



NEW ZEALAND ECONOMICS

NBNZ QUARTERLY ECONOMIC FORECASTS

4 June 2010

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ON THE RECOVERY TRACK

NEW ZEALAND ECONOMIC OUTLOOK

The domestic recovery is underway. This partly reflects normal cyclical dynamics, as the economy rebounds from recession following policy support. However, continued deleveraging will contribute to a more gradual recovery over much of 2010 than is typically the norm. There will be volatility in the economic data over the second half of this year due to the increase in GST. We expect growth to strengthen from late this year as these structural forces unwind, and the boost to the terms of trade flows through the economy. Beyond a strong 2011, the five year picture is one of modest growth, which in part reflects a sustained period of structural change across the economy.

GLOBAL OUTLOOK

Global growth is set to return towards trend although this masks a huge dichotomy between developed and emerging market economies. Risks remain though, with inflation a growing concern in China, while sovereign debt concerns is set to weigh on growth prospects in the Eurozone and potentially spill across into the wider global economy. We put the odds of a double-dip global recession at 1 in 4.

FISCAL POLICY

Fiscal policy is moving to a slightly contractionary stance after supporting the economy through the recession. This is an inevitable part of fiscal consolidation and returning the accounts to better health. We view the 2010 Budget as a step in the right direction in terms of encouraging saving and enterprise, while lessening the attractiveness of consumption and investment in property. But it is a step that must be followed by others.

INFLATION

Headline inflation will be extremely volatile, pushing past 5 percent for a while due to government policy changes. Excluding "one-offs", we expect underlying inflation to remain within the target band, though at the upper end of that band. We view the inflation risks as more up than down, due to emerging supply side constraints.

EXCHANGE RATE

The outlook for the NZD is dominated by global forces. This includes EUR weakness, a resurgent USD and fickle investor sentiment. We see the NZD/USD being supported by high commodity prices and rising local interest rates over the year ahead, but for NZD/AUD to head lower as Australia continues to outperform New Zealand on the growth front. On a trade weighted basis, the NZ dollar will remain firm over the near-term. However, the risk profile is that a weaker UER/USD biases the NZD/USD the same way over the coming six months.

INTEREST RATES

With the economy on the recovery path and momentum expected to accelerate later this year, the RBNZ is set to remove policy stimulus from June. We envisage a gradual tightening cycle, with a pause along the way to assess the impact. Elevated bank funding costs, more borrowers on floating rates and a steep yield curve mean the terminal cash rate will be lower for this cycle. Prospects for further global jitters may defer the initial removal of policy support, but not the spirit of rising rates towards a lower endgame.

KEY ECONOMIC FORECASTS

Calendar years	2007	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
NZ Economy (annual average % change)							
Real GDP	2.8	-0.2	-1.6	2.6	3.9	2.1	2.3
Employment	1.9	0.6	-1.1	1.1	2.2	1.7	1.7
Unemployment Rate (Dec qtr)	3.5	4.6	7.1	5.6	4.9	5.0	4.9
Terms of Trade	5.9	2.4	-6.9	10.3	2.5	-0.6	-0.4
Global Growth (annual average % change)							
United States	2.1	0.4	-2.4	2.7	2.8	3.3	2.5
Australia	4.7	2.4	1.3	3.2	3.3	3.5	3.2
Japan	2.3	-1.2	-5.2	2.0	1.8	2.1	2.0
China	12.0	9.1	8.5	10.4	9.9	10.8	9.6
Trading Partner Growth	4.2	1.7	-0.9	3.8	3.7	4.1	3.8
NZ Inflation (annual % change)							
CPI Inflation	3.2	3.4	2.0	5.0	3.0	2.4	3.1
Non-tradable Inflation	3.5	4.3	2.3	4.7	3.8	3.3	2.9
Tradable Inflation	2.8	2.3	1.5	5.4	2.0	1.3	2.8
NZ Financial Markets (end of December quarter)							
TWI	71.8	56.2	66.3	69.4	71.1	67.1	68.4
NZD/USD	0.77	0.58	0.72	0.71	0.72	0.67	0.68
NZD/AUD	0.88	0.82	0.81	0.79	0.78	0.80	0.85
Official Cash Rate	8.25	5.0	2.5	3.5	5.3	5.5	5.5
90-day Bank Bill Rate	8.9	5.1	2.8	3.8	5.7	5.8	5.8
10-year Bond Rate	6.4	4.6	5.8	5.4	6.2	6.3	5.9
Fiscal and External Balance							
Current Account Balance (\$m)	-14,200	-15,800	-5,600	-8,700	-7,700	-9,700	-11,000
as % of GDP	-5.2	-4.8	-4.3	-4.5	-4.5	-4.8	-5.0
Government OBEGAL (\$m)*	5,860	5,637	-3,893	-6,800	-7,200	-5,000	-3,900
as % of GDP	3.5	3.1	-2.2	-3.6	-3.5	-2.3	-1.7

* Operating balance excluding gains and losses, June years

Forecasts and text finalised 4 June 2010.

KEY FORECAST ASSUMPTIONS:

- Dubai oil prices are expected to trade within a US\$75 to US\$85 per barrel range for the rest of this year, gradually rising towards US\$90 per barrel by 2011.
- Annual net migration has already peaked early this year, and will ease towards 12,000 with departures picking up, especially to Australia.
- 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.
- The sovereign debt crisis in Europe is contained and does not spread contagion into the global financial system.

NEW ZEALAND ECONOMIC OUTLOOK

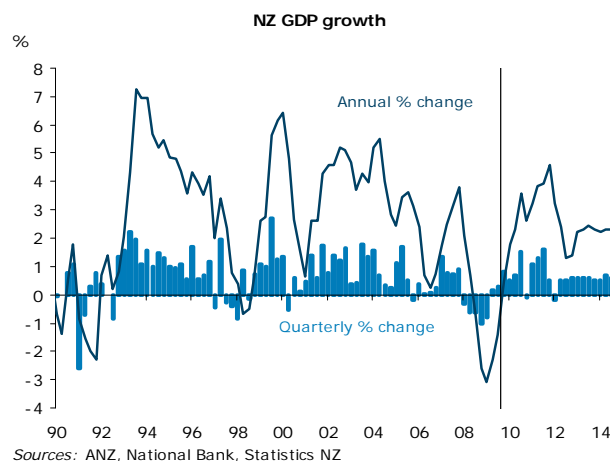
The domestic recovery is underway. This partly reflects normal cyclical dynamics, as the economy rebounds from recession following policy support. However, continued deleveraging will contribute to a more gradual recovery over much of 2010 than is typically the norm. There will be volatility in the economic data over the second half of this year due to the increase in GST. We expect growth to strengthen from late this year as these structural forces unwind, and the boost to the terms of trade flows through the economy. Beyond a strong 2011, the five year picture is one of modest growth, which in part reflects a sustained period of structural change across the economy.

THE BIG PICTURE

Right up front we need to encourage readers to focus on the spirit of our economic story, which is one of an elongated adjustment where there is growth, but intertwined with volatility. The old-school economic model where credit can grow at 2 to 3 times the rate of income growth is dead and buried. It led to excessive risk taking, unsustainable current account deficits and asset valuations that were leverage driven (based on expectations of capital gain) rather than based on fundamentals. Within the process of recovery, the global economy is undergoing a profound period of change. No longer can debt grow in excess of GDP. Regulation and prudential policy is forcing changes in behaviour. Households, businesses and even governments are largely in deleveraging mode. Resources are set to shift. Challenges remain, particularly in getting the global economy to rebalanced, which involves less spending in the West and more spending in the East. But if excessive leverage got us into the 2008/09 pickle, then leverage is not going to get us out. Hence, the need to change.

The process of change involves elements of learning, and if there is one huge layer of uncertainty over the next five years, it is about how such learning will take place. It is human nature to grab the "old" as oppose to embrace the "new". Already in 2010 we have seen some sovereigns (i.e. Greece) resist change initially by continuing to leverage up, only for market forces (in the form of widening credit spreads and soaring bond yields) to force change upon them. In the current environment, greater attention will be paid to structural indicators such as current account deficits and savings rates. Improvements in these indicators are pre-conditions to a sustainable upturn and the process of change being cemented.

