

NEW ZEALAND ECONOMICS

ANZ QUARTERLY ECONOMIC FORECASTS

29 September 2010

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BUILDING A BASE FOR A BETTER 2011

NEW ZEALAND ECONOMIC OUTLOOK

The near-term economic outlook has softened compared to our June forecasts. The recovery is ongoing, but extremely patchy with households, farms and businesses concentrating on improving balance sheets. We still expect a substantive recovery to emerge in 2011. Within the spirit of a strong 2011, the five year picture is one of modest growth, which in part reflects a sustained period of structural change across the economy.

GLOBAL OUTLOOK

The pace of global expansion remains uneven, with robust growth out of ex-Japan Asia contrasting with a more sedate pace of expansion among developed market economies – a dichotomy that is expected to continue. Importantly for New Zealand, strong growth is expected to continue in increasingly influential trading partners. While not our central scenario, we put the odds of a double-dip global recession at one in four.

FISCAL POLICY

After providing economic support through the recession, fiscal policy continues to move to a more contractionary stance. However, one-offs and low income growth are expected to contribute to the deficit peaking in 2010/11. A key challenge facing the government is fostering an economic framework that encourages robust and sustainable growth, when they need to focus on restraint. Watch for tensions between leadership and populism.

INFLATION

Headline inflation is set to push past 5 percent on the back of the GST increase. But abstracting from that, underlying inflation is set to remain well contained. Weak domestic demand and an elevated NZD will see further downward pressure on retail related goods which will be offset by higher food prices and price pressure from the non-contestable parts of the economy.

EXCHANGE RATE

The NZD is being buffeted by contrasting forces. A weak outlook for domestic demand and a more gradual tightening profile by the RBNZ may signal a lower NZD, but the reality is that New Zealand's prospects still look better compared to others. A rampant AUD and high commodity prices will provide support for the NZD, with the threat of further quantitative easing (QE) by the US Federal Reserve weighing down the USD in the near-term. The NZD looks destined to remain in a 0.70 to 0.74 range into next year, but should remain sub 80 cents against the AUD for a while to come.

INTEREST RATES

A loss of economic momentum and a weak economic outlook has prompted the RBNZ to call a halt to rate rises. While we agree with the spirit of the RBNZ's latest assessment (and the market's), we think they have turned from being overly optimistic three months ago to too bearish on prospects now. We see a resumption of rate hikes in March 2011, and for a gradual and staggered profile, but more aggressive than current market pricing.

KEY ECONOMIC FORECASTS

Calendar years	2007	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
NZ Economy (annual average % change)							
Real GDP	2.8	-0.2	-1.7	1.9	3.9	2.6	2.0
Employment	1.9	0.6	-1.1	0.7	2.0	1.6	1.5
Unemployment Rate (Dec qtr)	3.5	4.6	7.1	6.4	5.4	5.6	5.3
Terms of trade (SNA basis)	5.9	2.5	-6.8	8.4	3.2	-1.4	-1.1
Global Growth (annual average % change)							
US	1.9	0.0	-2.6	2.7	2.5	3.3	2.6
Australia	4.8	2.2	1.2	3.3	3.9	3.9	3.6
Japan	2.3	-1.2	-5.2	2.7	1.5	2.0	2.0
China	12.0	9.1	8.5	10.2	9.6	9.8	9.3
Trading Partners	4.2	1.6	-0.9	4.5	3.9	4.2	4.0
NZ Inflation (annual % change)							
CPI Inflation	3.2	3.4	2.0	4.6	3.0	2.4	3.1
Non-tradable Inflation	3.5	4.3	2.3	5.2	3.8	3.3	2.9
Tradable Inflation	2.8	2.3	1.5	3.8	2.0	1.3	2.8
NZ Financial Markets (end of December quarter)							
TWI	71.8	56.2	66.3	66.2	69.1	65.5	67.2
NZD/USD	0.77	0.58	0.72	0.71	0.72	0.67	0.68
NZD/AUD	0.88	0.82	0.81	0.76	0.77	0.77	0.83
Official Cash Rate	8.25	5.00	2.50	3.00	4.25	5.25	5.25
90-day bank bill rate	8.9	5.1	2.8	3.3	4.7	5.5	5.5
10-year bond rate	6.4	4.6	5.8	5.2	6.2	6.3	5.9
Fiscal and External Balance							
Current Account Balance (\$m)	-14,400	-16,059	-5,366	-5,900	-7,600	-9,800	-11,600
as % of GDP	-8.1	-8.8	-2.9	-3.0	-3.6	-4.4	-5.0
Government OBEGAL (\$m)*	5,850	5,637	-3,893	-5,700	-8,700	-4,800	-3,800
as % of GDP	3.4	3.1	-2.1	-3.0	-4.3	-2.2	-1.7

* Operating balance excluding gains and losses, June years

Forecasts and text finalised 29 September 2010.

KEY FORECAST ASSUMPTIONS:

- Dubai oil prices are expected to trade within a US\$70 to US\$85 per barrel range for the rest of this year, gradually rising towards US\$90 per barrel by 2011.
- Annual net Permanent and Long-term immigration, which peaked at the start of the year, will ease to an annual net inflow of 8,000 persons by the end of the year. An easing off in PLT departures will see net immigration pick-up to a net inflow of 12,000 in the calendar 2011 year.
- The longer-term potential growth rate is now seen in the 2 to 2½ percent range.
- The neutral Official Cash Rate is around 5 percent given high bank funding costs, which are expected to remain elevated for some time.

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SUMMARY

The near-term economic outlook has softened compared to our June forecasts. The recovery is ongoing, but extremely patchy. Deleveraging remains pervasive as households, farmers and businesses concentrate on improving their balance sheets. We still expect a substantive recovery to emerge in 2011 as the process of balance sheet repair nears an end, earthquake reconstruction work gets underway, the labour market recovery strengthens, higher rural incomes eventually filter through, and benefits of the global recovery flow-through into export incomes. However, this outlook remains contingent on the projected global recovery eventuating. Within the spirit of a strong 2011, the five year picture is one of modest growth, which in part reflects a sustained period of structural change across the economy.

THE BIG PICTURE

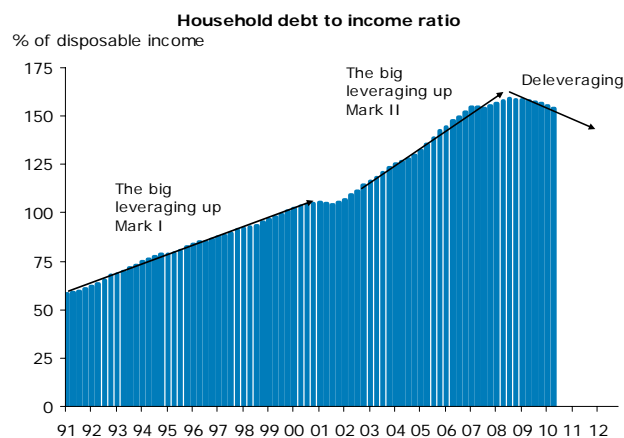
Right up front we need to draw attention to the big picture and acknowledge some critical dynamics that underpin our forecasts.

- **The New Zealand economy is facing an elongated period of structural change** as it rebalances away from a spending centric model towards more balanced growth. **During this period, the trend rate of growth will be lower.** Or put another way, making a buck will require more hard graft.
- **Deleveraging remains a dominate influence on the business cycle.** It is constraining growth in 2010, but the process of balance sheet repair raises the potential for some pent-up demand to be unleashed in 2011, but within the spirit of a subdued five-year picture.
- **We have regularly characterised the post-credit crisis as a “bathtub with waves” shaped cycle,** and the spirit of this remains intact. There are massive tensions within the global financial system, and despite record monetary and fiscal policy stimulus supporting the global economy, you simply don't emerge from a credit crisis in the space of two years. There is much work still to be done. These include the process of global rebalancing, implementing regulatory changes, and navigating monetary and fiscal policy so that they support near-term prospects, but do not undermine the medium-term outlook. In practice, this is a tall order to deliver on and is adding additional layers of uncertainty and wider than usual error bands around the forecasts.

INITIALLY A SLOW RECOVERY

The gradual recovery of the New Zealand economy continues. Normal cyclical dynamics, policy support and inventory rebuilding have played a key role. Higher bank funding costs have placed a wedge between the OCR and actual borrowing rates to households and firms. Nonetheless, overall borrowing rates remain below historical averages. Despite tentative signs that the demand for credit is returning, credit conditions remain tighter than during the boom years. Momentum is being restrained by structural headwinds. **Deleveraging remains pervasive as households, farmers and businesses concentrate on improving balance sheets.**

The process of balance sheet repair has further to run. Household debt to income has fallen from at peak of 159 percent in late 2008 to 154 percent currently. New Zealand's net external debt has fallen from 91 to 86 percent of GDP. Such dynamics tell us structural headwinds are abating. However, the household sector still has a negative savings rate and rural sector debt is 25 percent of GDP, with dairy sector debt rising from \$12 to \$29 billion in six years. This compares to total sector income (before expenses) of around \$10bn. As such, the industry is heavily leveraged. **Such forces are restraining the potential for pent-up demand and a pro-cyclical recovery from being unleashed.**



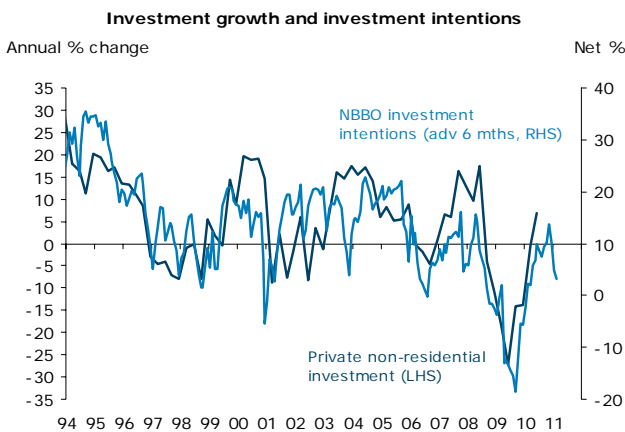
We see ongoing growth in the near-term outlook, but of a patchy nature and certainly at a slower rate that what would normally be expected at this stage of the cycle. The usual base effects are supporting growth, but for now business and residential investment remains restrained. Manufacturing is one of the stronger performers and has mirrored the robust recovery in manufacturing seen in our major trading partners

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courtesy of re-stocking, although of late momentum in the New Zealand manufacturing sector has slowed. Stocks have been rebuilt, but final demand is still weak.

