Monetary Policy Statement

December 2009[1]

This *Statement* is made pursuant to Section 15 of the Reserve Bank of New Zealand Act 1989.

Contents

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1 Projections finalised on 27 November 2009. Policy assessment finalised on 9 December 2009.

1 Policy assessment

The Official Cash Rate (OCR) remains unchanged at 2.5 percent.

The New Zealand economy continues to recover but there remains considerable uncertainty about the durability of the expansion.

Global activity has continued to rebound. Most obviously, activity in Australia, China and emerging Asia continues to increase and solid growth is expected over the next few years.

The picture is more mixed in the major developed economies. While activity is expanding, sustained growth is not assured. Financial sectors are still impaired in a number of economies and economic activity is still heavily dependent on policy support.

In New Zealand, the economy continues to recover, reflecting improved world growth, higher export commodity prices, increased government spending and housing strength. A key uncertainty is the extent to which higher house prices are eventually reflected in increased consumer spending. At this point credit growth remains subdued suggesting households are being relatively cautious.

While business confidence has improved, actual business spending remains weak. In addition, the high level of the New Zealand dollar has limited the scope for exports to contribute to the recovery. After some short-term correction the current account deficit is expected to widen in the future.

Annual CPI inflation is expected to remain below 2 percent until early 2011 and track within the target range over the medium term.

The economy is being assisted by both monetary and fiscal policy support. As growth becomes self sustaining, fiscal consolidation would help reduce the work that monetary policy might otherwise need to do.

If the economy continues to recover, conditions may support beginning to remove monetary stimulus around the middle of 2010. Recent tightening in financial conditions, driven by a higher exchange rate, increased long-term interest rates and a wider gap between the OCR and bank funding costs, reduces the need for more immediate action.

Alan Bollard

Governor

2 Overview and key policy judgements

The New Zealand economy continues to recover, reflecting the positive impacts of an improved world outlook, higher export commodity prices and increased house prices. However, we continue to see little need to increase the OCR immediately, given tighter financial conditions brought about by appreciation in the New Zealand dollar, growing market expectations of an increase in the OCR and increasingly aggressive competition for deposits among financial institutions. Importantly, annual CPI inflation is forecast to remain inside the target range over the medium term.

Global activity has continued to rebound. Indeed, activity throughout our trading partner economies seems likely to have expanded over the second half of 2009. Most obviously, activity in Australia, China and emerging Asia continues to increase. Despite these improvements, medium-term risks remain. Without ongoing monetary and fiscal support, the capacity for a sustained global recovery remains unclear, and household wealth, while well up on its early 2009 trough, is still below its pre-crisis level. Nonetheless, we now expect annual trading-partner growth to average about 3.5 percent over the projection.

As a result, export commodity prices have increased significantly. While gains have occurred for a variety of commodities, including aluminium and forestry, the most significant improvement has been in international dairy prices. According to auction data, these prices have increased by almost 90 percent since their July low, and almost 50 percent since September *Statement* was finalised.

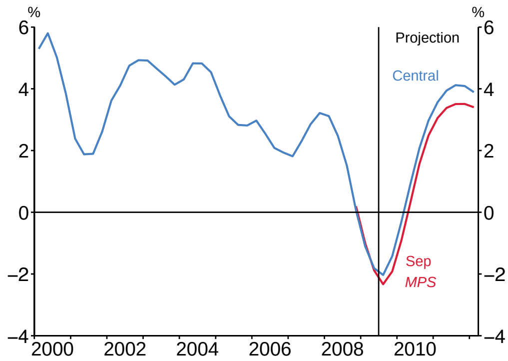
The improved outlook for global growth and increased export commodity prices are clearly beneficial. However, in aggregate, we expect these gains to be largely offset by recent appreciation in the New Zealand dollar. As such, our outlook for modest export earnings growth is relatively unchanged from the September *Statement*.

Domestically, we believe New Zealand has moved out of recession and estimate that the economy grew only slightly below trend through the second half of 2009.

The housing market has strengthened considerably. Despite turnover remaining quite muted, house prices have risen from their early 2009 trough. We expect stronger activity in the housing market to be mirrored by a pick-up in residential building. Consistent with this, retail spending appears to have troughed, suggesting improved consumer confidence will soon flow through to higher sales.

Overall, we expect growth to be relatively strong over the coming year or so, as activity regains its pre-recession level (figure 2.1).

Figure 2.1
GDP growth
(annual average)



Source: Statistics New Zealand, RBNZ estimates.

Many firms elected to retain workers through the recession, so it is likely that increased demand will initially be met by increasing the hours of existing staff, rather than through new hiring or capital investment. It would seem then, that just as the impact of the recession on the unemployment rate is turning out to be surprisingly muted, so too might the impact of the recovery on employment growth.

Turning to the outlook for inflation, appreciation in the New Zealand dollar over the past few months has seen the outlook for tradable inflation reduce noticeably. Despite gains in world commodity prices, we expect tradable prices to decline over the coming six months.

Offsetting this, the outlook for non-tradable inflation has increased. Through the recession, we were surprised by the extent to which non-tradable prices held up. Construction costs, for instance, hardly declined, despite significant contraction in building activity. Furthermore, rents held broadly steady, despite house prices falling about 10 percent.

It seems the recession simply took the heat out of inflation, rather than driving it to an especially low rate. Wage inflation, while easing significantly, moderated to only just below average. Similarly, inflation expectations, while

Box A

Recent monetary policy decisions

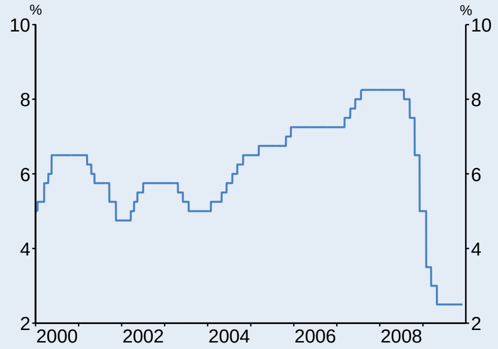
The OCR was cut by 5.75 percentage points in the nine months between the July 2008 and April 2009 OCR reviews (figure A1). This unprecedented rate of reduction was in response to a rapidly deteriorating global outlook, tightening credit conditions, widening interest rate spreads, and continued contraction in the New Zealand economy – all of which were projected to result in a significant reduction in medium-term inflation.

Financial markets tend to price some degree of interest rate normalisation once participants believe that the OCR has reached a peak or a trough. This tendency was last apparent in 2006, where markets expected the then historically high OCR to be reduced, despite the outlook for inflation remaining elevated.

In an attempt to combat this tendency, the Bank communicated repeatedly its expectation that the OCR would be kept at 2.5 percent for a considerable period. We believe this communication has helped reduce the extent to which markets priced near-term OCR increases.

The degree to which the New Zealand economy has contracted and inflation pressures abated suggests these attempts to prolong monetary policy stimulus were appropriate.

Figure A1
Official Cash Rate

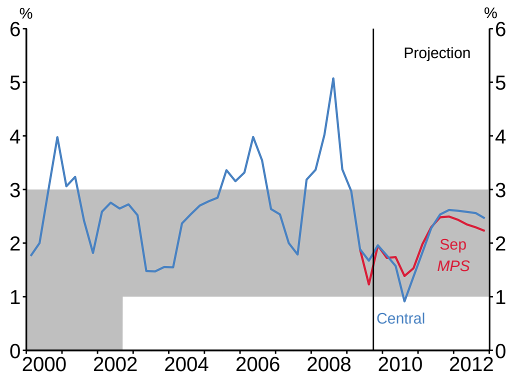


Source: RBNZ.

falling sharply, did not move below the centre of the CPI inflation target band.

