

Quarterly Economic Forecasts

New Zealand

June 2009

THE BATHTUB

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Page 2: Key economic forecasts

Page 3: New Zealand economic outlook

- > The NZ economy continues to face an elongated adjustment process. Technically, we have the economy rebounding in late 2009, after a period of extended weakness. But this will mask regional and sectoral disparities. A respective cyclical and Rugby World Cup induced upswing dominates from mid 2010 and over 2011. But the big picture points towards an extended period of relatively subdued growth over a number of years as the economy rebalances.

Page 7: Global outlook

- > Aggressive action by policymakers has removed systemic risks across the financial system and improved the tenor of forward-looking data. While encouraging, we struggle to see a historical "V" shaped recovery taking hold, as de-leveraging across the household sector and a purging of global imbalances lean against massive policy stimulus.

Page 9: Fiscal policy

- > Fiscal policy is supporting the economy for now, but is set to move gradually towards a restrictive stance. We expect sustained large deficits and sizeable bond tender programs over the coming years, with any improvement likely to be a slow grind, given the economic backdrop.

Page 10: Inflation

- > Inflation has returned to the RBNZ's target band, and considerable spare capacity and a weak labour market should ensure that it remains there for the foreseeable future. While talk of future inflation danger is topical at present, we do not see it as an imminent risk – just something that should go on the watch list.

Page 11: Exchange rate

- > We continue to envisage a weaker NZD as forming a critical part of the rebalancing process for the economy. With the NZD/USD somewhat constrained by weak USD sentiment, a larger part of the adjustment may be borne by the NZD/AUD.

Page 13: Interest rates

- > We expect the OCR to remain on hold until late 2010 and policy normalisation to take place over 2011. Long-term bond yields are expected to remain biased higher on rising bond issuance and percolating inflation fears, although we ultimately do not expect the latter to materialise.

Page 15: Economic forecasts

Page 16: New Zealand key economic indicators

KEY ECONOMIC FORECASTS

Calendar years	2006	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)
NZ Economy (annual average % change)							
Real GDP	2.0	3.2	0.2	-2.6	1.5	4.6	2.1
Employment	2.4	1.9	0.6	-1.6	-1.0	2.1	2.1
Unemployment Rate (Dec qtr)	3.8	3.5	4.7	7.0	7.8	7.2	6.6
Terms of Trade	-3.0	5.9	2.4	-5.8	-2.8	3.0	1.8
Global Growth (annual average % change)							
United States	2.8	2.0	1.1	-2.8	1.2	2.6	2.9
Australia	2.8	4.0	2.3	0.0	0.4	3.0	2.8
Japan	2.0	2.3	-0.7	-6.6	1.3	1.5	1.6
China	10.7	11.7	9.1	6.5	8.1	9.6	10.1
Trading Partner Growth	3.7	4.0	1.9	-2.2	1.7	3.3	3.6
NZ Inflation (annual % change)							
CPI Inflation	2.6	3.2	3.4	1.8	2.6	2.5	2.2
Non-tradable Inflation	3.8	3.5	4.3	1.6	2.2	3.0	3.1
Tradable Inflation	1.2	2.8	2.3	1.8	3.1	1.6	1.1
NZ Financial Markets (end of December quarter)							
TWI	68.0	71.6	55.1	54.9	57.0	60.8	64.5
NZD/USD	0.69	0.77	0.56	0.55	0.56	0.61	0.65
NZD/AUD	0.88	0.88	0.83	0.75	0.74	0.76	0.84
Official Cash Rate	7.3	8.3	5.0	2.5	3.0	5.5	5.5
90-day Bank Bill Rate	7.7	8.9	5.2	2.8	3.6	5.8	5.8
10-year Bond Rate	5.8	6.4	4.9	5.6	6.3	6.7	6.5
Fiscal and External Balance							
Current Account Balance (\$m)	-14,200	-14,300	-16,000	-8,900	-9,400	-10,500	-11,700
as % of GDP	-8.7	-8.2	-8.9	-5.0	-5.2	-5.4	-5.8
Government OBEGAL (\$m)*	7,100	5,900	5,600	-2,900	-7,900	-8,500	-8,100
as % of GDP	4.5	3.5	3.1	-1.6	-4.5	-4.5	-4.1

* Operating balance excluding gains and losses, June years

Forecasts and text finalised 30 June 2009.

Key forecast assumptions:

- > Dubai oil prices are expected to trade within a US\$65 to US\$75 per barrel range for the rest of this year, then rise towards US\$90 per barrel by 2011.
- > Annual net migration peaks at around 20,000 by early next year, before easing towards 12,000 with departures picking up again as the global growth cycle recovers.
- > The longer-term potential growth rate is now seen in the 2 to 2½ percent range.
- > The neutral real (wholesale) interest rate is 3.5 percent.
- > Inflation expectations remain well anchored at a modest level.

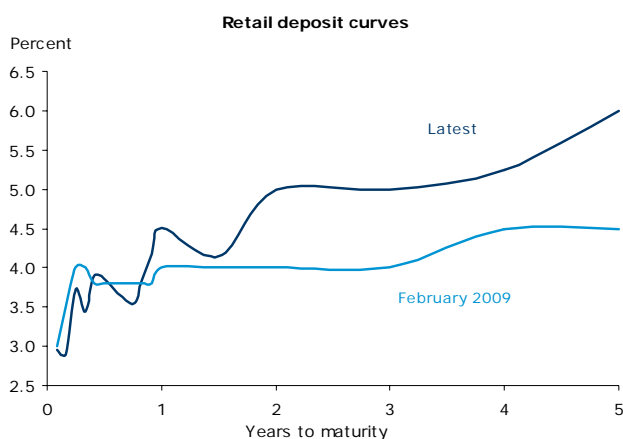
NZ ECONOMIC OUTLOOK

The NZ economy continues to face an elongated adjustment process. Technically, we have the economy rebounding in late 2009, after a period of extended weakness. But this will mask regional and sectoral disparities. A respective cyclical and Rugby World Cup induced upswing dominates from mid 2010 and over 2011. But the big picture points towards an extended period of relatively subdued growth over a number of years as the economy rebalances.

One overarching theme dominates our economic assessment

The New Zealand economy is rebalancing.

New Zealand's growth model has been domestic centric for the past two decades. This has been reflected in rapid debt accumulation, running persistently large current account deficits, negative household saving rates and excess consumption as households benefited from the positive wealth effect of surging house prices. New Zealand has some of the largest (relative) external imbalances in the developed world, with a current account deficit and stock of net international liabilities at 8.5 and 98.3 percent of GDP respectively. Such imbalances have now been exposed given the structural shift in the pricing of risk around the globe. The New Zealand economy is now transitioning towards a more balanced model where greater importance is assigned to earnings, exports and savings.



This is a process that is well underway.

Imports have collapsed (falling 8.6 percent in the March quarter and 6.5 percent in the December quarter) as they played catch-up to soft domestic demand over 2008. The current account deficit has fallen from a recent peak of 9 percent of GDP. Annual housing credit growth has eased to below 3 percent, a far cry from the double-digit rates of the decade prior. Credit card billings are now below levels of a year ago. There has been an upward

shift in the pricing of risk around the globe. Credit criteria have been tightened. Retail interest rates have moved up, despite the RBNZ cutting the Official Cash Rate, owing to rapidly rising deposit rates. The incentives are shifting in favour of investors and savers, at the expense of borrowers. All are symptomatic of a wider de-leveraging dynamic across the economy, and growth is the sacrificial pawn in a de-leveraging environment.

However, it is a process that will take time and no doubt be intertwined with volatility.

Businesses can de-leverage or restore health to their balance sheets relatively quickly, as has been the historical experience. Costs can be cut, investment deferred, capital raised, inventory brought down to manageable levels and dividends slashed. Certainly in some pockets this is occurring already as less consumer spending impacts on the business sector. However, the starting position for business balance sheets in New Zealand is strong. A key differentiating aspect in this economic cycle is that the rapid debt accumulation over the previous decades has largely been a household phenomenon, and it is households that are facing the greatest need to de-leverage. When households de-leverage, they have only one lever to pull, namely reduced discretionary spending. Hence, household de-leveraging tends to take more time. On top of this, the weak global backdrop is hampering the ability of the tradable sector to pick up the growth baton that has been dropped by a de-leveraging domestic economy. Moreover, the NZ dollar remains stubbornly elevated (although we doubt for long – refer page 11). It is curtailing the ability of the export sector to assist in the rebalancing process, although we are encouraged by recent trade figures.

