Economic Overview

July 2011

Westpac

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Against the tide

Welcome to Westpac's quarterly Economic Overview. On the back cover you will find comprehensive economic forecasts, while the articles inside delve into the New Zealand economy, the global economy, and financial markets.

There are three main messages to take away.

First, the global economy is entering a distinct soft patch. Central banks in Asia are determined to cool their overheating economies. Ballooning government debt is taking a toll in the United States and Europe. And most importantly for us, consumer confidence is plunging in Australia.

Second, after three tough years the New Zealand economy is finally experiencing a bona fide recovery. The economy gathered quite a head of steam over the first half of 2011 despite the Canterbury earthquakes, and we believe growth will accelerate further over the coming year or two.

By the way, it is not all that unusual for New Zealand growth to "decouple" from the global cycle in this way. In 2001 and 2002 New Zealand enjoyed high growth while the global economy merely puttered along. And the tables were turned last year, when we languished while the global economy steamed ahead. Being small, the New Zealand economy is sometimes buffeted by idiosyncratic developments such as local climatic conditions.

The third and final key message is that interest rates are going up. It may not happen immediately, or even soon. But it will happen. We are forecasting a three percentage point rise in interest rates over the course of two years, which is a lot more than markets are currently pricing in.

Dominick Stephens
Chief Economist

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Picking up the pace

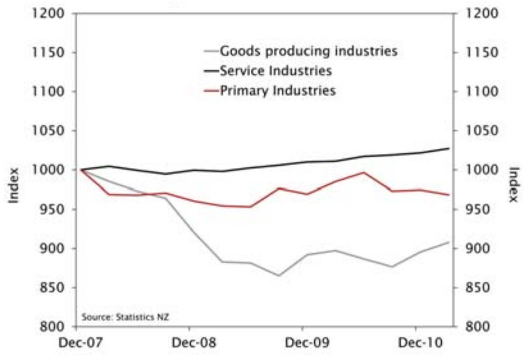
New Zealand's economy is gaining momentum, supported by high commodity prices, low interest rates and increasing confidence. Although the net effect of the Canterbury earthquakes wasn't as severe as first feared, the massive rebuilding task will still dominate New Zealand's growth prospects for some time to come. Add to this a strong pickup in business investment and ongoing improvement in domestic demand, and GDP growth is set to accelerate strongly next year.

A head of steam

New Zealand's economic recovery gained momentum in recent months, despite the ground continuing to shake in Canterbury. Although February's quake caused massive damage (equivalent to around 8% of New Zealand's GDP – much larger relative to the size of the economy than other big natural disasters such as Kobe, or Hurricane Katrina) there was more limited disruption to national economic activity than initially feared. For example, Statistics New Zealand concluded that there was no discernible impact at the national level from extended school closures in the region. Statistics New Zealand reported widespread displacement of economic activity (meaning economic activity migrated from one place to another, rather than disappearing altogether). And disruption that did occur was partially offset by increased activity in other sectors in the immediate aftermath of the earthquake. For example, the increased emergency civil defence activity and thousands of EQC assessments taking place. Add to this news that activity in late 2010 was considerably stronger than first thought – and the New Zealand economy is on much firmer footing than we feared 3 months ago.

Manufacturing made a strong contribution to March quarter growth but this is following a very weak period. Manufacturers have been hit hard by the high New Zealand dollar, which makes imported goods relatively cheaper and reduces the competitiveness of New Zealand manufactured exports in offshore markets. Solid manufacturing growth ensured that the goods producing sectors grew most strongly in the March quarter (1.4%). However the level of activity in this sector is still well below pre-recession levels (figure 1). In contrast the service industry sector has continued to gradually expand while the primary sector has led the way in recent years (despite posting a modest decline in the March quarter).

Figure 1: Sectoral real GDP



While GDP growth of 1.4% for the year to March provided confirmation of greater momentum in activity, we had already been tipped off by the rapid rebound in the confidence of both firms and households. Nationally, business and consumer confidence has recovered to (or even surpassed) pre-quake levels — no doubt helped in part by the Reserve Bank's 50 basis point insurance rate cut in March. Firms' reports of trading activity from the Quarterly Survey of Business Opinion suggest momentum continued into the middle part of the year. Consumers too are

more optimistic about the year ahead – including in Canterbury where households see job prospects improving, a nod to the surge in demand that will accompany the eventual rebuild in the region.

A noticeable improvement in the housing market has provided support for domestic demand, especially in Auckland. Housing turnover there is up 27% on a year ago, while nationwide house sales are 14% higher. Although turnover had started to move higher before February's earthquake, the RBNZ's interest rate cut almost certainly gave the market an extra leg up. House price gains however have been more modest. We continue to expect house prices nationwide to be up about 4% in 2011 before returning to zero price action amid rising interest rates.

