

# NEW ZEALAND ECONOMICS

## ANZ QUARTERLY ECONOMIC FORECASTS

21 December 2010

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## STRUGGLING ON

### NEW ZEALAND ECONOMIC OUTLOOK

The near-term economic outlook has weakened compared to our September forecasts. The recovery continues to be a hard slog. We expect strong growth to emerge in the second half of 2011, but off such a low base that times still won't feel great, with the level of total output not returning to its late 2007 peak until the end of next year! No wonder people are grumpy. The five year picture remains one of only modest growth, which reflects a sustained period of debt reduction and structural change across the economy.

### GLOBAL OUTLOOK

The US economy is expected to grow more robustly next year, while the major Asian economies go through a policy-induced slowdown. The Eurozone will struggle as austerity measures weigh. Risks to the global outlook are to the downside, as Asian policymakers grapple with rising inflation and Western hemisphere policymakers try to rein in ballooning fiscal deficits. 2011 will be a bumpy ride.

### FISCAL POLICY

Our projections show the deficit approaching six percent of GDP in 2010/11 before moving closer to balance by 2014/15. Fiscal policy will move into a progressively tighter stance from 2011/12. With New Zealand's sovereign credit rating on negative outlook, and much of the deficit structural, returning to fiscal surpluses will involve difficult choices.

### INFLATION

The lift in GST is expected to temporarily increase headline inflation, which is set to reach 5 percent by mid-2011. In an underlying sense, our projections still have annual inflation within the 1 to 3 percent RBNZ target band, albeit at the top end of this range. However, upside inflation risks are prevalent in the medium term if the recovery pans out and supply constraints see capacity absorbed quickly.

### EXCHANGE RATE

The NZD continues to defy domestic economic weakness, staying elevated despite signs of easing momentum throughout most of the year. A rampant AUD, which is set to trade through parity for most of next year, looks set to keep the NZD up, though still within a 0.70 to 0.74 range. A new decade low against the AUD is in prospect. The key risk is of a resurgent USD if the US economy surprises to the upside next year.

### INTEREST RATES

A more subdued recovery, well-anchored inflation expectations and a tighter fiscal stance provide the RBNZ with ample scope to leave monetary policy accommodative for longer. We see a mid-year tightening cycle next year, but one that goes in mini-cycles RBA-style. The RBNZ may well be on hold for all of 2011. With bank funding costs set to stay elevated for a while, as long as households do not return to their borrow and spend ways of old, we see a peak in the OCR of 4.75 percent.

## KEY ECONOMIC FORECASTS

Calendar Years	2007	2008	2009	2010(e)	2011(f)	2012(f)	2013(f)
<b>NZ Economy (annual average % change)</b>							
Real GDP	2.8	-0.2	-1.7	1.6	3.2	2.9	2.0
Employment	1.9	0.6	-1.1	0.9	2.1	1.5	1.5
Unemployment Rate (Dec qtr)	3.5	4.6	7.1	6.5	5.8	5.6	5.4
Terms of trade (SNA basis)	5.9	2.5	-6.8	8.7	6.4	-0.9	-1.7
<b>Global Growth (annual average % change)</b>							
US	1.9	0.0	-2.6	2.7	3.1	3.2	2.5
Australia	4.6	2.6	1.3	2.6	2.9	4.0	3.7
Japan	2.3	-1.2	-6.3	4.2	1.0	2.0	2.1
China	12.3	9.2	8.5	10.1	9.6	9.5	9.1
Trading Partners	4.2	1.7	-1.0	4.4	3.6	4.2	4.0
<b>NZ Inflation (annual % change)</b>							
CPI Inflation	3.2	3.4	2.0	4.1	2.9	2.4	3.0
Non-tradable Inflation	3.5	4.3	2.3	5.0	3.8	3.3	2.9
Tradable Inflation	2.8	2.3	1.5	3.0	2.0	1.3	2.8
<b>NZ Financial Markets (end of December quarter)</b>							
TWI	71.8	56.2	66.3	67.2	67.8	65.2	65.6
NZD/USD	0.77	0.58	0.72	0.74	0.74	0.70	0.69
NZD/AUD	0.88	0.82	0.81	0.75	0.74	0.76	0.81
Official Cash Rate	8.25	5.00	2.50	3.00	3.75	4.75	4.75
90-day bank bill rate	8.9	5.1	2.8	3.2	4.0	5.0	5.0
10-year bond rate	6.4	4.6	5.8	5.6	5.9	5.8	5.8
<b>Fiscal and External Balance</b>							
Current Account Balance (\$m)	-14,400	-16,059	-5,366	-4,700	-5,800	-7,000	-9,000
as % of GDP	-8.1	-8.8	-2.9	-2.4	-2.7	-3.1	-3.9
Government OBEGAL (\$m)*	5,850	5,637	-3,893	-6,315	-11,100	-5,500	-4,100
as % of GDP	3.4	3.1	-2.1	-3.3	-5.5	-2.5	-1.8

\* Operating balance excluding gains and losses, June years

Forecasts and text finalised 21 December 2010.

#### KEY FORECAST ASSUMPTIONS:

- Dubai oil prices are expected to trade within a US\$85 to US\$95 per barrel range over 2011, gradually rising over US\$100 per barrel in 2012.
- Annual net Permanent and Long-term immigration, which peaked at the start of the year, will ease to an annual net inflow of 8,000 persons by the end of the year. An easing off in PLT departures will see net immigration pick-up to a net inflow of 12,000 in the calendar 2011 year.
- The longer-term potential growth rate is now seen in the 2 to 2½ percent range.
- The neutral Official Cash Rate is around 5 percent given high bank funding costs, which are expected to remain elevated for some time.

# NEW ZEALAND ECONOMIC OUTLOOK

## SUMMARY

The near-term economic outlook has weakened compared to our September forecasts. The recovery continues to be a hard slog. We expect strong growth to emerge in the second half of 2011, but off such a low base that times still won't feel great, with the level of total output not returning to its late 2007 peak until the end of next year! No wonder people are grumpy. The five year picture remains one of only modest growth, which reflects a sustained period of debt reduction and structural change across the economy.

## THE BIG PICTURE

The big picture is still one of the New Zealand economy fighting considerable headwinds. Underpinning our forecasts are a few crucial themes.

- The New Zealand economy is undergoing a period of structural change** from a spending-based model towards more balanced growth. This is necessary, but not fun. **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.
- There are significant risks threatening growth in our trading partners**, particularly due to the sovereign debt crisis in Europe. But even growth powerhouse China faces a difficult task to correct imbalances while maintaining growth. The second round of the financial crisis, as governments face the bill for their 2008-09 rescue actions, is looking ugly. History shows that recovery from credit crises is slow. Further high drama is quite possible, and there are wider-than-usual error bands around our forecasts.
- Growth in the next 12 months is seriously threatened by drought.** Again. Widespread rain a week before Christmas was like gold, but severe La Nina conditions remain.

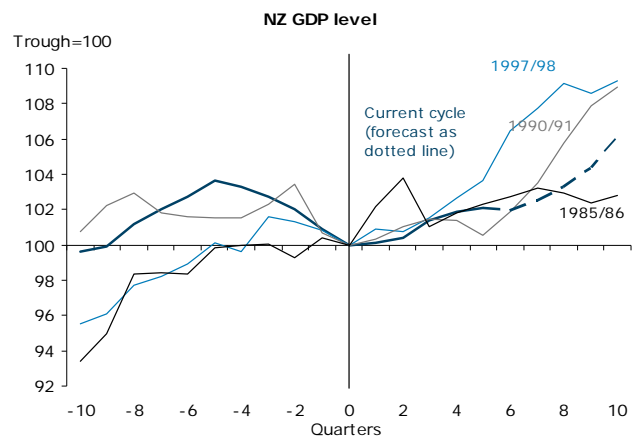
## A SLOW RECOVERY

**2011 will be a year of "grumpy growth", focused in the second half of the year.** The New Zealand economy continues to drag itself slowly out of the hole. Accommodative monetary policy and high commodity prices are helping, but the headwinds of a strong currency, contractionary fiscal policy, a dead housing market, adverse

weather and ongoing debt reduction will continue to have the upper hand in the short term.

