early 2006. The New Zealand economy subsequently recovered and the NZD is much higher as interest rates ended up moving higher. The US economy looks to have found a floor and we note the bias for interest rates from the Federal Reserve remains up.



**Complicating our forecast story is a strong AUD courtesy of pending hikes from the RBA post the election.** Such further strength in the AUD could provide some support for the NZD, particularly given the backdrop of weakness in the JPY and USD. All forecasters are facing an inconsistency at present when they try to tie in a consistent NZD/USD, AUD/USD and NZD/AUD track. Do we run with a high NZD/USD for another year courtesy of a strong AUD (with the RBA looking set to hike post election), which presents a more palatable NZD/AUD track on the assumption the AUD stays high, or a turn in the NZD/USD as implied by the fundamentals and associated massive rout in the NZD/AUD? We are fundamentalists at heart. It is the NZD/USD that is of far more importance to this economy and the route we have decided to take.



**Internationally, global interest rates are on the ascent – albeit gradually.** The NZ-trading partner 90-day differential is actually 50 basis points lower compared to the end of 2005, with the RBA, ECB, and BoE raising rates. Risk gauges at present remain benign, although a key issue is whether this can be sustained in an environment where global interest rates are rising. The last few months have been notable for spasmodic pick-ups in volatility in response to big swings, although this has not been sustained. We expect volatility to gradually pick-up over the coming six months as central bank’s continue with a tightening path.

**The path for dairy prices is now a key directional gauge for the kiwi dollar (given its significance to the economy in general), and we question whether recent strength can be sustained.** While we concur with the generally bullish long-term outlook for dairy prices, the magnitude of the rise (100 percent over the past year) implies some very aggressive

price rises in dairy related products at the supermarket. What no one seems to know at present is how the consumer is going to respond when prices move up aggressively. Dairy goods range from being necessities (milk) to luxury items (upper end cheeses) so the price elasticity is likely to be diverse. We suspect some consumer resistance is likely to see world dairy prices give up some of the recent exuberance at some stage, and be taken by the financial market as a key directional gauge for the NZD. Level wise, we remain bullish on the general outlook for dairy prices, but the market is likely to jump on any signs of a turn.

**Standing back, the end-game for the NZ economy is slower growth and the NZD will not sustain current levels under such a circumstance.** We expect “global forces” including interest rates and perceptions towards risk to turn progressively NZD negative over the coming year, and accentuate the move lower.

### NEW ZEALAND DOLLAR EXCHANGE RATE FORECASTS (average for the quarter)

	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
<b>Dec-03</b>	<b>0.62</b>	<b>0.87</b>	<b>68.0</b>	<b>0.37</b>	<b>0.53</b>	<b>63.9</b>
<b>Dec-04</b>	<b>0.70</b>	<b>0.92</b>	<b>74.0</b>	<b>0.38</b>	<b>0.54</b>	<b>67.6</b>
<b>Dec-05</b>	<b>0.69</b>	<b>0.93</b>	<b>81.4</b>	<b>0.40</b>	<b>0.58</b>	<b>71.5</b>
Mar-06	0.66	0.90	77.6	0.38	0.55	68.2
Jun-06	0.62	0.84	71.3	0.34	0.50	62.8
Sep-06	0.63	0.84	73.7	0.34	0.50	63.5
<b>Dec-06</b>	<b>0.67</b>	<b>0.87</b>	<b>79.2</b>	<b>0.35</b>	<b>0.52</b>	<b>67.1</b>
Mar-07	0.70	0.89	83.1	0.36	0.53	68.8
Jun-07	0.75	0.90	91.1	0.38	0.55	73.3
Sep-07	0.76	0.91	93.7	0.38	0.55	74.3
<b>Dec-07</b>	<b>0.71</b>	<b>0.86</b>	<b>89.0</b>	<b>0.36</b>	<b>0.52</b>	<b>70.0</b>
Mar-08	0.68	0.81	85.7	0.35	0.50	67.0
Jun-08	0.66	0.79	83.0	0.34	0.50	65.4
Sep-08	0.64	0.78	79.4	0.34	0.50	63.8
<b>Dec-08</b>	<b>0.62</b>	<b>0.78</b>	<b>76.5</b>	<b>0.33</b>	<b>0.50</b>	<b>62.8</b>
Mar-09	0.61	0.77	73.4	0.33	0.49	61.4
Jun-09	0.60	0.78	71.8	0.33	0.49	61.1
Sep-09	0.60	0.80	71.8	0.33	0.50	61.5
<b>Dec-09</b>	<b>0.60</b>	<b>0.82</b>	<b>71.2</b>	<b>0.33</b>	<b>0.50</b>	<b>61.8</b>
Mar-10	0.61	0.88	70.7	0.34	0.51	62.8
Jun-10	0.62	0.91	71.4	0.34	0.51	64.0
Sep-10	0.62	0.89	71.3	0.34	0.52	64.0
<b>Dec-10</b>	<b>0.62</b>	<b>0.89</b>	<b>70.8</b>	<b>0.34</b>	<b>0.52</b>	<b>63.8</b>