Figure 2: House sales and prices

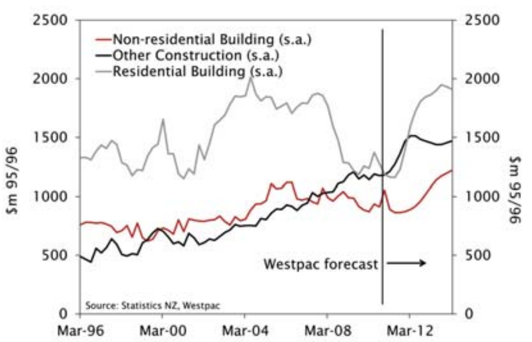
Against this backdrop, consumers have gradually begun to open their wallets. Electronic card transactions have shown solid gains — despite retail activity in Canterbury remaining about 5% below its pre-quake levels. Yet for many retailers, while the recent improvement in sales is no doubt welcome, they will still find that times are tougher than a few years ago. Consumers are still spending 8.5% less per person than they were at their 2007 peaks.

The other factor that has been helping both business and consumer confidence, particularly in the rural sector, has been recent strength in commodity prices combined with excellent growing conditions in many regions. This confidence is gradually starting to be reflected in farmers' spending decisions. Tractor registrations are rising strongly, anecdotally farmers are increasingly willing to spend on farm inputs (such as fertiliser) while retail sales are up most strongly in rurally dominated regions. Nevertheless the factors that have been a drag on rural spending over the last year remain in the background. Rural property prices have broadly stabilised (the volume of farm sales has even ticked up in recent months) but show no signs of recovery to pre-GFC levels. High debt levels remain a concern for some in the sector (although improving cash flows have provided some relief).

Rebalancing Act

So from this strong starting point, we are expecting growth to accelerate rapidly next year. However, the drivers of this growth over the next few years will look quite different to last decade, with debt accumulation playing a lesser role. One of the most obvious drivers will be mammoth rebuilding task in Canterbury. This is set to dominate New Zealand's economic growth profile over the coming years. While there remains considerable uncertainty around the pace of rebuild, our judgement is that residential building activity will begin in earnest next year. Longer lead times for non-residential construction mean activity in this sector won't really ramp until 2013. Infrastructure repair and replacement, which also makes up a significant chunk of the $15bn-plus estimated spend, is expected in grow strongly for a number of years.

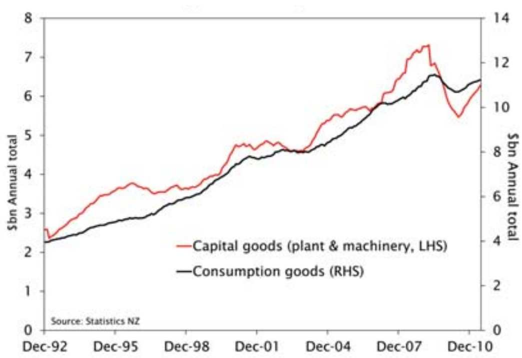
Figure 3: Construction activity by sector



And while earthquake reconstruction is a mammoth task, we also expect growth in residential building activity in particular to increase beyond Canterbury. Prolonged weakness residential building activity (June consent issuance is just half of 2007 peaks) has meant the supply of houses has not kept pace with ongoing population growth. As employment and wage growth improve and house prices stabilise, this squeeze will underpin the demand for new housing.

Another important feature of the outlook is stronger investment in plant and machinery and transport equipment. After underinvestment during the prolonged recession, imports of capital equipment have soared since the start of the year. And with interest rates low, finance availability much better now than in recent years and the strong New Zealand dollar making importing capital an attractive option, conditions are ripe for substantial increase in investment. Added to this one-offs such as the specialist capital equipment required for rebuilding and repairing in Canterbury and Air New Zealand's fleet upgrade, and business investment is set to boom in 2012.

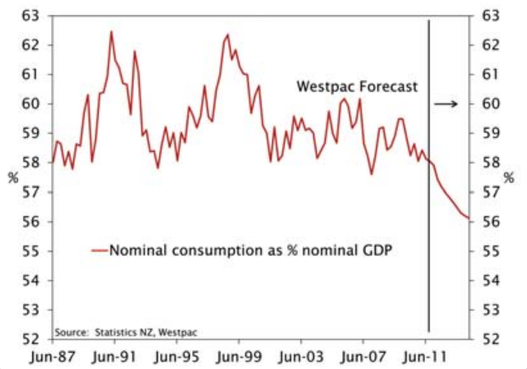
Figure 4: Imports of consumer, capital goods



Elevated commodity prices should continue to provide support for New Zealand's externally focused sectors. But we don't expect commodity prices to remain at such extremely high levels in the second half of the year. Instead commodity prices are forecast to soften as the pace of emerging market demand growth slows, high prices on offer encourage producers worldwide to lift production and some of the supply disruptions present over the last year dissipate. Yet despite expecting some volatility in commodity prices in the near term, we are not backing away from our longer term view that increasing demand for food globally will outpace increases in supply, putting upward pressure on food prices over the medium term.

