

NEW ZEALAND ECONOMICS

ANZ QUARTERLY ECONOMIC FORECASTS

28 October 2011

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CONFRONTING GLOBAL CHALLENGES

NEW ZEALAND ECONOMIC OUTLOOK

The New Zealand economy is navigating four large events simultaneously, at a time when there is growing downside risk to the global scene. The interaction of these shocks will see more volatility across the business cycle amidst a lower trend growth rate. A better national balance sheet is a precursor to a strong pro-cyclical upswing and we are not there yet. But progress is being made.

GLOBAL OUTLOOK

A global recession in 2012 is not our core view. However, tail risks from a structural overhang of global debt will take years to overcome, and Western economies face a period of lower trend growth. Robust growth from emerging economies will provide an offset to some extent, but we are cautious over how much they can be insulated from a slowdown in growth in the developed world.

COMMODITY PRICES

We expect New Zealand's export commodity prices to remain elevated, supported by favourable supply-demand dynamics. We are bullish on the long-term trend for commodities, but caution against banking on excessive gains. Sustainable commodity price trends will be more slow-moving.

LABOUR MARKET

The unemployment rate is expected to ease lower over the forecast horizon. A by-product of a "getting back to basics" approach across the economy is expected to see better productivity growth, but this will take time.

FISCAL POLICY

Any new government is in a fiscal straitjacket for a decade, with fiscal policy staying contractionary for five years at least. Such austerity will present an economic headwind, but will keep interest rates lower than otherwise.

INFLATION

We have an inflation trajectory averaging 2¾ percent over the forecast horizon. To us, slightly higher inflation outcomes will be a natural by-product (or sacrificial pawn) of navigating multiple shocks and greasing the wheels of the economy through such frictions.

EXCHANGE RATE

Global wobbles will throw the NZD around in the near-term. Our key judgement is that the USD faces significant structural headwinds, and if the USD is lower the NZD is higher by default. We see NZD picking up next year on our expectation that the New Zealand economy is set to outgrow a lot of other developed economies, and helped by the RBNZ lifting interest rates.

INTEREST RATES

Our core view is for a mid-2012 start to OCR hikes, but the risk profile is clearly towards a later increase as opposed to sooner. Long-end interest rates are also likely to remain lower for longer, in line with global rates. Indeed, the US Federal Reserve is trying to extend its influence further along the yield curve with "operation twist" and global markets are sceptical of the growth outlook.

KEY ECONOMIC FORECASTS

Calendar Years	2008	2009	2010	2011(e)	2012(f)	2013(f)	2014(f)
NZ Economy (annual average % change)							
Real GDP	-0.1	-2.0	1.7	2.1	2.7	3.3	2.5
Employment	0.6	-1.1	0.7	1.7	1.3	1.4	1.2
Unemployment Rate (Dec qtr)	4.5	7.0	6.7	6.4	5.9	5.8	5.9
Terms of trade (SNA basis)	3.0	-7.8	7.5	3.6	2.3	-0.2	-1.2
Global Growth (annual average % change)							
US	-0.3	-3.5	3.0	1.7	1.7	2.9	2.8
Australia	2.6	1.4	2.7	1.3	3.1	4.0	3.3
Japan	-1.2	-6.3	4.0	-0.7	2.4	1.9	1.5
China	8.9	8.7	10.4	9.5	9.5	9.3	9.4
Trading Partners	1.8	-0.8	4.8	3.2	3.9	4.5	4.1
NZ Inflation (annual % change)							
CPI Inflation	3.4	2.0	4.0	2.5	2.6	2.7	2.7
Non-tradable Inflation	4.3	2.3	4.6	2.9	3.6	3.4	3.5
Tradable Inflation	2.3	1.5	3.3	1.9	1.5	1.7	1.6
NZ Financial Markets (end of December quarter)							
TWI	56.2	66.3	69.2	68.4	74.8	75.4	69.7
NZD/USD	0.58	0.72	0.78	0.77	0.89	0.90	0.78
NZD/AUD	0.82	0.81	0.76	0.79	0.81	0.82	0.83
Official Cash Rate	5.00	2.50	3.00	2.50	3.25	4.25	4.50
90-day bank bill rate	5.1	2.8	3.2	2.7	3.5	4.5	4.8
10-year bond rate	4.6	5.8	5.9	4.3	4.4	5.0	4.9
Fiscal and External Balance							
Current Account Balance (\$bn)	-16.2	-4.8	-6.7	-7.3	-9.8	-11.2	-12.1
– as % of GDP	-8.8	-2.6	-3.4	-3.6	-4.5	-4.9	-5.0
Government OBEGAL (\$bn)*	5.6	-3.9	-6.3	-18.4	-13.8	-7.1	-2.0
– as % of GDP	3.1	-2.1	-3.3	-9.2	-6.5	-3.1	-0.8

* Operating balance excluding gains and losses, June years. Forecasts and text finalised 28 October 2011.

KEY FORECAST ASSUMPTIONS

- The value of earthquake reconstruction work is equivalent to 1 percent of GDP per annum over the next five years, with the step-up in work apparent from the second half of 2012. This assumes, critically, that the insurance market frees up.
- Commodity export prices are expected to correct lower in the coming year but to remain at historically high levels.
- Dubai oil prices are expected to trade within a US\$95 to US\$105 per barrel range over 2011, before settling at around US\$100 per barrel in 2012.
- An annual permanent and long-term (PLT) migration outflow of around 1,500 persons is expected for calendar 2011. An easing off in PLT departures and strengthening arrivals will see PLT migration pick up to a net inflow of around 9,000 persons in the 2012 calendar year.
- The longer-term potential growth rate remains in the lower part of the 2 to 2½ percent range.
- The neutral Official Cash Rate is around 4-4.5 percent.

NEW ZEALAND ECONOMIC OUTLOOK

SUMMARY

The New Zealand economy is navigating four large events simultaneously: debt payback, rebalancing, the Canterbury earthquakes, and a terms of trade boost. At the same time there is growing downside risk to the global scene. The interaction of these shocks will see more volatility across the business cycle amidst a lower trend growth rate. We've pencilled in around 3 percent growth over the next two years and continue to characterise the outlook as one of "grumpy growth" that is coming off a low base. A better national balance sheet is a precursor to a strong pro-cyclical upswing and we are not there yet. But progress is being made.

THE BIG PICTURE

The economy is being affected by four major shocks simultaneously. We noted these in our July 2011 Quarterly Economic Forecasts and they remain material influences on the outlook.

- **Getting our balance sheet in order.** Our national balance sheet remains weak. The net international liability position is 70 percent of GDP. The household savings rate is barely positive, although there has been a \$13bn turnaround from housing equity withdrawal since 2007. Increased saving by households and farmers will be at the expense of growth in the near term, but is essential for sustainable medium-term growth.
- **Rebalancing: earning a buck before we spend one.** The economy remains lopsided with excessive concentration in spendthrift activity, and this is at the expense of earning. Since 2004 the tradable sector has gone backwards and income growth has not kept up with spending. It will take years for resources (i.e. labour and capital) to respond to different price signals, for opportunities to be unlocked and the DNA of society to change. This means we are set to see some job displacement in certain sectors over the coming year in response to structural and cyclical challenges, with these resources inevitably remobilised to others.
- **A positive income shock.** We're seeing structurally higher demand for commodities, which is manifesting via our goods terms of trade hitting a 37 year high. Asia is increasingly relevant for New Zealand as an export market (accounting for 39 percent of merchandise exports) and we're getting better connected in regard to the Asian region, with a free trade agreement with India being negotiated at present.
- **The Canterbury earthquakes.** The impact channels are endless. A lot of wealth has been destroyed. Canterbury's population will not be the

same. There will eventually be a rebuild bigger than Ben Hur, though the ground needs to stop shaking first. Over time the costs of Canterbury will hit consumers' pockets via increased EQC levies, higher insurance premiums and less government spending in other areas.

These four shocks are complementary in some facets but opposing in others. The income shock is helping to get our balance sheet back in order via income generation. Conversely, rebuilding Canterbury will involve dedicating huge amounts of resources to rebuilding domestic capital (i.e. housing and infrastructure) at a time we're also supposed to be investing in other regions and sectors.

The interaction of these shocks will see more volatility across the business cycle amidst a lower trend growth rate. While our forecasts portray a fairly smooth path of economic activity going forward, the reality is likely to be very different, considering the multitude of cyclical and structural influences, not to mention the high degree of economic tensions, at play. And while we see growth, it is coming off a low base so in level terms will take time to get critical mass.