The domestic housing market still remains subdued and we doubt this picture will change soon. With price expectations of buyers and sellers still poles apart, sales volumes remain low. Prices have barely budged since September last year. These factors will keep residential investment in check, with consents close to cyclical lows as a proportion of the housing stock. Recent declines in fixed mortgage interest rates are expected to prop up the market over the next few months. But the stark reality for house prices is that low affordability and weak balance sheets are proving more influential than pending supply-demand imbalances. Of course, all property doesn't come under this generalisation, but as a broad principle it applies.

Business confidence remains respectable, but sub-components are flagging a lack of conviction. Firms remain relatively upbeat when looking at their own business prospects, but of late we've seen a worrying easing in firms' appetite to invest and hire. Both are critical elements for the recovery to broaden but are missing in action at present.



The recovery in business investment has been gradual and has lagged the cycle. Survey measures of investment intentions have weakened sharply in recent months and are well below where they should be at this stage of the cycle. Profitability is constrained, with demand for credit low. Businesses lack conviction about the duration of the upswing, with plant and machinery investment volumes nearly 30 percent below pre-recession peaks. Weakness in business investment is not just problematic for the demand side of the equation, but what it foretells of in terms of building

supply-side capacity. **Current weakness does not bode well for the economy's capacity in 2011-2013.**

The Canterbury earthquake proved to be costly. Thankfully there was no immediate loss of life, but the magnitude 7.1 earthquake on September 4 caused significant damage to property and the productive capital stock. Latest official estimates place the cost of damage at \$4bn (0.6 percent of New Zealand's net capital stock). The rebuild will create growth per se, but this merely replaces lost capital so the growth is more technical than real. Around one third of this is from repairing the estimated 100,000 affected dwellings that have suffered damage as a result of the quake. Damage to infrastructure, residential structures and contents above the EQC threshold (\$120,000 plus GST) and non-residential structures very quickly make up the remainder. While insurance companies are likely to pick up some of the tab, the government and affected households and businesses are likely to be significantly out of pocket and balance sheet wealth has taken a hit.

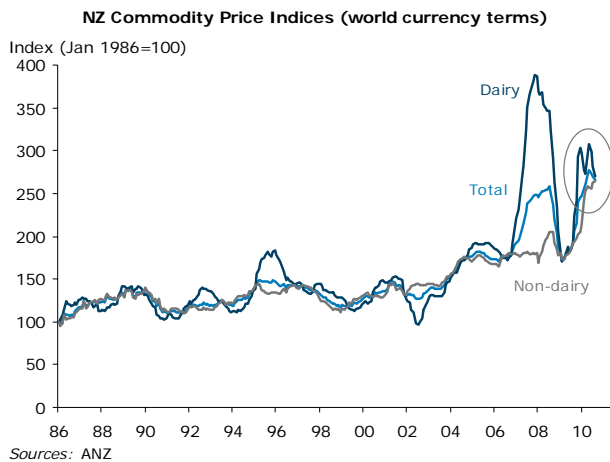
The earthquake is expected to contribute to volatility in economic activity. With the Canterbury region accounting for 15 percent of NZ's GDP, earthquake disruptions are likely to temporarily weigh on economic activity. We put the near-term cost of disruption at around 0.5 percent of GDP. Some aspects will spill into 2011, such as the flow-on for tourism, but this should be more than offset by reconstruction related activity in 2011. For 2011, we expect the net impact to be positive by around 0.5 percent of GDP.

The patchiness of the recovery and the need to provide ongoing policy support is expected to see the RBNZ remain on the sidelines for the rest of 2010.

Despite near-term challenges, we are still seeing some positive signs. First-up, we take weakness in housing and retailing as a positive for 2011. They foretell of balance sheet repair and set the scene for a more durable upturn. Resources are in the process of shifting to the earning side of the economy from the spending side. **High export commodity prices continue to provide support.** Export commodity prices are just shy of record highs and remain at historically high levels in globally inflation adjusted terms. Furthermore, commodity price strength has been more broad-based and not just confined to dairy. Whilst global dairy export prices are around a tenth off April levels, supply shortages and higher feed costs are expected to underpin robust prices for some time to

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come.

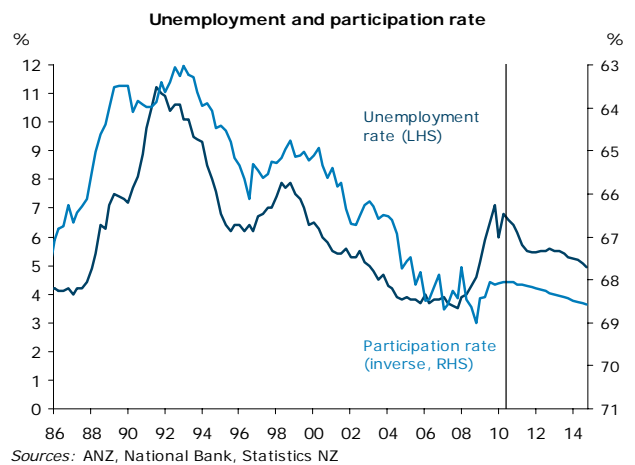


Among our trading partners, strong momentum remains evident in Asia (ex-Japan) and Australia. These economies are becoming increasingly influential for New Zealand. Inc, taking around 55 percent of our merchandise exports as opposed to 35 percent two decades ago. Stronger demand from these markets is supporting our commodity based exports, with dairy, meat and forestry exports now accounting for nearly half of total merchandise exports.

Manufacturing sector exports have been benefiting from the global recovery in manufacturing activity as inventories are rebuilt. Strong demand from Australia and the low NZD/AUD exchange rate are also proving supporting and a NZD/AUD at sub 80 cents is simply money for jam. This currency cross and a good ski season are also supporting services exports. However, a high NZD relative to the GBP and EUR is appearing to adversely impact visitor arrivals and tourism spending from Europe, as well as exports to those destinations.

The labour market has turned the corner and is in subdued net job creation mode. But demand is very segmented across industries. New Zealand labour market data has been notoriously volatile of late and if we are to believe the statistics (which we don't), unemployment fell from 7.1 percent at the end of 2009 to 6 percent in Q1 2010 and rose back to 6.8 percent in Q2. What we know is that leading surveys of employment have softened of late as some caution re-emerges. But industry contacts suggest a better underlying picture and a very segmented market with strong demand for some industries but poor demand for others. Official numbers of registered unemployed are starting to ease – albeit very slowly. Hours per employee remain lower than average (33.5 hours versus a historical average of 34.7 and a trough of

33.0). So firms have been increasing their demand for labour via longer hours and there is scope for more of this to come. Gross earnings are up 4.6 percent on a year ago, which when combined with a flat retailing environment is allowing households to allocate more to saving and repairing balance sheets. Net-on-net the underlying unemployment rate looks to be slowly easing. This is a positive, but still a far-cry from sub-6 percent unemployment rates that fosters real job security and strong wage demands.



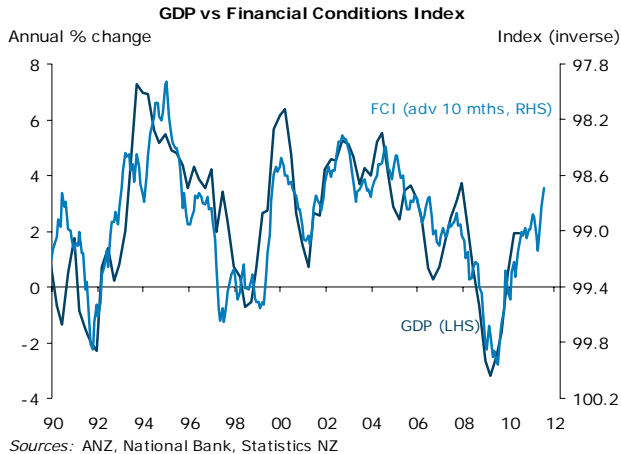
STRONGER 2011

We are remaining optimistic about prospects for 2011. We have always taken a sub-consensus view on 2010 growth and an above-consensus view for 2011, and see little reason to change our stance, least of all on a lagging weak Q2 GDP read, which all and sundry are now jumping on. **Our stronger assessment for 2011 is premised on:**

- The income boost from higher export prices flowing through the economy.
- The process of balance sheet repair in 2010 and weakness in some sectors allowing a lower base for growth to spring from. Technically, this will feel like statistical growth, but we'll still take it!
- Reconstruction work from the September 2010 Canterbury earthquake will boost residential and non-residential construction activity.
- A cyclical rebound in business and residential investment starts. Improving corporate and household balance sheets will be influential.
- A strengthening in trading partner growth and boost from the Rugby World Cup.
- Supportive financial conditions. Despite recent global malaise, financial markets have moved accordingly (i.e. expectations for a higher OCR

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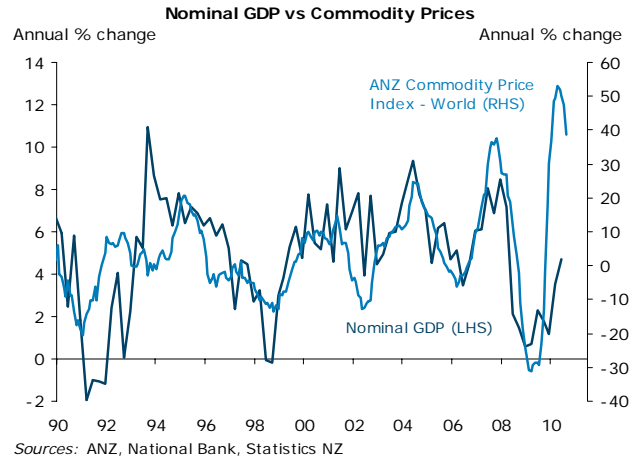
have been pushed out), and this should support activity in 2011.