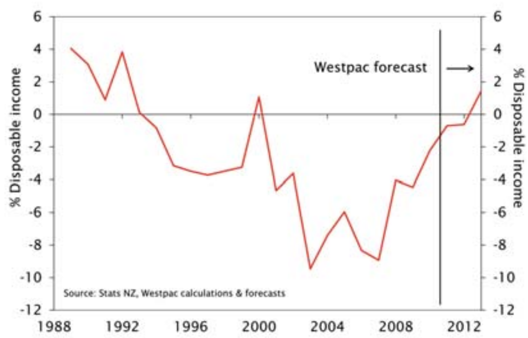
International developments are however providing something of a headwind. Closest to home, the outlook for the Australian economy has deteriorated – led by a softer outlook for the Australian consumer (discussed further in "Growing and Slowing Pains" pg 10). New Zealand's tourism sector is sure to feel a chill wind from the cooling Australian economy. Australian tourists are the lynchpin of the New Zealand tourism industry and while the strong Australian dollar is making New Zealand an affordable destination, we think this will be outweighed by the sharp deterioration in consumer sentiment which will eventually flow through to softer Australian consumer spending. Fortunately the Rugby World Cup should provide a much needed fillup in the second half of the year.

Figure 5: Nominal consumption



Consumer demand is expected to gradually improve from here, but will not be the engine of economic growth that it was last decade. Instead, growth in consumer spending will lag the broader economy (itself supercharged by Canterbury reconstruction). Despite improving job prospects, households will be squeezed by rapidly rising interest rates and a return to zero house price inflation in 2012. Solid wage growth should allow households to both continue to modestly increase spending but also reduce debt. At a national level, our forecasts imply that the household savings rate continues to increase. While in the near term this attitude acts as something of a drag on growth, over the medium-term it is a critically important rebalancing which will mean a more robust economy.

Figure 6: Household savings rate



Rates heading higher

Having seen stronger GDP and inflation figures, financial markets are now fully on board with the message that the RBNZ will resume raising interest rates soon. We see reason for caution in the near term, given the (possibly over-exuberant) exchange rate and the precarious global environment, but we think that interest rates will ultimately need to rise further than the market or the RBNZ anticipates.

Interest rates and inflation

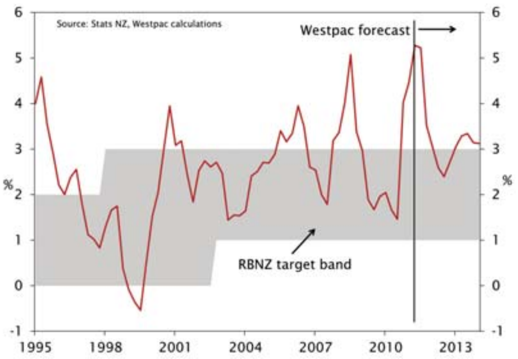
It's been eerily quiet on the interest rate front since the Reserve Bank's half-percent 'insurance' rate cut in March. But that fact hides the major forces that have been working against each other in that time: the stronger leads on the domestic economy on the one hand, and the rising sense of alarm in European and US markets on the other. The recent upside surprises to GDP and inflation have swung the balance decisively towards the first factor, and the market is now fully on board with the idea that the Official Cash Rate will be heading higher over the next few years.

The remaining questions are the timing and extent of rate hikes. The June *Monetary Policy Statement* was a significant advance on previous RBNZ statements, as it signalled that the timing was no longer seen as linked to the start of reconstruction in Christchurch, but would be "guided by the speed of recovery." The RBNZ's projections suggested a hike in December; market pricing has oscillated between this September and next March.

On domestic conditions alone, the RBNZ has enough evidence now that the insurance rate cut is no longer needed and could be unwound today. The domestic economy has outstripped expectations by surging ahead over the first half of 2011. Domestic demand is expected to accelerate into next year, and given the unusually high degree of certainty about the source of this growth (being partly insurance-funded reconstruction), there is a case to be made for pre-emptive tightening.