## INTEREST RATES – DONE AND DUSTED?

*We do not expect to see interest rates head higher again, despite potentially unwelcome inflation news over the coming month. The yield curve is now working more in the Reserve Bank's favour. Fixed lending rates are at 9 percent, and the NZD is undermining those 70 percent of exporters not insulated by strong commodity prices. However, the risk profile for rates remains skewed to the upside and a further announced uplift in the dairy payout could deliver some palpitations.*

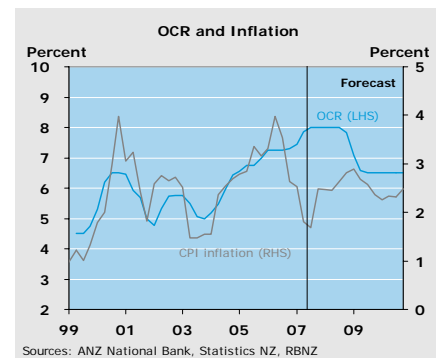
**Monetary policy faces different challenges when the economy is close to full capacity.** Despite a slowdown in growth over the past two years, resources remain as stretched as ever. The unemployment rate remains below 4 percent and capacity utilisation has stayed high. The rebound in activity from late last year has led to a re-acceleration in non-tradable inflation and a sharp increase in pricing intentions.

**The problem the Reserve Bank is facing resides from the supply-side of the economy and not demand.** Inflation has remained more persistent and elevated despite two years of 2 percent growth. Why hasn't inflation eased when growth has slowed? The solution resides in deteriorating productivity growth, weak investment and resource demand that is not responding to price signals (such as favouring capital over labour). These are areas that the upcoming review of monetary policy should look at addressing as opposed to the monetary policy framework itself, which has served the economy well.

**The Reserve Bank will remain on tenterhooks, despite already hiking three times.** The June *Monetary Policy Statement* was notable for the lack of inflation headroom. The composition of the June quarter non-tradable inflation result is likely to be unfriendly. Soft commodity prices – a noted upside growth and inflation risk in the June *Statement* – continue to surge, with the latest ANZ World Commodity Price Index up a whopping 6.1 percent in the month, and 30 percent on a year ago. In the current environment, and with inflation to remain near the top of the target band through to 2010, it reinforces the bias for the OCR to remain to the upside.

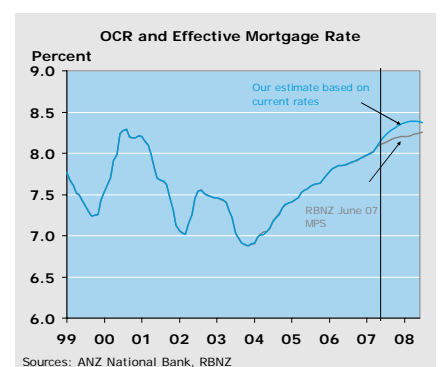
**Nonetheless, we feel the Reserve Bank has made their final interest rate increase for this tightening cycle.** Significant in our eyes is that:

- **The yield curve is now working in the Reserve Bank's favour.** The importance of this cannot be understated. Overseas yields have increased in the past month as global market perceptions towards interest rate cycles are reassessed. Monetary policy is more than merely pulling the OCR lever. It is about manipulating the yield curve. Low longer-dated yields had suppressed the monetary policy transmission mechanism over the past few years. The combination of higher global yields and outright capitulation along the NZ yield curve post the June *Statement* is delivering the policy tightening essential to slowing the housing market.
- **The effect of the pipeline tightening is huge.** By our calculations, the effective mortgage interest rate is set to rise from 8.1 percent to 8.4 percent over the coming year, and households' debt servicing as a share of income from 13.3 percent of disposable income towards 14 percent. Moreover, it is the speed of the change that may be potentially a very effective policy tool if it dents the bullet-proof persona of the housing market.
- **There is now nowhere for borrowers to run.** Borrowers typically shunted along the yield curve previously when their mortgage came up for renewal, and with a heavily inverted mortgage curve, this effectively left cashflow unchanged. The recent sizable increase in longer-dated lending rates has removed this option. A 2-year fixed mortgage is now around 100 basis points higher than in February, similarly for a 5-year



### Assumptions for policy

- Neutral real interest rate of between 3.75 and 4 percent.
- Inflation expectations remain well anchored.
- Longer-term potential growth of the economy remains at around 3 percent.



rate. Almost all fixed lending rates are now close to 9 percent, and the average interest rate on mortgages rolling off over the coming year is 7.8 percent.

- **The currency has to matter at current levels**, with more than 70 percent of exporters not insulated by strong commodity prices.

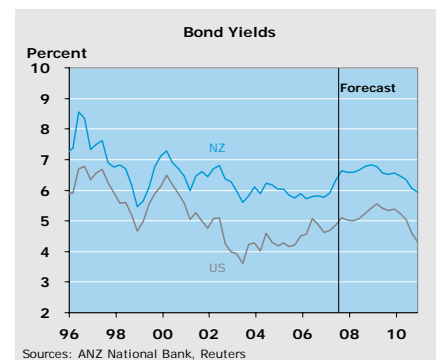
**This does not mean the job is done.** The talk will invariably remain tough to ensure the yield curve continues to work in their favour. The risk profile for rates over the coming months remains skewed to the upside. Our expectations for a more aggressive turn in the NZD will see headline inflation quickly jump towards 3 percent, at a time non-tradable inflation will only just be starting to moderate. There is going to be some inflation unease for a considerable period. In addition, how fiscal policy in an election year impacts on inflation pressure will also be a major concern.

**Tactically, we expect a false-start rally in rates late in the year**, in a similar fashion to early 2006, particularly with our core forecasts explicitly including a negative quarter for GDP. However, we are looking for the currency to be the main release valve that any economic weakness is primarily expressed through. Any rally in rates will be short-lived and not turn into a trend until 2008.

**We see interest rates staying elevated for some time** although 2 to 5-year swap yields are expected to gradually ease over 2008 in anticipation of policy normalisation at some stage. The tight resource pressure facing the economy, upside risks to inflation, and the strong possibility of a large fiscal stimulus in 2008 makes it difficult to foresee materially lower interest rates for some time. Even if economic activity were to slow, the Reserve Bank will want to see concrete evidence that inflation pressures are truly easing. This means the Reserve Bank will take a cautious approach when deciding to cut interest rates.

**But we expect the easing cycle to be aggressive when it does occur.** We have pencilled in the easing cycle to start at the end of 2008, with progressive cuts taking the OCR to 6½ percent by mid-2009. While the magnitude looks large, it is really one of policy normalisation rather than a significant loosening of monetary policy. Previous easing cycles have seen the cash rate with a 5 in from of it. The longer lags in the monetary policy transmission channel also works the other way when interest rates go down, so the easings will take time to stimulate economic activity.

**Globally, the interest rate tightening cycle is set to continue.** Central banks continue to warn of inflation risks, with the combination of tight labour markets, high hard commodity prices, and more recently strengthening soft commodity prices traditionally becoming cost-push inflation forces. With global demand likewise strong, central bankers are naturally on alert. All are generally on the tightening treadmill with the exception of the Fed, whom nonetheless continues to see upside risks to inflation. Certainly, the New Zealand experience of the past few years is that inflation pressure, after being dormant, can quickly escalate and necessitate far more aggressive action from the central bank.