Overall, because of weak tradable inflation, we expect annual headline CPI inflation to remain below 2 percent through calendar 2010. In 2011, partly driven by an assumption that the New Zealand dollar will moderate from the middle of next year, annual CPI inflation is projected to increase to 2.6 percent. Beyond this, inflation is expected to moderate (figure 2.2).

Figure 2.2
CPI inflation
(annual)



Source: Statistics New Zealand, RBNZ estimates.

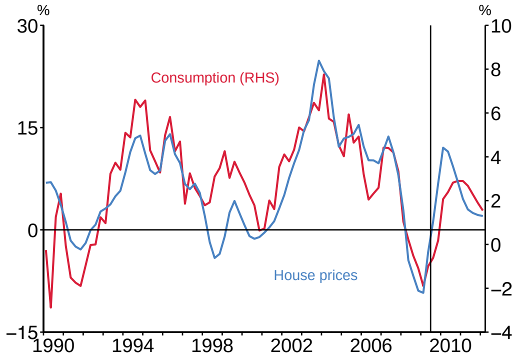
Monetary policy judgements

Over recent months, we have been surprised by the extent to which house prices have risen. Despite relatively muted turnover, the housing market has tightened significantly, with properties selling very quickly. As discussed in the September *Statement*, this appears due to unusually low numbers of properties being offered for sale while demand for properties appears to have lifted, given relatively strong population growth. However, evidence of a lack of accommodation in New Zealand remains mixed, with residential rents holding steady. As such, the sustainability of house price increases over the medium term is questionable.

These uncertainties aside, with mortgage rates still below average and relatively strong net immigration, it is likely that house prices will continue to rise in the short term. However, with permanent and long-term departures to Australia likely to rise, we expect house price inflation will moderate through 2010. Beyond this, price gains of note seem unlikely given the high cost of houses relative to household income.

But perhaps even more uncertain than the outlook for the housing market is the extent to which its recent pick-up is eventually reflected in increased consumer spending. There is a long-standing relationship between house price inflation and growth in consumer spending (figure 2.3). We believe the household sector – which has faced the impacts of recession, falling house prices and rising unemployment over the past year – will be very cautious in its spending decisions over the coming year or so. In addition, banks are likely to be reluctant to allow households to leverage off recent house price gains, constraining the scope for debt-fuelled increases in consumer spending.

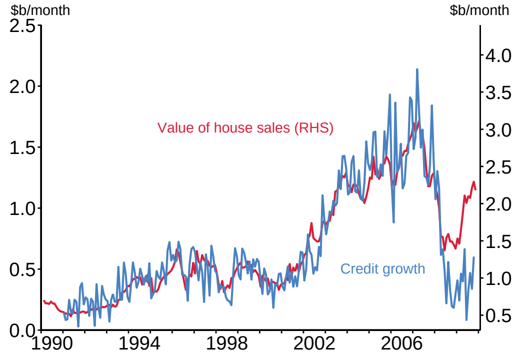
Figure 2.3
Real house price inflation and private consumption growth
(annual)



Source: Statistics New Zealand, PropertyIQ, RBNZ estimates.

Recent credit market developments support a picture of moderation. Despite a significant upturn in the value of housing turnover, net lending to households has remained relatively muted (figure 2.4). Anecdote suggests householders are choosing to maintain their nominal mortgage payments, despite recent interest rate reductions. Furthermore, an unusually high proportion of house sales have been undertaken with the intention of actively reducing debt.

Figure 2.4
Household credit growth and the value of house sales



Source: REINZ, RBNZ.

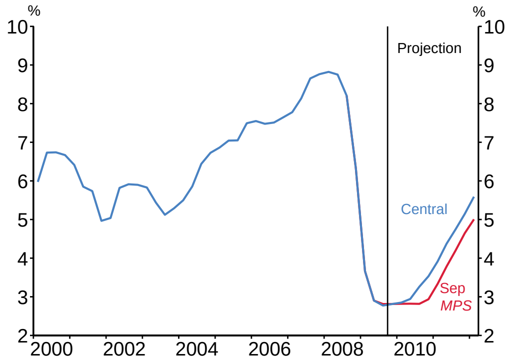
Continued risks to New Zealand's medium-term outlook are also likely to induce caution in the household sector. As discussed extensively in the September *Statement*, strength in the New Zealand dollar has seen the outlook for the economy become progressively more unbalanced.

Since the start of the year, currency appreciation has largely offset the gains seen in the outlook for trading-partner activity and export commodity prices. While prospects for some exporters have improved, the higher exchange rate is likely to have put more pressure on some exporters, particularly those not selling commodities. However, the outlook for consumer spending has increased markedly. This is particularly so for spending on consumer imports, with the stronger New Zealand dollar acting to reduce the price of imported products.

While the headline current account has improved sharply through 2009, this has been driven by weaker demand for imports, reduced interest payments and profits accruing to foreigners, and tax settlements against the banking sector. Once these temporary influences pass, New Zealand's current account deficit is likely to widen once more. In line with this, net foreign liabilities are expected to hold at a level equivalent to New Zealand's annual GDP – one of the highest levels in the OECD. Such high net foreign liabilities are likely to see the risk premium charged on New Zealand borrowing almost certainly continue, and perhaps even enlarge, over the medium term.

These risks noted, if the economy continues to recover as projected, we would expect to begin removing policy stimulus from around the middle of 2010 (figure 2.5). Several factors have reduced the need for policy tightening before then.

Figure 2.5
90-day interest rate



Source: RBNZ estimates.

First, after several years where longer-term interest rates have been relatively low, New Zealand now faces an upward sloping yield curve. Indeed, since the September *Statement*, longer-term interest rates have increased even further.

Second, these relatively high longer-term interest rates have seen borrowers shorten the duration of their debt. This has been particularly apparent for housing debt, with the average mortgage duration reducing from about 20 months to just over 12 months in the past two years.

This reduced duration, along with a continued upward sloping yield curve, means that when the Reserve Bank eventually elects to tighten policy, the translation of a higher OCR to the interest rates actually faced by households and businesses may occur relatively quickly.

Third, during 2009 banks have been placing more emphasis on domestic funding. Because the pool of available funds is relatively small, the cost of bank funding has increased markedly, causing the margin between their customer deposit and lending rates to increase relative to the OCR.

Fourth, for several months now, markets have priced an earlier and greater increase in the OCR than has been consistent with our projections. This has been apparent both in debt markets and through strength in the New Zealand dollar. These tighter conditions have offset, to an extent, the inflationary impact of an earlier and more robust recovery in economic conditions.

As always, the Bank will continue to make full assessment of economic conditions between now and that time. It could be that our current projections are overly optimistic or unduly pessimistic. If so, the timing of the removal of stimulus could well be adjusted.

While we will obviously be paying close attention to economic activity in our trading partners, we will also be quite interested in the communications and actions of foreign central banks. Globally, central banks have been clear that policy stimulus will not be removed prematurely. As such, suggestions that liquidity or interest rate stimulus will be removed would be a clear positive signal that the global recovery is becoming self sustaining. At the same time, we are also mindful of the possibility that stimulus is removed too gradually, which could see global inflation pick up.

We will also be looking for assurance that the domestic recovery is on a solid footing and can be self sustained as policy stimulus is withdrawn. Signs that the domestic recovery is translating through to increased corporate expenditure will be one such gauge.

In particular, increased credit flows would be a sign that households and firms had become confident enough to take on debt. That said, we would be quite concerned if borrowing increased excessively. Strong credit growth would potentially signal a stronger pick-up in domestic demand than we currently project.

