Quarterly Economic Forecasts

New Zealand

October 2009

THE PROCESS OF CHANGE

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Page 3: New Zealand economic outlook

> Momentum is building and our central scenario has the economy recovering progressively over 2010 and 2011. History shows that recoveries tend to surprise on the upside and economists often underestimate this dynamic. We also remain mindful of structural forces at play. Firstly, the NZ and global economy is undergoing significant structural change. Rather than try to get cute in picking exact movements six months ahead, we see the economy growing at a lower trend rate of growth over the coming four years. Secondly, we believe there is a material risk of a double-dip.

Page 9: Global outlook

> The global economy is recovering courtesy of aggressive policy stimulus. How this stimulus is unwound without generating additional economic evils (ballooning government debt and inflation), and how the global rebalancing process plays out, are key challenges. We expect such tensions to manifest via short-term bouts of euphoria and despair, and the big picture recovery process to be gradual.

Page 10: Fiscal policy

> Expansionary fiscal policy is supporting the economy. However, this will progressively be unwound going forward as the focus shifts to fiscal consolidation and curtailing the rising debt profile. This means inevitable structural changes in the delivery of some government services.

Page 11: Inflation

> Inflation is set to remain comfortably within the target band over the next few years. In the near term, significant resource slack in the economy and an elevated currency will put downward pressure on inflation.

Page 12: Exchange rate

> A weak USD, buoyant AUD, improving risk sentiment and a recovering global scene (thereby encouraging high-beta plays) are supporting the NZD. These dynamics are expected to persist for some time despite going against the domestic fundamentals. However, our cautiousness over the global scene (a potential W cycle) and its sustainability also leaves us wary of another sharp down-leg for the NZD. But at present this is a high probability scenario as opposed to our central track.

Page 14: Interest rates

> There is enough uncertainty around the recovery path and excess capacity to warrant the RBNZ remaining on hold for some time. But extended caution means aggressive normalisation from Q3 2010. We expect the OCR to peak at 5.5 percent – a reflection of what we believe is a lower neutral level. Bond yields are expected to drift higher on rising issuance and US bond movements.

Page 17: Economic forecasts

Page 18: 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	0.0	-1.3	2.4	3.3	2.0
Employment	2.4	1.9	0.6	-1.1	-0.5	1.7	1.7
Unemployment Rate (Dec qtr)	3.8	3.5	4.7	6.6	7.0	6.7	6.3
Terms of Trade	-3.0	5.9	2.3	-6.7	2.7	2.1	1.5
Global Growth (annual average % change)							
United States	2.7	2.1	0.4	-2.6	2.1	2.6	3.2
Australia	2.8	4.0	2.4	0.9	2.5	3.2	3.8
Japan	2.0	2.4	-0.8	-5.8	1.0	1.6	2.0
China	11.0	12.0	9.1	8.1	8.9	9.3	10.1
Trading Partner Growth	3.7	4.0	1.7	-1.3	2.7	3.3	3.9
NZ Inflation (annual % change)							
CPI Inflation	2.6	3.2	3.4	2.1	2.6	2.9	2.2
Non-tradable Inflation	3.8	3.5	4.3	2.2	2.2	3.4	2.9
Tradable Inflation	1.2	2.8	2.3	1.8	3.1	2.1	1.3
NZ Financial Markets (end of December quarter)							
TWI	68.0	71.6	55.1	63.8	61.9	61.4	60.3
NZD/USD	0.69	0.77	0.56	0.71	0.68	0.64	0.62
NZD/AUD	0.88	0.88	0.83	0.80	0.78	0.83	0.81
Official Cash Rate	7.3	8.3	5.0	2.5	4.0	5.5	5.5
90-day Bank Bill Rate	7.7	8.9	5.2	2.8	4.5	5.8	5.8
10-year Bond Rate	5.8	6.4	4.9	5.3	6.1	6.8	6.5
Fiscal and External Balance							
Current Account Balance ($m)	-14,000	-14,200	-15,800	-6,400	-10,400	-10,300	-10,400
as % of GDP	-8.6	-8.1	-8.8	-3.5	-5.6	-5.2	-5.1
Government OBEGAL ($m)*	7,100	5,900	5,600	-2,700	-6,700	-7,100	-6,900
as % of GDP	4.5	3.5	3.1	-1.5	-3.7	-3.7	-3.4

* Operating balance excluding gains and losses, June years

Forecasts and text finalised 9 October 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 interest rate (Official Cash Rate) is 3.0 to 3.5 percent.

> Inflation expectations remain well anchored at a modest level.

NZ ECONOMIC OUTLOOK

Momentum is building and our central scenario has the economy recovering progressively over 2010 and 2011. History shows that recoveries tend to surprise on the upside and economists often underestimate this dynamic. We also remain mindful of structural forces at play. Firstly, the NZ and global economy is undergoing significant structural change. Rather than try to get cute in picking exact movements six months ahead, we see the economy growing at a lower trend rate of growth over the coming four years. Secondly, we believe there is a material risk of a double-dip.

The big picture

Four themes dominate our core economic view.

> **The NZ economy continues to face an elongated period of de-leveraging.** This started in the household sector. But with household debt still at 157 percent of disposable income and the debt servicing burden still high (at 12.2 percent of income versus an average of 9.6 percent since the early 1990s), there is some way to go. In addition, the emerging and pending story is one of adjustment in the rural sector, particularly dairy, as past excesses are purged. NZ's current account deficit has improved considerably, but it remains large. The household savings rate is still negative despite the retail sector effectively being in recession since late 2007.

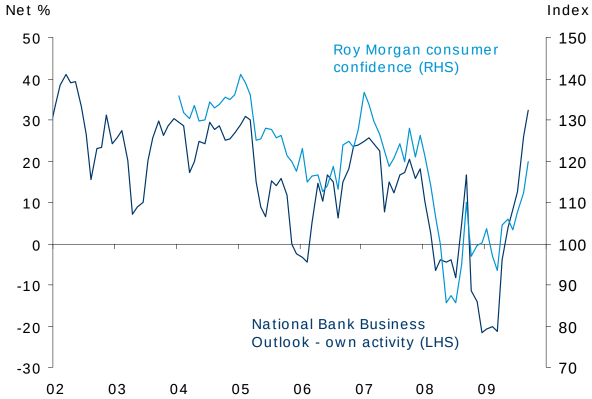
> **What we experienced during the credit boom years of 2002 to 2007 was not "normal" and we struggle to see a return to that environment.** During that time, credit growth ran at two to three times the rate of nominal GDP growth, house prices almost doubled in real terms, and there was a general expectation that asset prices could continue to grow at double-digit rates. Cash-flow fundamentals were supplanted by expectations of strong capital gains. The by-products were nasty imbalances including excessive leverage and risk-taking, a high current account deficit, significant affordability issues and an economic system that became explosive. Policymakers would be irresponsible to let such behaviour and imbalances return.

> **The world is facing considerable structural change as it rebalances.** The term "balanced" was mentioned 30 times by the G20 in its recent communication. The framework agreed to by the G20 ultimately involves the withdrawal of fiscal stimulus, aligning global current account imbalances, and increasing financial regulation and supervision (to prevent excess credit growth and leverage). NZ is no different. The government is looking at containing government expenditure, and new prudential regulations have been put in place by the RBNZ. Ultimately, global rebalancing is a structural process that will simply take time. However, we also know that resources do not reallocate to different price signals overnight. Well established behaviours that heavily influence the economic cycle can be slow to adapt to new realities.

> **NZ has key areas of strategic advantage, but it needs to get its house in order first.** We've written at length before about the growing importance of China (now NZ's third largest trading partner, although we remain wary of near-term risks), a long-term positive view for commodity prices and key areas of strategic advantage across the economy (including natural resources). These themes still apply. But "unlocking" these requires a fundamental change in behaviour, investor mindset and resource allocation across the economy. Resources need to shift from less productive (read housing) into more productive investment activities. Some relative price signals are assisting, while others (including the currency) are not. A lot of this rebalancing also involves adapting human behaviour (i.e. NZ's fixation with housing and aversion to equity markets) and this will no doubt take time. And, we suspect, also require pending tax changes.

We have pulled together a relatively safe set of core economic forecasts that are built around a gradual recovery. Momentum builds late this year into 2010, courtesy of policy stimulus, infrastructure spending (including for the Rugby World Cup), pent-up demand, net migration inflows and a recovering global economy. Although a higher unemployment rate until mid-2010 means the early legs of recovery are largely statistical in nature.

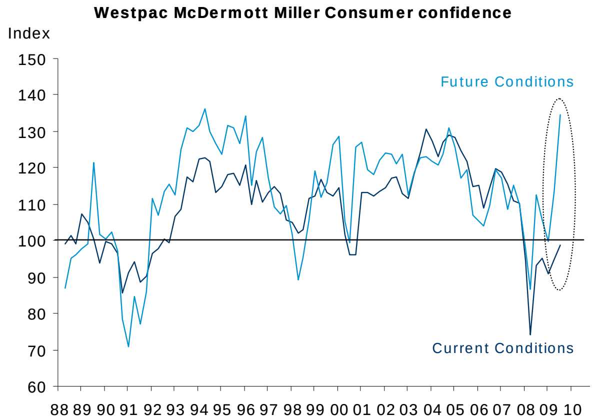
NZ Business and Consumer Confidence



Sources: ANZ National, Roy Morgan

The global and NZ economies have emerged from recession a tad earlier than expected and we are mindful of this in terms of the near-term picture. Confidence is improving sharply amongst businesses and consumers. **History shows that pent up demand can quickly be unleashed as confidence returns, and upturns tend to be inversely proportional to the degree of the downturn.** Economists are notoriously bad at under-estimating both the booms and the busts. Migration inflows and natural population growth are powerful support factors, particularly when accompanied by policy stimulus. Hence there is the potential for considerable upside in our forecasts over the coming year.