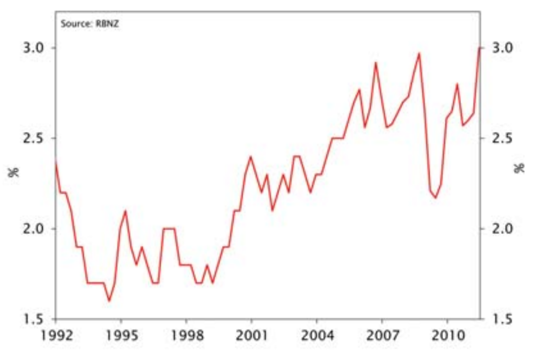
Perhaps most importantly, there have been worrying signs on the inflation front. The fact that inflation hit a 21-year high of 5.3% in the year to June 2011 is not in itself a major concern, as it was boosted by a number of temporary factors in the last year, including hikes in GST and ACC levies, the Emissions Trading Scheme, and spikes in global oil and food prices (figure 7). But there are also signs that underlying inflation is warming up. Most intriguing was the 0.9% lift in the 'home ownership' category, which captures the cost of construction – one of the RBNZ's biggest headaches during the 2003-07 boom. We have been anticipating a bout of construction-cost inflation as the Christchurch reconstruction effort squeezes the industry's resources; to see it happening this early doesn't bode well.

Figure 7: Inflation forecasts



As always, a short-term spike in inflation should only concern the RBNZ if it infects wage and price expectations, thereby generating second-round inflation. But the news here is not good either. The RBNZ's quarterly survey found that expectations for inflation two years ahead have reached 3%, the highest in the inflation-targeting era (figure 8). Business surveys show that pricing intentions are on the rise, and the perceived scarcity of finding skilled workers is nearing the levels seen in last decade's tight labour market, despite unemployment remaining near 11-year highs for the last year.

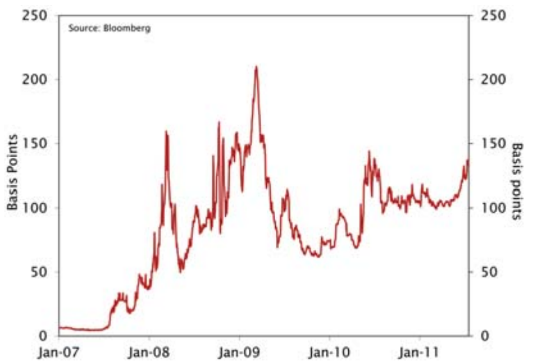
Figure 8: Inflation expectations 2yrs ahead



However, we see two factors that could leave the RBNZ cautious about earlier tightening. The first is that the New Zealand dollar has soared to new post-float highs (see below), which will directly help to contain inflation. Moreover, the RBNZ has a historical tendency to delay OCR hikes on the grounds that higher interest rates would cause a further unwelcome appreciation of the exchange rate.

The second factor is the gathering clouds around the global economy (see the International Outlook section). Australian consumers' loss of confidence could hit the NZ tourism industry, and slower growth in China and India could hurt commodity export prices. Most importantly, financial markets' concern about the impact on European banks of the inevitable debt restructure in Greece (not to mention worries about the long-term solvency of bigger countries like Italy), has caused a squeeze in credit markets that is being felt worldwide. Credit default swap (CDS) spreads for the Australasian banks have risen to their highest level since May-June last year, when Greece first required a bailout (figure 9). IF CDS spreads remain high for long, bank funding costs could rise, leading to a de facto tightening independently of the RBNZ, as seen in 2009.

Figure 9: Australian bank CDS spreads



Barring any reversal in these two factors, we continue to forecast a December rate hike, later than the Sep-Oct start that the market is currently pricing in. The real point of difference in our forecasts remains in the extent of the tightening cycle. The RBNZ's most recent projections suggested an OCR peak of around 4.5% by early 2013; market interest rates, despite the more aggressive near-term profile, imply a peak of around 4%. We expect OCR hikes to continue through 2013, reaching a peak of 6%.

We have long been sceptical of the idea that the 'neutral' level of the OCR has permanently fallen in the wake of the global financial crisis. Notably, the RBNZ's assumption of a lower neutral rate was partly based on a sense that a 2.5% cash rate was providing less stimulus than expected; the latest GDP figures (including upward revisions to history) test that logic.

Secondly, on our forecasts, Christchurch reconstruction activity will see the NZ economy running above its long-term potential for an extended period. That implies some monetary rigour will be needed just to keep average inflation near the upper bound of the 1-3% target.

Exchange rates

It's been largely one-way traffic for the New Zealand dollar in the past few months. After a period of relative stability that extended all the way back to late 2009, the trade-weighted index has risen to its highest level since February 2008. Against the US dollar, the currency's rise has been more spectacular, reaching a new post-float high above 86 cents. Gains against the US dollar alone are somewhat understandable – rightly or wrongly, the market has regarded the increasingly dangerous global environment as most negative for the USD, which appears to be losing its 'safe haven' status (that dubious honour now belongs to, if anything, the Swiss franc).