- An element of pent-up-demand ready to be unleashed. We still believe deleveraging remains a key constraint on the business cycle. However, we struggle to see consumers keeping their wallets perennially shut. With the current account deficit at 3 percent of GDP, there seems some scope for pent-up demand to occur before we get into the worry zone of 4½ to 5 percent deficits. (Beyond that zone net external debt relative to the size of the economy starts to rise).
- Underlying population growth. Bottom's on seats provides support. Natural population growth is around 0.9 percent per annum. While net immigration is easing and there remains the normal uproar about losing people to Australia, net immigration remains positive. Since the start of 2008 the economy has shrunk by 1.2 percent. But real per capita GDP has shrunk by 4.1 percent - which is a better underlying measure of the economic adjustment the economy has gone through. Though challenges remain we struggle to see how growth will not bounce back given greater scope for pent-up demand to be unleashed.

A more broad-based recovery is expected to eventuate, with the economy growing at a robust above trend rate. The income boost provided by higher export commodity prices will now be more broad-based across various sectors. We continue to assume a fair chunk of the proceeds will be used to repair rural balance sheets and retire outstanding debt. But we also suspect a fair portion of the proceeds will be spent on critical investment, maintenance and expenditure. Households receive a \$600 million tax windfall from October 1 (tax cuts and GST come in, but the full

"costs" such as changes to property depreciation rules are not implemented until April 1 next year).



Our projections assume that the earthquake reconstruction work will take up to five years to fully complete, with around half of the work completed by early 2012. Initially this is likely to coincide with the foreshadowed cyclical rebound in residential and business investment activity. Implicit in our projections is the assumption that there will be enough spare capacity in the construction sector to handle both of these competing demands. We also assume that the Canterbury region will be able to secure the necessary capacity to carry out the work. At present there is considerable spare capacity within the construction sector with the floor area of residential consent issuance approximately one third percent below historical averages as a portion of the dwelling stock.

However, the rebound in activity is likely to be hamstrung by the wider effects of the earthquake. Despite insurance companies and EQC picking up much of the tab, household balance sheets have not escaped the quake unscathed altogether. Moreover, the likes of tourism flows are likely to be impacted into 2011, house prices in certain Christchurch suburbs will come under pressure, and no doubt we'll see higher insurance premiums across the whole country after the quake, which siphons consumer spending power.

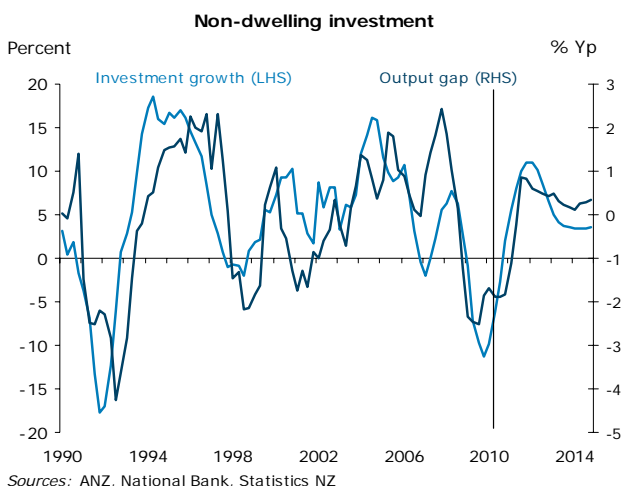
Furthermore, there remains some tension within the outlook. While progress is being made at rebalancing the economy, the job is not yet complete. Low domestic interest rates and subdued business profitability had previously helped to narrow the current account deficit and arrest the trend increase in external indebtedness. However, as corporate profitability and the demand for imports recover, we still expect to see a

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widening current account deficit over the forecast horizon. Rising external debt leaves New Zealand vulnerable and emphasises how important it is for us to get our house in order.

Also driving a widening in the current account deficit will be a strengthening in consumer spending in 2011. Key to this will be an improving labour market. We see employment following the improvement in hours worked, with the unemployment rate to gradually decline towards 5½ percent by the end of next year. Wage growth will also start to firm as additional capacity in the labour market is used up. Strengthening residential investment and a recovering housing market will also underpin demand for consumer durables.

We expect a pick-up in business investment by mid-next year as profitability increases and the narrower margin of spare capacity facilitates more capacity enhancing investment. The improvement in business investment is forecast to be broad based, with plant and machinery and transport equipment set to feature prominently. Implicitly, this judgment is premised on the view that the current weakness in surveyed business investment intentions is temporary. Non-residential construction is expected to lag the improvement in other components, with earthquake reconstruction work proving support at the margin. Also providing some support will be the cut to the company tax rate from 30 percent to 28 percent from April next year.



Export activity will also be underpinned by a broadening in trading partner demand.

Commodity exports should continue to benefit from strong demand from emerging economies, although biological constraints will limit the volume response. Services exports are due to benefit from the 2011 Rugby World Cup and the labour market recovery in

key overseas tourist markets. Manufacturing exports should continue to receive additional support from the recovering global economy, not to mention a favourable NZD/AUD exchange rate.

The strengthening evident in economic activity and underlying inflationary pressures are expected to prompt the RBNZ to resume policy tightening. Our projections assume a series of measured 25 basis point hikes from March next year, although we acknowledge the possibility of moving in 50 basis point chunks could not be ruled out altogether. **We forecast the OCR to peak below 5½ percent this cycle, although there is the risk of a higher peak if the RBNZ leaves the policy tightening too late.**

THE FIVE-YEAR STORY

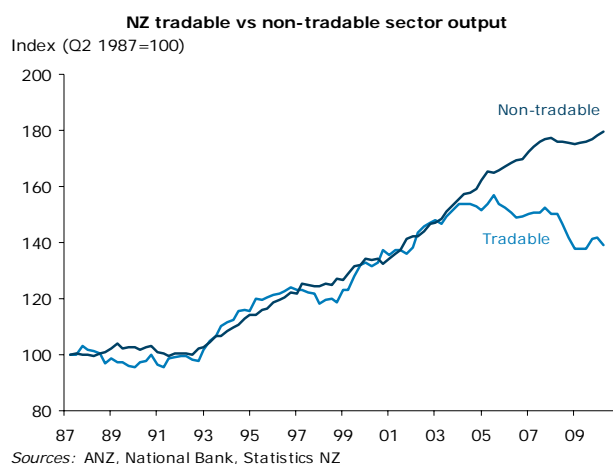
Beyond 2011 we assume a sedate period of growth. This reflects the wider rebalancing process for the economy as growth in the tradable sector closes in on the non-tradable sector, or the economy seeks the holy grail of economics, namely more balanced growth. This journey is expected to be punctuated by volatility and we are under no illusions about the challenges ahead. Moreover, this journey faces a few reality checks.

- You need a plan (or opportunity) in the first place. A shift in global growth momentum towards Asia provides this.
- Policymakers need to be taking a more proactive policy stance. We have seen the first stage of this in the 2010 Budget with a major realignment of the tax system. But follow-up initiatives are required.
- Resources (think capital and labour) take time to physically shift across sectors. For instance, even if we start training more engineers, scientists and tradespeople today (which are required for a more tradable-centric growth model), we are unlikely to see tangible supply-side benefits for another four to five years.
- Exit strategies need to be conducted. The fiscal position needs to return to the black, and monetary policy settings need to normalise.

This is a tall order to flow through into any economic assessment so while we have portrayed a growth-friendly trajectory, we suspect the reality will be anything but with greater volatility over the time horizon. Some of this volatility is going to be determined by economic issues, opportunities and challenges. But behavioural dynamics will also be prevalent. We are talking about a generational shift in peoples' attitudes to housing, saving and investing.

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Moreover, challenges and the opportunities the economy faces are also coming at a time when demographics are working against us. There is a huge portion of the nation's capital tied up in the 55 to 65 age bracket and one immediate challenge here will be firing them up for the opportunities that beckon.



RISKS

Like any economic assessment, there are the normal risks and caveats. We assume that global economic activity evolves broadly as projected. Our projections assume that supply-side capacity will be sufficient to accommodate a modest strengthening in growth from early next year. We also assume that net immigration inflows remain positive. Implicit in our forecasts is the assumption that the NZD plays a buffering role and does not overtly strengthen and hamper the rebalancing of the economy.

