

NEW ZEALAND ECONOMICS

ANZ QUARTERLY ECONOMIC FORECASTS

4 April 2011

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NEW ZEALAND ECONOMIC OUTLOOK

The February 22 earthquake was a game changer, effectively pushing back the economic recovery by six months. While the first half of this year will be weak, we still expect strong growth to emerge from the second half of the year, and for this recovery to continue well into 2012. A bigger near-term challenge fosters a stronger springboard-style recovery. The five year picture remains one of modest growth, which reflects a sustained period of debt reduction and structural change across the economy.

GLOBAL OUTLOOK

The global economy is recovering but with this comes challenges. Excess liquidity needs to be mopped up. Inflation is rising. A banking debt crisis risks being replaced with a sovereign one. We've pencilled in trend growth across New Zealand's major trading partners but fully expect bouts of both optimism and wobbles. The literature tells us excesses associated with a financial crisis take seven years to purge. We're not there yet.

FISCAL POLICY

All political parties will find themselves in a fiscal straitjacket if they get elected. A credit rating downgrade is on the cards. After providing fiscal support and funding part of the earthquake rebuilding programme, fiscal policy needs to move into a progressively tighter stance. There will be no easy choices over the next five years. A more proactive growth agenda could help lessen pressure for tough choices in other areas.

INFLATION

A perfect storm of inflation shocks is set to see headline inflation close to 6 percent by mid-2011. We're placing faith in the monetary policy framework to achieve a moderation in inflation towards the latter part of the projection period. However, our projections still have underlying annual inflation skirting the top of the 1 to 3 percent RBNZ target band.

EXCHANGE RATE

The currency markets are looking past the near-term negative impact of the Christchurch earthquake. Reinsurance flows and exporter demand will keep the NZD supported on any dips, while generalised USD weakness and AUD strength look set to push the NZD higher over the near-term. A decline from next year is expected despite the RBNZ starting to lift rates, mainly due to a cyclical rebound in the USD.

INTEREST RATES

The RBNZ's 50bp "insurance" cut in March was designed to minimise the negative impact from the Christchurch earthquake. Our view is that a quicker start to the rebuilding effort and a less benign inflation picture will see policy normalisation begin at the end of this year. The shape of the mortgage curve and more people on variable rates mean the RBNZ can afford to move in 25bp steps, rather than larger moves.

KEY ECONOMIC FORECASTS

Calendar Years	2007	2008	2009	2010	2011(f)	2012(f)	2013(f)
NZ Economy (annual average % change)							
Real GDP	2.9	-0.2	-2.1	1.5	1.0	4.1	3.1
Employment	1.9	0.6	-1.1	0.7	1.5	1.8	1.7
Unemployment Rate (Dec qtr)	3.4	4.6	7.0	6.8	6.4	6.1	5.9
Terms of trade (SNA basis)	5.9	3.1	-7.8	7.5	7.4	1.8	-1.4
Global Growth (annual average % change)							
US	1.9	0.0	-2.6	2.9	3.5	3.2	2.5
Australia	4.6	2.6	1.3	2.7	1.8	4.2	3.9
Japan	2.3	-1.2	-6.3	4.0	1.0	2.5	2.3
China	12.3	9.2	8.5	10.4	9.6	9.5	9.6
Trading Partners	4.1	1.8	-1.0	4.5	3.4	4.4	4.2
NZ Inflation (annual % change)							
CPI Inflation	3.2	3.4	2.0	4.0	3.7	2.6	3.3
Non-tradable Inflation	3.5	4.3	2.3	4.6	4.0	3.8	3.2
Tradable Inflation	2.8	2.3	1.5	3.3	3.1	1.5	2.8
NZ Financial Markets (end of December quarter)							
TWI	71.8	56.2	66.3	69.2	67.3	64.4	64.7
NZD/USD	0.77	0.58	0.72	0.78	0.75	0.70	0.69
NZD/AUD	0.88	0.82	0.81	0.76	0.73	0.73	0.77
Official Cash Rate	8.25	5.00	2.50	3.00	2.75	4.00	4.75
90-day bank bill rate	8.9	5.1	2.8	3.2	3.1	4.3	5.0
10-year bond rate	6.4	4.6	5.8	5.9	6.1	6.1	6.0
Fiscal and External Balance							
Current Account Balance (\$m)	-14,387	-16,034	-5,354	-4,300	-3,300	-12,600	-14,200
as % of GDP	-8.0	-8.7	-2.9	-2.2	-1.6	-5.6	-6.0
Government OBEGAL (\$m)*	5,850	5,637	-3,893	-6,315	-16,800	-9,200	-5,700
as % of GDP	3.4	3.1	-2.1	-3.3	-8.4	-4.3	-2.5

* Operating balance excluding gains and losses, June years. Forecasts and text finalised 4 April 2011.

KEY FORECAST ASSUMPTIONS:

- We assume preliminary earthquake reconstruction gets underway before the end of the year. The value of reconstruction work is equivalent to 1.5 percent of GDP per annum over the next five years.
- Commodity export prices are expected to remain around current levels in nominal terms, but to decline throughout the projection in inflation-adjusted terms.
- Dubai oil prices are expected to trade within a US\$95 to US\$105 per barrel range over 2011, before settling at around US\$100 per barrel in 2012.
- Annual net permanent and long-term immigration will ease to an annual net inflow of around 4,000 persons by the end of the year. An easing off in PLT departures and strengthening arrivals will see net immigration pick-up to a net inflow of 10,000 persons in the calendar 2012 year.
- The longer-term potential growth rate remains in the lower part of the 2 to 2½ percent range.
- The neutral Official Cash Rate is around 4.5-5 percent, given high bank funding costs, which are expected to remain elevated for some time.

NEW ZEALAND ECONOMIC OUTLOOK

SUMMARY

The short-term outlook is looking weaker than it did three months ago. This has been a familiar theme of late, although the causes vary. The February 22 earthquake was a game changer, causing significant damage to the Christchurch area and effectively pushing back the economic recovery by six months, despite the insurance interest rate cut by the RBNZ in March. While the first half of this year will be weak, we still expect strong growth to emerge from the second half of the year, and for the recovery to continue well into 2012. A bigger near-term challenge fosters a stronger springboard-style recovery. Considering the destruction to balance sheets and the weak starting position of the New Zealand economy, this is hardly growth to crow about, yet it is growth nonetheless. The five year picture remains one of modest growth, which reflects a sustained period of debt reduction and structural change across the economy.

THE BIG PICTURE

At the start of the year we viewed the economy as being at an inflection point. Prospects for 2011 were looking fundamentally better than the close of 2010. Some of the key themes still apply: financial conditions are supportive, commodity prices are at record highs and the global economy is recovering nicely. **But the February Christchurch earthquake was a game-changer.** When the circumstances change, so must our economic view.

As we see it, the economy is being affected by three major shocks:

- **Ongoing deleveraging and the cessation of our old "borrow and spend" style growth model.** Largely as a consequence of past excesses, our external debt remains too high and national savings too low. Households and farmers are in the process of consolidating debt holdings. When balance sheets are being consolidated the sacrificial lamb in the near term is growth, though such steps are positive for medium-term growth. **The trend rate of growth will be lower for years to come.** There will be little easy money to be made for a while, as debt reduction continues to dominate the business cycle.
- **Structurally higher demand for commodities.** Historically high commodity export prices are part of the positive medium-term story for NZ.Inc. Looking forward, the secular trend for commodity prices is upwards for decades to come. It is simply a question of time before the terms of

trade boost diffuses into the broader economy. However, some of the current price lift is cyclical and driven by excess global liquidity that will unwind when central banks, such as the US Federal Reserve, start lifting interest rates. Despite the potential for a correction, we still believe commodity prices and our terms of trade have shifted to a structurally higher equilibrium.

- **The February 22 Christchurch earthquake caused significant damage,** loss of life, and considerable disruption in the Christchurch area. Earthquake reconstruction will be a multi-year undertaking and will affect resource allocation throughout the economy. It has also adversely affected confidence, but for how long remains to be seen. Amongst the alphabet of economic recoveries, the growth pattern following a disaster is an S, tipped over sideways with a line through the middle. Initially, growth slips below trend. Rebuild-related activity pushes momentum eventually above trend. In the long-run growth is lower in level terms (relative to a no-quake scenario) as higher insurance premiums, the opportunity cost of resource allocations and repaying fiscal debt leave you in a slightly worse position.

These events are complementary in some facets. Ongoing deleveraging and high commodity prices are both necessary to facilitate the economic rebalancing towards a more earnings-centric model. Post a natural disaster, policymakers are likely to find the path to structural reform less politically heated and the public less resistant to change. Suddenly, so-called "sacred cow" policy initiatives such as Working for Families are not so sacred.

However, there will undoubtedly be tensions. The earthquake has destroyed part of our national capital stock. The rebuild will absorb resources and mean an opportunity cost with regards to what could otherwise have taken place. While the economy still needs to deleverage, the public sector will be releveraging to fund earthquake reconstruction and support the economy. Both the RBNZ and government face several years of difficult decisions as they weigh up competing challenges, including inflation versus growth and borrowing versus reducing/reprioritising spending.

Reconstruction work of \$15-20bn is massive, equivalent to up to 10 percent of our annual GDP. Christchurch faces challenges here: the earth needs to stop shaking first! The provision of core services and the need for temporary housing should support activity over 2011, though the real rebuild will not

NEW ZEALAND ECONOMIC OUTLOOK

start till late this year or early next year. Beyond that there are challenges in making sure resources move effectively to facilitate the rebuilding work, and policymaker attention needs to turn quickly to ensuring we have the supply-side capacity for the work. Immigration and training (e.g. investing in apprenticeship schemes) need immediate action.