Finally, New Zealand's economic recovery is being assisted by both monetary and fiscal support. While such support remains appropriate for now, once growth becomes self sustaining, fiscal restraint beyond that described in *Budget 2009* would be welcome and would help reduce the work that monetary policy might otherwise need to do.

The linkages between monetary, fiscal and tax policy

The linkages between monetary policy, fiscal policy and tax policy were central to the Finance and Expenditure Committee's 2008 Inquiry into the monetary policy framework. These linkages are also likely to feature in the reports of a number of government commissioned advisory groups, such as the Tax Working Group, the Capital Markets Development Taskforce and the 2025 Taskforce. Earlier, the joint Treasury and Reserve Bank Supplementary Stabilisation Instruments report and conference on stabilisation policy also explored economic policy settings, including tax and government spending.

The Reserve Bank is interested in fiscal and tax policy settings because government spending, and the mix and overall level of taxes, influence:

- aggregate demand pressures in the economy; and,
- the incentives for spending and saving, which over time affect potential or trend growth and the average level of interest rates.

As a result, any policy action taken in response to the work of these groups together with the Government's budget decisions, will affect how hard monetary policy has to work to achieve price stability and potentially where the burden of adjustment falls.

Faster fiscal consolidation would reduce aggregate demand pressures in the economy. If this led to an overall increase in national saving it would reduce the extent to which interest rates need to lean against inflation pressures. Other things being equal, a lower interest rate path would likely contribute to a lower exchange rate.

The tax system also influences cyclical pressures in the economy. Our assessment is that the current system exacerbates the economic cycle through its impact on saving and investment decisions, particularly the way it encourages demand for housing.

Over the medium term, tax policy settings affect the structural features of the economy. These are also important for monetary policy. Higher potential or trend growth pushes up the speed limit of the economy and the point at which monetary policy actions are required to curb inflation. Higher saving rates would likely lead to lower interest rates on average, meaning that interest rates would not have to be as high to have the same impact on demand. In addition, by moving New Zealand's average interest rates closer to that of the rest of the world, there would be less pressure on the exchange rate at times when monetary policy here is out of synch with that of other countries.

There are a range of possible policy options that could reduce the extent to which the tax system exacerbates the cycle and improve the structural features of the economy. These include a mix of changes to income and consumption tax rates that would encourage increased private saving; removing or offsetting the current favourable treatment of property and housing; a more comprehensive or even-handed treatment of capital income; and adjusting the tax system for inflation.

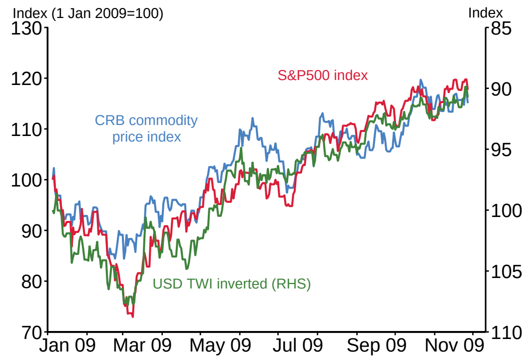
3 Financial market developments

Overview

Increasing investor confidence and a greater appetite for risk has seen global asset prices continue to increase, with movements correlated across asset classes (figure 3.1). This positive sentiment has been sustained by better-than-expected corporate earnings and economic data, as well as ongoing monetary and fiscal support. The US dollar has continued to fall in response to reduced safe-haven demand and its increasing use as a funding base for carry trades. Credit market conditions have continued to improve, supported by ongoing central bank liquidity measures.

Local interest rates have been pressured higher in response to market expectations of policy tightening from the Reserve Bank, although have fallen from highs in October. This increase in wholesale rates has caused the local mortgage curve to steepen.

Figure 3.1
Equity and commodity prices and the US dollar

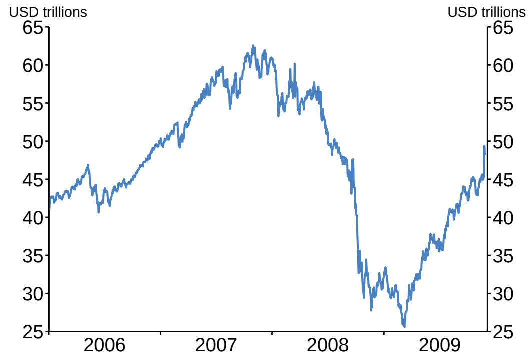


Source: Bloomberg.

International financial market developments

Global equity markets have continued to rebound in recent months. These markets have now gained around 75 percent from their March lows, although still remain more than 25 percent off their 2007 highs (figure 3.2). Supporting the rally in equities has been better-than-expected third quarter corporate earnings. However, rather than being driven by improvements in revenue and sales, much of these positive surprises were caused by cost-cutting measures. Many firms have reported little, if any, increase in sales and most remain cautious about the outlook for profits over 2010. Economic data have tended to be more positive, although concerns remain about unemployment and consumer spending in most major economies. Nonetheless, investors have tended to focus on the more positive developments, with markets supported by the expectation of ongoing monetary and fiscal support. However, questions have been raised about the speed and extent of the rebound in equity markets, with some suggestion that the current rally is overstretched. Compared to underlying fundamentals, investors may have underpriced the level of associated risk around the global recovery.

Figure 3.2
World equity market capitalisation



Source: Bloomberg.

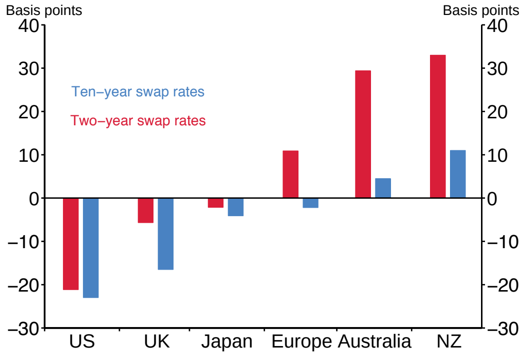
Interest rate moves in major economies have been mixed over the past few months. Most central banks have left interest rates unchanged, although some have started to remove liquidity support programmes which are no longer being used.

The Federal Reserve has started to withdraw some of its liquidity support programmes. Purchases of mortgage securities have continued and officials have suggested that interest rates will remain low. Other central banks have tended to remain cautious about the outlook for recovery, with the Bank of England expanding its asset purchase programme in recent months.

In contrast, the Reserve Bank of Australia has raised its policy rate and is expected to tighten further in coming months. This has seen interest rates in Australia and New Zealand rise while rates in other developed economies have fallen (figure 3.3).

Figure 3.3

Global swap rates changes since the September *Statement*

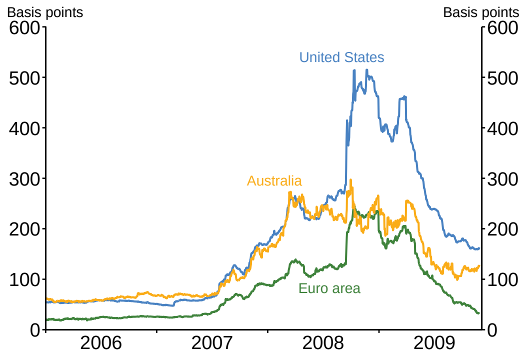


Source: Bloomberg.

The ongoing improvement in risk appetite has seen corporate credit spreads continue to narrow (figure 3.4). However, these spreads are still somewhat elevated compared to pre-crisis levels. Short-term money market pressures have steadied almost back at pre-crisis levels, aided by sizeable liquidity support programmes. However, it is unclear to what extent this contraction in spreads will be sustained when this liquidity support is eventually withdrawn. Central banks have indicated they will ensure that the recovery in markets is robust before this occurs.