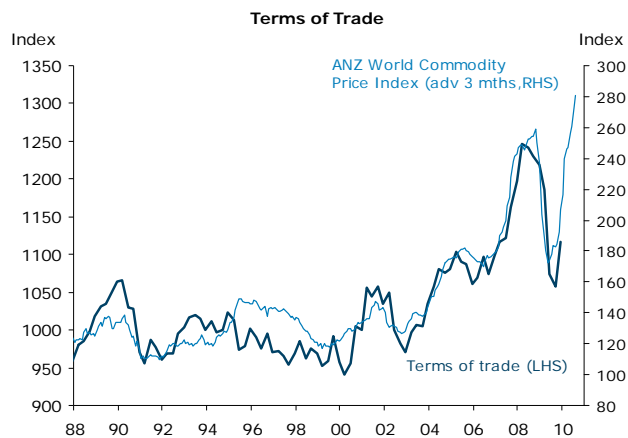
Any set of forecasts at this juncture contain a wider than normal degree of uncertainty. The after-effects from the global financial crisis continue to linger and it is unrealistic to believe such a shock passes in 18 months. Once policymakers are comfortable on the growth outlook, there is the inevitable challenge of taking the patient off life support without crippling the recovery process. To believe this will take place in a seamless fashion is rather heroic. With this in mind, we encourage readers to focus on the average rate of growth across a number of years as opposed to discrete yearly movements. **The broad spirit of our forecasts for the New Zealand economy is one where there will be positive growth, but at a lower rate on average compared to what was achieved in the previous decade.**



INITIALLY A MORE GRADUAL RECOVERY

The New Zealand economy continues to recover. This partly reflects normal cyclical dynamics, as the economy rebounds from recessionary conditions, with the rebuilding of inventories expected to provide a near-term fillip to growth. Policy support is also playing a key role, although elevated bank funding costs suggests that financial conditions are tighter than what is implied by the low OCR.

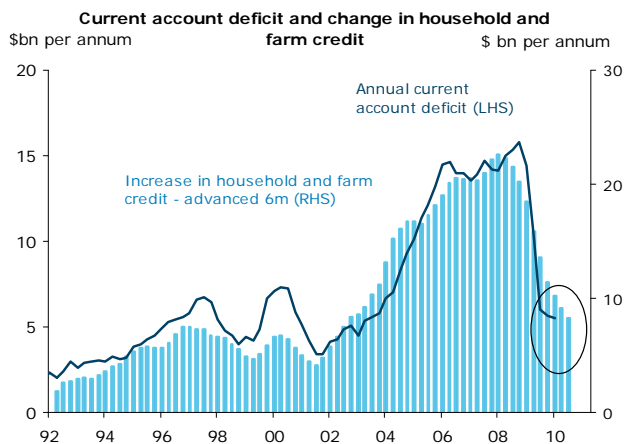
Signs of the global recovery are clearly evident in commodity prices, which have rebounded from last year's dip. New Zealand's export commodity prices have firmed to all time highs in world price and NZD terms. This is expected to translate into an improving terms of trade, and will underpin domestic spending growth. Business and consumer sentiment has strengthened, with investment and employment intentions firming.



Sources: ANZ, National Bank, Statistics NZ

While momentum indicators are pointing towards a typical cyclical recovery, growth in labour incomes and profitability remains low.

Domestic spending and the demand for imports are also being held down by ongoing deleveraging throughout the economy, with households, firms and the agricultural sector seeking to rebuild balance sheets. All are critical ingredients for a sustained and durable upswing to take hold. Low domestic interest rates and subdued business profitability are also helping to narrow the current account deficit. Despite tentative signs that the demand for credit is returning, credit conditions remain tighter than in the boom years.



Sources: ANZ, National Bank, RBNZ, Statistics NZ

These factors are expected to contribute to a modest recovery in business and consumer spending over the next few months.

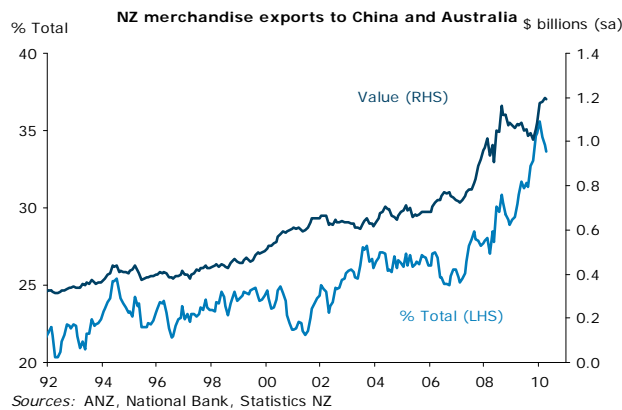
Complicating the near-term picture will be volatility associated with the increase to GST from 1 October. A sharp rise in spending, particularly on durables as consumers seek to beat the GST increase, will lead to a sharp spike in Q3 GDP. However, this will be followed by a slump in Q4.

The domestic housing market was being weighed down by an increase in inventory for sale. Prices have barely budged since late last

year, and may have been affected by uncertainty over tax changes to investment property. These factors had also been weighing down on residential building, with consents close to historical lows as a ratio of the housing stock. With the tax changes announced in the Budget not going as far as initially feared (i.e. no ring fencing of losses), we expect to see some pent-up demand being unleashed leading to a pick-up in house sales. This in turn will see building consents recover and for residential investment to undergo a cyclical upswing into 2011. At the margin, additional construction work to repair leaky buildings will provide support, now that central and local government have agreed to fund half the remedial cost.

The recovery in business investment is likely to be gradual and lag the cycle.

Profitability is constrained, with demand for credit low. Nevertheless, the capital stock should benefit from the planned increases in government capital spending. Policy support remains evident, with the growth in government spending to continue, albeit at a much reduced pace compared to earlier years. But with balance sheet repair among businesses nearing its end and profit expectations rising, we should see business investment recover off cyclical lows later this year. The cut to the company tax rate from 30 percent to 28 percent should encourage more investment at the margin.



Sources: ANZ, National Bank, Statistics NZ

Among our trading partners, stronger momentum is evident in emerging Asia and Australia.

These economies are becoming increasingly influential for New Zealand's merchandise exports. Forestry exports are expected to continue to do well, although recent weather conditions may temporarily slow the improvement in primary sector volumes. Manufacturing sector exports are expected to continue to benefit from strong demand from Australia and the US, with the favourable NZD/AUD exchange rate assisting. This currency cross will also benefit services exports where Australia is the largest source market for tourists. However, a high NZD relative to the GBP and EUR will adversely

impact visitor arrivals and tourism spending from Europe, as well as exports to those destinations.

The labour market has turned the corner and is in net job creation mode. However, wage inflation remains close to a decade low. And with the average hours worked per employee also near record lows, most of the increase in labour demand will be sourced from working the existing workforce harder. This means employment growth may be at a slower pace as the recovery progresses. Coupled with weak wage growth in the near-term, this will lead to a much more gradual improvement to labour incomes.

The improving economic outlook is expected to result in the RBNZ removing policy stimulus from June. However, the slower pace of recovery and tighter financial conditions will prompt a series of small increases in the OCR, with the RBNZ expected to pause in late 2010 with rates still below neutral levels.

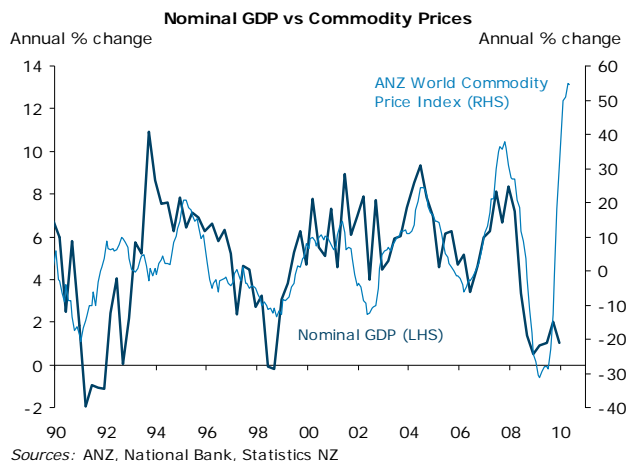
STRONGER 2011

Key drivers behind our view of a stronger 2011 are a combination of cyclical and structural factors:

- The income boost from higher export prices flows through the economy.
- An expected broadening in trading partner growth.
- Earlier balance sheet repair by firms and households has placed them on a sounder footing. Or put another way, weaker momentum in 2010 courtesy of deleveraging provides some resilience to 2011.

