NEW ZEALAND ECONOMICS
ANZ ECONOMIC OUTLOOK

SEPTEMBER 2014

INSIDE

Key Economic Forecasts 2
NZ Economic Outlook 3
Global Outlook 7
Commodity Prices 8
Labour Market 9
Fiscal Policy 10
Inflation 11
Exchange Rate 12
Interest Rates 15
Economic Forecasts 18
Key Economic Indicators 19

NZ ECONOMICS TEAM

Cameron Bagrie
Chief Economist
Telephone: +64 4 802 2212
E-mail: Cameron.Bagrie@anz.com

David Croy
Head of Global Markets Research, NZ
Telephone: +64 4 576 1022
E-mail: David.Croy@anz.com

Mark Smith
Senior Economist
Telephone: +64 9 357 4096
E-mail: Mark.Smith2@anz.com

Sharon Zöllner
Senior Economist
Telephone: +64 9 357 4094
E-mail: Sharon.Zollner@anz.com

Carrick Lucas
Strategist
Telephone: +64 4 802 2357
E-mail: Carrick.Lucas@anz.com

Steve Edwards
Economist
Telephone: +64 9 357 4065
E-mail: Steve.Edwards@anz.com

Con Williams
Rural Economist
Telephone: +64 4 802 2361
E-mail: Con.Williams@anz.com

Sam Tuck
Senior FX Strategist
Telephone: +64 9 357 4086
E-mail: Sam.Tuck@anz.com

SWINGS AND ROUNDABOUTS

NEW ZEALAND ECONOMIC OUTLOOK

Talk of a "downturn" following a growth peak is unjustified; the cycle is simply maturing from strong growth off lows, to moderate growth off good levels. There are more risks to manage at this juncture but we're still picking a solid outlook over the years ahead (3.0% growth for calendar 2015), and a better trend that the business cycle will invariably oscillate around.

GLOBAL OUTLOOK

It's a fractured global economy. The US economy is strengthening. Conversely, prospects in Europe are subdued and more questions are being asked of China's outlook. Low interest rates have helped plaster over many cracks, but question marks remain over the sustainability of the expansion. We've pencilled in modest growth but we look set for heightened volatility.

COMMODITY PRICES

The outlook for in-market prices has turned increasingly precarious for more sectors in recent months. Forestry and dairy have had notable downward adjustments, but others also look to have done their dash. On the dairy front we have cut our 2014/15 milk price to $5.25/kg MS, but remain optimistic there will be a better outcome of $6.50 kg MS in 2015/16.

LABOUR MARKET

The labour market recovery is broadening, although clear disparities across regions and sectors remain. Encouragingly, the supply side is also stepping up. The unemployment rate is likely to drift down to the low 5s over the forecast horizon. We are assuming coming wage increases will largely be matched by improvements in productivity – a critical factor in prolonging the expansion.

FISCAL POLICY

The fiscal accounts are headed back into the black but there's limited headroom for a sizeable spend-up. That's classic countercyclical fiscal policy in operation, which helps take pressure off the RBNZ. We take comfort from the broad consensus across the political spectrum with regards to prudent fiscal management.

INFLATION

By traditional metrics the economy should be facing an inflation challenge by now. It's not, with a host of temporary and more enduring influences expected to keep annual inflation below 2% for at least the next year. Our expectation is that outcomes over the next few years will hover around the inflation target midpoint.

EXCHANGE RATE

The NZ dollar is losing its shine but we can't foresee a dramatic fall; the growth outlook is reasonable and it's the highest yielding of the 10 most-traded free-floating currencies. With the FOMC set to shift stance, the USD's allure will return. We expect NZD/AUD to remain above long-run averages.

INTEREST RATES

The OCR is on hold but we're expecting further tweaks higher over the coming two years. However, there is a fair degree of uncertainty. The US Fed and Europe's ECB are having contrasting impacts on global long yields; we do not expect a strong trend higher. NZGS will continue to outperform their global counterparts.

KEY ECONOMIC FORECASTS

Calendar Years	2011	2012	2013	2014(f)	2015(f)	2016(f)	2017(f)
NZ Economy (annual average % change)							
Real GDP	1.9	2.5	2.8	3.6	3.0	2.6	2.6
Employment	0.7	1.6	0.5	1.6	3.2	1.6	1.0
Unemployment Rate (Dec qtr)	6.4	6.8	6.0	5.4	5.4	5.3	5.2
Terms of trade (SNA basis)	3.2	-3.3	7.6	5.5	-4.1	-2.2	0.7
Global Growth (annual average % change)							
US	1.6	2.3	2.2	2.3	3.1	2.7	2.5
Eurozone	1.6	-0.6	-0.4	1.0	1.8	2.0	1.8
Australia	2.6	3.6	2.4	3.2	3.2	3.4	2.8
Japan	0.3	0.3	1.7	1.7	1.8	2.0	1.5
China	9.3	7.8	7.7	7.5	7.3	7.0	7.0
Trading Partners	3.4	3.1	3.1	3.9	4.1	3.8	3.6
NZ Inflation (annual % change)							
CPI Inflation	1.8	0.9	1.6	1.3	1.8	2.3	2.1
Non-tradable Inflation	2.5	2.5	2.9	2.8	2.8	3.3	3.0
Tradable Inflation	1.1	-1.0	-0.3	-0.5	0.4	0.9	1.1
NZ Financial Markets (end of December quarter)							
TWI	69.3	74.4	77.3	77.5	71.9	70.0	
NZD/USD	0.78	0.82	0.82	0.80	0.75	0.73	
NZD/AUD	0.76	0.80	0.92	0.91	0.87	0.87	
Official Cash Rate	2.50	2.50	2.50	3.50	4.25	4.75	
90-day bank bill rate	2.7	2.7	2.8	3.8	4.7	5.0	
10-year bond rate	3.8	3.5	4.7	4.6	5.0	5.1	
Fiscal and External Balance							
Current Account Balance ($bn)	-5.9	-8.5	-7.2	-7.6	-14.1	-14.5	-14.5
as % of GDP	-2.9	-4.1	-3.3	-3.3	-5.9	-5.8	-5.5
Government OBEGAL ($bn)*	-18.4	-9.2	-4.4	-2.6	0.3	0.8	1.9
as % of GDP	-9.2	-4.4	-2.1	-1.1	0.1	0.3	0.7

*Operating balance excluding gains and losses, June years. Forecasts and text finalised 22 September 2014.

KEY FORECAST ASSUMPTIONS:

- The NZD is assumed to ease to 80 US cents by the end of 2014 and to 73 US cents by late 2016. The NZD TWI is projected to ease to around 70 by late 2016.
- Net annual permanent and long-term (PLT) migration inflows are assumed to peak at around 50,000 persons over late 2014/early 2015, and taper off progressively over the projection period, ending 2017 slightly below 20,000 persons.
- The value of earthquake reconstruction work is equivalent to $40bn in 2013 dollars. This will be spread across residential ($20bn), commercial and social assets ($15bn), and infrastructure ($5bn). More than 50% this work is assumed to be completed by the end of 2017. The economic impact will be partly diluted by contractionary fiscal policy, equivalent to around 2.4% of GDP over the projection period.
- Dubai oil prices are assumed to trade within a USD95 to USD115 per barrel range over the forecast period.
- Potential growth is expected to remain around 2¾-3% in the early part of the projections and around 2¾% over the medium-term.
- Average bank funding costs (as opposed to marginal funding costs) are assumed to continue to gradually decline from current levels. This will push the neutral OCR from around 4¼-4½% at present towards the 4½-4¾% zone by the end of the projection period.

ANZ

NEW ZEALAND ECONOMIC OUTLOOK

SUMMARY

Talk of a "downturn" following a growth peak is unjustified; the cycle is simply maturing from strong growth off lows, to moderate growth off good levels. There are more risks to manage at this juncture but we're still picking a solid outlook over the years ahead (3.0% growth for calendar 2015), and a better trend that the business cycle will invariably oscillate around.

OUTPERFORMING

We forecast the New Zealand economy to grow 3.6% in calendar 2014 and 3.0% the following year. That's a remarkable performance in the global context. Admittedly we can't – or wouldn't want to – take the credit ourselves as a nation for some of the drivers, including a once-in-a-generation terms of trade boost and an earthquake rebuild – but there is plenty for New Zealanders to be justifiably chuffed about. New Zealand has tidied up its act. Debt is a much lower share of GDP than it was during the GFC, and the pool of labour is growing. Along with signs we are also working smarter, these factors are setting the nation up for a period of stronger trend growth in the years ahead. Inflation is expected to remain well contained. Global deflationary forces and a still-high NZD have played a role, but so too has larger supply side capacity, with improving productivity holding the key to boosting living standards.

Of course, the economic cycle around the trend matters too, particularly for those at the sharper edges of the economy. That **cycle is now maturing from strong growth rates off lows, to moderate growth off good levels. That's not a bad thing.** Indeed, it has been partly prompted by policy settings. After a certain point, additional cyclical growth comes with an associated build-up in nasty imbalances, necessitating a bust later. The New Zealand economy appears to have pulled up short of a boom-bust scenario, and that's a positive for the medium-term outlook.

There are good reasons why the economy will slow from here, but also good reasons why it is unlikely to fall into a hole. We take a look at the known positives and negatives in turn, and then discuss the risks to the outlook on both sides.

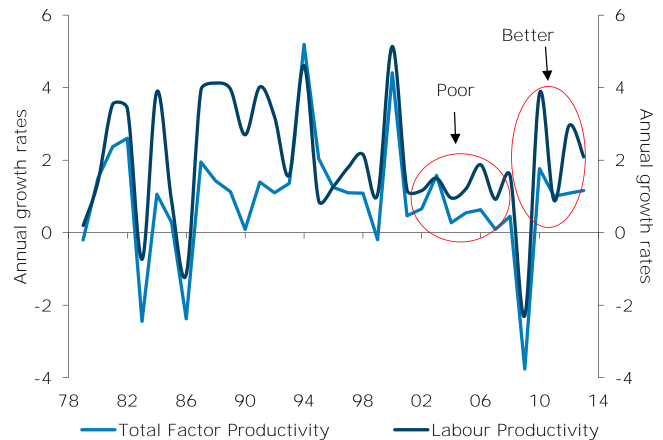
THE GLASS IS HALF FULL

Optimists will find plenty to be positive about.

- **Moderate growth is a good thing.** A boom-bust scenario is not in anyone's interest. The economy has a nice "Goldilocks" feel at present – good growth and low inflation. That's the stuff enduring economic expansions are made of.
- **Anecdotes and, increasingly, the data, support the notion that the economy is "fighting fit"** – firms are leaner, and are investing and employing to becoming more productive, with higher trend growth leaving the New Zealand economy well placed. Despite this, resource bottlenecks and skill shortages remain in some pockets of the economy.