Figure 3.4

AA-rated corporate bond spreads



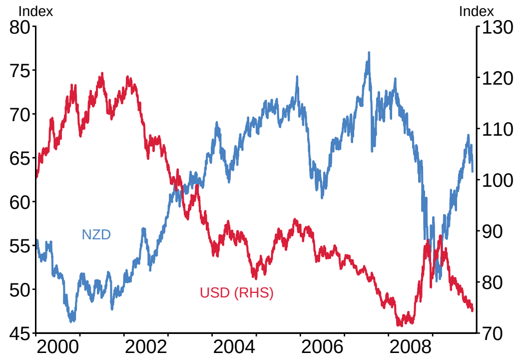
Source: Bloomberg.

Foreign exchange markets

Foreign exchange markets have continued to move in line with equity and commodity markets. The expectation of the policy rate in the US remaining low, combined with increasing risk appetite, has seen demand for US dollar assets fall. There has also been increasing use of the US dollar to fund carry-trades, with investors selling the US dollar and investing back in higher yielding currencies. This has partly been a move by investors back into more balanced portfolios from the extreme levels of risk aversion experienced during the crisis. Speculative investors also continue to sell US dollars, although the extent of these positions has been pared back more recently. The New Zealand dollar has moved higher against the US dollar over the past couple of months, predominantly driven by US dollar weakness (figure 3.5).

Figure 3.5

New Zealand and US trade weighted indices



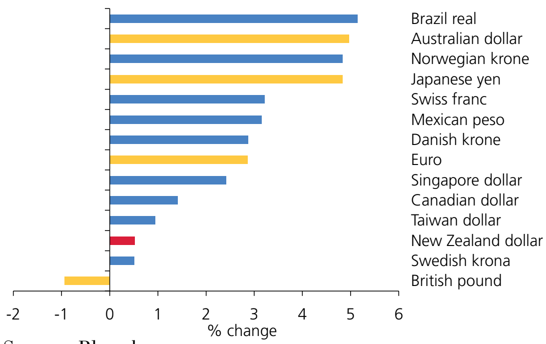
Source: Bloomberg.

The increased appetite for higher yields has pressured commodity sensitive currencies higher as the global growth outlook continues to improve. The Australian dollar has gained strongly in recent months (figure 3.6). This has also seen the New Zealand dollar pushed lower against the Australian dollar, helping bring the New Zealand dollar trade weighted index (TWI) back to levels seen a few months ago.

Figure 3.6

Movements in currencies against the US dollar

(Percent change since September Statement)



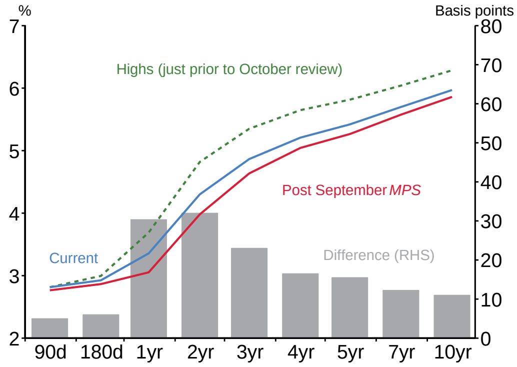
Source: Bloomberg.
Note: TWI currencies shown in yellow.

Domestic financial market developments

Domestically, interest rates have risen further over the past few months in response to continued improvement in New Zealand's economic outlook, with the most pronounced moves occurring in the one to three year part of the yield curve (figure 3.7). Interest rates peaked in October after stronger-than-expected September quarter inflation data, before paring gains somewhat following the October OCR Review. New Zealand rates have also been pressured higher by sharp rises in Australian interest rates. The Overnight Index Swap market is now pricing a total of 170 basis points of increases in the OCR over the next 12 months. Increases in Australasian interest rates have been significantly larger than in other major economies.

Figure 3.7

Wholesale interest rate curve



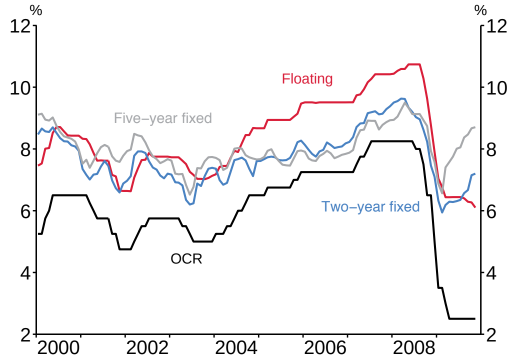
Source: Bloomberg.

Financing and credit

The domestic mortgage curve has continued to steepen in recent months, in response to rising medium to longer term wholesale interest rates (figure 3.8). The degree to which the mortgage rate curve is now positively sloped is unusual, with the spread between floating and five-year mortgage rates at historic highs, encouraging borrowers into shorter-term mortgage contracts. This has seen the average mortgage duration reduce after starting to increase around the middle of this year. Some borrowers are preferring short-term fixed contracts, rather than the lowest (floating) rates available.

Figure 3.8

Mortgage rates offered to new borrowers

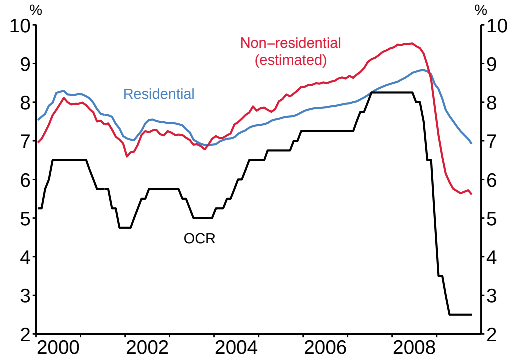


Source: RBNZ.

The effective mortgage rate has continued to fall as borrowers coming up for repricing select floating and short-term fixed mortgages with relatively lower rates. The effective cost of credit for businesses has fallen further than for residential borrowers as the OCR has moved lower, but now appears to have stabilised (figure 3.9).

Figure 3.9

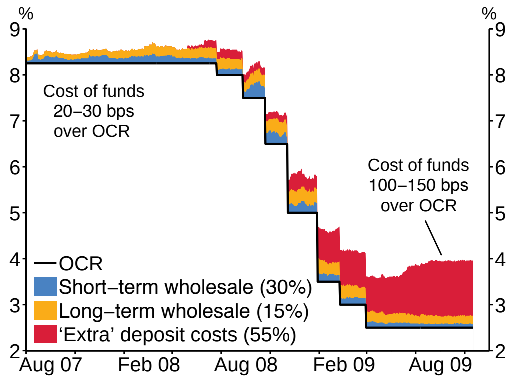
Effective lending rates by sector and the OCR



Source: RBNZ estimates.

The easing in global money market and credit pressures has seen an improvement in wholesale funding conditions relative to late 2008/early 2009. However, deposit funding costs remain elevated in the face of high levels of competition for these funds. This has seen many term deposit interest rates increase to around 100 to 150 basis points over wholesale rates. Deposit funding costs have risen by a greater extent than wholesale funding costs have eased, causing the estimated overall marginal cost of funding to remain elevated compared to pre-crisis levels.

Figure 3.10
Indicative marginal funding costs relative to the OCR



Source: RBNZ estimates.
Note: Weights assume banks are raising funds in proportion to the existing structure of their liabilities. The composition of funding at any particular point in time will vary from these weights.

4 Current economic conditions

Overview

New Zealand's trading partners have begun to recover from the international recession, aided by substantial stimulus from both monetary and fiscal policy. To date this recovery remains patchy and concentrated in certain countries.

Notwithstanding the fragility of the recovery in global activity, the world prices of New Zealand's export commodities have strengthened, boosting the terms of trade. Meanwhile, housing-market activity has gathered momentum, with house prices almost returning to the 2007 peak.