However, a lot of this confidence appears to be built on hope rather than substance at present. While confidence gauges have proved time and time again to be accurate barometers, we note that there is a large disconnect between current reality and expectations for the future. The former remains subdued, while the latter has improved sharply, and it is the former that is most important for spending. This is true for both households and businesses.



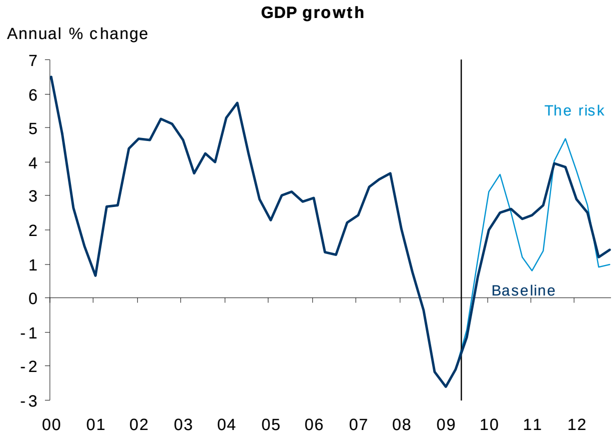
Sources: ANZ National, Westpac

We should be clear up front that our quantitative assessment must be read in conjunction with two key dynamics:

> **We have lowered our view of trend growth for NZ to just over 2 percent over the coming five years** as the NZ economy struggles with structural change and excesses built up over the preceding decade are repaid. Households, government (including local authorities) and businesses are facing a fundamentally different economic climate. The debt-fuelled consumption model which dominated in the previous upswing no longer applies. Households need to rebuild precautionary savings. The Government is facing a twenty year change process to turn deficits into surpluses. Service rationalisation is inevitable. It will take time to adjust. We would encourage readers to focus on the trend in variables as opposed to the cycle – with the latter subject to a huge degree of uncertainty at present.

> **We believe there is a material risk of a double-dip style recession.** Candidates for the potential trigger include:

- Accelerated de-leveraging and rebuilding of precautionary savings buffers. The Christmas period is shaping up as critical for the NZ retail sector in particular.
- The financial crisis part 2, caused by rising loan defaults from high unemployment, further removal of spare capacity and feedback effects from the real economy to the financial system. While attention is focused on the US and UK, weakness in commercial property prices globally is a key candidate to set off leg number two. We must also not lose sight of the fact that less spending must ultimately manifest in reduced capacity. This means subsequent adjustments (rebalancing) for Japan, Europe and China, with the latter a key area we are watching.
- A policymaker induced recession. Like it or not, the provision of excess liquidity that has averted economic Armageddon will need to be mopped up (the so-called exit strategies). There are simply too many variables and unknowns for us to believe policymakers are going to get this transition exactly right and hit the holy-grail of economics (strong growth with low inflation). Policymakers are between the proverbial rock and a hard place. Yet if they are serious in their desire to ensure that another financial crisis does not emerge, then tough-love is going to have to be delivered at some stage. This means the removal of excess liquidity – when the time is right – in a rapid fashion. The scenario may become reality if the economy recovers strongly from the recession in the first instance. In addition, if behavioural aspects in the economic cycle show a failure to accept that the world has changed, policymakers are likely to take it upon themselves to act.



Sources: ANZ National, Statistics NZ

Out of recession…

The economy is growing again, after five straight quarters of contraction – the longest recession since the 1970s – and a cumulative GDP loss of 2.9 percent. Lead indicators have risen strongly and our composite growth indicator from the National Bank *Business Outlook* Survey is pointing towards 2½ percent growth by mid-2010. Firms' own activity expectations are consistent with 4 percent growth. Aggressive policy stimulus resides at the heart of the turnaround, in combination with migration trends and natural population growth. But a better feel-good factor is also developing with house prices rising again, the global scene recovering and a general perception that the worst has passed.

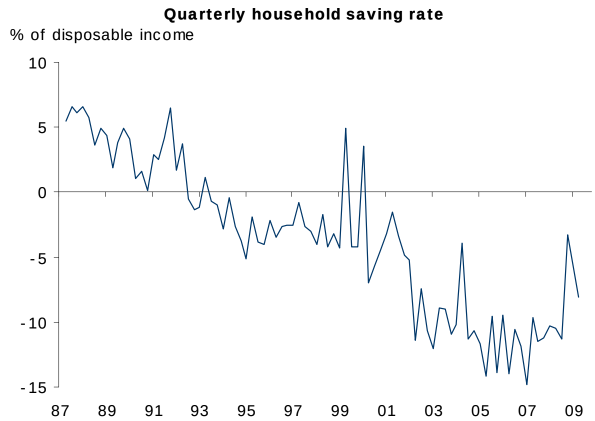
There has been a notable move towards the required rebalancing of the economy. The current account deficit has narrowed to a five year low of 5.9 percent. Export volumes have surpassed import volumes for the first time since March 2003 – largely due to a capitulation in the latter. Subdued retail spending suggests households have saved a reasonable proportion of the $2 billion worth of tax cuts and the reduction of $1 billion worth of debt servicing costs.

Forward momentum looks likely to continue into H2 2009 and early 2010. As confidence improves, an element of pent-up-demand is typically unleashed and we fully expect this dynamic to manifest over the coming quarters. Housing market activity (both prices and turnover) have improved off lows and net migration has risen as fewer New Zealanders choose to leave. A decent inventory cycle is expected to underpin domestic growth in the coming six months, after de-stocking knocked a cumulative 4.8 percentage points off GDP growth since the December 2008 quarter.

However, the sectoral and regional picture remains mixed and we need to be mindful of distinguishing between the level and change. We view the recovery in the first instance as largely "statistical". Auckland and housing are at the forefront of the recovery – a natural dynamic after 18 months of recession. Conversely, weakness is now more pronounced in rural aligned areas. Unemployment is still rising and wage growth is subdued. Signs of green shoots in areas such as residential building consents (with the number up 21 percent from recent lows) are to be respected. But consent issuance still remains at low levels not seen since the early 1980s. On top of this, the total value of building consent issuance is still falling. The levels versus (percentage) change dynamic is also notable in industries such as car sales, manufacturing, and even housing turnover. So while we are seeing improvement (the change), there is a long way to go and the level portends of continued pressure for consolidation in an array of industries.

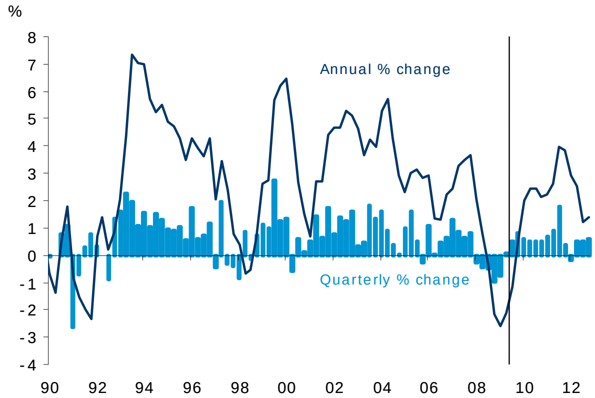
…but not out of the woods

The economy and recovery remains "unbalanced". The non-tradable sector grew 0.4 percent in the June quarter, while the tradable sector contracted 0.9 percent – its seventh contraction in the past eight quarters. Forward looking indicators continue to have this "feel" about them as the housing market bounces back. Sectoral readings from the NBNZ *Business Outlook* suggest that services and construction will outperform other sectors in the near-term. This is hardly the appropriate "mix" to correct imbalances. On top of this, households remain dis-savers. A prerequisite to a sustained recovery remains the rebuilding of precautionary savings and this should ensure that consumer spending remains subdued. The trade balance has improved markedly, but now looks set to deteriorate as import demand picks up and the high NZ dollar makes a dent on export earnings.



Sources: ANZ National, Statistics NZ

Taking all the above together, we continue to take a guarded view towards the outlook. We forecast a "statistical" (inventory led) recovery over H2 2009, with the economy posting modest growth of around ½ percent per quarter for most of 2010. Putting the non-trivial risk of a double-dip aside for the time being, our baseline view has the economy growing by 2.4 percent over 2010. A Rugby World Cup induced boost takes growth to 3.2 percent over 2011, before then settling back to 2.0 percent in the year to 2012. If it were not for the imbalances and challenges listed in the preamble, four-percent plus growth would be a shoe-in for at least one year. But we find the structural forces hard to ignore and hence both the business cycle and average rate of growth over the forecast period are modest relative to historical experience.