FIGURE 1. PRODUCTIVITY MEASURES

Measured sector, New Zealand

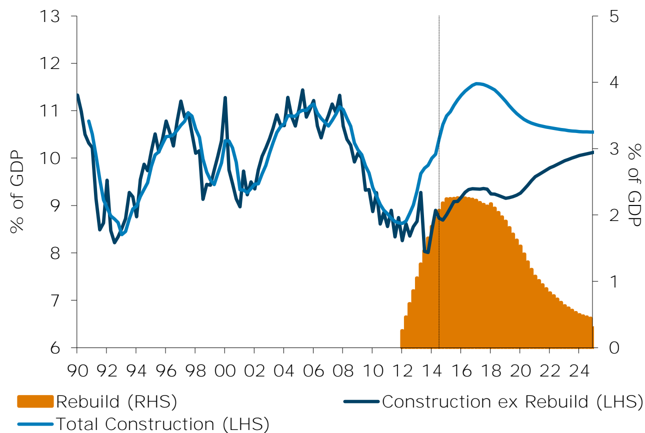


Source: ANZ, Statistics NZ

- **A period of deleveraging has helped,** with net external debt at 62% of GDP, well below its 86% peak during the GFC. **Household spending is increasingly being supported by rising labour incomes** rather than the 'borrow and spend' mentality of old. The household saving rate, while negligible, is on the right side of zero. Borrowing growth continues to undershoot the growth in incomes, with the household sector in aggregate no longer using housing equity to fund consumption. We still have our points of vulnerability (overvalued houses for instance, along with a strong reliance on offshore funding), but **we don't have the build-up of collective imbalances that are typical precursors to an economic cleanout.** Inflation is low, banks have more long-term funding in place, and the fiscal position is sound.
- **The Christchurch rebuild stimulus will ease over the next year or two** (in terms of its contribution to growth), **but this will free up resources that can be deployed elsewhere.** As construction cost inflation eases, other projects will become more economic. The pipeline of construction growth around the country remains strong. **We expect construction to peak as a share of GDP in late 2016/early 2017.** Other sectors such as manufacturing are also benefiting.

NEW ZEALAND ECONOMIC OUTLOOK

FIGURE 2. CONSTRUCTION SHARE OF GDP



Source: ANZ, Statistics NZ, RBNZ

- **The foot is gradually coming off the fiscal brake.** Tax cuts are being mooted and commitments in upcoming Budgets have been raised a tad. Current Treasury and Reserve Bank forecasts suggest the direct impact from lessening stimulus from the rebuild effort and the weakening headwind from fiscal policy will more or less offset each other in the years ahead.

- **The long-run positive global food story is independent of supply cycles and market disruptions.** A growing middle class across Asia is "westernising" and enriching their diets, demanding ever more protein. New Zealand is well placed to tap into those opportunities. Massive inroads into the fast-growing Asian region continue to be made.

- **Outside of dairy and forestry, commodity prices remain buoyant,** although prices for many of these commodities appear to have done their dash, with limits to how much further they can go without facilitating a more aggressive supply response. **New Zealand's terms of trade remain elevated**.

- **Net migration is on track to hit 50,000 people by the end of the year.** That would be a record high, adding more than 1% to the resident population. That's a hefty stimulus, and will put a floor under the housing market and retail as well as boosting supply-side capacity. The fact that 60% of the turnaround in migration is coming from fewer departures also tells us something about the economic vibe; people are staying in New Zealand because they can see upside.

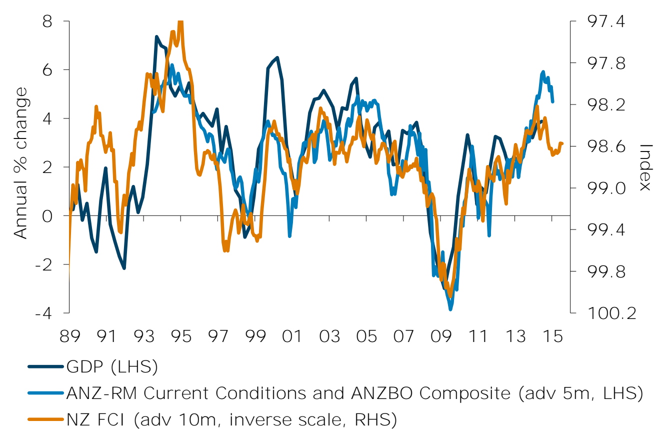
- **Thinking small to stand tall.** There is a swathe of microeconomic initiatives around the country adding to the country's economic muscle – the likes of a relaxed evening curfew on night flights into Queenstown, for instance. Sometimes we get too caught up in the big picture stuff and lose track of small things that are more controllable and really add up to a big impact.

- **Inflation is low.** The RBNZ may have hiked 100bps but they're now in cruise control.

- **Financial conditions are tighter than they were 12 months ago but are still flagging around 3%+ growth going forward.**

- The falls in **business and consumer confidence** have hit the headlines but the **levels remain consistent with unrealistically high growth.** Lack of demand is clearly not a problem.

FIGURE 3. ANZ CONFIDENCE COMPOSITE AND GDP



Source: ANZ, Statistics NZ

THE GLASS IS HALF EMPTY

Pessimists can also find plenty to talk about.

- **Having arrived early, the dairy sector is now looking like it will be one of the first to leave the party**, with GlobalDairyTrade prices having nearly halved since February. This will have a marked impact on spending in the regions, with farmers set to cut both investment and discretionary spending. **The $5bn+ hit to dairy incomes will hurt rural regions and the wider economy, putting a significant dent in household incomes over the next year or so**.

- **The NZD is well off its peaks but is adjusting downward only slowly**, making life hard for exporters and import-competing firms. Prospects for interest rates to remain low around the globe mean the NZD will remain disconnected with local fundamentals for a little longer yet.

- **Despite recent improvement, debt levels across the economy are still high**, limiting borrow-and-spend options.

NEW ZEALAND ECONOMIC OUTLOOK

- **Fiscal policy is still contractionary**, and will remain significantly so for a year or so yet.
- While US growth is continuing to improve, **growth in China and Europe is faltering**. Australia continues to make hard work of transitioning into a post mining boom economy.

THE GLASS MAY OVERFLOW…

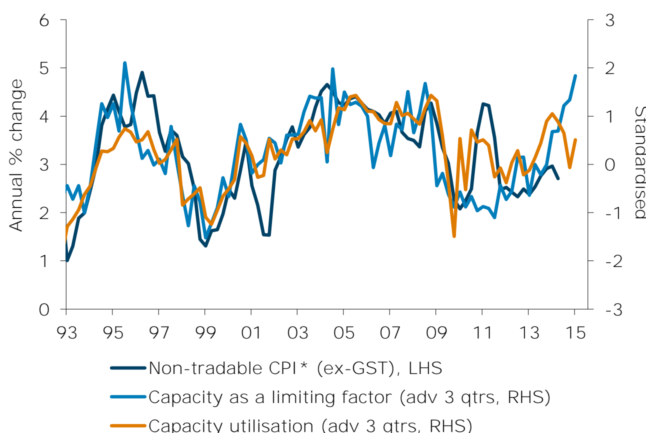
Strong growth across the economy typically fuels inflation, OCR hikes and an untimely end to the expansion. That doesn't mean the RBNZ are party-poopers; rather in prior cycles they've probably let the expansion run too far, too fast, necessitating a more extreme clamp-down.

Inflation has been behaving a bit oddly this time around. Pricing intentions, capacity constraints, output gap estimates – all suggest that an inflation issue should be emerging about now. But it isn't. The Reserve Bank is starting to put some weight on the possibility that it won't, as are we. But as always, "this time it's different" assumptions carry a risk that it will in the end turn out to be exactly the same.

Four obvious risks include:

- **Capacity metrics suggest increasing resource pressure is around the corner.** Yet we are now forecasting CPI inflation to be under 1.5% for the remainder of the year.

FIGURE 4. CAPACITY UTILISATION AND INFLATION



Source: ANZ, NZIER

- **Strengthening migration would ordinarily be the recipe for the housing market going into overdrive.** Pockets of strength remain, but on a nationwide basis the housing market appears to be under control, with the LVR restrictions, 100bps of OCR rises, and stretched affordability seemingly winning the tug of war. Nonetheless, the RBNZ will remain wary of declaring victory prematurely.
- **The labour market is strengthening, and wages may rise more than expected.** Sharply higher labour force participation and the migration-assisted boost to labour supply have helped to put a lid on wage inflation, but it is picking up.
- **The suppressing influence on inflation from a high NZD unwinds as the TWI corrects lower** and – hey presto – suddenly headline inflation is close to 3%. It's a risk but while we forecast the NZD a bit lower we see it remaining elevated; and we should also note that part of the reason for the decline, weaker commodity prices, are inflation suppressants.

We're paying homage to all possibilities, but our central scenario involves modest rates of inflation (refer page 11), and in that environment the RBNZ does not have to be heavy-handed (page 15).

… OR THE GLASS MAY BREAK

New Zealand has enjoyed the unusual status of a "safe haven" in global markets over recent years due to the fact that we hooked ourselves to the China train, which has barrelled on in the years since the global financial crisis. Our normal status is that of a small cork in a large global ocean, as epitomised by the fact that our currency is typically traded as a proxy for risk. Perhaps not surprisingly then, the main downside risks to the economy emanate from offshore.

- **Global financial markets look vulnerable to a sharp reality check** as the US Federal Reserve inches ever closer to normalising monetary policy. While the US economy is looking robust, question marks hang over the ability of some emerging markets to weather a reversal of the capital inflows they have seen as the QE wall of cash has sought higher returns than have been available in the US.
- **Our projections assume the goods terms of trade (SNA basis) will fall approximately 8% from current levels,** but will end the projection period around 20% above historical averages. **Much of the projected fall is due to dairy, which remains the wild card.** Dairy prices are being pushed down by a combination of increased supply, Russian sanctions pushing EU production onto the broader global markets, and less positive signs in China. As always, the freely floating NZD remains the nation's safety valve.

We also have a homegrown risk – **house prices remain overvalued relative to both incomes and rents**, and there is a chance that the current moderation could turn into a rout. However, as long as

NEW ZEALAND ECONOMIC OUTLOOK

migration remains high it is difficult to foresee a situation of marked oversupply emerging.

Moreover, while we're respectful of various **structural deficiencies** (weak balance sheet, high leverage in pockets, low savings rate), we simply **don't appear to have the degree of vulnerability across these gauges that foretells of serious corrections**, which can quickly manifest into downturns.

OUR CENTRAL SCENARIO – GLIDE PATH

Forecasting is a tough business, as the risks discussed above highlight.

Growth is certainly slowing, and more risks are manifesting in some sectors (i.e. dairying). But this moderation needs to be put in perspective. **The economy is transitioning from bouncing off lows to less stellar growth but off a higher level. Resource availability (i.e. labour) is currently as relevant as demand itself.**

We conclude with a summary of our take on the default path for the economy in the years ahead and some key observations.

- **Real annual GDP growth** peaks at 3.6% in 2014 (annual average change) **but is still 3% next year,** and around 2.5% in the next two years.
- **Employment growth moderates:** 3.2% this year, 1.6% in 2015, and 1% in 2017, with the unemployment rate falling into the low 5% zone. Despite moderating employment growth, finding the right people for the job will get more difficult.
- **There is a strong investment-centricity across the forecasts** – both business and residential.
- **We've pencilled in a modest pace of consumption.** We believe the change in consumers' spending patterns is more structural than transitory. It's a key assumption. If a construction boom is to be absorbed without generating across-the-board inflation, consumption needs be restrained.
- Courtesy of the falling terms of trade and the domestic demand nature of the expansion, New Zealand's annual merchandise trade balance is expected to move into deficit by the end of the year and to remain there for much of the projection period. This sees **the current account deficit widen from around 2.5% at the start of the projection period to above 5% over the latter part.**

NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual % change)	2011	2012	2013	2014(f)	2015(f)	2016(f)	2017(f)
Total Consumption	**2.3**	**1.9**	**2.8**	**2.8**	**2.2**	**2.0**	**2.2**
Private Consumption	2.7	2.9	3.3	2.8	2.8	2.3	2.6
Public Consumption	0.7	-1.4	1.0	2.4	0.2	0.6	0.8
Total Investment	**2.8**	**7.1**	**9.6**	**7.9**	**7.4**	**4.3**	**3.0**
Residential investment	-1.0	15.6	17.3	18.8	11.8	6.3	0.7
Other investment	3.7	5.6	8.1	5.6	6.3	3.7	3.6
Stockbuilding[1]	**0.2**	**0.2**	**-0.1**	**0.7**	**0.0**	**0.1**	**0.0**
Gross National Expenditure	**2.4**	**2.9**	**3.9**	**4.6**	**3.6**	**2.6**	**2.4**
Total Exports	**3.3**	**1.8**	**1.1**	**3.1**	**2.0**	**2.9**	**3.2**
Goods	3.2	3.8	1.1	3.0	2.2	2.9	3.1
Services	3.6	-4.3	0.9	3.5	1.4	3.0	3.6
Total Imports	**2.0**	**2.8**	**6.1**	**7.3**	**3.8**	**2.5**	**2.0**
Goods	2.0	3.6	6.5	8.3	4.5	2.6	2.0
Services	2.0	0.1	5.0	4.5	1.6	2.1	2.0
Expenditure on GDP	**2.8**	**2.6**	**2.5**	**3.2**	**3.1**	**2.7**	**2.8**
GDP (production based)	**1.9**	**2.5**	**2.8**	**3.6**	**3.0**	**2.6**	**2.6**

[1] Percentage point contribution to growth

ANZ

GLOBAL OUTLOOK

SUMMARY

It's a fractured global economy. The US economy is strengthening. Conversely, prospects in Europe are subdued and more questions are being asked of China's outlook. Low interest rates have helped plaster over many cracks, but question marks remain over the sustainability of the expansion. We've pencilled in modest growth but we look set for heightened volatility, particularly with prospective higher interest rates in the US expected to impact more negatively on some former emerging market darlings.

