NEW ZEALAND ECONOMICS
ANZ PROPERTY FOCUS

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INSIDE

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MEXICAN STANDOFF

SUMMARY

Our monthly *Property Focus* publication is aimed at providing an independent appraisal of recent developments in the property market. This month the Bank's Chief Economist comments on the current economic recovery.

THE MONTH IN REVIEW

We can see semblances of a Mexican standoff across the market. Restrained supply, higher rents and lifting volumes portend better collective underlying movement. Yet the market lacks the conviction to push on, with structural (balance sheet) and cyclical (a net migration outflow) forces weighing. In this sort of environment, it is no surprise to see a standoff between buyers and sellers.

PROPERTY GAUGES

While the housing market has been slowly recovering, the construction sector remains weak. Residential consent issuance remains at a historically low proportion of the dwelling stock. There are still pockets of weakness in certain regions, which have not yet responded to the emergency OCR cut and the lower mortgage interest rates on offer. The turnaround in short- and long-term migration to a net outflow is also set to relieve housing shortages, although we expect regional differences to become more stark.

ECONOMIC BACKDROP

The NZ economy continues to be buffeted by a host of structural and cyclical events. The economy faces further deleveraging headwinds, given a still high net external debt position of 78 percent of GDP. The nationwide balance sheet is now also weaker as a result of the February 22 earthquake. Yet booming commodity prices have pushed the terms of trade to a 37-year high and we are seeing stronger income generation across the economy.

MORTGAGE BORROWING STRATEGY

Mortgage rates were unchanged from last month. Given increased uncertainty, we favour floating for now. Broadly speaking, the rises implied by the mortgage curve are consistent with the RBNZ's projections, and our own expectations. If it were purely a question of cost, it would thus be a line call between remaining floating, or choosing a fixed term like 2-3 years.

FEATURE ARTICLE – COMMENT FROM THE CHIEF ECONOMIST

Our Chief Economist offers his thoughts on the journey the New Zealand economy started three years ago. While challenges remain and the economy is progressing through a stage of "grumpy" growth, the spirit of the journey is about creating some earnings backbone and spine for the economy. The quality of housing as an investment over the long haul will ultimately be determined by the tenacity behind it.

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STATISTICS NZ, BUILDING WORK PUT IN PLACE – MARCH

South of the border

The volume of residential building work declined 2.1 percent in the March quarter and is down 5.7 percent on a year ago. **Residential work put in place volumes are very weak**, being 13 percent below post 1990 averages and 37 percent below pre-recession peaks.

DEPT OF BUILDING AND HOUSING, MEDIAN RENTS - MAY

The rental market is tightening. Nationwide rentals are 3.3 percent higher than a year ago. Shortages in Auckland are beginning to be reflected in higher rents in the region.

STATISTICS NZ, BUILDING CONSENTS – APRIL

Viva la revolution

1,008 residential building consents were issued for April. Compared to March consents eased 1.7 percent, while ex-apartment figures posted a respectable 3.7 percent gain. However, the ex-apartment lift still leaves the level of issuance very low. There were strong regional differences, with **ex-apartments outside of Canterbury down 0.5 percent**, whereas issuance in Canterbury surged 12 percent. Consent work on planned alterations and additions eased in April, falling a 6 percent.

MORTGAGE APPROVALS – LATEST AVAILABLE (MID JUNE)

Mortgage approvals are a timely gauge of pending housing market activity. The value of mortgage approvals have been tracking around 12 percent above levels seen in 2010. However, volumes are tracking broadly in line with 2010 levels.

RBNZ, MONETARY POLICY STATEMENT – JUNE

Matador looking for a bull fight

The RBNZ left the Official Cash Rate (OCR) unchanged at 2.5 percent as widely expected. The tone was circumspect about the economy but still decidedly more upbeat than previously. The RBNZ **lifted their growth forecasts and flagged gradually rising interest rates from late in 2011.**

RBNZ, CREDIT GROWTH – APRIL

Flat as a tortilla

Household lending lifted 0.2 percent in April, following the first monthly dip in the series in March. Compared to last year, **lending to households has only increased 1.4 percent.** With income growth up 4.0 percent on a year ago, households continue to focus on deleveraging.

REINZ, HOUSING DATA – MAY

Aztec levels

Nationwide sales rose 10.2 percent in May, but remain around **one quarter below historical averages** as a portion of the dwelling stock. The REINZ House Price Index fell 1.5 percent, reversing a 1.3 percent rise in April. The median days to sell remains sticky around 44 days. Section sales lifted to the highest level seen in a year, which holds out the promise of more building consent issuance.

STATISTICS NZ, NET MIGRATION – MAY

A Mexican wave (goodbye)

May saw a net outflow of 350 persons and continues the trend of weakness seen over preceding months. Annualising the last three months shows a **net outflow of 3960,** although the complete yearly picture is still a net inflow of 4670 persons**.**

ECONOMIC BACKDROP

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We use ten gauges to assess the state of the property market, and for signs that changes are emerging.