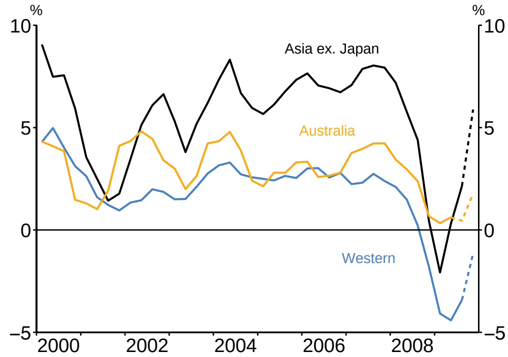
Reflecting these factors, domestic production is beginning to pick up. The labour market appears to be near its trough, after steep falls in employment over the past 18 months. Annual CPI inflation has continued to moderate, reaching 1.7 percent in the September quarter.

International economic conditions

The recovery in global activity has consolidated over the past few months, but remains fragile. Several factors are contributing to the rebound in activity. The fear of a protracted global recession is receding, aiding a recovery in sentiment and trade flows. The considerable stimulus arising from monetary policy loosening and fiscal policy measures is proving effective. Furthermore, the large level of destocking earlier this year appears to be easing, particularly in Asia.

The improvement in global growth is uneven across countries. The recovery in many Western economies remains muted (figure 4.1), with the underlying economic challenges greater than elsewhere and confidence remaining low. Conversely, activity in Asia has rebounded sharply, with retail sales and industrial production in some countries regaining pre-crisis levels. Activity in Australia has also remained firm; substantial fiscal stimulus, favourable trading patterns and increased confidence are supporting growth.

Figure 4.1
GDP growth by region
(annual, dashed lines represent estimates)



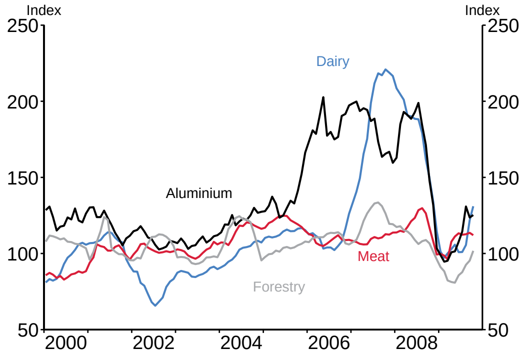
Source: Datastream, RBNZ estimates.
Note: Asia ex. Japan comprise: China, Hong Kong, Indonesia, Malaysia, the Philippines, Singapore, South Korea, Taiwan, Thailand, and Vietnam.
Western economies comprise: the United Kingdom, the United States and the euro area.

Domestic economic conditions

External sector

The recovery in world output has helped support the prices of New Zealand's export commodities, which have continued to rise from mid-year lows (figure 4.2). The rise has been particularly marked in dairy prices, with average *global*DairyTrade auction prices up almost 90 percent in US dollar terms since July. These gains have resulted in a significant increase in Fonterra's forecast end of season payout. At $6.05 per kilogram of milk solids, surveys suggest most dairy farmers will return a profit in the 2009/10 season. This is a substantial improvement on earlier payout predictions which suggested most farmers would make a loss.

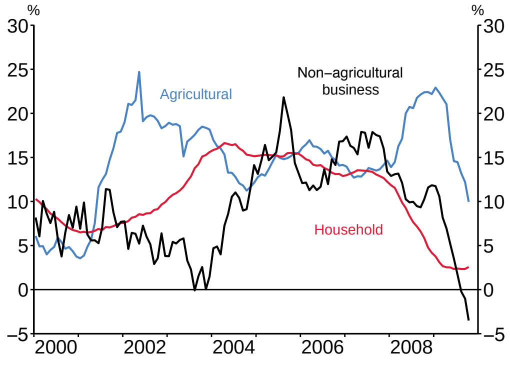
Figure 4.2
Export commodity prices
(SDR terms)



Source: ANZ National Bank Group Ltd.

While obviously a welcome development for the New Zealand economy, it should be noted that substantial dairy intervention stocks are currently held in the United States and European Union. As such, further gains in price may be relatively limited. In line with this, and following the revenue swings of the past two seasons, it is likely that New Zealand farmers will initially respond conservatively to the lift in incomes. Indeed, annual lending growth to agriculture has declined in recent months (figure 4.3).

Figure 4.3
Credit growth
(annual)

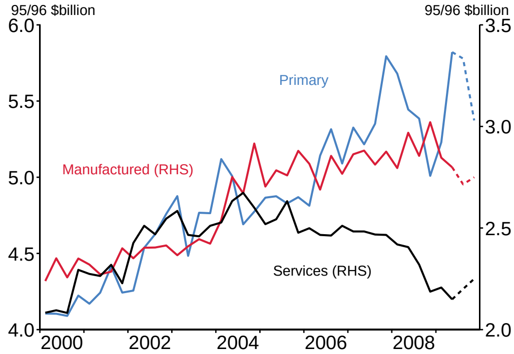


Source: RBNZ.

These higher world prices will have fed through to higher export prices over the second half of 2009. Over the same period, the New Zealand dollar has appreciated. While reducing the gains to exporters, this also reduces the cost of imported goods, distributing the benefits of higher export prices to other sectors in the economy.

Higher world demand was also reflected in export volumes, which increased over the middle of the year. In particular, strong demand from China resulted in greater exports of logs and whole milk powder (figure 4.4). However, with dairy inventories in New Zealand sharply lower, that level of exports is unlikely to have been sustained in the December quarter. Meat exports are also estimated to have fallen over the second half of 2009, due to farmers rebuilding stock numbers after the 2008 drought.

Figure 4.4
Export volumes
(dashed lines represent estimates)

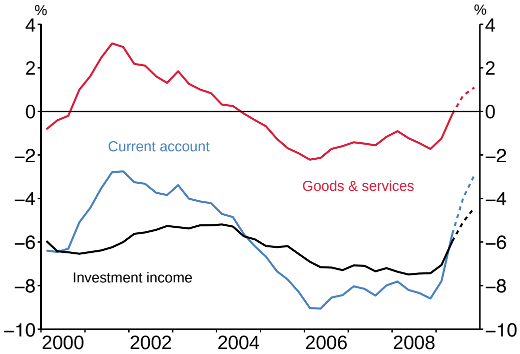


Source: Statistics New Zealand, RBNZ estimates.

Manufactured exports are estimated to have remained weak over the second half of 2009, given the sharply lower level of domestic production. Conversely, exports of services are estimated to have improved over the same period. Overall visitor numbers increased, including a rebound in traditionally high-spending visitors from Asian markets, perhaps reflecting reduced fears of the H1N1 influenza virus.

Import volumes fell sharply over the first half of the year, as investment and consumption declined. Intermediate goods imports also declined, reflecting both lower output and a reduction in inventories. With activity recovering, we estimate import volumes have increased in the December quarter. Despite that increase, the annual balance on trade in goods and services is estimated to be positive in the December quarter (figure 4.5).

Figure 4.5
Current account, trade and investment income balances
(annual, percent of nominal GDP; dashed lines represent estimates)



Source: Statistics New Zealand, RBNZ estimates.

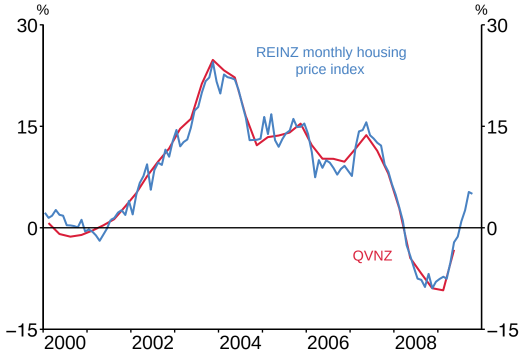
The investment income deficit also reduced markedly over the first half of the year. Revisions to the historic balance resulted in a narrower deficit. These were augmented in June by a one-off tax charge relating to the banking sector. Provisions by the banking sector in the September quarter for further tax liabilities point to a continued short-term improvement. Combined, these tax charges account for about 1 percentage point of the estimated change in the investment income balance to December.