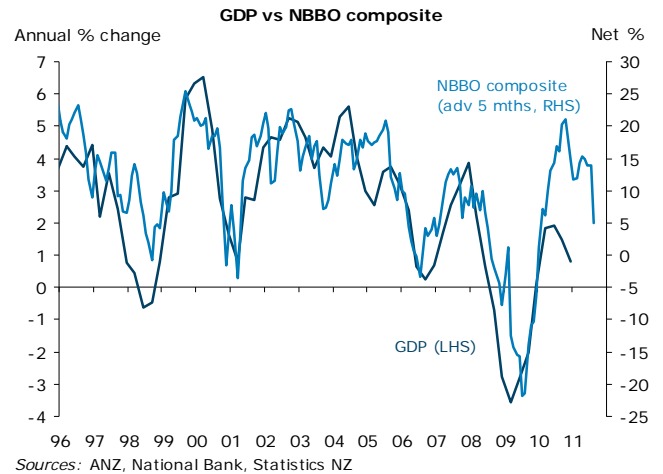
Beyond local events, uncertainty surrounding the global economy remains.

More optimistic signs are emerging out of the US economy. However, downside risks dominate the global outlook, with the world economy lurching from one crisis to another. A banking crisis risks being replaced by a sovereign debt crisis, and fiscal austerity is required across most of the OECD. Expect a public and social backlash. The Chinese economy is facing growing pains in the form of inflation. The Japanese economy faces a large damage bill following the catastrophic March 11 earthquake and tsunami. High oil prices, if sustained, pose another source of downside risk. Strong commodity prices are pushing up inflation rates, and central banks are closely watching inflation expectations. The post-GFC excesses in liquidity need to be unwound. There will be some wobbles. Nonetheless, despite all the challenges, the global economy looks in better shape compared to three months ago.

A WEAK H1 2011

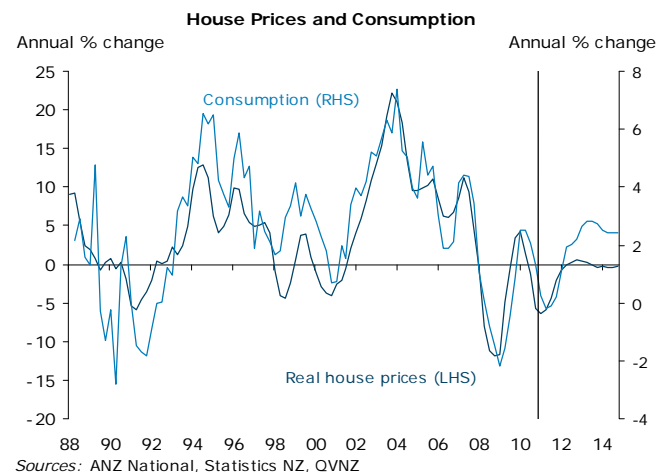
Our expectations of the economy being at an inflection point in Q1 2011 have been pushed out by six months. **The February 22 earthquake effectively put paid to emerging signs of an early 2011 recovery.** Before then, signs of improvement were commonplace, with firms showing more willingness to invest and employ. Consumers were also starting to emerge from their shells. The earthquake changed all of this.

We estimate that the Christchurch earthquake has knocked about one percentage point off Q1 GDP. Christchurch represents 10 percent of national GDP and with pockets still at a standstill, the impact is non-trivial. March saw the second biggest decline in business confidence ever recorded in the National Bank survey. There were declines in confidence across all regions, so it's not merely a Christchurch displacement issue. Thankfully there was a decent starting point, but the message is that businesses are in a holding pattern for now. We expect uncertainty and hand wringing to keep momentum soft into Q2.



Abstracting from seismic events, the economy still looked weaker on the domestic side anyway.

Apart from rising business sector credit, deleveraging dominated everywhere else. The domestic housing market remains subdued and we do not expect this to change in the foreseeable future. Sales volumes remain low and prices in many regions are going backwards. Yet houses remain at the unaffordable end of the scale compared to incomes. This is likely to continue exerting downward pressure on prices, despite low mortgage rates and housing shortages becoming more acute in some areas. Residential investment in the first half of 2011 will remain weak, and the wealth effect on consumption will remain notably absent.



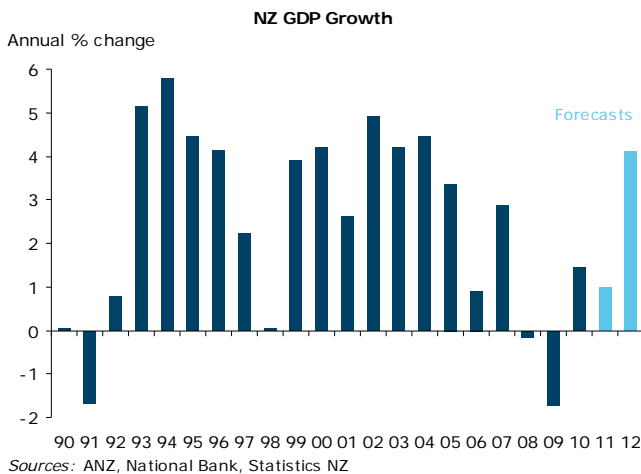
Abstracting from the quarterly volatility in the employment statistics, **a gradual recovery has been evident in the labour market, and this is set to continue.** Despite a weak near-term outlook for economic activity and signs of increased business caution, we still expect annual increases in employment in the one to two percent range throughout the next few years. Recovering labour

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force participation and continuing working age population growth are likely to slow the decline in the unemployment rate, which is set to edge below 6 percent by late 2013. We do not see wage growth becoming a concern for the RBNZ, apart from some pockets (e.g. construction) where skill shortages will become more acute.

STRENGTHENING ACTIVITY FROM H2 2011

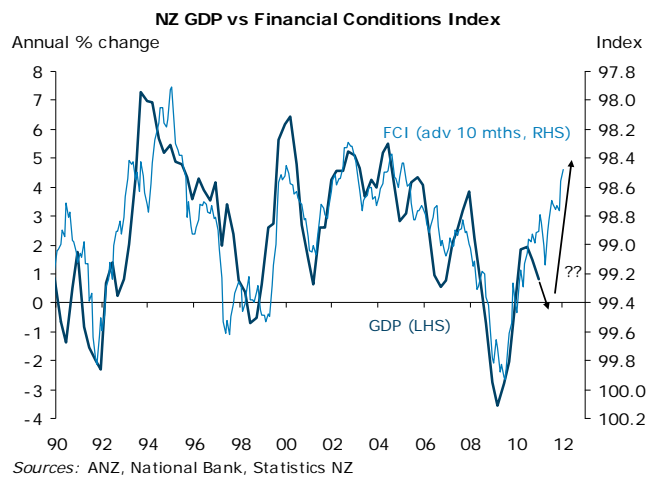
The near-term negative impact on growth in H1 2011 is obvious. But the groundwork for a material rebound in economic activity over H2 2011 is being laid.



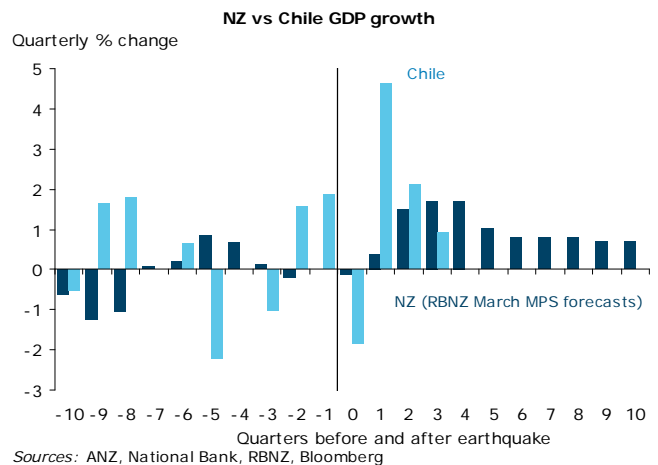
The low levels of activity and a large amount of fiscal and monetary policy stimulus will provide greater springboard from which growth will rebound. We are looking for continued strengthening in business investment, which remains at historically low levels for this stage of the cycle. Implicit in our forecasts is the assumption that surveyed investment intentions climb higher throughout this year. Financial conditions are extremely stimulatory for the parts of the country that are not impacted by the earthquake. The springboard effect is coming off a lower base, but could surprise on the upside.

A key part of our story is that there will be more economic activity from earthquake reconstruction in 2011 than most (including the RBNZ) expect. The state of emergency remains in place and the Government has moved quickly to facilitate the deployment of resources and fast-track otherwise slow processes (like demolition and repair). A new authority, the Canterbury Earthquake Recovery Authority (CERA), has been established as a stand-alone government department to co-ordinate the rebuilding of Christchurch. Ultimately, the ground has to stop shaking first, but the speed of the

Government's response to date demonstrates a resolve and commitment to get things done quickly. As such, we expect signs of increased activity to become evident in the New Zealand data from Q3 of this year. This is not to say the rebuild will be hitting its straps by Q3 – that is a 2012 story. Rather we see the combination of immediate need for core services and temporary premises (for residents as well as businesses) underpinning momentum in a steadily rising fashion, as opposed to the consensus, which seems centred around work going from zero to a huge boom overnight.