**The process of balance sheet repair has further to run.** The household debt to income ratio has fallen only slightly, as has New Zealand's net external debt. The household sector still has a negative measured savings rate and rural sector debt remains massive compared to the sector's size. Increased saving puts the brakes on the money merry-go-round, and **this necessary process will continue to dampen demand over the year ahead.**

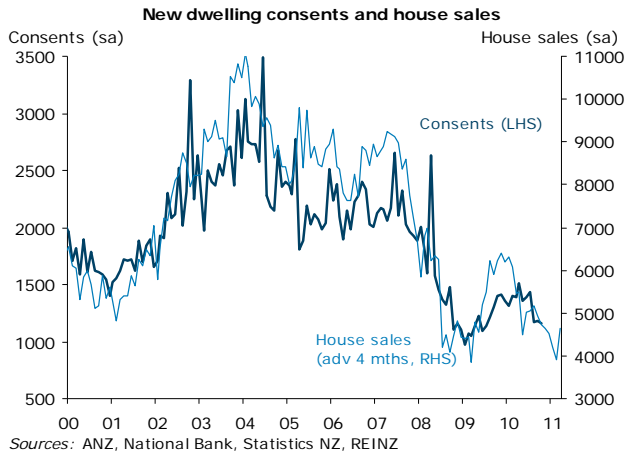
**Growth in the near-term will be patchy and sputtering.** The chart below illustrates the level of GDP preceding and following recessions in recent New Zealand history. We see a recovery unfolding more akin to the painful 1990-91 slog than the post Asian Crisis joyful leap. Our forecasts, even though they are picking good growth in the second half of next year, do not have the level of GDP returning to its pre-recession peak until more than two years after the trough (*three years on a per-capita basis*). That hurts.



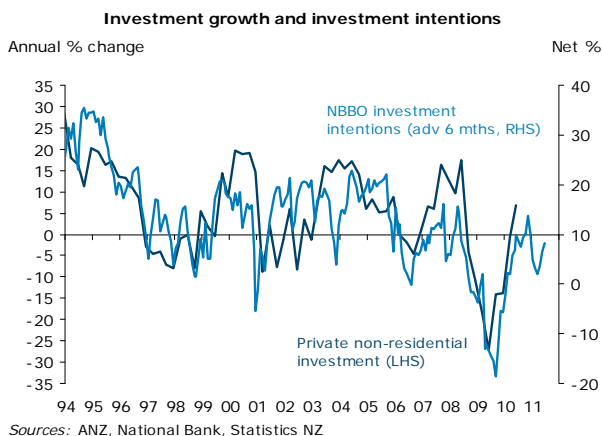
Sources: ANZ, National Bank, Statistics NZ

**The domestic housing market is subdued and we expect this to remain the case for 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. Immigration is looking weaker as departures to Australia spike up again. These factors are likely to outweigh any positive effects from housing shortages and cheap mortgage rates over the next year, keeping residential investment and house prices subdued.

# NEW ZEALAND ECONOMIC OUTLOOK



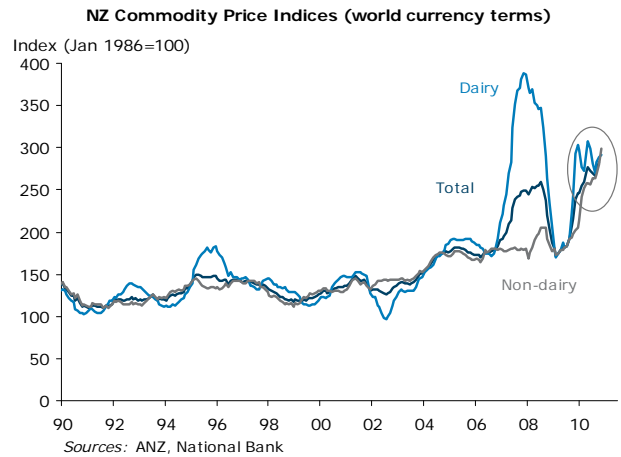
**Business confidence remains high.** Very recently we've seen a welcome lift in firms' appetite to invest and hire. A pick-up in investment and employment would go a long way to broaden and strengthen the economic recovery. But whether the observed good intentions will actually be followed through on remains to be seen. Profitability is still under pressure, and false starts are quite possible, such as we saw in 2001/02 (see chart). We suspect investment will remain weak for the next six months before picking up mid-2011. Looking further ahead, **current weakness in capacity-enhancing investment does not bode well for the economy's capacity to grow in 2011-2013.**



**The patchiness of the recovery and the need to provide ongoing policy support is expected to see the RBNZ remain on the sidelines until mid next year.** Even then, a hike would be highly conditional on a number of ducks lining up, and it is quite feasible that the resumption of the hiking cycle will be further delayed. For details of our assessment, see our Interest Rates section on page 13.

**It is not all bad. The current pain is not purely**

**a "loss" to the economy. Debt repayment is necessary.** We spent more than we earned for a period, and now we have to spend less for a bit. Current restraint sets the scene for a more durable upturn. Moreover, we do have some tailwinds. High commodity prices are assisting the debt reduction process for the heavily leveraged rural sector. And this time round, commodity price strength has not been confined to dairy. Assuming China rolls on, supply shortages and higher feed costs are expected to keep export prices robust for some time yet. But unfortunately widespread dry conditions may well subdue production across the agricultural sector again this season.



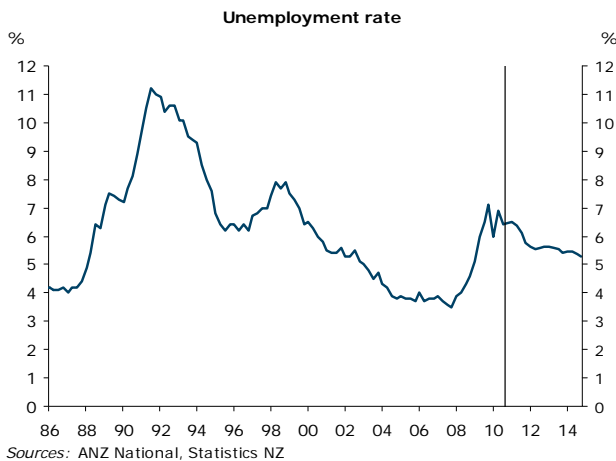
**Our trading partners are facing quite disparate outlooks over the next year and beyond. Strong momentum remains evident in Asia (ex-Japan) and Australia,** although Q3 Australian GDP disappointed. Strong demand from these markets is supporting our commodity-based exports. An apparent asset price bubble in China is a key risk to this happy story, with a non-trivial risk that the economic landing could be somewhat harder than currently envisaged, with ugly consequences for commodity prices.

Manufacturing sector exports provide a mixed picture but have on the whole been benefiting from the global recovery in manufacturing activity as inventories are rebuilt. The low NZD/AUD exchange rate is particularly helpful. Abstracting from the Rugby World Cup, services exports are expected to continue to find it tough, as ongoing economic turmoil in our richer tourism markets and a high NZD relative to the GBP and EUR is adversely affecting visitor arrivals and tourist spending from Europe.

**The labour market appears to have turned the corner, but employers remain cautious.** Volatility in recent data has not been helpful, but

# NEW ZEALAND ECONOMIC OUTLOOK

the overall picture is of a gradual recovery in employment, and an easing in the unemployment rate. Hours per employee remain lower than average, however, so some of the increasing labour demand will be met by working existing staff harder. We do not see wage growth becoming a concern for the Reserve Bank.



## GRUMPY GROWTH IN 2011

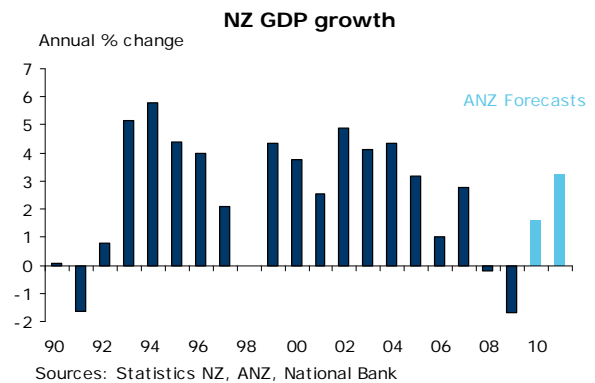
**2011 looks likely to be a reasonable year on the whole**, but growth will be focused in the second half of the year. But it won't feel like party time – not off such a weak base, and not when the growth is all in earning, not spending.

**Nonetheless, our stronger assessment for the second half of 2011 is premised on:**

- A weaker 2010! Not exactly cause for cheer, but it's easier to grow off a low base.
- The income boost from higher export prices flowing through the economy. Admittedly, much more of the boost is going into debt reduction this time round, but it's still helpful. Strictly speaking, the commodity price boost will on balance be a 2012 feature, with stabilising rural land values a precondition to rural cheque books being opened.
- Reconstruction work from the September 2010 Canterbury earthquake. We expect the 2011 net impact to be around +0.5 percent of GDP.
- A cyclical rebound in business and residential investment off very low levels. It has to happen sometime! But we think it will probably be delayed until the second half of next year.
- A boost from the Rugby World Cup.
- Supportive financial conditions, particularly low interest rates and the low NZD/AUD.
- Consumers may start to relax a little, within the

broader context of ongoing deleveraging. They've cut back hard, and may be getting tired of sausages for dinner.