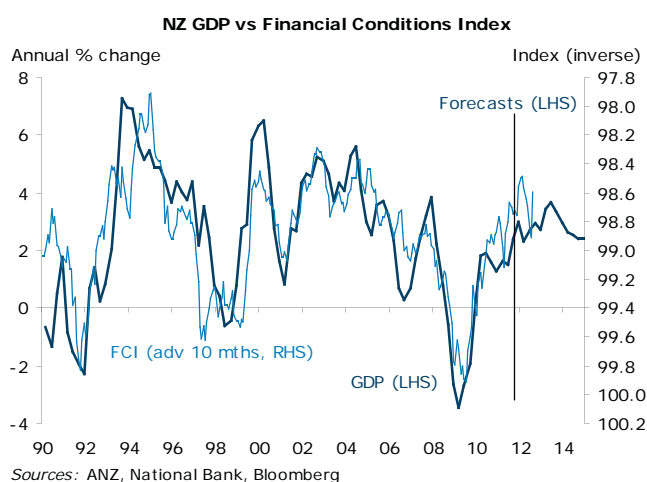
An uncertain global scene complicates the picture further. Suffice to say that while the global economy is still moving forward at present, challenges abound. **For New Zealand, we're closely watching the five C's, namely confidence, commodity prices, China, the currency, and the cost of credit.**

- **Confidence.** Global lead indicators have weakened of late. While we've seen some softening in New Zealand's confidence indicators, the levels remain healthy – for now. But the trend is easing and we are detecting more caution.
- **Commodity prices.** They've softened but remain at historically high levels. We are assuming this remains the case – a crucial assumption and by no means a sure thing.
- **China.** A strong Chinese economy is good for the New Zealand (and world) economy. The realignment in Chinese activity towards domestically driven expansion may affect our other major trading partners, notably Australia. Increased spending by Chinese households provides opportunities for New Zealand's agricultural exports. However, questions surround how durable China's outlook can remain in the absence of a pick-up in domestic demand in the US and Europe.
- **Currency.** The NZD typically acts as a "shock absorber" and is around 6 US cents down from its August high. At around 82 US cents, however,

NEW ZEALAND ECONOMIC OUTLOOK

the NZD is almost 35 percent above post 1990 averages against the USD (15 percent above average on a TWI basis). High commodity prices provide an offset to a high currency, but the non-commodity exporting sectors of the economy, namely tourism and manufacturing, will feel the brunt. On the whole, the currency is flip-flopping but it's acting as a key shock absorber to global developments. It's a safety valve pockets of Europe would love to have.

- **Cost of credit.** The potential for a partial Greek default has sent shock waves through funding markets. The major local banks remain well funded, but the longer the turmoil persists, the greater the likelihood that higher funding costs will need to be built into retail interest rates. The cost of borrowing internationally remains expensive and is a key source of vulnerability to a nation that has a large external borrowing requirement.



MIXED MESSAGES

Given the multitude of complementary and competing shocks and risks, it is not surprising to find the data providing mixed messages.

In fact, we'd characterise the economy as being totally schizophrenic. In aggregate the economy is performing reasonably well. Growth averaged 0.5 percent per quarter in the first half of 2011 – a decent performance considering the Canterbury earthquake. However, indicators are polarised. The retailing environment remains tough. Building consents are lifting, but off record lows. The level of house sales remains low, credit growth is weak, but the average days to sell a house is trending lower. Farmers are pulling in record cashflow, but much of this is being directed at debt repayment, though farm sales are lifting. Capital imports have been picking up, suggesting businesses are starting to invest

after a period of hibernation. The unemployment rate is drifting lower, a healthy sign for consumers. **There is growth across the economy but it's spasmodic and patchy.**

This is naturally seeing tensions across the economy.

- The necessary process of household and farm balance sheet repair is blunting the flow-through of improved incomes to domestic spending. While this means we will see more subdued consumption growth than we have been used to, this is a much-needed development in order to get the share of private consumption back towards sustainable historical averages.
- Businesses have also been repairing their balance sheets. But with low current levels of business investment and more of our existing capital stock approaching the end of its shelf-life, increasing capital formation is a prerequisite for maintaining (and rebuilding) productivity growth and living standards.
- After using its balance sheet to cushion the economy from the impact of the Canterbury earthquakes, the Government looks set to maintain a course of fiscal consolidation. This will be an important channel to improve nationwide savings to meet our investment needs. It will subtract from demand pressures and will leave more of the onus of policy support on the OCR.
- Export activity has been mixed, not helped by the high NZD. Rebalancing the economy requires more resources shifting to the productive sector but we need to be realistic about how quickly the benefits will accrue.

Supporting the New Zealand economy during an increasingly dark period for the global economy have been some supportive one-off factors.

The Rugby World Cup has ended. Recent anecdotes of the economic impact of the event have been mixed, with many comments alluding to the displacement effects. The boost to electronic card spending in Q3 was not as much as optimists had hoped for, but the actual impact on retail spending will be considerably higher once the boost from cash spending is taken into account. We estimate the impact of the event is likely to contribute between 0.5 to 1 percent of GDP over the second half of this year, with around two thirds of this occurring in Q4. The Rugby World Cup is a much bigger event than the 2005 Lions Tour, but we live in more cautious times and have been reasonably conservative in our assessment of the event's GDP impact. Unhelpful developments such as the current Maui gas pipeline issues will dent broader impetus in Q4.

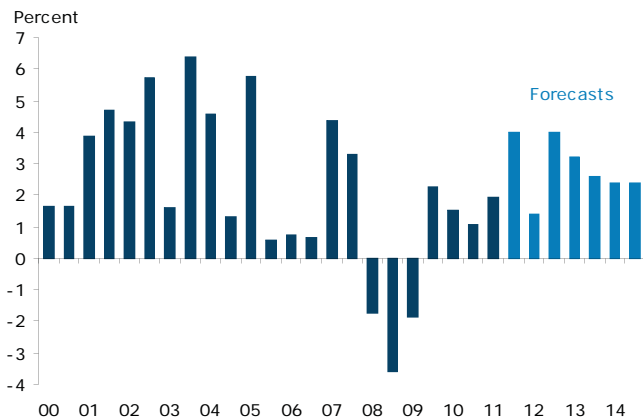
NEW ZEALAND ECONOMIC OUTLOOK

2012 – ANOTHER YEAR OF TWO HALVES

The economy is likely to enter a soft patch in early 2012. While we can see support emanating from the rural chequebook as farmers' process of balance sheet repair winds down, there will very likely be a period after the end of the Rugby World Cup and before earthquake reconstruction, where quarterly economic growth will be weak. The economy is expected to remain on the expansion path, given the support provided by the high terms of trade, steady (but not spectacular) labour income growth and the fact that interest rates facing borrowers, while not as low as implied by the OCR, are set to continue declining in an effective sense as borrowers roll off higher fixed rate terms. However, we would not rule out a negative quarter, particularly if the world economy takes a turn for the worse and domestic firms and businesses decide to put up the shutters.

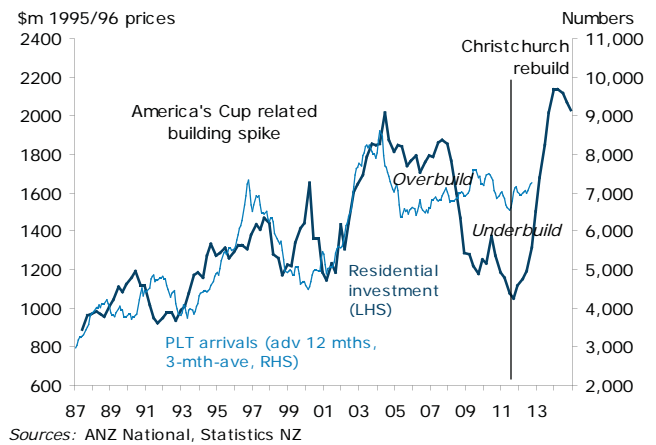
Headline activity is expected to accelerate in the second half of 2012, as the Canterbury earthquake rebuilding finally gets underway. We have already pushed back the timing of the ramp-up in reconstruction activity by six months, and we admit that huge uncertainties remain. With some of the resources already mobilised, this timeframe is critically dependent on aftershocks receding and insurance issues being resolved.

Half yearly GDP growth (annualised)



Earthquake reconstruction work is estimated at between \$20 to 25bn, which is massive and will be a multi-year undertaking. We estimate the work will be equivalent to 1 percent of GDP per annum over the next five years. As a result of the reconstruction, we expect residential investment to nearly double as a share of GDP by 2013, and remain above historical averages for a few years beyond that. Rebuilding destroyed capital, while important for future productivity, is not usually growth of the 'feel-good' variety compared to a good old retail spend-up.

Residential investment and net migration

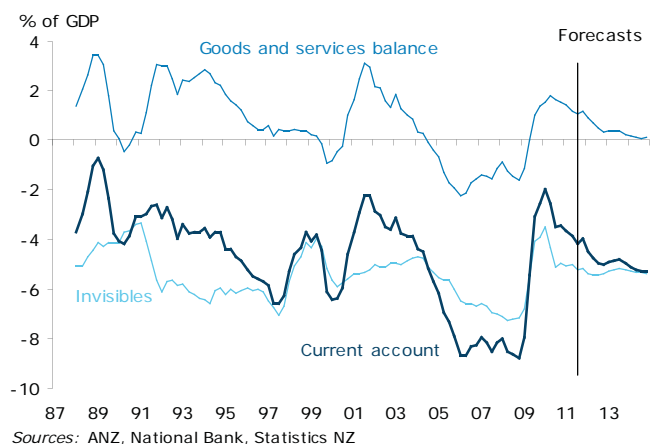


With the Government funding \$9.1bn of the earthquake costs directly from its balance sheet, hard decisions will need to be made on the fiscal policy front, with the axe falling on other areas of government spending. There will also be far-reaching implications for resource allocation within the economy, as reconstruction will take up resources that could have been used elsewhere. The sacrificial pawn to make room for the construction boom will be consumer spending. The RBNZ can not allow a house price boom to accompany a building boom.

2013 AND BEYOND – DELEVERAGING AND ECONOMIC REBALANCING

Abstracting from the multi-year boost to economic activity from earthquake reconstruction, the spirit of our assessment is for base momentum in the economy to remain subdued as resources take time to respond to economic signals. The combined headwinds of ongoing deleveraging, fiscal consolidation, a fickle global scene and a high NZD will also temper growth.