AFFORDABILITY. For new entrants into the housing market, we measure affordability using the ratio of house prices-to-income (adjusted for interest rates), and mortgage payments as a proportion of income.

SERVICEABILITY / INDEBTEDNESS. For existing homeowners, serviceability relates interest payments to income, while indebtedness is measured as the level of debt relative to income.

INTEREST RATES. Interest rates affect both the affordability of new houses and the serviceability of existing mortgage payments.

MIGRATION. A key source of demand for housing.

SUPPLY-DEMAND BALANCE. We use dwelling consents issuance to proxy growth in supply. Demand is derived via the natural growth rate in the population, net migration, and the average household size.

CONSENTS AND HOUSE SALES. These are both key gauges of activity in the property market.

LIQUIDITY. We look at growth in Private Sector Credit relative to GDP to assess the availability of credit in supporting the property market.

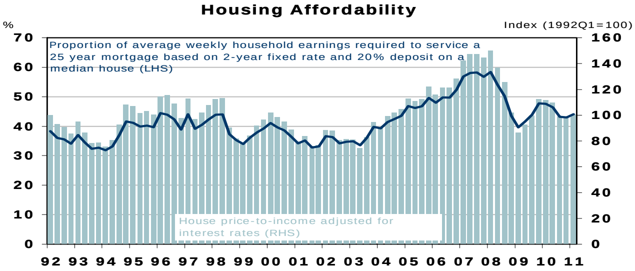
GLOBALISATION. We look at relative property price movements between New Zealand, the US, UK and Australia in recognition of the important role that globalisation is playing in NZ's property cycle.

MORTGAGEE SALES. We look at how mortgagee sales are tracking for an indication of distress in the property market.

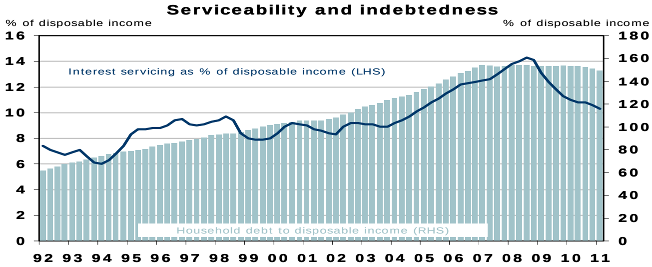
RENTAL GROWTH. We look at growth in the median market rent as an indication of whether it is a better time to buy versus rent, and how rental yields are shaping up for the property investor.

Indicator	Level	Direction for prices	Comment
Affordability	Less affordable	↓	Little improvement over the past six months.
Serviceability / indebtedness	Saved by debt payback	↓	Debt payback still in play.
Interest rates	Poised for a change	↑	Mortgage rates were unchanged across the curve for the second successive month.
Migration	Easing	↓	A net outflow = less demand.
Supply-demand balance	Regional gaps exist	↔/↑	Drop in both sides of the equation, but an excess of demand still prevails.
Consents and house sales	Lifting but off low base	↔/↑	Sales picks up. Will the lift in section sales lift building consents?
Liquidity	Not moving	↓	Drop in borrowing, at a time that the economy is slowly expanding.
Globalisation	Dropping	↔	Double or it is the triple dip?
Mortgagee sales	High but dated	↔	Remains high but the data hasn't been updated for 8 months.
Median rent	Upward	↑	Lifted to a 2½ year high and will go higher
On balance	**Directionless**	↔	**Turnover recovering but prices listless.**

PROPERTY GAUGES



Sources: ANZ, National Bank, Statistics NZ, REINZ, Reserve Bank



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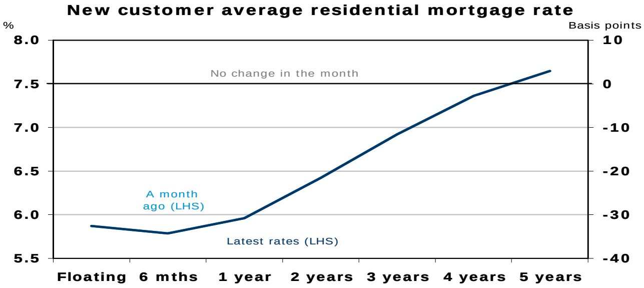
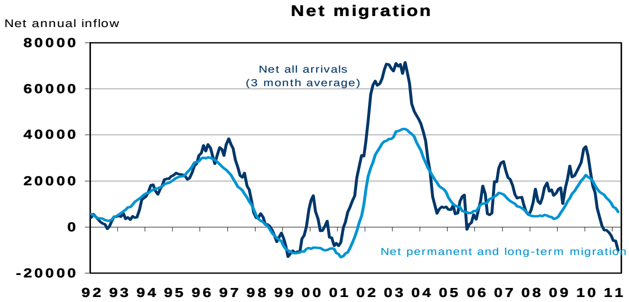