Beyond these, we remind readers of the underlying spirit of our forecasts: **the world and New Zealand.Inc are undergoing a period of profound change.** Events of 2008, 2009 and 2010 are the start of a long journey. The economic outlook is more positive. But **the speed we can grow will still be capped for some time by the decisions we have made in the past, and the time it takes to get our house in order.**

NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual percent change)	2007	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
Total Consumption	4.0	0.8	-0.2	2.2	1.7	1.6	1.8
Private Consumption	3.9	-0.3	-0.7	1.9	1.7	1.5	1.8
Public Consumption	4.1	4.9	1.5	3.3	1.9	2.0	1.8
Total Investment	5.4	-1.1	-12.5	3.0	11.3	7.1	3.9
Residential investment	4.6	-16.6	-18.4	8.8	12.8	9.2	5.9
Other investment	5.6	2.8	-11.3	2.0	11.0	6.6	3.5
Stockbuilding¹	0.4	0.4	-2.5	0.7	1.0	0.4	0.1
Gross National Expenditure	4.8	0.4	-5.2	3.5	5.0	3.3	2.4
Total Exports	3.9	-1.1	0.4	4.3	9.1	5.4	4.4
Goods	5.5	0.1	1.8	5.9	8.3	5.9	4.2
Services	0.0	-4.5	-4.4	-1.6	9.9	3.7	5.2
Total Imports	8.7	2.8	-15.1	8.7	11.5	6.9	5.1
Goods	8.9	3.5	-16.2	9.2	13.5	7.7	5.3
Services	8.1	0.9	-11.5	5.7	4.3	4.2	4.3
Expenditure on GDP	3.3	-0.6	-0.5	2.3	4.0	2.6	2.1
GDP (production based)	2.8	-0.2	-1.7	1.9	3.9	2.6	2.0

¹ Percentage point contribution to growth

GLOBAL OUTLOOK

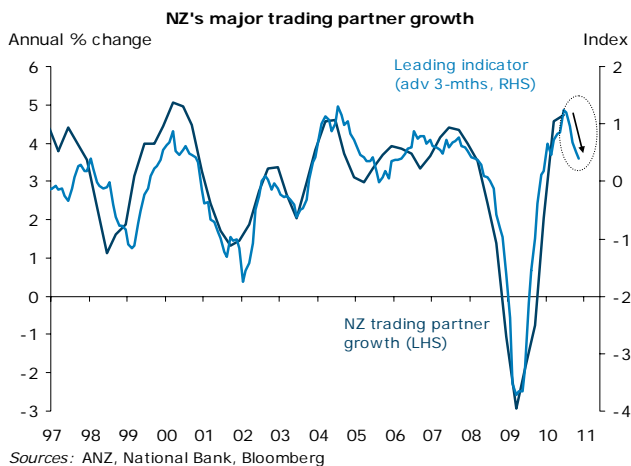
SUMMARY

The pace of global expansion remains uneven, with robust growth out of Asia ex-Japan contrasting with a more sedate pace of expansion among developed market economies – a dichotomy that is expected to continue. Importantly for New Zealand, strong growth is expected to continue in increasingly influential trading partners. However, the overall global recovery is expected to remain patchy and skittish. While not our central scenario, we put the odds of a double-dip global recession at one in four.

UNUSUALLY UNCERTAIN

The global economy recovered strongly from recession, posting strong growth rates late last year and over the first half of this year.

This was underpinned by extraordinary fiscal and monetary policy stimulus, alongside an inventory rebuilding cycle. Policy remains extremely accommodative. However, the inventory cycle has now run its course. With final demand in advanced economies still weak and global imbalances far from resolved, momentum has stalled, though there is a notable East-West divide that has emerged.



Rising demand from emerging economies is continuing to drive the global economy forward. The Australian economy remains a major beneficiary of this growth, with resource related investment set to boost 2011 economic activity.

GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2007	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
United States	1.9	0.0	-2.6	2.7	2.5	3.3	2.6
Australia	4.8	2.2	1.2	3.2	3.9	4.0	3.6
Japan	2.3	-1.2	-5.2	2.5	1.5	2.0	2.0
Euro Zone	2.9	0.3	-4.0	1.3	1.2	1.8	1.9
China	12.0	9.1	8.5	10.2	9.6	9.8	9.3
Trading Partner Growth	4.2	1.6	-0.9	4.5	3.9	4.2	4.0

China remains a growth enigma, so much so that policymakers look to face inflation challenges. How orderly they can rein such pressures in presents another layer of global uncertainty. Prospects in the US have dimmed as households concentrate on repairing balance sheets, with policy settings already at full stretch. The US economy has slowed to stall speed, making it susceptible to adverse shocks. In many other OECD economies, policymakers are already pushing on a string.

New Zealand's major trading partners are forecast to grow by 4.5 percent this year, an above trend pace. However, this masks diverging prospects not only between economies themselves, but also the relative pace of growth between the first and second half of the year. With the inventory cycle no longer providing impetus to growth, and Asian policymakers seeking to slow growth in their economies towards more sustainable rates, we are forecasting a pullback in 2011 trading partner growth to 3.9 percent.

Our central scenario has Chinese policymakers successfully steering their economy towards a sustainable growth path of 9 to 9.5 percent.

This relies on the Chinese economy becoming less reliant on exports and investment as the main drivers of growth, switching towards a greater focus on domestic demand. Achieving this switch will likely see greater volatility in the short-term.

However, the risks remain to the downside. Sovereign debt concerns in Europe have not been addressed. Austerity measures are yet to fully hit home in the peripheral Eurozone economies. In addition, the **parlous state of federal and state government finances, the soggy housing market and high unemployment are encouraging US households to bolster saving,** acting as a huge drag on US growth prospects. Offsetting this to some extent are strong corporate balance sheets. We see policy support eventually gaining traction, leading to better US growth performance next year. But the **chances of a double-dip are non-trivial in our view, and we place the odds of this occurring at about one in four.**

FISCAL POLICY

SUMMARY

After providing economic support through the recession, fiscal policy is moving to a contractionary stance. One-offs and low income growth are expected to contribute to the deficit peaking in 2010/11, before continued expenditure restraint and a recovery in tax revenues start to erode the deficits. Abstracting from balancing the books, a key challenge facing the government is fostering an economic framework that encourages robust and sustainable growth, at a time when they need to focus on restraint. Watch for tension between leadership and populism.

GETTING THE HOUSE IN ORDER

The fiscal deficit is expected to peak at 4.3 percent of GDP in the 2010/11 fiscal year, with a weak economy, an overhang of prior Budget spending decisions and one-offs all contributing. The Government faces challenges supporting the economy – via spending, tax and the regulatory framework, but within the context of returning the public finances to the black. The latter is essential if current projections of net debt peaking at 27 percent of GDP are to be achieved. While Budget 2010 delivered a sizeable tax package, the package itself was fiscally neutral (although not over the 1 October 2010 to 1 April 2011 period where there is a net injection of 0.3 percent of GDP). **We then expect the process of fiscal consolidation to continue, with the fiscal tightening equivalent to approximately 0.5 to 1 percent of GDP per annum over a number of years.**

A key element to maintaining fiscal discipline will be continued expenditure constraint with the Government committing to \$1.1 billion in new discretionary spending per year (versus over \$2 billion committed per annum from 2000 to 2007). But this in itself may not be sufficient and it will be difficult to control expenditure growth in certain

areas. For example, since 2000 increases in health expenditure have averaged \$650m per annum, and health only accounts for 21 percent of total core Crown expenses. The Government is no different to a lot of businesses across New Zealand in that they are now facing the reality of a different economic environment. This requires a fundamental rethink of the entire business operation. It is untenable to keep spending in excess of income, but selling this to an electorate demanding champagne level government spending on a beer income will be challenging.

We forecast the underlying operating balance (OBEGAL) to gradually improve from -4.3 percent of GDP in 2010/11 to around -1.3 percent by 2013/14, returning to surplus thereafter. Net public debt (excluding NZ Super Fund assets) is expected to reach close to 26.7 percent of GDP by 2013/14 but trend down thereafter.

The more significant challenge for Governments, both locally and globally, is fostering an economic framework that encourages robust and sustainable growth. The 2010 Budget made inroads here by cutting taxes, raising GST and making life tougher for property investors. But such steps are small and incremental in magnitude. There are a host of working groups that have already reported or are looking at key areas at present. These include the tax system, capital markets, saving and investment. The challenge is to take the recommendations and formulate it into a policy prescription that accelerates the rebalancing process of the economy and promote robust growth. **Globally and locally leadership versus populism style decision making is going to be critical to watch. Some nations look better placed than others.**

FISCAL FORECAST

June years	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)	2014(f)
Operating Balance (\$m)	2,384	-10,505	-3,000	-7,100	-2,900	-1,800	-900
- as % of GDP	1.3	-5.7	-1.6	-3.5	-1.3	-0.8	-0.4
OBEGAL (\$m)	5,637	-3,893	-5,700	-8,700	-4,800	-3,800	-3,100
- as % of GDP	3.1	-2.1	-3.0	-4.3	-2.2	-1.7	-1.3
Net Core Crown Debt (\$m)	10,258	17,119	26,500	40,400	49,900	56,700	62,800
- as % of GDP	5.6	9.3	14.0	19.8	22.8	25.0	26.7
Core Crown residual cash (\$m)	2,057	-8,639	-8,900	-13,400	-9,000	-6,900	-6,100
Bond Tender Programme (\$m)	1,889	5,493	12,500	13,500	10,500	9,500	6,000

INFLATION

SUMMARY

Headline inflation is set to push past 5 percent on the back of the GST increase. Underling inflation is expected to remain contained within the upper half of the RBNZ target band. Weak domestic demand and an elevated NZD will see further downward pressure on retail related goods. But higher food prices and upward price pressure from the non-contestable parts of the economy will offset.