This rebalancing theme weighs heavily within our economic assessment,

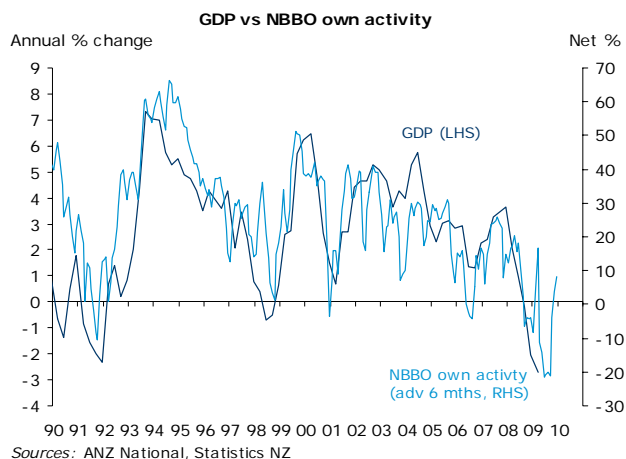
impacting the economy's ability to grow strongly on average over the forecast period and follow the normal pattern of strong upturns following recessionary periods (the so-called "V" shaped recovery). Nonetheless, we have still introduced a very pro-cyclical upswing from mid-2010 as pent-up demand, policy stimulus and the Rugby World Cup come to the fore. Strong net migration inflows are also influential. These dynamics need to be respected. But this forecast upturn is short in duration (by historical standards) and needs to be read within the context of the deepest economic adjustment since the 1970's. We expect the economy's transition and rebalancing process (including resource allocation) to extend beyond our forecast horizon.

A bathtub shaped cycle - with waves

The economy is still in recession, or moving down one side of the bathtub. Forward indicators continue to point to an economy that is

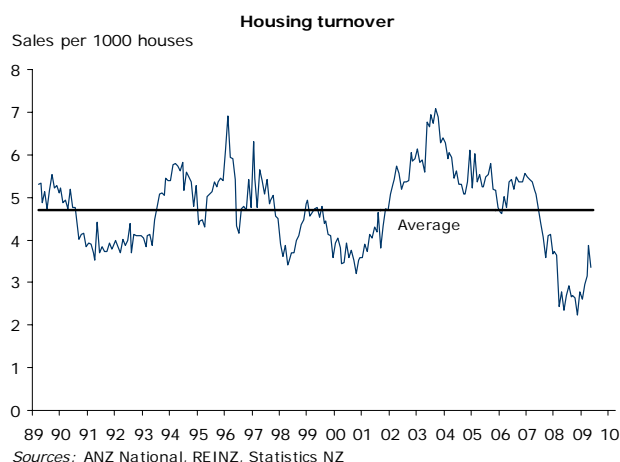
contracting, though the pace of contraction is moderating. The unemployment rate is rising rapidly and is set to continue heading higher into next year. Despite tax cuts and lower mortgage rates, consumer spending remains subdued as households increase their precautionary savings. Private consumption has now fallen for an unprecedented five consecutive quarters. Building consents are at levels not seen since the 1960s, and residential investment is down over 30 percent from its 2007 peaks. Business profitability has been under pressure and firms have been responding accordingly. Business investment has been cut back, falling 15 percent from a year ago – the steepest fall since the early 1990s.

A base is still forming. House sales are up 50 percent from their lows, as buyers respond to lower interest rates. We expect this to flow through to a sizeable recovery in building consents in the second half of 2009, and into actual residential construction activity late this year and early next year. Natural population growth is also providing underlying support to demand. Firms' own activity expectations from the National Bank *Business Outlook* (NBBO) survey – a key leading indicator – is now back in positive territory. Consumer confidence is similarly back above the key 100 level, indicating that optimists once again outnumber pessimists. Net migration is running strong, with the last three months seeing an annualised gain of 26,400 people, representing a key source of upside support to the domestic economy. All are welcome.



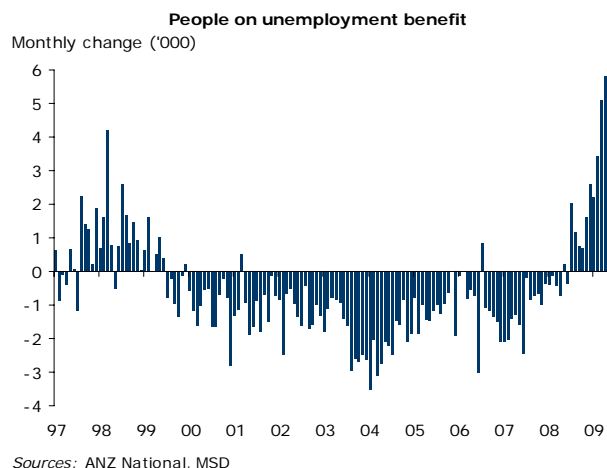
At this stage we are still cautious about the near-term outlook.

> **There is a base effect to be wary of as the bungy-cord dynamic takes hold.** Housing related activity may be up 50 percent from its lows, but it is still down over 30 percent from its late-2006 highs. Hence, while we are seeing positive directional changes in some data, the overall level remains low.



> **The global scene remains fragile and we see an elongated adjustment panning out (refer to page 7).**

> **Firms are now being forced to react via reduced investment and employment.** This reflects both the recession itself and also the intensity of the downturn in activity over late 2008 and early 2009. In particular, leading gauges of employment remain weak. While the unemployment rate remains relatively resilient at 5 percent at present, timely administrative data from the Ministry of Social Development show almost 6,000 people being added to the unemployment benefit a month, up from around 1,000 a month in mid-2008. However, the flipside is improving productivity growth once the recovery starts to take hold. Nevertheless, ongoing job losses mean that for many households, the recession will not feel like it is over until well into next year.

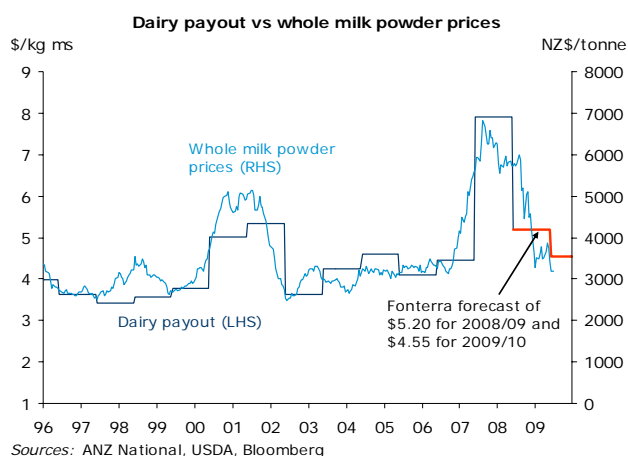


We expect forward momentum to be regained from late 2009. This partly reflects the bungy-cord dynamic at work, following what is likely to be seven successive quarters of contraction. We expect to see some FIFO (first in, first out) characteristics at work, with improved activity in the housing market driving a recovery in residential construction, and retail spending starting to recover

as some confidence returns to consumers (but within the context of still low levels of activity). A rebuild in inventories following a large rundown is also expected to drive some of the early recovery.

We have pencilled in relatively sedate growth over H2 2009 to mid-2010, but we expect to see higher than normal inter-quarter volatility courtesy of inventory adjustments and sectoral swings.

Stabilisation will mask heavy regional and sectoral disparities. 2008 was really an Auckland or upper North Island centric recession, as weak housing activity, retailing and a squeeze on income from rising costs (i.e. petrol and food prices) bit. There is still some intensity in these pockets but increased housing activity in Auckland is now outstripping other parts of the country. Petrol prices have fallen from over \$2.20 per litre to \$1.70, and food price inflation has eased back. Conversely, collapsing manufacturing activity, weakening tourism flows and the big show-stopper – a lower forecast payout to the dairy sector – are set to impact heavily on tradable or export aligned regions. Rural land prices in particular are under significant pressure, and the flow-on effects from a tighter farming chequebook should not be underestimated. While the economy will be travelling along the bottom of the bathtub from the second half of 2009, it will remain a bathtub with waves.