- Underlying population growth. Natural population growth is just short of 1 percent per annum. And while we continue to lose people to Australia, net immigration remains positive.



**Key to a lift in consumer spending in 2011 will be an improving labour market.** The unemployment rate is expected to gradually decline over next year. Wage growth will also start to firm as labour market spare capacity is used up. But some sectors are expected to buck the trend, with job losses still likely in some industries in early 2011.

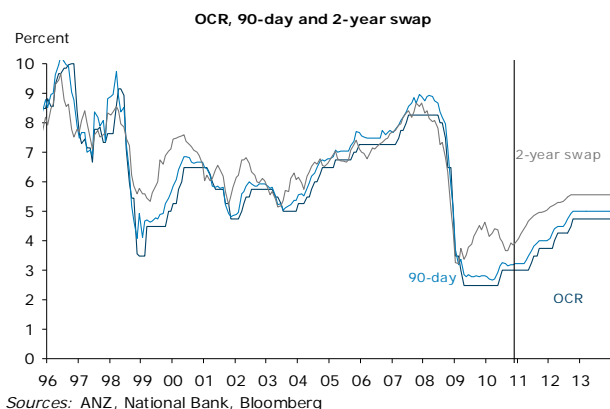
**We expect a pick-up in business investment in the second half of next year** as the gradual improvement in the economy soaks up available capacity. The improvement in business investment is forecast to be focused in plant and machinery and transport equipment, rather than construction. The cut to the company tax rate from 30 to 28 percent from April next year should help at the margin.

**Export incomes will be underpinned by healthy commodity prices and an improvement in the US economy.** However, biological constraints and unhelpful weather in spring and summer will limit the commodity volume response, meaning the impact on GDP will be limited. Services exports should benefit from the 2011 Rugby World Cup and the labour market recovery in key overseas tourist markets. Manufacturing exports should continue to receive additional support from the favourable NZD/AUD exchange rate.

At some point the RBNZ has to resume policy tightening. However, we anticipate that domestic data outturns will remain weak over the next six months, and the tone of RBNZ assessments likewise downbeat. Our projections assume a series of measured 25 basis point hikes from June next year,

## NEW ZEALAND ECONOMIC OUTLOOK

but an even later resumption of the tightening cycle is certainly possible. **We forecast the OCR to peak at 4.75 percent this cycle, although there is the risk of a higher peak if the RBNZ leaves the policy tightening too late.** We see this as a distinct possibility on current forecasts, as we believe the RBNZ may be underestimating the bounce in the second half of next year.



### RISKS

As with any economic assessment, there are

#### risks and caveats.

Front of mind, there is a real risk the forecast rebound in growth from mid-2011 could be still further delayed. NZ is not out of the woods yet, and confidence is fragile. Another negative shock could yet send us into a double-dip recession. We're watching the emerging drought anecdotes with considerable alarm.

More generally, our forecasts are contingent on: a) global economic activity evolving broadly as projected, b) on inflation expectations remaining anchored, c) net immigration inflows remaining positive, and d) the NZD not going through the roof.

But even with these helpful assumptions, **the spirit of our forecasts is hard graft and payback.** We spent more than we earned for a long time, and the events of 2008, 2009 and 2010 are the start of a long journey. The economic outlook *is* more positive for next year, particularly the second half. But overall, growth is going to be unspectacular yet again in 2011 as we continue to get our house in order.

### NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual percent change)	2007	2008	2009	2010(e)	2011(f)	2012(f)	2013(f)
<b>Total Consumption</b>	<b>4.0</b>	<b>0.8</b>	<b>-0.2</b>	<b>2.3</b>	<b>1.7</b>	<b>1.7</b>	<b>1.8</b>
Private Consumption	3.9	-0.3	-0.7	2.1	1.6	1.6	1.8
Public Consumption	4.1	4.9	1.5	3.2	1.9	2.2	1.8
<b>Total Investment</b>	<b>5.4</b>	<b>-1.1</b>	<b>-12.5</b>	<b>3.0</b>	<b>8.9</b>	<b>7.3</b>	<b>3.9</b>
Residential investment	4.6	-16.6	-18.4	6.8	6.2	9.7	5.9
Other investment	5.6	2.8	-11.3	2.2	9.4	6.9	3.6
<b>Stockbuilding<sup>1</sup></b>	<b>0.4</b>	<b>0.4</b>	<b>-2.5</b>	<b>0.8</b>	<b>0.9</b>	<b>0.5</b>	<b>0.1</b>
<b>Gross National Expenditure</b>	<b>4.8</b>	<b>0.4</b>	<b>-5.2</b>	<b>3.6</b>	<b>4.3</b>	<b>3.5</b>	<b>2.4</b>
<b>Total Exports</b>	<b>3.9</b>	<b>-1.1</b>	<b>0.4</b>	<b>3.1</b>	<b>7.7</b>	<b>6.2</b>	<b>4.4</b>
Goods	5.5	0.1	1.8	4.5	6.3	6.0	4.2
Services	0.0	-4.5	-4.4	-2.1	10.5	6.7	5.2
<b>Total Imports</b>	<b>8.7</b>	<b>2.8</b>	<b>-15.1</b>	<b>8.6</b>	<b>10.3</b>	<b>6.9</b>	<b>5.1</b>
Goods	8.9	3.5	-16.2	9.1	12.0	7.7	5.3
Services	8.1	0.9	-11.5	5.7	3.8	4.2	4.3
<b>Expenditure on GDP</b>	<b>3.3</b>	<b>-0.6</b>	<b>-0.5</b>	<b>2.1</b>	<b>3.2</b>	<b>3.1</b>	<b>2.1</b>
<b>GDP (production based)</b>	<b>2.8</b>	<b>-0.2</b>	<b>-1.7</b>	<b>1.6</b>	<b>3.2</b>	<b>2.9</b>	<b>2.0</b>

<sup>1</sup> Percentage point contribution to growth

## GLOBAL OUTLOOK

### SUMMARY

The US economy is expected to grow more robustly next year, while the major Asian economies go through a policy-induced slowdown. The Eurozone will struggle as austerity measures weigh. Risks to the global outlook are to the downside, as Asian policymakers grapple with rising inflation and Western hemisphere policymakers try to rein in ballooning fiscal deficits. Our numbers portray a robust backdrop but the spirit of our assessment is more circumspect. 2011 will be a bumpy ride.

### WILL THE US CONSUMER BOUNCE BACK?

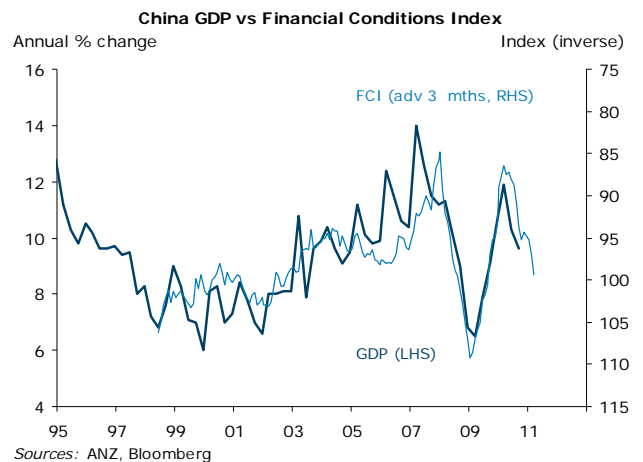
**Fears of a double dip in the US have receded.** Recent economic data out of the US have generally beaten expectations, though the unemployment rate remains high at 9.8 percent, and looks set to stay elevated for some time. But the Bush tax cuts and unemployment benefit extensions should lend support to growth next year, though at the cost of a higher fiscal deficit. Encouragingly though, there are signs that US consumers could be starting to come out of their shells. A more enduring recovery rests on US businesses deciding to invest and employ, and while definitive signs of this are still lacking, small business optimism is improving and corporate balance sheets are in a healthy state with ample cash on hand. Policymakers in the US look set to continue providing very accommodative policy settings to nurse the recovery; hence our forecast for a more robust growth rate next year.

**Eurozone growth will be held back by fiscal austerity.** The core countries of the Eurozone, Germany in particular, are doing well. But troubles in the peripherals risk spreading contagion. **The Australian economy is forecast to grow robustly.** Despite a mid-cycle slowdown as past RBA rate hikes start to have an impact, an expected investment boom is set to drive strong growth from mid-next year.

### GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2007	2008	2009	2010(e)	2011(f)	2012(f)	2013(f)
United States	1.9	0.0	-2.6	2.7	3.1	3.2	2.5
Australia	4.6	2.6	1.3	2.6	2.9	4.0	3.7
Japan	2.3	-1.2	-6.3	4.2	1.0	2.0	2.1
Euro Zone	2.8	0.3	-4.0	1.7	1.2	1.8	2.0
China	12.3	9.2	8.5	10.1	9.6	9.5	9.1
<b>Trading Partner Growth</b>	<b>4.2</b>	<b>1.7</b>	<b>-1.0</b>	<b>4.4</b>	<b>3.6</b>	<b>4.2</b>	<b>4.0</b>

Following very strong growth in 2010, we expect the major Asian economies to undergo a policy-induced slowdown in 2011. The threat of deflation may be a big issue in the US, but in Asia, it is rising inflation that is of pressing concern for Asian policymakers. We have already seen policy being tightened across Asia, and we can expect further tightening over next year to bring growth rates down to more sustainable levels. Our financial conditions index for China suggests further near-term slowing is in prospect.



**After expanding at around 4½ percent in 2010, we see NZ's major trading partner growth rate slowing to around 3½ percent in 2011, before rising towards trend the following year.** The numbers mask diverging performances across economies, but in aggregate, these are still robust rates of growth that will continue to support commodity prices and demand for NZ's exports.

**At present, the risks to the global outlook are mostly to the downside.** One key risk is that sovereign debt woes infect the European banking system, triggering a mini financial crisis in the region. Another risk is that Asian policymakers tighten too much, bursting the property bubble and causing a much sharper slowdown in growth across Asia. In such a scenario, commodity prices would come off very quickly, as would the NZD.

## FISCAL POLICY

### SUMMARY

Our projections show the deficit approaching six percent of GDP in 2010/11 before moving closer to balance by 2014/15. After providing support through the downturn, fiscal policy will move into a progressively tighter stance from 2011/12. With New Zealand's sovereign credit rating on negative outlook, and much of the deficit structural, returning to fiscal surpluses will involve difficult choices. While household savings are on an improving trajectory, fiscal policy must play a key role in improving national savings performance. A key challenge facing the government is fostering an economic framework that encourages robust and sustainable growth, while at the same time focusing on expenditure restraint.

### GETTING THE HOUSE IN ORDER

**The deficit on the underlying operating balance (OBEGAL) is expected to peak at nearly 6.0 percent of GDP in the 2010/11 fiscal year.** A weak economy, costs from the Canterbury earthquakes, and leaky buildings all contributed to the deficit blow-out. With S&P placing New Zealand on negative outlook, and with the RBNZ calling for greater restraint, pressure is mounting to get the Government's house in order. We expect the OBEGAL deficit profile to improve through the remainder of the projections, **with the fiscal position close to balance by 2014/15.** **Net public debt (excluding NZ Super Fund assets) is expected to approach 29 percent of GDP by 2014/15, but to then head lower.**

**The key factor driving the improving fiscal profile is expenditure constraint.** Around four-fifths of the Budget deficit is structural and largely the consequence of sizeable increases in past government spending. A cyclical recovery will narrow the budget deficit but a tighter fiscal stance will be needed to place the public finances on a more sustainable path.

### FISCAL FORECAST

June years	2010(a)	2011(f)	2012(f)	2013(f)	2014(f)	2015(f)
Operating Balance (\$m)	-4,509	-9,100	-3,600	-2,000	800	2,400
- as % of GDP	-2.4	-4.5	-1.6	-0.9	0.3	1.0
OBEGAL (\$m)	-6,315	-11,100	-5,500	-4,100	-1,700	-200
- as % of GDP	-3.3	-5.5	-2.5	-1.8	-0.7	-0.1
Net Core Crown Debt (\$m)	26,738	42,100	51,400	59,300	65,500	70,300
- as % of GDP	14.1	20.8	23.4	26.0	27.8	28.7
Core Crown residual cash (\$m)	-9,000	-15,600	-9,200	-7,900	-6,300	-5,200
Bond Tender Programme (\$m)	12,500	13,500	13,800	12,700	9,200	9,800

**The Government is now facing up to the reality of a different economic environment. All parties are heading into election year in a fiscal straitjacket.**

The impact of fiscal consolidation is likely to be felt from 2011/12, with the **fiscal tightening equivalent to approximately 0.5 to 1 percent of GDP per annum from 2011/12.** This is likely to occur slightly later than assumed in the Budget, but will be marginally tighter from 2011/12 onwards.

**Our poor private sector saving record places greater onus to get the public finances back into the black.** With the current account set to deteriorate as the economy recovers (stripping out the positive impact from the earthquake reinsurance payments), fiscal policy needs to be held up as a beacon of responsibility and prudence. A tighter fiscal policy stance will also allow monetary policy to do more of the heavy lifting and will take pressure off the NZD. Changes to tax policy favouring the income-generating part of the economy are a step in the right direction. In combination with a tighter fiscal stance, they are setting up a better platform for sustainable growth.

**With the Investment Statement, the government is also focusing on managing its huge balance sheet** (120 percent of GDP) more effectively to get better value for money for the taxpayer and to boost economic efficiency.

**With sovereign debt and fiscal solvency likely to be key issues for 2011, it is imperative to make these changes.** Globally and locally, true leadership versus populist decision-making is going to be critical. Some nations look better placed than others, and we don't have a strong private savings record to fall back on.

## INFLATION

## SUMMARY

The lift in GST is expected to temporarily increase headline inflation, which is set to reach 5 percent by mid-2011. In an underlying sense, our projections still have annual inflation within the 1 to 3 percent RBNZ target band, albeit at the top end of this range. Weak domestic demand and an elevated NZD may provide further near-term downward pressure on retail-related prices. However, upside inflation risks are prevalent if the recovery pans out and supply constraints see capacity absorbed quickly.

## GST BOOST TO HAVE TEMPORARY INFLATION IMPACT

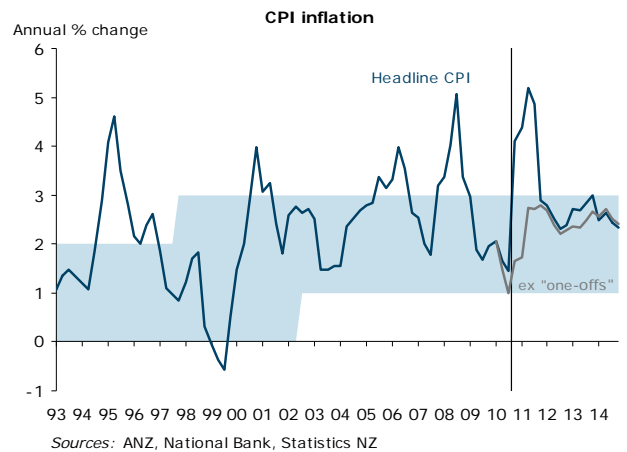
**Inflation has remained at or slightly below the midpoint of the RBNZ's target band since the June 2009 quarter.** The weak household environment is becoming more evident, with widespread retail discounting and inflation in housing components remaining well contained.

Government-related one-offs and weather-related impacts on food prices may have prevented a more sizeable fall in headline inflation, but **measures of core inflation remain relatively well behaved. However, the battle is far from over.** Inflation survey measures suggest continued stickiness in inflation. Our monthly inflation gauge continues to detect stubbornly high domestically generated inflation in certain pockets.

**Headline inflation has bottomed and is set to move considerably higher over the next 12 months.** The headline inflation outlook is largely driven by "one-offs" that are going to cause considerably volatility in the headline CPI profile. Chief amongst these is the October increase in GST. The degree to which consumer prices respond is partly a function of the degree of demand pressures within the economy. At present there are some near-term downside inflation risks, on account of sluggish domestic demand and the elevated NZD/USD. These factors could produce a slightly lower peak in annual headline inflation by June next year.

**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 December MPS inflation projections, which have inflation settling just above the midpoint of the target band by early 2013. The differences partly reflect 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.** A limited margin of spare capacity has the potential to translate higher demand into intensifying domestically generated inflationary pressure. This could emerge in mid-2011 as the economic recovery gets back into gear. With retail margins already wafer thin, there could be an "inflation payback" as firms seek to recover profitability. Rising global food prices may also make their presence felt more in New Zealand, with the uptrend in export commodity prices still evident. Pressures on government finances may also see additional upward pressure on government charges, over and above what we have assumed here. There could also be the inflationary impact of a weaker NZD/USD to contend with.



## CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Jun-10	0.3	1.8
Sep-10	1.1	1.5
<b>Dec-10 (f)</b>	<b>2.4</b>	<b>4.1</b>
Mar-11 (f)	0.6	4.4
Jun-11 (f)	1.0	5.2
Sep-11 (f)	0.8	4.9
<b>Dec-11 (f)</b>	<b>0.5</b>	<b>2.9</b>
Mar-12 (f)	0.5	2.8
Jun-12 (f)	0.7	2.5
Sep-12 (f)	0.6	2.3
<b>Dec-12 (f)</b>	<b>0.6</b>	<b>2.4</b>
Mar-13 (f)	0.8	2.7
Jun-13 (f)	0.7	2.8
Sep-13 (f)	0.7	2.9
<b>Dec-13 (f)</b>	<b>0.7</b>	<b>3.0</b>

## EXCHANGE RATE

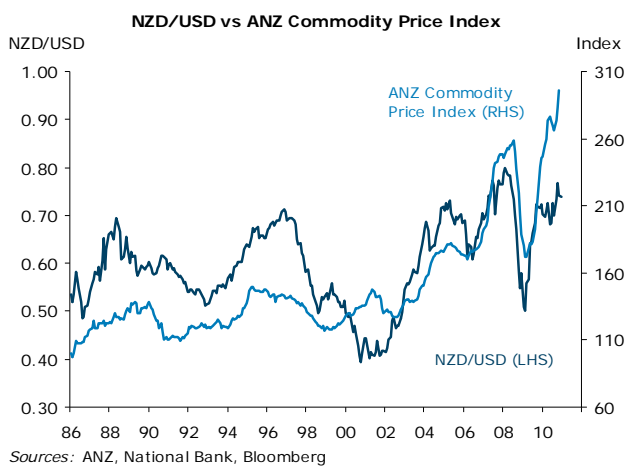
### SUMMARY

The NZD continues to defy domestic economic weakness, staying elevated despite signs of easing momentum throughout most of the year. A rampant AUD, which is set to trade through parity for most of next year, looks set to keep the NZD up, though still within a 0.70 to 0.74 range. A new decade low against the AUD is in prospect. The key risk is of a resurgent USD if the US economy surprises to the upside next year. If this were to eventuate, the NZD could find itself playing catch-up to its fundamental fair value in the mid-0.60s.

### SAVED BY HIGH COMMODITY PRICES

By most accounts, the NZD should be lower than where it is at present. The economic rebalancing that the NZ economy needs to undertake would be greatly assisted by a lower currency. Instead, the NZD has defied most expectations by pushing higher throughout the year, reaching almost 0.80 against the USD at one stage, though it has backed off in recent months. The NZD is finding support from three pillars:

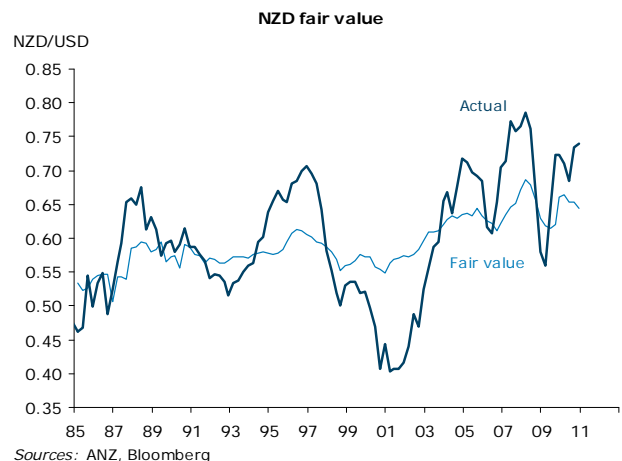
- **Record high commodity prices.** The ANZ Commodity Price Index reached record levels, and NZ's terms of trade look set to reach their highest level since the 1970s. The strong correlation means that the NZD will continue to be underpinned by high commodity prices.



- **USD weakness.** Mid-year fears of a possible double dip in the US and the prospect of further quantitative easing by the US Federal Reserve (subsequently announced in early November) led to a sell-off in the USD, which pushed the NZD higher by default. Broader moves in the USD are still influential for the NZD's direction.
- **AUD strength.** Strong growth (a soft Q3 GDP aside) and rate hikes from the RBA sent the

AUD to post-float highs. With currency markets tending to lump NZD and AUD in the same basket, the NZD found itself tagging along for the ride, but it under-performed, which saw the NZD/AUD cross fall to decade lows.

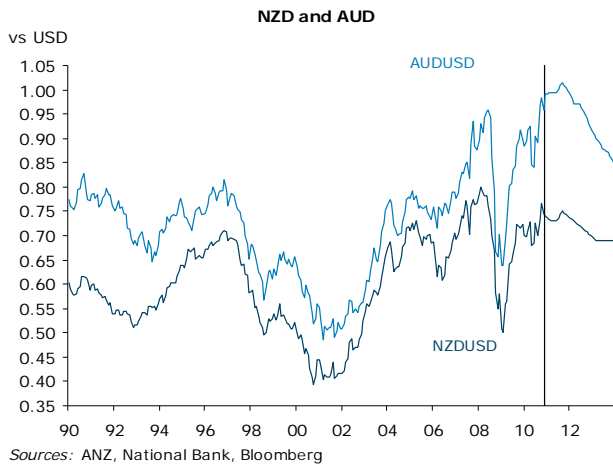
**Notwithstanding record-high commodity prices and temporary support from the Rugby World Cup and earthquake reconstruction next year, fundamentals overall do not support a strong NZD.** Yes, our commodity prices are high, but things like poor productivity growth lean against this. The RBNZ's tightening cycle will be later and more elongated than previously thought. In addition, our fundamental fair value estimate of the NZD suggests it should be close to the mid-0.60s rather than in the mid-0.70s.



**However, in the current environment, it is difficult to form a view of the NZD based purely on domestic fundamentals.** Where the AUD heads next year look set to have a driving influence on the NZD. With strong fundamentals there, including the prospect of further RBA hikes, we see the AUD trading above parity for most of 2011. The housing market in Australia may be slowing and retail sales are feeling the effect of past RBA hikes. But the pending investment boom is set to drive growth over the next couple of years. An AUD above parity would make it hard for the NZD to fall too far, though we expect fresh decade lows in the NZD/AUD to be reached.

**We forecast the NZD/USD in a 0.70 to 0.74 range next year.** Our forecasts play off the offsetting forces of near-term weakness in the domestic economy (which is NZD negative) against high commodity prices and a rising AUD (both NZD positive), resulting in the NZD muddling along.

## EXCHANGE RATE



**Beyond that, we think the pillars of support for the NZD that we mentioned above will start to fade away, pushing the NZD lower.** Commodity prices go through cycles, and we cannot see the sorts of gains experienced this year repeating. We are firm believers that NZ's terms of trade is on a structurally higher plane. But we don't see current levels necessarily holding or pushing higher in a straight line from here.

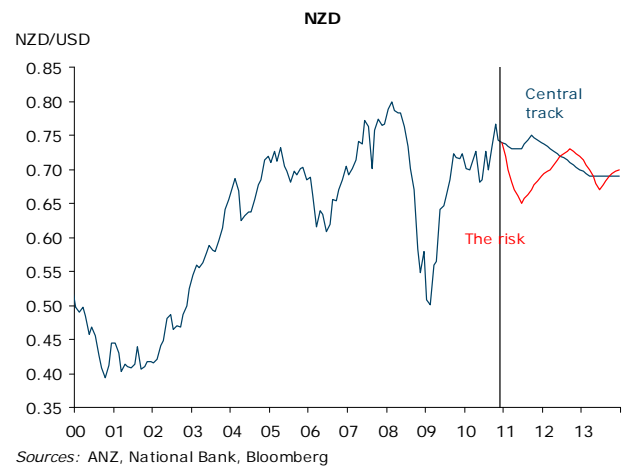
**We think the USD is due for a comeback, though this may be more of a 2012 story.** The US Federal Reserve will be leaving rates on hold throughout next year. But with policymakers doing all they can to ensure the recovery in the US takes hold, we see better US performance in the back half of next year, which will see the Fed starting to remove some of the policy accommodation by early 2012. This could be the catalyst for a re-rating of the USD. When this occurs, it will be difficult for the NZD and even the AUD to shine.

### WATCH SOVEREIGN CONCERNS AND ASIAN POLICYMAKERS

The key risks to our currency view are:

- **A worsening in sovereign woes in Europe,** leading to renewed EUR/USD weakness and a return of risk aversion. As we have seen this year, sentiment is fickle and can turn on a dime. The strong correlation between NZD/USD and EUR/USD mean that the NZD will get dragged down on any EUR weakness.
- **More aggressive tightening by Asian policymakers.** Should the Asian economies slow more sharply than expected in response to tighter policies, commodity prices will come off the boil and weigh on the NZD.

In both those instances, we could find the NZD heading towards the mid-0.60 zone in quick fashion.