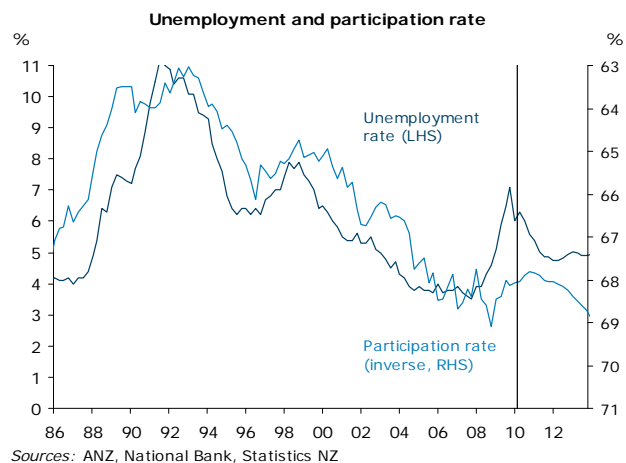
A broad-based recovery is expected to eventuate, with the economy starting to fire on all cylinders. The income boost provided by higher export commodity prices will be substantial. Some of the proceeds will be used to repair balance sheets in the rural sector and retire outstanding debt. But we assume a fair portion of the proceeds will be spent. This will lead to some tension within the outlook as the current account deficit is set to widen, contributing to a rising trajectory for New Zealand's net external debt. This is not the stuff of a sustainable recovery, but a recognition that the process of change mentioned at the start will prove to be an elongated process.

Consumer spending will also be boosted by the improvement in labour incomes as increasing demand for labour translates into increased labour hours and higher wages by late 2011. The housing market is forecast to strengthen as incomes improve, with durables consumption expected to benefit from the recovery in residential investment.



We expect a pick-up in business investment towards the end of the year as profitability increases and the narrower margin of spare capacity facilitates increasing capacity enhancing investment. The improvement in business investment is forecast to be broad based, with plant and machinery and transport equipment expected to lead the charge.

Export activity will also be underpinned by a broadening in trading partner demand, with services exports to benefit from the 2011 Rugby World Cup, and manufacturing exports being assisted by strong demand from Australia and the US, and the low NZD/AUD.



We see employment growth lagging the improvement in hours worked and the unemployment rate to gradually decline towards 5 percent by the end of next year.

The strengthening evident in economic activity and underlying inflationary pressures are expected to prompt the RBNZ to resume policy tightening from early 2011. **With the neutral OCR now estimated to be around 5 percent and the slope of the yield curve working in their favour, the endgame is likely to be a lower OCR.** We forecast the OCR to peak below 6 percent this cycle.

RISKS

We assume that global economic activity evolves broadly as projected. Clearly there are wide margins of error around this. We also assume financial market impacts from sovereign debt and liquidity issues in Europe are contained, and do not contribute to widening risk aversion and higher credit spreads, both of which could have a marked impact on New Zealand's financial conditions. If these eventuate, the projected path of monetary tightening will be even more gradual than assumed.

We also assume the NZD does not materially strengthen in response to the improving economic outlook. Implicit in this is the assumption that more of the gains from the higher terms of trade will accrue to producers. Our projections implicitly assume that a repeat of the 2000/01 boost to primary sector incomes is in prospect. However, a higher NZD could hamper the rebalancing of the economy.

Our forecasts do not incorporate a significant impact from the Emissions Trading Scheme (ETS), apart from the impact on inflation. While input costs for businesses will rise, especially in agriculture, we expect high commodity prices to allow the sector to mitigate the ETS impact. The risk is that we see a bigger negative impact on businesses as a result of the ETS.

Capacity constraints could become more pressing. Our projections assume potential growth of between 2 and 2½ percent per annum. Implicit in this is a projected recovery in business investment. If this does not eventuate, it does not augur well for the future supply-side performance of the economy.

NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years (average annual percent change)	2007	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
Total Consumption	4.0	0.8	-0.2	2.9	1.7	1.7	1.6
Private Consumption	3.9	-0.3	-0.6	3.1	1.6	1.5	1.6
Public Consumption	4.1	4.8	1.5	2.0	2.0	2.1	1.8
Total Investment	5.3	-1.2	-12.7	4.4	11.2	6.8	3.9
Residential investment	4.6	-16.3	-18.7	8.0	18.2	8.6	3.2
Other investment	5.5	2.6	-11.5	3.7	9.9	6.4	4.0
Stockbuilding¹	0.4	0.4	-2.4	2.2	0.0	-0.3	0.1
Gross National Expenditure	4.8	0.4	-5.2	5.5	3.9	2.6	2.3
Total Exports	3.8	-1.4	0.0	4.5	9.8	5.5	4.4
Goods	5.5	0.2	1.9	3.8	9.1	6.0	4.2
Services	-0.4	-5.7	-6.2	4.6	12.4	3.7	5.2
Total Imports	8.7	2.5	-15.2	13.5	9.3	7.4	5.1
Goods	8.9	3.1	-16.1	14.1	11.4	8.5	5.3
Services	8.1	0.6	-12.3	9.5	2.0	3.5	4.3
Expenditure on GDP	3.3	-0.6	-0.6	2.5	3.9	2.0	2.2
GDP (production based)	2.8	-0.2	-1.6	2.6	3.9	2.1	2.3

¹ Percentage point contribution to growth

GLOBAL OUTLOOK

Global growth is set to return towards trend although this masks a huge dichotomy between developed and emerging market economies. Risks remain though, with inflation a growing concern in China, while sovereign debt concerns is set to weigh on growth prospects in the Eurozone and potentially spill across into the wider global economy. We put the odds of a double-dip global recession at 1 in 4.

POWERING ALONG ON ONE ENGINE

Global growth has rebounded strongly.

Officially, the “Great Recession” is over with the major economies recording positive growth. However, **the global recovery has been uneven**, and in many respects is still underwritten by generous policy support. When policy rates in many countries are at record lows and government spending remains stimulatory to the detriment of the health of the fiscal position, we cannot be sure that the recovery is self sustaining. The fact that we have strong growth across the emerging world while the recovery remains tepid in the developed one, leave us uneasy despite all the near-term indicators pointing towards reasonable momentum. **The developed world has not yet deleveraged sufficiently for a quality upswing to take hold.**

The bright spot has clearly been Asian growth, particularly in China. However, the global economy cannot continue to rely solely on that region. With fears of overheating in China and concerns over a possible property bubble emerging, Chinese policymakers have been active in withdrawing liquidity. The million dollar (or is it yuan?) question remains whether the fabled soft landing can be achieved.

Trading partner growth is forecast to return towards trend growth of near 4 percent. The initial rebound is inventory led, and there is a large base effect at work. New Zealand’s two largest export destinations, Australia and China, are expected to grow strongly.

A key assumption underpinning our trading partner growth forecasts is that policymakers in China and Australia are able to guide their respective economies towards soft landings as inflationary pressures are curbed.



The emergence of wider sovereign debt concerns, which started with Greece, highlights the still fragile state that the global economy remains in. The global financial crisis saw the transfer of excessive leverage from the private sector to the public sector. Fiscal consolidation is now required but it can be difficult to forge the necessary political consensus. Considerable tensions remain in the global economy (growth versus the need to deleverage, liquidity versus solvency, leadership versus populism to name but a few). **To believe that we are embarking on the holy grail of recoveries when such tensions exist simply seems a stretch. Odds of a double-dip style recession are non-trivial.**

The big upside surprise could be the US economy. Leading indicators have been stronger than expected. The economy is starting to add jobs again. The credit tap is also slowly being turned on, which could see the US consumer awaken from their slumber. Challenges remain, but if the US economy is able to make a stronger recovery, it will help provide more support to the global recovery.