Sources: ANZ, National Bank, www.interest.co.nz



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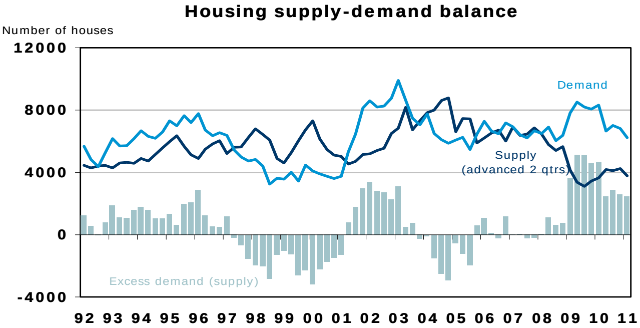

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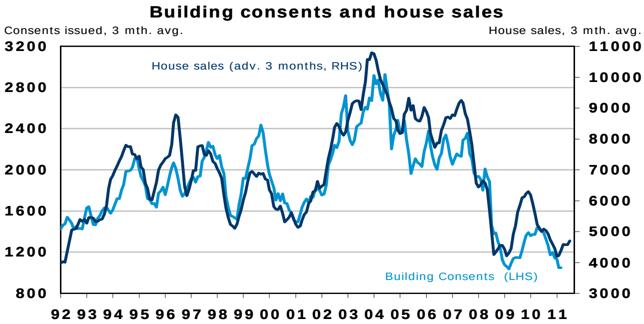

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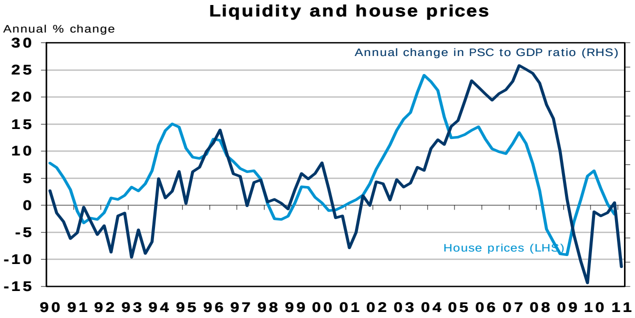
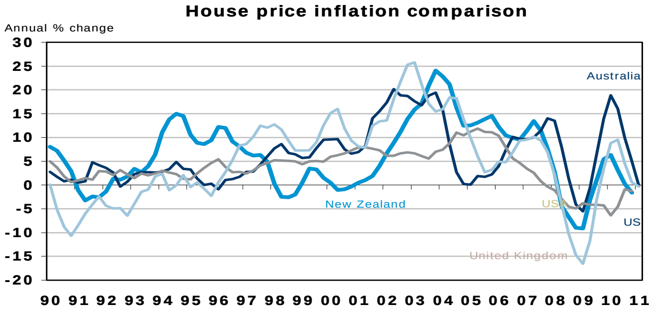
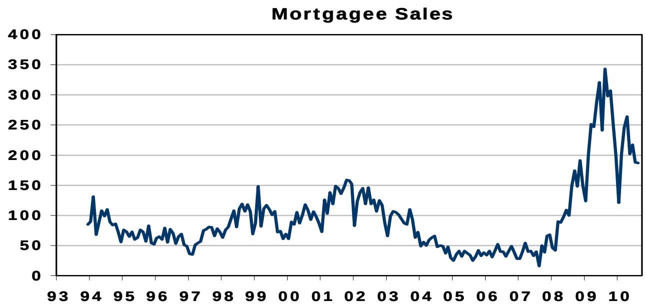


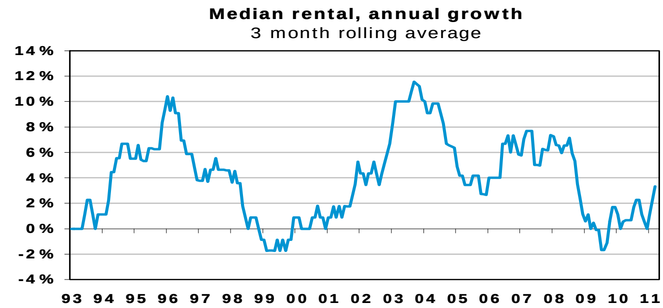
Sources: ANZ, National Bank, QV, Reserve Bank



Sources: ANZ, National Bank, QV, Nationwide, Bloomberg



Sources: ANZ, National Bank, Terralink



Sources: ANZ, National Bank, Dept of Building and Housing

ECONOMIC BACKDROP

The New Zealand economy continues to be buffeted by a host of structural and cyclical events. The economy faces further deleveraging headwinds, given a still high net external debt position of 78 percent of GDP. The nationwide balance sheet is now also weaker as a result of the February 22 earthquake. Yet booming commodity prices have pushed the terms of trade to a 37-year high and we are seeing stronger income generation across the economy. The latter is giving some scope for a pickup in domestic demand and housing activity.