"UNDERLYINGLY" CONTAINED**Inflation has remained in the middle of the RBNZ's target band for over a year now.**

Despite the worst recession in a generation, inflation never seriously threatened the bottom of the 1 to 3 percent target band. Measures of domestically generated inflation regularly surfed at (or above) the top end of the target range and various expectation measures were anchored above two percent.

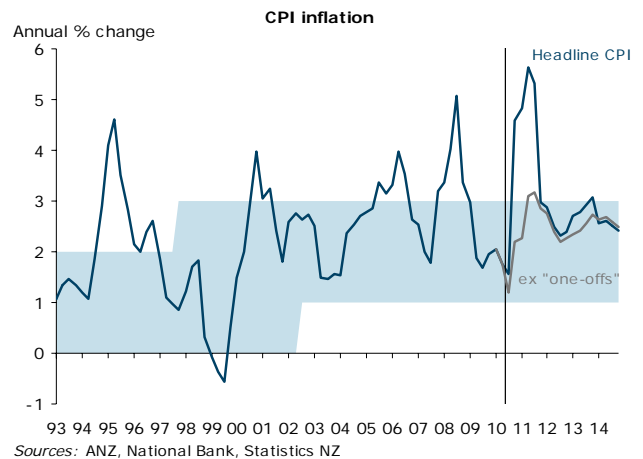
The last few quarterly outturns have been benign and have accorded with the difficult retail environment. Food prices have also been trending downwards and retail discounting has been more pervasive. Price increases from housing related components have also been capped as activity in the sector remains subdued.

Annual inflation is likely to have already troughed. Given the intensity in retail discounting and subdued wage growth, retail related prices will be held down. But with commodity prices still close to record highs, annual food price inflation looks set to accelerate above 5 percent before early next year. Our monthly inflation gauge continued to detect stubbornly high domestically generated inflation in certain pockets. Construction costs, while subdued at present, are expected to rise driven by a cyclical rebound in residential activity. At the margin, reconstruction work related to the Canterbury earthquake is also likely to add to inflationary pressures in the construction sector.

The inflation outlook is complicated by a series of "one-offs" that is going to cause volatility and stickiness in the headline CPI. Emissions Trading Scheme related charges and ACC related increases to motor vehicle and motorcycle registration fees are expected to boost quarterly inflation in Q3 2010. The rise in GST from 12.5 percent to 15 percent on 1 October, will take headline inflation to a peak of 5.6 percent in the June 2011 quarter. However, we expect underlying inflation, which excludes the impact of the various "one offs", to remain within the target band. Key to this is that inflation expectations remain in check.

Wage growth, a key medium-term driver of inflation, is expected to remain subdued over the year ahead. This will help contain the extent of upward inflationary pressure emanating from the labour market, and will help to prevent the full impact of the "one-offs" on inflation flowing through into wages. The October income tax cuts are also likely to prevent an inflation spiral.

Weak domestic demand and an elevated NZD mean there are near-term downside risks for inflation. However, the risk is pointed up for next year, as high commodity prices eventually translate into higher food inflation. Given reduced supply side capacity of the economy, inflation pressures can also be expected to emerge sooner, particularly as firms seek to recoup margins quickly as the recovery really starts firming. This will be more acute in the non-contestable parts of the economy.



CPI FORECAST

Quarter	Otr % chg	Ann % chg
Mar-10	0.4	2.0
Jun-10	0.3	1.8
Sep-10 (f)	1.1	1.6
Dec-10 (f)	2.8	4.6
Mar-11 (f)	0.6	4.8
Jun-11 (f)	1.0	5.6
Sep-11 (f)	0.8	5.3
Dec-11 (f)	0.5	3.0
Mar-12 (f)	0.5	2.9
Jun-12 (f)	0.7	2.5
Sep-12 (f)	0.6	2.3
Dec-12 (f)	0.6	2.4
Mar-13 (f)	0.8	2.7
Jun-13 (f)	0.7	2.8
Sep-13 (f)	0.7	2.9
Dec-13 (f)	0.7	3.1

EXCHANGE RATE

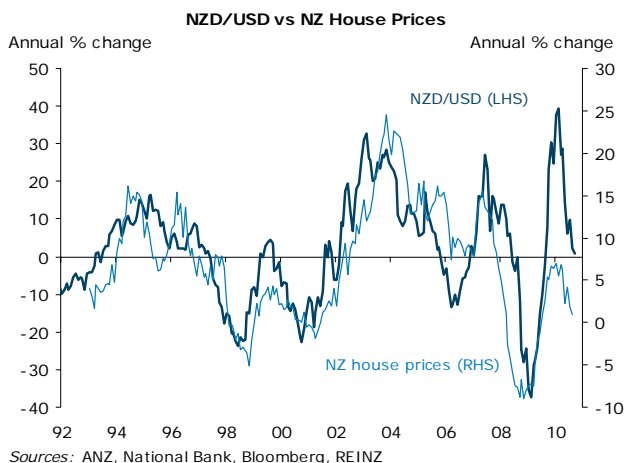
SUMMARY

The NZD is being buffeted by contrasting forces. A weak outlook for domestic demand and a more gradual tightening profile by the RBNZ may signal a lower NZD, but the reality is that New Zealand's prospects still look better compared to others. A rampant AUD and high commodity prices will provide support for the NZD. And the threat of further quantitative easing (QE) by the US Federal Reserve mean the USD will stay weak in the near-term, keeping the NZD up by default. The NZD look destined to remain in a 0.70 to 0.74 range into next year, but should remain sub 80 cents against the AUD for a while to come.

GLOBAL FORCES MATTER MORE

In currency markets, it is all about relativity.

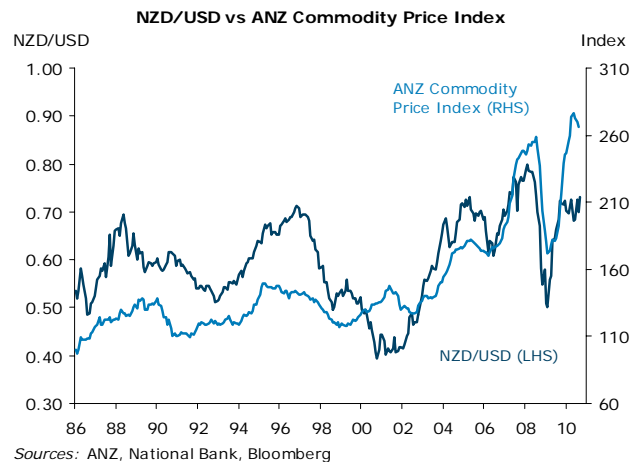
The New Zealand economy may have lost momentum and the housing market is looking soft, but compared to other OECD nations, New Zealand is still an outperformer. In normal times, a 3 percent OCR, sub-par growth rates and falling house prices would have seen the NZD fall out of bed and heading below 60 cents against the USD in a flash. But in the current environment, a 3 percent OCR looks attractive when rates are close to zero in the US. To be fair, the market is not chasing yield at all. Rather, the weekly pattern is one of "risk-on" and "risk-off", or more lately "new world" (Asia and connections) versus "old world".



It is difficult for the NZD to move lower in an environment of competitive currency devaluations. Everyone appears to desire a weaker currency to kick start their respective economies. It is mathematically impossible. Globally, fundamentals dictate that it is the better performing Asian economies that should have appreciating currencies relative to the West. But because most Asian currencies are heavily

managed, such an adjustment is slow to take place, resulting in the pressure points emerging in other areas. The result has been a strengthening Swiss franc and Japanese yen.

Moreover, the NZD is being supported by high commodity prices. While the ANZ Commodity Price Index has eased off in recent months, the level is still very high, which will see improved rural incomes next year even if the NZD remains at current levels.

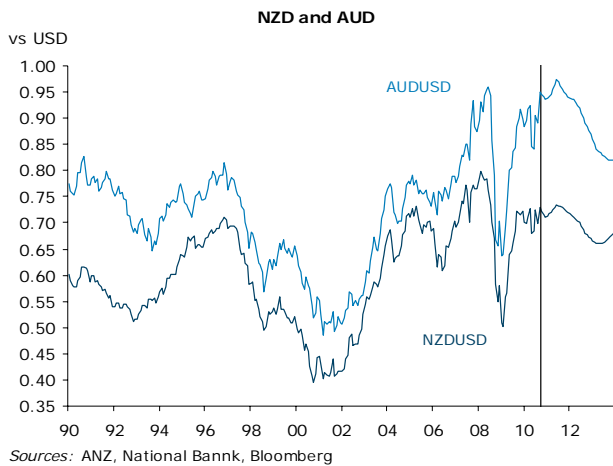


Worries over a poor US outlook have prompted the US Federal Reserve to open the door for further quantitative easing. This will have the effect of seeing the USD weaken further, which effectively means the NZD will stay elevated by default. We are not entirely convinced the US is: (a) weak enough to justify further quantitative easing or (b) looks worse than the Eurozone area on the growth stakes. However, currency market perception is siding heavily with the euro at present in somewhat of a pygmy trading dynamic (nb: pygmies are neither tall nor attractive). But if there is a key risk late in the year, it will be a sudden turn in the EUR/USD on sovereign concerns. This could see the NZD/USD dragged lower for the ride. Certainly, when look at potential adjustment mechanisms for the problem regions in the Eurozone, a weaker euro is the most feasible alternative. But at present sentiment remains so bearish regarding the US economy and the USD that such dynamics are secondary.