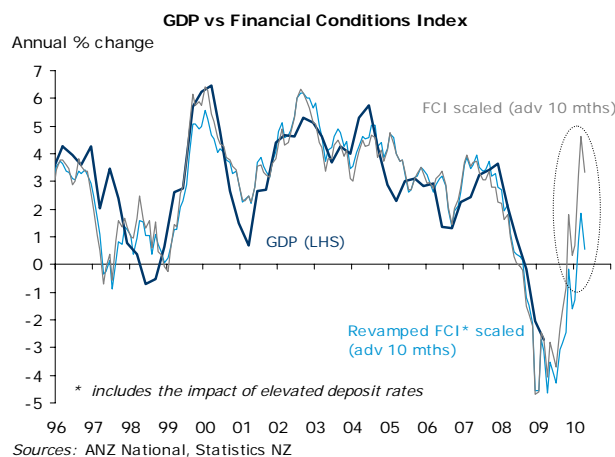
A recovery...of sorts

Pent-up demand, traditional stimulus and the Rugby World Cup will drive strong performance from mid-2010. While an overarching de-leveraging dynamic weighs heavily within our economic assessment – a transition that will take time – we nonetheless expect 2011 to be a boomer year. This reflects:

- > **The accumulation of pent-up demand.** As it becomes clear that the economy is on the mend, households and businesses will look to catch-up on spending that had been put off during the recession. The cyclical rebound in residential investment in particular is expected

to be strong, with year-on-year growth rising to over 20 percent by mid-2011. This looks strong on the face of it, but would still only see residential investment returning to the March 2008 level by the end of 2012.

- > **Loose financial conditions.** The easing cycle by the RBNZ has been unprecedented, taking financial conditions to levels that are stimulatory for growth. While the credit centric nature of the global shock means the traditional financial conditions channel may not be as strong compared to the past, loose financial conditions will still see a recovery in activity. Our revamped Financial Conditions Index, which incorporates the impact that rising deposit rates are having on lending rates, suggests a more modest rebound compared to the previous measure.



- > **The positive impact of the Rugby World Cup, which is potentially bigger than Ben Hur.** New Zealand has hosted some major sporting events before (e.g. 2000 America's Cup and 2005 Lions Tour) and the positive impact on activity has been evident. The Rugby World Cup in 2011 will easily be the largest sporting event New Zealand has hosted to date. Infrastructure related activity in the lead-up will buoy activity, and the influx of visitors and their spending will also provide a good boost to the economy. We are already seeing early signs of activity in non-residential building consents data.

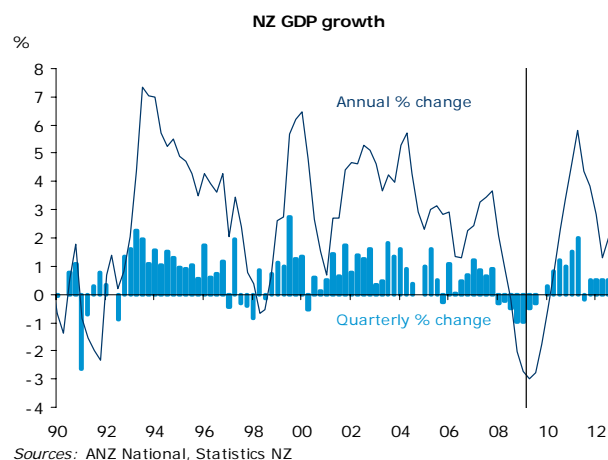
The above forces are respected within our economic assessment. Economists in general have a notorious tendency to both underestimate downturns and upswings, and we are in no doubt that once confidence returns the accumulation of pent-up demand and the like will quickly see the economy performing strongly. Building consents for instance, at a low 1,200 per month, are simply unsustainable given the natural population growth and migrant inflow.

But for 2012 and beyond, structural challenges are likely to linger

Unlike previous cycles, we have heavily tempered the length and magnitude of the cyclical recovery. Some post Rugby World Cup payback is likely in 2012 and we remain wary of structural aspects to this economic cycle.

The adjustment the economy is going through at present (while far from painless) is fundamentally a positive dynamic. Resources are set to relocate to more productive endeavours. It will reduce New Zealand's vulnerability to swings in the credit cycle. The penny seems to be dropping that New Zealand's proximity to Asia, and their shift to a more consumer centric model, provides huge opportunities. The challenge remains to lift productivity growth and get the framework in place from which businesses can prosper. We are seeing some positive signs in this regard but insufficient critical mass. We now see potential growth residing in the 2 to 2½ percent range, as opposed to the widely considered 3 percent rate. This partly reflects reduced

investment and capacity over this cycle but also an acknowledgement that the adjustment and process of resource allocation is a dynamic that will take time.



NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years	2006	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)
Total Consumption	3.1	4.0	0.9	-1.1	1.1	2.2	1.7
Private Consumption	2.5	4.1	0.1	-2.2	0.7	2.0	1.5
Public Consumption	5.0	3.6	3.9	2.6	2.4	2.8	2.2
Total Investment	0.1	4.6	-2.8	-15.6	1.8	16.0	7.5
Residential investment	-3.0	5.0	-17.1	-24.6	1.3	20.6	16.3
Other investment	0.9	4.5	0.8	-13.8	1.9	15.1	5.9
Stockbuilding¹	-0.7	0.3	0.4	-1.7	0.8	0.2	0.1
Gross National Expenditure	1.5	4.5	0.1	-6.1	2.1	5.4	3.2
Total Exports	1.8	3.8	-1.5	-3.6	3.3	7.0	6.6
Goods	3.3	5.5	0.2	-2.6	3.0	4.8	6.2
Services	-1.8	-0.8	-6.5	-8.2	3.0	15.3	7.8
Total Imports	-2.6	8.5	2.5	-16.7	3.7	10.1	8.9
Goods	-2.0	8.8	3.1	-17.2	3.5	10.1	9.3
Services	-4.4	7.3	0.7	-16.1	3.4	10.0	7.5
Expenditure on GDP	2.7	3.0	-1.0	-1.8	1.9	4.4	2.3
GDP (production based)	2.0	3.2	0.2	-2.6	1.5	4.6	2.1

¹ Percentage point contribution to growth

GLOBAL BACKDROP

Aggressive action by policymakers has removed systemic risks across the financial system and improved the tenor of forward-looking data. While encouraging, we struggle to see a historical “V” shaped recovery taking hold, as de-leveraging across the household sector and a purging of global imbalances lean against massive policy stimulus.

Green shoots?

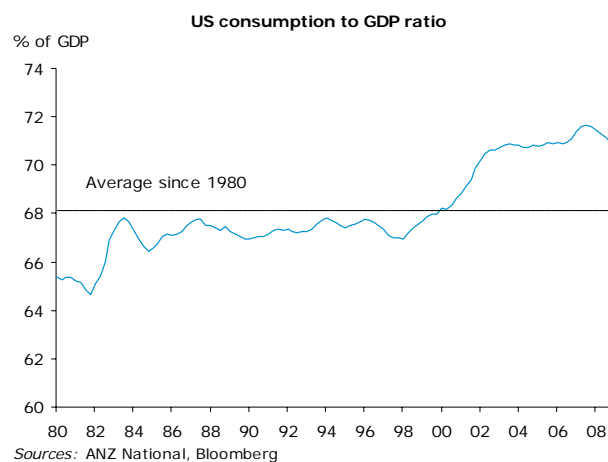
The financial system is healing, courtesy of unprecedented policy stimulus. Policymakers have worked aggressively to remove systemic risks across the financial system over the past six months. This includes record low interest rates, quantitative easing, capital injections, bailouts and considerable fiscal policy stimulus. It's working. Inter-bank lending rates have fallen considerably. Corporate credit spreads have also narrowed. Financial conditions in general have eased, although access to credit remains “tight”. Markets have generally taken this news in a positive light. The improvement in functionality across the financial system via the provision of capital and liquidity – thereby averting the “Armageddon” (or depression) economic scenario – has contributed to equity markets rising back to levels last seen in September 2008. Key leading economic indicators around the globe, such as PMI and confidence surveys, have recovered off record lows across the OECD, and sentiment seems to be improving considerably in China. The Baltic Dry Freight index peaked around 12,000 in 2008, subsequently fell to around 660, before now recovering to around 3,700. The CRB commodity futures index is up 26 percent from its lows.

There is still some way to go. Inter-bank lending rates have fallen to pre-Lehman Brothers collapse levels. Improvement in liquidity has been less stark (whilst still encouraging) in the longer part of the curve. There are considerable concerns lingering over Eastern Europe and its potential impact on the financial system. A lot of the improvement we are seeing across “real” economic barometers appears to reflect the bungy-cord dynamic off precipitous lows. The US consumer has been the single most important driver of global growth for more than a decade, but core US retail sales dropped 8.3 percent over the six months to January and have been virtually unchanged since then. A temporary inventory fillip looks to be driving commodity prices. Most leading indicators are still pointing to contraction – just at a slower rate.

We still see a lot of tension within the global economy. First-up we need to acknowledge the overwhelming economic stimulus in place. It's unprecedented, and traditionally there would be no

debate about a “V” shaped recovery. In fact we are already seeing some signs of this as inventories are rebuilt as conditions stabilise. Yet at the other extreme we need to remember that stepping aside from financial sector improvement (a necessary but not sufficient condition for recovery) it is household balance sheets in most need of repair in key Anglo-Saxon nations. “Credit” healing has quickly seen markets shift to inflation risks with upwards pressure on global interest (mortgage) rates, at a time the global economy is still contracting and pressure on households is intensifying as unemployment rates rise. Higher unemployment rates and falling asset prices are placing additional pressure on the financial system. This means credit availability – the credit channel of monetary policy – will remain restrictive and lean heavily against traditional policy stimulus.