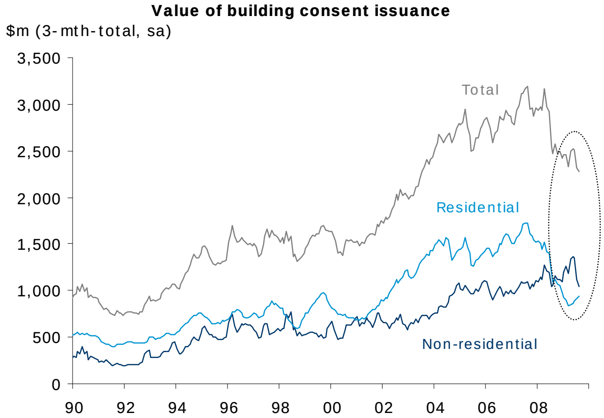


Sources: ANZ National, Statistics NZ

The labour market will remain weak for a time. While businesses are feeling more confident about the outlook, this confidence is yet to reach a critical mass for them to begin hiring again (or investing in plant and machinery). A cost and efficiency theme continues to percolate across the economy. Employment intentions remain below average levels. Hours worked are down 3.5 percent, while employment is down a more modest 1.8 percent. This puts hours per person employed at all time lows. Underemployment, a measure of under-utilisation of the labour force, continues to rise with the number of part-timers wanting to work more hours up 36 percent since early 2008. This portends of considerable labour slack that can be absorbed without adding to employment in the first legs of the recovery. We expect the unemployment rate to push through 7 percent in early 2010 and remain sticky for some time. This dynamic is expected to accentuate household's rebuilding of precautionary savings.

A recovery in residential investment will provide some support to growth. Rising migration inflows will naturally see pent-up demand support residential construction. A turn in residential building consent issuance is already signalling this. After falling almost 19 percent in 2009 and hitting a record low as a percentage of GDP, residential investment is expected to grow by 14 and 18 percent over 2010 and 2011 respectively. While these rates of growth seem impressive, the level of activity is still expected to remain below the recent 2007 peak. However, we are closely watching the leaky building crisis, which has the potential to spur residential construction substantially, although who ends up paying remains the million (billion?) dollar question.

Non-residential construction is expected to wane as it typically lags the cycle. Vacancy rates are rising (though off lows) and rents are under pressure as tenancy risk comes to the fore. Areas such as Auckland and Wellington now face a surfeit of supply. The floor area of non-residential consent issuance has tumbled 38 percent from its recent peak and we expect it to remain under pressure. Less capital investment from the likes of the dairy industry will also be influential. With the exception of government infrastructure projects and work for the Rugby World Cup, anecdotal evidence suggests a drying up of pipeline construction work in the major centres. Roading related activity remains strong, but the level shift up in this occurred two years ago. Going forward its more a case of plateauing at a high level, as opposed to further incremental moves up. A key wild-card at this juncture is whether hidden value in NZ's natural resource base will be unlocked. We suspect this will be the case, but towards the end of the forecast horizon.



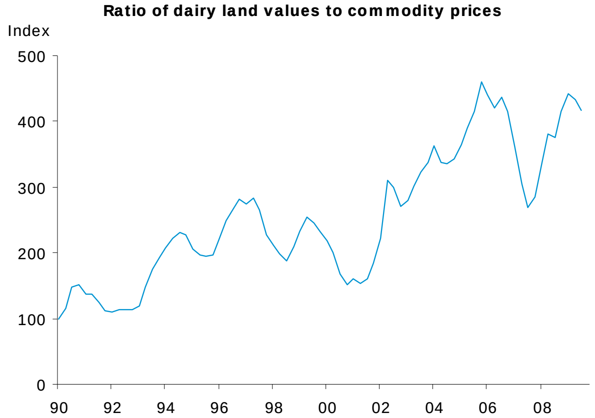
Sources: ANZ National, Statistics NZ

Impetus from net migration is expected to wane into 2010. Steady arrivals and fewer departures have been a key source of baseline demand for the economy over 2009, boosting population growth. Net migration (3-month annualised) has increased from 5,800 to 22,900 over the past year. We see this impetus remaining positive going forward but of a lesser magnitude. The big swing factor here is departures to Australia. These have collapsed over the past six months but look set to increase again going forward given relative unemployment rates and job prospects. New Zealand Immigration Service data shows that offshore residency and work permit approvals have fallen 41 percent in the past seven months. We expect a combination of declining arrivals and rising departures to result in annual net migration moderating to around 12,000 later in 2010.

Improved export performance will come eventually, but just not yet. After contracting 2.7 percent over 2009, export volume growth is forecast to grow just 0.3 percent over 2010 as the high level of the NZD impacts. A considerable rundown in dairy inventories also means further dairy export growth will need to be met out of production – with biological constraints naturally weighing. Tourism inflows have been supported by a significant increase in the number of Australian arrivals (this has nearly surpassed the total of all other countries). But with less "high value" tourists, the total spend looks set to remain under pressure. That aside, the Christmas period is likely to be telling for the sector. As a discretionary item, tourism flows naturally suffer when household budgets are under pressure and unemployment is rising. It is not until the NZD begins to ease over the latter parts of 2010 and the global economy begins to show sustained recovery that export performance, including tourism, picks up solidly. Export growth is forecast at 5.4 percent in 2011 and 6.1 percent in 2012.

Recent commodity price gains are undeniably positive, but there is still the issue of previous gains being capitalised. The recent increases in global dairy prices and the boost in Fonterra's payout forecast for the 2009/10 season will go a long way to alleviate significant cash-flow pressures in the dairy industry. It will help ensure that excesses are worked through in an orderly fashion. But we doubt the rural chequebook is about to be flung open. High debt levels and an ongoing adjustment to land prices will see hesitation when it comes to spending.

Ratio of dairy land values to commodity prices



Sources: ANZ National, REINZ, QV

Any current account deficit improvement looks set to be a slow grind. The terms of trade is now expected to rise once again after a 9 percent fall in the June quarter, given recent commodity price gains. This will support domestic demand despite lack-lustre export volume growth. However, with relative price signals (read the currency) hampering the ability for sustained improvement in export performance, and import demand set to recover in line with the domestic economy, the current account deficit looks likely to remain relatively large and above 5 percent of GDP. We continue to view this as a major structural weakness within the economy, but until we see a material change in savings behaviour, it's an area of vulnerability that is likely to persist.

At the crossroads

There is a considerable amount of uncertainty with the outlook as we weigh up competing cyclical and structural forces. One-offs such as the Rugby World Cup complicate the picture and put a degree of noise into the forecasts. We have pencilled in gradually rebuilding momentum and a relatively benign adjustment across the economy. But we need to be clear: there is a huge amount of tension within the economic system – cyclical forces pushing for a greater rebound but constrained by an economy that needs to de-leverage and undergo considerable change.

The past fifteen years was not normal in terms of credit facilitation and creation, and the path for asset prices. Abstracting from fits-and-starts and the odd year of good performance, **we expect the process of change and a move to more "normal" conditions to manifest in a lower trend rate of growth over a number of years.** Looking past the threat of a double-dip, the worrying risk is that a stronger near-term rebound breeds complacency. Habits of old return and an opportunity is squandered. We are placing a lot of faith in policymakers to make sure this does not eventuate.

NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual percent change)	2006	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)
Total Consumption	**3.1**	**3.9**	**0.8**	**-0.6**	**1.6**	**2.0**	**1.6**
Private Consumption	2.5	4.1	-0.1	-1.0	1.6	2.0	1.5
Public Consumption	4.9	3.5	3.8	0.8	1.4	2.0	2.1
Total Investment	**0.1**	**4.7**	**-3.0**	**-11.9**	**2.8**	**8.4**	**6.0**
Residential investment	-3.0	5.0	-16.7	-18.7	14.1	18.3	8.6
Other investment	0.9	4.6	0.5	-10.4	0.7	6.2	5.4
Stockbuilding[1]	-0.7	0.3	0.3	-1.9	1.5	0.0	-0.1
Gross National Expenditure	**1.5**	**4.6**	**-0.1**	**-5.0**	**3.4**	**3.5**	**2.6**
Total Exports	**1.7**	**3.8**	**-1.2**	**-2.7**	**0.3**	**5.4**	**6.1**
Goods	3.3	5.5	0.3	-1.5	-0.3	4.7	6.8
Services	-2.3	-0.4	-5.7	-7.7	1.3	8.2	3.4
Total Imports	**-2.6**	**8.7**	**2.5**	**-16.9**	**5.3**	**6.3**	**7.8**
Goods	-2.0	8.9	3.1	-17.1	5.0	8.1	8.9
Services	-4.3	8.1	0.5	-16.8	5.5	0.0	3.5
Expenditure on GDP	**2.7**	**2.9**	**-1.1**	**-0.1**	**1.9**	**3.3**	**1.9**
GDP (production based)	**2.0**	**3.2**	**0.0**	**-1.3**	**2.4**	**3.3**	**2.0**

[1] Percentage point contribution to growth

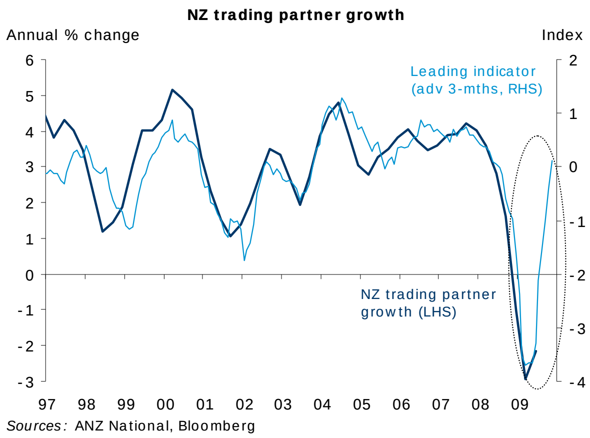
GLOBAL BACKDROP

The global economy is recovering courtesy of aggressive policy stimulus. How this stimulus is unwound without generating additional economic evils (ballooning government debt and inflation), and how the global rebalancing process plays out, are key challenges. We expect such tensions to manifest via short-term bouts of euphoria and despair, and the big picture recovery process to be gradual.