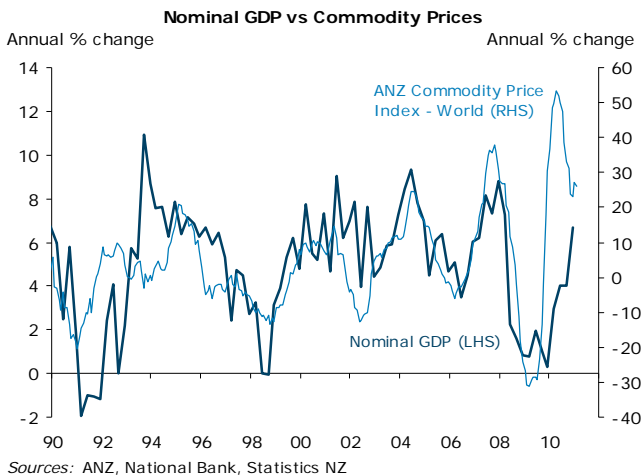
We are mindful of the Chilean experience following their February 2010 earthquake. Like agriculture in New Zealand, their crucial mining industry was largely unaffected. A key driver of the rapid rebound was the speed of the Government response, paid for by trimming other expenditure, reallocating spending, temporarily increasing taxes, and borrowing more. The parallels to what is happening in New Zealand are obvious.



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Nevertheless, earthquake reconstruction will be a multi-year undertaking. We estimate the work will be equivalent to 1.5 percent of GDP over the next five years. While reconstruction will boost economic activity over the next few years, it will not be of the feel-good variety. Considering the destruction of nationwide wealth and loss of life from the Christchurch earthquake, GDP is a hollow measure of economic wellbeing. The mobilisation of resources for the rebuild is not without cost. There are hard decisions to be made on the fiscal policy front, with the axe falling on other areas of government spending.

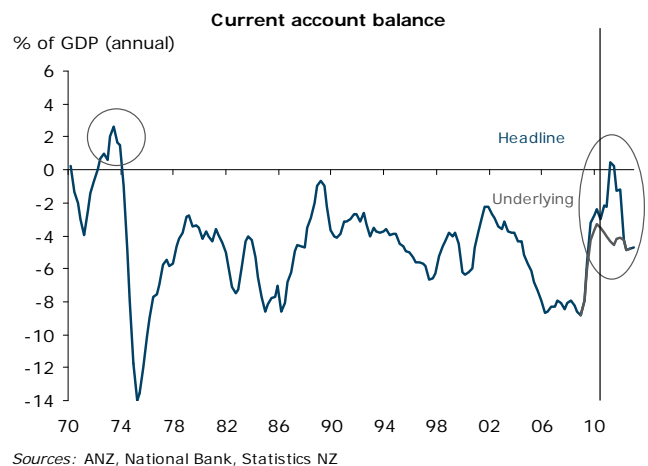
The Rugby World Cup is now less than six months away. The direct boost from an extra 85,000 overseas visitors will be around \$700m (0.4 percent of GDP) during the duration of the tournament (September 9 to October 23). We suspect the overall impact will be far bigger when we eye the amount of domestic activity as well. The Lions tour in 2005 coincided with a 1.7 percent lift in GDP in one quarter alone (followed by a 0.5 percent increase and then a small decline). There is the potential for the same strong impetus in the September and December quarters of this year. Activity over 2012 will be supported by earthquake reconstruction and the terms of trade boost eventually hitting the economy.



With all that has been going on, we need to remind ourselves of the medium-term support provided by commodity prices. The ANZ Commodity Price Index stands at a record high. The dairy payout looks like being the highest on record at \$7.70-7.75 after retentions, and prospects for the upcoming season look promising (around \$7 per kg of milk solids even with some moderation in international prices). Lamb prices are above \$100 per head, beef is at all-time highs, wool has doubled over the last year and just about everything else is

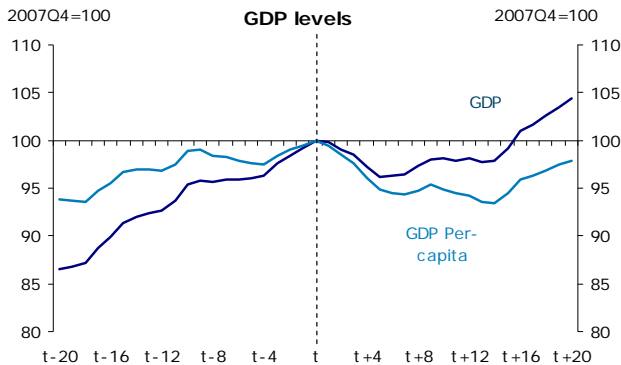
either up to some degree or at least on par. Historically there has been a 6-9 month lag between strong commodity prices and the broader economy. This lag is now longer with deleveraging and balance sheet repair across the rural sector curtailing the flow-through. However, it seems only a question of time before farmers start to open the chequebook. Some are already. We expect some critical mass from later in the year.

Abstracting from the short-term rebound in economic activity, the five year outlook remains one of modest growth. There remain a number of structural headwinds posed by our high external debt and insufficient national saving for our investment needs. In the near term, \$6bn in reinsurance inflows from the February 2011 earthquake will add to the \$3.6bn of inflows from the September 2010 quake and help push the current account to its first annual surplus since the early 1970s. **Beyond that, however, high fiscal deficits and the shifting of resources for earthquake reconstruction will halt the economic rebalancing and will worsen our external debt profile.** We see the current account deficit moving from 1.5 percent of GDP by the end of this year to 6 percent of GDP by the end of 2013.



The forecast recovery is considerably more muted than past cyclical recoveries. By the end of next year, the level of GDP will be less than 5 percent above pre-recession peaks, with per-capita output still more than 2 percent below late 2007 levels. Hardly anything to crow about. Such is the reality of repaying debt and dealing with years of excesses.

NEW ZEALAND ECONOMIC OUTLOOK



Source: ANZ, National Bank, Statistics New Zealand

Despite the modest medium-term growth outlook, inflation is likely to surprise on the upside. Courtesy of higher food and energy prices, the short-term inflation outlook is looking ugly. Whether this will pose a medium-term inflation challenge remain to be seen. But we can see upside medium-term inflation risks on a number of fronts. There are serious question marks over the ability of the supply-side capacity to accommodate the strengthening in demand, and whether expectations of wage and price setters will remain anchored to a lower inflation rate than they are experiencing in actuality.

We expect the RBNZ to raise the OCR gradually, starting with a 25bp hike in December and a 25bp hike in January. This effectively removes the 50bp insurance cut, and takes the first step towards policy normalisation. It is then followed by gradual series of 25bp hikes and some pauses, with the OCR ending 2012 at 4.00 percent and reaching 4.75 percent by mid-2013. Relative to past cycles, this is low and slow.

RISKS

There are the usual risks and caveats around our assessment.

Our forecasts are contingent on the following assumptions:

- earthquake reconstruction work gets underway over the second half of this year;
- seismic events only have a modest temporary impact on confidence and spending;
- global economic activity evolve broadly as projected;
- export commodity prices remain at historically high levels;
- inflation expectations remain anchored; and
- net immigration inflows remain positive.

In practice this combination looks a tall order, so we'll remind readers that the coming years promise to be volatile, and what growth there is we refer to as being of the "grumpy" variety.

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

As we have noted earlier, we retain a fair degree of caution over the global outlook. Significant delays in earthquake reconstruction could see the foreshadowed H2 2011 rebound get pushed back. Migration inflows could turn sharply into a net outflow, further hampering domestic spending and the housing market. A slower rebound in business and consumer sentiment would see consumers and businesses further delay spending and investment decisions.

The spirit of our forecasts remains hard graft and payback. We have spent more than we have earned and now we have to pay the piper. The Christchurch earthquake simply adds more to the bill. The government will be joining the private sector in getting its balance sheet in order.

NEW ZEALAND ECONOMIC OUTLOOK

NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual percent change)	2007	2008	2009	2010	2011(f)	2012(f)	2013(f)
Total Consumption	4.1	0.9	-0.5	2.1	0.4	1.8	2.5
Private Consumption	4.1	-0.3	-0.8	2.1	0.0	1.8	2.8
Public Consumption	4.1	5.0	0.6	2.2	1.7	1.8	1.8
Total Investment	6.0	-1.4	-11.9	3.4	15.8	18.6	5.1
Residential investment	4.7	-17.1	-19.3	2.8	-6.7	66.9	-0.1
Other investment	6.3	2.5	-10.4	3.6	19.9	11.9	6.2
Stockbuilding¹	0.3	0.4	-2.4	1.6	0.6	0.3	-0.1
Gross National Expenditure	4.9	0.3	-5.1	4.1	5.0	6.4	3.1
Total Exports	3.9	-1.7	1.9	2.8	6.8	5.2	4.6
Goods	5.4	-0.8	3.6	4.4	6.2	5.6	4.3
Services	0.0	-4.6	-4.2	-2.0	6.4	3.8	5.7
Total Imports	8.7	2.6	-14.9	10.0	16.5	11.0	4.2
Goods	8.9	3.2	-15.9	10.8	18.1	12.5	4.2
Services	8.1	0.8	-11.5	6.9	9.3	5.2	4.0
Expenditure on GDP	3.6	-0.9	0.0	2.3	1.2	4.2	3.1
GDP (production based)	2.9	-0.2	-2.1	1.5	1.0	4.1	3.1

¹ Percentage point contribution to growth

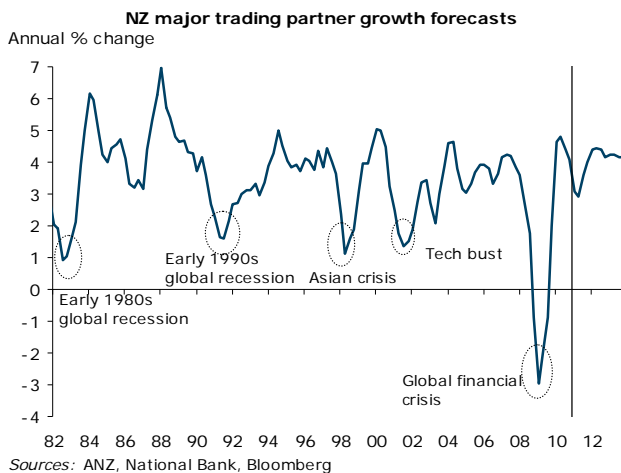
GLOBAL OUTLOOK

SUMMARY

The global economy is recovering but with this comes challenges. Excess liquidity needs to be mopped up. Inflation is rising. A banking debt crisis risks being replaced with a sovereign one. We've pencilled in trend growth across New Zealand's major trading partners but fully expect bouts of both optimism and wobbles. The literature tells us excesses associated with a financial crisis take seven years to purge. We're progressing but are not there yet.