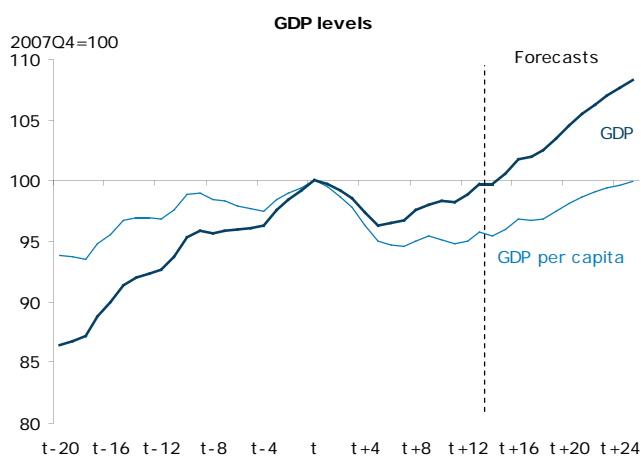
Annual balance of payments



NEW ZEALAND ECONOMIC OUTLOOK

One of the key themes we have been emphasising for a while has been the need for the New Zealand economy to rebalance. This looks to be a tall order over the next few years given global challenges and the resource requirements of the Canterbury rebuild. Prospects for non-primary exports (particularly tourism) remain difficult. In such an environment, we see policy support remaining a key part of the New Zealand story. While there is limited scope for fiscal policy to provide additional support if further credit downgrades are to be averted, we still have some monetary policy firepower left. We see the current account deficit moving towards the 5 percent of GDP zone towards the end of the forecast period.

The recovery so far has been considerably more muted than past cyclical recoveries, and we forecast this to continue. By the start of 2014 the level of GDP will be around 8 percent above pre-recession peaks (Q4 2007). Per capita output will be back to late 2007 levels. Hardly a stellar result, but such is the reality of repaying debt and dealing with the aftermath of years of excesses.



RISKS

The usual risks and caveats around our assessment have only grown more significant in the past three months.

Our forecasts are contingent on the following assumptions:

- global economic activity evolves broadly as projected;
- export commodity prices remain elevated;
- implied bank funding costs decline gradually over the forecast period;
- no further major aftershocks in Canterbury, with the resolution of insurance issues leading to a step-up in reconstruction work from the second half of next year; and
- inflation expectations remaining consistent with the inflation target band.

We admit this combination looks a tall order.

The balance of risks around our activity forecasts are predominantly to the downside.

Tail risks posed by a global downturn are becoming increasingly probable. A weaker world economy is not good news for export activity or export commodity prices even if the NZD plays a buffering role. Greater global uncertainty could also scupper domestic momentum by causing local firms to re-evaluate their employment and investment plans. A key assumption we have made is that bank funding costs do not climb further. If they do, the upshot is likely to be an even more gradual path of monetary policy tightening than we have forecast.

NEW ZEALAND ECONOMIC OUTLOOK

NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual percent change)	2008	2009	2010	2011(e)	2012(f)	2013(f)	2014(f)
Total Consumption	0.9	-0.6	2.5	1.8	1.5	1.6	1.4
Private Consumption	-0.2	-0.9	2.3	1.8	1.8	1.9	1.8
Public Consumption	5.0	0.5	3.4	1.9	0.4	0.4	0.4
Total Investment	-1.4	-11.9	3.3	6.1	12.9	11.3	6.2
Residential investment	-17.1	-19.3	2.7	-13.1	17.2	48.8	8.8
Other investment	2.5	-10.5	3.4	9.6	12.3	5.7	5.7
Stockbuilding¹	0.4	-2.4	1.6	0.0	0.3	0.1	0.0
Gross National Expenditure	0.3	-5.2	4.1	3.1	4.8	4.2	2.7
Total Exports	-1.3	2.2	2.7	2.9	0.1	5.3	4.2
Goods	-0.8	3.6	4.3	3.5	0.1	5.4	4.0
Services	-2.6	-3.0	-2.1	0.3	-1.4	5.1	4.9
Total Imports	3.0	-14.9	10.0	7.3	5.8	7.2	4.2
Goods	3.2	-15.9	10.9	7.4	6.6	8.2	4.5
Services	2.3	-11.7	7.4	5.7	2.5	3.6	3.1
Expenditure on GDP	-0.8	0.1	2.2	1.6	2.6	3.4	2.6
GDP (production based)	-0.1	-2.0	1.7	2.1	2.7	3.3	2.5

¹ Percentage point contribution to growth

GLOBAL OUTLOOK

SUMMARY

We've got our fingers, ankles and toes crossed that the European sovereign debt crisis does not turn into a global recession in 2012. But the risks are obvious. Tail risks from a structural overhang of global debt will take years to overcome, and Western economies face a period of lower trend growth. Robust growth from emerging economies will provide an offset to some extent, but we are cautious over how much they can be insulated from a slowdown in growth in the developed world.

ON A KNIFE-EDGE

Most Western societies now have more total debt as a share of GDP in 2011 than in 2008. Private sector deleveraging has been superseded by sovereign leveraging. A banking bust is being replaced by the potential for a sovereign equivalent. And the lack of growth in key nations is exacerbating concerns. What started as a transitory slowdown in H1 2011 has turned into something more substantial. You can point to volatility in global markets, political uncertainty (ineptitude) or even one-off climatic and seismic events as a cause for the slowdown. Some of it also reflects the growing new reality of a lower trend rate of growth for many developed economies. But increasingly the realities of deleveraging, which means growth sacrifices, are starting to set in.

We've got our ankles, toes and fingers crossed that an orderly deleveraging dynamic does not turn into a systemic problem. Policymakers' experience in dealing with the GFC mean they should be more versed this time. Private sector balance sheets are in better shape. Policy has been more pre-emptive in averting liquidity tensions. China doesn't have the same firepower to provide some stimulus as in 2008, but it still has the ability to provide stimulus if needed. However, there are brutal realities. The policy toolkit is looking bare. We need a government-led policy response, and that takes us into the realms of politics and populism. A growing number of countries are now staring down the barrel of borrowing rates that are higher than the outlook for nominal GDP growth, and fiscal austerity hasn't even started. For these countries, a debt trap beckons.

Our baseline assumes kitchen sink-style economics will win over in terms of providing a temporary reprieve, but this is far from a full-blown solution. In a deleveraging world, a "kicking the can down the road" prescription (a term synonymous with policymakers' tendency to defer hard decisions) can only buy you time until the market says time's up. This may be close for some key nations.

Across our key trading partners, we expect Europe to slip into recession in a technical sense in H1 2012, the US to avert one, China to remain solid, and Australia to pick up off lows experienced in early 2011. **We are forecasting trading partner growth of 3.9 percent in calendar 2012. This still looks respectable on the face of it, though the qualitative assessment says otherwise.**

The forecasts mask a diverging picture between the advanced and emerging economies, with the former forecast to grow by only 2.2 percent in 2012 compared to the latter's 6.8 percent. Given New Zealand's increasing reliance on the emerging economies, their better relative performance should bode well for us, and help underpin commodity prices. We are believers in the long-term secular story for Asia. But in the near term, we remain cautious. **The balance of risks to the global outlook are clearly to the downside,** and a deleveraging environment could mean a slower return to trend growth in our trading partners than forecast.



GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2008	2009	2010	2011(f)	2012(f)	2013(f)	2014(f)
United States	-0.3	-3.5	3.0	1.7	1.7	2.9	2.8
Australia	2.6	1.4	2.7	1.3	3.1	4.0	3.3
Japan	-1.2	-6.3	4.0	-0.7	2.4	1.9	1.5
Euro Zone	0.3	-4.2	1.8	1.5	0.3	1.7	1.4
China	8.9	8.7	10.4	9.5	9.5	9.3	9.4
Trading Partner Growth	1.8	-0.8	4.8	3.2	3.9	4.5	4.1

COMMODITY PRICE OUTLOOK

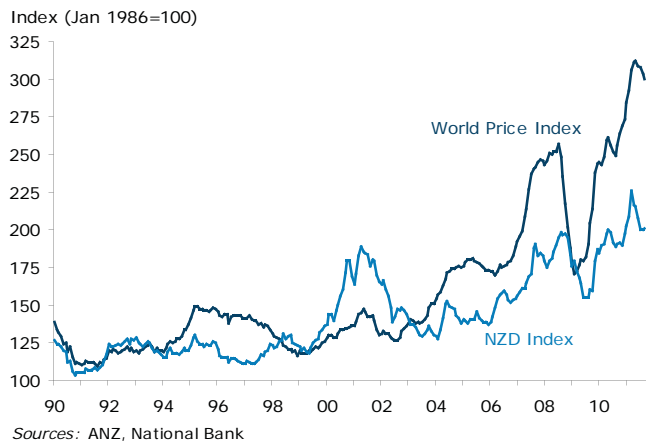
SUMMARY

We expect New Zealand's export commodity prices to remain elevated, supported by favourable supply-demand dynamics. We are bullish on the long-term trend for commodities, but caution against banking on excessive gains. Sustainable commodity price trends will be more slow-moving.

CAUTIOUSLY OPTIMISTIC

The historical pattern has been for commodity prices to come under pressure during periods of duress and uncertainty. Based on this, you would expect New Zealand's key commodity export prices to be falling like a stone. Certainly the past few months have seen commodity prices ease, but from extraordinary highs. The declines have not been as great as seen in other markets. Simply eyeballing the ANZ Commodity Price Index series, you can see a retreat in the level of world prices, but to a level that is still above previous peaks! The high currency has been more problematic over the last six months, taking the cream off world prices at the farm/orchard gate. Nevertheless, relative to history, most prices are still either at historical records, or close to it.

ANZ Commodity Price Index



So why aren't New Zealand's commodity prices crashing?