The spirit of our currency forecasts is of the NZD/USD remaining within a 0.70 to 0.74 range into next year. The RBNZ may be out of play until early next year, but the US Federal Reserve will not be lifting rates possibly until late 2011 or 2012. The yield advantage will firmly be in New Zealand's favour. In addition, we see further AUD strength, as the RBA seeks to take the cash

EXCHANGE RATE

rate above neutral and into restrictive territory. But the broad trends in the EUR/USD will have a huge say. It, like the NZD, looks range-bound but may well be the surprise factor over the coming months.

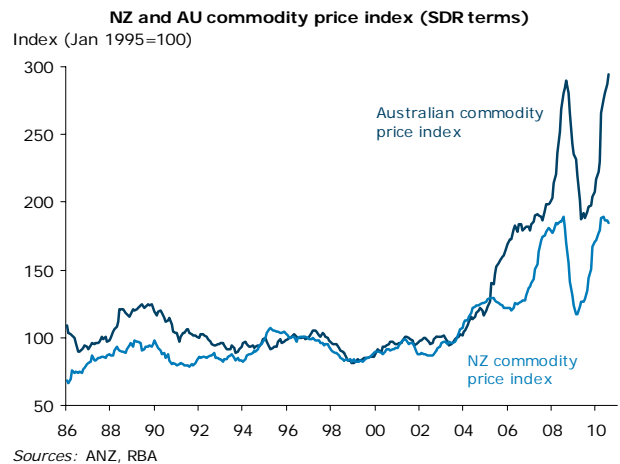


A further widening in the AUD's yield advantage will see it test its 2008 high of 0.9850 against the USD. This will lend further support to the NZD, though we see it being capped to the topside of recent ranges. This means that NZD/AUD has room to move lower, and we see a 0.76 to 0.80 range developing.

Further out, we see both the NZD and AUD easing against the Greenback, as commodity prices correct lower off their peaks and the US economy starts to respond to extraordinary stimulus and begins to recover. The higher peak in the AUD means that there is scope for a bigger fall compared to the NZD, or a mean-reverting snapback in the NZD/AUD further out. All our fundamental long-run models point to fair value for the NZD/USD sitting in the 0.66 zone. This is higher than simple historical average estimates and reflects structural factors such as higher commodity export prices. Over time, we would expect fair value to continue rising, on the assumption that New Zealand continues to get its house in order, but in a gradual fashion. Conversely, we believe fair value for the NZD/AUD has fallen from 0.85-

0.88 to around 0.80. So any snapback in the NZD/AUD still needs to be put in perspective in terms of where it ends up.

The diverging economic performance between the New Zealand and Australian economy mean that a lower NZD/AUD is justified for a time. GDP growth in Australia looks set to head towards 4 percent and be maintained there for a while, underpinned by a far bigger surge in their commodity prices relative to New Zealand's.



We have to recognise though, that market sentiment can turn quickly if risk aversion were to flare up. Our currency forecasts are premised on no further major banking or sovereign risk shocks, and for the Chinese economy to ease towards more sustainable, but robust growth rates, which will still keep commodity prices high and the "new world" story intact. How China manages to engineer the fabled soft landing remains the key challenge here. We have also included a relatively stable EUR/USD trajectory. When we eye positioning at present, the odds look to be building for an aggressive turn lower. If so the NZD/USD may test the downside of the 0.70-0.74 range. But we would find it difficult to be bearish too far below that given New Zealand's individual specifics.

EXCHANGE RATE

NEW ZEALAND DOLLAR FORECAST (END OF QUARTER)

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
Dec-05	0.68	0.93	80.4	0.40	0.58	70.4
Dec-06	0.70	0.89	83.8	0.36	0.53	69.4
Dec-07	0.77	0.88	85.6	0.39	0.53	71.8
Dec-09	0.72	0.81	67.2	0.45	0.50	66.3
Mar-10	0.71	0.77	66.4	0.47	0.53	66.0
Jun-10	0.68	0.81	60.5	0.46	0.56	66.6
Sep-10	0.73	0.77	61.6	0.46	0.55	66.4
Dec-10 (f)	0.71	0.76	60.4	0.46	0.57	66.2
Mar-11 (f)	0.72	0.76	62.6	0.46	0.60	68.0
Jun-11 (f)	0.73	0.75	65.3	0.47	0.61	69.1
Sep-11 (f)	0.73	0.76	67.2	0.47	0.61	69.3
Dec-11 (f)	0.72	0.77	67.7	0.46	0.61	69.1
Mar-12 (f)	0.71	0.76	69.6	0.45	0.60	68.6
Jun-12 (f)	0.70	0.76	70.0	0.43	0.58	67.6
Sep-12 (f)	0.68	0.76	68.0	0.42	0.57	66.2
Dec-12 (f)	0.67	0.77	67.0	0.41	0.56	65.5
Mar-13 (f)	0.66	0.79	67.3	0.41	0.54	64.9
Jun-13 (f)	0.66	0.80	67.3	0.41	0.54	65.1
Sep-13 (f)	0.67	0.82	68.3	0.41	0.55	66.2
Dec-13 (f)	0.68	0.83	69.4	0.42	0.56	67.2

INTEREST RATES

SUMMARY

A loss of economic momentum mid-year and a weak outlook for domestic demand has prompted the RBNZ to call a halt to rate rises. While we agree with the spirit of the RBNZ's latest assessment (and the market's), we think they have turned from overly optimistic three months ago to too bearish on prospects now. We see a resumption of rate hikes in March 2011, and for a gradual and staggered profile, but one that is more aggressive than what is currently priced in by the market.

TAKING THE MIDDLE GROUND

After two successive hikes in June and July, the RBNZ has signalled a pause. The loss of economic momentum in the economy, uncertainty and volatility in global financial markets, and the Canterbury earthquake all mean that taking a breather is the appropriate course of action.

The market and the RBNZ are now saying the OCR will be on hold until March next year and head to 4 percent by the end of 2011 and 4.5 percent by the end of 2012. To put this in perspective, we need to cast our minds back a mere three months. Then, the RBNZ was projecting 1 percent quarterly growth rates this year and the OCR reaching 6 percent, and even then some commentators thought that looked low!

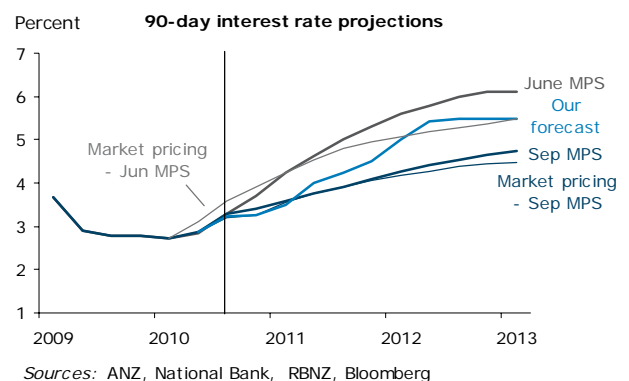
Markets look to have over-reacted – once again. For sure, the recovery remains patchy, with pockets of weakness. The global outlook remains fragile and uncertain. Business and consumer sentiment has eased sharply in recent months. The labour market is improving only gradually, while the housing market remains moribund and households are concentrating on improving balance sheets. Yet:

- **We still see better prospects for 2011.** After effectively 3 years of anaemic growth (real per capita GDP has averaged -0.7 percent per year!) it couldn't be much worse! The necessary adjustment that the economy is undertaking now sets a better platform for growth next year, alongside the Rugby World Cup, earthquake reconstruction activity and pent-up demand being unleashed.
- **Our inflation trajectory contains an element of stickiness.** Weak growth is dampening the immediate flow-through but it is worth emphasising that the recession did not crush inflation – it merely took it to the middle of the 1 to 3 percent policy band. Capacity

could be absorbed quickly in 2011, if as we expect momentum picks-up. We also believe there is a little more pricing power in specific sectors (particularly non-contestable pockets) that will make the RBNZ's life challenging.

- **We remain concerned over the margin of supply-side capacity.** Monetary policy outcomes are determined by both supply capacity and demand. The risk is that diminished supply leads to the quicker emergence of inflation, forcing the RBNZ's hand. Business lending has been falling since late 2008 and the net balance for surveyed investment intentions is barely positive and well below historical averages. Capital imports are starting to show signs of vigour, but remain below where they should be for this stage of the cycle. With business investment lagging the cycle, the implications are not good for future productivity growth – which is a key inflation suppressant.

We now reside on the more hawkish side on interest rates relative to the RBNZ and market pricing. We expect a resumption of the tightening cycle from March next year and the OCR to end 2011 at 4.25 percent and 2012 at 5.25 percent.

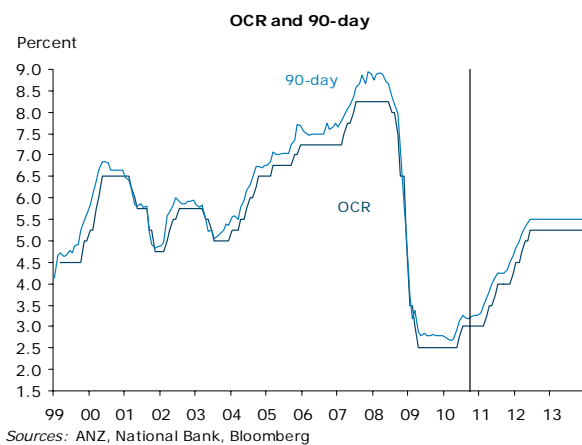


While it is on the hawkish side of market expectations, the projected tightening still needs to be put in perspective:

- **There are global forces at play.** With the FOMC potentially about to embark on further QE we need to see how this plays out first, as it has consequences for global growth.
- **We see a somewhat staggered tightening cycle.** Our tightening profile has a series of 25bp hikes starting in March 2011, pausing at 4 percent to assess things, before further tightening from December 2011. This staggering reflects the reality of a recovery that will remain susceptible to bouts of inertia.