OUR CORE ECONOMIC VIEW

The economy continues to navigate an array of shocks.

- A high net external debt position (78 percent of GDP) means the economy needs to deleverage further.
- The economy needs to rebalance. That is, to foster more income generation (tradable activity) to support and underpin the spending (non-tradable sector). Resources do not adjust overnight so this process remains a long journey.
- New Zealand's terms of trade have surged to a 37 year high. Debt repayment was the prime focal point for the rural sector in 2009/10 and the early part of 2011. But there are signs that the rural chequebook is opening. Strong demand for what NZ sells looks set to persist for decades. There is great hope we'll nail a free-trade agreement with India in the coming year.
- Seismic events have destroyed in excess of $20 billion dollars of capital. Most is insured, but the balance sheet (government and individuals in some cases) has still taken a hit. The rebuild will boost growth, which is a positive. However, the resources tied up here could have otherwise been used rebalancing the economy.

At the same time we're seeing a huge amount of uncertainty around the globe. Momentum in the global economy has softened. Some looks temporary (i.e. supply chain disruptions after the Japanese tsunami). Some nations (China and Australia) need to slow, given inflation pressures. Sovereign concerns out of the likes of Greece continue to undermine what fragile confidence there is. The after-effects of the global financial crisis continue to linger.

Given this combination it is only natural to see mixed economic signals. Business confidence has perked up considerably. In contrast, consumer confidence remains more sedate (though lifting of late). Retailing remains soft and housing momentum, while improving, is still very low. Demand for credit is pretty well non-existent. The tourism sector is flat-lining. In contrast, momentum looks to be improving in the labour market, commodity prices are at record highs and manufacturing momentum is on the improve.

Leading indicators are holding out the allure of a sharp upswing. Financial conditions are extremely supportive, with a high dairy payout set to add to export incomes. Business confidence has returned to early 2010 levels, which coincided with the initial recovery, though this subsequently petered out in late 2010. The immediate question is whether business confidence is once again over-estimating prospects. Are we set for a repeat of 2010 where surging confidence was not matched by reality on the ground? Certainly the global scene requires close monitoring, and the deleveraging dynamic has not yet come to an end. Yet there are growing real-time anecdotes that suggest the 2011 lift in confidence has more reality and substance below the surface. This is coinciding with more hard data, such as business sector credit, employment and capital imports lifting.

We continue to expect a cyclical fillip in growth off a low base in H2 2011, with this upswing likely to be more income-led than previous cyclical lifts. Rugby World Cup fever (while temporary) and Christchurch rebuild activity will add to momentum. After three years of very subdued domestic activity, the economy appears to have made enough progress across structural indicators (we believe the household savings rate is now positive) for domestic momentum to lift, which in laymen parlance really means a bit of fun after numerous years of squirrel-like behaviour. However, we remain mindful that there is still a structural imperative that the economy rebalances, but it will take time for resources to shift. So the fillip to growth is within the context of a cautious view of fairly subdued trend growth for years to come.

The RBNZ face a delicate balancing act in providing economic support, yet ensuring that inflation expectations and the NZD remain under control. Strengthening economic activity and upside inflation risks are expected to prompt the RBNZ into moving the OCR higher, starting with a 25 basis point hike in the December MPS. Beyond that we expect rates to rise gradually.

MORTGAGE BORROWING STRATEGY

Mortgage rates were unchanged from last month. Given increased uncertainty, we favour floating for now. Broadly speaking, the rises implied by the mortgage curve are consistent with the RBNZ's projections, and our own expectations. If it were purely a question of cost, it would thus be a line call between remaining floating, or choosing a fixed term like 2-3 years.

OUR VIEW

Mortgage rates remain unchanged, with no changes to either floating or fixed rates for at least 2 months. The two standout features of the term structure of mortgage rates are (1) that **the floating rate is the lowest rate**; and (2) that **it costs considerably more to lock in for a longer term.**

Not surprisingly, **more borrowers are now on a floating rate than at any time since fixed rates became the norm in the late 1990s**. **This "strategy" has been a savvy one** on the part of the borrowing public, mainly because floating rates have stayed lower for much longer than most people expected. Indeed, if you cast your mind back to March 2009, you may recall that there was a mass rush to fix. The "conventional wisdom" at the time was that rates had gotten as low as they were ever going to go. With little or no difference between floating and fixed rates, many people chose to fix. **Many who did not were miffed at having missed the chance. However, here we are now, 27 months later, and the OCR is back at 2.5 percent, and floating rates are at their lowest levels in over 40 years. Missing out may have been a good thing!**