TREAD CAREFULLY

Growth in New Zealand's major trading partners is expected to slow this year, as natural disasters negatively impact on growth in Australia (flooding) and Japan (earthquake and tsunami). Growth in emerging Asia is also expected to pull back from last year's frantic pace, as policymakers tighten policy in an attempt to prevent overheating. **We forecast a return to trend growth from next year.**



There are some compositional shifts emerging within the major trading partners. The global recovery in the past two years has been led by emerging markets, particularly in Asia. But we could now be seeing a switch back towards the US, with signs that the world's biggest economy is gathering momentum. The labour market is still

GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2007	2008	2009	2010	2011(f)	2012(f)	2013(f)
United States	1.9	0.0	-2.6	2.9	3.5	3.2	2.5
Australia	4.6	2.6	1.3	2.7	1.8	4.2	3.9
Japan	2.3	-1.2	-6.3	4.0	1.0	2.5	2.3
Euro Zone	2.8	0.3	-4.0	1.7	1.6	1.8	1.9
China	12.3	9.2	8.5	10.4	9.6	9.5	9.6
Trading Partner Growth	4.1	1.8	-1.0	4.5	3.4	4.4	4.2

Weak, with unemployment high, and the housing market remains in the doldrums. However, manufacturing activity is perky, partly due to a weak USD. All the lead indicators suggest further growth ahead, and point to ongoing declines in the unemployment rate. Stronger US growth is timely, when emerging market policymakers need to slow their economies to address inflation concerns. The US fiscal situation still needs to be addressed, but markets are still giving the US the benefit of the doubt.

Europe is not getting such generosity from the market. **Sovereign debt concerns still linger in Europe, with Portugal now next in line to be bailed out.** EU leaders have extended the EFSF and created another bailout facility, yet bond yields for some of the heavily indebted peripherals continue to hit new post-euro highs. **But the core of the Eurozone, Germany, remains strong and could yet pull the region through.**

The two-speed nature of the Australian economy looks set to continue. The negative impact of the Queensland floods will be temporary, and the mining investment boom is expected to drive growth from later this year. As Australia remains our largest trading partner, a strongly performing Australian economy bodes well for NZ.

Despite a slowing in Chinese growth, the shift towards greater domestic demand there will be beneficial for NZ. Rising wages and ongoing appreciation of the RMB will see the purchasing power of Chinese consumers increase. With China set to become a net food importer, there is scope for NZ to increase its exports to China further.

All up, global healing continues but this process is not without challenges. Inflation is rising and expectations measures will be key to watch. Excess liquidity still needs to be mopped up, but doubts remain whether the economic patient is strong enough to be taken off life support. We see some really tough challenges for central banks and Governments ahead. Whichever path they pursue, markets are going to remain on edge for some time. There is no free lunch.

FISCAL POLICY

SUMMARY

All political parties will find themselves in a fiscal straitjacket if they get elected. The opening position is tenuous, with an underlying deficit peaking above 8 percent of GDP in 2010/11. Net public debt looks set to move above 30 percent of GDP by 2012/13 and to continue rising over the remainder of the forecast period. A credit rating downgrade is on the cards. After providing fiscal support and funding part of the earthquake rebuilding programme, fiscal policy needs to move into a progressively tighter stance from 2012/13. There will be no easy choices over the next five years. Limited growth and ongoing reprioritisation of spending will become commonplace. It's either that or we saddle the next generation with even more debt and higher taxes. A more proactive growth agenda could help lessen pressure for tough choices in other areas.

A WEAKER STARTING POINT

The deficit on the underlying operating balance (OBEGAL) is expected to peak above 8 percent of GDP in the 2010/11 fiscal year. In part this is due to the weaker near-term outlook, with the New Zealand economy expected to tread water in the June 2011 year.

Costs to the Crown from the 2010 and 2011 earthquakes are substantial. On top of the \$3bn from EQC claims, replacing damaged infrastructure and government buildings, and providing transitional support will see the bill to the Crown closer to \$8bn. Not all of this will show up in the deficit numbers but it will be apparent in a worsening debt trajectory.

Fiscal policymakers are in a difficult situation. With New Zealand already on negative outlook from S&P and Fitch, pressure is mounting to get the Government's house in order at a time when fiscal support is needed to get the economy through a rough patch.

For the moment, using the Government's large balance sheet to fund the Christchurch reconstruction and support the economy must take priority. Higher fiscal deficits and public debt in the near term are a price worth paying.

We expect fiscal deficits throughout the projection period. **Net public debt (excluding NZ Super Fund assets) is expected to move above 30 percent of GDP by 2012/13** and to continue rising until at least 2014/15.

The hole in the public finances will significantly reduce fiscal flexibility for at least the next five years and more likely a decade. All political parties will be in a fiscal straitjacket. **There will be no easy decisions going forward.** The options are simple: keep borrowing, raise taxes, and/or reprioritise/cut spending.

Freeing up money from asset sales and unlocking growth opportunities (i.e. water, minerals, better productivity growth) should also be a part of the response mix. Growing your way out of difficulty is more appealing than slashing your way through it. But even this faces populist-style challenges. **Stepping back, there is nothing like a disaster to crystallise the need for decisive thinking and action.** On this front, the Government appears to have a golden opportunity.

We expect fiscal policy to move to a progressively tighter stance, with fiscal tightening equivalent to approximately 1 percent of GDP per annum from 2012/13. This is slightly later than previously assumed, but it will be more aggressive. A cyclical economic recovery will narrow the budget deficit but a significantly tighter fiscal stance will ultimately be needed to place the public finances on a better course. A weaker Government balance sheet shifts more of the burden of adjustment to the household sector and this will also act to contain private sector consumption.

FISCAL FORECASTS

June years	2009	2010	2011(f)	2012(f)	2013(f)	2014(f)	2015(f)
Operating Balance (\$m)	-10,505	-4,509	-13,800	-7,400	-3,600	-1,600	100
- as % of GDP	-5.7	-2.4	-6.9	-3.4	-1.6	-0.7	0.0
OBEGAL (\$m)	-3,893	-6,315	-16,800	-9,200	-5,700	-4,000	-2,600
- as % of GDP	-2.1	-3.3	-8.4	-4.3	-2.5	-1.7	-1.1
Net Core Crown Debt (\$m)	17,119	26,738	48,900	61,200	70,800	79,200	86,200
- as % of GDP	9.2	14.1	24.5	28.2	30.9	33.2	34.7
Core Crown residual cash (\$m)	-8,639	-9,000	-21,300	-12,900	-9,400	-8,600	-7,500
Bond Tender Programme (\$m)	5,493	12,500	19,200	17,200	14,100	11,800	12,400

INFLATION

SUMMARY

A perfect storm of inflation shocks is set to see headline inflation close to 6 percent by mid-2011. We're placing faith in the monetary policy framework to achieve a moderation in inflation towards the latter part of the projection period. However, our projections still have underlying annual inflation skirting the top of the 1 to 3 percent RBNZ target band. Upside inflation risks are prevalent in the medium term if inflation expectations prove to be anchored by anything less than reinforced concrete.

HOW MANY TEMPORARY INFLATION SHOCKS DOES IT TAKE TO CHANGE INFLATION EXPECTATIONS?

In the December 2010 quarter the hike in GST saw headline inflation spike to 4.0 percent, ruining the RBNZ's track record of CPI inflation at or slightly below the midpoint of the target band since June 2009. True, ex-GST inflation remained well contained. However, from this point on we will see a perfect storm of one-offs pushing up headline inflation.

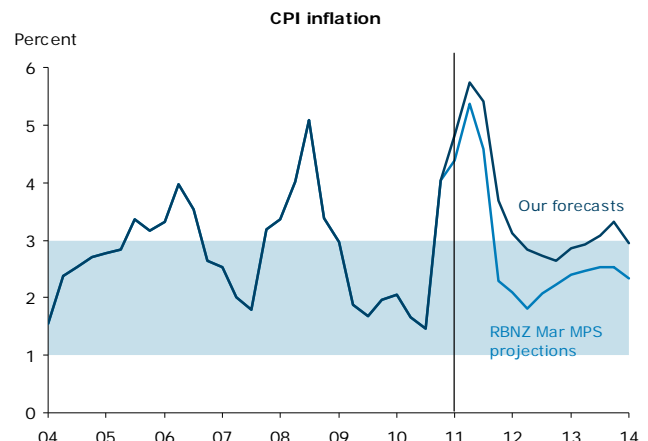
- **Food prices.** Unlike 2008, a wide range of food prices has risen sharply. Great for farmers, bad for shoppers.
- **Energy prices.** Petrol prices are set to make a massive 0.5ppt contribution to CPI inflation in Q1, and 0.4ppt in Q2 if unchanged from here. To top it off, electricity prices are also set to rise.
- **Rents.** This one is a bit out of left field after years off the inflation radar. But housing shortages exist in both Auckland and Christchurch, and rents are the first place they'll show up in the CPI.
- **Insurance.** Premiums are going only one way after the Christchurch quake.