GLOBAL ECONOMIC GROWTH FORECAST

Calendar years	2007	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)
United States	2.1	0.4	-2.4	2.7	2.8	3.3	2.5
Australia	4.7	2.4	1.3	3.2	3.3	3.5	3.2
Japan	2.3	-1.2	-5.2	2.0	1.8	2.1	2.0
Euro Zone	2.7	0.5	-4.0	0.5	1.0	1.5	1.9
China	12.0	9.1	8.5	10.4	9.9	10.8	9.6
Trading Partner Growth	4.2	1.7	-0.9	3.8	3.7	4.1	3.8

FISCAL POLICY

Fiscal policy is moving to a slightly contractionary stance after supporting the economy through the recession. This is an inevitable part of fiscal consolidation and returning the accounts to better health. We view the 2010 Budget as a step in the right direction in terms of encouraging saving and enterprise, while lessening the attractiveness of consumption and investment in property. But it is a step that must be followed by others.

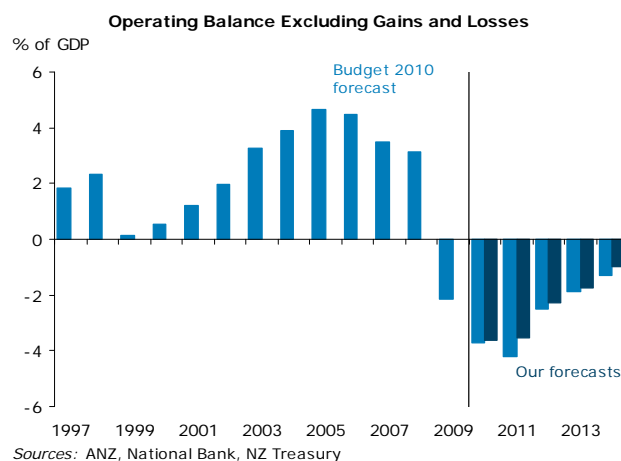
GETTING THE HOUSE IN ORDER

The fiscal position is expected to improve over the coming years. After supporting the economy through the recession via the so-called automatic stabilisers, a key imperative is that the public accounts return to the black. To do otherwise commits the next generation to higher taxes, or runs the risk of running foul with global investors (many of whom are now looking more closely at fiscal solvency). An improving tax base will contribute to a narrowing in fiscal deficits, but further expenditure restraint will also make an important contribution.

The fiscal stance is set to turn mildly contractionary. We estimate this will be equivalent to approximately 0.5 to 1 percent of GDP per year. This is part and parcel of ensuring the accounts return to the black. A key element of this will be continued expenditure constraint with the Government committing to \$1.1 billion in new discretionary spending per year (versus over \$2 billion committed per annum from 2000 to 2007). This will prove politically difficult to achieve and will involve clear spending re-prioritisation. Fiscal prudence will reduce medium-term pressure on monetary policy, with interest rates not having to go up as far as would otherwise be the case.

The underlying operating balance (OBEGAL) is expected to gradually improve from around -3.5 percent of GDP in 2010 to around -1.0 percent by 2013/14 and return to surplus thereafter. Net public debt (excluding NZ Super Fund assets) is expected to climb past 25 percent by 2013/14. But

critically, an earlier return to surpluses should ensure that the debt track starts to head lower by 2014/05. Ensuring debt remains contained is critical. While government debt is low, net external debt for the nation is high. Fiscal profligacy would be the coup-de-grace for a credit downgrade.



The Government is embarking on incremental policy change as opposed to big-bang reform.

We view changes in taxation policy in the 2010 Budget as a step in the right direction. However, other supply-side reforms will be needed to lift New Zealand's economic performance. Incremental steps can work if they move consistently in the right direction, though it will be some time before we will see the impact on economic performance. Relative to what we are seeing across a lot of other nations, the decisions enshrined in the Budget appear to display some degree of leadership, as opposed to the growing populist style decisions seen around the globe. This may provide one way for New Zealand to close the income gap with the rest of the world: we do things incrementally better and others take a step back.

FISCAL FORECAST

June years	2008	2009	2010(f)	2011(f)	2012(f)	2013(f)	2014(f)
Operating Balance (\$m)	2,384	-10,505	-3,000	-6,200	-3,000	-1,900	-500
- as % of GDP	1.3	-5.8	-1.6	-3.0	-1.4	-0.8	-0.2
OBEGAL (\$m)	5,637	-3,893	-6,800	-7,200	-5,000	-3,900	-2,300
- as % of GDP	3.1	-2.2	-3.6	-3.5	-2.3	-1.7	-1.0
Net Core Crown Debt (\$m)	10,258	17,119	26,300	36,000	44,000	51,000	60,000
- as % of GDP	5.7	9.5	13.9	17.6	20.2	22.7	25.7
Core Crown residual cash (\$m)	2,057	-8,639	-8,900	-12,500	-8,500	-7,000	-5,500
Bond Tender Programme (\$m)	1,889	5,493	12,500	12,500	10,500	9,000	6,000

INFLATION

Headline inflation will be extremely volatile, pushing past 5 percent for a while due to government policy changes. Excluding “one-offs”, we expect underlying inflation to remain within the target band, though at the upper end of that band. We view the inflation risks as more up than down, due to emerging supply side constraints.

A SERIES OF REGULAR “ONE OFFS”

Inflation is currently in the middle of the RBNZ’s target band. Yet, given the severity of the recession, and the fact that the NZ dollar did not depreciate as much as expected, it is somewhat surprising inflation did not threaten to move towards the bottom of the band. Contained but not crushed is how the RBNZ characterised it. An implication from this is that the economy was operating far above potential at the onset of the crisis and the recession merely removed such excesses as opposed to opening up abundant spare capacity. There is certainly a portion of slack, but just not as much as previously thought.

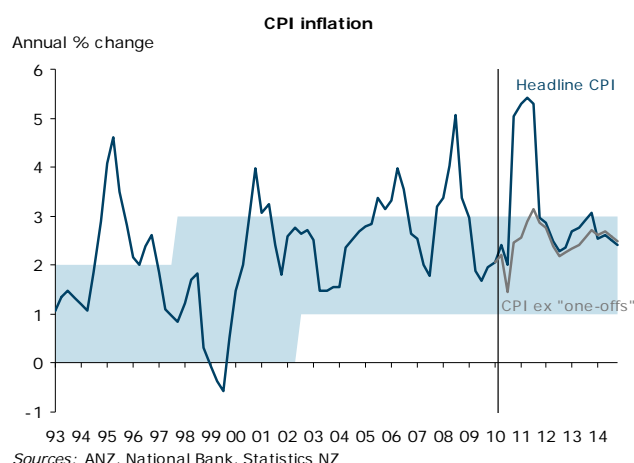
We have now seen the trough for inflation at 2 percent, and it is set to rise. Given weakness in consumer spending and intense competition, retail related prices will be held down. But with commodity prices at record highs, annual food price inflation looks set to accelerate from under 1 percent currently to above 4 percent by the end of the year. Construction costs, while subdued at present, are expected to rise as the housing market recovers, partly due to higher construction costs due to rising timber and steel prices. In addition, pricing intentions surveys have been picking up, and our monthly inflation gauge has started to detect an upward trend in domestically generated inflation.

The inflation outlook is complicated by a series of “one offs” that is going to cause volatility in the headline CPI. Increases in the tobacco tax, emissions trading scheme related charges, increases to the ACC component of motor vehicle and motorcycle registration fees, and a rise in GST from 12.5 percent to 15 percent, will take headline inflation to a peak of 5.4 percent in the June 2011 quarter. However, we expect underlying inflation, that is excluding the impact of the various “one offs”, to remain within the target band albeit hovering towards the top half of that band.

Wage growth, a key medium-term driver of inflation, is expected to remain subdued over the year ahead despite a fall in the unemployment rate. This will help contain the extent of upward inflationary pressure emanating from the labour

market, and prevent the full impact of the “one offs” on inflation flowing through into wages.