But **is floating still the best strategy**? It's impossible to know for sure and only time will tell. As we alluded to in the previous paragraph, things don't always turn out the way you expect, and we have been knocked by a multitude of surprises over the past few years, and we may well be buffeted by more. However, **if the recovery progresses the way leading indicators suggest it might, and inflation picks up as we think it will, then the OCR is set to go higher later in the year, taking mortgage rates with it**. Or perhaps put another way – it was an extraordinary series of events that got us to where we are now, and it is going to take something even more extraordinary to take the OCR lower yet. As such, **it makes sense to get ready for higher floating rates at some stage.**

The question is; what does "at some stage" mean? We have a fairly strong view on that, and as we highlighted in the Economic Backdrop section, **we believe the RBNZ will start raising rates from December, with more to come in 2012.** The RBNZ also believe that's pretty well what they're going to do. Indeed, **in the March *Monetary Policy Statement* (MPS) they projected the 90 day bill rate (off which floating mortgage rates are set) to rise by 0.27 percent between Q3 and Q4 this year, and a further 1.59 percent over 2012**. In fact, the RBNZ see project the 90 day bill rate to rise by 2.12 percent between now and the middle of 2013, two years away.

This might leave you asking two questions. **The first is; how believable are these projections? The second is; what might they imply for mortgage rates?** Both are a matter of judgement, and **such questions are further compounded by each borrower's individual circumstances**. Some may be cashflow constrained, and simply want to pay the cheapest rate. Some may be thinking about a longer term horizon, and want to achieve the lowest overall cost over that time. **Others will be prepared to pay a premium for certainty**. Others will be worried about what's happening globally, and believe that this may further delay RBNZ rate hikes. This may well be the case – things do look a little more uncertain than they were when the RBNZ put out their MPS. Whatever the case, there are judgements to be made.

Without knowledge of circumstances, it's not possible to be a good judge of what is, or is not, a good strategy. **But what we can do is analyse the current set of mortgage rates on offer, and see what they imply about the future**. Individual borrowers can then compare these against their own expectations, and make a more informed decision. **We believe breakeven analysis is helpful when contemplating whether to fix, and if so, for how long**, as our regular readers will be aware.

So what do breakevens tell us? As the table overleaf shows, **future rates are assumed to be higher than current rates**. Because rates have not changed in the past month, the breakeven rates also remain unchanged. For example, the 1 year rate is expected to rise from its current level of 5.95 percent to 6.44 percent in 6 months, then up to 7.03 percent in 1 year, and so on until it gets to 7.99 percent in 2 years. That seems steep, but it isn't far away from what the RBNZ is projecting. Indeed, recall that the RBNZ see the 90 day bill rate rising by 2.12 percent over the next 2 years. This implies that **you either need to be convinced that mortgage rates will rise as quickly as the RBNZ projects them to, or put a high value on**

MORTAGE BORROWING STRATEGY

certainty, in order to want to choose a longer term rate, like the 3 year fixed rate. Of course, some of the rise in breakeven rates reflects the fact that the 1 year rate is a "special" rate, in that it's lower than both the 6 month rate and the 2 year rate.

Mortgage Rates		Breakevens			
Term	**Current**	**in 6mths**	**in 1yr**	**in 18mths**	**in 2 yrs**
Floating	5.74%				
6 months	5.99%	5.91%	6.97%	7.09%	7.74%
1 year	5.95%	6.44%	7.03%	7.42%	7.99%
18 months	6.29%	6.66%	7.27%	7.69%	8.19%
2 years	6.49%	6.93%	7.51%	7.92%	8.41%
3 years	6.99%	7.43%	7.95%	8.22%	8.51%
4 years	7.45%	7.77%	8.14%		
5 years	7.70%				

Given increased uncertainty, we favour floating for now. Broadly speaking, the rises implied by the mortgage curve are consistent with the RBNZ's projections, and our own expectations. If it were purely a question of cost, it would thus be a line call between remaining floating, or choosing a fixed term like 2-3 years. But is this enough? Given that you'd need to see interest rates rise by *more* than breakevens imply to be worse off remaining floating, many borrowers may not see that as a good enough reason to fix, especially as it offers less flexibility, and means paying a higher rate straight away.

On the other hand, **those looking for certainty may be prepared to pay a premium for it**, and if it is a line call, that may be enough reason to fix. If that is the case, our preference is either the 1 year or 2 year. Each has its appeal. For example, the 1 year is a special rate (it's lower than the 6 or 18 month) and one wouldn't need to see the floating rate rise by much for this strategy to immediately pay off. But when it rolls off, rates may be in the process of rising quickly, and you may get caught by timing. On the other hand, the 2 year costs a bit more. But it may see you through the bulk of upcoming rate rises, and if you can afford it, it may offer a good mix of cost and certainty.