Even with no further shocks, the CPI is set to peak in the June 2011 quarter at 5.7 percent. Tradables inflation is projected to peak at 5.9 percent in Q2, versus a still-hefty GST-affected 5.5 percent for non-tradables.

Underlying inflation is expected to track inside the upper part of the inflation band over the projection period. This is slightly firmer than the benign RBNZ March MPS inflation projections, which have inflation settling around 2.5 percent by 2013. The difference reflects our more optimistic outlook for economic activity over the second half of 2011, and our lower assessment for potential growth.

Upside inflation risks are still present for 2011 and 2012. The February Christchurch

earthquake will put pressure on construction resources for years. Retail margins are already wafer thin, and we simply don't see any more ability to absorb cost increases on the part of retailers. At some point there must be an "inflation payback" as firms seek to recover profitability. It is still far from clear that global food prices have peaked, with food safety scares in Japan the next wildcard. Pressures on government finances may also see additional upward pressure on Government charges. The NZD is always important and unpredictable. And most importantly, it could be that inflation expectations are not as solidly anchored as the RBNZ is assuming. Our analysis has found they are highly influenced by petrol prices. That's fine, as long as they aren't inherently persistent. But the data show inflation expectations are more persistent than inflation itself. In any case, it is an accepted truth that it is much easier to let inflation out of the bag than to cajole it back in. We'll be watching inflation expectations with great interest.



CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Sep-10	1.1	1.5
Dec-10	2.3	4.0
Mar-11 (f)	1.1	4.8
Jun-11 (f)	1.0	5.7
Sep-11 (f)	0.8	5.4
Dec-11 (f)	0.7	3.7
Mar-12 (f)	0.6	3.1
Jun-12 (f)	0.8	2.8
Sep-12 (f)	0.7	2.7
Dec-12 (f)	0.6	2.6
Mar-13 (f)	0.8	2.9
Jun-13 (f)	0.8	2.9
Sep-13 (f)	0.8	3.1
Dec-13 (f)	0.8	3.3

EXCHANGE RATE

SUMMARY

The currency markets are looking past the near-term negative impact of the Christchurch earthquake. Reinsurance flows and exporter demand will keep the NZD supported on any dips, while generalised USD weakness and AUD strength look set to push the NZD higher over the near term. We expect the NZDUSD to comfortably average around 0.75 throughout this year. High commodity prices and a low NZDAUD cross rate mean the export sector will not be too troubled by an exchange rate at those levels. A decline from next year is expected despite the RBNZ starting to lift rates, mainly due to a cyclical rebound in the USD.

SHAKEN BUT NOT STIRRED

The decline in the NZD earlier this year, on the back of weak data and natural disasters in New Zealand and Japan, proved to be short-lived.

The NZDUSD went from 0.78 in early February down to the low 0.75s when a run of weak data appeared. The February 22 Christchurch earthquake saw further weakness in the NZDUSD, as markets started to price in a decent chance of rate cuts from the RBNZ. A run down to the low 0.73s ensued as the RBNZ delivered a 50bp cut at their March assessment. The earthquake and tsunami in Japan on March 11 led to further NZD weakness, with a brief dip below 0.72.

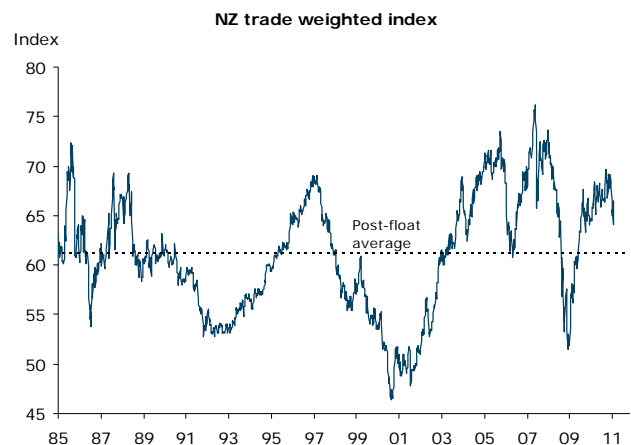
The rebound in the NZD since has been sharp.

The resilience of the NZDUSD can be seen from the fact that it managed to survive with a 7 handle in front of it despite all the negative news being priced in (including fears of a double dip recession). The NZD has now recovered to pre-Christchurch earthquake levels.

We have a very stable and conservative forecast profile for the NZDUSD, averaging 0.75 throughout this year, before gradually declining from next year. Despite the NZD being overvalued based on fundamental fair value models (our estimate is around 0.65 while the IMF noted that their estimate of overvaluation is between 5 and 20 percent from a medium-term perspective), we think the currency can comfortably stay in the mid-70s range for a while. Record high prices for New Zealand's major export commodities are a key reason justifying current levels. In addition, while the NZD may be some 25 percent above its post-float average, on a trade weighted index (TWI) basis, the NZ dollar is only around 9 percent above its post-float average. This is well within the normal range of fluctuation.

Importantly, a low NZDAUD cross rate is providing a real boon for exporters to Australia.

Any NZDAUD rate below 0.80 is generally regarded as favourable. The current rate below 0.74 therefore makes New Zealand exporters very competitive. In many respects, the combination of a high NZDUSD and a low NZDAUD cross is the best of both worlds. Commodity exporters have the benefit of high commodity prices, the country benefits from cheaper imports, and New Zealand exporters are very competitive in Australia, which is New Zealand's largest trading partner.



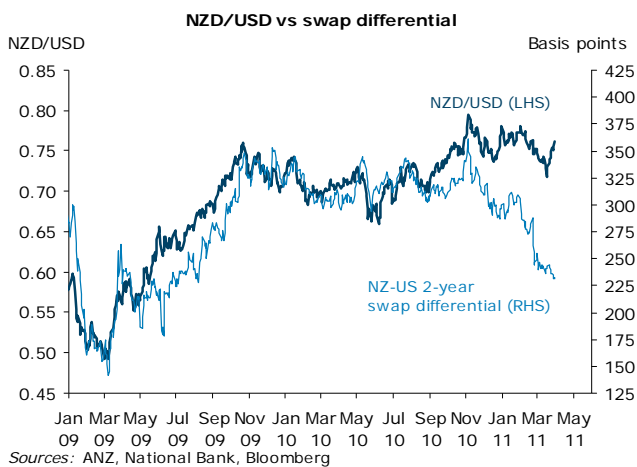
Sources: ANZ, National Bank, Bloomberg

In the near term, we see a risk of the NZDUSD heading higher, with a move towards 0.80 not out of the question. Support is coming from the following sources:

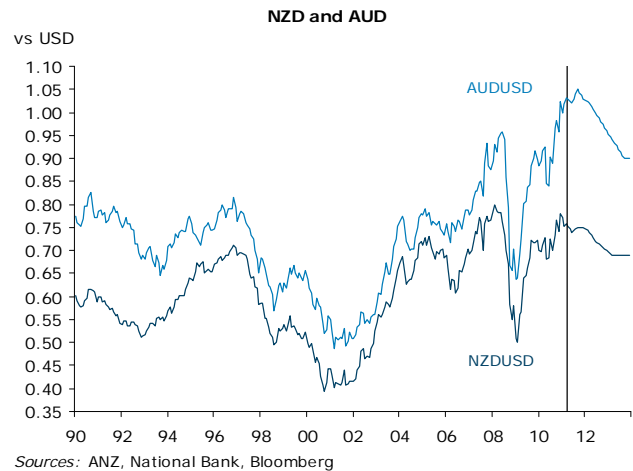
- **Ongoing exporter demand for NZD.** With high commodity prices across the board and strong demand out of Asia for New Zealand's products, there is a constant need for exporters to be converting their foreign currency earnings back into NZD.
- **Reinsurance flows following the earthquakes.** We estimate that offshore reinsurance claims from both the September and February earthquakes will total close to \$10bn. Most of these flows will be against the EUR and GBP, with some in USD and AUD. The reinsurers will likely drip-feed the money into New Zealand over time, which will provide some support for the NZD.
- **Asian Central Bank demand for New Zealand government bonds.** The New Zealand Government will need to issue more debt to fund the Christchurch rebuild. Most of the additional debt will be sold to offshore investors. There is strong demand for New Zealand debt, particularly from Asian Central Banks, given their large foreign exchange reserves and their desire to diversify away from US Treasuries.

EXCHANGE RATE

- Generalised USD weakness.** The greenback is being used as a de facto funding currency. The US Federal Reserve looks likely to be the last major central bank to be hiking rates. As such, despite further evidence that the US economy is gaining momentum, the USD has failed to rebound. The extent of USD weakness can be seen from the decoupling of the NZDUSD and yield differentials. Despite the narrowing of the NZ-US yield courtesy of the RBNZ's 50bp cut, the NZDUSD remains in the mid-0.70s whereas the past correlation suggests it should be closer to 0.60.