- The global scene is weaker, but a repeat of the GFC is not expected.
- The main driver on the demand side has come from emerging market economies, where they have become net importers of protein and other key foodstuffs. This support is expected to continue.
- Cost of production is up on many fronts via land values, wages, increasing food safety and animal welfare standards, oil and energy prices flowing into transportation and packaging, and

the introduction of new technology to increase efficiency and quality of products. These cost increases have been particularly prevalent in emerging countries.

- Increased production of grain is taking place on marginal land, with a more volatile climate. This increases the marginal cost of production and also means there is a greater risk of failure.
- In many cases, where there has been an increase in supply, this has been required to replenish inventory levels that were at historical lows and remain so.

In terms of the key commodities that New Zealand exports: **dairy** has softened due to an increase in supply from major producing countries. Strong prices for fat-based products earlier in the year encouraged a tilting of production, allowing inventory levels of milk-fat based products such as butter to be rebuilt from very low levels at the start of the year. However, the increase in inventory levels has flattened out recently, while demand remains robust, indicating the market is nicely poised with the NZD providing the downside. Currently we see the milk price component of the 2011-12 payout at \$6.50 per kg MS with a dividend after retentions of \$0.30. All up that's \$6.80 per kg MS for a farmer who is 100 percent share backed. Out beyond this, a milk price around \$6.30 per kg MS looks reasonable, with a dividend after retentions of \$0.30-\$0.50 per share.

Lamb looks overdone compared with substitutes. A slight increase in supply from New Zealand and Australia signals a turning point lower. **Beef** demand remains reasonable in most markets. The short-term focus is on the liquidation of cattle in the US southern states, higher input costs, and supplies of pork and poultry. Near-term this is expected to see softer beef prices but once these short-term factors dissipate a further leg up is expected. **Wool** prices look over-extended compared with cotton, but lower supply is expected to provide some support. In the horticultural sector the large 2011 vintage continues to plague **grape** prices, while reasonable in-market prices for **kiwifruit** and **pipfruit** are being offset by a higher NZD.

We are optimistic that the long-term trend for commodities is up. However, we would caution against excessive hype. There will be consumer price resistance, unfriendly government intervention, other substitutes becoming viable, and strong prices do elicit a supply-side response. Belarus is a recent example, emerging as a major supplier of dairy products. Its share of world cheese exports is now 7 percent and growing, while skim milk powder exports stand at 80,000 tonnes (one-third of US exports). All of these things can upset the apple cart.

LABOUR MARKET OUTLOOK

SUMMARY

The unemployment rate is expected to ease lower over the forecast horizon as employment growth meanders along between 1¼ and 1½ percent per annum. A by-product of a “getting back to basics” approach across the economy is expected to see better productivity growth, but this will take time. We envisage a modest pick-up in wages but rising polarisation across sectors.

TIGHTENING UP?

Near-term indicators suggest the unemployment rate will continue to fall from its current level of 6.5 percent. Job advertisements and employment intentions from business confidence surveys indicate a willingness on the part of employers to start hiring more people. **The key question is the extent to which these good intentions may be derailed by uncertainty emanating from the volatile global situation.** A solid performance by the labour market is required if our central expectation that momentum in the New Zealand economy will hold up better than many of our trading partners is to pan out.

We are expecting the unemployment rate to drop to 5.8 percent by the end of 2012, and to continue improving (falling) modestly from there. These forecasts do not see the unemployment rate back at its pre-GFC lows, but that’s the reality of a lower trend growth in an environment of debt repayment.

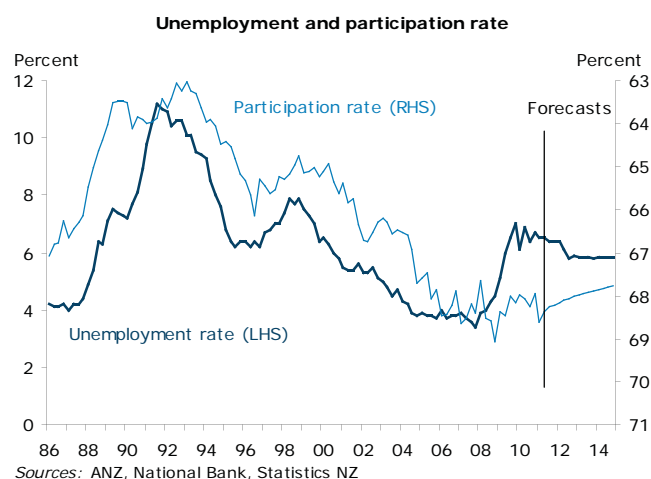
The labour market is becoming increasingly polarised between the skilled and unskilled. A by-product of the economy’s wider rebalancing process is also expected to be increasing skill mismatches. Sectors that must lead the growth agenda for NZ.Inc in the next decade have been hollowed out or under-invested in over a period of time. This is evident in the low number of tradespeople and engineers available (beyond Christchurch’s needs). Demographic factors are also starting to impact. Participation rates are lifting across older age segments and we pretty well have full employment (i.e. unemployment of around 4 percent) for ages 35 plus. Conversely, the unemployment rate is over 17 percent for those aged 15-24. This risks becoming a huge social problem if not addressed.

A key sector to watch will be construction, where resources are set to become extremely stretched as New Zealand attempts to rebuild Canterbury and grow Auckland at the same time. There are ample resources here and now. It’s from late 2012 that we could hit capacity issues. The relative performance of Australia will have a significant impact as well. The outperformance of

their construction sector has seen a sharply higher exodus of construction-related workers from New Zealand over the past 12 months. All else equal, it would be helpful if the construction sector over the ditch were to take a breather when the inevitable boom hits here. Early signs are that this may indeed be the case.

We envisage modest productivity growth over the forecast period. We are seeing a strong back-to-basics approach to management and resource utilisation across the economy. In a slow “grumpy growth” environment, business success will be critically dependent on adding value by working smarter. The message is sinking in. Slowly but surely more growth is coming from the tradable and higher valued added sectors of the economy. A stronger focus on spending across Government circles is dampening public sector unit labour costs. However, the potential for productivity growth to pick up strongly will be tempered by under-investment in plant, machinery and equipment over the past few years, and various legacy issues that are still being worked through.

We expect a modest pickup in wages. Our preferred wage measure, the labour cost index (which is a pure wage inflation measure as it removes productivity effects), is expected to drift into the 2 to 2.5 percent range. Nominal QES wage growth is expected to lift towards 3½ percent. Neither will panic the RBNZ but will certainly have them watching closely.



FISCAL POLICY

SUMMARY

Any new government is in a fiscal straitjacket for a decade. With a record fiscal deficit in 2010/11 and rising debt, the kitty is empty. Fiscal policy will be contractionary for five years at least. Such austerity will present an economic headwind, but will keep interest rates lower than otherwise. Relative to global peers our political system, and the parties within it, look more cognisant of the key economic issues, including saving and rebalancing.

NO ROOM TO MANOEUVRE

All political parties are in a fiscal straitjacket for years to come.

- 2010/11 recorded the largest fiscal deficit on record of 9.2 percent of GDP. Half the deficit was owing to Canterbury, but even stripping that out it's one of the larger deficits in our history.
- Net debt has risen from 5.6 to 20 percent of GDP in three years. Thankfully the opening position was low. But it's rising quickly and it's the trend that matters.
- Net debt will continue rising until the Government achieves a surplus, forecast to be in 2014/15. This requires no unforeseen surprises and voters being continually receptive towards the need for fiscal frugality, both of which are heroic assumptions.
- The economy's trend rate of growth is lower and we're in a volatile global environment. This means subdued revenue growth.

The menu is limited: raise taxes, sell assets (and reallocate to other public sector investments), drive public sector efficiency gains, cut spending or welfare, borrow more, or up the ante on exploiting our natural resource endowments. Each has its attractions and pitfalls, and the politics around these choices will be lively. The near-term challenges for fiscal policy are many. But the job won't get any easier. Population ageing means if we don't keep a tight rein on our national balance sheet in the years to come, some extremely unpalatable choices lie ahead.

FISCAL FORECASTS

June years	2009	2010	2011	2012(f)	2013(f)	2014(f)	2015(f)
Operating Balance (\$bn)	-10.5	-4.5	-13.4	-15.8	-5.6	0.5	2.9
– as % of GDP	-5.7	-2.4	-6.7	-7.5	-2.5	0.2	1.2
OBEGAL (\$bn)	-3.9	-6.3	-18.4	-13.8	-7.1	-2.0	0.4
– as % of GDP	-2.1	-3.3	-9.2	-6.5	-3.1	-0.8	0.1
Net Core Crown Debt (\$bn)	17.1	26.7	40.1	56.7	69.2	75.2	80.4
– as % of GDP	9.2	14.1	20.0	26.8	30.8	32.0	32.8
Core Crown residual cash (\$bn)	-8.6	-9.0	-13.3	-16.6	-12.5	-6.0	-5.1
Bond Tender Programme (\$bn)	5.8	12.4	19.5	13.5	12.0	10.0	8.0

Fiscal austerity will present an economic headwind but this will be tempered by three dynamics.

- It will keep interest rates lower than would otherwise be the case.
- The counterfactual of doing nothing and continually increasing our borrowing is untenable.
- The economy needs certainty. This is where politically difficult decisions can help for they eliminate uncertainty. Witness what political fractioning and a failure to act decisively is doing to confidence in the US and Europe.

We expect a steady improvement in the fiscal accounts over the coming years. This will see the pace of debt accumulation slow, and finally peak in the year to June 2015 (as a percent of GDP) at around 33 percent of GDP, whereas the Pre-Election Economic and Fiscal Update 2011 saw it peaking just under 30 percent. This reflects our view that the trend growth rate of the economy is slower, we'll see more volatility over the coming years, and some areas of spending that have been contained in the past couple of years will eventually, thanks to population ageing, become hand grenades that go off, specifically health.