We'll finish with one final observation. The conventional wisdom is that you take the RBNZ's 90-day projections and add the current spread between 90-day rate and mortgage rate to come up with a projected mortgage rate. This seems intuitively sensible and we see media and commentators doing it all the time. However, it is possibly too simplistic, for it assumes the 90-day/mortgage rate wedge will remain where it is. We certainly think there has been a structural change in the pricing of risk so this spread will remain wide, but the real question is, how wide will it be in future? A simple litmus test for us in terms of the OCR heading towards 5 percent is that the global economy would need to be a far better place. Otherwise, why would the OCR need to head up that far? Historically it's still low, but 200 plus basis points from here is a long way. And if the world economy is a better place, **eventually we'd expect the current 90-day/mortgage rate wedge to narrow somewhat**. This latter point is really another argument against panicking and jumping into the security fixed rates offer, and being wary of the simple maths people sometimes use. Certainty is good thing, of course: as long as you know there is a price you are paying for it.

FEATURE ARTICLE – COMMENT BY THE CHIEF ECONOMIST

SUMMARY

Our Chief Economist offers his thoughts on the journey the New Zealand economy started three years ago. While challenges remain and the economy is progressing through a stage of "grumpy" growth, the spirit of the journey is about creating some earnings backbone and spine for the economy. The quality of housing as an investment over the long haul will ultimately be determined by the tenacity behind it.

OVERVIEW

Last year I detailed **5 distinct stages for the NZ economy.** The first stage was the "*old normal*", specifically the decades prior to 2007 and particularly 2002 onwards where growth was heavily influenced by excessive leverage and risk taking, which led to asset price bubbles and artificial wealth-induced spending. Stage 2 saw the inevitable *purging* that followed such excesses over 2008 and 2009. Stage 3 was the healing or *recovery* process, helped by aggressive policy action. It started in late 2009 but petered out from mid 2010 as the realities of true balance sheet repair and global deleveraging came to the fore. The economy effectively rolled over as opposed to kicking on.

At some point in 2010 I thought the economy would enter the *transition* stage, which I characterise as "grumpy growth": there is growth, but it's not the sort we've been used to, and it's not in the feel-good areas of consumption and housing. Growth started to be led by different sectors, namely earning as opposed to spending. And this mix needs to be sustained: we require a secular (as opposed to cyclical) long-term change in the balance between producing and consuming. More of the former is required to sustain and give some backbone to the latter. The fifth and final stage is the endgame, where decisions in the transition phase will determine our long-term growth outlook. Or put another way, influence whether our children will inherit a rich land or something decidedly average.

Despite the major buffeting from earthquakes on the one side and record commodity prices on the other, and the escalating economic and financial drama in peripheral Europe providing a black cloud over our heads, **this basic framework is still a very useful way to think about the journey the New Zealand economy is on. The transition stage is critical.** Key here are your starting position (think national balance sheet), areas of comparative advantage (NZ is a lucky country too), structural changes around the globe (the emergence of the fabled Asian consumer and a less important US consumer), changes in the regulatory environment (think banking), incentive structures towards saving versus spending, and leadership versus populist style decision-making. All will play a role (or not) in helping the economy adjust. Will it happen in an orderly fashion? Of course not. The journey that started a few years ago is not just about economics, it involves a fundamental change in our society's DNA! And big pockets of New Zealand (and some global peers) still have that Freddie Mercury "I want it all and I want it now" attitude.

Stepping back, we know that:

- New Zealand has a poor balance sheet. Net external debt is 82 percent of GDP. It's world class, at the wrong end of the scale. A disproportionate share of GDP in this country is siphoned off to service that debt each year. It will remain our Achilles heel for years to come. People can point to supply-demand balance dynamics in housing all they want, but the bottom line is that the nation can afford only what it can afford and the balance sheet is critical.
- New Zealand is hugely rich in natural resources. Think water, climatic conditions, coal, natural beauty and a large seafood economic exclusive zone, to name a few. This gives New Zealand the opportunity to fix its balance sheet via income generation – much more pleasant than the alternative of years of austerity.
- The Asia story is phenomenal. Commodity prices have gone through the roof and New Zealand is a net commodity exporter. New Zealand's terms of trade sit at a 37 year high. True global rebalancing requires western societies to save more and Asia to save less, stimulating consumption. This defines the trend for commodities over the next fifty years, which is up. That said, it won't be any smoother a ride than it was on the way down over the last forty years. My personal view is that some of the current heat in commodity markets is liquidity driven and will unwind once US interest rates start to be normalised.
- The Doha trade round looks dead, but New Zealand is making huge inroads seeking bilateral trade agreements. The countries with which New Zealand already has a free-trade-agreement (FTA) with cover

FEATURE ARTICLE – COMMENT BY THE CHIEF ECONOMIST

almost 2 billion people (29 percent of global population), 15 percent of global GDP (in current prices), account for almost half of New Zealand's merchandise trade, and, importantly, are with countries that have been growing at a much faster rate than global growth. The FTAs under negotiation cover 1.8 billion people (27 percent of global population), 32 percent of global GDP and currently account for around 20 percent of New Zealand's trade. If all of them were to prove successful (they won't, but we'll stay positive!) then New Zealand would have free access to over half the world's population, accounting for close to half of global GDP. This represents a big playground for a country of just 4.4 million people.