A key risk to the inflation outlook emanates from the supply-side capacity of the economy as opposed to the demand side. The economy is undergoing structural change, courtesy of the global financial crisis and concrete steps by New Zealand policymakers. Consumption excesses of the prior decade need to be repaid. However, resources do not shift instantaneously to new industries, owing to various frictions that restrict the immediate mobilisation of capital and labour. In such instances, the supply-side capacity is curtailed, which implies less ability to expand without generating domestic inflationary pressure. At present we put trend growth closer to 2 percent than 3 percent. This means inflation pressure could start to emerge much sooner in the recovery process compared to previous cycles.



CPI FORECAST

Quarter	Otr % chg	Ann % chg
Mar-10	0.4	2.0
Jun-10 (f)	0.9	2.4
Sep-10 (f)	0.9	2.0
Dec-10 (f)	2.8	5.0
Mar-11 (f)	0.6	5.3
Jun-11 (f)	1.0	5.4
Sep-11 (f)	0.8	5.3
Dec-11 (f)	0.5	3.0
Mar-12 (f)	0.5	2.9
Jun-12 (f)	0.7	2.5
Sep-12 (f)	0.6	2.3
Dec-12 (f)	0.6	2.4
Mar-13 (f)	0.8	2.7
Jun-13 (f)	0.7	2.8
Sep-13 (f)	0.7	2.9
Dec-13 (f)	0.7	3.1

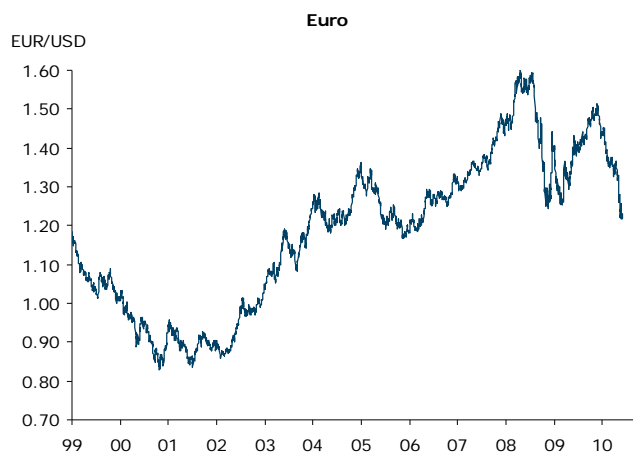
EXCHANGE RATE

The outlook for the NZD is dominated by global forces. This includes EUR weakness, a resurgent USD and fickle investor sentiment. We see the NZD/USD being supported by high commodity prices and rising local interest rates over the year ahead, but for NZD/AUD to head lower as Australia continues to outperform New Zealand on the growth front. On a trade weighted basis, the NZ dollar will remain firm over the near-term. However, the risk profile is that a weaker UER/USD biases the NZD/USD the same way over the coming six months.

BUFFETED BY GLOBAL FORCES

The NZD is the two-bit player at the roulette table. Prospects for the NZD are looking good. Higher short-term interest rates are on the way, record high commodity prices, still strong demand from China and a government that looks like a beacon of fiscal austerity relative to other countries lend support. But we live in unsettling times. The after-effects from the global financial crisis continue to linger and there are wider issues at play. Specifically:

- **The EUR remains under pressure and will likely continue to do so.** The €750bn EU/IMF stabilisation package may have fixed near-term liquidity problems for the highly indebted nations in the Eurozone, but the wider issue of solvency remains. The latter requires a fundamental improvement in competitiveness and we struggle to see that occurring without the EUR weakening further. The same applies to the GBP.

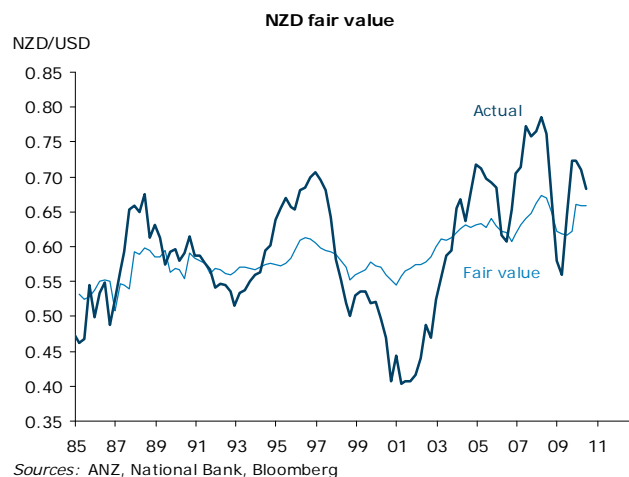


Sources: ANZ, National Bank, Bloomberg

- **An element of USD strength is emerging.** The US economy is recovering better than expected and quantitative easing has come to an end, though the US Federal Reserve is still set to leave rates on hold for some time. Say

what you like about the economic challenges still facing the US (and therefore the USD), they simply look better than the other majors. The US Treasury market is also deep and liquid, making the USD the sole natural beneficiary during times of global ructions.

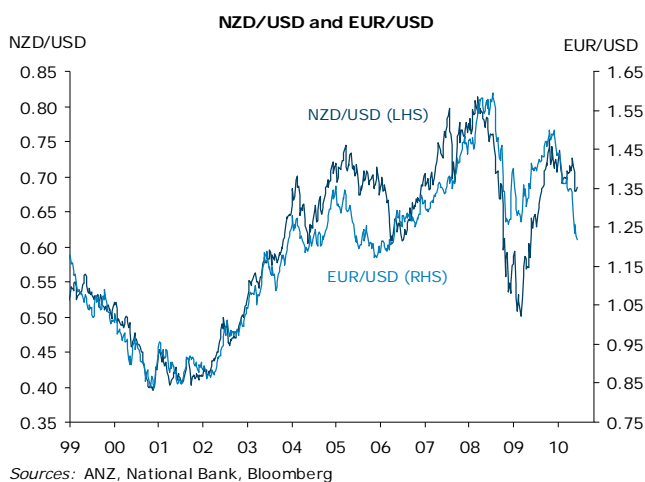
- **There is some mean reversion at play.** While currencies can be volatile beasts at the best of times, the "corrections" we have seen over the past few weeks have done nothing more than return various pairs closer to fair value. For instance, the EUR/USD started its existence in 1999 at 1.18, which is a reasonable proxy for fundamental fair value. We put fair value for NZD/USD at around 0.66 based on economic fundamentals (and this is distinct from cyclical fair value estimates that can be as volatile as the NZD itself). This is higher than the historical average of 0.59.



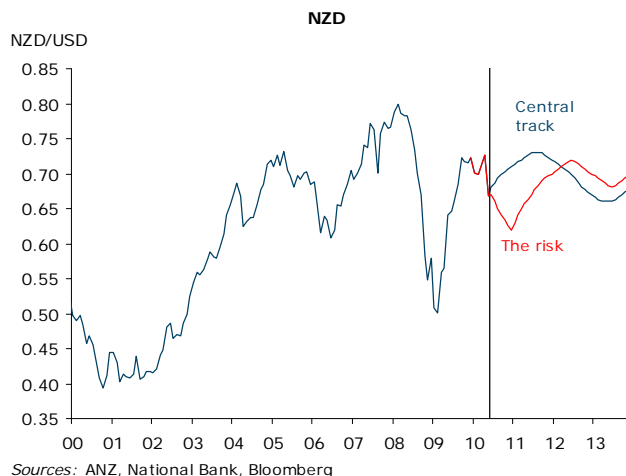
- **Positioning has been flushed.** Commodity currencies, including the NZD, have been used as a play on the global recovery story. This saw speculative net long positions being built, pushing commodity currencies higher. Recent sovereign concerns have led to questions being asked about the global recovery story, which in turn led to long positions being unwound. The NZD got caught up in the rush to square up as speculators tried to exit through a narrow door.
- **Question-marks are emerging surrounding China.** There is no doubting the medium-term story and this will support commodity prices and a general drift higher in structural fair value for the NZD over time. However, in the near-term, inflation pressures are uncomfortably high. The Chinese equity market has underperformed global peers (down 22 percent year to date, compared to the 6.6 percent loss in the MSCI World Index). There is also a hot

debate raging over whether there is a property bubble or not, and if so when it will pop.