What's more puzzling is why the NZ dollar is performing so well against a broad range of currencies in such an environment, with the NZD/AUD cross rate providing the most intriguing test. Having plumbed a two-decade low of around 73c in March, the cross rate has since bounced to 80c. Our modelling suggested that a bounce was due – expectations for GDP growth and interest rates have swung in NZ's favour, and it was already stretched from its long-term 'fair value' (figure 10). However, including current bank CDS spreads in our model, as a proxy for the difficulty of raising offshore funding (New Zealand, with a larger overseas borrowing requirement than Australia, is more vulnerable to global financial shocks), points to a weaker NZ dollar. Either the market is taking a punt that global financial conditions will quickly improve, or the rise in the NZD/AUD cross rate has been overdone.

Figure 10: NZD/AUD fair value model

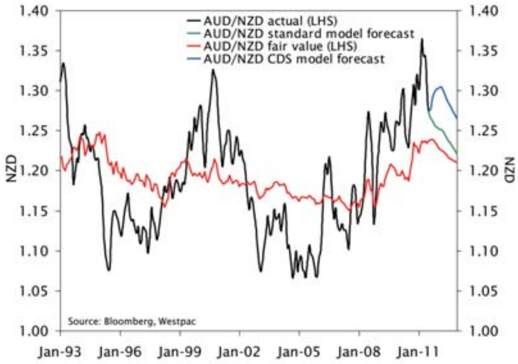
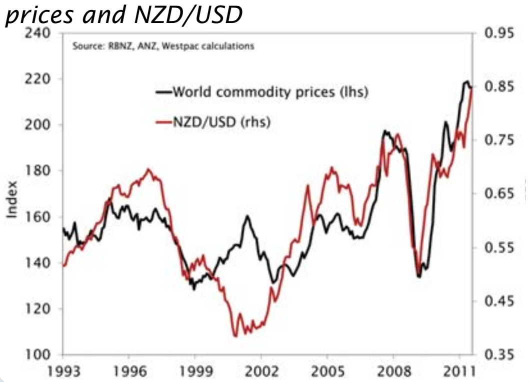


Figure 11: Inflation-adjusted commodity prices and NZD/USD



Stratospheric global food prices have been supporting the NZD (figure 11). But as China continues its managed slowdown and other parts of the Northern Hemisphere soften, we expect food prices to enter a cyclical downswing over the next year, which would drag the NZD lower. That said, we do expect both the currency and export commodity prices to remain at higher levels than the average of the past few decades, even through the cyclical downturn.

Financial Markets Forecasts (end of qtr)

	OCR	90 Day Bill	2 Year Swap	5 Year Swap	NZD/ USD	NZD/ AUD	NZD/ EUR	NZD/ GBP	NZD/ JPY	TWI
Sep-11	2.50	2.70	3.60	4.50	0.82	0.77	0.58	0.51	68.1	71.54
Dec-11	2.75	3.20	3.90	4.70	0.79	0.78	0.57	0.50	67.2	70.29
Mar-12	3.25	3.50	4.20	5.00	0.77	0.78	0.56	0.48	67.0	68.98
Jun-12	3.50	3.90	4.60	5.30	0.76	0.78	0.57	0.47	67.6	69.15
Sep-12	4.00	4.20	4.90	5.60	0.77	0.78	0.57	0.46	67.0	69.11
Dec-12	4.25	4.70	5.30	5.90	0.78	0.78	0.57	0.45	66.3	69.16
Mar-13	4.75	5.00	5.60	6.00	0.78	0.78	0.57	0.43	65.0	69.21
Jun-13	5.00	5.40	5.80	6.20	0.77	0.78	0.57	0.42	63.8	68.42
Sep-13	5.50	5.70	6.00	6.30	0.75	0.79	0.57	0.40	63.4	67.81
Dec-13	5.75	6.10	6.20	6.40	0.74	0.79	0.57	0.40	62.9	67.39
Mar-14	6.00	6.20	6.30	6.40	0.74	0.79	0.57	0.40	63.6	67.54

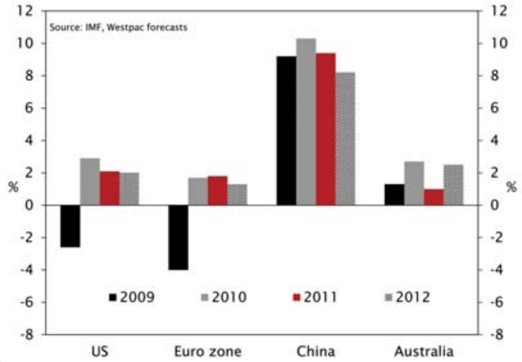
Growing and slowing pains

Global growth prospects have started to look shakier in recent months. A slowing in China and in the beleaguered G-3 was always on the cards and doesn't dent New Zealand's medium-term export outlook. But the Australian domestic economy is starting to look weaker than expected, and the risk of sovereign debt woes precipitating fresh financial turmoil has grown.