## EXCHANGE RATE

## NEW ZEALAND DOLLAR FORECAST (END OF QUARTER)

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
Dec-05	0.68	0.93	80.4	0.40	0.58	70.4
Dec-06	0.70	0.89	83.8	0.36	0.53	69.4
Dec-07	0.77	0.88	85.6	0.39	0.53	71.8
Dec-09	0.72	0.81	67.2	0.45	0.50	66.3
Mar-10	0.71	0.77	66.4	0.47	0.53	66.0
Jun-10	0.68	0.81	60.5	0.46	0.56	66.6
Sep-10	0.73	0.76	61.3	0.47	0.54	66.3
<b>Dec-10 (f)</b>	<b>0.74</b>	<b>0.75</b>	<b>62.9</b>	<b>0.48</b>	<b>0.56</b>	<b>67.2</b>
Mar-11 (f)	0.73	0.73	62.1	0.47	0.56	66.4
Jun-11 (f)	0.73	0.73	63.5	0.48	0.57	67.0
Sep-11 (f)	0.75	0.74	66.0	0.48	0.59	68.6
<b>Dec-11 (f)</b>	<b>0.74</b>	<b>0.74</b>	<b>66.6</b>	<b>0.47</b>	<b>0.57</b>	<b>67.8</b>
Mar-12 (f)	0.73	0.75	67.2	0.46	0.55	67.2
Jun-12 (f)	0.72	0.74	67.7	0.45	0.54	66.1
Sep-12 (f)	0.71	0.75	67.5	0.44	0.53	65.5
<b>Dec-12 (f)</b>	<b>0.70</b>	<b>0.76</b>	<b>67.9</b>	<b>0.44</b>	<b>0.52</b>	<b>65.2</b>
Mar-13 (f)	0.69	0.77	67.6	0.43	0.51	64.7
Jun-13 (f)	0.69	0.78	68.3	0.43	0.51	65.1
Sep-13 (f)	0.69	0.79	69.0	0.43	0.51	65.3
<b>Dec-13 (f)</b>	<b>0.69</b>	<b>0.81</b>	<b>69.0</b>	<b>0.43</b>	<b>0.51</b>	<b>65.6</b>

## INTEREST RATES

### SUMMARY

A more subdued recovery, well-anchored inflation expectations and a tighter fiscal stance provide the RBNZ with ample scope to leave monetary policy accommodative for longer. We see a mid-year tightening cycle next year, but one that goes in mini-cycles RBA-style. The RBNZ may well be on hold for all of 2011. With bank funding costs set to stay elevated for a while, as long as households do not return to their borrow and spend ways of old, we see a peak in the OCR of 4.75 percent.

### PROCEEDING WITH CAUTION

The December *Monetary Policy Statement* paints a picture of the RBNZ in no hurry at all to lift rates. They appear comfortable with the underlying inflation profile, and are confident that inflation expectations and wage demands will stay moderate. After just two rate hikes this year, the OCR at 3 percent remains at historically low levels. But it is an appropriate setting, given the loss in economic momentum since mid-year.

**We still expect the next move in rates to be up.** The recovery is expected to gather momentum next year, by which time spare capacity in the economy will be gradually used up, causing upside inflation pressure to emerge. However, the RBNZ will want to see clear evidence of the recovery in the hard data before acting. Business confidence may be improving, but we doubt the RBNZ will take that at face value this time. We suspect part of the decision to hike in June this year was on the back of rising business confidence, and a rogue unemployment print that subsequently proved to be unreliable. With rising business confidence earlier this year proving to be a head fake, the RBNZ will not want to put too much reliance on it this time. This means **the hurdle to a rate hike is very high, and will require confirmation in the hard data that a robust recovery is actually underway. This is a way off.**

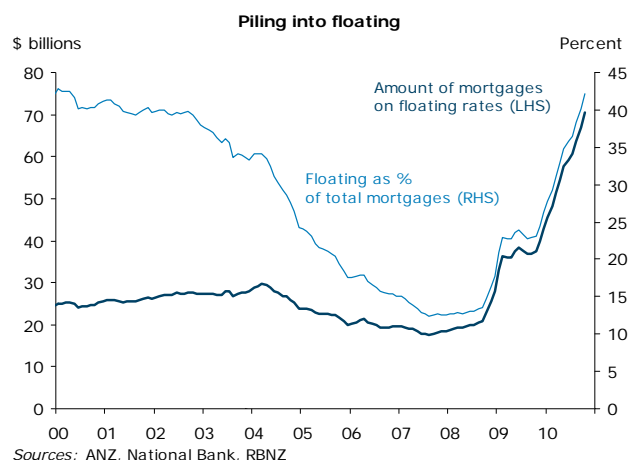
Given that there is still near-term weakness in the economy at present, any emerging strength will not be apparent in the dataflow until Q2 next year. This is why we see the tightening cycle being a mid-year story at the earliest. If growth in 2011 does not pick up or have more than "one off" substance, the RBNZ may be on hold the entire year.

**A mid-year, or even later, start to the tightening cycle will also be dependent on the inflation outlook.** At present, underlying inflation is comfortably below the mid-point of the target band, but food price inflation is set to drive headline inflation higher next year. We also doubt that the

retail sector can continue to aggressively discount to the same extent as they have over the past couple of years, which means we will not see the same extent of downward pressure on inflation from retail goods. There are the usual non-contestable pockets that will continue to push non-tradable prices higher. The biggest risk remains the extent of spare capacity in the economy. If potential growth is far lower than initially thought, then inflation pressures will emerge much sooner, even in an environment of modest growth.

Assuming the fears over supply constraints do not materialise, then **we envisage an elongated tightening cycle that is set to drag out over a couple of years.** This is more akin to "mini" tightening cycles where rates move up a few times, followed by a long pause, then up again – similar to how the RBA operates. How comfortable the RBNZ will feel with such a strategy will depend on:

- **The proportion of households on floating mortgage rates** - currently at its highest since early 2000, and set to increase further. This gives monetary policy more potency. At present, a 25bp increase in the OCR would translate into an immediate 10bp tightening in the effective mortgage rate, compared to only 3bp in 2007 when the proportion of floating mortgages was at its lowest. But keeping households on floating is dependent on an expectation that the RBNZ will not be aggressively tightening in the near term. The more households on floating rates, the more leverage the RBNZ has and the less tightening they need to do, which in turn will see more people opt for the cheaper floating rate.



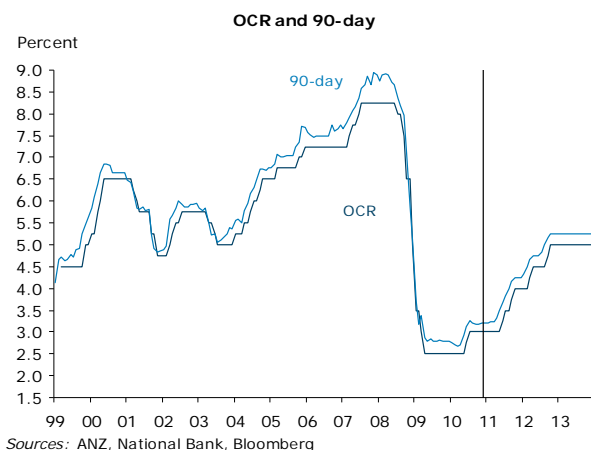
- **Consumers' and businesses' appetite for debt.** The RBNZ noted in the December *Statement* that "current low interest rates are having a less stimulatory effect than in the

## INTEREST RATES

past." With the deleveraging dynamic having further to run, households are taking advantage of low interest rates to pay down debt faster, rather than take more debt on. So long as this attitude remains, the RBNZ can leave rates low.

- **How quickly the fiscal position returns to surplus.** The fiscal stance is stimulatory to the tune of 1.5 percent of GDP in the 2010/11 year, but is set to turn contractionary the following year. The Half Year Economic and Fiscal Update 2010 flagged a tighter fiscal rein at the margin, with the Government now including items that were previously excluded from their \$1.12bn per annum operating allowance at each Budget. The commitment to return to surplus as soon as possible also suggests that any upside surprises in tax revenue will be used for deficit reduction, rather than spending. On the face of it, this should provide support to monetary policy by allowing the RBNZ to tighten less.

**Our core OCR view is for three 25bp moves starting in June 2011, followed by a pause as the RBNZ assesses the impact of this tightening.** By then, touch wood, the economic recovery will be in full flight, and further increases in the OCR will take place over 2012 until it reaches 4.75 percent. We do not foresee more aggressive moves at this point, partly because of the traction that monetary policy has with the high proportion of mortgages on floating. But it remains a risk and we cannot rule it out completely. As we have stated before, historical experience has taught us that tightening cycles almost always end up being more aggressive than initially envisaged, as policymakers seek to get to neutral and beyond quickly. For now, monetary policy looks like it will be getting some assistance from fiscal policy, as well as prudential policy (including the core funding ratio), allowing for more measured moves.