New Zealand's political framework looks better than most. We mention this primarily because of the growing populism and fracturing we are seeing globally, and our view that leadership versus populism will be a key investment theme over the coming decade. There are certainly bones of contention locally in regard to policy prescriptions, and we see elements of populism. However, relative to global peers our political system, and the parties within it, look more cognisant of the key economic issues, including saving and rebalancing. There are not many countries in which saving and raising the retirement age could be mooted as an election platform! We're far from perfect, but better than most.

INFLATION

SUMMARY

We have an inflation trajectory averaging 2¾ percent over the forecast horizon, which the RBNZ will take umbrage at, given the 2 percent midpoint of the policy target band. To us, slightly higher inflation outcomes will be a natural by-product (or sacrificial pawn) of navigating multiple shocks and greasing the wheels of the economy through such frictions. Eventually, inflation “expectations” will need to be re-anchored closer to 2 percent, but it’s beyond this forecast horizon.

TESTING TIMES

The RBNZ will take umbrage at our outlook for inflation. In contrast to the benign RBNZ inflation assessment, where inflation is expected to settle towards the midpoint of the 1 to 3 percent inflation target, we see something in the 2.5 to 3 percent range as being more realistic.

We could go into details over the different judgements but the essence of the matter is simple: **we see slightly higher average inflation outcomes as one sacrificial pawn greasing the economy’s wheels through a collection of shocks.**

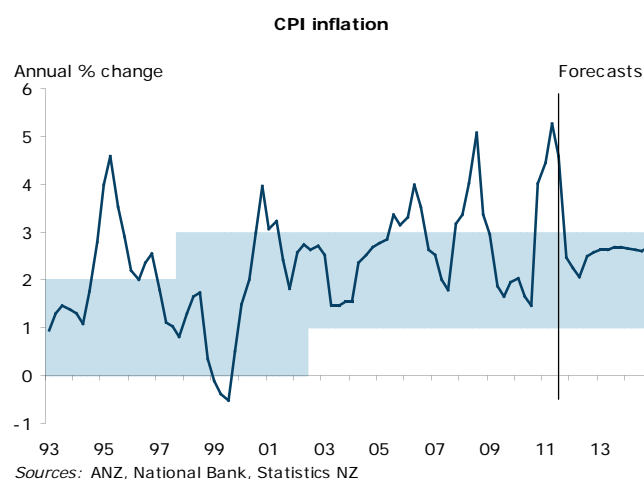
To fully appreciate the tensions here you need to understand the array of shocks hitting the economy, coupled with uncertainties in key areas.

- **We have a global deleveraging (deflationary) shock in Western Society but an inflationary dynamic in the East.**
- **The headline inflation rate is elevated and so too are inflation expectations.** The usual assumption is that inflation expectations are well anchored, but this critical tenet of inflation targeting regimes hasn’t really been tested. Our research suggests inflation expectations tend to be extraordinarily persistent.
- **We have had natural disasters in Canterbury,** which tend to be **inflationary.**
- **We have fewer inflationary suppressants than were apparent over the 1990s.**
- **We are seeing numerous cost shocks** ranging from price rises in non-contestable pockets of the economy to a structural uplift in commodity prices. Just how long margins can continue to be squeezed remains uncertain.
- **There is less supply-side spare capacity.** While the demand side is the traditional driver of the business cycle and inflation, the supply side matters too. Trend growth is likely to reside in the lower part of the 2 to 2½ percent range, and there is likely to be a limited margin of labour market

capacity in key pockets. We remain sceptical of the ability of the NZ economy to accommodate the Canterbury rebuild and grow Auckland at the same time without generating significant bottlenecks.

- **Global central banks are providing ample support but there are trade-offs.** The longer ample liquidity and supportive conditions remain in place (and they need to for some time) the greater the chance central banks end up behind the curve.

Given this collection of tensions, the spirit of our assessment is simple: it would be heroic to assume inflation will average the middle of the policy band. Some upwards drift seems more likely. We have enough faith in central banks to be confident the drift won’t derail their frameworks. But suffice to say we suspect there’ll be some tension a few years down the track. Eventually, the upwards drift in “expectations” will need to be re-anchored in concrete.



CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Mar-11	0.8	4.5
Jun-11	1.0	5.3
Sep-11	0.4	4.6
Dec-11 (f)	0.3	2.5
Mar-12 (f)	0.6	2.3
Jun-12 (f)	0.7	2.1
Sep-12 (f)	0.9	2.5
Dec-12 (f)	0.4	2.6
Mar-13 (f)	0.6	2.6
Jun-13 (f)	0.7	2.6
Sep-13 (f)	0.9	2.7
Dec-13 (f)	0.4	2.7
Mar-14 (f)	0.6	2.7
Jun-14 (f)	0.7	2.6
Sep-14 (f)	0.9	2.6
Dec-14 (f)	0.4	2.7

EXCHANGE RATE

SUMMARY

Global wobbles will throw the NZD around in the near-term. However, absent a repeat of the GFC, we think the downside in the NZD is more limited due to ongoing demand from reinsurance, commodity earnings conversion flows and investor demand. Beyond that our key judgement is that the USD faces significant structural headwinds, and if the USD is lower, the NZD is higher by default. We see NZD picking up next year on our expectation that the New Zealand economy is set to outgrow a lot of other developed economies, and helped by the RBNZ lifting interest rates.

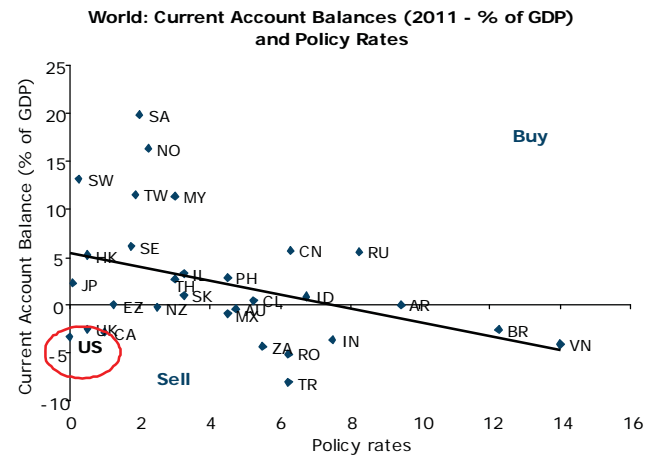
CURRENCY TENSIONS

The NZD finds itself at the mercy of global gyrations once again. After reaching post-float highs of 0.88 against the USD in early August, the NZD retraced all the way back towards 0.75 in early October, only to bounce back over 0.80 late in the month. Negative global sentiment was one of the key factors behind the initial fall, alongside a more downbeat RBNZ and disappointing economic data, not to mention a downgrade of New Zealand's foreign currency rating from AA+ to AA by Fitch and S&P. Optimism over policymakers reaching a plan to address the European debt crisis led to the more recent rally in the NZD.

At present, there is a lot of tension in the global currency market. Weak economies with policy rates at zero would like a lower currency to help stimulate activity (e.g. US, UK, Japan and Switzerland). Currencies of stronger-performing economies, particularly those with current account surpluses, should see greater appreciation. However, the latter are mainly in emerging economies with heavily managed currencies. In addition, we also have currency flows that are not based on where the best returns are, but at times based on safe haven considerations. Risk appetites are flaky, liquidity poor and mixed signals common. The upshot is massive volatility, which we expect to continue.

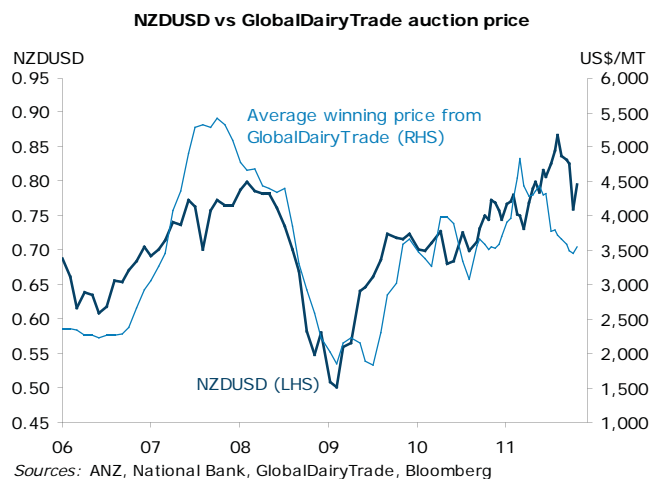
With global considerations having a more material sway on the NZD, ultimately it is what happens to the USD that will determine the path of the NZD. While the USD may benefit from safe haven demand during times of market stress, our core view on the USD remains a bearish one. We think that the fundamentals are still consistent with a lower USD, as zero interest rates will not be sufficient to sustainably attract enough capital inflows to fund a 3 percent of GDP current account deficit.

A weaker USD mean the NZD will be stronger by default. In the near term, there is potential downside to the NZD, especially if we see more



Sources: ANZ, National Bank, IMF

moves lower in commodity prices. One of the key channels through which a slowing global economy will hit New Zealand is via commodity prices. The Fonterra GlobalDairyTrade auction has seen prices decline for eight consecutive events before posting a small increase in mid-October. The average winning price at present is US\$3,540/MT, which is almost 27 percent below the recent March peak of US\$4,826/MT. The last time the auction price was at current levels, NZDUSD was in the low 0.70s.