It's been a nervous few months for global economy watchers, as global growth has lost steam, the European sovereign debt crisis continues to simmer, and fears have grown that the US, too, may slide into technical default. Some of the slowdown that we're seeing hasn't come as a surprise to us. If anything, China will probably need to slow more than it has to date to avoid higher inflation. And we aren't too surprised by a loss of momentum in the major Northern Hemisphere economies, where deep structural problems were always going to make years of sub-par growth likely once the initial burst of policy stimulus ended. That said, the global economy is facing some additional headwinds relative to a few months ago. The Japanese earthquake of 11 March has wreaked havoc with global production chains, particularly in the automotive sector. In Australia, which has been grappling with some of the growing pains associated with a mining boom, it's starting to look as if the non-mining part of the economy is hunkering down to a greater extent than expected. And as growth slows the potential threats to fiscal sustainability in the US and parts of Europe are starting to look a little more real.

In all likelihood, the hit to growth from the Japanese earthquake will be temporary, and a period of slower global growth doesn't change the stellar longer-term outlook for New Zealand's exports, which is driven by much longer-lived patterns of Asian economic development. But commodity prices will probably ease over the next year or so – hard commodity prices have already come off, food prices are likely to follow. Tourist operators and non-commodity exporters will feel a consumer-led slowdown in Australia, New Zealand's biggest trading partner. And while we think markets have largely digested the likelihood of a debt restructuring in Greece or Ireland, if any of the currently unthinkable should happen – a technical default in the US, a significant deterioration in the debt outlook for Spain or Italy – the resulting market turmoil could make global funding conditions a lot more challenging. That's largely a question of politics – can the political actors in those countries find a way to share the pain of slow growth and austerity? We will continue to watch developments. What's certain is that as long as Northern Hemisphere fiscal problems remain unresolved financial markets will stay jittery.

Figure 12: Trading partners' GDP growth



China

China, India and other fast-developing Asian economies are slowing because they cannot keep growing at the breakneck rates seen over the past two years without rising inflation pressures. In China, inflation topped 6% in May, only in part due to the boom-bust nature of Chinese pork prices, and in India, inflation has risen above 9%. In response, governments have been gradually tightening monetary policy – in the past 9 months, the Chinese central bank has raised interest rates three times and tightened bank reserve requirements 9 times, and Indian interest rates have been hiked 10 times.

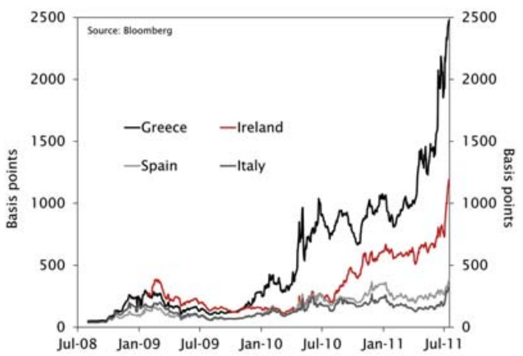
So far, the consequences have been very mild, particularly in China, New Zealand's second largest trading partner. At 9.5% over the year to June, China's GDP growthm was only slightly lower than in the year to March, and the data are pointing to ongoing momentum in real estate investment. We do expect that tighter monetary policy will eventually bite. Signs of an impending slowdown are already present - lending has slowed from its previous unsustainable pace, business surveys have come off, and there are signs of cooling in the car and housing markets. We expect a further correction in the Chinese property market later this year as construction currently in the pipeline hits the market. But this is a managed slowdown and we don't expect a crash.

Australia

Australia has had to deal with its own share of natural disasters, as cyclones and floods brought about a 1.2% decline in March quarter GDP. Business activity has since rebounded, though Australian coal exports are likely to take longer to recover. But floods aside, the Australian economy is looking less rosy than one might have expected given terms of trade at near 50 year highs. Consumer confidence is approaching lows last seen in the aftermath of the GFC, and business confidence has sagged. Weak confidence is showing up in retail spending, and may exacerbate a slowing in the labour market.

On the one hand, Australia is facing some of the challenges that come with a commodity boom. The uplift in Australia's national income has boosted population and jobs growth, but also caused inflation, prompted interest rate hikes and lifted the exchange rate to multi-decade highs. This is squeezing investment and spending in the non-mining parts of the economy. At the same time, even as mining companies' investment intentions grow ever more stratospheric, actual capital spending in the sector has undershot plans, and there are reports of individual projects hitting bottlenecks and delays.