Improvement around the globe will only take place via one dynamic, and it's called the passage of time. This means that while we respect the considerable stimulus in place we also need to be mindful of wider forces. There are massive structural aspects to this cycle and none more apparent than the role the US consumer has played during the debt-fuelled spending binge of the past decade, and will likewise play as such excesses are purged or returned to more normal conditions. This means consumption as a share of GDP will ease over time, and resources transitioning in a similar fashion to what we expect to happen in New Zealand. But less consumer excess in the US also implies the removal of excess capacity on the other side (i.e. Asia and Germany) and hence the rebalancing process is not merely a US economic story.

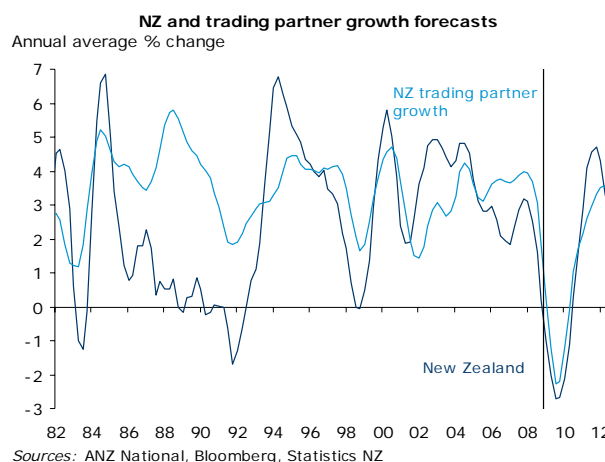


The global economy is expected to remain weak over 2009 abstracting from inventory adjustments which will introduce a fair degree of volatility into the cycle. Momentum is expected to improve over 2010 but it is not until 2011 that the global economy approaches a trend rate of expansion.

There is a strong geographical story within the aggregate picture. The US, Europe, UK, and Japan – all traditional markets for New Zealand – are expected to remain structurally weaker for longer, and resemble soup-bowl shaped cycles. Conversely, China is expected to remain relatively robust on the assumption domestic demand can be stimulated from lows – but not unscathed given the need to reduce capacity in key areas. Collectively, reducing the US “excess” spending will be partly countered by stimulating non-Japan Asia’s “repressed” spending or low share of consumption as a share of GDP. This dynamic is expected to support both New Zealand and our largest and most important trading partner, Australia, over time. But emphasis should be placed on the word time.

In terms of New Zealand’s trading partner growth *per se*, after contracting by 2.2 percent this year,

growth rebounds to a still below-trend 1.7 percent in 2010, before returning to trend over 2011 and 2012. However, significant uncertainties remain.



GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2006	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)
United States	2.8	2.0	1.1	-2.8	1.2	2.6	2.9
Australia	2.8	4.0	2.3	0.0	0.4	3.0	2.8
Japan	2.0	2.3	-0.7	-6.6	1.3	1.5	1.6
Euro Zone	3.1	2.7	0.6	-4.2	0.7	1.5	2.2
China	10.7	11.7	9.1	6.5	8.1	9.6	10.1
Trading Partner Growth	3.7	4.0	1.9	-2.2	1.7	3.3	3.6

FISCAL POLICY

Fiscal policy is supporting the economy for now, but is set to move gradually towards a restrictive stance. We expect sustained large deficits and sizeable bond tender programs over the coming years, with any improvement likely to be a slow grind, given the economic backdrop.

Consolidation mode

Fiscal policy is supporting the economy, for now. The fiscal stance is expansionary, and the government's balance sheet – via rising debt – is being used to buffer the economy from the worst of the recession. Tax cuts were delivered in April, roading remains a key priority, and the home insulation package is an example of support to pockets such as the construction industry.

This is expected to place continued pressure on the fiscal position over the coming years, with underlying operating deficits of 4 percent of GDP and rapidly rising net debt and bond issuance. We expect net debt to progressively rise towards 30 percent of GDP and bond tender programs approaching \$14 billion. This would still leave NZ's government debt levels low by international standards but it is the rate of ascent that is the primary focal point, with history showing that turning such trends is no simple task.

Fiscal policy is set to move gradually towards a restrictive stance. In the absence of material changes in fiscal settings, the 2008 *December Update* projected gross debt rising to over 70 percent of GDP. Action was required and the 2009 *Budget* contained some tough decisions. Despite the obvious groans towards deferring future tax cuts, suspending NZS Fund contributions, finding baseline savings, and reducing operating spending allocations for future budgets, the cold hard reality is that borrowing today just shifts the burden to the next generation. Someone always needs to pay the money back.

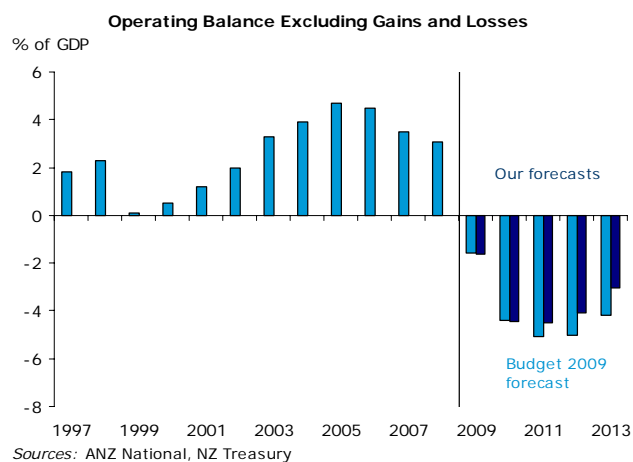
The strategy surrounding fiscal policy is critical for the economy. For one, the transition from fiscal support to consolidation needs to be handled carefully, given the fragility of the

FISCAL FORECAST

June years	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)	2013(f)
Operating Balance (\$m)	8,000	2,400	-9,400	5,900	-6,000	-4,500	-4,000
- as % of GDP	4.7	1.3	-5.2	3.3	-3.2	-2.3	-1.9
OBEGAL (\$m)	5,900	5,600	-2,900	-7,900	-8,500	-8,100	-6,300
- as % of GDP	3.5	3.1	-1.6	-4.5	-4.5	-4.1	-3.0
Net Core Crown Debt (\$m)	13,400	10,300	15,500	28,200	38,600	48,500	60,000
- as % of GDP	7.9	5.7	8.6	15.9	20.5	24.4	28.7
Core Crown residual cash (\$m)	2,900	2,100	-8,900	-12,000	-11,500	-11,100	-9,900
Bond Tender Programme (\$m)	2,300	1,800	5,900	8,700	10,500	14,000	14,000

economy: now is not the time for extremes including excess pump-priming nor the temptation to slash and burn. Second, the rating agencies (Standard & Poor's) have taken the Government at their word that they can deliver, hence the need to follow through. Third, we should not have any illusions about what fiscal consolidation looks like. New initiative spending in budgets since 2000 has averaged more than \$2 billion per year. The government is committing to \$1.1 billion per year over the coming years in order to hit its fiscal targets and stabilise the debt trajectory. That's a massive shift (considering health alone typically gets a \$750 million top-up each year), and implies some deep-rooted structural changes in terms of the delivery mechanisms for key services. Watch this space.

The local government sector is facing similar challenges. In the near-term there is intense pressure to support regional growth strategies and social initiatives. Some regions require significant infrastructure investment. Debt is rising and will continue to do so. At the same time, income is under pressure from a weak property market and narrow income base. Local Authority rates have risen at double the rate of inflation for the past decade (a bug-bear at the RBNZ). Such increases will continue to be required in order for services to be maintained and expanded. Yet this seems as odds with economic reality. The endgame here looks to be consolidation as well across local government.



INFLATION

Inflation has returned to the RBNZ's target band, and considerable spare capacity and a weak labour market should ensure that it remains there for the foreseeable future. While talk of future inflation danger is topical at present, we do not see it as an imminent risk – just something that should go on the watch list.

Within the band

Inflation is finally within the RBNZ's target band. Following a period of unprecedented commodity price growth, persistent domestic inflation pressures and price increases from non-contestable pockets – which all contributed to annual CPI inflation hitting 5.1 percent in September last year – the weak domestic and international backdrop has seen inflation ease to 3.0 percent in the March quarter. This is the first time inflation has been within the RBNZ's target band since September 2007. In fact, annual inflation is set to temporarily fall through the bottom of the target band as the strong quarterly increase in the September 2008 quarter “drops out” of the annual calculation.