Sources: ANZ, National Bank, GlobalDairyTrade, Bloomberg

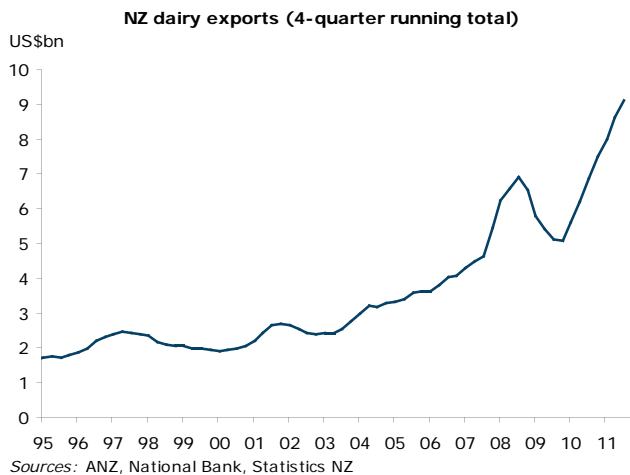
But absent a repeat of the GFC, we think NZD will find good support on any dips due to:

- **Inflows from reinsurance claims.** Statistics NZ estimates that the reinsurance claims expected from offshore are some NZ\$12.5bn (US\$10bn). What is less clear is how much of the reinsurance flows have already been transacted, and how long it would take for all the reinsurance flows to go through. Given the slow progress in settling claims to date, we think that the bulk of the reinsurance money is yet to be converted into NZD, and that it is reasonable to assume that anywhere between

EXCHANGE RATE

\$8 and \$10bn of reinsurance flows will come through over the next two to three years.

- Ongoing conversion of dairy export receipts into NZD.** Ten years ago, dairy export receipts were around US\$2.5bn. Due to a combination of rising international dairy prices and increased domestic milk production (milk production increased by over 20 percent in the past decade), annual export receipts are now close to US\$9bn. Even if international dairy prices were to correct lower, this would be offset somewhat by an expected 5 percent increase in domestic milk production. The bulk of the dairy export receipts are converted back into NZD, because dairy companies need to pay their farmer suppliers in local currency, and that constitutes the bulk of their input costs.
- Growing recognition of New Zealand's linkages with Asia, particularly via the agriculture sector.** We believe foreign investors will increasingly buy into the positive secular commodity story, and view New Zealand as a positive exposure to this, and the Asia story. Increased investment flows into New Zealand as a result will provide support for the NZD.



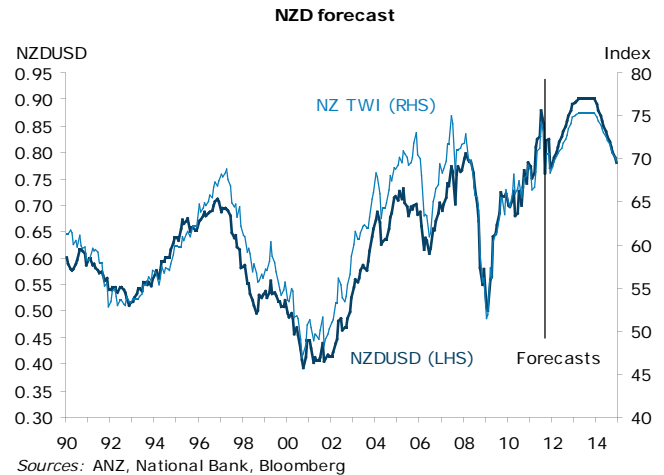
KIWI TO GET A LIFT IN 2012

NZDUSD should push higher towards 0.90. This is due to our expectations that:

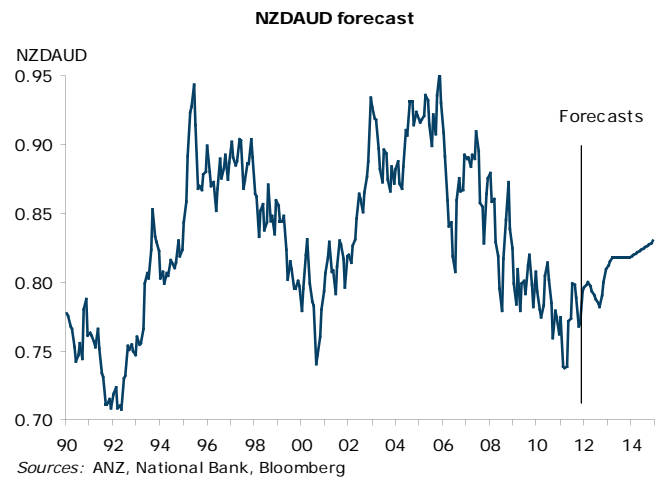
- the NZ economy will outperform most developed economies in 2012, aided by earthquake reconstruction;
- the European sovereign debt crisis will go a long way towards resolution by then; and
- the USD remains structurally weak.

The NZD will also be assisted next year by our expectation that the RBNZ will start to lift the OCR

from mid-year. The widening positive interest rate differential between New Zealand and the US will keep the NZD elevated over 2013, but we see the USD making a comeback further out, which will see NZDUSD easing back towards notions of fair value.



We expect the NZDAUD cross rate to rise but stay at a level that is comfortable for exporters next year. Given the poor outlook in the Eurozone, even if the debt crisis is resolved, we expect NZDEUR to reach new highs, which will make it tough for export sectors that service the European market.



The broad message with regards to the NZD, however, is that there will be ongoing volatility with wild swings expected. In the current environment, big near-term moves in currencies are to be expected. The average level of NZDUSD over the next few years will be higher than historical averages, reflecting a structural upward shift in New Zealand's terms of trade.

The risk profile for the NZD is to the downside, should the global economy slow by more than expected, and sovereign debt concerns do not get resolved.

EXCHANGE RATE

NEW ZEALAND DOLLAR FORECAST (END OF QUARTER)

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
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
Dec-10	0.78	0.76	63.2	0.50	0.58	69.2
Mar-11	0.76	0.74	63.3	0.48	0.54	66.7
Jun-11	0.83	0.77	66.8	0.52	0.57	71.2
Sep-11	0.76	0.79	58.7	0.49	0.57	68.3
Dec-11(f)	0.77	0.79	57.8	0.50	0.57	68.4
Mar-12(f)	0.80	0.80	60.0	0.51	0.58	70.3
Jun-12(f)	0.83	0.79	59.8	0.52	0.59	71.3
Sep-12(f)	0.86	0.78	61.9	0.53	0.61	72.8
Dec-12(f)	0.89	0.81	64.1	0.55	0.61	74.8
Mar-13(f)	0.90	0.82	63.0	0.55	0.62	75.4
Jun-13(f)	0.90	0.82	63.0	0.55	0.62	75.4
Sep-13(f)	0.90	0.82	63.0	0.55	0.62	75.4
Dec-13(f)	0.90	0.82	63.0	0.55	0.62	75.4
Mar-14(f)	0.87	0.82	62.6	0.53	0.61	74.0
Jun-14(f)	0.84	0.82	62.2	0.52	0.60	72.6
Sep-14(f)	0.81	0.83	61.6	0.50	0.58	71.2
Dec-14(f)	0.78	0.83	60.8	0.48	0.57	69.7

INTEREST RATES

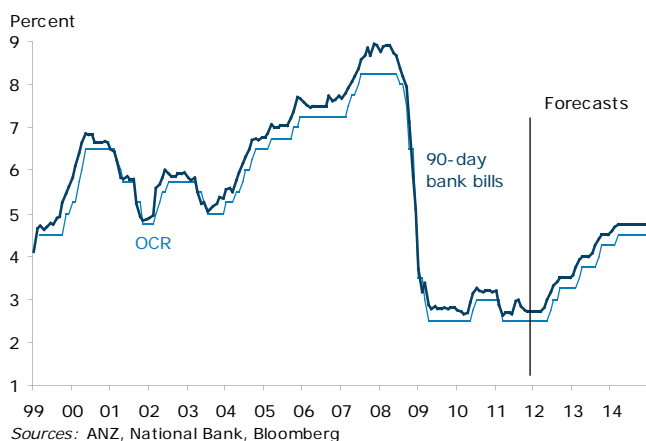
SUMMARY

Although sentiment towards the European sovereign debt crisis has improved markedly over the past month, the situation remains fragile, and has been influential in the RBNZ's decision to remain on the sidelines, especially with inflation moderating. Monetary policy remains stimulatory, and we continue to look for a mid-2012 start to the tightening cycle, but the risks are clearly tilted towards a later increase as opposed to sooner. With the OCR on hold for longer, expect short-end interest rates to be subdued. Long-end interest rates are also likely to remain lower for longer, in line with global rates, which are expected to moderate as recent optimism surrounding the European debt plan fades.

GLOBAL EVENT RISK DOMINATES THE OUTLOOK

Although domestic economic activity has held up relative to other OECD countries and the outlook remains better than most, momentum has slowed and downside risks have increased. As a result, there is significantly less urgency for the RBNZ to lift the OCR, in contrast with the picture mid-year, when the Bank was hinting at the need for impending hikes.

OCR and 90 day bank bills



Although our core view is a mid-2012 start to the tightening cycle, with global markets still in a state of flux, we do regard the timing of the Bank's next move as somewhat "fluid", and highly dependent on global developments. The Bank still has a tightening bias – it just believes that global uncertainty and recent weaker than expected CPI readings have bought it more time to assess the outlook. Things may well deteriorate further, and we are mindful that global issues have escalated quickly in the past. However we are not at that point yet, and unless things do deteriorate markedly, it is likely that the OCR will still rise in due course.