INTEREST RATES

- We see a lower endgame for the OCR.**
 This primarily reflects the interaction of new prudential rules such as the core funding ratio for banks, an assumption that current offshore funding costs remain elevated and we believe we are experiencing a structural adjustment in household behaviour (read: lower expectations towards house price gains). We put the neural OCR around 5 percent now. History tells us we will push through neutral at some stage, but we don't believe it will be soon, or that the magnitude of the extension will be significant.



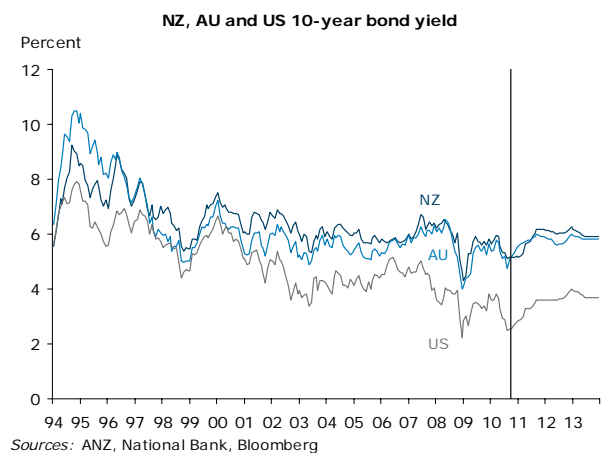
We continue to ponder the possibility of a 50bp hike at some stage if the near term uncertainty has passed. This may seem ridiculous at present but it is worth stressing that keeping interest rates at low levels for a protracted period of time implies prompt action may be needed when the economy snaps back quickly. Monetary policy does not have an asymmetric reaction function: support needs to be balanced by decisiveness if required. A faster than expected recovery for the global economy, stronger than expected domestic recovery, or more limited supply-side capacity could produce an adverse medium-term inflation outlook, to which monetary policy would need to respond.

While this is not our central case, we cannot rule out a more aggressive move at some stage, but within the spirit of a lower endgame. A more aggressive tightening cycle would certainly be more consistent with historical experience, where policy interest rates move to neutral and beyond relatively quickly. But this time around there looks to be sufficient prudential policy breezes brewing (i.e. regulation) that will both accentuate monetary policy's effectiveness and also act in a complimentary fashion as a de facto mate for monetary policy.

US RATES TO STAY LOW FOR A WHILE, AUSTRALIAN RATES HEADED UP

Internationally, we have seen a divergence in central bank policies. Asian central banks have started to lift rates, with China seeking to employ administrative measures in order to slow credit growth and suppress rampant property price inflation. Among the major Western central banks, the RBA is the most advanced in normalising policy. The Bank of Canada starting to lift rates off low levels. However, the US Federal Reserve has not only confirmed their stance of keeping rates low for an extended period, but they have also decided to maintain the size of their balance sheet and flagged a preparedness to engage in further quantitative easing (QE) should the US growth outlook deteriorate further.

The threat of further QE by the Fed has seen long end US bond yields fall, dragging New Zealand rates down with it. We see US yields eventually lifting next year as the US economy starts to recovery. Like New Zealand, we suspect there has been an overreaction to recent developments, although this is a far cry from saying everything in the US looks fine and dandy. The US economy faces a protracted recovery path. But for now US rates look to have overshot somewhat to the downside, and we expect a gradual normalising path over 2011. Such normalisation is expected to give New Zealand yields a mild upward bias. There is of course some risk of wider sovereign concerns plaguing Europe filtering to the New Zealand market, but this looks to be mitigated by New Zealand's strong sovereign balance sheet and solid macroeconomic framework.



While the RBNZ is on hold until next year and the Fed is a long way off lifting rates, it is a different situation for the RBA. With the Australian economy already at full employment and

INTEREST RATES

the full impact of the “Commodity Boom Mark 2” still to be felt, the RBA will need to move rates from neutral towards restrictive in order to contain inflation. We see 50bps of hikes by the RBA by year end, with more to come next year. This will keep the New Zealand market somewhat perplexed with NZ-US and NZ-Aus correlations strong.

INTEREST RATE FORECAST (END OF QUARTER)

Quarter	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
Dec-05	7.25	7.7	7.1	6.7	5.7	4.4	5.2
Dec-06	7.25	7.7	7.6	7.2	5.9	4.7	5.9
Dec-07	8.25	8.9	8.7	8.2	6.4	4.0	6.3
Dec-09	2.50	2.8	4.6	5.6	5.8	3.8	5.6
Mar-10	2.50	2.7	4.3	5.2	6.0	3.8	5.8
Jun-10	2.75	3.1	4.1	4.8	5.3	2.9	5.1
Sep-10	3.00	3.2	3.7	4.3	5.1	2.5	5.1
Dec-10 (f)	3.00	3.3	4.2	4.8	5.2	2.8	5.5
Mar-11 (f)	3.25	3.7	4.7	5.2	5.3	3.0	5.7
Jun-11 (f)	3.75	4.2	5.1	5.7	5.8	3.3	5.8
Sep-11 (f)	4.00	4.3	5.3	6.1	6.2	3.6	6.0
Dec-11 (f)	4.25	4.7	5.6	6.2	6.2	3.6	5.9
Mar-12 (f)	4.75	5.2	5.8	6.3	6.1	3.6	5.8
Jun-12 (f)	5.25	5.5	5.9	6.2	6.0	3.6	5.6
Sep-12 (f)	5.25	5.5	5.9	6.3	6.1	3.7	5.7
Dec-12 (f)	5.25	5.5	6.0	6.4	6.3	4.0	6.0
Mar-13 (f)	5.25	5.5	6.0	6.3	6.1	3.9	5.9
Jun-13 (f)	5.25	5.5	5.9	6.1	5.9	3.7	5.8
Sep-13 (f)	5.25	5.5	5.9	6.1	5.9	3.7	5.8
Dec-13 (f)	5.25	5.5	5.9	6.1	5.9	3.7	5.8

ECONOMIC FORECASTS

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
Real Gross Domestic Product												
Total GDP, QPC	0.5	0.2	0.4	0.5	1.2	1.4	1.6	0.5	0.3	0.5	0.5	0.5
Total GDP, APC	1.9	1.9	2.1	1.6	2.3	3.5	4.8	4.8	3.9	2.9	1.8	1.8
Total GDP, AAPC	-0.4	0.7	1.6	1.9	2.0	2.4	3.0	3.9	4.3	4.1	3.4	2.6
Real GDP Components												
Private Consumption, QPC	0.4	0.1	0.2	0.2	0.4	0.6	0.9	0.3	0.1	0.3	0.4	0.4
Private Consumption, AAPC	7.3	7.3	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1	7.1
Public Consumption, QPC	1.7	0.5	0.7	0.3	0.4	0.4	0.8	0.5	0.5	0.4	0.4	0.4
Public Consumption, AAPC	1.2	1.9	2.7	3.3	3.3	2.8	2.2	1.9	2.0	2.1	2.1	2.0
Residential Investment, QPC	1.4	11.1	-2.0	-3.0	5.9	5.7	4.8	1.9	1.5	1.0	1.9	2.4
Residential Investment, AAPC	-11.7	-2.6	6.7	8.8	12.1	10.1	9.8	12.8	13.5	14.2	12.2	9.2
Other Investment, QPC	-0.3	4.7	1.4	1.9	2.4	4.0	2.9	2.1	1.2	0.8	0.9	1.0
Other Investment, AAPC	-9.9	-6.2	-2.7	2.0	5.5	8.0	10.0	11.0	10.9	10.2	8.6	6.6
Gross National Expenditure, QPC	0.7	-0.2	1.2	1.0	1.5	1.6	1.4	0.8	0.5	0.7	0.6	0.6
Gross National Expenditure, AAPC	-3.2	-0.2	2.6	3.5	3.7	4.0	4.3	5.0	5.2	4.8	4.0	3.3
Exports, QPC	1.2	1.3	1.0	2.3	2.0	2.9	3.7	1.3	0.3	0.7	1.3	1.2
Exports, AAPC	3.0	3.8	3.9	4.3	4.6	6.0	8.1	9.1	9.5	8.9	7.1	5.4
Imports, QPC	1.6	0.6	2.2	3.6	3.1	3.1	2.6	1.8	1.0	1.6	1.6	1.4
Imports, AAPC	-9.6	-1.4	5.5	8.7	9.6	10.3	10.9	11.5	11.2	9.8	8.2	6.9
Prices												
Headline CPI, QPC	0.4	0.3	1.1	2.8	0.6	1.0	0.8	0.5	0.5	0.7	0.6	0.6
Headline CPI, APC	2.0	1.8	1.6	4.6	4.8	5.6	5.3	3.0	2.9	2.5	2.3	2.4
Non-tradable CPI, QPC	0.5	0.6	1.4	2.6	1.0	0.9	1.0	0.8	1.0	0.8	0.7	0.7
Non-tradable CPI, APC	2.1	2.2	2.7	5.2	5.8	6.1	5.6	3.8	3.8	3.6	3.4	3.3
Tradable CPI, QPC	0.1	-0.1	0.8	3.0	0.2	1.1	0.5	0.2	-0.2	0.5	0.5	0.4
Tradable CPI, APC	2.0	1.1	0.3	3.8	3.9	5.1	4.9	2.0	1.6	1.1	1.1	1.3
External Accounts												
Annual Balance on Goods, % of GDP	1.4	1.6	2.0	2.6	2.7	2.6	2.4	2.2	2.0	1.8	1.6	1.4
Annual Balance on Services, % of GDP	0.1	0.0	-0.1	-0.1	-0.1	0.0	0.3	0.5	0.6	0.7	0.6	0.5
Annual Balance on Invisibles, % of GDP	-3.8	-4.7	-5.7	-5.5	-5.9	-6.0	-6.2	-6.3	-6.3	-6.3	-6.3	-6.3
Annual Current Account Balance, % of GDP	-2.4	-3.0	-3.7	-3.0	-3.3	-3.3	-3.4	-3.6	-3.7	-3.8	-4.1	-4.4
Net International Invt Position, % of GDP	-85.9	-86.4	-85.5	-84.6	-83.9	-83.1	-81.9	-81.1	-80.8	-80.8	-81.2	-81.8
Terms of Trade (SNA basis)												
Export Prices, QPC	7.4	3.5	4.1	1.2	-1.4	-1.2	-1.0	-0.8	-0.5	-0.1	0.6	0.5
Export Prices, APC	-8.4	4.2	14.7	17.2	7.6	2.7	-2.3	-4.2	-3.4	-2.3	-0.7	0.6
Import Prices, QPC	3.3	2.6	0.9	0.1	-1.7	-1.3	-1.5	-0.3	0.1	0.4	1.2	1.0
Import Prices, APC	-11.0	-5.3	2.9	6.9	1.8	-2.1	-4.3	-4.7	-3.0	-1.3	1.4	2.7
Terms of Trade, QPC	4.0	0.9	3.2	1.2	0.3	0.1	0.5	-0.4	-0.6	-0.5	-0.5	-0.4
Terms of Trade, APC	2.9	10.0	11.5	9.6	5.7	4.8	2.1	0.5	-0.4	-1.0	-2.0	-2.1
Labour Market												
Employment, QPC	1.0	-0.3	0.5	0.4	0.6	0.7	0.6	0.4	0.3	0.3	0.3	0.3
Employment, APC	-0.1	0.0	1.3	1.6	1.2	2.2	2.3	2.3	2.0	1.6	1.3	1.3
Labour Force, QPC	-0.1	0.6	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Labour Force, APC	0.9	0.9	1.3	0.9	1.3	1.0	1.1	1.2	1.3	1.4	1.4	1.4
Unemployment Rate, sa	6.0	6.8	6.6	6.4	6.1	5.7	5.5	5.4	5.5	5.5	5.5	5.6
Participation Rate, sa	68.1	68.0	68.1	68.1	68.1	68.1	68.1	68.2	68.2	68.2	68.3	68.3
Private Sector Wages (apc)	1.6	1.4	0.7	1.6	2.5	2.4	2.0	2.2	2.4	2.7	2.9	3.1
Public Sector Wages (apc)	3.7	3.9	2.0	2.0	1.9	1.5	1.4	1.5	1.8	2.3	2.3	2.5