MOVING APART

Policy support is substantial. Central bank policy rates remain sub 1% in nations accounting for two-thirds of global GDP. The US might be winding back QE, but Japan is stepping it up, and prospects are for the ECB to engage as well. Financial conditions are incredibly supportive all round.

Despite record stimulus, recent dataflow has highlighted the uneven nature of global expansion. The US economy is strengthening, Europe is flat-lining, China is slowing, and Australia is just muddling along.

There are real tensions. In aggregate, world growth is actually okay; the mix is just different – more from the East and less from the West (OECD). Asset prices remain well bid; that's natural when interest rates are so low. Interest rate-sensitive pockets in some economies are responding; liquidity traps remain in others. Debt burdens are not being addressed in key sovereigns (Europe) and the pricing of risk – credit spreads – is back to pre-GFC levels.

US interest rates – a global bellwether for the global cost of capital and asset valuations – **are increasingly at odds with economic developments.** Inflation is settling around 2% and the unemployment rate is trending down. The FOMC will not be able to maintain dovish overtures for long.

Ironically, while lifts in interest rates are welcome (they are reflective of a better US economy and will dent the NZD) – **it'll present considerable challenges going forward**. The New Zealand (RBNZ) experience is that interest rates don't need to move up too much to get the desired impact in the modern era; the world still has considerable leverage. Emerging markets darlings who have leveraged heavily in the low interest rate environment will come under the spotlight. Liquidity trumps fundamentals when interest rates are low, but we gravitate to the latter when the global cost of capital moves up; asset prices should take note.

We've pencilled in moderate growth around the globe, but there is a fair bit of hand-wringing in that. Across the key regions we expect:

- **Underlying robustness to the US outlook.** Corporate balance sheets are strong, the household sector has deleveraged, and employment and labour incomes are picking up.
- **Subdued activity in the Eurozone.** Growth (a necessary condition for solvency) remains absent, with little mettle to drive microeconomic reform. Monetary policy can only do so much.
- **Moderate growth in Australia. The RBA has stimulated the interest-sensitive sectors and the economy is transitioning away from the mining boom.** For the lucky country 3% growth still looks odd on. But this will mask grumpy undertones. Hard commodity prices are retreating further, productivity growth is weak, and a host of industries need reform to lift competitiveness.
- **Circa 7% growth is assumed for China.** Our forecasts assume the Chinese authorities will help manage the transition away from an investment-driven model without the economy falling into the abyss. However, there are clear risks of a more marked slowdown given falls in residential property values and the tone of recent data. And China is one of those emerging market darlings who leveraged heavily during the era of incredibly low rates. Watch this space.

Trading partner growth is expected to average around 4% per annum over the next few years, with risks tilted to the downside.

GLOBAL ECONOMIC GROWTH FORECAST

Calendar Years (annual average % change)	2011	2012	2013	2014(f)	2015(f)	2016(f)	2017(f)
United States	1.6	2.3	2.2	2.3	3.1	2.7	2.5
Australia	2.6	3.6	2.4	3.2	3.2	3.4	2.8
Japan	0.3	0.3	1.7	1.7	1.8	2.0	1.5
Euro Zone	1.6	-0.6	-0.4	1.0	1.8	2.0	1.8
China	9.3	7.8	7.7	7.5	7.3	7.0	7.0
Trading Partner Growth	**3.4**	**3.1**	**3.1**	**3.9**	**4.1**	**3.8**	**3.6**

ANZ

EXPORT COMMODITY PRICES

SUMMARY

The outlook for in-market prices has turned increasingly precarious for more sectors in recent months. Forestry and dairy have had notable downward adjustments, but others also look to have done their dash. There has been the curve ball of Russian sanctions, moderating Chinese demand due to a range of factors, and a better Northern Hemisphere growing season for a number of key crops. A firmer USD – while welcome from a NZD perspective – is also proving commodity price negative. There are some wide divergences between sectors depending on exposure to these forces, though. On the dairy front we have cut our 2014/15 milk price to $5.25/kg MS, but remain optimistic there will be a better outcome of $6.50 kg MS in 2015/16.

CURVE BALLS

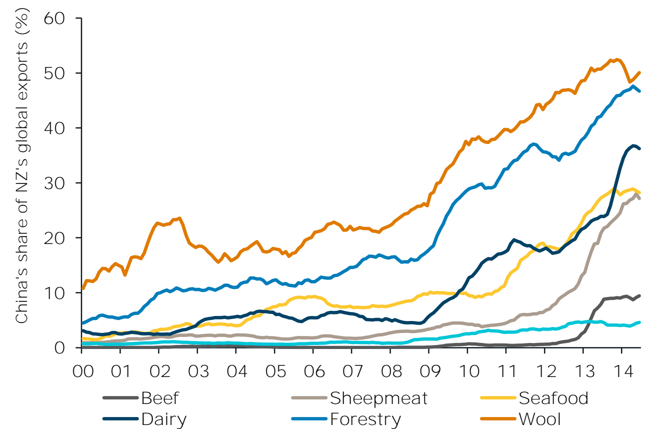
Russian sanctions, a softer Chinese economy with an overhang of inventory for some key sectors (notably dairy and forestry), and an excellent Northern Hemisphere growing season for a number of key crops have thrown some curve balls into the outlook for some sectors farm-gate prices. The USD has also strengthened. As well as being negative for world commodity prices (most are priced in USD), this also seems to be starting to pressure in-market prices and affordability in lower-income emerging markets. While a lower NZD/USD should help at the farm-gate, it won't always be a straightforward adjustment: timing will be important for influencing season-average prices.

The real curve ball since our last update has been Russian sanctions on a wide range of foodstuffs from 32 countries. Trade sanctions never end well no matter what sector, or form. While New Zealand hasn't been banned and can continue to export to Russia, Russia is a large global importer of many products, so sanctions are changing market dynamics around the globe. **The biggest indirect exposures are for dairy and fruit** – there are already lower prices for the likes of skim milk powder and Braeburn apples.

This, alongside generally softer economic conditions in Europe and China, means rising inter-market competition for some sectors has probably run its course for now. There will still be tension where there is a shortage of supply, but there is a limit to how far things can be pushed in the current environment. Perhaps the best example of this is sheepmeat returns, where in-market prices have taken a decent step-up since 2013 and reduced supply is forecast for 2014/15. However, there are concerns that pushing prices too far would risk a repeat of 2012 when lamb was priced off the shopping list.

Softer economic conditions in China, inventory hangover for some sectors, and other policy changes (tighter trade finance and a crack-down on luxury gifts) mean the substantial lift in the proportion of earnings from China has done its dash also. The proportion of earnings from China for wool, forestry, co-products, seafood, dairy and possibly sheepmeat are likely to decline in 2014/15. Beef could possibly grow due to more processing plants being certified for export and better prices than other major markets.

FIGURE 1. SHARE OF NZ'S TOTAL EXPORTS TO CHINA



Sources: ANZ, Statistics NZ

Key Northern Hemisphere crops have also had near-ideal conditions throughout the growing season and this has seen substantial price falls for the likes of US corn (-22%), soybeans (-24%) and wheat (-27%). This portends increased competition from other livestock producers sometime in the future.

All up, it makes for a mixed outlook depending on the sector and degree of exposure to these forces. The relief valve for farm-gate returns remains the NZD. An ongoing easing in the pressure from this source will be key.

For the dairy sector, Russian sanctions, strong supply growth from all the major exporters, and cautious end demand in key markets have made for a nasty mix and have seen the likes of milk powder prices drop by 46% since February. With current prices below the cost curve for all major exporters, prices can't stay here for ever, but at this stage it is difficult to see a catalyst for a bounce-back in the near-term. With Fonterra's NZD/USD hedging largely locked into the low 0.80s it's going to be a tougher year. **We are currently forecasting $5.25/kg MS for 2014/15. We remain constructive on a better outcome of $6.50 kg MS in 2015/16.** This is due to a lower NZD, an assumption that lower farm-gate prices will lead to slower milk production growth, and the fact that present prices are unsustainable long term.

LABOUR MARKET OUTLOOK

SUMMARY

The labour market recovery is broadening, although clear disparities across regions and sectors remain. Encouragingly, the supply side is also stepping up, with lifts in both working age population and participation. The unemployment rate is likely to drift down to the low 5s over the forecast horizon. Wage pressures are expected to build over the next year or so, underpinning moderate rates of consumer spending. We are assuming wage increases will largely be matched by improvements in productivity, a critical factor in prolonging the expansion.

SUPPLY SIDE STEPS UP

The labour market has strengthened over the last year or so, with the economy adding an additional 82,000 jobs in the June 2014 year. Employment levels are more than 6% above 2008 levels. Both HLFS and QES measures of employment/filled jobs have picked up over the last year or so, following the expansion in GDP. Employment in most sectors and regions is on the up, although Canterbury and the construction sector remain standouts.

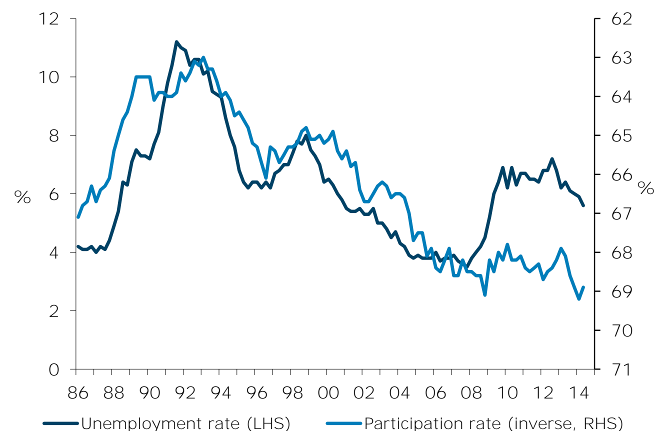
Forward gauges of demand point to continued employment gains. This is starting to put pressure on capacity and more reports of skills shortages, though with the unemployment rate still at 5.6% and hours per full-time equivalent low, we're not seeing an associated lift in wages at this juncture (beyond a couple of sectors).

One of the pleasing aspects has been the ability of the supply side of the labour market to step up to meet demand. Courtesy of strengthening net permanent and long-term immigration (both a cause and effect), the annual growth in working age population reached a decade high in June. We expect this to strengthen further over the course of the year and into 2015. About 60% of this is due to fewer people leaving, much of which reflects a turnaround in net migration inflows from Australia. This flow is closely connected with the relativities between the two labour markets.