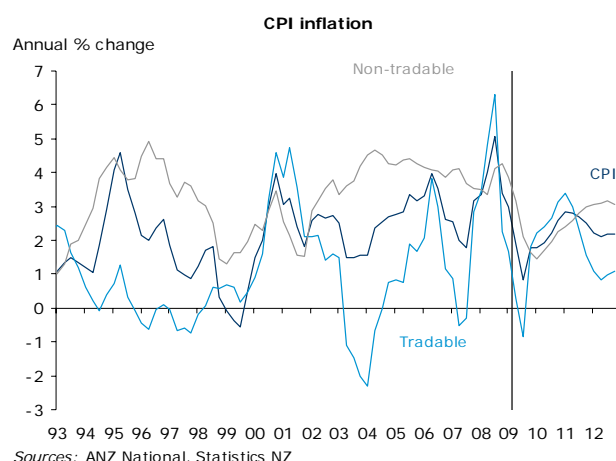
The weak domestic backdrop will ensure subdued pricing pressures. An economy that is set to remain well below trend for at least another 12 months, an unemployment rate that is expected to rise to near 8 percent, significant excess capacity opening up within many sectors and a reduction in previously high inflation expectations all bode well for the medium-term inflation outlook. In fact, near-term risks to inflation look to reside to the downside as the weak demand environment provides little opportunity to push through price increases. There are also some signs (around electricity pricing and local authority rates for example) that the political reality of events is dampening the ability to increase prices.

However, we see little risk of deflation. While some areas, such as retailing and even construction, could potentially experience falling prices for a time (a common occurrence in previous recessions), sustained price falls across the whole economy seem unlikely. The aggressive monetary policy response and also the fact that the economy now looks to be forming a base, appears to have averted this scenario.

Inflation is set to remain within the target band, although the NZD will potentially introduce considerable volatility. After a blip to 0.8 percent in the September quarter, annual inflation is forecast to remain at around 2 percent till the latter part of 2010. It is then expected to rise slightly over 2010 to the upper part of the band as tradable inflation rises and consolidation gives

some sectors more pricing power, particularly as the economy picks up momentum.

Inflation is on our watch list, as opposed to fear list. Those wary of inflation point to the simple consequences of excess liquidity. To that we would add that inflation is probably the most politically appealing way of easing some Anglo-Saxon nations' debt burden, and pricing power will return following consolidation across industries. The latter are themes we acknowledge. In our eyes, however, these dynamics will be capped by a) considerable excess global capacity, b) use of non-traditional monetary means (i.e. regulation) to control the business cycle (under the guise of reducing systemic risks), c) forward-looking markets with long-term yields tracking higher, thereby restraining the magnitude of the recovery, and d) policymakers, whom already seem to be setting the scene for the transition away from systemic risks and towards inflation stability.



CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Mar-08	0.7	3.4
Jun-08	1.6	4.0
Sep-08	1.5	5.1
Dec-08	-0.5	3.4
Mar-09	0.3	3.0
Jun-09 (f)	0.6	1.9
Sep-09 (f)	0.5	0.8
Dec-09 (f)	0.5	1.8
Mar-10 (f)	0.3	1.8
Jun-10 (f)	0.7	1.9
Sep-10 (f)	0.7	2.2
Dec-10 (f)	0.8	2.6
Mar-11 (f)	0.5	2.8
Jun-11 (f)	0.7	2.8
Sep-11 (f)	0.6	2.7
Dec-11 (f)	0.6	2.5
Mar-12 (f)	0.3	2.2
Jun-12 (f)	0.6	2.1
Sep-12 (f)	0.7	2.2
Dec-12 (f)	0.6	2.2

EXCHANGE RATE

We continue to envisage a weaker NZD as forming a critical part of the rebalancing process for the economy. With the NZD/USD somewhat constrained by weak USD sentiment, a larger part of the adjustment may be borne by the NZD/AUD.

The core spirit of our currency view remains unchanged from the previous quarter. To recall:

- > Low savings nations must ultimately have weaker currencies over time. Even relative to other low savers such as the US, we need to remember that New Zealand's savings rate or current account deficit is amongst the poorest, and we have a net external stock of liabilities near 100 percent of GDP. New Zealand has already seen import volumes fall 20 percent from their peak, in line with collapsing domestic demand. But the current account deficit remains at 8.5 percent of GDP! Collapsing imports cannot be relied on to truly correct New Zealand's external imbalances: the currency must play a role to support the export sector as has been the historical experience.
- > Weak USD sentiment can only go so far, with a material USD adjustment being hampered by the potential for sustained rises in the euro and yen. The former is at odds with the underlying vulnerability of the Euro-region given Eastern Europe's debt mountain. It is also clear from Japan's collapsing export performance that the yen cannot move too much higher. Everyone wants a lower currency, but this is not mathematically possible.
- > The currency cycle to date has been mild and short whereas the average cycle typically extends to 3 to 4 years above (and likewise below) fair value. An average across six different structural model specifications gives fair value for the NZD/USD in the 0.60-0.65 range, which we define the cycle around. If the NZD has "adjusted" it would be one of the shortest cycles in history.

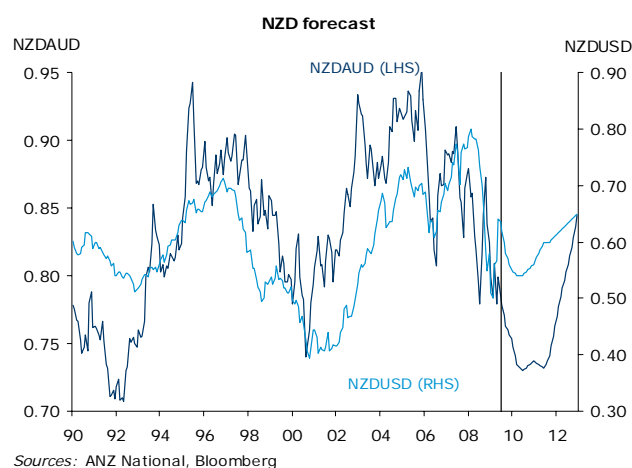
For now we are viewing the NZD's recent rise as not much more than noise. Risk sentiment, or more bluntly the nightly movements in the Dow Jones Industrial Average, is dominating at present. But this is a correlation that is simply awful over time. Beyond that, it's simply a story of flow and broad USD sentiment. Turning this trend requires either a) escalating risk aversion (with Eastern Europe the most likely candidate) and a correction in the EUR/USD towards 1.20 or b) the market to become confident towards the unwinding of various support measures put in place by the US Federal Reserve. These include an end to Quantitative

Easing, unwinding the swap lines, or firming potential for rate hikes. It is (a) that presents the greatest potential at present, although we are already starting to see some signs of the latter with the reduction or removal of some of the Fed's emergency loan facilities, which were put in place over the past 18 months. Many are viewing this as the first signs of an "exit strategy".

Domestically, there are many potential "triggers" but global moves are dominating.

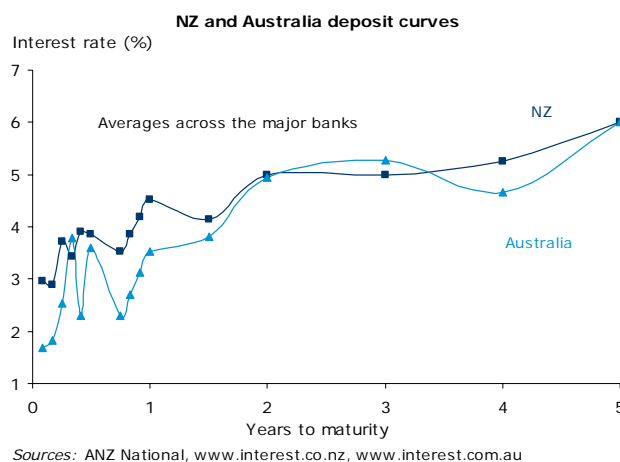
The interest rate market is expecting the RBNZ to be hiking from early next year, a dichotomy we expect to be redressed gradually in favour of the RBNZ's on hold until late 2010 mantra. Risks surrounding the external position simply don't seem to be well understood. Neither is the importance a materially lower dairy payout (which is falling each day the currency rises) will have on asset prices, and activity, particularly across the rural regions. Whether green shoots for the New Zealand economy are sustained into the September quarter is likely to be telling. Rising deposit rates across the economy are symptomatic of the de-leveraging dynamic that is occurring. But the scale of de-leveraging does not appear to be well understood across the currency market.