Forecasts in bold

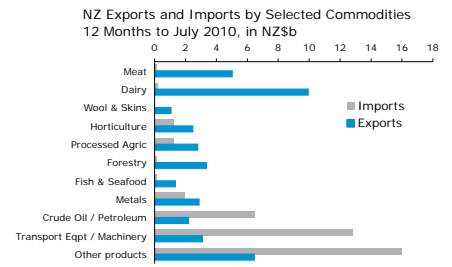
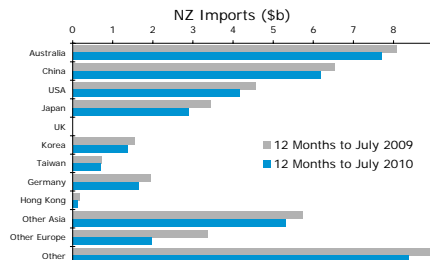
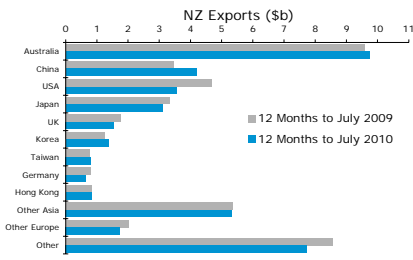
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

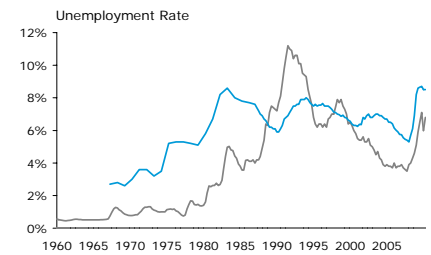
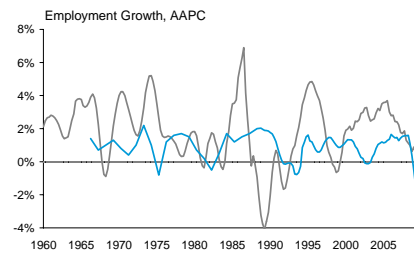
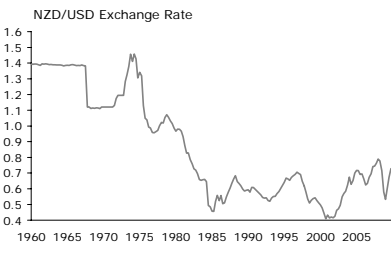
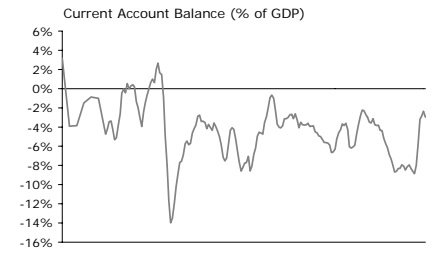
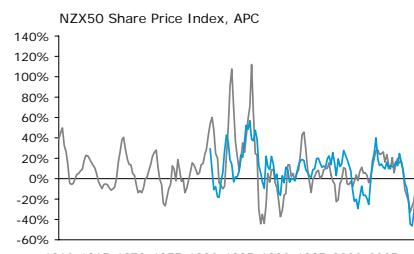
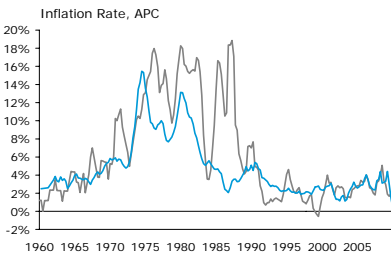
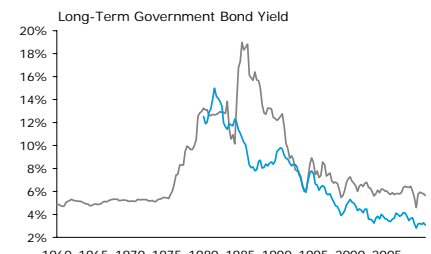
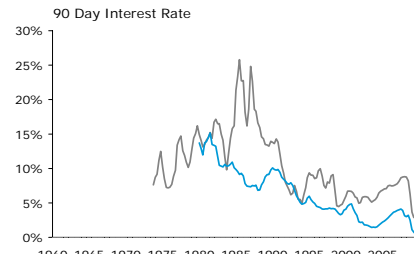
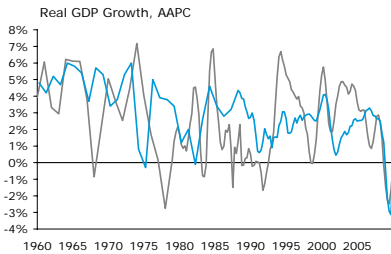
sa – seasonally adjusted

KEY ECONOMIC INDICATORS



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

	NZ	Australia	USA	Japan	UK	China	Germany	South Korea	Taiwan	Malaysia	Hong Kong	Singapore	Indonesia
Population, in millions	4.3	22.1	308.6	127.7	61.3	1,368	82.1	51.4	22.9	25.7	7.1	4.6	257.7
Area in 1,000 km ²	271	7,713	9,373	378	244	9,561	357	92	36	330	1	1	1,905
Inhabitants per km ²	15.7	2.9	32.9	338.0	251.1	143.1	230.2	557.5	636.1	77.9	7,130	4,600	135.3
GDP, in billion NZ\$	189	1,413	20,175	7,120	3,096	69,746	4,734	1,184	537	271	298	251	770
Change in real terms (yr-on-yr %)	0.7	2.7	0.0	-1.4	-3.1	10.8	-2.1	6.1	9.3	4.5	1.7	5.1	4.8
Nominal GDP per capita in NZ\$	44,352	65,941	65,332	55,176	48,223	5,739	56,361	25,515	25,234	10,151	42,722	55,204	3,439
NZ exports to ..., NZ\$ million (FOB)	n/a	9,298	3,522	2,835	1,610	3,800	1,022	1,279	791	720	788	1,194	972
Share of NZ Exports (%)	n/a	23.5	8.9	7.2	4.1	9.6	2.6	3.2	2.0	1.8	2.0	3.0	2.5
NZ imports to ..., NZ\$million (VFD)	n/a	7,559	4,222	2,659	946	6,029	1,644	1,455	676	1,192	139	1,415	659
Share of NZ Imports (%)	n/a	19.0	10.6	6.7	2.4	15.2	4.1	3.7	1.7	3.0	0.3	3.6	1.7
Current Account balance (% of GDP)	-3.0	-4.9	-3.0	3.6	-1.5	0.6	5.3	4.1	10.6	15.2	8.0	20.8	1.8



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.
- ING (NZ) Holdings Limited (ING), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ING and its related companies, including ING (NZ) Limited, may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- 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:



IMPORTANT NOTICE

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

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

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

NEW ZEALAND DISCLAIMER

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

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

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