Out of recession, but a rocky road ahead

The worst of the financial crisis has passed thanks to aggressive policy stimulus. Credit spreads have narrowed to pre-crisis levels, the financial system has stabilised, confidence is returning and there were no further massive writedowns from large financial institutions in the third quarter. Equity markets globally have rallied strongly since bottoming in March, initially on relief that a depression scenario has been averted, and increasingly as investors look for higher beta assets (including the NZD) on any recovery story.

The global economy has emerged from recession. Second quarter GDP data has mostly surprised to the upside, showing positive growth in a number of economies. Leading indicators suggest strong forward momentum over the next few quarters ahead. The rebound has been especially pronounced in the Asian region, with a strong performing Chinese economy a key feature.



Sources: ANZ National, Bloomberg

History and policy stimulus is pointing to a V-shaped recovery. Recoveries tend to be inversely proportional to downturns. The co-ordinated policy stimulus has been massive, and pent-up demand can quickly be unleashed as confidence improves.

At the same time, a lot of tension remains within the global economy.

> Global growth remains “unbalanced” and still overly reliant on the US consumer. The G20 is committed to rebalancing, but achieving such a dynamic is easier said than done when intertwined with political reality. There are structural aspects to be wary of going forward: *“We will not allow a return to banking as usual”* (G20 Statement of 26 September). Changes to the process, creation and facilitation of credit means greater attention to cash-flow and yield as opposed to debt-fuelled asset price gains.

> Policymakers face clear challenges in regard to how they exit from extraordinary policy stimulus in an orderly fashion: too early and we see a double-dip; too late and inflation and government balance sheet largesse will need to be mopped up. If inflation fears emerge, any re-anchoring of expectations will not be growth friendly. Despite G20 commitments to maintaining policy stimulus for an extended period, it is notable to see tone changes from some key central bank policymakers as they look toward future challenges.

> Final demand remains weak as consumers face the reality of both cyclical and structural moves higher in unemployment rates, and the need to de-leverage and rebuild precautionary savings.

> China has been somewhat of a white-knight, but it too needs final demand from the US to pick-up, and excess money supply growth is merely fuelling an asset bubble in the region. We remain bullish China’s long-term story, but very wary near-term.

We expect such tensions to manifest via short-term bouts of economic euphoria and despair, and the big picture recovery process to be gradual. We have pencilled in a moderate recovery in the global economy although it is not until 2011 that we see trading partner growth returning above trend. **The real spirit of our view remains cautionary.** There are simply too many variables and tensions within the system for us to accept that the deepest financial crisis in 80 years can pass in the space of 12 months.

GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2006	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)
United States	2.7	2.1	0.4	-2.6	2.1	2.6	3.2
Australia	2.8	4.0	2.4	0.9	2.5	3.2	3.8
Japan	2.0	2.4	-0.8	-5.8	1.0	1.6	2.0
Euro Zone	3.1	2.7	0.6	-4.0	0.8	1.5	2.2
China	11.0	12.0	9.1	8.1	8.9	9.3	10.1
Trading Partner Growth	**3.7**	**4.0**	**1.7**	**-1.3**	**2.7**	**3.3**	**3.9**

FISCAL POLICY

Expansionary fiscal policy is supporting the economy. However, this will progressively be unwound going forward as the focus shifts to fiscal consolidation and curtailing the rising debt profile. This means inevitable structural changes in the delivery of some government services.

Taxing times

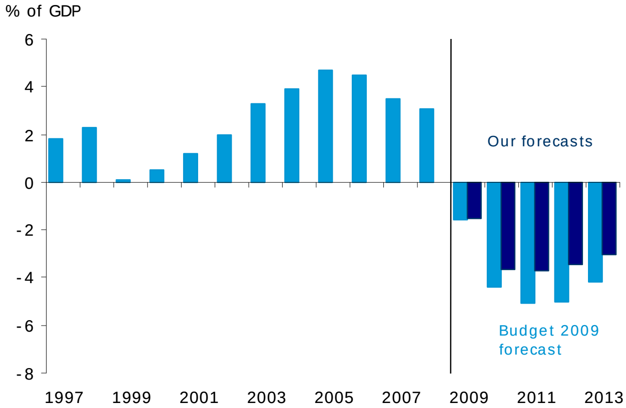
Expansionary fiscal policy came at an advantageous time. Call it luck or good vision (we suspect a bit of both), fiscal policy provided support to the economy when it needed it most. While you could always argue about the efficiency of Government spending, the recession would have been more severe in the absence of fiscal stimulus. Not only have automatic stabilisers (increased benefit payments, lower tax payments) kicked in, but the delivery of tax cuts in October last year and April this year, alongside increased infrastructure spending, has helped offset the retrenchment in private sector demand.

But this support has come at the expense of a significant deterioration in the fiscal position. Following 14 years of underlying operating surpluses, the fiscal accounts slipped into the red in the 2009 financial year, with a decade of deficits expected. While it is entirely correct to lean on the Government's balance sheet at times like these, if left unchecked, the Treasury projects that Government gross debt could quickly rise to 42 percent of GDP by 2015/16, thereby burdening future generations.

The process of fiscal consolidation will not come easily. Challenges come from three levels. Firstly, the economy is expected to grow slower on average over the coming decade. Second, demographics are starting to move against the fiscal position as more people approach the age of retirement. Finally, a fair portion of the deterioration in the fiscal position has been structural. The latter, in particular, means fundamental changes to the delivery of key services if the next generation is not to be burdened with more debt. While this year's *Budget* identified over $2 billion worth of savings, future savings will be harder to come by. Reprioritisation and seeking greater efficiency from the public sector is easier said than done, particularly given the political reality and voter demands for more services as opposed to less.

We see this process of consolidation and structural change taking place on a gradual fashion over a number of years. There is a fine balancing act to be struck. This is reflected in our projections of continued deficits, but of a progressively smaller magnitude. This still leaves debt rising and hence large bond tender requirements for the next few years.

Operating Balance Excluding Gains and Losses



Sources: ANZ National, NZ Treasury

Stated goals, such as closing the income gap with Australia, now need deliverable actions. The Government has put in place numerous working groups and reviews, including Taskforce 2025, a Tax Working Group, RMA Technical Advisory Group, Capital Market Development Taskforce (put in place by the last government), and the Ministerial Review of the Electricity Market. All need to deliver something concrete that will not only provide a point of differentiation for NZ.Inc, but also stand the test of time. For policies to make a difference, businesses need certainty that they will stick. Otherwise investment will not take place. The second-best policy option can often be the most effective in this regard. Unlocking NZ's natural endowments in areas such as mineral wealth could also greatly assist.

FISCAL FORECAST

June years	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)	2013(f)
Operating Balance ($m)	8,000	2,400	-8,300	-3,300	-4,800	-3,700	-3,200
- as % of GDP	4.7	1.3	-4.6	-1.8	-2.5	-1.8	-1.5
OBEGAL ($m)	5,900	5,600	-2,700	-6,700	-7,100	-6,900	-6,400
- as % of GDP	3.5	3.1	-1.5	-3.7	-3.7	-3.4	-3.0
Net Core Crown Debt ($m)	13,400	10,300	14,700	23,200	34,300	42,800	51,100
- as % of GDP	7.9	5.8	8.2	12.7	18.0	21.2	24.3
Core Crown residual cash ($m)	2,900	2,100	-8,000	-9,600	-10,900	-10,400	-9,500
Bond Tender Programme ($m)	2,300	1,800	5,900	8,500	10,000	11,500	12,000

INFLATION

Inflation is set to remain comfortably within the target band over the next few years. In the near term, significant resource slack in the economy and an elevated currency will put downward pressure on inflation.

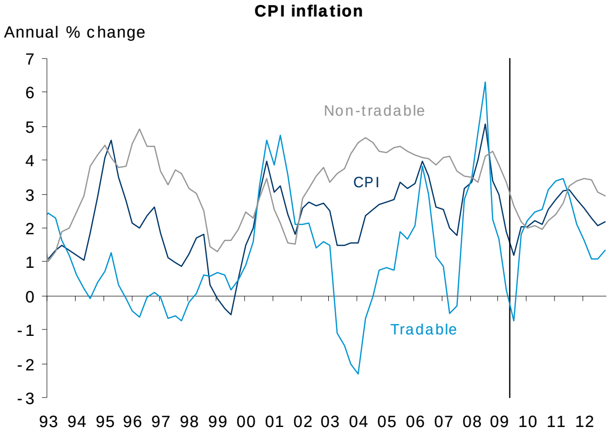
Well behaved

Inflation pressures remain subdued. After falling to the RBNZ's target band at the start of the year, annual CPI inflation has continued to moderate, easing to 1.9 percent in the June quarter. Importantly, non-tradable (or domestically driven) inflation has moderated to just 3.3 percent in annual growth terms – the lowest since June 2002. Significant spare capacity, more subdued increases in construction costs as the housing market weakened, flat to lower rents and a weaker labour market all contributed to the reduced inflation pressures. Food prices, and even some non-contestable areas, such as local authority rates, have also shown an easing price trend.