We expect broad EUR/USD direction to remain pivotal for the NZD. If the EUR is heading down, the USD becomes somewhat of a default play, thereby capping upside NZD strength. Recent market movements look to be overdone, so there is potential for some pull-back. But the spirit is simple. We see the EURUSD heading to 1.12 by mid next year, which makes it tactically difficult for the NZD/USD to retest previous highs. But it also biases the NZD/EUR up over the year ahead. We forecast the NZD/EUR to surpass the previous 2005 high of 0.6094.



A key assumption in our NZD forecast is that we will see a delinking from wider EUR moves, as the market differentiates New Zealand's better fiscal position and favourable terms of trade in a positive light. However, the clear risk is that the close historical correlation between NZD/USD and EUR/USD reasserts itself, which will bias the NZD down over the rest of this year. If this were to occur, then ongoing EUR/USD weakness could see NZD/USD head towards the low 0.60s by year-end.



Despite recent AUD/USD weakness, we continue to favour a gradual appreciation towards 0.90 by year-end. The RBA may be on hold for now, and Q1 GDP showed a moderation in growth. But Australia's macroeconomic fundamentals are among the strongest in the developed world. Moreover, unlike most other developed economies, Australia still has significant scope to loosen fiscal or monetary policy should global conditions suddenly deteriorate sharply. While this would hurt AUD in the short-term, it would also set the scene for a solid AUD rebound once risk appetite starts to recover.

We see the NZD/AUD remaining within a 0.78 to 0.82 range for the foreseeable future. We still see the NZD/AUD biased towards the lower end of that range in the near-term due to Australia's economic outperformance. However, we do not expect to see a re-test of the 0.76 low seen in April. Overall, on a trade weighted basis, the NZD will continue to firm in the year ahead, mainly due to gains against the GBP and EUR.

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 (f)	0.68	0.81	63.2	0.48	0.55	66.4
Sep-10 (f)	0.70	0.80	66.5	0.50	0.58	68.3
Dec-10 (f)	0.71	0.79	68.2	0.49	0.60	69.4
Mar-11 (f)	0.72	0.78	69.8	0.49	0.63	70.7
Jun-11 (f)	0.73	0.78	71.5	0.48	0.65	71.7
Sep-11 (f)	0.73	0.78	73.0	0.47	0.65	71.8
Dec-11 (f)	0.72	0.78	72.0	0.46	0.64	71.1
Mar-12 (f)	0.71	0.79	71.7	0.45	0.63	70.5
Jun-12 (f)	0.70	0.80	71.4	0.44	0.61	69.5
Sep-12 (f)	0.68	0.79	71.4	0.42	0.59	67.9
Dec-12 (f)	0.67	0.80	70.4	0.41	0.58	67.1
Mar-13 (f)	0.66	0.80	70.6	0.40	0.56	66.4
Jun-13 (f)	0.66	0.83	70.6	0.40	0.56	66.5
Sep-13 (f)	0.67	0.84	73.7	0.40	0.56	67.6
Dec-13 (f)	0.68	0.85	74.8	0.40	0.57	68.4

INTEREST RATES

With the economy on the recovery path and momentum expected to accelerate later this year, the RBNZ is set to remove policy stimulus from June. We envisage a gradual tightening cycle, with a pause along the way to assess the impact. Elevated bank funding costs, more borrowers on floating rates and a steep yield curve mean the terminal cash rate will be lower for this cycle. Prospects for further global jitters may defer the initial removal of policy support, but not the spirit of rising rates towards a lower endgame.

TAKING THE FOOT OFF THE ACCELERATOR

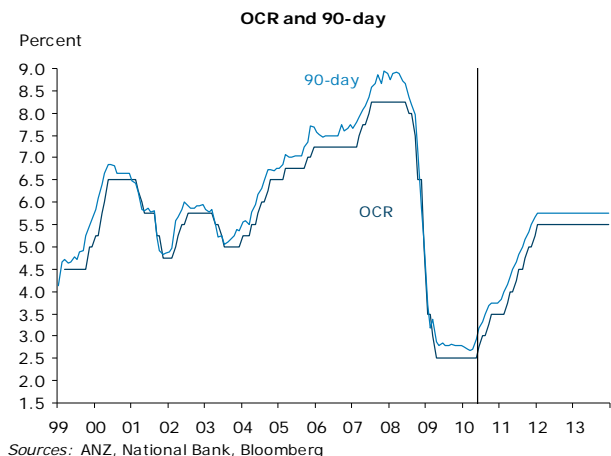
Based on local considerations the RBNZ will feel comfortable raising interest rates in June.

The recovery remains patchy and there are still pockets of weakness – particularly housing. But there is no doubting that the recovery is on track. The unemployment rate is falling and commodity prices have risen strongly. There are signs that banks are starting to free up on the availability of credit, and inflation expectations are starting to drift up.

Global ructions make June itself a tight call.

Some caution is warranted given volatility in financial markets as concerns over the sovereign debt situation in Europe spread. However, **at present we have not seen sufficient negative impact on NZ.Inc to really say the RBNZ should not go.** The banking sector continues to have access to global capital markets, albeit at a slightly more expensive rate. The US Libor rate has started to stabilise after rising over the past few weeks. But even the increase in Libor has been gradual as opposed to the sharp spikes seen when Lehman's went under in late 2008. But clearly there are strong reasons to be cautious at this juncture with an inevitable flow-on from what we are seeing in Europe. It is just a question of degree.

The spirit of our interest rate view is one of rising rates, but in a gradual manner. Indeed, the challenge for the RBNZ is to raise rates to a more neutral setting (a somewhat arbitrary concept) without derailing the economic recovery. Hence, the focus is very much on removing policy stimulus, as opposed to moving to a tightening stance. In layman's terms, the RBNZ is taking the foot off the accelerator as opposed to stepping on the brakes. This is a fine balancing act considering the structural forces that are occurring at the same time (e.g. deleveraging, tax changes, increased bank regulations).



Sources: ANZ, National Bank, Bloomberg

Our tightening profile has four consecutive 25bp hikes starting from June, taking the OCR from 2.5 to 3.5 percent by October. This is followed by a pause to assess the impact, before embarking on the next stage of the tightening cycle from early next year, which will eventually see the OCR back towards neutral. We see the neutral rate at close to 5 percent. **The main message is that the policy normalisation path will be a gradual one.**

Of course there is another, historically appealing, scenario where rates move to neutral and beyond relatively quickly as the RBNZ ends up "behind the curve". This was the case in the early 1990's and again over 2004/05. While the structural dynamics mentioned above lean heavily against this, we would never want to rule it out. "This time it's different" is a graveyard phrase for economic (and interest rate) views. The most likely candidates driving this scenario seem to stem from either:

- the historical experience where once the New Zealand economy gets going, it proves difficult to rein in as we seek to return to the "old" normal, or;
- the China story being maintained and New Zealand following the Australian terms of trade experience, or;
- the diminished supply side capacity of the economy becoming problematic for the inflation outlook.

The RBNZ's new prudential liquidity policy, alongside proposed new global banking regulation, should ensure that we do not go back to the "old" normal. The China story remains compelling over the medium-term. But we see the policy actions by Chinese policymakers to slow down growth and bring inflation down as dampening the extent of further commodity price

gains from here.

The final point about diminished supply side capacity is one we hold most concerns about.

Credit growth into the business sector is down – not a positive sign for business investment. Capital imports have been picking up of late but off a low base. At the same time it looks like the unemployment rate has peaked. Arguably getting the right labour-capital mix is just as important as the tradable-non-tradable mix to growth. While the latter is improving, the former is deteriorating, which will have negative implications for future productivity growth. Monetary policy outcomes are determined by both supply capacity and demand. The risk is that diminished supply lead to a quicker emergence of inflation, forcing the RBNZ's hand.

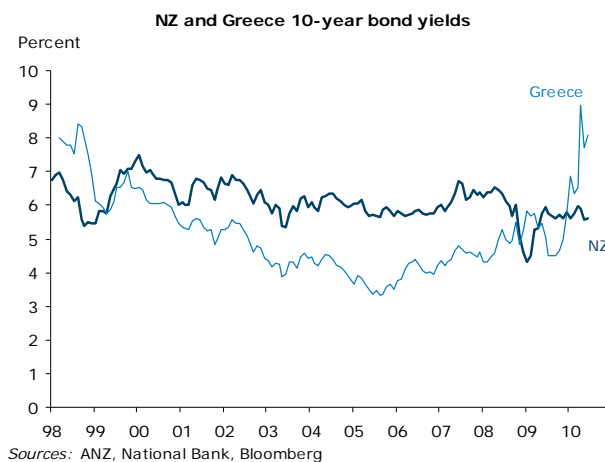
EXIT STRATEGIES ON HOLD?