**INTEREST RATE FORECASTS (average for the quarter)**

	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
<b>Dec-03</b>	<b>5.0</b>	<b>5.3</b>	<b>6.1</b>	<b>6.5</b>	<b>6.1</b>	<b>4.3</b>	<b>5.8</b>
<b>Dec-04</b>	<b>6.4</b>	<b>6.7</b>	<b>6.6</b>	<b>6.6</b>	<b>6.0</b>	<b>4.2</b>	<b>5.4</b>
<b>Dec-05</b>	<b>7.0</b>	<b>7.5</b>	<b>7.2</b>	<b>6.9</b>	<b>5.9</b>	<b>4.5</b>	<b>5.4</b>
Mar-06	7.3	7.6	7.0	6.7	5.7	4.6	5.3
Jun-06	7.3	7.5	7.0	6.7	5.8	5.1	5.7
Sep-06	7.3	7.5	7.3	6.9	5.8	4.9	5.7
<b>Dec-06</b>	<b>7.3</b>	<b>7.6</b>	<b>7.5</b>	<b>7.1</b>	<b>5.8</b>	<b>4.6</b>	<b>5.7</b>
Mar-07	7.4	7.8	7.7	7.4	5.9	4.7	5.8
Jun-07	7.9	8.1	8.1	7.8	6.3	4.9	6.0
Sep-07	8.0	8.3	8.3	8.0	6.6	5.1	6.2
<b>Dec-07</b>	<b>8.0</b>	<b>8.2</b>	<b>8.1</b>	<b>7.8</b>	<b>6.6</b>	<b>5.0</b>	<b>6.2</b>
Mar-08	8.0	8.1	7.8	7.6	6.6	5.0	6.3
Jun-08	8.0	8.1	7.5	7.3	6.7	5.1	6.3
Sep-08	8.0	8.1	7.4	7.3	6.8	5.2	6.4
<b>Dec-08</b>	<b>7.8</b>	<b>7.8</b>	<b>7.1</b>	<b>7.2</b>	<b>6.8</b>	<b>5.4</b>	<b>6.4</b>
Mar-09	7.1	7.0	7.0	7.3	6.8	5.6	6.4
Jun-09	6.6	6.7	7.0	7.2	6.6	5.4	6.3
Sep-09	6.5	6.7	7.0	7.2	6.5	5.3	6.2
<b>Dec-09</b>	<b>6.5</b>	<b>6.7</b>	<b>7.0</b>	<b>7.2</b>	<b>6.6</b>	<b>5.4</b>	<b>6.4</b>
Mar-10	6.5	6.7	6.9	7.1	6.5	5.2	6.3
Jun-10	6.5	6.7	6.9	7.0	6.4	5.1	6.3
Sep-10	6.5	6.7	6.8	6.8	6.1	4.6	6.0
<b>Dec-10</b>	<b>6.5</b>	<b>6.7</b>	<b>6.8</b>	<b>6.7</b>	<b>5.9</b>	<b>4.3</b>	<b>5.7</b>