The medium-term drivers of inflation remain favourable, which will see it remain comfortably within the RBNZ's target band over the forecast horizon. Rising unemployment (and underemployment as well) suggest there are considerable resource pressures that can be soaked up when momentum does indeed return in a sustainable fashion. Wage growth is easing and productivity is rising. A large negative output gap will ensure that pricing pressures remain subdued for some time yet. Our expectation of a moderate global recovery and excess capacity is expected to keep imported inflation low, despite obvious support to commodity prices being provided from Chinese demand. Pricing intentions in NZ are low and inflation expectations contained. We forecast inflation to ease to 1.2 percent in the September quarter, rising temporarily past 3 percent in 2011 before settling at 2¼ percent by the end of the forecast period.

The NZD will potentially introduce considerable volatility to the CPI figures. Recent volatility in the currency will flow through into greater variability in tradable inflation than usual. We have already seen higher prices for retail related goods over the first half of this year when the NZD was low, despite a weak retailing environment. The rise in the currency since March will result in lower tradable prices later this year and into early next year. However, we suspect that retailers will be taking advantage of the higher currency to rebuild depleted margins rather than pass through costs savings fully. And tradable inflation will face upward pressure when the currency starts to correct lower.

We remain somewhat agnostic towards inflation becoming problematic at some stage. 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 burdens, 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 and a fragile global economy; (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 driving long-term yields higher on any inflation concern thereby restraining the magnitude of the recovery; and (d) policymakers whom we believe are set to move aggressively to mop up excess liquidity once a sustained recovery takes hold. We have a lot of sympathy for d) in particular, as we think policymakers will want to be quick to restore their inflation fighting credibility.



Sources: ANZ National, Statistics NZ

CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Mar-09	0.3	3.0
Jun-09	0.6	1.9
Sep-09 (f)	0.8	1.2
Dec-09 (f)	**0.4**	**2.1**
Mar-10 (f)	0.3	2.0
Jun-10 (f)	0.7	2.2
Sep-10 (f)	0.7	2.1
Dec-10 (f)	**0.8**	**2.6**
Mar-11 (f)	0.5	2.8
Jun-11 (f)	1.0	3.1
Sep-11 (f)	0.8	3.1
Dec-11 (f)	**0.5**	**2.9**
Mar-12 (f)	0.3	2.6
Jun-12 (f)	0.7	2.3
Sep-12 (f)	0.6	2.1
Dec-12 (f)	**0.6**	**2.2**

EXCHANGE RATE

A weak USD, buoyant AUD, improving risk sentiment and a recovering global scene (thereby encouraging high-beta plays) are supporting the NZD. These dynamics are expected to persist for some time despite going against the domestic fundamentals. However, our cautiousness over the global scene (a potential W cycle) and its sustainability also leaves us wary of another sharp down-leg for the NZD. But at present this is a high probability scenario as opposed to our central track.

Global forces

The NZD is coat-tailing global forces. Risk appetites are up, the VIX is down, credit markets are thawing, commodity prices (notably dairy) are rising again and the global scene is improving. As a result, investors are seeking exposure to high-beta plays, which includes the AUD and NZD. The former is also benefiting from the RBA being the first major central bank to start hiking, which is giving it yield pick-up in a low interest rate world. Since February, the NZD has risen 44 percent against the USD, 25 percent against the euro and is even up 4.5 percent against the AUD (based on month-end closes). The latter is particularly puzzling given the prospective paths for interest rates. But it merely goes to show that the NZD is a $2 player at the high-roller international roulette table.

In the absence of a turn in global sentiment, these forces are expected to persist. We now expect the NZD to maintain recent gains and stay above 0.70 through until mid-2010, before gradually easing to a higher endpoint than in previous forecasts.

A major driver of the stronger NZD profile is the expected persistence of cyclical and structural forces that have been weakening the USD of late. From a cyclical perspective, a sluggish US economy, an extended period of low interest rates and a rapid expansion of the monetary base will continue to encourage capital outflow. Further, the USD has achieved 'funding currency' status with zero interest rates and ample liquidity across the financial system. Investors are borrowing money in USDs, usually on very short terms to buy into 'risky' trades; in essence a carry trade. It is this dynamic that will see short-term fluctuations in the USD highly correlated with risk appetite (which continues to build).

From a longer-term perspective we are not USD bears, at least not against the great majority of currencies, and particularly when we see productivity in the US recovering far faster than global counterparts. But there will be an important structural force working against the greenback. The USD is becoming less important as a reserve currency, that is, a currency that the central banking community holds reserves in. There are other reserve currencies, most notably the EUR and the JPY, and this list could well be expanded to include the GBP, CAD and AUD. More recently, some central banks have included the NZD in their mandates. While the USD will not lose its reserve status, just as it is unlikely that the EUR or JPY will, it is likely to be a less dominant reserve currency than it has been in the recent past.

Over the next five years we expect the USD to move in a wide range but for the trend to be broadly sideways. In the short-term we are likely to see the greenback define the bottom of that range as cyclical and structural forces work towards depreciation. At some stage the cyclical forces will turn positive, overwhelming the secular pressures and allowing for a modest rally in the USD that helps define the top of the range.

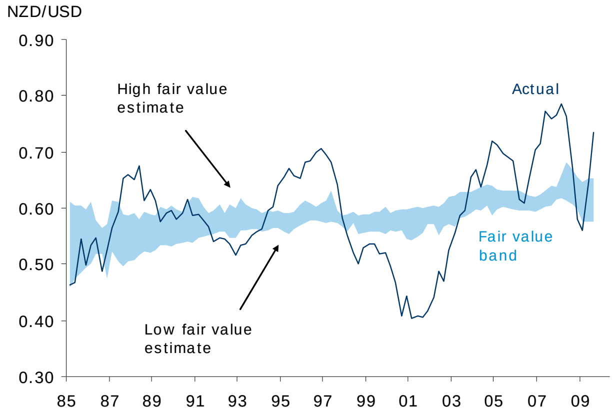
The key cyclical force to watch at present is the so-called exit strategies for the various central banks. This has the ability to (a) remove the USD's funding status; (b) question the durability of any recovery; and (c) unwind massively short positioning that has been built up against the USD.

Concerns over the endgame

Over time it is inevitable that current account deficit nations will see their currencies move lower. This is an inevitable part of the global rebalancing that the G20 nations are trying to achieve. However, the currency moves do not necessarily have to be vis-à-vis the USD. From a longer term macroeconomic perspective, the currencies of deficit nations (which include the NZD, USD, GBP and AUD) will need to depreciate against the surplus nations (notably the Asian currencies, in particular the Chinese Renminbi). However, the managed currency regimes in Asia make such adjustments difficult to achieve. Hence we are seeing much greater volatility being expressed through freely floating currencies.

Our structural estimates of fair value for the NZD, which are built around such equilibrium rebalancing notions, continue to point towards a more exaggerated adjustment in the NZD, with fair value residing around 0.62 cents. From a fundamental structural perspective, we cannot get away from the fact that NZ's net international liability position stands at 95 percent of GDP, its productivity growth performance lags behind those of the US and Australia, and a meaningful adjustment to the external imbalances cannot be achieved with a seven handle in front of the NZD. Yet, we know that currencies do tend to deviate away from structural notions of fair value for some time. But ultimately, the rubber band gets too taut and we see a pullback.

NZD/USD fair value band

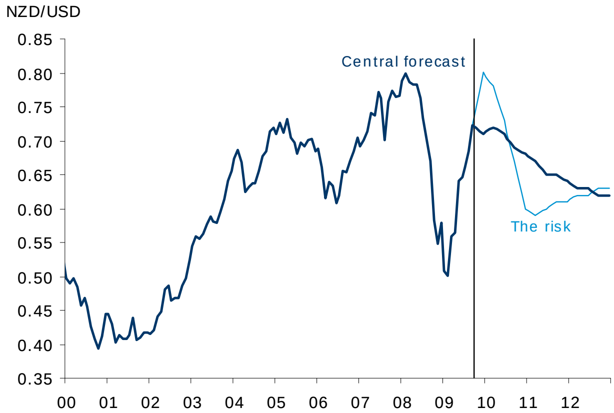


Sources: ANZ National, Bloomberg

For now, the NZD looks hostage to wider global forces. But we continue to have reservations over the end-game. The NZD is increasingly trading off foreign as opposed to local fundamentals. Even the NZDAUD has become disconnected relative to commodity price and interest rate trends. It has all the hallmarks of a flow and perception driven market, as opposed to anything of substance.

We see a material risk that continued improvements in risk appetites and the USD weakness theme pushes the NZDUSD towards 0.75 or higher in the near term, but a sharp correction follows. In the meantime, the trend remains the market's friend. Improving risk appetites and ample liquidity support equity markets. But under this scenario instability within the global system builds. A weak USD is simply "exporting" problems elsewhere and USD sentiment is now so negative it looks to be capitulation, which normally flags a turning point. China's growth rebound and commodity flow is bubble driven. The sharp improvement in risk appetite bears all the hallmarks of returning to the habits of 2002 to 2007. Policymakers are on a tightrope when it comes to exit strategies. Such a combination leaves us very wary of a W shaped cycle and a further bout of risk aversion.