Overall, these developments have resulted in a marked reduction of the annual current account deficit over the course of the year, likely to be around 3 percent of GDP by the December quarter.

Household sector

The housing market has picked up pace over the past few months (figure 4.6). House prices have regained most of the fall that occurred over 2008 and early 2009. At the current rate of house price growth, the 2007 peak in nominal house prices is likely to be regained early in 2010. The recent strength in house sales relative to the trough has been maintained, albeit still at per-capita levels witnessed during previous recessions.

Figure 4.6
House price inflation
(annual)

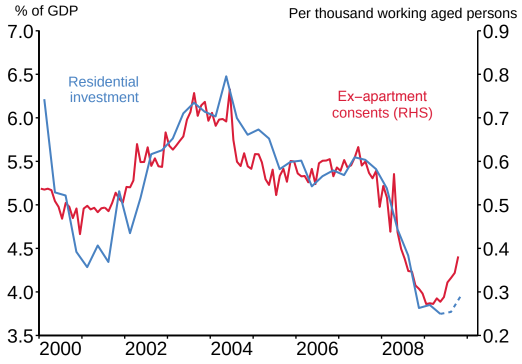


Source: REINZ, PropertyIQ.

The growth in house prices is supported by unusually low mortgage interest rates, and the lower level of emigration, notably to Australia. As discussed in the September *Statement*, the level of listings remains low, which causes additional tightness in the market.

The turnaround in the housing market appears to be encouraging an increase in residential building. Dwelling consents have increased notably over the past six months and suggest positive growth in residential investment over the second half of 2009 (figure 4.7).

Figure 4.7
Ex-apartment consents & residential investment
(seasonally adjusted, dashed lines represent estimates)

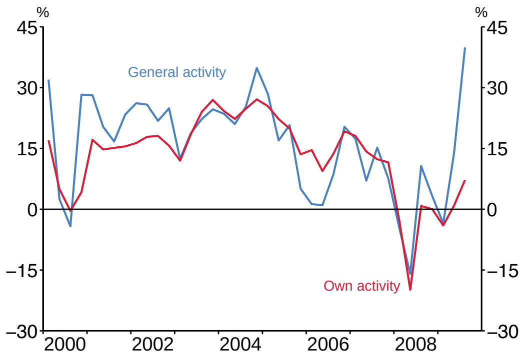


Source: REINZ, Statistics New Zealand, RBNZ estimates.

The pass-through of housing market activity to consumption has been muted so far. Total lending to the household sector has increased little over the past few months (figure 4.3 on the previous page). Potential explanations for this include a greater incidence of households trading down to reduce debt, or mortgagors maintaining repayment levels despite lower interest rates, thereby paying down more principal.

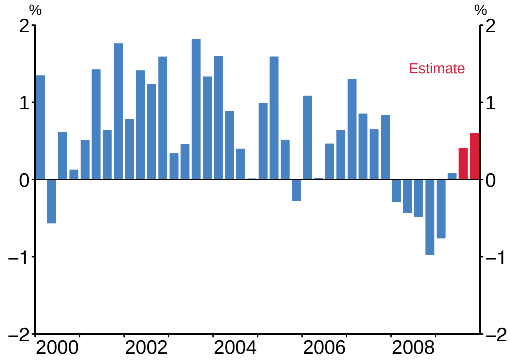
Headline consumer confidence has increased over the second half of 2009. However, this appears mostly driven by households' perceptions of general activity, rather than of their own situation (figure 4.8). Following several quarters of large falls, retail sales volumes posted small gains in the June and September quarters. The recovery in consumption is likely to have gathered pace over the final few months of the year, although still remains below the 2007 peak.

Figure 4.8
Consumer confidence
(net balance)



Source: Westpac McDermott Miller.

Figure 4.9
GDP growth
(quarterly)



Source: Statistics New Zealand, RBNZ estimates.

Business sector and output

Improvements in export prospects and the domestic housing market have helped rejuvenate business sentiment. First evident in views of general activity, there is now growing evidence of higher confidence in businesses' own prospects.

Investment intentions have rebounded, but as yet businesses do not appear to have increased their capital investment. Projects typically take several quarters to be brought on stream, resulting in a lag between intentions and actual investment. Furthermore, profitability remains weak, and lending to businesses is currently contracting (figure 4.3 above), despite some easing in credit constraints.

Output stabilised in the June quarter, with GDP 0.1 percent higher than in the previous quarter (figure 4.9). We estimate that the recovery gathered momentum over the latter half of 2009. Initially this was likely to have been concentrated in commodity exports, and those sectors benefiting from the turnaround in the housing market. But the recovery is estimated to have become more widespread across the economy towards the end of the year.

One major uncertainty for the pace of growth recorded over the latter half of 2009 is the extent to which businesses have rebuilt stocks. The level of destocking in the June quarter was unprecedented. While some further destocking is likely to have taken place over the second half of the year, it is possible businesses have chosen to rebuild inventories, meaning production may be higher than sluggish sales data suggest.

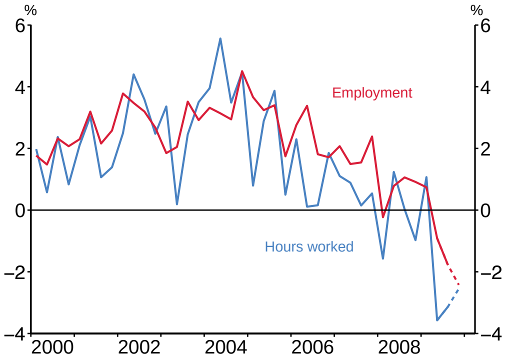
Labour market

With activity stabilising, there are signs that the labour market is near its trough. Falling employment over the recession brought about a very large increase in the unemployment rate, albeit tempered by falling participation as discouraged workers left the labour force. As activity picks up over the near term, the unemployment rate is likely to settle a little above its current level.

Despite the fall in employment, much of the adjustment in the labour force has been because of reduced hours (figure 4.10). Businesses appear to have retained workers where possible, following several years of skill shortages. Consequently, it is likely that firms will be able, in the short term, to meet increased production from existing staff.

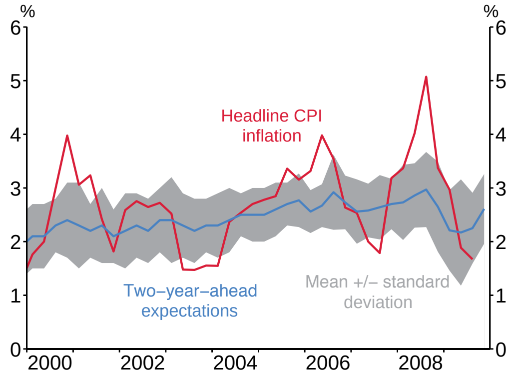
Weakness in the labour market over 2009 resulted in a moderation in wage growth. There was a significantly lower proportion of workers receiving a rise of 5 percent or more, and a sharp rise in those receiving no pay increase. The Labour Cost Index, which adjusts for productivity, rose by 0.4 percent in the September quarter and we expect a similar result in December.

Figure 4.10
Employment and hours worked
(annual change, dashed lines represent estimates)



Source: Statistics New Zealand, RBNZ estimates.

Figure 4.11
Headline CPI inflation and inflation expectations
(annual)



Source: Statistics New Zealand, RBNZ.