While they are in no rush, the RBNZ still expects to lift interest rates at some stage. This is predicated on two key assumptions:

- **The first is that global developments only have a mild impact on New Zealand.** Certainly this is the case at present, with limited flow-through to commodity prices and confidence in New Zealand, *relative* to what we have seen in other countries. However, the situation is very fluid and in the current environment we need to rely increasingly on anecdotes as timely barometers of what is going on. On this front, we are seeing more real-time evidence of follow-through. We would not classify it as either "mild" or "severe" at this stage. But it is a reminder of where the risk profile resides.
- **The second assumption is regarding the global scene itself,** where the RBNZ notes that "the European sovereign debt crisis could cause a further slowing in global activity". We are more wary than the consensus regarding the situation in Europe. We view sticking points such as the nominal GDP to 10-year bond yield gap in key nations such as Italy, how fiscal integration is achieved, and political dynamics as serious challenges to a package ultimately holding together.

Thankfully, we are now starting to see progress being made in Europe. Although announcements made in late October were short on detail, the very fact that there now is a plan in place has been viewed very positively by markets. So what does the plan call for? Briefly, the key elements are as follows:

- Banks will be required to hold at least 9 percent core tier 1 capital by mid 2012. Stress tests using September data suggest this means an additional €106bn capital.
- The EFSF will be leveraged to around €1trn, but we do not know which method (SPV or insurance) will be used.
- 50 percent "voluntary" haircuts on Greek debt, which have been proposed to avoid triggering a credit event.
- Treaty change options are "to be explored" which include new rules, closer monitoring, and greater enforcement.

Although we harbour concerns about the ability to enact this plan (let alone get final agreement on some of the detail), it is nonetheless a very encouraging starting point. Progress has been made on key issues in Europe, where market attention has been most closely focussed. But lasting resolution is still some time away, and we suspect

INTEREST RATES

the market has been subjected to a fair degree of optimism in recent weeks. As such, we would be surprised if the recent rise in global and New Zealand long-term interest rates is sustained.

Plenty of challenges still lie ahead. For example, Italian and Spanish pledges with regard to fiscal reform are the Achilles Heel of the European plan, for if we do not see credible results, and markets go after them, authorities simply don't have the resources to save them. This goes hand in hand with the ability to generate sufficient nominal GDP growth so as to be able to keep on top of debt, and get it down to more sustainable levels. We see a real critical point here being Q1 next year, where we suspect nominal GDP will disappoint as the Eurozone enters a recession. The endgame in Europe requires greater fiscal integration, which will involve sovereigns ceding some of their democratically elected mandates: not a simple requirement!

Credit rating agencies are also lurking in the shadows, and it would be surprising if more "core country" downgrades are not forthcoming. New Zealand has already been downgraded by 2 agencies, and in a sense, much of the bad news is behind us. But Moody's still have us on AAA, and if things start to go awry offshore, we may well get caught up in the mix, even if it is because of factors largely out of our control. While any downgrade is unwelcome, globally we're seeing countries move down multiple notches and remain on a negative outlook. Hence, New Zealand looks solid in a relative sense.

Global policy actions will continue to play a key role in determining the direction of local interest rates. Let's not forget that even though the tempo of US data has improved significantly, which goes some way to justify the circa half percent rise in 10 year Treasury bond yields, the US Federal Reserve's "operation twist" is still underway, and has been implemented with the express intention of lowering long term interest rates. Japan has also just expanded its QE programme by another JPY 5 trillion, and continues to lean into its soaring exchange rate, unleashing yet another wave of liquidity on global markets.

Domestic market conditions are also improving. We note for instance that demand for NZGS bonds at the weekly tenders has improved noticeably since the Fitch and S&P downgrades. This is an encouraging sign for the local market, as has been the strength of the NZD of late – even though it does seem somewhat out of character.

Finally, we are mindful of relative value aspects of New Zealand long term interest rates. Not only are they among the highest yielding investments in the so-called "dollar bloc", but the steep slope of the yield curve just adds to their appeal, boosting returns as bonds "roll" down the yield curve.

Putting it all together, our OCR expectations portray cautiousness. We have rates moving up, but not for a while, in a stop-start pattern, and expect the tightening cycle to end around 4-4.5 percent. With the RBA cash rate having peaked in Australia at 4.75 percent, a push beyond that makes little sense to us. **We see long term rates remaining very well supported over coming quarters,** but given the heady heights rates have moved to in October (10 year swaps are up almost half a percent off early October lows) on what we have dubbed "Europhoria", the balance of risks is clearly tilted to the downside.

Eventually – as we move beyond a global deleveraging headwind and subdued recovery process with considerable volatility – we expect to see inflationary challenges to become more prevalent. But that dynamic is beyond the current forecast horizon.

INTEREST RATES

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-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
Dec-10	3.00	3.2	3.8	4.7	5.9	3.3	5.5
Mar-11	2.50	2.6	3.3	4.5	5.7	3.5	5.5
Jun-11	2.50	2.7	3.4	4.4	5.1	3.2	5.2
Sep-11	2.50	2.9	3.1	3.8	4.4	1.9	4.2
Dec-11(f)	2.50	2.7	3.3	3.9	4.3	1.9	4.1
Mar-12(f)	2.50	2.7	3.6	4.1	4.3	1.9	4.0
Jun-12(f)	2.75	3.2	3.9	4.2	4.3	1.9	4.0
Sep-12(f)	3.25	3.5	4.1	4.4	4.3	2.0	4.1
Dec-12(f)	3.25	3.5	4.2	4.5	4.4	2.2	4.2
Mar-13(f)	3.50	3.9	4.4	4.6	4.4	2.4	4.2
Jun-13(f)	3.75	4.0	4.6	4.8	4.6	2.7	4.3
Sep-13(f)	4.00	4.4	4.9	5.1	4.8	3.1	4.6
Dec-13(f)	4.25	4.5	5.0	5.2	5.0	3.4	4.9
Mar-14(f)	4.50	4.8	5.1	5.2	4.9	3.4	4.9
Jun-14(f)	4.50	4.8	5.1	5.2	4.9	3.4	4.9
Sep-14(f)	4.50	4.8	5.1	5.2	4.9	3.4	4.9
Dec-14(f)	4.50	4.8	5.1	5.2	4.9	3.4	4.9

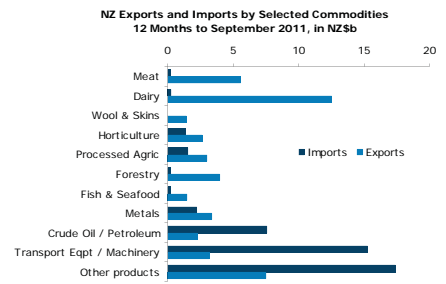
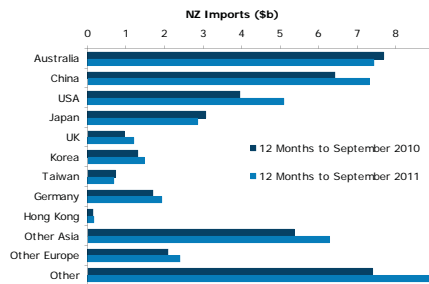
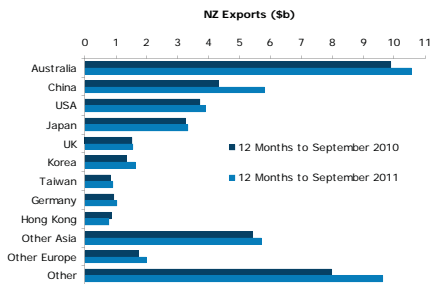
ECONOMIC FORECASTS