Figure 13: Sovereign CDS spreads



But it's fair to say that confidence has taken more of a hit than we've been allowing for. Surveys show Australian households fear for their finances and are becoming more nervous about their housing wealth (house prices have peaked and are now below where they were a year ago). Overall we now expect below average growth in Australian domestic demand this year and next.

The G-3

The Japanese earthquake has dented manufacturing along the Japanese supply chain, particularly in the car and electronics industries. Japan itself was particularly hard hit, as were some Asian countries such as Malaysia and the Philippines, but the earthquake has also affected manufacturing in the US and Europe. But the earthquake effects are likely to be temporary – though it remains well below pre-quake levels, Japanese production has already rebounded sharply.

US and European consumer spending has also been squeezed by high fuel prices. Inflation has eroded all gains in US households' spending power this year. But oil prices have eased from their April peaks and are likely to fall further if growth in Asia continues to moderate, which will restore some of those real income losses.

But the malaise in the G-3 economies goes deeper than earthquake disruption and fuel prices. The US continues to suffer the consequences of a burst housing bubble, including revenue shortfalls at state and local government level which are now forcing budget cutbacks. We would also argue that the US has been experiencing a slow decline in underlying competitiveness — its terms of trade (the price of its exports relative to its imports) have been sliding since the late 1990s as the US has increasingly been squeezed between low-cost competitors in developing Asia and rising commodity prices. And if US fiscal problems look daunting, those in parts of Europe look close to insurmountable – with a fixed exchange rate and a European Central Bank keeping a hawk's eye on inflation, Greece and Ireland have little scope to export or inflate their way out of debt.

These problems mean pain and low growth for the countries affected, but a fast-growing G3 was never a crucial part of the New Zealand and Australian commodity boom story. The main concern for New Zealand is that sovereign defaults in any of these countries could lead to another spike in funding costs. The risk here is less a Greek or Irish debt restructuring – that's close to inevitable and everyone knows it – than a run on one of the larger European economies if debt prospects there start to look shakier. Some of this risk is political (agreement on the necessary austerity packages and bailouts may not come in time), some economic (for example, the Spanish banking system could take a turn for the worse, beyond what the latest European bank stress tests allowed for). The major dramas being played out over the past few months have been of the political kind: US politicians continue to play hard ball over the increase in the Federal debt limit that is needed for the US government to be able to roll over its debts; and while the Greek parliament has ratified a new austerity package in the face of huge opposition, the form of a new bail-out deal for Greece still needs to be agreed. And in Italy, market fears about the ongoing political will to avoid default (there and in Brussels) have led to funding spikes and forced more austerity, showing that the risk of contagion beyond the worst problem countries is still very much present.

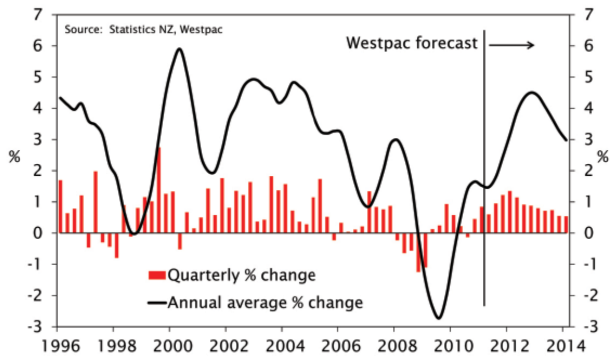
Economic and Financial Forecasts

Economic Forecasts (Calendar Years)	2007	2008	2009	2010	2011f	2012f
New Zealand						
Real GDP % yr	2.9	-0.1	-2.0	1.7	2.4	4.5
CPI inflation % annual	3.2	3.4	2.0	4.0	3.5	2.7
Unemployment %	3.4	4.5	7.0	6.7	6.1	4.8
Australia						
Real GDP % yr	4.0	2.2	1.3	2.7	1.0	2.5
CPI inflation % annual	3.0	3.7	1.8	2.8	3.2	2.4
Unemployment %	4.8	4.4	5.6	5.2	4.9	5.6
United States						
Real GDP %yr	1.9	0.0	-2.6	2.9	2.1	2.0
Consumer Prices %yr	2.9	3.8	-0.3	1.6	2.7	2.1
Unemployment Rate %	4.6	5.8	9.3	9.6	8.9	8.8
Japan						
Real GDP %yr	2.2	-1.5	-6.6	4.3	-0.5	4.0
Consumer Prices %yr	0.1	1.4	-1.3	-0.7	0.2	0.6
Unemployment Rate %	3.9	4.0	5.1	5.1	4.7	4.6
Euroland						
Real GDP %yr	2.8	0.3	-4.0	1.7	1.8	1.3
Consumer Prices %yr	2.1	3.3	0.3	1.7	2.4	1.6
Unemployment Rate %	7.5	7.5	9.5	10.0	10.3	10.5
United Kingdom						
Real GDP %yr	2.7	-0.1	-4.9	1.4	1.0	1.4
Consumer Prices %yr	2.3	3.6	2.2	3.2	4.0	2.8
Unemployment Rate %	5.3	5.6	7.6	7.8	8.0	8.2
China						
Real GDP %yr	14.2	9.6	9.2	10.3	9.4	8.2
Consumer Prices %yr	4.8	5.9	-0.7	3.3	4.8	2.7