Prices

Annual CPI inflation eased to 1.7 percent in the September quarter, mainly reflecting a moderation in food and petrol prices. Inflation is estimated to have ticked up to 2.0 percent in the December quarter.

The lagged effect of the depreciation in the TWI at the start of 2009 has supported annual tradable inflation over the year. While estimated to have fallen over 2009, non-tradable inflation has remained higher than we expected, given the level of spare capacity in the economy. In part this is a result of large increases in administered prices. It also reflects a smaller-than-expected decline in construction costs.

Inflation expectations have remained robust relative to the change in economic conditions over the past 18 months. This may reflect the path of actual inflation; the recession appears to have simply taken the heat out of inflation, rather than driving it to an especially low rate. Near-term expectations remain contained, with survey balances of businesses' pricing intentions little changed. But there are signs of longer-term expectations moving higher (figure 4.11).

Table 4.1

Measures of inflation and inflation expectations

(annual)

	2008				2009		
	Mar	Jun	Sep	Dec	Mar	Jun	Sep
CPI	3.4	4.0	5.1	3.4	3.0	1.9	1.7
CPI components							
CPI non-tradables	3.5	3.4	4.1	4.3	3.8	3.3	3.0
Non-tradables housing components	4.6	4.0	3.2	2.4	1.5	1.0	0.6
Non-tradables ex housing, cigarettes and tobacco components	3.1	3.1	4.5	5.1	4.8	4.3	4.2
CPI tradables	3.4	4.8	6.3	2.3	1.7	0.2	-0.1
Petrol	20.5	25.9	29.3	-4.8	-9.3	-17.0	-19.0
Other inflation measures							
Factor model estimate of core CPI inflation	3.1	3.3	3.6	3.1	2.9	2.4	2.2
CPI trimmed mean (of annual price change)	3.5	3.8	4.0	3.1	2.9	2.2	2.0
CPI weighted median (of annual price change)	3.2	3.4	3.7	3.0	2.9	2.9	2.8
CPI ex food, petrol and government charges	1.9	1.9	2.2	2.0	1.9	1.6	1.9
CPI ex food and energy	2.4	2.5	3.5	3.6	3.5	3.1	3.0
GDP deflator (derived from expenditure data)	6.1	3.8	2.2	2.4	2.4	2.1	n/a

	2008				2009			
	Mar	Jun	Sep	Dec	Mar	Jun	Sep	Dec
Inflation expectation measures								
RBNZ Survey of Expectations - inflation one-year-ahead	3.0	3.3	3.6	2.8	2.0	1.8	1.8	2.1
RBNZ Survey of Expectations - inflation two-years-ahead	2.7	2.9	3.0	2.7	2.2	2.2	2.3	2.6
AON Economist survey - inflation one-year-ahead	3.1	3.1	3.5	3.0	2.1	2.2	1.7	1.6
AON Economist survey - inflation four-years-ahead	2.6	2.6	2.7	2.7	2.5	2.6	2.5	2.4
NBBO - inflation one-year-ahead (quarterly average)	3.3	3.4	3.7	3.5	2.7	2.6	2.6	n/a

5 The macroeconomic outlook

It appears that a recovery in domestic activity is under way. Although uncertainty remains, we forecast GDP to increase by 3 percent in 2010 and 4 percent in 2011.

Activity in New Zealand's trading partners has improved quickly, particularly in Asia. As a result, we have revised upward our outlook for trading-partner activity and now expect growth to average about 3.5 percent over the projection. Consistent with this, export commodity prices have risen markedly, stimulating the New Zealand economy over the next few years.

Annual house price inflation is expected to reach double-digit rates by early next year, before easing back to 2 percent in 2011. High household debt levels appear to be less constraining on house prices than previously thought. As such, low mortgage rates and high net immigration are expected to impact positively on house prices in the near term.

Rising house prices suggest household spending will also increase. But there is considerable uncertainty regarding this relationship. Compared to usual cycles, we assume tight credit conditions will make households more cautious about their spending, thus diminishing the rise in consumption associated with higher house prices.

Trading partner activity and terms of trade

The outlook for trading partner growth has improved (table 5.1). Stimulus from monetary and fiscal policy appears to have been effective, while rebuilding of inventories has been rapid in Asia.

But this short-term strength in growth is likely to ease over the coming year, with underlying economic conditions remaining weak in the US and Europe. The impulse from fiscal policy is likely to wane as governments act to reduce budget deficits. High debt levels and continuing tightness in credit supply are impairing domestic demand growth. We expect the recovery in global activity to be more gradual than recoveries from previous recessions.

That said, the outlook for Asian economies remains relatively healthy. Further, Asian economies are becoming increasingly important markets for our exports and are also providing considerable stimulus for our largest trading partner, Australia. Thus, the mix of global growth is likely to favour New Zealand. To reflect recent trends, we have increased the number of countries factored into our forecasts to 16, as set out in the forthcoming *Bulletin*.

Consumer prices in our trading partner economies are expected to increase slowly in 2010 and 2011. Strong Asian demand is expected to drive commodities prices higher, more so than consumption goods prices – consistent with weak consumer spending in Western economies.

New Zealand's terms of trade are forecast to rise 10 percent over the next year (figure 5.1), reflecting strong growth in dairy prices. Whole milk powder prices have increased significantly over recent months, more than implied by the rise in global activity, suggesting this may prove short lived (chapter 4). However, we expect growth

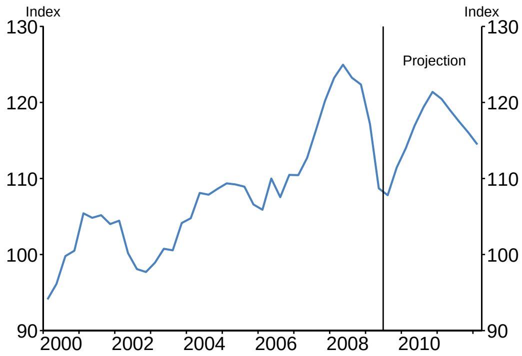
Table 5.1
Forecasts of trading partner GDP
(calendar year, annual average percent change)

Country	2005	2006	2007	2008	2009f	2010f	2011f
Australia	2.8	2.8	4.0	2.4	0.8	2.8	3.4
Asia ex-Japan*	6.5	7.1	7.7	4.4	1.5	6.2	5.8
Japan	1.9	2.0	2.3	-0.7	-5.5	1.5	2.7
United States	3.1	2.7	2.1	0.4	-2.5	2.6	1.2
Euro area**	1.8	3.1	2.7	0.5	-3.9	1.2	1.5
United Kingdom	2.2	2.9	2.6	0.6	-4.6	1.2	1.7
Main trading partners (trade-weighed aggregate)	3.5	3.8	4.2	1.9	-1.0	3.4	3.6

Source: DataStream, RBNZ estimates.
* Includes China, Hong Kong, Malaysia, Singapore, South Korea, Taiwan, Indonesia, Thailand, Vietnam and the Philippines.
** Includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia and Spain.

in Asian demand, and a limited supply response due to high international stock-feed costs, to hold dairy prices at their current level in the medium term.

Figure 5.1
OTI terms of trade (goods)
(seasonally adjusted)

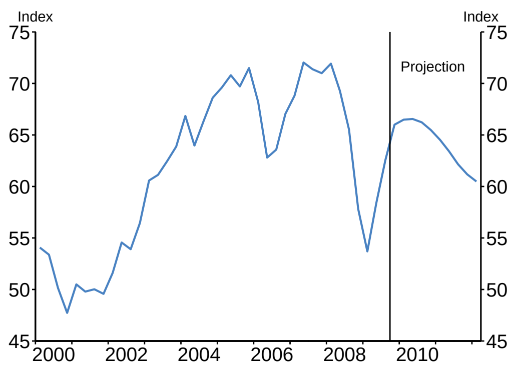


Source: Statistics New Zealand, RBNZ estimates.