## ANZ ECONOMIC FORECASTS

	Mar-06	Jun-06	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
<b>Real Gross Domestic Product</b>												
Total GDP, QPC	0.6	0.4	0.3	0.8	1.0	<b>0.6</b>	<b>-0.2</b>	<b>0.3</b>	<b>0.4</b>	<b>0.4</b>	<b>0.4</b>	<b>0.5</b>
Total GDP, APC	1.7	1.0	1.1	2.1	2.5	<b>2.7</b>	<b>2.3</b>	<b>1.8</b>	<b>1.1</b>	<b>0.9</b>	<b>1.5</b>	<b>1.7</b>
Total GDP, AAPC	2.0	1.6	1.4	1.5	1.7	<b>2.1</b>	<b>2.4</b>	<b>2.3</b>	<b>1.9</b>	<b>1.5</b>	<b>1.3</b>	<b>1.3</b>
<b>Real GDP Components</b>												
Private Consumption, QPC	0.6	-0.1	0.4	1.4	2.1	<b>0.5</b>	<b>-0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.2</b>	<b>0.2</b>
Private Consumption, AAPC	4.5	3.5	2.8	2.3	2.4	<b>3.1</b>	<b>3.7</b>	<b>3.7</b>	<b>2.9</b>	<b>1.8</b>	<b>1.0</b>	<b>0.5</b>
Public Consumption, QPC	0.9	1.8	1.0	0.2	0.9	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.1</b>	<b>1.0</b>	<b>0.9</b>
Public Consumption, AAPC	5.2	4.9	5.1	4.8	4.5	<b>4.2</b>	<b>3.6</b>	<b>3.7</b>	<b>3.8</b>	<b>4.1</b>	<b>4.4</b>	<b>4.4</b>
Residential Investment, QPC	0.7	-5.8	4.0	2.0	-0.3	<b>0.3</b>	<b>-0.3</b>	<b>-0.2</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.2</b>	<b>0.2</b>
Residential Investment, AAPC	-5.0	-5.0	-3.4	-2.7	-2.1	<b>1.5</b>	<b>1.9</b>	<b>1.6</b>	<b>1.5</b>	<b>-0.3</b>	<b>-1.0</b>	<b>-1.1</b>
Other Investment, QPC	-0.9	-5.3	0.8	0.6	5.1	<b>1.5</b>	<b>-0.1</b>	<b>0.3</b>	<b>0.6</b>	<b>0.9</b>	<b>1.1</b>	<b>1.4</b>
Other Investment, AAPC	6.7	3.8	0.8	-2.4	-3.3	<b>-0.2</b>	<b>2.7</b>	<b>5.8</b>	<b>6.2</b>	<b>4.5</b>	<b>3.5</b>	<b>2.8</b>
Gross National Expenditure, QPC	1.1	-1.4	0.5	2.5	1.2	<b>1.5</b>	<b>0.1</b>	<b>0.3</b>	<b>0.3</b>	<b>0.4</b>	<b>0.5</b>	<b>0.6</b>
Gross National Expenditure, AAPC	4.1	2.3	0.8	0.7	0.6	<b>2.4</b>	<b>4.1</b>	<b>4.2</b>	<b>4.1</b>	<b>2.9</b>	<b>2.0</b>	<b>1.7</b>
Exports, QPC	-1.4	2.7	2.6	-2.4	2.0	<b>-0.5</b>	<b>0.3</b>	<b>0.7</b>	<b>0.8</b>	<b>1.0</b>	<b>1.1</b>	<b>1.1</b>
Exports, AAPC	-0.3	0.4	1.4	1.9	3.2	<b>3.4</b>	<b>1.9</b>	<b>2.1</b>	<b>1.2</b>	<b>1.5</b>	<b>2.6</b>	<b>3.0</b>
Imports, QPC	-1.1	-1.3	0.7	1.6	4.3	<b>2.4</b>	<b>0.8</b>	<b>0.5</b>	<b>0.8</b>	<b>1.2</b>	<b>1.1</b>	<b>0.8</b>
Imports, AAPC	4.0	0.9	-2.3	-2.5	-1.2	<b>2.3</b>	<b>5.9</b>	<b>8.1</b>	<b>7.8</b>	<b>6.4</b>	<b>4.9</b>	<b>3.9</b>
<b>Prices</b>												
Headline CPI, QPC	0.6	1.5	0.7	-0.2	0.5	<b>0.8</b>	<b>0.6</b>	<b>0.6</b>	<b>0.5</b>	<b>0.8</b>	<b>0.8</b>	<b>0.8</b>
Headline CPI, APC	3.3	4.0	3.5	2.6	2.5	<b>1.8</b>	<b>1.7</b>	<b>2.5</b>	<b>2.5</b>	<b>2.5</b>	<b>2.6</b>	<b>2.8</b>
Non-tradable CPI, QPC	1.0	1.0	1.0	0.8	1.2	<b>1.0</b>	<b>1.0</b>	<b>1.0</b>	<b>1.0</b>	<b>0.9</b>	<b>0.9</b>	<b>0.8</b>
Non-tradable CPI, APC	4.1	4.1	4.0	3.8	4.1	<b>4.0</b>	<b>4.0</b>	<b>4.2</b>	<b>4.1</b>	<b>4.0</b>	<b>4.0</b>	<b>3.8</b>