Our forecasts have the NZD falling to around the mid-50's against the USD. This is still a substantial correction from current levels but nonetheless considerably higher than flagged last quarter and largely reflects a more bearish USD bent across our global forecasts (up to a point). A stronger AUD/USD, with Australia proving once again to be the lucky country and averting a technical recession, also ensures that the NZD's adjustment against the USD is not as large as initially envisaged, as we ride in kanga's pouch.



However, we now expect a greater adjustment against the AUD. Both economies have similar structural issues, such as household dis-saving and current account deficits. Both are also embarking on rebalancing processes to a degree. But the outright starting point for NZ, with a current account deficit of 8.5 percent compared to

Australia's 3.1 percent, naturally means that the NZ economy has a larger adjustment to go through. The relative extent of this de-leveraging dynamic is no better shown than by the respective country's retail deposit curves. Despite New Zealand's wholesale interest rates sitting below those of Australia, due in part to a weaker economy and a lower central bank policy rate, New Zealand's retail deposit rates are higher. In fact, on average New Zealand's wholesale interest rate curve sits around 40bps below Australia's, while the retail deposit curve is around 68bps higher. It clearly shows that de-leveraging is a greater force in New Zealand at present and in this situation the currency should likewise drift lower. Throw in divergent economic performance, terms of trade levels and even interest rate expectations (with the RBA looking to be morphing towards hikes in early 2010), and the backdrop clearly lies in favour of the AUD over the NZD. To be fair, the cross is already sitting below historical averages but the economic picture continues to point lower.



NEW ZEALAND DOLLAR FORECAST (end of quarter)

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
Dec-05	0.68	0.93	80.4	0.40	0.58	70.4
Dec-06	0.70	0.89	83.8	0.36	0.53	69.4
Dec-07	0.77	0.88	85.6	0.39	0.53	71.8
Dec-08	0.58	0.82	52.5	0.40	0.41	56.2
Mar-09	0.56	0.81	55.4	0.39	0.42	57.3
Jun-09	0.64	0.79	62.5	0.39	0.45	60.2
Sep-09 (f)	0.58	0.76	56.8	0.37	0.46	57.4
Dec-09 (f)	0.55	0.75	52.3	0.35	0.44	54.9
Mar-10 (f)	0.54	0.73	52.4	0.36	0.44	54.3
Jun-10 (f)	0.54	0.73	54.0	0.36	0.45	54.8
Sep-10 (f)	0.55	0.73	56.7	0.37	0.46	56.0
Dec-10 (f)	0.56	0.74	58.8	0.38	0.47	57.0
Mar-11 (f)	0.58	0.73	62.1	0.39	0.48	58.4
Jun-11 (f)	0.60	0.73	66.0	0.39	0.48	59.9
Sep-11 (f)	0.60	0.74	66.0	0.39	0.48	60.0
Dec-11 (f)	0.61	0.76	67.1	0.39	0.48	60.8
Mar-12 (f)	0.62	0.78	68.2	0.39	0.49	61.9
Jun-12 (f)	0.63	0.80	69.3	0.39	0.49	62.6
Sep-12 (f)	0.64	0.82	70.4	0.39	0.49	63.3
Dec-12 (f)	0.65	0.84	71.5	0.39	0.50	64.5

INTEREST RATES

We expect the OCR to remain on hold until late 2010 and policy normalisation to take place over 2011. Long-term bond yields are expected to remain biased higher on rising bond issuance and percolating inflation fears, although we ultimately do not expect the latter to materialise.

The RBNZ now look to be in a holding pattern.

The RBNZ's job looks to be done with 575 basis points of stimulus already delivered in anticipation of tough times, the economy showing signs of stabilisation and credit markets improving offshore. Admittedly, financial conditions are tightening in other areas with fixed mortgage rates moving up and the NZD remaining stubbornly elevated. The reasoning behind both has little to do with monetary policy and the use of the Official Cash Rate as a policy instrument, despite the obvious frustration at the RBNZ. Considerable downside risks still surround the economic outlook, but in the current circumstances we agree with the spirit of the RBNZ's recent projections where this was conveyed via an easing bias as opposed to actually cutting the OCR. In the absence of a massive turnaround in migration we'd be more inclined to look for the OCR to hit 2 percent. But given this support, the hurdle to restart an easing cycle will be high.

Attention is now turning to the movement upward in the OCR. This is only natural given the massive trend down as markets look for the reciprocal to take place. The RBNZ is now, in part, victim to previous policy actions where there have been typically short periods between the last cut and the first hike. Throw in rising migration as a potential inflationary accelerant and markets that are mindful of a quantitative easing driven global inflationary dynamic, and (at the time of writing) the NZ rates market was expecting the OCR to be moving up by early 2010 and hitting around 4.5 percent by the end of that year.

We expect the OCR to remain on hold until late 2010, and hence disagree with market sentiment. There are four reasons for this:

- > A more cautious view of stabilisation in recent data around the globe as opposed to outright jumping on the green shoots bandwagon (refer page 7). As noted by the RBNZ in their June *Monetary Policy Statement* "we do not expect the global economy to continue contracting at the rapid pace seen in recent quarters. Nevertheless, we still expect that global economic activity will remain weak for an extended period."
- > This is a consumer de-leveraging story for the economy. It implies that the economy will

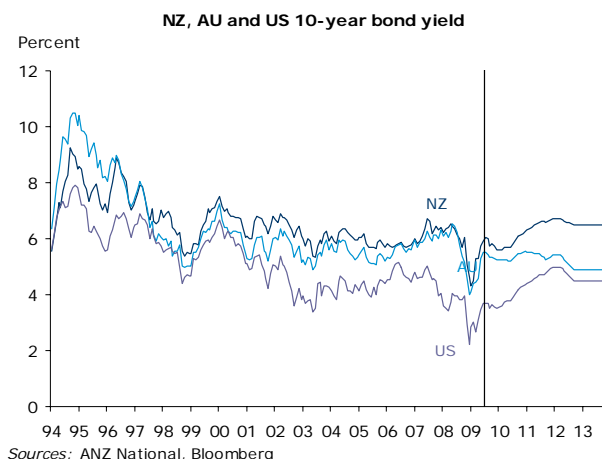
remain depressed (and monetary policy will be easier) for *longer*. While we acknowledge that outright retail interest rates may need to rise (witness the move in deposit rates of late), this is more likely to be reflected in margins, rather than policy rates. The RBNZ needs to keep the OCR low to provide somewhat of an offset.

- > There is a likelihood of non-traditional monetary policy mechanisms for controlling the availability and price of money within the economy going forward. While central banks will remain wary of over-reacting to economic circumstances, there is an inevitability about the increasing use of regulatory means as a way of reducing volatility and the amplitude of the business cycle (under the veil of reducing systemic risks). A by-product will be the OCR – though still the primary instrument – not being relied on as heavily or needing to (eventually) increase as much.
- > We are not huge buyers of the global inflationary story at present, particularly given the fragile economic backdrop. Simple static analysis of "printing money" or excess liquidity and inflation makes no allowance for the contractionary impact on aggregate cash within the system by collapsing credit markets and shrinking use of complicated derivative based products. Nor the deflationary impact structural changes in US consumer spending will have on global manufacturing capacity. However, we are attuned to the reality that inflation is probably the most politically appealing means of fixing housing balance sheets and the transition from arresting systemic failure across the financial system to inflation fighting is one heck of a tightrope to tread, with the risk that too much insurance is taken out against the former. Collectively, this leaves us biased towards higher inflation at some stage, but at a considerably later date. Policymakers are well aware and already look to be plotting transition strategies.

We expect policy normalisation to take place over 2010 and into 2011, but the potential overshoot in the OCR (beyond what we term the neutral level) to be mitigated by sustained structural shifts in the pricing of risk and use of non-traditional monetary mechanisms. The latter are expected to be reflected in retail borrowing rates, which all else being equal, means less need to push the primary policy instrument as high.

Bond yields are expected to continue drifting higher. In many countries (including New Zealand) the public sector has moved from being a net saver to a large net borrower, and in a relatively short space of time. Simultaneously, the private sector is moving to become net savers from a period of being significant net borrowers. In

either case, this is placing upward pressure on term interest rates and we expect this theme to continue. At this stage, while there have been some jitters in terms of the extent of government issuance, this process has so far been orderly. Government bond tenders, on the whole, have gone reasonable well. However, fiscal deficits are set to get much worse before they get better and the risks do appear skewed to interest rates rising sharply. This is another key risk to the global economic recovery story.