Internationally, some central banks have already started to tighten policy. The RBA has tightened by 150bps since October last year though are now on hold. China has raised their reserve requirements several times, as well as tightening lending into the property sector. The Bank of Canada has started their tightening cycle early this month. The US Federal Reserve has withdrawn all the liquidity facilities which were put in place during the global financial crisis, and their quantitative easing policy has expired.

But we are set for a longer period of accommodative monetary policy in the major economies. The sovereign debt crisis in Europe is forcing much more aggressive and earlier fiscal consolidation, at a time when growth in the Eurozone area is still fragile. The European Central Bank has been forced down the route of quantitative easing, while the Bank of England has not ruled out enlarging the size of their asset purchase programme. The US Federal Reserve is in no hurry to hike rates, especially when their unemployment rate is yet to turn despite a return of positive jobs growth.

To date, the sovereign debt crisis has not resulted in higher borrowing costs for the New

Zealand government. On the contrary, New Zealand government bond yields have actually fallen. We are being seen as a legitimate “safe-haven” destination for investments, courtesy of our enviable level of government debt, high credit rating and strong macroeconomic framework (e.g. floating exchange rate, an independent central bank and fiscal transparency). The increased demand for New Zealand government bonds has helped keep a lid on interest rates, contributing to a widening in swap spreads recently. That is, while swap yields have been rising as the market prices in tightening by the RBNZ, government bond yields have been falling. We expect this trend to continue.



Nonetheless, broadly speaking we expect long bond yields to drift higher as the RBNZ embarks on the tightening cycle. Even though the market is expecting rate hikes, the actual announcement typically sees swap and bond yields rise, at least in the early stages. Interest rates will peak well before the rate hike cycle matures, but that is several quarters away. Barring a surprise (and most pundits expect that to be either China getting speed wobbles or European sovereign debt issues spilling over into money markets), anticipate rates to continue grinding higher for the foreseeable future.

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 (f)	2.75	3.2	4.4	5.2	5.5	3.2	5.3
Sep-10 (f)	3.25	3.7	4.6	5.3	5.4	3.2	5.4
Dec-10 (f)	3.50	3.8	4.7	5.4	5.4	3.2	5.5
Mar-11 (f)	3.75	4.2	5.1	5.7	5.6	3.3	5.7
Jun-11 (f)	4.25	4.7	5.4	5.9	5.8	3.3	5.8
Sep-11 (f)	4.75	5.2	5.9	6.4	6.2	3.6	6.0
Dec-11 (f)	5.25	5.7	6.1	6.4	6.2	3.6	5.9
Mar-12 (f)	5.50	5.8	6.1	6.4	6.1	3.6	5.8
Jun-12 (f)	5.50	5.8	6.1	6.3	6.0	3.6	5.6
Sep-12 (f)	5.50	5.8	6.1	6.3	6.1	3.7	5.7
Dec-12 (f)	5.50	5.8	6.2	6.5	6.3	4.0	6.0
Mar-13 (f)	5.50	5.8	6.1	6.4	6.1	3.9	5.9
Jun-13 (f)	5.50	5.8	6.0	6.2	5.9	3.7	5.8
Sep-13 (f)	5.50	5.8	6.0	6.2	5.9	3.7	5.8
Dec-13 (f)	5.50	5.8	6.0	6.2	5.9	3.7	5.8

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
Real Gross Domestic Product												
Total GDP, QPC	-0.8	0.2	0.3	0.8	0.5	0.7	1.5	-0.1	1.1	1.3	1.6	0.5
Total GDP, APC	-3.1	-2.3	-1.4	0.5	1.8	2.3	3.6	2.6	3.2	3.9	4.0	4.6
Total GDP, AAPC	-1.4	-2.2	-2.3	-1.6	-0.4	0.8	2.0	2.6	2.9	3.3	3.4	3.9
Real GDP Components												
Private Consumption, QPC	-1.1	0.4	0.9	0.9	0.5	0.6	3.0	-2.0	0.4	0.6	1.2	0.3
Private Consumption, AAPC	-1.1	-1.4	-1.2	-0.6	0.5	1.6	2.9	3.1	3.0	2.7	1.5	1.6
Public Consumption, QPC	0.4	-1.3	0.6	0.9	0.5	0.6	0.6	0.3	0.4	0.4	1.0	0.5
Public Consumption, AAPC	4.2	3.1	2.6	1.5	0.9	1.3	1.6	2.0	2.3	2.1	1.9	2.0
Residential Investment, QPC	0.8	-2.4	-4.1	4.9	2.0	1.5	5.0	5.0	4.0	4.0	6.0	2.0
Residential Investment, AAPC	-22.6	-24.8	-25.3	-18.7	-11.8	-4.9	4.2	8.0	12.2	16.0	17.6	18.2
Other Investment, QPC	-6.6	-0.3	-0.9	-2.5	2.0	3.8	1.7	1.6	2.1	4.0	1.9	2.0
Other Investment, AAPC	-1.0	-7.5	-10.1	-11.5	-9.7	-5.1	-1.3	3.7	6.6	8.4	9.6	9.9
Gross National Expenditure, QPC	-2.6	-2.0	0.7	3.0	1.3	1.3	2.3	-0.6	1.1	1.4	1.1	0.6
Gross National Expenditure, AAPC	-1.7	-4.1	-5.6	-5.2	-3.2	0.4	4.1	5.5	5.7	5.2	3.9	3.9
Exports, QPC	0.3	4.6	0.2	-0.9	2.0	0.7	1.3	2.9	2.0	2.9	3.8	1.4
Exports, AAPC	-3.3	-3.9	-3.2	0.0	3.0	3.6	3.8	4.5	4.8	6.7	9.0	9.8
Imports, QPC	-7.7	-2.7	1.5	6.0	3.8	3.0	4.1	0.9	2.0	2.8	2.1	1.7
Imports, AAPC	-4.6	-12.5	-16.5	-15.2	-9.1	0.4	9.3	13.5	13.8	12.6	10.1	9.3
Prices												
Headline CPI, QPC	0.3	0.6	1.3	-0.2	0.4	0.9	0.9	2.8	0.6	1.0	0.8	0.5
Headline CPI, APC	3.0	1.9	1.7	2.0	2.0	2.4	2.0	5.0	5.3	5.4	5.3	3.0
Non-tradable CPI, QPC	0.7	0.5	1.0	0.1	0.5	0.8	0.7	2.6	1.0	0.9	1.0	0.8
Non-tradable CPI, APC	3.8	3.3	3.0	2.3	2.1	2.4	2.1	4.7	5.2	5.4	5.7	3.8
Tradable CPI, QPC	-0.4	0.8	1.6	-0.5	0.1	1.0	1.2	3.0	0.2	1.1	0.5	0.2
Tradable CPI, APC	1.7	0.2	-0.1	1.5	2.0	2.3	1.9	5.4	5.5	5.5	4.8	2.0
External Accounts												
Annual Balance on Goods, % of GDP	-0.6	0.4	1.2	1.3	1.1	1.1	1.1	1.4	1.6	1.6	1.8	1.6
Annual Balance on Services, % of GDP	-0.6	-0.5	-0.4	-0.2	0.0	0.0	0.1	0.2	0.3	0.4	0.7	0.9
Annual Balance on Invisibles, % of GDP	-6.6	-5.4	-4.1	-4.2	-4.1	-4.9	-6.2	-6.0	-6.3	-6.3	-6.3	-6.2
Annual Current Account Balance, % of GDP	-7.8	-5.5	-3.2	-3.0	-2.9	-3.8	-5.1	-4.4	-4.4	-4.3	-3.8	-3.6
Net International Invnt Position, % of GDP	-94.4	-93.2	-93.3	-90.2	-89.9	-89.3	-88.5	-87.3	-86.3	-85.2	-84.1	-83.1
Terms of Trade (SNA basis)												
Export Prices, QPC	-3.7	-9.4	-5.5	-2.2	6.8	5.5	2.9	2.9	1.0	0.5	0.5	-0.4
Export Prices, APC	8.4	-4.0	-13.5	-19.3	-10.6	4.1	13.3	19.2	12.7	7.4	4.9	1.6
Import Prices, QPC	-1.8	-4.0	-7.0	-4.7	1.9	1.8	1.1	1.6	1.0	0.6	0.3	0.1
Import Prices, APC	18.0	6.3	-7.7	-16.5	-13.3	-8.1	0.0	6.6	5.7	4.4	3.6	2.1
Terms of Trade, QPC	-1.9	-5.6	1.6	2.6	4.8	3.6	1.8	1.2	0.0	-0.1	0.2	-0.5
Terms of Trade, APC	-8.1	-9.7	-6.2	-3.4	3.2	13.2	13.4	11.8	6.7	2.9	1.3	-0.4
Labour Market												
Employment, QPC	-1.3	-0.5	-0.7	0.0	1.0	0.2	0.4	0.6	0.6	0.7	0.6	0.4
Employment, APC	0.7	-0.9	-1.8	-2.4	-0.1	0.6	1.7	2.2	1.8	2.3	2.5	2.3
Labour Force, QPC	-0.8	0.4	-0.1	0.7	-0.1	0.5	0.1	0.1	0.4	0.3	0.4	0.4
Labour Force, APC	2.0	1.2	0.6	0.2	0.9	1.0	1.1	0.6	1.1	0.9	1.3	1.5
Unemployment Rate, sa	5.1	5.9	6.5	7.1	6.0	6.3	6.0	5.6	5.4	5.0	4.9	4.9
Participation Rate, sa	68.4	68.4	68.0	68.1	68.1	68.1	67.9	67.8	67.9	67.9	68.0	68.1
Private Sector Wages (apc)	5.1	3.7	4.4	3.1	1.6	1.8	0.5	1.4	2.3	1.8	2.0	2.2
Public Sector Wages (apc)	4.2	5.6	5.9	5.7	3.7	3.5	1.6	1.6	1.5	1.5	1.4	1.5