New Zealand dollar



Sources: ANZ National, Bloomberg

NEW ZEALAND DOLLAR FORECAST (end of quarter)

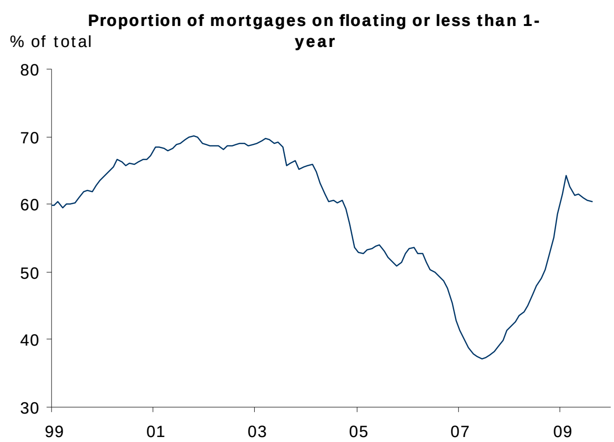
Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
Dec-05	**0.68**	**0.93**	**80.4**	**0.40**	**0.58**	**70.4**
Dec-06	**0.70**	**0.89**	**83.8**	**0.36**	**0.53**	**69.4**
Dec-07	**0.77**	**0.88**	**85.6**	**0.39**	**0.53**	**71.8**
Dec-08	**0.58**	**0.82**	**52.5**	**0.40**	**0.41**	**56.2**
Mar-09	0.56	0.81	55.4	0.39	0.42	57.3
Jun-09	0.65	0.80	62.2	0.39	0.46	61.3
Sep-09	0.72	0.82	64.9	0.45	0.49	65.4
Dec-09 (f)	**0.71**	**0.80**	**62.5**	**0.43**	**0.48**	**63.8**
Mar-10 (f)	0.72	0.78	61.9	0.43	0.47	63.6
Jun-10 (f)	0.71	0.78	62.5	0.43	0.47	63.3
Sep-10 (f)	0.69	0.78	62.1	0.42	0.47	62.3
Dec-10 (f)	**0.68**	**0.78**	**62.6**	**0.41**	**0.46**	**61.9**
Mar-11 (f)	0.67	0.79	63.0	0.40	0.46	61.6
Jun-11 (f)	0.65	0.79	61.8	0.39	0.45	60.6
Sep-11 (f)	0.65	0.82	63.1	0.38	0.46	61.6
Dec-11 (f)	**0.64**	**0.83**	**63.4**	**0.38**	**0.46**	**61.4**
Mar-12 (f)	0.63	0.84	63.0	0.37	0.46	61.0
Jun-12 (f)	0.63	0.84	63.0	0.36	0.47	61.2
Sep-12 (f)	0.62	0.82	62.6	0.36	0.47	60.3
Dec-12 (f)	**0.62**	**0.81**	**63.2**	**0.36**	**0.47**	**60.3**

INTEREST RATES

There is enough uncertainty around the recovery path and excess capacity to warrant the RBNZ remaining on hold for some time. But extended caution means aggressive normalisation from Q3 2010. We expect the OCR to peak at 5.5 percent – a reflection of what we believe is a lower neutral level. Bond yields are expected to drift higher on rising issuance and US bond movements.

The RBNZ has signalled a period of monetary policy stability. Though the RBNZ maintained a soft easing bias in their September *Monetary Policy Statement*, we do not expect them to act on it. With the economy technically out of recession, business and consumer confidence rebounding strongly, and the housing market picking up, there is no longer a case for further monetary policy stimulus to be delivered. As such, attention has now quickly turned to the timing of the inevitable policy normalisation cycle.

There is enough uncertainty around the recovery path, not to mention the excess capacity in the economy, to warrant the RBNZ remaining on hold for some time. Global risks abound, the unemployment rate is still rising, the currency is elevated and inflation pressure is contained. Structural changes, such as the new liquidity rules for banks introduced by the RBNZ, are having a material impact by increasing long-dated yields. This in turn is encouraging borrowers to shorten their borrowing profile, which will give the RBNZ a lot of comfort that when they decide to move, they will not face the previous problems with gaining policy traction. Sixty percent of borrowing at present is on floating or fixed for 1-year or less. These suggest the RBNZ has considerable time on its side. From a purely technical perspective – and given the current negative output gap position for the economy – we believe the RBNZ needs to see two quarters of above trend growth before moving. We struggle to see this happening before mid 2010.



Sources: ANZ National, RBNZ

However, when policy normalisation does occur, the RBNZ will seek to move quickly. We envisage a series of 50bp hikes as the RBNZ seeks to return towards more neutral levels quickly from Q3 2010.

A key issue at this juncture is where does the neutral rate reside? Estimates by the RBNZ have previously put the neutral real interest rate at between 3.25 and 4.25 percent based on the 90-day rate (or a nominal rate of between 5.25 and 6.25 percent assuming a 2 percent inflation rate)[1]. A more recent estimation by the RBNZ looking at monetary policy rules put the neutral nominal interest rate (90-day) at 6.68 percent.[2]

We believe the neutral rate is lower than previously estimated levels. It is borrowing rates that matter as opposed to wholesale rates and there has been a structural change in the pricing of risk around the globe (read bank margins). If the neutral borrowing rate is unchanged and margins are wider, then the wholesale component needs to be lower to compensate. In addition, households are carrying much higher levels of debt compared to a decade ago, which means a 25bp increase in borrowing costs now have a greater effect than in the past. Conversely, if inflation expectations were to deteriorate, the neutral rate could be higher. But at this juncture we see little evidence of this.

We are also mindful of structural regulatory changes. Though a strong distinction needs to be made between the regulatory area (for financial stability purposes) and monetary policy, there is still a huge degree of overlap between the two. We see changes in the former as assisting the latter indirectly. New liquidity rules have structurally changed the shape of the mortgage yield curve and the level of long-dated borrowing, which means borrowers must now factor in an uncertainty premium into their decisions. Short-term borrowing is cheaper, but you need to allow for less certainty, hence giving policy more traction. Altered capital requirements (a prudential measure) for areas such as agriculture will influence the pricing of risk. In a recent speech RBNZ Governor Bollard stated *"Prudential policy offers a more direct approach to constraining excessive or misdirected borrowing and lending behaviour. The crisis has added a great deal of impetus to the international policy work programme focused on reducing the tendency for financial activity to exacerbate macroeconomic booms and busts. This work programme involves, among other things,*

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[1] Basdevant, O., Bjorksten, N and Karagedikli O., (2004), Estimating a time varying neutral real interest rate for New Zealand, RBNZ Discussion Paper Series DP2004/01

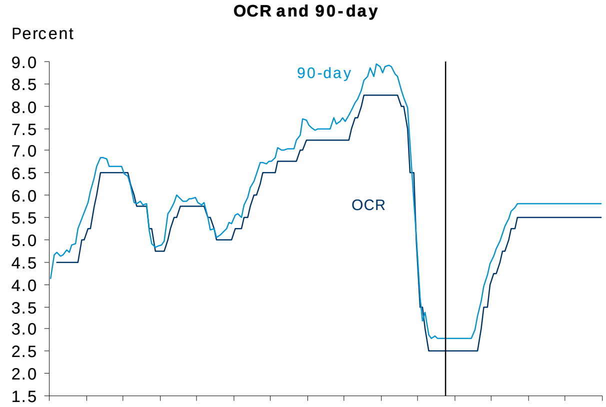
[2] RBNZ Select Committee Submission into the monetary policy framework: July 2007, Supporting Paper A3.

attention to minimum capital and other prudential requirements as potential tools to dampen business cycles, the impact of smaller and peripheral financial institutions on financial system behaviour, how cross-border financial activity should be monitored or regulated, and bridging the gap between the micro and the macro consequences of strong lending growth."

At this stage we would put the neutral OCR in the 5.0 to 5½ percent range as opposed to 5½ to 6.0. We expect this tightening cycle to target that range in the first instance, with a series of 50 basis point moves to start but more modest moves subsequently, with the endgame being a lower end-point relative to previous forecasts.

Internationally we see other central banks pursuing similar strategies of lower for longer but aggressive normalisation. That is, waiting patiently but then moving aggressively in 50 basis point moves. The G20 has made it clear that policy stimulus is expected to remain in place for an extended period, although we also note some growing dissent is emerging in terms of the timing of so-called exit strategies. The exception to this rule is obviously the RBA, which has become the first G20 nation to hike rates, but early moves also imply a more gradual step-change. Australia can run this strategy because they have not faced a deep recession. Other central banks need to be more patient to make sure recovery is taking hold.

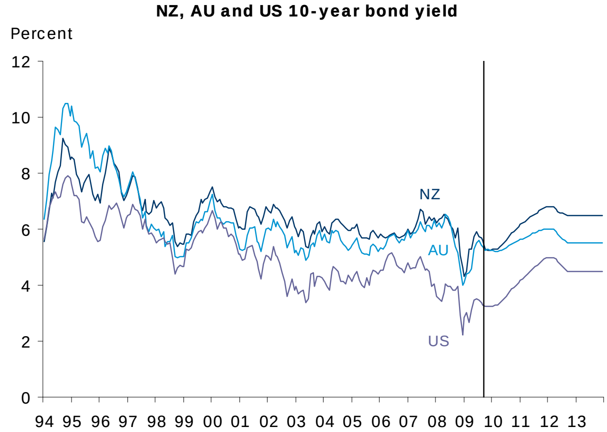
We strongly suspect this strategy across the majors will deliver the *coup-de-grâce* on a W shaped cycle. But such will be the reality of restoring central banks' credibility on the inflation front. As the global economy stabilises over time and "extraordinary" circumstances pass, attention will invariably shift back to central banks' prime mandate of inflation stability. A failure to do so risks continuing the pattern of excessively low interest rates supporting asset bubbles, creating financial risks, necessitating further policy support, creating further asset bubbles… and the spiral from what we have seen since 1997 remains in motion. There is no doubt tighter regulatory regimes will play a role, but we also hope the lessons of the past decade have also been learnt: policy was kept too supportive for too long. This does not mean central banks need to turn into narcissists, merely that they must be prepared to act decisively when conditions warrant.