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	7.3	7.7	7.1	6.7	5.7	4.4	5.2
Dec-06	7.3	7.7	7.6	7.2	5.9	4.7	5.9
Dec-07	8.3	8.9	8.7	8.2	6.4	4.0	6.3
Dec-08	5.0	5.1	4.3	4.7	4.6	2.2	4.0
Mar-09 (f)	3.0	3.4	3.7	4.9	5.3	2.7	4.4
Jun-09 (f)	2.5	2.8	3.8	5.2	5.9	3.7	5.5
Sep-09 (f)	2.5	2.8	3.7	5.2	5.8	3.5	5.4
Dec-09 (f)	2.5	2.8	3.9	5.1	5.6	3.5	5.3
Mar-10 (f)	2.5	2.8	4.0	5.3	5.7	3.8	5.3
Jun-10 (f)	2.5	2.8	4.1	5.3	5.7	3.8	5.2
Sep-10 (f)	2.5	2.8	4.4	5.7	6.1	4.2	5.5
Dec-10 (f)	3.0	3.6	5.0	6.0	6.3	4.4	5.6
Mar-11 (f)	4.0	4.5	5.5	6.3	6.4	4.5	5.5
Jun-11 (f)	4.5	5.0	5.8	6.6	6.6	4.7	5.5
Sep-11 (f)	5.0	5.5	6.1	6.7	6.6	4.8	5.3
Dec-11 (f)	5.5	5.8	6.3	6.8	6.7	5.0	5.4
Mar-12 (f)	5.5	5.8	6.3	6.8	6.7	5.0	5.4
Jun-12 (f)	5.5	5.8	6.3	6.7	6.6	4.8	5.2
Sep-12 (f)	5.5	5.8	6.2	6.7	6.5	4.5	4.9
Dec-12 (f)	5.5	5.8	6.2	6.7	6.5	4.5	4.9

ECONOMIC FORECASTS

	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
Real Gross Domestic Product												
Total GDP, QPC	-0.3	-0.2	-0.5	-1.0	-1.0	-0.5	-0.3	0.0	0.3	0.8	1.2	1.0
Total GDP, APC	2.1	1.0	-0.2	-2.1	-2.7	-3.0	-2.8	-1.8	-0.5	0.8	2.3	3.3
Total GDP, AAPC	3.1	2.5	1.7	0.2	-1.0	-2.0	-2.6	-2.6	-2.0	-1.1	0.2	1.5
Real GDP Components												
Private Consumption, QPC	-0.4	-0.2	-0.1	-0.2	-1.3	-0.6	-0.3	0.2	0.3	0.3	0.4	0.5
Private Consumption, AAPC	3.2	2.2	1.1	0.1	-0.7	-1.4	-1.9	-2.2	-1.8	-1.1	-0.2	0.7
Public Consumption, QPC	1.6	0.4	0.4	1.5	0.4	0.5	0.5	0.6	0.5	0.7	0.7	0.7
Public Consumption, AAPC	4.0	4.4	3.9	3.9	3.3	3.0	3.1	2.6	2.4	2.3	2.2	2.4
Residential Investment, QPC	-6.2	-7.6	-7.1	-14.2	-0.3	-10.0	-5.0	0.5	2.0	2.5	4.0	2.0
Residential Investment, AAPC	4.6	-1.6	-8.5	-17.1	-22.9	-26.5	-28.3	-24.6	-21.2	-14.3	-5.0	1.3
Other Investment, QPC	-0.7	4.8	-8.1	-1.7	-7.3	-2.9	-0.9	-0.3	-0.4	1.7	2.5	4.7
Other Investment, AAPC	4.2	5.1	3.9	0.8	-2.9	-9.7	-12.4	-13.8	-12.0	-7.3	-3.3	1.9
Gross National Expenditure, QPC	0.3	0.4	-1.4	-2.0	-3.2	-1.2	-0.3	0.2	0.7	1.0	1.1	1.4
Gross National Expenditure, AAPC	4.4	3.1	1.6	0.1	-2.1	-4.3	-5.7	-6.1	-4.8	-2.5	-0.1	2.1
Exports, QPC	-2.8	0.1	-3.0	-3.1	0.6	-0.6	0.0	0.2	1.0	1.4	1.8	1.4
Exports, AAPC	2.9	2.7	2.5	-1.5	-3.3	-5.3	-5.8	-3.6	-2.1	0.1	2.0	3.3
Imports, QPC	1.1	3.2	-6.7	-6.5	-8.6	-2.1	0.2	0.2	1.5	1.4	1.4	2.5
Imports, AAPC	9.5	9.7	7.8	2.5	-4.2	-12.1	-16.3	-16.7	-12.8	-6.4	-0.9	3.7
Prices												
Headline CPI, QPC	0.7	1.6	1.5	-0.5	0.3	0.6	0.5	0.5	0.3	0.7	0.7	0.8
Headline CPI, APC	3.4	4.0	5.1	3.4	3.0	1.9	0.8	1.8	1.8	1.9	2.2	2.6
Non-tradable CPI, QPC	1.1	0.9	1.3	0.8	0.7	0.3	0.3	0.4	0.5	0.5	0.5	0.6
Non-tradable CPI, APC	3.5	3.4	4.1	4.3	3.8	3.2	2.1	1.6	1.4	1.7	2.0	2.2
Tradable CPI, QPC	0.2	2.3	1.9	-2.1	-0.4	0.9	0.8	0.6	0.0	1.0	1.0	1.0
Tradable CPI, APC	3.4	4.8	6.3	2.3	1.7	0.3	-0.8	1.8	2.2	2.4	2.7	3.1
External Accounts												
Annual Balance on Goods, % of GDP	-1.0	-1.1	-1.2	-1.2	-0.7	0.5	1.1	1.5	1.2	0.9	0.8	0.6
Annual Balance on Services, % of GDP	0.1	-0.1	-0.3	-0.6	-0.7	-0.7	-0.6	-0.6	-0.6	-0.8	-0.8	-0.7
Annual Balance on Invisibles, % of GDP	-7.1	-7.2	-7.1	-7.1	-7.0	-6.6	-6.3	-5.9	-5.4	-5.2	-5.1	-5.1
Annual Current Account Balance, % of GDP	-8.0	-8.5	-8.6	-9.0	-8.5	-6.8	-5.8	-5.0	-4.8	-5.1	-5.1	-5.2
Net International Invt Position, % of GDP	-86.4	-88.3	-92.0	-93.2	-98.3	-98.0	-97.7	-97.9	-98.1	-97.3	-95.9	-94.2
Terms of Trade (SNA basis)												
Export Prices, QPC	4.5	0.6	5.6	5.3	-3.2	-8.2	-2.6	1.1	0.4	-0.7	-0.8	-0.7
Export Prices, APC	12.0	13.7	18.3	16.9	8.3	-1.2	-8.9	-12.5	-9.2	-1.7	0.1	-1.7
Import Prices, QPC	1.6	5.7	6.2	7.2	-1.9	-7.7	-0.8	3.1	1.3	-0.6	-1.7	-1.3
Import Prices, APC	1.1	9.1	18.6	22.2	18.1	3.1	-3.8	-7.4	-4.4	3.1	2.1	-2.3
Terms of Trade, QPC	2.9	-4.8	-0.6	-1.8	-1.3	-0.5	-1.8	-1.9	-0.8	-0.1	0.9	0.6
Terms of Trade, APC	10.8	4.1	-0.2	-4.4	-8.3	-4.1	-5.3	-5.4	-5.0	-4.6	-1.9	0.6
Labour Market												
Employment, QPC	-1.0	1.2	0.2	0.6	-1.1	-1.0	-0.9	-0.4	-0.2	0.0	0.2	0.4
Employment, APC	-0.2	0.8	1.1	0.9	0.8	-1.3	-2.4	-3.4	-2.5	-1.5	-0.4	0.4
Labour Force, QPC	-0.7	1.4	0.5	1.0	-0.7	-0.4	0.0	0.2	0.3	0.3	0.4	0.3
Labour Force, APC	-0.3	1.1	1.7	2.2	2.1	0.3	-0.1	-1.0	0.1	0.8	1.2	1.3
Unemployment Rate, sa	3.8	4.0	4.3	4.7	5.0	5.6	6.4	7.0	7.5	7.7	7.9	7.8
Participation Rate, sa	67.7	68.5	68.6	69.1	68.4	67.9	67.7	67.6	67.6	67.5	67.5	67.5
Private Sector Wages (apc)	4.4	5.4	5.2	5.1	5.1	3.9	3.3	2.8	2.1	1.6	1.4	1.3
Public Sector Wages (apc)	5.4	4.8	6.4	5.3	4.4	5.6	3.8	3.4	1.6	1.6	1.7	1.8