- We're seeing changes to the regulatory framework aimed at realigning incentives. The *2010 Budget* tax package was the first step. The RBNZ has implemented new prudential measures. Greater use of prudential policy can potentially ameliorate the need to utilise the blunt OCR instrument excessively. The long-term consequence of this will be to take some pressure off monetary policy, which should result in more export-friendly currency outcomes over the cycle, US dollar challenges aside.

- It will take time for resources (capital and labour) to re-mobilise, as it responds to different economic incentives and price signals. Bottlenecks (particularly around the earthquake rebuild) could cause pockets of inflation that will challenge the Reserve Bank.

- A host of sectors are going through structural changes. This will produce winners and losers. As the mix to growth alters going forward, the "level" of normal activity in a host of sectors will be different. For example, we struggle to see the likes of house sales jumping back to 9,000 per month. Somewhere in the 6-7,000 zone is currently the "new normal". And the retail sector needs to get used spending growth mildly below income growth (sub 5 percent), as opposed to in excess of it.

- On the leadership-populism stakes, one metric for fostering change, New Zealand doesn't appear too bad – under either the red or blue hue. This may seem too generous an interpretation, as more could always be done. But my glass half-full view comes from eying other nations' "political" challenges! In a relative sense, we're doing okay.

- There are pockets of society that will simply not change. They will continue to believe that pre-crisis behaviour and outcomes (credit growth at double the rate of GDP) is normal. The fixation with housing remains a national pastime. Housing is still a good investment. However, it excessively dominates the average portfolio. However, it's not about changing everyone's behaviour and attitudes, merely getting critical mass. I suspect the likes of kiwisaver are having a more profound impact on how people view savings versus spending than is widely acknowledged.

- We have a narrow window of opportunity to "get things right". From 1985 to 2010, the population aged 15-64 was around 65 percent of the total. We had more workers and fewer dependants. We were in an earning / savings sweet-spot, but turned it into a spending free-for-all. The dependency ratio is now starting to move against us. Of course people are healthier and will work longer, but fewer workers and more dependants make it more imperative that progress is made immediately in unlocking income generation and fixing our national balance sheet.

Of course we need to put all this within a global context as well. Over the coming years we will continue to see wobbles. Simply shifting the debt burden from the private sector to the public sector in some key nations has mitigated extreme downside risks and bought a bit of time, but has not altered the requirement to get national balance sheets in order. Welcome to a decade of fiscal austerity, which means we pay. My personal watch-list includes European sovereign debt issues, with some form of haircut or, the latest euphemistic buzzword, "re-profiling," likely for bondholders. And those bondholders include key players in the global financial system. The US faces challenges here too, but appears to have greater economic flexibility to work their challenges through, though political gridlock and the lack of decisiveness over the fiscal position are worrying. Net on net though, I prefer US dollars over Euro, partly because so much bad news is priced into the US dollar. I'm a big believer in the Asia story, led by China, but would express a word of caution. With success come other challenges. Inflation in China is picking up and needs to be tamed. It's a social challenge as well as an economic one. Investment sits at close to 50 percent of GDP, a pretty well unprecedented level and I wonder about the return on some of that investment: investment quality should not be forsaken for quantity. The Chinese regulators have increased reserve requirements for banks 12 times and hiked interest rates four

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times since the start of 2010. Momentum needs to slow, albeit from a gallop to a canter. Fabled soft landings are desirable but sometimes difficult to hit.

Given this combination, it takes a brave economist to give a precise forecast for the coming years. There are fiscal austerity and regulatory changes to be worked through, and exit strategies from unprecedented stimulus to be devised (most notably when the Fed lifts interest rates and of course locally the RBNZ). Fears of deflation in the west have been countered by rising inflation in the east! And a second round of global financial crisis cannot be ruled out, if the Greece sovereign debt crisis explodes into something larger. Locally we have seismic events to contend with on top of this. The risks are clear.

But all up I'm progressively becoming more encouraged. Progress is being made. Analysis by Reinhart and Rogoff in their bestselling book "This Time is Different" shows that the recovery process following a financial crisis is slow, taking something in the order of 7 years. This is something of which we need to be mindful. **Nonetheless, with each passing year, progress is being made.** For housing investors and a spendthrift society the past few years in New Zealand have seen some bitter medicine delivered. But such hard yakka is giving some spine and backbone to the economy. **Housing will become a better long-term investment because of it.**

Cameron Bagrie

Chief Economist

KEY FORECASTS

Weekly mortgage repayments table (based on 25-year term)