While there are concerns that the ageing of the population structure will lower aggregate labour force participation, the participation rate as it stands is the third highest on record. There has been a steady increase in participation in the over 55s age group, both for lifestyle and balance sheet considerations, a trend we expect to continue, supporting overall labour force participation. In the absence of the participation rise, the unemployment rate would be much lower than the 5.6% it is now. There are potential benefits for labour market productivity, via the transfer of experience and skills to younger workers. Welfare reform and microeconomic initiatives helping people into the workforce will also play a role.

With the economy transitioning to a moderating growth trajectory, so too will the labour market, but with a lag. Surveyed employment intentions and job advertising suggest we are past the peak for annual employment growth. We expect annual HLFS employment growth to moderate from around 3.7% at present to around 1.6% in 2015 and 1.0% in 2016, with the unemployment rate likely to drift slightly lower. Part of this will reflect slightly softer demand, but it will also **become increasingly difficult to attract the right employee as the unemployment rate falls – things tend to bite around 5%.**

FIGURE 1. UNEMPLOYMENT RATE AND PARTICIPATION RATE



Source: Statistics NZ, ANZ

It's normal for wage inflation to pick up as labour market capacity constraints approach and workers demand a greater share of the pie. **What has been surprising so far is how moderate the lift in overall wage inflation has been – a carbon copy of the consumer price backdrop.**

We're expecting an element of lift in wage inflation going forward. Annual private sector wage growth is expected to settle around 3½% by late next year. Along with steady employment growth this provides a decent platform for household incomes and spending.

We're assuming a continued strong focus on productivity growth will temper the impact on unit labour costs (and potentially inflation). A decent microeconomic platform will help ease frictions in some pockets (i.e. Christchurch and construction). But as the cycle matures and the unemployment rate drifts lower, market forces and signals will invariably send wages a tad higher.

ANZ

FISCAL POLICY

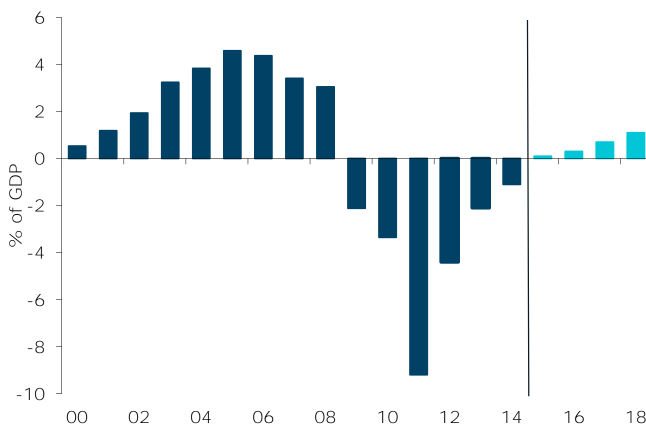
SUMMARY

The fiscal accounts are headed back into the black and despite some additional wiggle room being found for upcoming Budgets, there's limited headroom for a sizeable spend-up with only small projected surpluses. That's classic countercyclical fiscal policy in operation, which helps take pressure off the RBNZ. We take comfort from the broad consensus across the political spectrum with regards to prudent fiscal management.

RETURN TO SURPLUS ON TRACK

The Government remains on track to return to OBEGAL surplus by June 2015, although there's little margin for error with tax revenues from the dairy sector set to step down in the coming year. Nonetheless, trend-like GDP growth will continue to support higher nominal tax receipts in future years, while spending restraint also remains a core tenet of the fiscal consolidation effort. Core Crown expenditure has fallen from 35% of GDP in 2011 to a projected 30.3% of GDP in 2014/15. What's notable about that decline is that it has come not through outright spending cuts, but through a mixture of reprioritisation and better targeting of spending initiatives (supported by reasonable growth).

FIGURE 1. UNDERLYING OPERATING BALANCE



Source: ANZ, Bloomberg

Future surpluses are projected to rise from 0.1% to 1.1% of GDP. Anything in the "black" is welcome, but that's a tiny buffer to absorb adverse developments going forward, and also implies little scope for a post-election spend-up. **We expect net core Crown debt to peak at 27% of GDP in 2014/15 –** or around 15% of GDP after adjusting for NZ Super Fund holdings. That's an enviable fiscal position vis-à-vis fiscally profligate global peers, with average net debt across the OECD forecast at 73% of GDP in 2014. **Fiscal restraint will be ongoing** with net debt projected to fall to 20% of GDP by 2020/21. The Government's books need to be whiter than white when a high level of private sector debt (much of it externally funded) continues to irk credit rating agencies. Future demographic changes will add to superannuation and healthcare costs.

Tight fiscal policy continues to lean against the boost provided by the Canterbury rebuild, helping **to keep interest rates lower** than would otherwise be the case. While the fiscal stance remains contractionary to the tune of 2.4% of GDP over the next four years, the headwind to the overall growth outlook looks set to moderate in coming years. We've already seen the provision for further initiatives in upcoming Budgets raised from $1 to $1.5 billion – although that's still tight by historical standards.

THE BIGGER PICTURE

With projected surpluses within reach the strategic focus of fiscal policy is shifting. More cash in the door provides greater options. So we're set to see a combination of more spending, tax initiatives, paying down debt, and targeted investment. None will dominate, but all will feature; that seems reasonable to us. There are dangers in skewing to one side.

The microeconomic platform is adding to the economy's supply-side backbone (welfare reforms, deeper capital markets, unlocking natural resources, supply-side initiatives in the housing market *et al*) and we like some of the cross-bench support in key areas. It is notable that the three mainstream political parties all prepared Budgets working within the $1.5bn new initiative cap for subsequent Budgets. They may have different spending and tax mixes, but the commitment is telling us something as to how well ingrained fiscal responsibility has become. It's also probably because society demands it.

FISCAL FORECASTS

June years	2014(e)	2015(f)	2016(f)	2017(f)	2018(f)
OBEGAL ($bn)	-2.6	0.3	0.8	1.9	3.0
– as % of GDP	-1.1	0.1	0.3	0.7	1.1
Operating Balance ($bn)	2.8	3.0	3.6	4.8	6.1
– as % of GDP	1.2	1.2	1.4	1.8	2.2
Net Core Crown Debt ($bn)	59.9	64.3	67.0	67.5	67.9
– as % of GDP	25.9	26.8	26.7	25.8	25.0
Core Crown residual cash ($bn)	-4.2	-4.6	-2.9	-0.4	-0.3
Bond Tender Programme ($bn)	8.0	8.0	7.0	7.0	7.0

INFLATION

SUMMARY

By traditional metrics the economy should be facing an inflation challenge by now. It's not, with a host of temporary and more enduring influences expected to keep annual inflation below 2% for at least the next year. While inflation outcomes are expected to be higher in some pockets of the economy, they are being balanced by softness elsewhere. Our expectation is that aggregate outcomes over the next few years will hover around the inflation target midpoint, with few signs of the inflation genie getting out of the bottle.

WHAT INFLATION?

Inflation remains stuck below the midpoint of the inflation target as it has done for the past three years. That's despite the economy being adjudged to now have a positive output gap. Traditional harbingers of inflation are being usurped.

A better activity and inflation trade-off is likely to reflect some transitory features. The still-high NZD and benign external pricing backdrop are playing a role in holding down tradable CPI prices. Falling commodity export prices looks to have removed one of the potential upside risks to inflation. Strengthening net immigration – whilst adding to demand – is also helping to address some labour market bottlenecks. **There are potentially some more enduring influences**, with better productivity suppressing unit labour costs and technological change altering market dynamics. With credit growth below the rate of nominal GDP – and likely to be for a while yet – we're still in a deleveraging environment; that's hardly inflationary. We appear to be in an environment where inflation expectations are better anchored, though statistical evidence is limited.

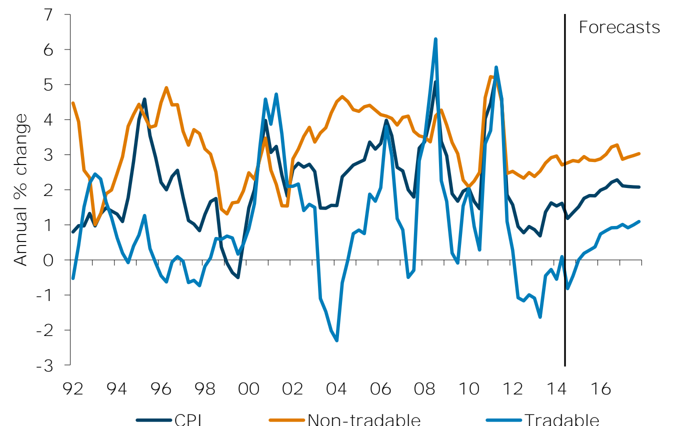
Pockets of pricing pressure remain, most notably in the construction sector, with still-high surveyed readings for capacity utilisation and skill shortages pointing to a pending rise in core inflation. To date, however, price increases in a number of sectors have been isolated, and have not filtered through into more generalised price lifts, a welcome dynamic. Even in the housing sector, an asset price hotspot, rents have not provided much of an inflationary sting.

Our projections assume that transitory and enduring influences will continue to feature. Annual CPI inflation moderates over the remainder of the year and remains below the midpoint of the inflation target until early 2016.

We're coy about jumping boots and all onto a new paradigm bandwagon. Yes, we have suppressants but we're also old school at heart; demand across the economy is outstripping supply. Annual non-tradable inflation is expected to lift from 2.7% at present to above 3% by late 2016. Sources of domestically generated inflation will broaden as the expansion matures and wage growth firms. Administrative price changes will also affect the inflation profile, with cuts to ACC levies from next July offsetting the impact of increasing tobacco and fuel excise on annual inflation through to the June 2016 year, after which the direct impact of the ACC cuts drop out of the annual comparison.

Inflation will invariably settle around 2%. The RBNZ is mandated to deliver precisely this. The technicalities are simple; a moderation in economic activity in relation to the speed limit of the economy (combined with no further announced increases in tobacco and fuel excises for 2017) eases the inflation profile towards the end of the projection period.

FIGURE 1. CPI INFLATION MEASURES



Source: ANZ, Statistics NZ

CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Mar-14	0.3	1.5
Jun-14	0.3	1.6
Sep-14 (f)	0.5	1.2
Dec-14 (f)	**0.2**	**1.3**
Mar-15 (f)	0.5	1.5
Jun-15 (f)	0.5	1.8
Sep-15 (f)	0.5	1.8
Dec-15 (f)	**0.3**	**1.8**
Mar-16 (f)	0.7	2.0
Jun-16 (f)	0.6	2.1
Sep-16 (f)	0.7	2.2
Dec-16 (f)	**0.3**	**2.3**
Mar-17 (f)	0.5	2.1
Jun-17 (f)	0.6	2.1
Sep-17 (f)	0.7	2.1
Dec-17 (f)	**0.3**	**2.1**

ANZ

EXCHANGE RATE

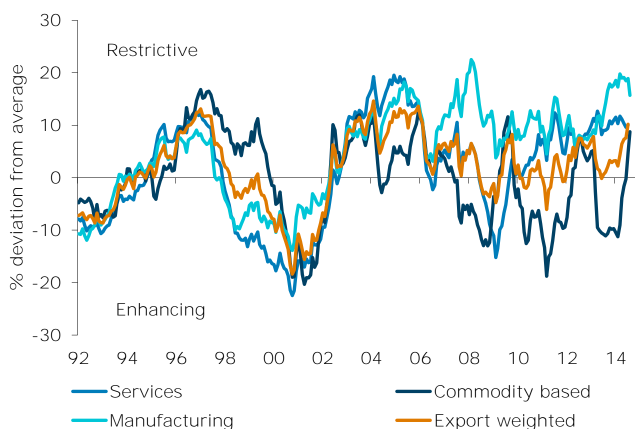
SUMMARY

The NZ dollar **is losing its shine but we can't foresee** a dramatic fall; the growth outlook is reasonable and **it's the highest yielding of the 10 most**-traded free-floating currencies. Europe and Japan are pursuing policies that will expand their monetary base and investors from those areas will continue to seek yield, supporting NZD/EUR and NZD/JPY. While a case can even be made for the NZD to rise, the currency story is set to turn increasingly US-centric. With the FOMC **set to shift stance, the USD's allure will return,** while there will be more question marks surrounding emerging markets – a further negative for NZD and AUD. We expect NZD/AUD to remain above long-run averages and view declines as opportunities to own NZD/AUD, banking carry and potential capital appreciation.