- AUD strength.** We now expect AUDUSD to rally to 1.05 into the September quarter this year, an upgrade from our previous peak of 1.02. The upward revision is underpinned by the prospect of additional Japanese demand for commodities during their post-tsunami rebuilding phase, along with the well-flagged resources investment boom (which will become more evident in the second half of the year). However, RBA policy expectations are less supportive, with policy comfortably on hold in the near term as the Australian economy exhibits less broad-based strength than in the first phase of the commodities boom. In the second half of 2011, we expect the RBA to raise the cash rate by 50bps. The AUDUSD should remain above/equal to parity until the June 2012 quarter, before slowly declining towards 0.90 over the longer term.



The key drivers behind our forecast of the NZD easing off from next year, despite policy normalisation from the RBNZ, are a corrective pullback in commodity prices and a resurgence in the USD. Commodity prices go through large

cycles, and while we believe that we are going through a secular long-term trend increase in commodity prices, this does not mean they will not undergo corrections. The sharp increase seen in commodity prices since late last year cannot be sustained, as it is already causing inflation concerns around the world. At the heart of this view is also our suspicion that ample global liquidity has had an outsized impact on commodity prices. As central banks turn their attention to lifting rates (with some central bankers already talking tough), commodity-related markets will suffer. This is not a capitulation story. We still like the secular commodity trend story. Rather, we see a corrective move as pending, as vertical growth simply doesn't look like a trend.

The USD comeback story is based on our view that the US Federal Reserve will start to lift rates next year, once the US recovery is strong enough to drive the unemployment rate lower. Given the extent of USD weakness seen this year, and the potential for further weakening in the near term, the rebound next year could be sharp. Past experience shows that New Zealand's domestic fundamentals count for little when the USD is on the move. The New Zealand economy on a much stronger footing and the RBNZ hiking rates may not be enough to stop the NZD heading lower. In practice, financial markets will be forward looking, so signals from the US Federal Reserve in regard to the unwinding of QE and more hawkish rhetoric will be more important and timely barometers. We are starting to see this already, and expect more hawkish rhetoric to appear by mid-year

EXCHANGE RATE

NEW ZEALAND DOLLAR FORECAST (END OF QUARTER)

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
Dec-05	0.68	0.93	80.3	0.40	0.58	70.4
Dec-06	0.70	0.89	83.8	0.36	0.53	69.4
Dec-07	0.77	0.88	85.6	0.39	0.53	71.8
Dec-09	0.72	0.81	67.2	0.45	0.50	66.3
Mar-10	0.71	0.77	66.4	0.47	0.53	66.0
Jun-10	0.68	0.81	60.5	0.46	0.56	66.6
Sep-10	0.73	0.76	61.3	0.47	0.54	66.3
Dec-10	0.78	0.76	63.2	0.50	0.58	69.2
Mar-11	0.76	0.74	62.5	0.47	0.54	66.4
Jun-11 (f)	0.74	0.73	62.9	0.46	0.53	65.6
Sep-11 (f)	0.75	0.71	64.5	0.47	0.55	66.4
Dec-11 (f)	0.75	0.73	66.0	0.47	0.56	67.3
Mar-12 (f)	0.74	0.73	66.6	0.47	0.56	67.0
Jun-12 (f)	0.72	0.72	66.2	0.46	0.54	65.7
Sep-12 (f)	0.71	0.72	66.0	0.45	0.53	64.9
Dec-12 (f)	0.70	0.73	66.5	0.45	0.52	64.4
Mar-13 (f)	0.69	0.73	66.2	0.44	0.51	63.9
Jun-13 (f)	0.69	0.75	66.9	0.44	0.51	64.3
Sep-13 (f)	0.69	0.77	67.6	0.44	0.51	64.7
Dec-13 (f)	0.69	0.77	67.6	0.44	0.51	64.7

INTEREST RATES

SUMMARY

The RBNZ's 50bp "insurance" cut in March was designed to minimise the negative impact from the Christchurch earthquake. An OCR of 2.5 percent provides considerable stimulus and we do not expect any further cuts. When the insurance cuts are removed will depend on how quickly the rebuilding can get underway. Our view is that a quicker start to the rebuilding effort and a less benign inflation picture will see policy normalisation begin at the end of this year. The shape of the mortgage curve and more people on variable rates mean the RBNZ can afford to move in 25bp steps, rather than larger moves.

FUNDAMENTALLY ALTERED

The February 22 Christchurch earthquake has fundamentally altered the economic and interest rate outlook. We have gone from expecting rate hikes this year, to seeing the RBNZ deliver a 50bp "insurance" rate cut in March. The rate cut was a pre-emptive move designed to "lessen the economic impact of the earthquake and guard against the risk of this becoming especially severe". In that regard, the cut has been delivered in anticipation of weak data, and the hurdle to further cuts is very high.

The pre-emptive nature of the rate cut means that it will be temporary. The RBNZ has noted that they "expect that the current monetary policy accommodation will need to be removed once the rebuilding phase materialises". As such, **when the RBNZ will start to hike rates depends largely on how quickly the Christchurch rebuilding can get going.** The RBNZ's assumption is that it will take some time, with reconstruction beginning only in 2012. Hence, the RBNZ's 90-day projections imply rate rises only from early next year.

We believe the RBNZ will end up raising interest rates slightly earlier, starting from December this year. This is based on the following reasons:

- **The Chilean experience suggests a quicker rebuild is possible.** Chile suffered an 8.8 magnitude earthquake on 27 February 2010, almost exactly one year before the second Christchurch quake. Infrastructure was seriously damaged and the total damage bill was around 15 percent of GDP, which, while higher than the estimate for Christchurch, is of a similar critical magnitude. At the time, the Chilean president estimated it would take 3-4 years to rebuild. The economy was already in recession and in the thick of the aftermath of the global financial crisis, with the policy interest rate at 0.5 percent.

However, the financial system was stable and the fiscal position sound. Analysts in both the private and public sectors rushed to revise down their forecasts of 2010 growth. However, in the event the economy rebounded sharply. Although GDP fell by 1.8 percent in Q1 2010, it rebounded by 4.6 percent in Q2, and expanded by 2.1 percent in Q3 and 0.9 percent in Q4.

- **This is election year in New Zealand and the Government will be judged on its handling of the rebuild.** Challenges are huge. The ground has to stop shaking first, liquefaction is a major issue, the CBD will take six months of demolition before the rebuild can even start, and self interest will no doubt act in some instances to stymie group and regional progress. However, money is being poured in, and while the rebuild itself may take time, the combination of immediate infrastructure triage, demand for housing (including modular homes), businesses seeking alternative premises and the like are expected to see building momentum in construction over the year. We see the rebuild starting on the outskirts of Canterbury (and this can start pretty quickly) and working in to the CBD. In an election year you hardly want to dilly-dally, despite the obvious challenges.
- **The natural springboard dynamic to growth in H2 2011.** Groundwork for a material rebound in economic activity over H2 2011 is being laid. The Rugby World Cup will provide a considerable boost to activity. The build-up to reconstruction work is likely to start from Q3/Q4. Financial conditions are extremely stimulatory for the parts of the country that are not impacted by the earthquake. The springboard effect is coming off a lower base, but could surprise on the upside.
- **Inflation will not be as benign as the RBNZ's forecast.** The March MPS forecast for inflation has it remaining comfortably around the mid-point of the target band. Given upside risks, we see inflation skirting around the top of the target band by the end of the projection period. The RBNZ will accommodate some relative price shifts. But they cannot ignore inflation that remains towards the top of the band for long.

We think a hike earlier than December is unlikely. There will not be sufficient information about the speed and extent of the rebuild by September, and October is getting too close to the election (November 26). However, the inflation picture will be clearer by then, and we could see the RBNZ alter the tone of their policy assessments

INTEREST RATES

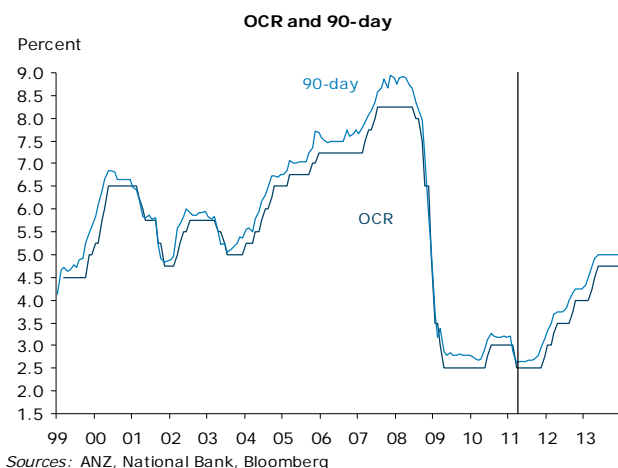
towards a more hawkish bent come September or October.

We still envisage an elongated policy normalisation process when it gets underway.

The end-point for the OCR (i.e. the neutral rate) is still lower compared to previous cycles, which we now estimate to be around 4½ percent compared to 6 percent pre-GFC.

The high proportion of households on floating mortgage rates will give the RBNZ considerable policy traction. This means the RBNZ is unlikely to need to move in 50bp steps. The effectiveness of last year's 50bp increase in slowing down the housing market and domestic demand is testament to how effective the OCR tool is presently. Hence, we see the RBNZ adopting more of a stop-start RBA-style tightening cycle, as opposed to rapid-fire rate hikes.