Tradable CPI, QPC	-0.1	2.3	0.3	-1.3	-0.4	<b>0.5</b>	<b>0.2</b>	<b>0.2</b>	<b>-0.1</b>	<b>0.6</b>	<b>0.7</b>	<b>0.8</b>
Tradable CPI, APC	2.1	3.8	3.0	1.2	0.9	<b>-0.9</b>	<b>-1.0</b>	<b>0.5</b>	<b>0.8</b>	<b>0.9</b>	<b>1.4</b>	<b>2.0</b>
<b>External Accounts</b>												
Annual Balance on Goods, % of GDP	-2.7	-2.5	-2.1	-2.0	-1.8	<b>-1.7</b>	<b>-1.6</b>	<b>-1.4</b>	<b>-1.2</b>	<b>-1.0</b>	<b>-1.1</b>	<b>-1.4</b>
Annual Balance on Services, % of GDP	0.0	0.0	0.0	0.1	0.1	<b>0.2</b>	<b>0.1</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.0</b>	<b>0.2</b>
Annual Balance on Invisibles, % of GDP	-6.9	-7.1	-7.0	-7.0	-6.8	<b>-6.5</b>	<b>-6.4</b>	<b>-6.2</b>	<b>-6.0</b>	<b>-6.0</b>	<b>-6.0</b>	<b>-6.0</b>
Annual Current Account Balance, % of GDP	-9.6	-9.6	-9.1	-9.0	-8.5	<b>-8.0</b>	<b>-7.9</b>	<b>-7.5</b>	<b>-7.1</b>	<b>-7.0</b>	<b>-7.1</b>	<b>-7.3</b>
Net International Invt Position, % of GDP	-83.3	-83.7	-86.6	-89.4	-88.8	<b>-87.8</b>	<b>-88.5</b>	<b>-88.9</b>	<b>-88.2</b>	<b>-88.2</b>	<b>-89.7</b>	<b>-90.5</b>
<b>Terms of Trade (SNA basis)</b>												
Export Prices, QPC	3.0	3.1	0.0	0.2	0.3	<b>-1.4</b>	<b>2.8</b>	<b>4.9</b>	<b>2.4</b>	<b>1.2</b>	<b>1.4</b>	<b>1.1</b>
Export Prices, APC	3.8	9.2	8.2	6.4	3.6	<b>-0.9</b>	<b>1.9</b>	<b>6.6</b>	<b>8.9</b>	<b>11.7</b>	<b>10.2</b>	<b>6.2</b>
Import Prices, QPC	3.9	5.4	0.3	-3.9	-1.1	<b>-5.0</b>	<b>2.1</b>	<b>2.9</b>	<b>2.8</b>	<b>1.8</b>	<b>1.8</b>	<b>1.3</b>
Import Prices, APC	8.0	13.7	12.0	5.4	0.3	<b>-9.5</b>	<b>-7.9</b>	<b>-1.3</b>	<b>2.6</b>	<b>9.9</b>	<b>9.6</b>	<b>7.9</b>
Terms of Trade, QPC	-0.9	-2.2	-0.3	4.4	1.4	<b>3.9</b>	<b>0.6</b>	<b>2.0</b>	<b>-0.4</b>	<b>-0.6</b>	<b>-0.5</b>	<b>-0.2</b>
Terms of Trade, APC	-3.9	-3.9	-3.4	0.9	3.2	<b>9.6</b>	<b>10.6</b>	<b>8.1</b>	<b>6.2</b>	<b>1.6</b>	<b>0.5</b>	<b>-1.6</b>
<b>Labour Market</b>												
Employment, QPC	0.9	0.9	-0.5	0.1	1.2	<b>0.2</b>	<b>-0.2</b>	<b>0.0</b>	<b>0.1</b>	<b>0.2</b>	<b>0.0</b>	<b>0.2</b>
Employment, APC	2.6	3.1	1.4	1.4	1.7	<b>0.9</b>	<b>1.3</b>	<b>1.2</b>	<b>0.1</b>	<b>0.1</b>	<b>0.3</b>	<b>0.5</b>
Labour Force, QPC	1.2	0.6	-0.3	0.0	1.2	<b>0.2</b>	<b>0.0</b>	<b>0.1</b>	<b>0.1</b>	<b>0.3</b>	<b>0.1</b>	<b>0.2</b>
Labour Force, APC	2.7	3.0	1.6	1.6	1.6	<b>1.2</b>	<b>1.4</b>	<b>1.5</b>	<b>0.4</b>	<b>0.5</b>	<b>0.6</b>	<b>0.7</b>
Unemployment Rate, sa	3.9	3.6	3.8	3.7	3.8	<b>3.8</b>	<b>3.9</b>	<b>4.1</b>	<b>4.1</b>	<b>4.2</b>	<b>4.3</b>	<b>4.3</b>
Participation Rate, sa	68.5	68.7	68.2	68.1	68.6	<b>68.5</b>	<b>68.3</b>	<b>68.2</b>	<b>68.0</b>	<b>68.0</b>	<b>67.8</b>	<b>67.7</b>
Private Sector Wages (apc)	4.6	4.9	5.4	5.5	5.5	<b>4.9</b>	<b>4.2</b>	<b>4.5</b>	<b>5.0</b>	<b>4.2</b>	<b>3.8</b>	<b>3.8</b>
Public Sector Wages (apc)	7.8	2.0	3.2	4.1	1.9	<b>6.1</b>	<b>6.5</b>	<b>5.2</b>	<b>3.4</b>	<b>4.1</b>	<b>4.4</b>	<b>4.8</b>