A RESTRICTIVE CURRENCY

New Zealand's economic story has become more nuanced. Dairy prices have plummeted, the housing market is softening, and the RBNZ has emphasised it is appropriate for a "period of monitoring and assessment before considering further policy adjustment". The currency has not yet played its traditional role in buffering the economy against commodity price falls, with the NZD still in restrictive territory for the broader export sector.

FIGURE 1: ANZ REAL EFFECTIVE EXCHANGE RATES



Source: ANZ, Bloomberg

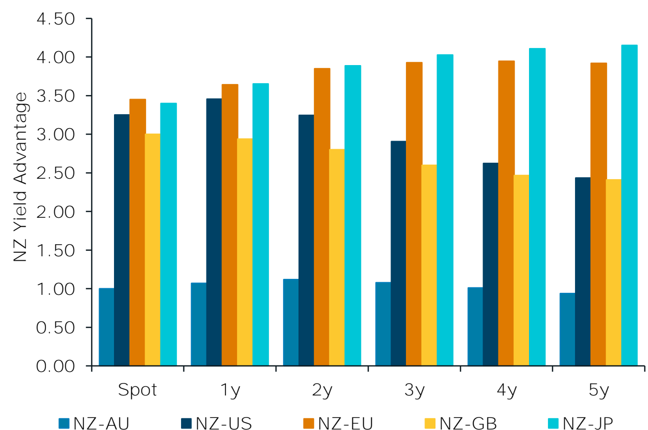
While the **New Zealand economic expansion has a reasonable degree of solidity to it, we look to be past the peak growth** that helped drive NZD outperformance early this year. This removes a leg of support for the NZD, allowing the currency to be driven by external events to a greater degree. While many of the catalysts behind a more moderate New Zealand economic outlook appear to be external (e.g. commodity price falls), the domestic environment has become more nuanced as well, and while we see little reason for immediate concern, potential downside risks to the economy – and hence the NZD – have increased.

The RBNZ has classified the current level of the currency as 'unjustified and unsustainable' and expect a "further significant depreciation, which should be reinforced as monetary policy in the US begins to normalise". ANZ agrees with this view, and we expect the path of the NZD/USD to also reflect US developments.

Globally we are expecting a cyclical lift in the USD, and believe this to be a dominating factor for NZD/USD over the coming quarters as the FOMC moves towards the first steps of interest rate normalisation. We expect USD strength to see the NZD end 2014 around 0.80, and 0.78 by end of Q1 2015, at which time we expect the FOMC to begin the process of normalising policy. **We then expect the pace of NZD/USD decline to significantly abate, pencilling in only 1c a quarter thereafter – only just above the cost of carry.** However, we are mindful of some confounding influences:

- **The NZD yield differential is still significant and likely to remain so.** The NZD has to decline over US 3.5c per year just to offset the carry available against USD, with similar yield differentials to JPY and EUR. This is a significant hurdle to overcome, and there will be periods in the cyclical USD bull market where it is preferable to own NZD. Carry is likely to remain an important support for the NZD/JPY and the NZD/EUR, with the BOJ and ECB still in the process of adding policy stimulus.
- **The US policy normalisation process is likely to be long and drawn out.** We expect the Fed to tread carefully, with lifts in interest rates – and their impact on USD – to be gradual. Timing, as they say, is everything.

FIGURE 2: CURRENT NZ FORWARD CURVE YIELD ADVANTAGE (SWAP IMPLIED)



Source: ANZ, Bloomberg

EXCHANGE RATE

Asian currencies have seen a relatively sustained appreciation over the past decade, as Asia has benefited from substantial capital inflows in recent years. However, their path over the **next year or two is likely to be rockier**, with the return to health of core economies (the US in particular) likely to drive capital outflows from Asia. As capital outflows to core markets pick up we are likely to see Asian interest rate structures shift higher, which will impact regional fundamentals, **domestic financial markets and liquidity conditions in Asia. This will impact NZD through both the export channel and the reserves channel.**

Geopolitics ensures that the world is a more uncertain place, presenting risks to the NZD. Western relationships with Russia are strained, and have resulted in a trade dispute (sanctions and counter-sanctions) that have directly affected dairy exports. This dynamic looks unlikely to change for the remainder of 2014. Nor are problems in the Middle East easily solved, with a potential trade spat looming given Chinese territorial claims. **Developments in geopolitics seem more likely to weaken NZD than strengthen it.**

Overall we expect measured declines for the NZD and stabilisation at levels (around 0.73 USD) that are historically strong. We see this decline as being a positive development for New Zealand, restoring some export profitability and boosting the attraction of NZ goods and services.

NZD/AUD: STRUCTURALLY HIGHER

The NZD has retreated against the AUD of late, temporarily falling below the important 0.90 level. The RBNZ's period of assessment could potentially be a long one, reducing support for the NZD/AUD, and lowering the range in which we expect NZD/AUD to trade. **However, we do not expect the NZD/AUD to trade below long-run averages, and view declines as opportunities to own NZD/AUD, banking carry and capital appreciation**. We see fair value for this cross as having structurally shifted higher, reflecting improving metrics in the NZD's favour.

We believe **the declines in NZ commodity prices are due to factors that will resolve with time** (such as Chinese inventories, EU and Russian sanctions), **whereas Australian commodities are suffering from a large increase in global supply** to meet a China infrastructure spend that is waning. New Zealand has a more flexible labour force, far less capacity within the labour force to meet demand, less regulation, and a better mix of goods and services to take advantage of the structural changes of a burgeoning Asian middle class.

NZD/GBP: REVERTING

Fundamentally we expect GBP to strengthen against NZD, as the BoE moves to normalise policy. In a similar vein to the US we expect GBP gains to be most prominent as the BoE transitions to raise rates; and we expect the process to significantly slow once the process becomes normalised in market eyes. The main risk to our view for the UK is domestic politics and Europe.

The Scottish independence vote, irrespective of the outcome, has highlighted that the UK is not the bastion of stability that some would have believed, which will weigh on GBP. **Europe is of course the other main factor, being the UK's largest trading partner.** An economic or political implosion in Europe would drag UK and GBP down with it.

NZD/EUR: STABLE, WITH DOWNSIDE RISKS

Europe looks increasingly likely to embark on policies that substantially increase its monetary base (QE). These policies should see the EUR keep pace with NZD declines, making the carry available in NZD/EUR attractive for investment flows. Potential for greater political integration and structural reform within the EUR, along with trade and current account surpluses, drive EUR support through our forecast horizon, although we acknowledge the political will for reform often seem lacking.

NZD/JPY: AN ELEVATED RANGE

Japan is undergoing the largest expansion of its monetary base (relative to its balance sheet) that has ever been attempted. This commitment to reflating the Japanese economy should ensure JPY remains weak over the foreseeable future, and that investment flows seek high-yielding assets such as the NZD. We expect this to see NZD/JPY remain in an elevated range, with periodic bouts of weakness an opportunity to buy NZD with JPY assets.

EXCHANGE RATE

EXCHANGE RATE FORECASTS (AVERAGE OF QUARTER)

Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
Mar-13	0.84	0.80	78.9	0.55	0.65	76.9
Jun-13	0.77	0.85	76.7	0.51	0.59	73.3
Sep-13	0.83	0.89	81.6	0.51	0.61	77.1
Dec-13	**0.82**	**0.92**	**86.5**	**0.50**	**0.60**	**77.3**
Mar-14	0.87	0.94	89.4	0.52	0.63	80.6
Jun-14	0.88	0.93	88.7	0.51	0.64	80.9
Sep-14	0.83	0.91	87.2	0.50	0.64	79.2
Dec-14	**0.80**	**0.91**	**88.0**	**0.48**	**0.63**	**77.5**
Mar-15	0.78	0.91	85.8	0.48	0.61	76.2
Jun-15	0.77	0.90	84.7	0.47	0.59	74.7
Sep-15	0.76	0.88	83.6	0.46	0.57	73.2
Dec-15	**0.75**	**0.87**	**82.5**	**0.45**	**0.56**	**71.9**
Mar-16	0.75	0.89	84.0	0.45	0.55	72.3
Jun-16	0.74	0.88	82.9	0.44	0.54	71.0
Sep-16	0.74	0.88	85.1	0.44	0.53	71.1
Dec-16	**0.73**	**0.87**	**84.0**	**0.43**	**0.52**	**70.0**

INTEREST RATES

SUMMARY

The OCR is on hold but we're expecting further tweaks higher over the coming two years. However, there is a fair degree of "skew" around our central forecast, such are the uncertainties. We still expect the Fed to complete tapering by October, causing global long-term interest rates to rise. However, Europe remains a mess and low yields there are holding down US and NZ yields. Interest rates globally are not set to trend higher, merely go through "ratcheting" ranges. NZGS will continue to outperform their global counterparts, having largely priced in prospective OCR increases.

THE ONLY CERTAINTY IS UNCERTAINTY

Now the RBNZ has delivered four 25 basis point lifts in the OCR, the trajectory from here contains a lot more uncertainty.

- The OCR is now 100 basis points shy of neutral compared to 200 at the start of the year; the rubber band is far less taut.
- The real economy has a more balanced risk profile; there are upside risks (migration, housing) and downside concerns (dairy payout, high NZD and global fragilities).
- We're not seeing the traditional flow-through from the real economy into the pricing side. New paradigm or not, some questions need asked (and answered). The burden of proof is now on inflation materialising.
- Monetary policy works with 1-2 year lags; there is the 100 basis points of tightening delivered so far to work through.

We're picking another couple of OCR nudges higher in the first half of 2015, and more six months after that. With our central scenario portraying above-trend growth, and a gradual lift in inflation pressures, the OCR will be biased upward.

There is the obvious temptation to push out prospects for OCR lifts for an extended period. A compelling case can be made; inflation will be sub 1.5% in early 2015 (refer page 11) and global uncertainties are high.

We're resisting this temptation for three key reasons.

- **We're expecting the NZD to maintain a slight downward bias**; our eyes are firmly on the US Federal Reserve to deliver a more upbeat tone before year-end which will buoy the USD further. However, while a lower NZD means easier monetary conditions here (and higher rates all else equal), there is a catch. Commodity prices are USD denominated so the "benefit" will be diluted. Moreover, we suspect the NZD will remain bid against other currencies in the TWI basket given prospects for Eurozone and Japanese monetary policy settings: QE, and rates going nowhere. Why the currency is adjusting matters immensely.
- **The New Zealand labour market is expected to keep firming**; a sub 5.5% unemployment rate beckons before year-end (page 9).
- A lot can change in six months; **nine months just seems an over-extended pause.** The central scenario is still one of pretty solid growth, albeit with some uncertainties over the transmission into inflation.