Mortgage Size ($'000)	Mortgage Rate (%)													
	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00	8.25	8.50	8.75	9.00
200	290	297	304	311	319	326	333	341	348	356	364	371	379	387
250	363	371	380	389	398	407	417	426	435	445	455	464	474	484
300	435	446	456	467	478	489	500	511	522	534	545	557	569	581
350	508	520	532	545	558	570	583	596	610	623	636	650	664	677
400	580	594	608	623	637	652	667	682	697	712	727	743	758	774
450	653	669	684	701	717	733	750	767	784	801	818	836	853	871
500	725	743	761	778	797	815	833	852	871	890	909	928	948	968
550	798	817	837	856	876	896	917	937	958	979	1000	1021	1043	1064
600	870	891	913	934	956	978	1000	1022	1045	1068	1091	1114	1137	1161
650	943	966	989	1012	1036	1059	1083	1108	1132	1157	1182	1207	1232	1258
700	1015	1040	1065	1090	1115	1141	1167	1193	1219	1246	1273	1300	1327	1355
750	1088	1114	1141	1168	1195	1222	1250	1278	1306	1335	1364	1393	1422	1451
800	1160	1188	1217	1246	1274	1304	1333	1363	1393	1424	1454	1485	1517	1548
850	1233	1263	1293	1323	1354	1385	1417	1448	1480	1513	1545	1578	1611	1645
900	1306	1337	1369	1401	1434	1467	1500	1534	1567	1602	1636	1671	1706	1742
950	1378	1411	1445	1479	1513	1548	1583	1619	1655	1691	1727	1764	1801	1838
1000	1451	1486	1521	1557	1593	1630	1667	1704	1742	1780	1818	1857	1896	1935

Housing market indicators for May 2011 (based on REINZ data)

	House prices (Ann % change)	3mth % chng	No of sales (s.a.)	Mthly % chng	Avg days to sell (s.a)	Comment
Northland	-12.1	-3.1	105	(+4%)	79	The weakest annual change in sale prices
Auckland	2.1	1.6	1,982	(+5%)	35	Auckland recorded the quickest sale time
Waikato/BOP/Gisborne	2.6	0.4	777	(+16%)	65	The strongest annual lift in house prices
Hawke's Bay	-2.8	-2.7	181	(+50%)	55	Sales numbers rebounded strongly
Taranaki	2.0	-1.1	261	(+17%)	54	The number of sales lifted to a 22-month high
Manawatu-Whanganui	-6.8	-0.7	171	(+26%)	60	The second strongest lift in sale numbers
Wellington	-2.6	-1.6	557	(+5%)	44	The average sale price hit a 2-year low
Nelson-Marlborough	-0.1	1.8	199	(+11%)	58	The highest monthly number of sales this year
Canterbury/Westland	1.6	2.4	648	(+9%)	38	Second shortest sale time across the regions
Central Otago Lakes	-6.2	6.1	101	(+8%)	72	The strongest 3 month price change
Otago	2.2	0.7	234	(+0%)	44	House sales in May lifted by one, from April
Southland	-8.1	-5.4	145	(+16%)	45	Recorded the weakest 3 month price change
NEW ZEALAND	0.1	1.3	5,323	(+10%)	44	Turnover up, but prices and selling time static

Key forecasts

	Actual			Forecast						
Economic indicators	**Sep 10**	**Dec 10**	**Mar 11**	**Jun 11**	**Sep 11**	**Dec 11**	**Mar 12**	**Jun 12**	**Sep 12**	**Dec 12**
GDP (Ann Avg % Chg)	1.3	1.5	1.2f	1.0	1.3	2.3	3.3	4.3	4.6	4.3
CPI Inflation (%)	1.5	4.0	4.5	5.1	4.8	3.1	2.9	2.9	2.7	2.6
Unemployment Rate (%)	6.4	6.7	6.6	6.6	6.3	6.3	6.2	6.2	6.0	6.0

	Actual			Forecast (end month)						
Interest rates	**Apr 11**	**May 11**	**Latest**	**Sep 11**	**Dec 11**	**Mar 12**	**Jun 12**	**Sep 12**	**Dec 12**	**Mar 13**
Official Cash Rate	2.50	2.50	2.50	2.50	2.75	3.25	3.50	3.75	4.00	4.25
90-Day Bank Bill Rate	2.7	2.7	2.7	2.7	3.1	3.7	3.8	4.2	4.3	4.8
Floating Mortgage Rate	6.0	6.0	6.1	6.1	6.4	6.8	6.9	7.0	7.1	7.4
1-Yr Fixed Mortgage Rate	6.1	6.1	6.0	6.1	6.4	6.7	6.7	7.0	7.1	7.6
2-Yr Fixed Mortgage Rate	6.5	6.5	6.5	6.7	7.1	7.4	7.4	7.7	7.7	8.1
5-Yr Fixed Mortgage Rate	7.7	7.7	7.7	8.1	8.4	8.6	8.7	8.7	8.6	8.6

IMPORTANT NOTICE

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.
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- Direct Broking Limited (DBL), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. DBL 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:

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- 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.

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