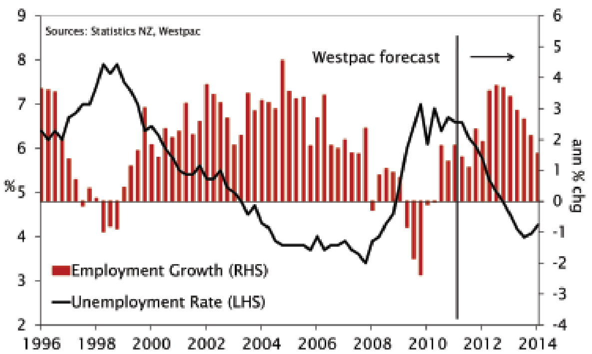
Forecasts finalised 22 July 2011

Annual Average % change	March years				Calendar years			
	2011	2012f	2013f	2014f	2010	2011f	2012f	2013f
Private consumption	1.9	2.1	2.7	1.8	2.2	1.9	2.7	2.0
Government consumption	2.4	1.0	-0.8	-0.4	2.3	2.1	-1.7	0.6
Residential Investment	2.3	7.2	35.0	6.2	2.8	-2.2	41.0	9.4
Business Investment	7.0	12.9	9.9	6.1	2.1	12.4	11.9	6.3
Stocks (% contribution)	1.4	0.3	0.2	0.0	1.9	-0.1	0.3	0.1
GNE	4.6	5.0	5.0	5.0	4.1	4.5	5.4	3.2
Exports	2.0	5.3	3.3	3.7	3.0	4.6	3.7	3.5
Imports	10.4	9.1	5.1	2.5	10.1	8.7	6.3	3.0
GDP (Production)	**1.5**	**3.1**	**4.4**	**3.0**	**1.7**	**2.4**	**4.5**	**3.3**
Employment (% annual)	1.8	1.9	3.4	1.6	1.3	2.3	3.7	2.1
Unemployment Rate (% s.a. end of period)	6.6	5.7	4.5	4.2	6.7	6.1	4.8	4.1
Private sector labour cost index	1.8	3.1	3.9	3.7	1.6	2.3	3.7	3.8
Inflation (% annual)	4.5	2.9	3.0	2.8	4.0	3.4	2.6	2.9
Current Account Balance (% of GDP)	-4.2	-5.5	-6.8	-5.3	-4.1	-4.8	-6.9	-5.7
Terms of Trade	6.8	-6.4	1.4	4.0	12.3	-2.1	-3.6	5.1
90 Day Bank Bills (end of period)	3.00	3.50	5.00	6.20	3.18	3.20	4.70	6.10
5 year swap (end of period)	4.54	5.00	6.00	6.40	4.60	4.70	5.90	6.40
TWI (end of period)	67.2	69.0	69.2	67.3	67.8	70.3	69.2	67.4
NZD/USD (end of period)	0.76	0.77	0.78	0.74	0.76	0.79	0.78	0.74
NZD/AUD (end of period)	0.75	0.78	0.78	0.79	0.77	0.78	0.78	0.79
NZD/EUR (end of period)	0.55	0.56	0.57	0.57	0.56	0.57	0.57	0.57
NZD/GBP (end of period)	0.47	0.48	0.43	0.40	0.48	0.50	0.45	0.40

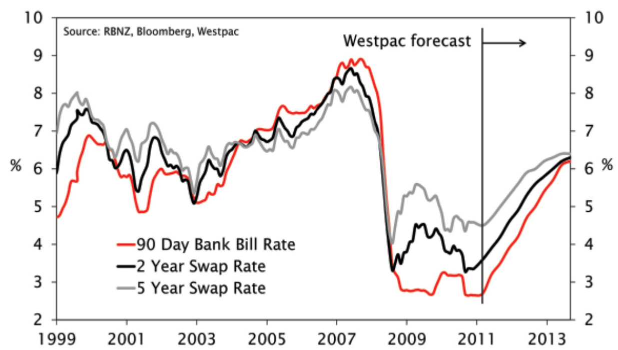
New Zealand GDP growth



New Zealand employment and unemployment



90 day bank bills, 2 year and 5 year swap rates



NZD/USD, NZD/AUD and TWI