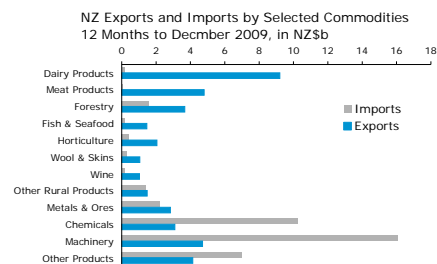
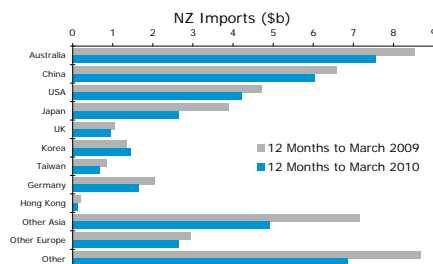
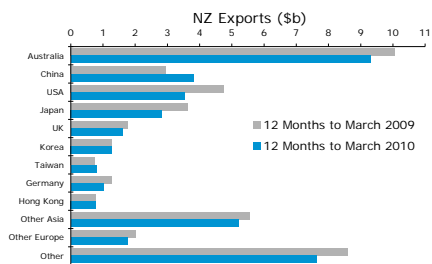
Forecasts in bold

QPC – quarterly percent change

APC – annual percent change

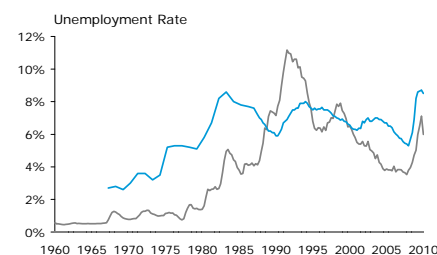
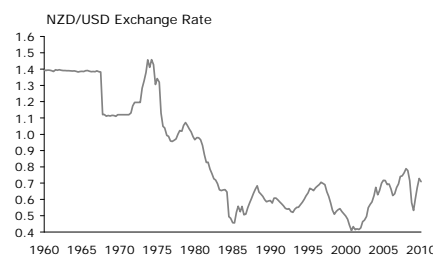
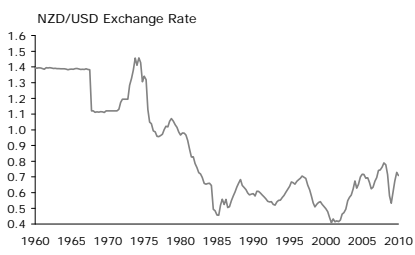
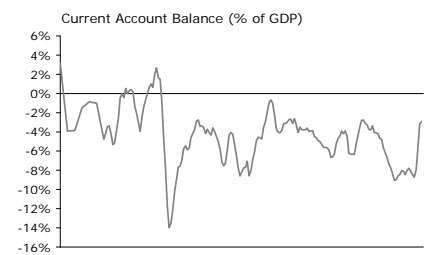
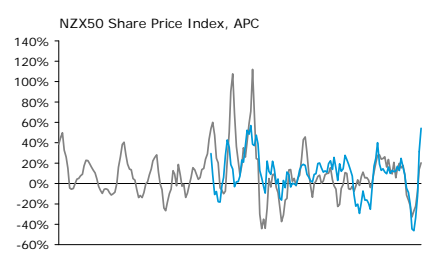
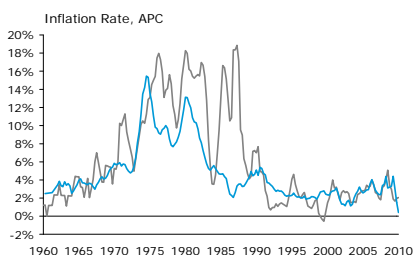
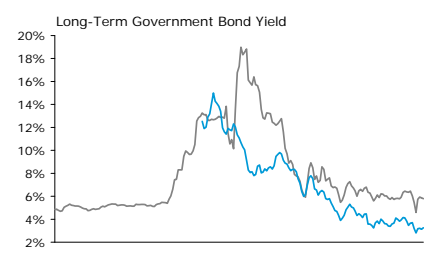
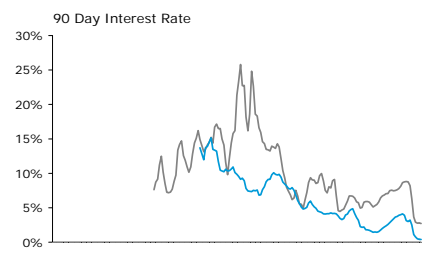
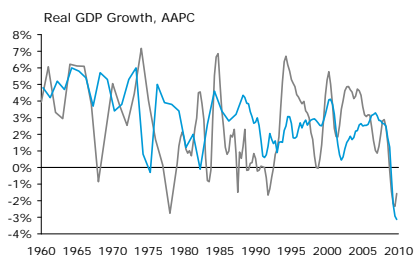
AAPC – annual average percent change

sa – seasonally adjusted



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 ²	271	7,713	9,373	378	244	9,561	357	92	36	330	1	1	1,905
Inhabitants per km ²	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\$	186	1,413	20,175	7,120	3,096	69,746	4,734	1,184	537	271	298	251	770
Change in real terms (yr-on-yr %)	-1.6	2.7	0.0	-1.4	-3.1	10.8	-2.1	6.1	9.3	4.5	1.7	5.1	4.8
Nominal GDP per capita in NZ\$	43,474	65,941	65,332	55,176	48,223	5,739	56,361	25,515	25,234	10,151	42,722	55,204	3,428
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)	-2.9	-4.2	-2.9	3.1	-1.3	0.6	5.2	4.2	11.2	16.6	8.7	19.1	1.9



DISCLOSURE INFORMATION

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

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

Qualifications, experience and professional standing**Experience**

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

Relevant professional body

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

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

Professional indemnity insurance

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

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

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

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

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

Criminal convictions

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

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

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

Fees

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

Other interests and relationships

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

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

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

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

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

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

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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