Forecast in bold

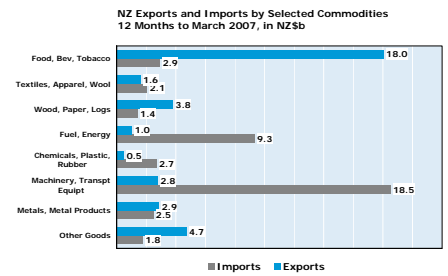
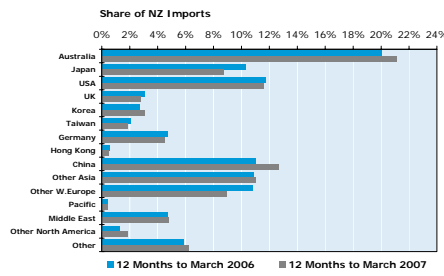
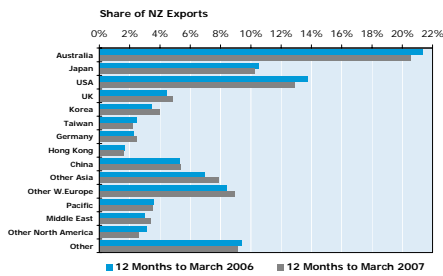
QPC - quarterly percent change

APC - annual percent change

AAPC - annual average percent change

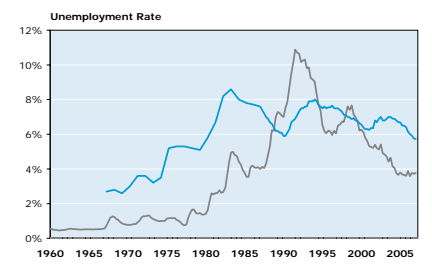
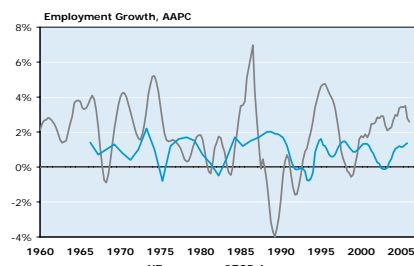
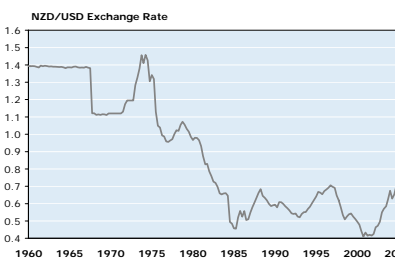
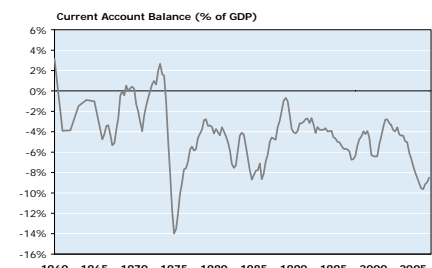
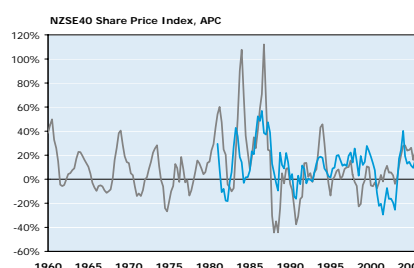
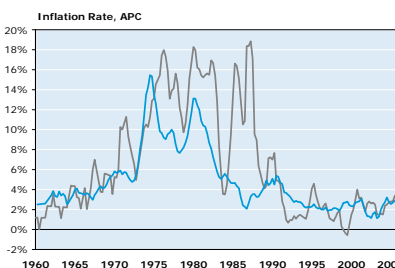
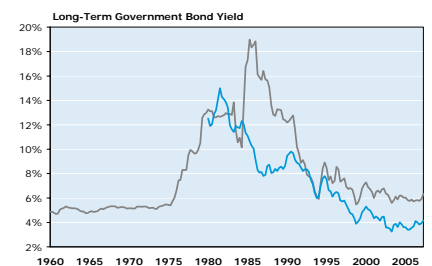
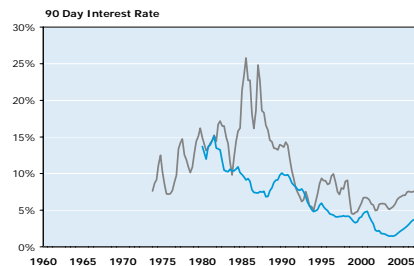
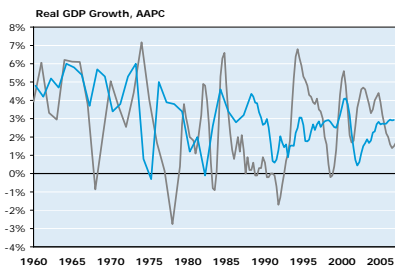
sa - seasonally adjusted

**NEW ZEALAND KEY ECONOMIC INDICATORS**



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

	NZ	Aust	USA	Japan	UK	China	G/many	SKorea	Taiwan	Malaysia	H/kong	S/pore	Indonesia
Population, in millions	4.1	20.1	298.2	128.1	59.7	1306.3	82.7	47.7	22.6	25.6	7.1	4.3	219.9
Area in 1,000 km <sup>2</sup>	271	7713	9373	378	244	9561	357	92	36	330	1	1	1905