We expect the RBNZ to raise the OCR gradually, starting with a 25bp hike in December and following up with three more 25bp hikes. This effectively removes the 50bp insurance cut, and takes the first step towards policy normalisation. A pause is then taken for the RBNZ to assess the impact of the hikes, before restarting the tightening cycle from Q3 next year, taking the OCR to 4.0 percent by the end of 2012, and reaching 4.75 percent by mid-2013. Relative to past cycles, this is low and slow.



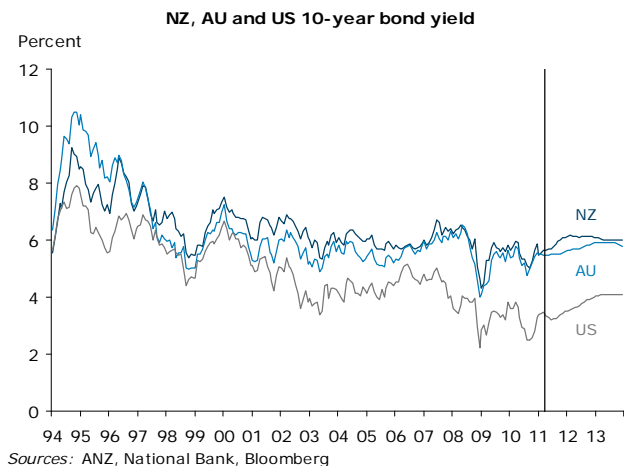
HIGHER GLOBAL RATES

Recent economic data continue to add weight to the view that the US economy is on the mend.

This has seen the Federal Open Market Committee (the FOMC, who sets US monetary policy) upgrading their assessment of the outlook. Previously, a high unemployment rate was still seen as a headwind to the recovery. Now, the FOMC is of the view that conditions in the labour market are gradually

improving. This is hardly surprising given the unemployment rate has dropped a whole percentage point (to 8.8 percent) in the four months to March and leading indicators of labour demand are very positive. **Also notable is the fact that the FOMC has indicated they are paying close attention to the evolution of inflation and inflation expectations.** Given the change in tone from the FOMC, and more hawkish rhetoric from some Fed officials, there is unlikely to be a QE3. If the run of positive US economic data continues, we may well see the FOMC start to tighten policy later this year. US bond yields will rise further in anticipation of eventual rate hikes.

Interest rates also look set to rise in Europe, with the ECB likely to hike as early as April, and the Bank of England could well be lifting rates by May on the back of inflation concerns. Across emerging Asia, policymakers have already been tightening policy to address upward inflation pressures. And while the RBA may be ahead of the curve having normalised policy much sooner than any other central bank, there is still further work to do. We are looking for another 50bp of hikes from the RBA by the end of this year.



Higher global yields will have a knock-on impact on the New Zealand market, but the nuances of how it will flow through this time around may be different from past episodes.

Indeed, while it may be intuitive to argue that higher yields in the US will lead to higher yields in New Zealand, the local market has tended to absorb recent volatility in the US, leading to a narrowing in NZ/US yield spreads. And with the New Zealand yield curve already steep, we would expect any further steepening to give the RBNZ even more reason to be circumspect when it comes to raising rates. Ironically, higher long-end rates may actually see policy expectations pared back, as the slope of the yield curve becomes

INTEREST RATES

influential in setting policy. This is the corollary of what we saw in 2006-07, when low US rates held down New Zealand long rates, meaning the RBNZ had to work harder to tighten monetary conditions. Now, the same will work in their favour.

INTEREST RATE FORECAST (END OF QUARTER)

Quarter	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
Dec-05	7.25	7.7	7.1	6.7	5.7	4.4	5.2
Dec-06	7.25	7.7	7.6	7.2	5.9	4.7	5.9
Dec-07	8.25	8.9	8.7	8.2	6.4	4.0	6.3
Dec-09	2.50	2.8	4.6	5.6	5.8	3.8	5.6
Mar-10	2.50	2.7	4.3	5.2	6.0	3.8	5.8
Jun-10	2.75	3.1	4.1	4.8	5.3	2.9	5.1
Sep-10	3.00	3.2	3.7	4.2	5.0	2.5	5.0
Dec-10	3.00	3.2	3.8	4.7	5.9	3.3	5.5
Mar-11	2.50	2.6	3.3	4.5	5.7	3.5	5.5
Jun-11 (f)	2.50	2.7	3.6	4.8	5.7	3.2	5.5
Sep-11 (f)	2.50	2.7	4.0	5.3	6.0	3.3	5.5
Dec-11 (f)	2.75	3.1	4.5	5.7	6.1	3.5	5.6
Mar-12 (f)	3.25	3.7	4.9	5.9	6.2	3.6	5.7
Jun-12 (f)	3.50	3.8	5.0	6.0	6.1	3.7	5.7
Sep-12 (f)	3.75	4.2	5.2	6.1	6.2	3.9	5.8
Dec-12 (f)	4.00	4.3	5.3	6.1	6.1	4.0	5.9
Mar-13 (f)	4.25	4.8	5.6	6.2	6.1	4.1	5.9
Jun-13 (f)	4.75	5.0	5.6	6.1	6.0	4.1	5.9
Sep-13 (f)	4.75	5.0	5.6	6.1	6.0	4.1	5.9
Dec-13 (f)	4.75	5.0	5.6	6.1	6.0	4.1	5.8

ECONOMIC FORECASTS

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13
Real Gross Domestic Product												
Total GDP, QPC	-0.4	0.1	1.4	1.8	0.7	0.9	0.9	0.8	0.7	0.8	0.7	0.6
Total GDP, APC	-0.3	-0.3	1.3	2.9	4.1	4.9	4.4	3.3	3.3	3.2	3.0	2.8
Total GDP, AAPC	1.0	0.5	0.4	1.0	2.0	3.3	4.0	4.1	4.0	3.6	3.2	3.1
Real GDP Components												
Private Consumption, QPC	-0.5	-0.3	0.5	0.5	0.4	0.5	0.6	0.7	0.8	0.7	0.6	0.6
Private Consumption, AAPC	1.5	0.9	0.3	0.0	0.2	0.8	1.3	1.8	2.2	2.4	2.6	2.8
Public Consumption, QPC	0.4	0.4	0.5	0.5	0.5	0.4	0.4	0.4	0.4	0.5	0.5	0.5
Public Consumption, AAPC	2.2	1.8	1.9	1.7	1.9	2.0	1.9	1.8	1.8	1.7	1.7	1.8
Residential Investment, QPC	-6.6	-1.6	6.5	20.8	20.7	13.8	10.7	3.0	-5.0	-4.0	-3.0	-2.0
Residential Investment, AAPC	0.7	-8.1	-12.1	-6.7	7.8	32.5	57.3	66.9	56.1	36.2	15.1	-0.1
Other Investment, QPC	4.0	4.3	5.7	4.2	2.6	1.9	0.8	0.4	1.6	2.7	1.9	1.1
Other Investment, AAPC	8.7	13.3	18.4	19.9	19.8	19.0	15.4	11.9	8.6	6.4	5.7	6.2
Gross National Expenditure, QPC	0.5	0.8	2.0	2.7	1.5	1.1	1.0	0.7	0.6	0.9	0.7	0.6
Gross National Expenditure, AAPC	4.6	4.7	4.6	5.0	5.8	6.5	6.9	6.4	5.4	4.3	3.5	3.1
Exports, QPC	1.9	2.0	3.0	1.7	0.3	0.7	1.3	1.3	1.2	1.0	0.9	0.9
Exports, AAPC	2.2	3.0	5.3	6.8	7.7	7.9	6.5	5.2	4.6	4.4	4.5	4.6
Imports, QPC	2.9	3.6	4.4	4.3	2.6	1.4	1.0	1.0	1.0	1.0	1.0	1.0
Imports, AAPC	12.0	14.1	15.9	16.5	16.8	15.7	13.5	11.0	8.2	6.0	4.7	4.2
Prices												
Headline CPI, QPC	1.1	1.0	0.8	0.7	0.6	0.8	0.7	0.6	0.8	0.8	0.8	0.8
Headline CPI, APC	4.8	5.7	5.4	3.7	3.1	2.8	2.7	2.6	2.9	2.9	3.1	3.3
Non-tradable CPI, QPC	1.0	0.9	1.0	1.0	1.1	1.0	0.9	0.8	0.8	0.8	0.8	0.8
Non-tradable CPI, APC	5.1	5.5	5.2	4.0	4.0	4.1	4.0	3.8	3.5	3.3	3.2	3.2
Tradable CPI, QPC	1.2	1.1	0.5	0.3	0.0	0.5	0.5	0.4	0.7	0.7	0.7	0.7
Tradable CPI, APC	4.4	5.9	5.4	3.1	1.9	1.3	1.3	1.5	2.2	2.4	2.5	2.8
External Accounts												
Ann. Balance on Goods, % of GDP	1.6	1.5	1.4	1.4	1.2	0.9	0.6	0.4	0.3	0.2	0.1	0.0
Ann. Balance on Services, % of GDP	-0.4	-0.5	-0.4	-0.3	-0.3	-0.2	-0.3	-0.4	-0.4	-0.3	-0.3	-0.2
Ann. Balance on Invisibles, % of GDP	-0.9	-0.8	-2.8	-2.7	-5.5	-5.6	-5.6	-5.6	-5.6	-5.7	-5.7	-5.7
Ann. CAB, % of GDP	0.3	0.2	-1.8	-1.5	-4.6	-4.9	-5.3	-5.6	-5.7	-5.8	-5.9	-6.0
Net Intl. Invt. Position, % of GDP	-78.6	-78.4	-77.8	-77.2	-76.9	-76.7	-76.7	-77.1	-77.5	-77.9	-78.4	-79.0
Terms of Trade (SNA basis)												
Export Prices, QPC	4.5	3.2	-0.2	0.7	-0.1	0.1	0.0	-0.3	-0.2	-0.7	-0.9	-0.8
Export Prices, APC	8.1	7.1	7.5	8.3	3.6	0.5	0.7	-0.3	-0.4	-1.2	-2.0	-2.6
Import Prices, QPC	1.9	1.3	-2.4	-0.5	0.1	0.5	0.3	0.1	0.2	-0.5	-0.6	-0.6
Import Prices, APC	1.2	-0.5	0.1	0.3	-1.6	-2.3	0.4	1.0	1.1	0.2	-0.8	-1.5
Terms of Trade, QPC	2.5	1.8	2.2	1.2	-0.2	-0.4	-0.3	-0.4	-0.3	-0.2	-0.2	-0.2
Terms of Trade, APC	6.9	7.7	7.4	8.0	5.2	2.9	0.3	-1.3	-1.5	-1.3	-1.2	-1.0
Labour Market												
Employment, QPC	0.9	0.2	0.5	0.5	0.5	0.4	0.5	0.4	0.4	0.4	0.5	0.5
Employment, APC	1.2	1.7	1.1	2.1	1.7	1.9	1.9	1.8	1.7	1.7	1.7	1.8
Labour Force, QPC	0.6	0.4	0.4	0.3	0.3	0.3	0.4	0.4	0.3	0.4	0.4	0.4
Labour Force, APC	1.6	1.4	1.2	1.8	1.5	1.4	1.4	1.4	1.4	1.5	1.5	1.5
Unemployment Rate, sa	6.5	6.7	6.6	6.4	6.3	6.2	6.1	6.1	6.0	6.0	5.9	5.9
Participation Rate, sa	68.1	68.2	68.3	68.3	68.3	68.4	68.4	68.4	68.5	68.5	68.6	68.6
Private Sector Wages, APC	2.7	2.6	2.3	2.2	2.4	2.7	2.9	3.1	3.2	3.3	3.3	3.3
Public Sector Wages, APC	1.2	0.8	1.0	1.5	1.8	2.3	2.3	2.5	2.5	2.7	3.1	3.0