This all adds up **to a risk that the inflation picture for the back half of 2015 could look quite different**, despite acknowledged uncertainties.

Despite expecting interest rates to move up again in 2015 **we're far from hawkish**; we're talking further tweaks to policy settings and nothing more than that as a central scenario.

There are still material downside risks surrounding the outlook and a majority of these risks stem from offshore. Chief is the impact of the eventual lift in US interest rates and the implications for emerging markets. China and others have binged on cheap global credit. **Now the deleveraging process has begun, China's economic indicators are slowing**, confirming what falling iron ore and steel prices foreshadowed over recent months. The trade-offs in China's monetary policy are becoming starker, as policymakers must weigh up potentially exacerbating financial stability risks through any attempts to mitigate downside risks to the growth outlook.

It may seem like blasphemy to some, but the OCR might not be moving at all in 2015. Recent AUD price action – when it moves we take notice – sizeable movements in some key commodities and question marks over the Chinese economy have us very watchful. The NZD might be playing catch-up to some local specifics, but also falling for other pending reasons. This sort of indefinite on-hold scenario was pie-in-the-sky stuff a few months ago; it's not now.

So we have a central scenario of the OCR moving up in a gradual fashion, but with a greater than normal degree of skew around potential outcomes.

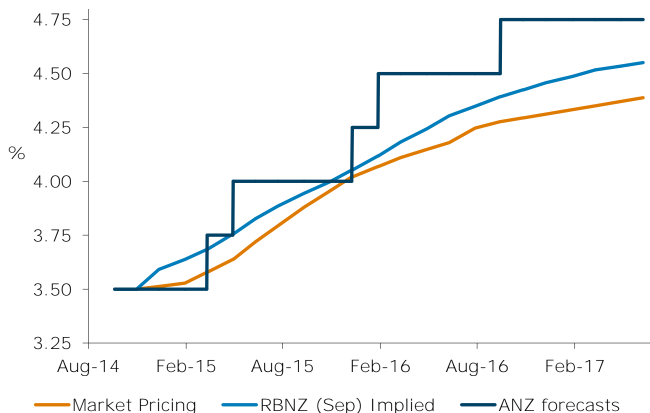
With the OCR on hold for now and the resumption in the tightening cycle some months away, **we**

ANZ

INTEREST RATES

expect short-end interest rates to hold fairly steady through to year-end. Market pricing is broadly consistent with the RBNZ's projections. However, **given the degree of uncertainty, and the amount of "carry" on offer, we expect interest rates to continue to trade "below" what the RBNZ's projections imply.** We are also mindful that now the NZD is moving lower, the RBNZ are unlikely to act in a way that might reverse that trend. This should be comforting for the short end. The RBNZ does not target the currency specifically (although it can intervene), but in broad terms, it has the market roughly where it wants it – pricing in mild rate hikes. Given the uncertainties at present, the RBNZ is far better off having the market pricing in a more modest tightening profile and having the NZD where it is, than having the market pricing in its projections, but the Kiwi back at more elevated levels.

FIGURE 1. OCR EXPECTATIONS



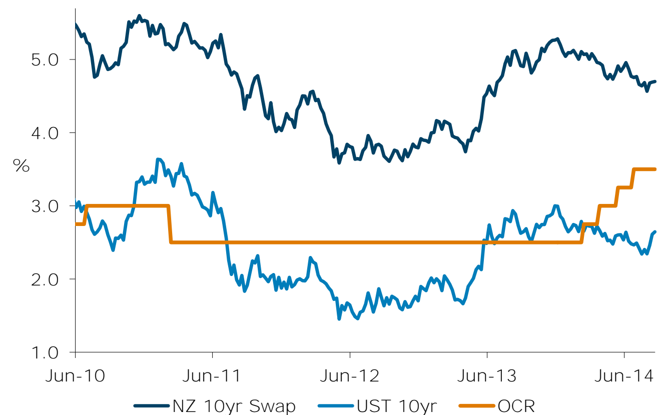
Source: ANZ, RBNZ, Bloomberg

Looking ahead more broadly, we suspect the cautious New Zealand rates experience (100bps then a pause) will become the model for other central banks that will eventually have to normalise monetary policy settings. Recall three central banks lifted interest rates sharply (100-175bps) earlier in the cycle: the RBA, Norgesbank and Riksbank. All ended up subsequently cutting.

UPSIDE RISK TO GLOBAL RATES BUT NOT OF THE TREND VARIETY

For the long end, it's all about the global scene, in particular US interest rates. Long-end interest rates are now as low as they have been all year, and as Figure 2 shows, long-end interest rates tend to be much more highly correlated with global long-end interest rates than does the OCR.

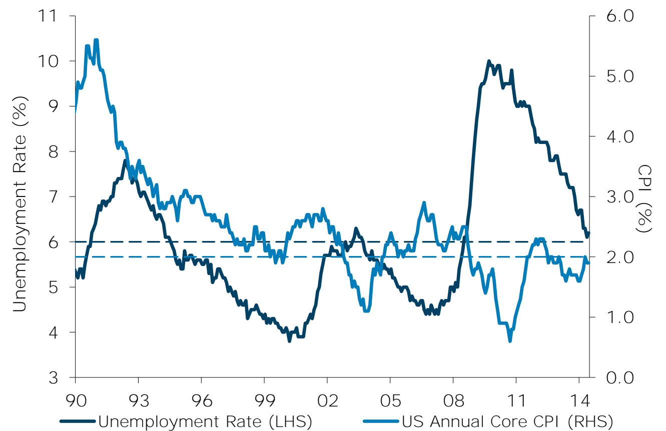
FIGURE 2. NZ AND US BOND YIELDS AND OCR



Source: ANZ, RBNZ, Bloomberg

Dichotomies across the international economic environment are being reflected in financial markets. German 10-year Bund yields are around 1%, a whopping 1.5% below US Treasuries. Europe is grappling with deflation risks, whereas the US is having some success in honing in on the FOMC's dual mandate (Figure 3), with inflation at 1.7% and the unemployment rate at 6.1%.

FIGURE 3. THE FED'S DUAL MANDATE



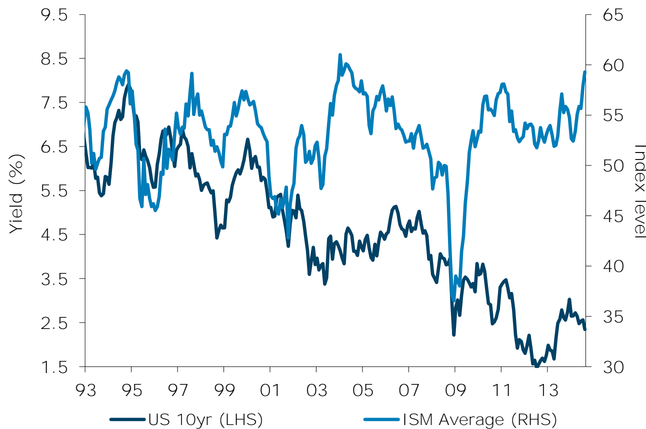
Source: ANZ, Bloomberg

The federal funds rate and the US 10 year Treasury yield are key bellwethers for the global cost of capital; where they go, others follow. While the FOMC is still talking in guarded tones – they've seen the green shoots of recovery turn brown before – there seems little denying growing momentum across the US economy. The FOMC will not be able to anchor the curve indefinitely with growing pressure (more open debate across FOMC members) on policy, and we appear close to a turning point for yields. **While we are mindful of just how much tightening the US economy can withstand, the Fed's language is slowly changing, and bond yields are now moving higher in response.**

INTEREST RATES

As global US yields head higher, so will NZ yields, and we now forecast the NZ 10-year bond yield to lift to 4.6% by year-end before peaking at 5.1% in early 2016. This is slightly lower than our previous forecasts, and is largely thanks to lower bond yields in Germany, Japan and the US.

FIGURE 4. ISM AND US 10YR BOND YIELDS



Source: ANZ, Bloomberg

Although the dramatic fall in German and Japanese bond yields will blunt the rise in dollar bloc interest rates as investors look to switch from Germany and Japan and into the US (and Australia and NZ), **markets do need to acknowledge the steady improvement in the tone of US data and the Fed's tone**. As Figure 4 shows, in level terms there has been a "disconnect" between key gauges like the ISM surveys and the US 10-year bond yield since the GFC. However, what is striking about 2014 has been the widening gap between the two, with bond yields at the year's low and the average of the 2 ISM surveys at a 10-year high.

Our forecasts assume a steeper yield curve, with the front end held down by maturing rate hike expectations, and the long end biased higher with global yields. They also allow for further tightening in the NZ/US bond spread. Market expectations for monetary policy are mature, and NZGS typically outperform in a rising yield environment. With offshore demand still strong (we note record levels of offshore participation in July), NZGS are resilient to upcoming OCR increases. **Both the NZ/AU and NZ/US 10 year spreads are forecast to tighten** to +0.5% and +1.5% respectively over the next 12 months.

NEW ZEALAND INTEREST RATE FORECASTS (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-12	**2.50**	**2.7**	**2.7**	**3.1**	**3.5**	**1.8**	**3.3**
Dec-13	**2.50**	**2.8**	**3.8**	**4.7**	**4.7**	**3.0**	**4.2**
Jun-14	3.25	3.5	4.1	4.5	4.4	2.5	3.5
Sep-14(e)	3.50	3.8	4.3	4.5	4.4	2.7	3.6
Dec-14(f)	3.50	3.8	4.3	4.7	4.6	2.9	3.8
Mar-15(f)	3.75	4.2	4.5	4.9	4.7	3.1	4.1
Jun-15(f)	4.00	4.3	4.6	5.0	4.8	3.3	4.3
Sep-15(f)	4.00	4.3	4.6	5.1	5.0	3.5	4.5
Dec-15(f)	4.25	4.7	4.8	5.1	5.0	3.5	4.5
Mar-16(f)	4.50	4.8	4.8	5.2	5.1	3.6	4.6
Jun-16(f)	4.50	4.8	4.9	5.3	5.1	3.7	4.7
Sep-16(f)	4.75	5.0	4.9	5.2	5.1	3.6	4.6
Dec-16(f)	**4.75**	**5.0**	**4.9**	**5.2**	**5.1**	**3.6**	**4.6**