Sources: ANZ National, Bloomberg

The long-end of the yield curve looks set to move higher as policy normalisation starts. While there were early concerns about the size of government issuance globally, to date there have been no lack of buyers for sovereigns. The quantitative easing programmes in the US and UK would have helped at the margin. But safe haven demand for bonds, diminished fear of an inflation threat and a lack of viable alternatives to US Treasuries (especially for Asian central banks) has kept longer dated yields low. We see global bond yields drifting higher and better reflecting economies' trend and inflation growth rates. Hence the view is heavily dependent on policymakers "getting it right". That is, normalising monetary policy and alleviating fiscal pressures in an orderly fashion. To be fair, we have serious misgivings about whether such a path is indeed achievable. History is not encouraging.

NZ bond tenders have generally attracted good support. However, we expect NZ bond yields to progressively drift higher on global moves, rising issuance and persistent concerns over the relatively unbalanced nature of the NZ economy. This is expected to keep NZ-US and NZ-Australia 10 year spreads wide relative to history.



Sources: ANZ National, Bloomberg

INTEREST RATE FORECAST (end of quarter)

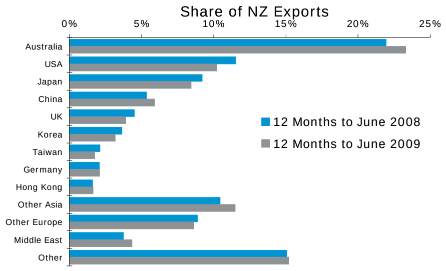
Quarter	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
Dec-05	**7.3**	**7.7**	**7.1**	**6.7**	**5.7**	**4.4**	**5.2**
Dec-06	**7.3**	**7.7**	**7.6**	**7.2**	**5.9**	**4.7**	**5.9**
Dec-07	**8.3**	**8.9**	**8.7**	**8.2**	**6.4**	**4.0**	**6.3**
Dec-08	**5.0**	**5.1**	**4.3**	**4.7**	**4.6**	**2.2**	**4.0**
Mar-09	3.0	3.4	3.7	4.9	5.3	2.7	4.4
Jun-09	2.5	2.8	3.8	5.3	5.9	3.5	5.5
Sep-09	2.5	2.8	4.3	5.5	5.6	3.3	5.4
Dec-09 (f)	**2.5**	**2.8**	**4.1**	**5.0**	**5.3**	**3.3**	**5.3**
Mar-10 (f)	2.5	2.8	4.0	5.0	5.3	3.3	5.2
Jun-10 (f)	2.5	2.8	4.2	5.2	5.5	3.5	5.3
Sep-10 (f)	3.0	3.6	4.9	5.8	5.9	3.9	5.5
Dec-10 (f)	**4.0**	**4.5**	**5.4**	**6.1**	**6.1**	**4.1**	**5.6**
Mar-11 (f)	4.5	5.0	5.7	6.3	6.3	4.3	5.7
Jun-11 (f)	5.0	5.5	6.1	6.6	6.5	4.6	5.9
Sep-11 (f)	5.5	5.8	6.3	6.8	6.7	4.8	6.0
Dec-11 (f)	**5.5**	**5.8**	**6.3**	**6.9**	**6.8**	**5.0**	**6.0**
Mar-12 (f)	5.5	5.8	6.3	6.9	6.8	5.0	6.0
Jun-12 (f)	5.5	5.8	6.3	6.7	6.6	4.8	5.8
Sep-12 (f)	5.5	5.8	6.2	6.7	6.5	4.5	5.5
Dec-12 (f)	**5.5**	**5.8**	**6.2**	**6.7**	**6.5**	**4.5**	**5.5**

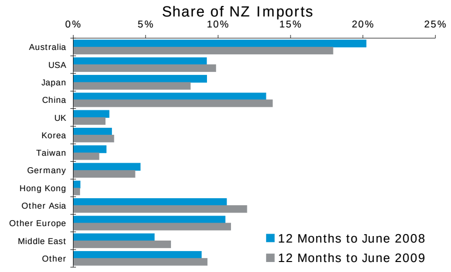
ECONOMIC FORECASTS

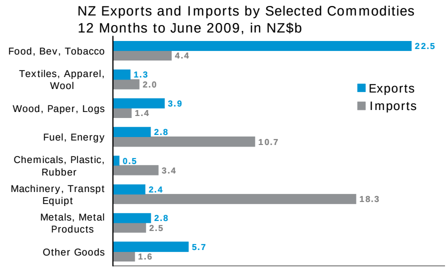
	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
Real Gross Domestic Product												
Total GDP, QPC	-0.4	-0.5	-1.0	-0.8	0.1	**0.5**	**0.8**	**0.6**	**0.6**	**0.6**	**0.5**	**0.7**
Total GDP, APC	0.8	-0.4	-2.2	-2.6	-2.1	**-1.2**	**0.6**	**2.0**	**2.5**	**2.6**	**2.3**	**2.4**
Total GDP, AAPC	2.5	1.5	0.0	-1.1	-1.8	**-2.0**	**-1.3**	**-0.2**	**1.0**	**1.9**	**2.4**	**2.5**
Real GDP Components												
Private Consumption, QPC	-0.5	0.0	-0.2	-1.2	0.4	**0.2**	**0.4**	**0.5**	**0.5**	**0.3**	**0.3**	**0.4**
Private Consumption, AAPC	2.2	1.0	-0.1	-0.8	-1.1	**-1.2**	**-1.0**	**-0.1**	**0.5**	**1.2**	**1.6**	**1.6**
Public Consumption, QPC	0.7	0.0	1.6	0.3	-1.0	**-0.5**	**0.6**	**0.6**	**0.6**	**0.6**	**0.3**	**0.4**
Public Consumption, AAPC	4.3	3.8	3.8	3.2	2.4	**1.9**	**0.8**	**0.1**	**0.2**	**0.7**	**1.4**	**1.9**
Residential Investment, QPC	-9.5	-6.8	-14.5	0.2	-2.6	**-2.0**	**2.5**	**5.0**	**6.0**	**6.0**	**3.0**	**4.0**
Residential Investment, AAPC	-1.2	-8.1	-16.7	-23.2	-25.4	**-25.2**	**-18.7**	**-11.0**	**-2.2**	**8.2**	**14.1**	**18.7**
Other Investment, QPC	5.5	-8.7	-1.1	-6.9	1.3	**-1.3**	**-0.1**	**0.6**	**0.3**	**0.3**	**0.5**	**2.0**
Other Investment, AAPC	5.1	3.6	0.5	-2.9	-8.7	**-10.1**	**-10.4**	**-7.7**	**-3.9**	**-1.6**	**0.7**	**1.4**
Gross National Expenditure, QPC	0.4	-1.5	-1.8	-3.0	-2.1	**2.8**	**1.3**	**0.8**	**0.5**	**0.6**	**0.2**	**1.0**
Gross National Expenditure, AAPC	3.1	1.4	-0.1	-2.2	-4.5	**-5.3**	**-5.0**	**-2.9**	**0.6**	**2.5**	**3.4**	**3.3**
Exports, QPC	-0.7	-2.4	-3.2	0.6	4.7	**-6.2**	**0.9**	**0.8**	**0.8**	**0.4**	**0.8**	**1.0**
Exports, AAPC	2.9	2.7	-1.2	-3.2	-3.8	**-4.7**	**-2.7**	**-1.3**	**-2.2**	**-0.4**	**0.3**	**1.1**
Imports, QPC	1.2	-5.6	-6.7	-8.3	-3.8	**0.3**	**3.4**	**2.7**	**0.9**	**0.6**	**-0.5**	**1.9**
Imports, AAPC	10.1	8.0	2.5	-4.6	-12.4	**-16.9**	**-16.9**	**-12.1**	**-4.7**	**2.0**	**5.3**	**5.4**
Prices												
Headline CPI, QPC	1.6	1.5	-0.5	0.3	0.6	**0.8**	**0.4**	**0.3**	**0.7**	**0.7**	**0.8**	**0.5**
Headline CPI, APC	4.0	5.1	3.4	3.0	1.9	**1.2**	**2.1**	**2.0**	**2.2**	**2.1**	**2.6**	**2.8**
Non-tradable CPI, QPC	0.9	1.3	0.8	0.7	0.5	**0.6**	**0.4**	**0.5**	**0.5**	**0.5**	**0.6**	**0.7**
Non-tradable CPI, APC	3.4	4.1	4.3	3.8	3.3	**2.7**	**2.2**	**2.0**	**2.1**	**2.0**	**2.2**	**2.4**
Tradable CPI, QPC	2.3	1.9	-2.1	-0.4	0.8	**1.0**	**0.5**	**0.0**	**1.0**	**1.0**	**1.0**	**0.3**
Tradable CPI, APC	4.8	6.3	2.3	1.7	0.2	**-0.8**	**1.8**	**2.2**	**2.5**	**2.6**	**3.1**	**3.4**
External Accounts												
Annual Balance on Goods, % of GDP	-1.2	-1.2	-1.3	-0.7	0.4	**1.0**	**1.1**	**0.7**	**0.4**	**0.4**	**0.5**	**0.6**
Annual Balance on Services, % of GDP	-0.1	-0.2	-0.5	-0.6	-0.5	**-0.4**	**-0.2**	**-0.1**	**-0.1**	**-0.2**	**-0.2**	**-0.1**
Annual Balance on Invisibles, % of GDP	-7.1	-7.1	-7.1	-6.7	-5.6	**-4.8**	**-4.4**	**-4.3**	**-5.0**	**-5.7**	**-5.9**	**-6.0**
Annual Current Account Balance, % of GDP	-8.4	-8.6	-8.8	-8.0	-5.8	**-4.2**	**-3.5**	**-3.7**	**-4.7**	**-5.5**	**-5.6**	**-5.6**
Net International Invt Position, % of GDP	-86.0	-89.9	-90.4	-96.6	-95.3	**-93.7**	**-93.7**	**-94.0**	**-94.1**	**-94.3**	**-94.4**	**-94.6**
Terms of Trade (SNA basis)												
Export Prices, QPC	2.0	4.6	5.4	-3.7	-9.5	**-2.7**	**-0.3**	**0.6**	**0.8**	**1.4**	**1.4**	**1.3**
Export Prices, APC	13.8	18.1	16.7	8.3	-4.0	**-10.6**	**-15.4**	**-11.6**	**-1.6**	**2.5**	**4.3**	**4.9**
Import Prices, QPC	7.1	5.5	7.0	-2.5	-3.5	**-5.6**	**-1.9**	**-0.2**	**0.2**	**1.0**	**1.0**	**0.8**
Import Prices, APC	9.3	18.7	22.2	17.9	6.2	**-5.0**	**-12.9**	**-10.9**	**-7.4**	**-1.0**	**2.0**	**3.1**
Terms of Trade, QPC	-4.8	-0.9	-1.5	-1.3	-6.2	**3.1**	**1.7**	**0.8**	**0.6**	**0.4**	**0.3**	**0.4**
Terms of Trade, APC	4.2	-0.5	-4.6	-8.2	-9.6	**-5.9**	**-2.9**	**-0.8**	**6.3**	**3.6**	**2.2**	**1.8**
Labour Market												
Employment, QPC	1.2	0.1	0.8	-1.4	-0.5	**-0.5**	**-0.2**	**-0.2**	**0.0**	**0.3**	**0.4**	**0.5**
Employment, APC	0.8	1.0	1.0	0.8	-0.9	**-1.6**	**-2.5**	**-1.3**	**-0.9**	**-0.1**	**0.5**	**1.2**
Labour Force, QPC	1.4	0.5	1.2	-1.1	0.6	**-0.2**	**0.1**	**0.2**	**0.2**	**0.2**	**0.3**	**0.5**
Labour Force, APC	1.1	1.7	2.2	2.0	1.2	**0.5**	**-0.6**	**0.7**	**0.3**	**0.7**	**1.0**	**1.3**
Unemployment Rate, sa	3.9	4.3	4.7	5.0	6.0	**6.3**	**6.6**	**6.9**	**7.1**	**7.0**	**7.0**	**6.9**
Participation Rate, sa	68.5	68.6	69.1	68.3	68.4	**68.0**	**67.8**	**67.7**	**67.6**	**67.6**	**67.6**	**67.7**
Private Sector Wages (apc)	2.0	1.1	0.8	1.1	0.7	**0.5**	**0.4**	**0.4**	**0.3**	**0.3**	**0.3**	**0.4**
Public Sector Wages (apc)	5.4	5.2	5.1	5.1	3.8	**3.2**	**2.8**	**2.1**	**1.6**	**1.4**	**1.3**	**1.3**