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
Real Gross Domestic Product												
Total GDP, QPC	0.9	0.1	0.8	1.2	0.2	0.5	1.0	1.0	0.9	0.7	0.7	0.6
Total GDP, APC	1.7	1.5	2.4	3.0	2.3	2.7	2.9	2.7	3.4	3.7	3.3	2.9
Total GDP, AAPC	1.6	1.5	1.7	2.1	2.3	2.6	2.7	2.7	3.0	3.2	3.3	3.3
Real GDP Components												
Private Consumption, QPC	0.5	0.3	0.3	0.6	0.2	0.6	0.6	0.5	0.5	0.4	0.4	0.4
Private Consumption, AAPC	2.1	1.9	1.8	1.8	1.7	1.7	1.7	1.8	2.0	2.0	2.0	1.9
Public Consumption, QPC	0.5	-0.1	0.2	0.2	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1
Public Consumption, AAPC	3.8	3.3	2.8	1.9	1.3	0.9	0.6	0.4	0.4	0.3	0.3	0.4
Residential Investment, QPC	-2.4	-7.2	-2.4	6.9	2.9	3.3	10.4	14.0	12.0	10.0	9.0	6.0
Residential Investment, AAPC	2.1	-7.0	-13.0	-13.1	-11.9	-3.8	7.0	17.2	29.3	40.5	47.3	48.8
Other Investment, QPC	-1.2	1.3	2.7	4.0	4.9	1.3	2.1	1.2	1.5	1.2	1.2	1.3
Other Investment, AAPC	7.1	9.6	11.2	9.6	10.0	11.1	11.7	12.3	10.4	8.6	6.8	5.7
Gross National Expenditure, QPC	-0.7	0.6	1.9	1.5	1.0	0.8	1.3	1.0	1.1	0.9	0.9	0.8
Gross National Expenditure, AAPC	4.4	4.0	3.4	3.1	3.6	4.2	4.6	4.8	4.6	4.4	4.3	4.2
Exports, QPC	0.8	-0.5	2.0	1.7	-2.5	-0.2	0.5	1.7	1.9	1.2	1.2	1.1
Exports, AAPC	1.7	1.3	2.5	2.9	2.6	2.5	1.3	0.1	1.0	2.1	3.8	5.3
Imports, QPC	-2.7	1.7	3.0	2.3	0.2	0.8	1.6	1.6	2.3	1.7	1.6	1.5
Imports, AAPC	10.4	10.2	9.6	7.3	7.2	6.7	5.8	5.8	5.6	5.8	6.5	7.2
Prices												
Headline CPI, QPC	0.8	1.0	0.4	0.3	0.6	0.7	0.9	0.4	0.6	0.7	0.9	0.4
Headline CPI, APC	4.5	5.3	4.6	2.5	2.3	2.1	2.5	2.6	2.6	2.6	2.7	2.7
Non-tradable CPI, QPC	1.1	0.6	0.6	0.6	0.9	0.7	1.1	0.7	0.9	0.7	1.1	0.7
Non-tradable CPI, APC	5.2	5.2	4.5	2.9	2.7	2.8	3.4	3.6	3.5	3.5	3.5	3.4
Tradable CPI, QPC	0.5	1.5	0.1	-0.1	0.2	0.8	0.6	-0.1	0.3	0.8	0.7	-0.1
Tradable CPI, APC	3.7	5.5	4.6	1.9	1.6	1.0	1.5	1.5	1.6	1.6	1.7	1.7
External Accounts												
Ann. Balance on Goods, % of GDP	1.7	1.6	1.7	1.9	1.8	1.6	1.3	1.0	0.8	0.6	0.4	0.2
Ann. Balance on Services, % of GDP	-0.3	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.6	-0.5	-0.4	-0.3	-0.3
Ann. Balance on Invisibles, % of GDP	-5.1	-5.0	-5.2	-5.0	-5.1	-5.1	-5.0	-4.9	-4.9	-4.8	-4.8	-4.8
Ann. CAB, % of GDP	-3.7	-3.9	-4.0	-3.6	-3.9	-4.0	-4.2	-4.5	-4.6	-4.7	-4.8	-4.9
Net Intl. Invt. Position, % of GDP	-68.7	-70.0	-69.7	-69.5	-69.9	-70.2	-70.5	-71.0	-71.3	-71.8	-72.3	-72.7
Terms of Trade (SNA basis)												
Export Prices, QPC	3.9	2.6	-4.8	0.1	-1.9	-1.4	-0.6	-0.7	-0.6	0.3	0.7	0.8
Export Prices, APC	8.2	6.5	2.0	1.5	-4.2	-7.9	-3.8	-4.5	-3.2	-1.6	-0.3	1.2
Import Prices, QPC	5.2	1.2	-7.1	-1.3	-1.7	-1.4	-0.6	-0.7	-0.7	0.4	0.9	1.1
Import Prices, APC	4.7	3.0	-1.7	-2.3	-8.7	-11.1	-4.9	-4.3	-3.4	-1.5	0.0	1.8
Terms of Trade, QPC	-1.3	1.3	2.5	1.4	-0.3	0.0	0.0	0.0	0.1	-0.2	-0.2	-0.3
Terms of Trade, APC	3.3	3.4	3.8	3.9	5.0	3.6	1.1	-0.2	0.2	0.0	-0.3	-0.6
Labour Market												
Employment, QPC	1.3	0.0	0.2	0.2	0.2	0.6	0.6	0.2	0.3	0.3	0.3	0.3
Employment, APC	1.8	2.0	1.2	1.7	0.7	1.2	1.6	1.6	1.7	1.4	1.2	1.2
Labour Force, QPC	1.1	0.0	0.1	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Labour Force, APC	2.3	1.6	1.2	1.4	0.5	0.8	1.0	1.1	1.1	1.1	1.2	1.2
Unemployment Rate, sa	6.5	6.5	6.4	6.4	6.4	6.1	5.8	5.9	5.9	5.8	5.8	5.8
Participation Rate, sa	68.6	68.4	68.3	68.2	68.2	68.1	68.1	68.0	68.0	68.0	67.9	67.9
Private Sector Wages, APC	2.5	3.1	2.9	2.7	3.1	2.7	2.9	3.2	3.4	3.5	3.5	3.5
Public Sector Wages, APC	2.8	2.2	2.4	2.4	0.8	1.5	1.5	1.8	1.8	1.8	2.0	2.1

Forecasts in bold

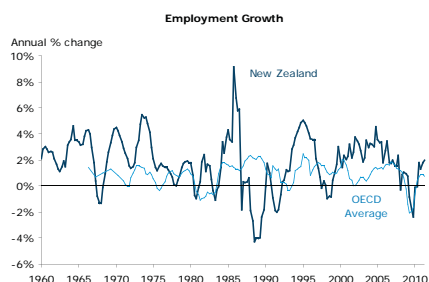
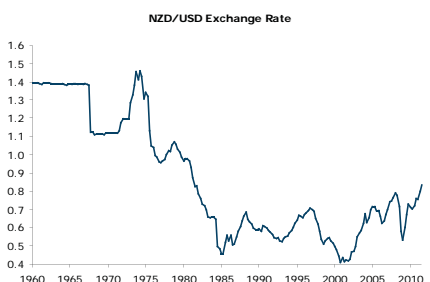
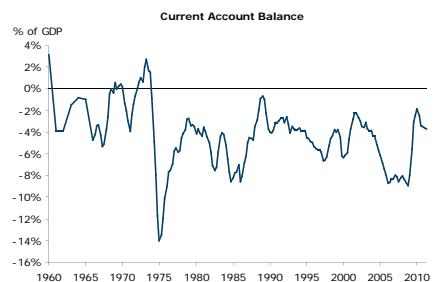
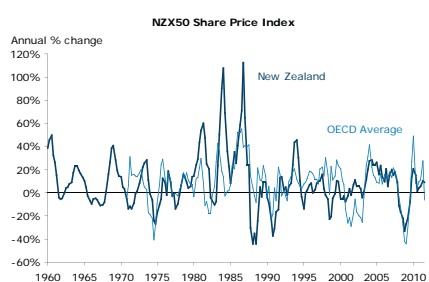
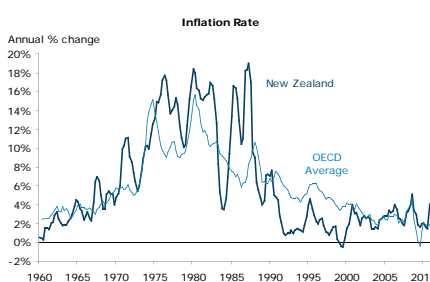
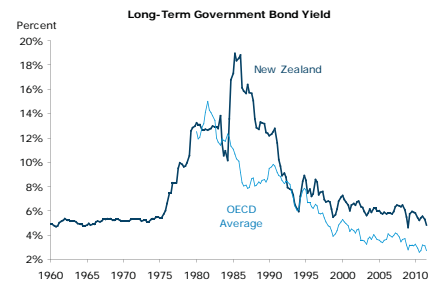
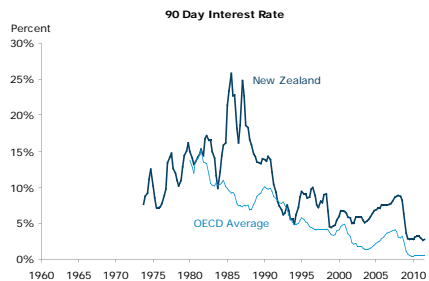
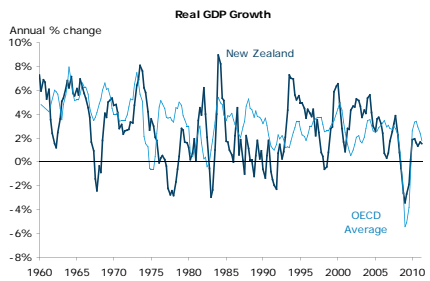
QPC – quarterly percent change, AAPC – annual average percent change, APC – annual percent change, sa – seasonally adjusted

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	4.4	22.7	312.3	128.0	62.3	1339.7	81.8	48.9	23.1	28.3	7.1	5.1	237.6
Area in 1,000 km2	268	7,741	9,827	378	244	9,597	357	100	36	330	1	1	1,905
Inhabitants per km2	16.4	2.9	31.8	338.6	255.6	139.6	229.1	490.2	641.0	85.9	6,419	7,284	124.7
GDP, in billion NZ\$	200	1,837	19,105	7,430	3,038	7,814	4,545	1,409	599	343	302	320	1,011
Change in real terms (yr-on-yr %)	1.5	1.9	2.2	1.3	1.5	9.5	3.8	3.9	6.6	4.7	6.5	7.9	6.4
Nominal GDP per capita in NZ\$	45,522	80,937	61,184	58,069	48,787	5,832	55,563	28,835	25,965	12,091	42,834	63,112	4,255
NZ exports to ..., NZ\$ million (FOB)	n/a	10,555	3,905	3,333	1,541	5,798	1,022	1,633	904	849	770	798	871
Share of NZ Exports (%)	n/a	22.6	8.3	7.1	3.3	12.4	2.2	3.5	1.9	1.8	1.6	1.7	1.9
NZ imports from , NZ\$million (VFD)	n/a	7,434	5,109	2,870	1,205	7,312	1,919	1,474	690	1,520	164	2,178	631
Share of NZ Imports (%)	n/a	16.1	11.1	6.2	2.6	15.9	4.2	3.2	1.5	3.3	0.4	4.7	1.4
Current Account balance (% of GDP)	-3.7	-2.1	-3.1	3.0	-1.8	4.0	5.6	2.8	8.2	11.5	6.2	21.1	0.6



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