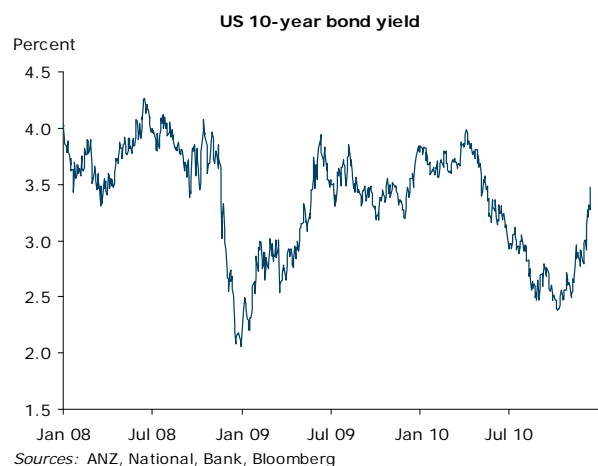


### HIGHER GLOBAL RATES

**Global interest rates will be heading higher next year, though not all of it courtesy of central bank action.** We expect Asian central banks to continue tightening as they seek to bring inflation pressures down. In Australia, the RBA is on hold for now but we see them coming back to the hiking table in April next year. The picture is different in the US and Europe, where weak growth and high unemployment mean the US Federal Reserve and ECB will be leaving their policy rates unchanged throughout next year. Indeed, the US Federal Reserve has provided more stimulus this year via a second round of quantitative easing.

**However, the major development for next year could well be what happens to long-end bonds.** Policymakers can control the front end of the curve, but they have less influence over the back end. Despite committing to a period of exceptionally low interest rates, the market is jittery over any signs of stronger growth that could trigger inflation. This has seen US 10-year bond yields rise sharply since the US Federal Reserve announced QE2 in early November. In addition, increasing concerns over sovereign debt has seen the market pricing in a larger risk premium, pushing long-end yields higher.

**Higher global long-end yields will flow through into NZ.** Given the high correlation between the NZ and US bond curve, we can expect NZ bond yields to move in tandem with rising global yields. While strictly speaking contractionary, this will help keep the NZ curve steep, which, by encouraging people to remain on floating mortgages, will allow the RBNZ to be more accommodative. The extent to which NZ yields follow offshore will also depend on the Government returning to surplus as soon as possible in order to differentiate NZ from other sovereigns that are being singled out by investors.



# INTEREST RATES

## INTEREST RATE FORECAST (END OF QUARTER)

Quarter	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
Dec-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
<b>Dec-10</b>	<b>3.00</b>	<b>3.2</b>	<b>3.9</b>	<b>4.7</b>	<b>5.6</b>	<b>2.5</b>	<b>5.2</b>
Mar-11	3.00	3.2	4.4	5.1	5.6	2.6	5.3
Jun-11	3.25	3.7	4.8	5.6	5.9	2.9	5.6
Sep-11	3.75	4.0	5.0	5.8	5.9	3.1	5.8
<b>Dec-11</b>	<b>3.75</b>	<b>4.0</b>	<b>5.1</b>	<b>5.8</b>	<b>5.9</b>	<b>3.2</b>	<b>5.7</b>
Mar-12	4.00	4.4	5.2	5.9	5.8	3.4	5.7
Jun-12	4.25	4.5	5.3	5.9	5.8	3.5	5.7
Sep-12	4.50	4.9	5.5	6.0	5.8	3.5	5.7
<b>Dec-12</b>	<b>4.75</b>	<b>5.0</b>	<b>5.6</b>	<b>6.0</b>	<b>5.8</b>	<b>3.5</b>	<b>5.7</b>
Mar-13	4.75	5.0	5.6	6.0	5.8	3.5	5.7
Jun-13	4.75	5.0	5.6	6.0	5.8	3.9	5.8
Sep-13	4.75	5.0	5.6	6.0	5.8	3.9	5.8
<b>Dec-13</b>	<b>4.75</b>	<b>5.0</b>	<b>5.6</b>	<b>6.0</b>	<b>5.8</b>	<b>3.9</b>	<b>5.8</b>

## ECONOMIC FORECASTS

	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
<b>Real Gross Domestic Product</b>												
Total GDP, QPC	0.5	0.2	-0.1	0.5	0.8	1.0	1.7	1.5	0.1	0.4	0.4	0.5
Total GDP, APC	1.9	1.9	1.6	1.1	1.4	2.2	4.1	5.1	4.4	3.7	2.4	1.4
Total GDP, AAPC	-0.4	0.7	1.5	1.6	1.5	1.6	2.2	3.2	4.0	4.3	3.9	2.9
<b>Real GDP Components</b>												
Private Consumption, QPC	0.4	0.1	0.7	0.0	0.3	0.5	0.9	0.5	0.1	0.3	0.4	0.4
Private Consumption, AAPC	0.5	1.5	2.0	2.1	1.7	1.5	1.4	1.6	1.9	1.9	1.8	1.6
Public Consumption, QPC	1.7	0.5	0.5	0.3	0.4	0.4	0.8	0.8	0.5	0.4	0.4	0.4
Public Consumption, AAPC	1.2	1.9	2.6	3.2	3.1	2.6	2.1	1.9	2.1	2.3	2.4	2.2
Residential Investment, QPC	1.4	11.1	-5.5	-3.0	1.9	4.8	4.8	2.9	1.5	1.0	1.9	2.4
Residential Investment, AAPC	-11.7	-2.6	5.7	6.8	8.1	3.9	3.3	6.2	8.9	12.2	11.8	9.7
Other Investment, QPC	-0.3	4.7	3.0	-0.3	2.4	3.0	2.9	2.7	1.2	0.8	0.9	1.0
Other Investment, AAPC	-9.9	-6.2	-2.3	2.2	5.6	7.8	8.4	9.4	9.5	9.4	8.7	6.9
Gross National Expenditure, QPC	0.7	-0.2	1.7	0.6	1.1	1.3	1.4	1.2	0.5	0.8	0.6	0.6
Gross National Expenditure, AAPC	-3.2	-0.2	2.7	3.6	3.7	3.9	3.7	4.3	4.6	4.5	4.2	3.5
Exports, QPC	1.2	1.3	-1.2	2.0	1.9	2.5	3.6	2.5	0.3	0.7	1.3	1.2
Exports, AAPC	3.0	3.8	3.4	3.1	2.8	3.4	5.8	7.7	9.0	9.4	8.0	6.2
Imports, QPC	1.6	0.6	2.6	2.4	2.6	3.1	2.6	1.8	1.0	1.6	1.6	1.4
Imports, AAPC	-9.6	-1.4	5.6	8.6	9.1	9.5	9.6	10.3	10.3	9.3	8.1	6.9
<b>Prices</b>												
Headline CPI, QPC	0.4	0.2	1.1	2.4	0.6	1.0	0.8	0.5	0.5	0.7	0.6	0.6
Headline CPI, APC	2.0	1.7	1.5	4.1	4.4	5.2	4.9	2.9	2.8	2.5	2.3	2.4
Non-tradable CPI, QPC	0.5	0.6	1.2	2.5	1.0	0.9	1.0	0.8	1.0	0.8	0.7	0.7
Non-tradable CPI, APC	2.1	2.2	2.5	5.0	5.5	5.8	5.6	3.8	3.8	3.7	3.4	3.3
Tradable CPI, QPC	0.1	-0.3	0.9	2.3	0.2	1.1	0.5	0.2	-0.2	0.5	0.5	0.4
Tradable CPI, APC	2.0	1.0	0.3	3.0	3.1	4.5	4.1	2.0	1.6	1.1	1.1	1.3
<b>External Accounts</b>												
Annual Balance on Goods, % of GDP	1.4	1.6	1.8	2.3	2.6	2.8	3.1	3.2	3.2	3.0	2.8	2.6
Annual Balance on Services, % of GDP	0.1	0.0	-0.1	-0.1	-0.2	-0.1	0.0	0.3	0.4	0.5	0.5	0.4
Annual Balance on Invisibles, % of GDP	-3.8	-4.7	-4.8	-4.6	-5.0	-5.1	-6.1	-6.2	-6.2	-6.1	-6.1	-6.1
Annual Current Account Balance, % of GDP	-2.4	-3.0	-3.1	-2.4	-2.6	-2.4	-3.0	-2.7	-2.6	-2.6	-2.8	-3.1
Net International Invt Position, % of GDP	-85.9	-86.4	-85.0	-84.2	-83.5	-82.5	-81.1	-79.7	-78.8	-78.3	-78.3	-78.5
<b>Terms of Trade (SNA basis)</b>												
Export Prices, QPC	7.4	3.5	0.0	4.0	6.1	1.8	0.4	-0.6	-0.5	-0.6	-0.1	0.0
Export Prices, APC	-8.4	4.2	10.2	15.6	14.1	12.3	12.8	7.8	1.1	-1.3	-1.9	-1.2
Import Prices, QPC	3.3	2.6	-2.9	1.5	4.5	0.4	0.0	-0.4	0.0	-0.2	0.5	0.6
Import Prices, APC	-11.0	-5.3	-1.0	4.4	5.6	3.3	6.4	4.5	0.0	-0.6	-0.1	0.9
Terms of Trade, QPC	4.0	0.9	3.0	2.5	1.5	1.4	0.5	-0.3	-0.5	-0.4	-0.6	-0.6
Terms of Trade, APC	2.9	10.0	11.3	10.8	8.1	8.6	6.0	3.2	1.1	-0.7	-1.8	-2.1
<b>Labour Market</b>												
Employment, QPC	1.0	-0.2	1.0	0.2	0.3	0.4	0.6	0.7	0.5	0.4	0.3	0.3
Employment, APC	-0.1	0.0	1.8	2.0	1.3	1.9	1.5	2.0	2.2	2.2	1.9	1.5
Labour Force, QPC	-0.1	0.7	0.5	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.4
Labour Force, APC	0.9	0.9	1.7	1.3	1.8	1.4	1.2	1.3	1.3	1.3	1.3	1.4
Unemployment Rate, sa	6.0	6.9	6.4	6.5	6.5	6.4	6.1	5.8	5.6	5.6	5.6	5.6
Participation Rate, sa	68.0	68.1	68.2	68.3	68.3	68.3	68.3	68.3	68.4	68.4	68.4	68.5
Private Sector Wages (apc)	1.6	1.4	0.7	1.6	2.5	2.4	2.0	2.2	2.4	2.7	2.9	3.1
Public Sector Wages (apc)	3.7	3.9	1.7	1.7	1.6	1.1	1.4	1.5	1.8	2.3	2.3	2.5