ECONOMIC FORECASTS

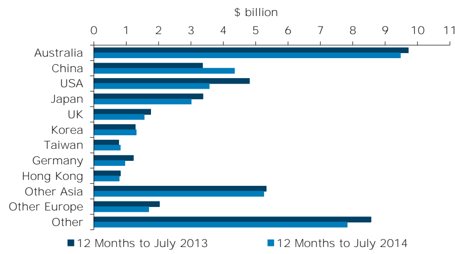
	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16
Real Gross Domestic Product												
Total GDP, QPC	1.0	0.7	**0.6**	**0.8**	**0.8**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**	**0.6**	**0.7**
Total GDP, APC	3.8	3.9	**3.4**	**3.2**	**3.0**	**3.0**	**3.1**	**2.9**	**2.7**	**2.6**	**2.6**	**2.6**
Total GDP, AAPC	3.2	3.5	**3.6**	**3.6**	**3.4**	**3.2**	**3.1**	**3.0**	**2.9**	**2.8**	**2.7**	**2.6**
Real GDP Components												
Private Consumption, QPC	0.1	1.2	**0.5**	**0.7**	**0.7**	**0.6**	**0.6**	**0.6**	**0.6**	**0.5**	**0.5**	**0.6**
Private Consumption, AAPC	3.3	3.3	**3.1**	**2.8**	**3.0**	**2.9**	**2.8**	**2.8**	**2.6**	**2.5**	**2.4**	**2.3**
Public Consumption, QPC	1.4	0.5	**-0.2**	**-0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.1**	**0.2**	**0.2**	**0.2**
Public Consumption, AAPC	1.7	2.6	**2.4**	**2.4**	**1.7**	**0.8**	**0.5**	**0.2**	**0.2**	**0.4**	**0.5**	**0.6**
Residential Investment, QPC	11.1	-0.2	**4.0**	**3.0**	**3.5**	**2.8**	**3.0**	**0.2**	**2.0**	**1.6**	**1.0**	**0.6**
Residential Investment, AAPC	17.0	18.2	**17.8**	**18.8**	**16.1**	**14.9**	**14.0**	**11.8**	**11.2**	**9.4**	**7.4**	**6.3**
Other Investment, QPC	0.1	1.9	**1.6**	**2.0**	**1.5**	**1.4**	**1.2**	**1.0**	**0.9**	**0.7**	**0.7**	**0.8**
Other Investment, AAPC	9.3	8.4	**6.7**	**5.6**	**5.4**	**5.9**	**6.4**	**6.3**	**5.6**	**4.9**	**4.2**	**3.7**
Gross National Expenditure, QPC	1.1	2.2	**0.6**	**0.8**	**0.7**	**1.1**	**0.9**	**0.6**	**0.6**	**0.6**	**0.6**	**0.6**
Gross National Expenditure, AAPC	4.7	5.0	**4.5**	**4.6**	**4.5**	**4.0**	**3.9**	**3.6**	**3.6**	**3.6**	**3.6**	**3.6**
Exports, QPC	2.8	-2.9	**1.2**	**0.7**	**0.6**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.7**	**0.8**
Exports, AAPC	2.7	2.9	**5.1**	**1.7**	**-0.5**	**3.2**	**2.7**	**2.7**	**2.9**	**2.9**	**2.9**	**3.0**
Imports, QPC	1.8	2.9	**0.5**	**1.0**	**0.9**	**0.8**	**0.7**	**0.7**	**0.6**	**0.6**	**0.5**	**0.5**
Imports, AAPC	8.0	8.8	**7.9**	**7.3**	**6.6**	**5.1**	**4.6**	**3.8**	**3.2**	**3.0**	**2.7**	**2.5**
Prices												
Headline CPI, QPC	0.3	0.3	**0.5**	**0.2**	**0.5**	**0.5**	**0.5**	**0.3**	**0.7**	**0.6**	**0.7**	**0.3**
Headline CPI, APC	1.5	1.6	**1.2**	**1.3**	**1.5**	**1.8**	**1.8**	**1.8**	**2.0**	**2.1**	**2.2**	**2.3**
Non-tradable CPI, QPC	1.1	0.4	**0.8**	**0.5**	**1.1**	**0.6**	**0.7**	**0.6**	**1.1**	**0.6**	**0.9**	**0.6**
Non-tradable CPI, APC	3.0	2.7	**2.8**	**2.8**	**2.8**	**2.9**	**2.8**	**2.8**	**2.9**	**3.0**	**3.2**	**3.3**
Tradable CPI, QPC	-0.7	0.2	**0.3**	**-0.2**	**-0.3**	**0.4**	**0.3**	**-0.1**	**0.1**	**0.5**	**0.5**	**-0.1**
Tradable CPI, APC	-0.6	0.1	**-0.8**	**-0.5**	**0.0**	**0.2**	**0.3**	**0.4**	**0.7**	**0.8**	**0.9**	**0.9**
External Accounts												
Ann. Balance on Goods, % of GDP	1.2	1.4	**1.5**	**0.6**	**-0.6**	**-1.4**	**-2.0**	**-2.4**	**-2.5**	**-2.5**	**-2.4**	**-2.4**
Ann. Balance on Services, % of GDP	0.5	0.6	**0.7**	**0.8**	**0.9**	**0.9**	**1.0**	**1.0**	**1.0**	**1.1**	**1.1**	**1.1**
Ann. Balance on Invisibles, % of GDP	-4.4	-4.5	**-4.7**	**-4.7**	**-4.7**	**-4.6**	**-4.5**	**-4.5**	**-4.5**	**-4.5**	**-4.5**	**-4.6**
Ann. CAB, % of GDP	-2.7	-2.5	**-2.4**	**-3.3**	**-4.4**	**-5.0**	**-5.6**	**-5.9**	**-6.0**	**-5.9**	**-5.9**	**-5.8**
Net Intl. Invt. Position, % of GDP	-66.9	-65.3	**-65.5**	**-66.3**	**-67.6**	**-68.7**	**-69.6**	**-70.3**	**-70.9**	**-71.3**	**-71.8**	**-72.1**
Terms of Trade (SNA basis)												
Export Prices, QPC	-1.5	-4.9	**-1.8**	**-1.5**	**0.3**	**0.9**	**1.1**	**1.3**	**1.5**	**1.0**	**0.6**	**0.6**
Export Prices, APC	12.5	6.2	**-2.2**	**-9.4**	**-7.7**	**-2.2**	**0.8**	**3.6**	**4.8**	**4.9**	**4.4**	**4.4**
Import Prices, QPC	-1.0	-1.4	**-0.3**	**0.2**	**1.2**	**1.4**	**1.0**	**1.1**	**1.1**	**0.6**	**0.1**	**0.1**
Import Prices, APC	-3.1	-3.7	**-6.6**	**-2.4**	**-0.3**	**2.6**	**3.9**	**4.8**	**4.8**	**3.9**	**3.0**	**3.0**
Terms of Trade, QPC	-0.5	-3.5	**-1.5**	**-1.8**	**-0.9**	**-0.6**	**0.1**	**0.1**	**0.3**	**0.4**	**0.5**	**0.5**
Terms of Trade, APC	16.1	10.3	**4.6**	**-7.2**	**-7.5**	**-4.6**	**-3.0**	**-1.1**	**0.0**	**1.0**	**1.4**	**1.4**
Labour Market												
Employment, QPC	0.9	0.4	**0.5**	**0.5**	**0.4**	**0.4**	**0.3**	**0.2**	**0.2**	**0.3**	**0.3**	**0.3**
Employment, APC	3.8	3.7	**2.9**	**2.4**	**1.9**	**1.8**	**1.6**	**1.3**	**1.1**	**1.0**	**0.9**	**1.0**
Labour Force, QPC	0.8	0.0	**0.4**	**0.4**	**0.4**	**0.4**	**0.3**	**0.2**	**0.2**	**0.2**	**0.2**	**0.2**
Labour Force, APC	3.4	2.7	**2.1**	**1.6**	**1.2**	**1.5**	**1.5**	**1.3**	**1.2**	**1.0**	**0.9**	**0.9**
Unemployment Rate, sa	5.9	5.6	**5.4**	**5.4**	**5.3**	**5.3**	**5.3**	**5.4**	**5.4**	**5.3**	**5.3**	**5.3**
Participation Rate, sa	69.2	68.9	**68.8**	**68.7**	**68.7**	**68.7**	**68.6**	**68.6**	**68.6**	**68.6**	**68.6**	**68.6**
QES Private Sector Wages, APC	2.9	3.1	**3.2**	**3.3**	**3.4**	**3.4**	**3.6**	**3.6**	**3.5**	**3.5**	**3.3**	**3.3**
QES Public Sector Wages, APC	1.8	1.3	**1.3**	**1.5**	**1.6**	**1.6**	**1.7**	**1.7**	**1.8**	**1.7**	**1.8**	**1.8**

Forecasts in bold
QPC – quarterly % change
APC – annual % change
AAPC – annual average % change
sa – seasonally adjusted

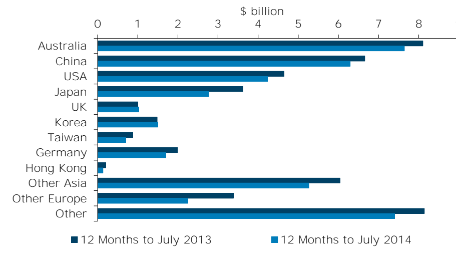
ANZ

KEY ECONOMIC INDICATORS

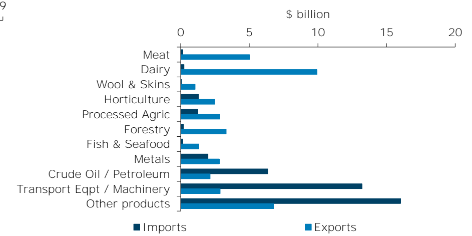
NZ EXPORTS



NZ IMPORTS



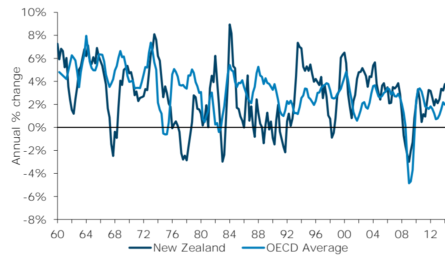
NZ EXPORTS AND IMPORTS BY SELECTED COMMODITIES 12 MONTHS TO JULY2014



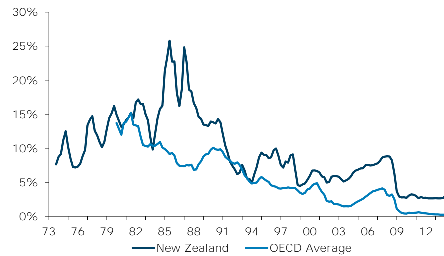
NEW ZEALAND COMPARED TO MAIN TRADING PARTNERS (LATEST AVAILABLE FIGURES)

	NZ	Australia	USA	Japan	UK	China	Germany	South Korea	Taiwan	Malaysia	Hong Kong	Singapore	Indonesia
Population, in millions	5	23	318	127	64	1,361	81	50	23	30	7	5	250
Area in 1,000 km^2	268	7,741	9,827	378	244	9,597	357	100	36	330	1	1	1,905
Inhabitants per km^2	16.9	3.0	32.3	336.6	261.5	141.8	225.8	503.5	649.7	91.0	6,531	7,746	131.2
GDP, in billion NZD	229	1,725	20,112	5,587	3,200	11,409	4,611	1,636	585	375	331	355	965
Change in real terms (yr-on-yr %)	3.5	2.8	2.4	1.9	2.7	7.6	1.2	3.6	2.7	5.7	2.6	4.3	5.4
Nominal GDP per capita in NZD	50,723	73,717	63,324	43,923	50,236	8,385	57,214	32,582	25,021	12,488	46,062	65,821	3,863
NZ exports to ..., NZDm (FOB)	n/a	9,472	3,566	3,006	1,553	4,345	956	1,310	819	748	782	1,148	874
Share of NZ Exports (%)	n/a	23.3	8.8	7.4	3.8	10.7	2.4	3.2	2.0	1.8	1.9	2.8	2.2
NZ imports from , NZDm (VFD)	n/a	7,644	4,233	2,768	1,025	6,293	1,697	1,499	702	1,413	135	1,457	582
Share of NZ Imports (%)	n/a	18.7	10.3	6.8	2.5	15.4	4.1	3.7	1.7	3.5	0.3	3.6	1.4
Current Account balance (% of GDP)	-2.5	-3.4	-2.3	-0.1	-4.5	1.7	7.3	6.4	12.9	5.9	1.6	18.8	-3.2