Forecasts in bold

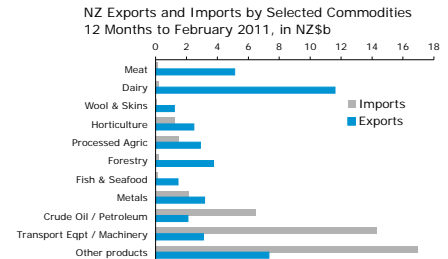
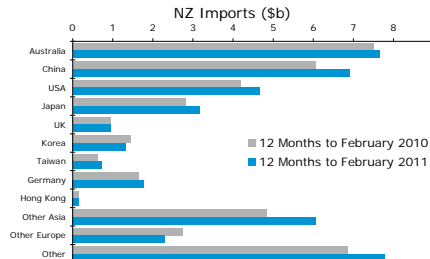
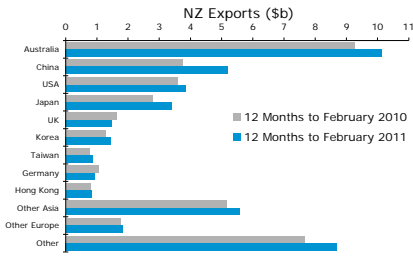
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

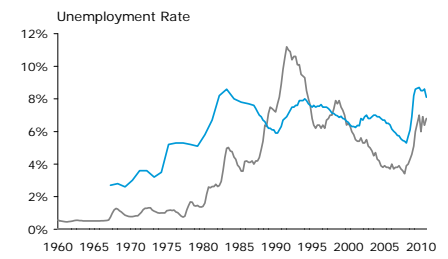
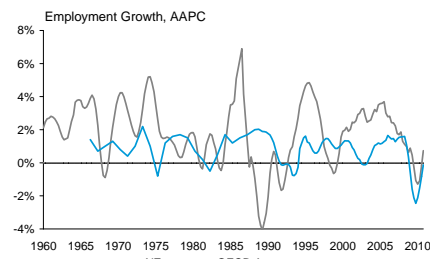
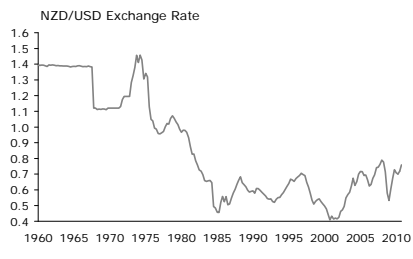
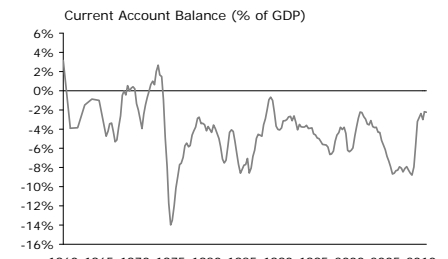
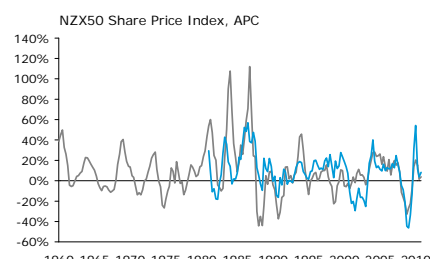
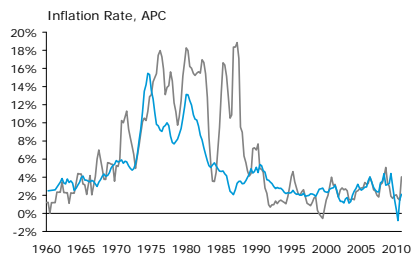
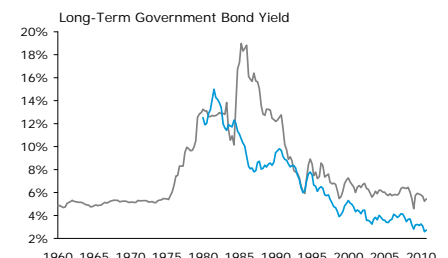
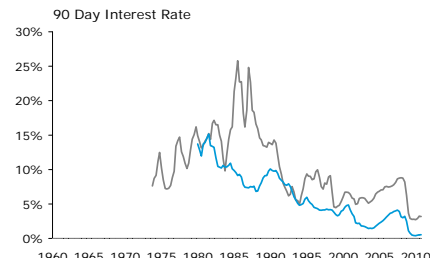
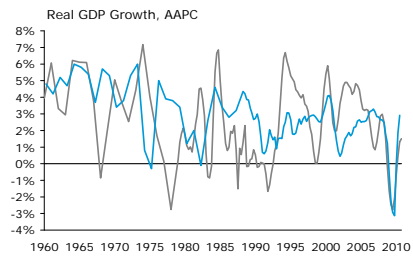
sa – seasonally adjusted

KEY ECONOMIC INDICATORS



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

	NZ	Australia	USA	Japan	UK	China	Germany	South Korea	Taiwan	Malaysia	Hong Kong	Singapore	Indonesia
Population, in millions	4.4	22.6	311.1	128.0	62.0	1,341	81.2	49.0	23.2	27.6	7.1	5.1	237.6
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	16.3	2.9	33.2	338.7	254.2	140.3	227.6	531.3	643.4	83.5	7,061	5,076	124.7
GDP, in billion NZ\$	195	1,745	20,814	8,102	3,221	7,822	4,702	1,413	589	310	314	288	1,006
Change in real terms (yr-on-yr %)	1.5	2.7	2.8	2.5	1.5	9.8	2.8	4.9	5.6	4.6	6.0	12.0	6.1
Nominal GDP per capita in NZ\$	44,174	65,941	67,154	57,358	50,512	5,688	59,166	25,226	24,380	10,161	44,528	58,828	3,480
NZ exports to ..., NZ\$million (FOB)	n/a	9,298	3,522	2,835	1,610	3,800	1,022	1,279	791	720	788	1,194	972
Share of NZ Exports (%)	n/a	23.5	8.9	7.2	4.1	9.6	2.6	3.2	2.0	1.8	2.0	3.0	2.5
NZ imports from , NZ\$million (VFD)	n/a	7,559	4,222	2,659	946	6,029	1,644	1,455	676	1,192	139	1,415	659
Share of NZ Imports (%)	n/a	19.0	10.6	6.7	2.4	15.2	4.1	3.7	1.7	3.0	0.3	3.6	1.7
Current Account balance (% of GDP)	-2.2	-2.6	-3.2	3.3	-1.8	6.0	5.3	2.9	9.7	12.7	6.6	24.2	0.9



IMPORTANT NOTICE

NEW ZEALAND DISCLOSURE INFORMATION

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

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

Qualifications, experience and professional standing Experience

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

Relevant professional body

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

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

Professional indemnity insurance

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

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

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

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

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

Criminal convictions

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

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

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

Fees

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

Other interests and relationships

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

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

- ANZ Investment Services (New Zealand) Limited (ANZIS), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ANZIS may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- OnePath (NZ) Limited, as a wholly owned subsidiary of the Bank, is an associated person of the Bank. OnePath and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- Direct Broking Limited (DBL), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. DBL may receive remuneration from a third party relating to a security sold by the Investment Adviser.

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

- Providing cash;



IMPORTANT NOTICE

- 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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