Forecasts in bold

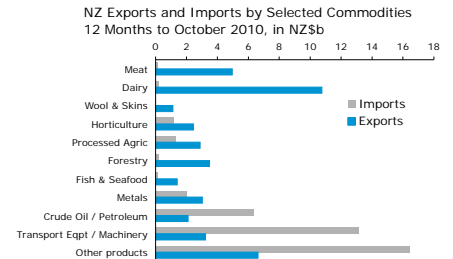
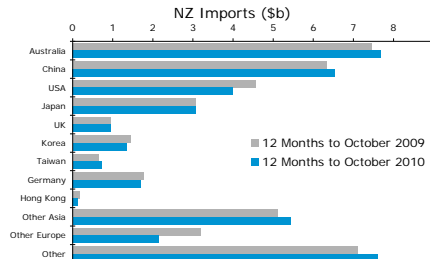
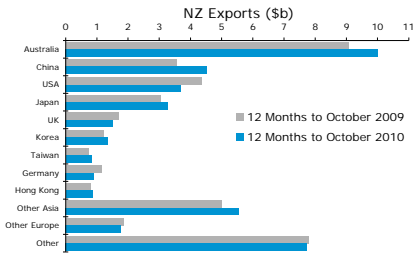
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

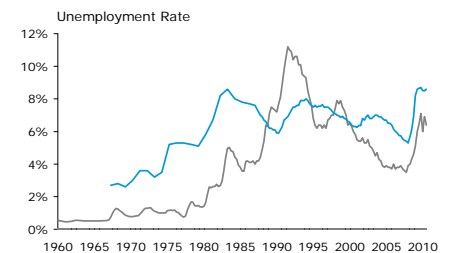
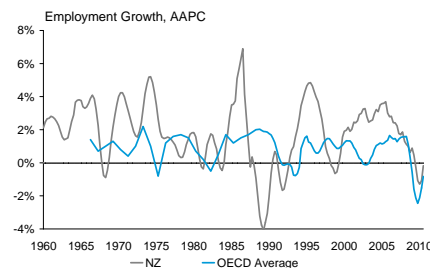
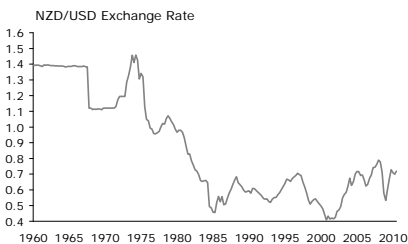
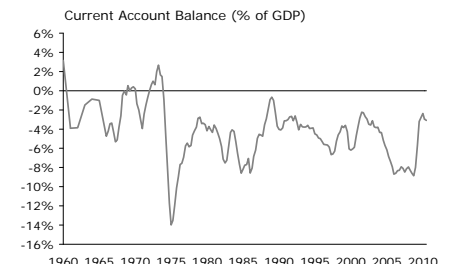
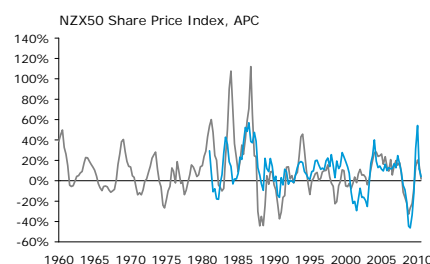
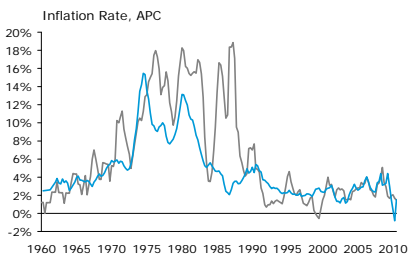
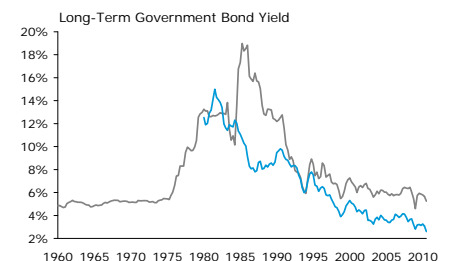
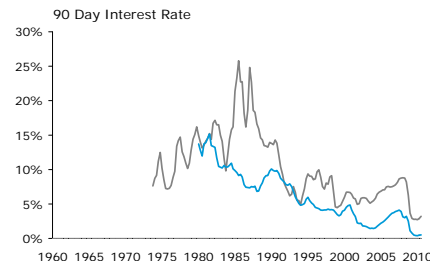
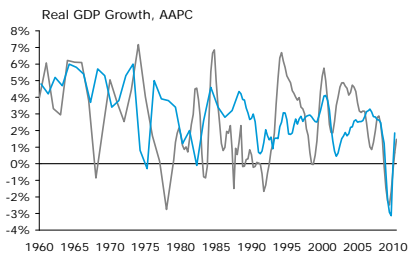
sa – seasonally adjusted

# KEY ECONOMIC INDICATORS



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

	NZ	Australia	USA	Japan	UK	China	Germany	South Korea	Taiwan	Malaysia	Hong Kong	Singapore	Indonesia
Population, in millions	4.3	22.1	308.6	127.7	61.3	1,368	82.1	51.4	22.9	25.7	7.1	4.6	257.7
Area in 1,000 km <sup>2</sup>	271	7,713	9,373	378	244	9,561	357	92	36	330	1	1	1,905
Inhabitants per km <sup>2</sup>	15.7	2.9	32.9	338.0	251.1	143.1	230.2	557.5	636.1	77.9	7,130	4,600	135.3
GDP, in billion NZ\$	189	1,423	20,095	7,148	3,107	7,233	4,748	1,193	539	276	302	261	781
Change in real terms (yr-on-yr %)	0.7	2.7	2.2	3.0	0.3	10.6	3.9	6.4	11.5	7.1	5.9	12.8	5.8
Nominal GDP per capita in NZ\$	44,352	65,941	66,762	57,638	49,915	5,729	59,815	25,587	25,742	10,404	44,486	59,248	3,470
NZ exports to ..., NZ\$ million (FOB)	n/a	9,298	3,522	2,835	1,610	3,800	1,022	1,279	791	720	788	1,194	972
Share of NZ Exports (%)	n/a	23.5	8.9	7.2	4.1	9.6	2.6	3.2	2.0	1.8	2.0	3.0	2.5
NZ imports to ..., NZ\$million (VFD)	n/a	7,559	4,222	2,659	946	6,029	1,644	1,455	676	1,192	139	1,415	659
Share of NZ Imports (%)	n/a	19.0	10.6	6.7	2.4	15.2	4.1	3.7	1.7	3.0	0.3	3.6	1.7
Current Account balance (% of GDP)	-3.0	-4.3	-3.0	3.7	-1.6	6.2	5.3	4.1	10.9	14.5	6.0	22.5	1.6



## 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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