Forecast in bold

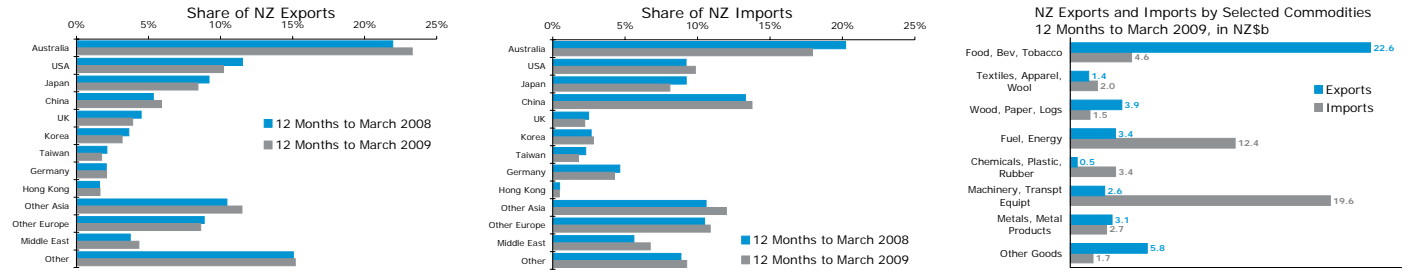
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

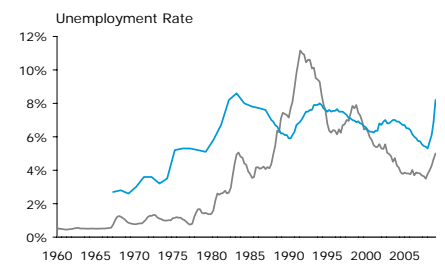
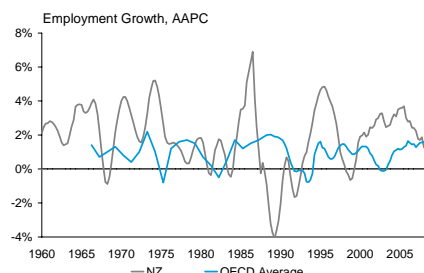
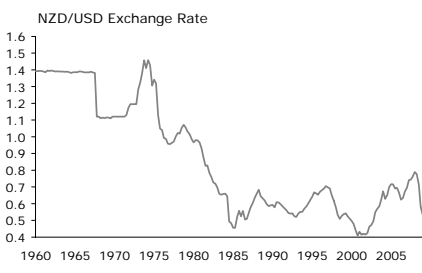
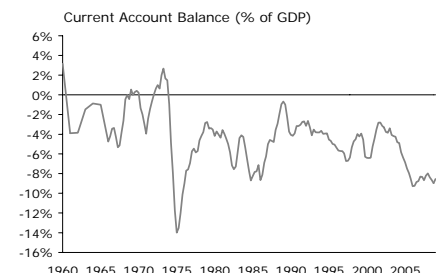
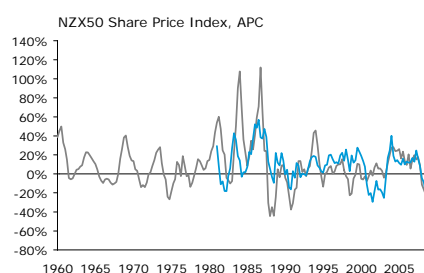
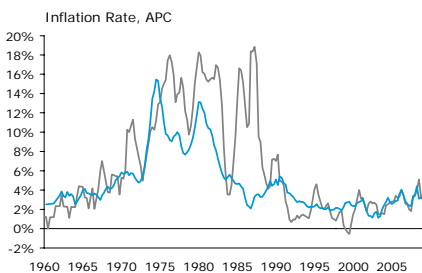
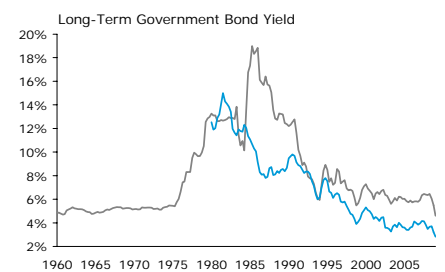
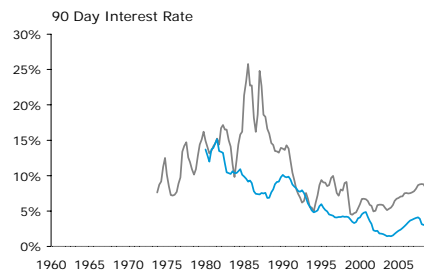
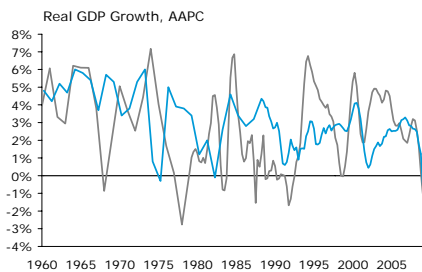
sa – seasonally adjusted

NEW ZEALAND KEY ECONOMIC INDICATORS



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

	NZ	Aust	USA	Japan	UK	China	Gmany	SKorea	Taiwan	Malaysia	H/Kong	S/pore	Indonesia
Population, in millions	4.2	21.8	306.8	128.6	60.2	1,368	81.9	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	15.4	2.8	32.7	340.4	246.6	143.1	229.7	557.5	636.1	77.9	7,130	4,600	135.3
GDP, in billion NZ\$	180	1,573	21,951	7,497	4,129	6,937	5,619	1,458	601	342	330	276	807
Change in real terms (year-on-year %)	-1.0	0.4	-2.5	-8.4	-4.2	6.1	-1.5	-4.3	-10.2	-6.1	-7.8	-10.4	5.6
Nominal GDP per capita in NZ\$	43,113	67,291	69,227	48,782	68,576	4,091	61,808	29,743	23,282	10,142	42,596	48,922	3,156
NZ exports to ..., in million NZ\$ (FOB)	n/a	9,995	4,382	3,613	1,672	2,534	895	1,358	752	949	700	863	1,006
Share of NZ Exports (%)	n/a	23.3	10.2	8.4	3.9	5.9	2.1	3.2	1.8	2.2	1.6	2.0	2.3
NZ imports to ..., in million NZ\$ (VFD)	n/a	8,098	4,449	3,653	1,002	6,215	1,931	1,269	806	1,696	203	2,260	1,048
Share of NZ Imports (%)	n/a	17.9	9.8	8.1	2.2	13.8	4.3	2.8	1.8	3.8	0.4	5.0	2.3
Current Account balance as a % of GDP	-8.5	-3.1	-4.4	2.3	-1.7	9.5	4.9	1.4	7.5	17.7	14.4	13.0	-0.2



NEW ZEALAND DISCLOSURE INFORMATION

The Bank (in respect of itself and its principal officers) makes the following investment adviser disclosure to you pursuant to section 41A of the Securities Markets Act 1988.

The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

Qualifications, experience and professional standing

Experience

The Bank is a registered bank and, through its staff, is experienced in providing investment advice about its own securities and, where applicable, the securities of other issuers. The Bank has been selling securities, and providing investment advice on those securities, to customers as a core part of its business for many years, drawing on the extensive research undertaken by the Bank and its related companies and the skills of specialised staff employed by the Bank. The Bank is represented on many bank, finance and investment related organisations and keeps abreast of relevant issues by running seminars and workshops for relevant staff and having its investment adviser staff attend external seminars where appropriate. The Bank subscribes to relevant industry publications and, where appropriate, its investment advisers will monitor the financial markets.

Relevant professional body

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

Professional indemnity insurance

The Bank (and its subsidiaries), through its ultimate parent company Australia and New Zealand Banking Group Limited, has professional indemnity insurance which covers its activities including those of investment advisers it employs.

This insurance covers issues (including 'prior acts') arising from staff fraud, electronic crime, documentary fraud and physical loss of property. The scope of the insurance also extends to third party civil claims, including those for negligence. The level of cover is of an amount commensurate with the size and scale of the Bank.

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

The Bank has a process in place for resolving disputes. Should a problem arise, you can contact any branch of the Bank for more information on the Bank's procedures or refer to any of the Bank's websites.

Unresolved complaints may ultimately be referred to the Banking Ombudsman, whose contact address is PO Box 10-573, Wellington.

Criminal convictions

In the five years before the relevant investment advice is given none of the Bank (in its capacity as an investment adviser and where applicable an investment broker) or any principal officer of the Bank has been:

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;

- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

Fees

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

Other interests and relationships

When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

- ANZ Investment Services (New Zealand) Limited (ANZIS), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ANZIS may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- The Bank has a joint venture relationship with ING (NZ) Holdings Limited (ING). ING and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.

Securities about which investment advice is given

The Bank provides investment advice on the following types of securities:

- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

If you wish to pay investment money to the Bank you can do this in several ways such as by:

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

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody

service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

NEW ZEALAND DISCLAIMER

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

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

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