Forecast in bold
QPC – quarterly percent change
APC – annual percent change
AAPC – annual average percent change
sa – seasonally adjusted

NEW ZEALAND KEY ECONOMIC INDICATORS

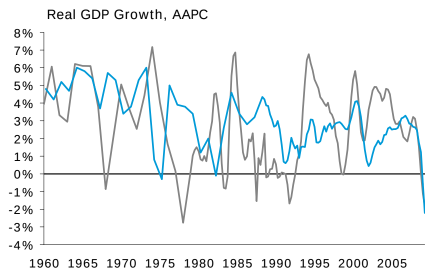


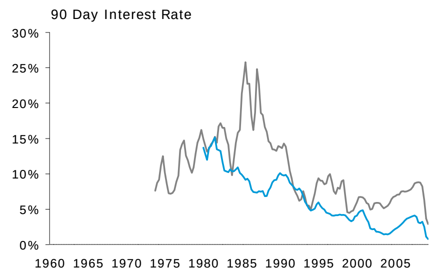


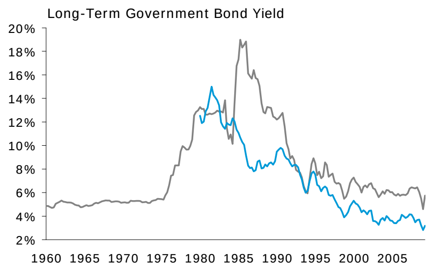


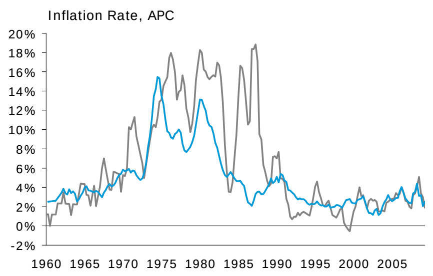
New Zealand Compared to Main Trading Partners (latest available figures)

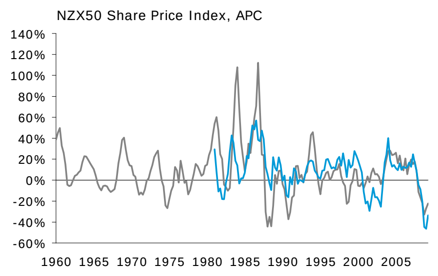
	NZ	Aust	USA	Japan	UK	China	Gmany	SKorea	Taiwan	Malaysia	H/Kong	S/pore	Indonesia
Population, in millions	4.2	21.8	306.8	128.6	60.2	1368.4	81.9	51.4	22.9	25.7	7.1	4.6	257.7
Area in 1,000 km2	271.0	7713.0	9372.6	377.8	244.1	9561.0	356.7	92.2	36.0	330.0	1.0	1.0	1905.0
Inhabitants per km2	15.4	2.8	32.7	340.4	246.6	143.1	229.7	557.5	636.1	77.9	7130.0	4600.0	135.3
GDP, in billion NZ$	179.8	1573.3	21950	7496.5	4129.5	6937.3	5619.4	1458.0	601.0	342.1	329.9	276.2	807.2
Change in real terms (year-on-year %)	-1.8	1.0	-2.3	-5.2	-4.3	7.5	-5.0	-1.7	-6.9	-1.4	-3.3	-4.4	4.0
Nominal GDP per capita in NZ$	43091	67693	69369	50485	68504	4145	59596	30550	24138	10649	44675	52198	3108
NZ exports to ..., in million NZ$ (FOB)	n/a	9995.3	4382.0	3613.5	1672.0	2533.6	894.9	1358.2	751.6	948.9	700.1	863.1	1005.8
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	8097.5	4449.0	3653.4	1001.7	6213.9	1930.6	1268.9	806.2	1695.7	203.3	2259.7	1047.5
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	-5.9	-2.9	-3.8	2.4	-2.0	8.2	4.4	2.9	8.2	18.4	14.8	12.0	0.8

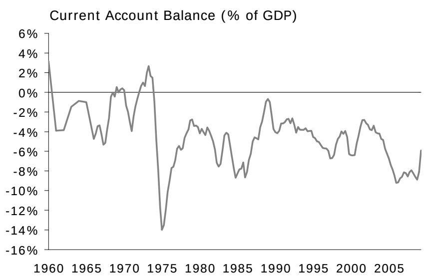


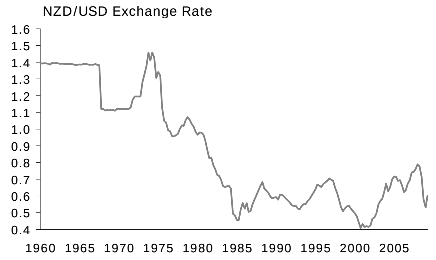


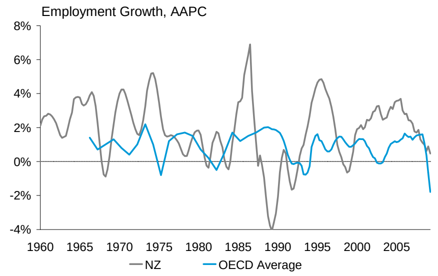


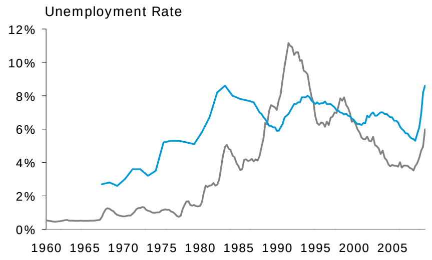












NEW ZEALAND DISCLOSURE INFORMATION

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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