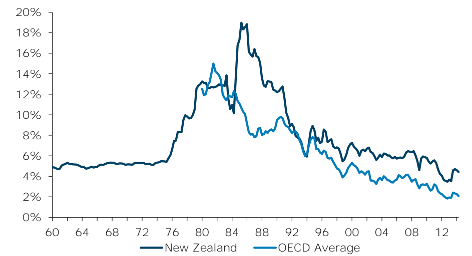
REAL GDP GROWTH



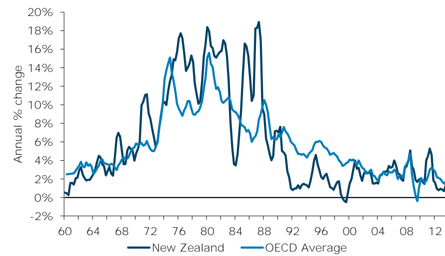
90 DAY INTEREST RATE



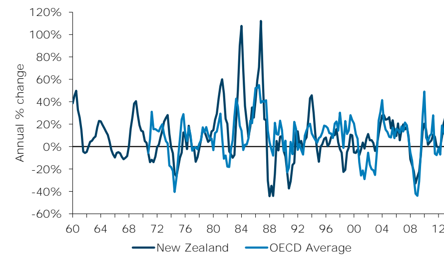
LONG-TERM GOVERNMENT BOND YIELD



INFLATION RATE

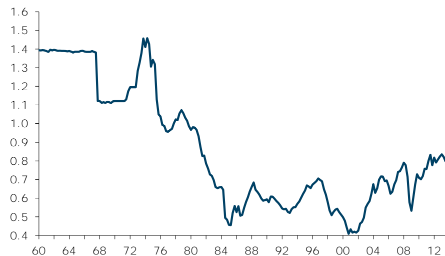


NZX50 SHARE PRICE INDEX

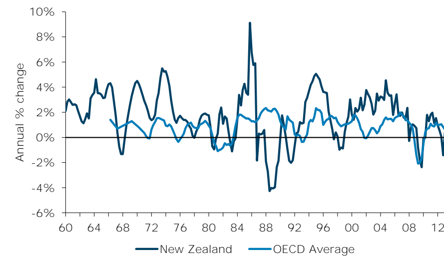


CURRENT ACCOUNT BALANCE

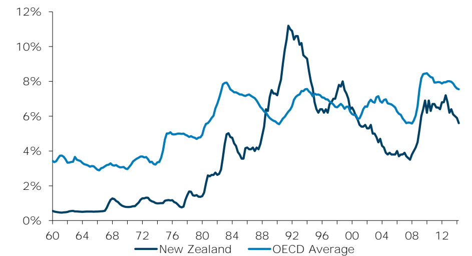
NZD/USD EXCHANGE RATE



EMPLOYMENT GROWTH



UNEMPLOYMENT RATE



Source: ANZ, Statistics NZ, Bloomberg, OECD

IMPORTANT NOTICE

The distribution of this document or streaming of this video broadcast (as applicable, "publication") may be restricted by law in certain jurisdictions. Persons who receive this publication must inform themselves about and observe all relevant restrictions.

1. Disclaimer for all jurisdictions, where content is authored by ANZ Research:

Except if otherwise specified in section 2 below, this publication is issued and distributed in your country/region by Australia and New Zealand Banking Group Limited (ABN 11 005 357 522) ("ANZ"), on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (collectively, "recipient"). This publication may not be reproduced, distributed or published by any recipient for any purpose. It is general information and has been prepared without taking into account the objectives, financial situation or needs of any person. Nothing in this publication is intended to be an offer to sell, or a solicitation of an offer to buy, any product, instrument or investment, to effect any transaction or to conclude any legal act of any kind. If, despite the foregoing, any services or products referred to in this publication are deemed to be offered in the jurisdiction in which this publication is received or accessed, no such service or product is intended for nor available to persons resident in that jurisdiction if it would be contradictory to local law or regulation. Such local laws, regulations and other limitations always apply with non-exclusive jurisdiction of local courts. Certain financial products may be subject to mandatory clearing, regulatory reporting and/or other related obligations. These obligations may vary by jurisdiction and be subject to frequent amendment. Before making an investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

The views and recommendations expressed in this publication are the author's. They are based on information known by the author and on sources which the author believes to be reliable, but may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this publication and are subject to change without notice; and, all price information is indicative only. Any of the views and recommendations which comprise estimates, forecasts or other projections, are subject to significant uncertainties and contingencies that cannot reasonably be anticipated. On this basis, such views and recommendations may not always be achieved or prove to be correct. Indications of past performance in this publication will not necessarily be repeated in the future. No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided. Additionally, this publication may contain 'forward looking statements'. Actual events or results or actual performance may differ materially from those reflected or contemplated in such forward looking statements. All investments entail a risk and may result in both profits and losses. Foreign currency rates of exchange may adversely affect the value, price or income of any products or services described in this publication. The products and services described in this publication are not suitable for all investors, and transacting in these products or services may be considered risky. ANZ and its related bodies corporate and affiliates, and the officers, employees, contractors and agents of each of them (including the author) ("Affiliates"), do not make any representation as to the accuracy, completeness or currency of the views or recommendations expressed in this publication. Neither ANZ nor its Affiliates accept any responsibility to inform you of any matter that subsequently comes to their notice, which may affect the accuracy, completeness or currency of the information in this publication.

Except as required by law, and only to the extent so required: neither ANZ nor its Affiliates warrant or guarantee the performance of any of the products or services described in this publication or any return on any associated investment; and, ANZ and its Affiliates expressly disclaim any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this publication.

If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. ANZ and its Affiliates do not accept any Liability as a result of electronic transmission of this publication.

ANZ and its Affiliates may have an interest in the subject matter of this publication as follows:

- They may receive fees from customers for dealing in the products or services described in this publication, and their staff and introducers of business may share in such fees or receive a bonus that may be influenced by total sales.
- They or their customers may have or have had interests or long or short positions in the products or services described in this publication, and may at any time make purchases and/or sales in them as principal or agent.
- They may act or have acted as market-maker in products described in this publication.

ANZ and its Affiliates may rely on information barriers and other arrangements to control the flow of information contained in one or more business areas within ANZ or within its Affiliates into other business areas of ANZ or of its Affiliates.

Please contact your ANZ point of contact with any questions about this publication including for further information on these disclosures of interest.

2. Country/region specific information:

Australia. This publication is distributed in Australia by ANZ. ANZ holds an Australian Financial Services licence no. 234527. A copy of ANZ's Financial Services Guide is available at http://www.anz.com/documents/AU/aboutANZ/FinancialServicesGuide.pdf and is available upon request from your ANZ point of contact. If trading strategies or recommendations are included in this publication, they are solely for the information of 'wholesale clients' (as defined in section 761G of the Corporations Act 2001 Cth). Persons who receive this publication must inform themselves about and observe all relevant restrictions.

Brazil. This publication is distributed in Brazil by ANZ on a cross border basis and only following request by the recipient. No securities are being offered or sold in Brazil under this publication, and no securities have been and will not be registered with the Securities Commission – CVM.

Brunei. Japan. Kuwait. Malaysia. Switzerland. Taiwan. This publication is distributed in each of Brunei, Japan, Kuwait, Malaysia, Switzerland and Taiwan by ANZ on a cross-border basis.

European Economic Area ("EEA"): United Kingdom. ANZ in the United Kingdom is authorised by the Prudential Regulation Authority ("PRA"). Subject to regulation by the Financial Conduct Authority ("FCA") and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This publication is distributed in the United Kingdom by ANZ solely for the information of persons who would come within the FCA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the PRA and the FCA. Germany. This publication is distributed in Germany by the Frankfurt Branch of ANZ solely for the information of its clients. Other EEA countries. This publication is distributed in the EEA by ANZ Bank (Europe) Limited ("ANZBEL") which is authorised by the PRA and regulated by the FCA and the PRA in the United Kingdom, to persons who would come within the FCA definition of "eligible counterparty" or "professional client" in other countries in the EEA. This publication is distributed in those countries solely for the information of such persons upon their request. It is not intended for, and must not be distributed to, any person in those countries who would come within the FCA definition of "retail client".

Fiji. For Fiji regulatory purposes, this publication and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this publication.

Hong Kong. This publication is distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated

ANZ

IMPORTANT NOTICE

activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong. If in doubt about the contents of this publication, you should obtain independent professional advice.

India. This publication is distributed in India by ANZ on a cross-border basis. If this publication is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing. Further copying or duplication of this publication is strictly prohibited.

New Zealand. This publication is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008.

Oman. This publication has been prepared by ANZ. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this publication is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and by receiving this publication, the person or entity to whom it has been dispatched by ANZ understands, acknowledges and agrees that this publication has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this publication is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China. If and when the material accompanying this publication does not only relate to the products and/or services of Australia and New Zealand Bank (China) Company Limited ("ANZ China"), it is noted that: This publication is distributed by ANZ or an affiliate. No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this publication in the People's Republic of China ("PRC"). Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this publication or any other method. This publication may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this publication relates to the products and/or services of ANZ China only, it is noted that: This publication is distributed by ANZ China in the Mainland of the PRC.

Qatar. This publication has not been, and will not be lodged or registered with, or reviewed or approved by, the Qatar Central Bank ("QCB"), the Qatar Financial Centre ("QFC") Authority, QFC Regulatory Authority or any other authority in the State of Qatar ("Qatar"); or authorised or licensed for distribution in Qatar; and the information contained in this publication does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC. The financial products or services described in this publication have not been, and will not be registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar. Accordingly, the financial products or services described in this publication are not being, and will not be, offered, issued or sold in Qatar, and this publication is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this publication and distribution of this publication is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this publication must abide by this restriction and not distribute this publication in breach of this restriction. This publication is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This publication is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore. In respect of any matters arising from, or in connection with the distribution of this publication in Singapore, contact your ANZ point of contact.

United Arab Emirates. This publication is distributed in the United Arab Emirates ("UAE") or the Dubai International Financial Centre (as applicable) by ANZ. This publication: does not, and is not intended to constitute an offer of securities anywhere in the UAE; does not constitute, and is not intended to constitute the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the United Arab Emirates, the Emirates Securities and Commodities Authority or the United Arab Emirates Ministry of Economy; does not, and is not intended to constitute an offer of securities within the meaning of the Dubai International Financial Centre Markets Law No. 12 of 2004; and, does not constitute, and is not intended to constitute, a financial promotion, as defined under the Dubai International Financial Centre Regulatory Law No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority ("DFSA"). The financial products or services described in this publication are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules. In addition, ANZ has a representative office ("ANZ Representative Office") in Abu Dhabi regulated by the Central Bank of the United Arab Emirates. ANZ Representative Office is not permitted by the Central Bank of the United Arab Emirates to provide any banking services to clients in the UAE.

United States. If and when this publication is received by any person in the United States or a "U.S. person" (as defined in Regulation S under the US Securities Act of 1933, as amended) ("US Person") or any person acting for the account or benefit of a US Person, it is noted that ANZ Securities, Inc. ("ANZ S") is a member of FINRA (www.finra.org) and registered with the SEC. ANZ S' address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). Except where this is a FX- related or commodity-related publication, this publication is distributed in the United States by ANZ S (a wholly owned subsidiary of ANZ), which accepts responsibility for its content. Information on any securities referred to in this publication may be obtained from ANZ S upon request. Any US Person receiving this publication and wishing to effect transactions in any securities referred to in this publication must contact ANZ S, not its affiliates. Where this is an FX- related or commodity-related publication, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). Commodity-related products are not insured by any U.S. governmental agency, and are not guaranteed by ANZ or any of its affiliates. Transacting in these products may involve substantial risks and could result in a significant loss. You should carefully consider whether transacting in commodity-related products is suitable for you in light of your financial condition and investment objectives. ANZ S is authorised as a broker-dealer only for US Persons who are institutions, not for US Persons who are individuals. If you have registered to use this website or have otherwise received this publication and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this publication in any way.

This document has been prepared by ANZ Bank New Zealand Limited, Level 7, 1 Victoria Street, Wellington 6011, New Zealand,
Ph 64-4-802 2212, e-mail nzeconomics@anz.com, http://www.anz.co.nz