Inhabitants per km <sup>2</sup>	15.0	2.6	31.8	339.1	244.6	136.6	231.8	517.4	627.8	77.6	7100.0	4300.0	115.4
GDP, in billion NZ\$	161.1	1080.7	18657.9	6187.2	3407.5	2767.5	4268.3	1238.7	442.4	203.0	257.7	182.4	447.7
Change in real terms (%)	1.7	2.2	2.1	2.3	2.8	11.1	3.7	4.0	4.0	5.7	7.0	6.0	6.1
Nominal GDP per capita in NZ\$	39,655	53,767	62,569	48,300	57,078	2,119	51,612	25,968	19,577	7,930	36,297	42,416	2,036
NZ exports to ..., in million NZ\$ (FOB)	n/a	7229	4542	3610	1699	1897	881	1412	776	533	579	568	645
Share of NZ Exports (%)	n/a	20.6	12.9	10.3	4.8	5.4	2.5	4.0	2.2	1.5	1.6	1.6	1.8
NZ imports to ..., in million NZ\$ (VFD)	n/a	8380	4607	3454	1112	5040	1786	1217	730	1069	201	1706	600
Share of NZ Imports (%)	n/a	21.1	11.6	8.7	2.8	12.7	4.5	3.1	1.8	2.7	0.5	4.3	1.5
Current Account balance as a % of GDP	-9.0	-5.9	-6.6	4.0	-3.4	8.3	5.1	0.7	8.2	15.7	11.2	28.5	3.1



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