Exchange rate and balance of payments

The New Zealand dollar TWI has risen since the September *Statement*. With the appetite for commodity-sensitive currencies recovering, and a relatively positive outlook for activity in New Zealand, the TWI is assumed to remain above its historic average over the projection. As Western economies start to recover, and their interest rates rise, the TWI is assumed to fall (figure 5.2).

Figure 5.2
Nominal TWI



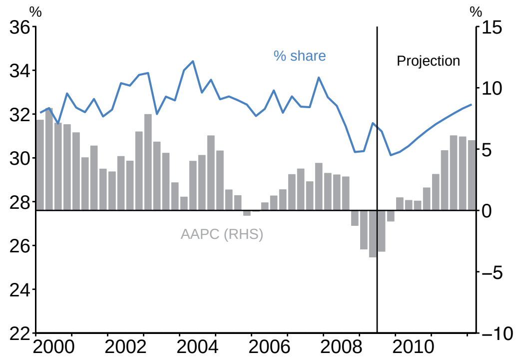
Source: RBNZ estimates.

This TWI assumption dampens the recovery in export volumes, largely offsetting the improving outlook for trading-partner demand and increased export commodity prices. Nonetheless, export volumes are expected to recover throughout the projection.

While manufacturing exports are unlikely to fall further, only a gradual recovery is forecast. In addition, a lack of northern hemisphere long-haul tourist numbers, along with the high TWI, prevents a faster recovery in the tourism sector.

Similarly, meat exports have been very weak lately, due to rebuilding stock numbers, but in time we expect meat exports to recover. Dairy export volumes are also expected to trend higher, from a higher starting point. Continued production gains from recent dairy farm conversions underlie this trend.

Figure 5.3
Export volumes
(percent of GDP)



Source: Statistics New Zealand, RBNZ estimates.

With New Zealand dollar strength lowering import prices, a significant degree of the forecast increase in household and corporate spending is likely to be on imports. That said, plentiful spare capacity in the domestic economy suggests there is less need for imports to meet demand, particularly with a weak outlook for business investment. As such, import penetration is expected to recover over 2010, and then flatten out (figure 5.4).

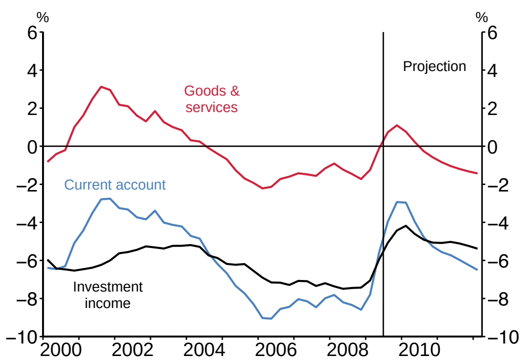
Figure 5.4
Import volumes
(percent of GDP)

Source: Statistics New Zealand, RBNZ estimates.

Rising import volumes are expected to outweigh the recovery in export volumes and rising terms of trade. Accordingly, the annual trade balance is forecast to decline from a surplus of 1 percent of GDP to a deficit of about the same magnitude in 2012.

In line with this, the current account deficit is forecast to widen over the medium term. In the near term, low interest and profit payments paid offshore, and tax settlements against the banking sector, are causing a significant rise in the investment income balance. Once these temporary influences pass, New Zealand's current account deficit is forecast to enlarge to about 6.5 percent of GDP (figure 5.5).

Figure 5.5
Current account, trade and investment income balances
(annual, percent of nominal GDP)



Source: Statistics New Zealand, RBNZ estimates.

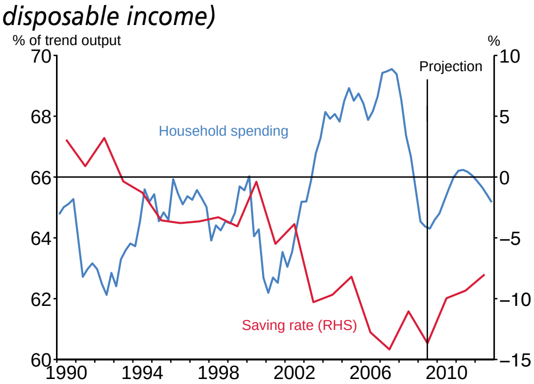
Households

Adding to the improved outlook for trading partner activity is stronger consumer spending – stemming from increasing house prices. Recent quarterly rates of house price inflation are expected to continue over the next six months, with annual house price inflation forecast to reach double digits by March next year. Credit does not seem to be constraining housing activity by as much as previously assumed. Low mortgage rates and strong population growth, driven by a net inflow of permanent and long-term migrants, support this near-term house price forecast.

However, we believe this initial recovery in house prices is unlikely to continue with such momentum. Low mortgage rates are likely to be temporary and a recovering Australian economy is expected to cause permanent and long-term departures to increase. Also, the high cost of houses relative to household income will limit price rises. We expect annual house price inflation to ease to 2 percent in 2011.

Consumer spending is forecast to recover in 2010. However, there is considerable uncertainty regarding the magnitude of this recovery. Households are highly indebted and servicing this debt is likely to become increasingly difficult as interest rates begin to rise. In addition, we expect consumers to increase their saving rate. Consumer spending is projected to grow 2.5 percent in 2010 and 1.5 percent in 2011 (figure 5.6).

Figure 5.6
Household spending volumes
(saving rate as a percentage of household disposable income)



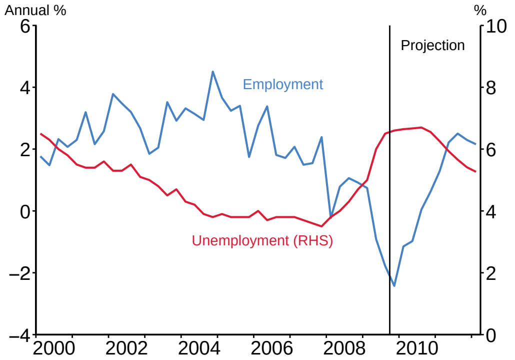
Source: Statistics New Zealand, RBNZ estimates.

Businesses

Rising consumption and trading partner activity suggest demand for businesses' outputs will increase. Recent surveys of business opinion already suggest this, as a net positive number of firms expect a rise in their activity. Given this, profitability is also likely to rise.

Through the recession, businesses appeared to retain workers where possible. As such, we expect increasing demand to be initially met by increasing existing workers' hours. To a degree, demand for new workers is also expected to improve. Employment is projected to rise 1 percent in 2010 and 2 percent in 2011. Accordingly, the unemployment rate is expected to peak soon.

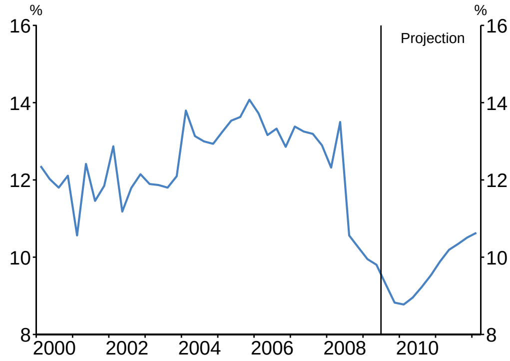
Figure 5.7
Employment growth and unemployment rate
(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

Business investment is projected to rise about 10 percent in 2010 and 2011, but remains below its 2007 peak. Productive capacity is likely to be quite plentiful, reducing the need for new capital investment. Tight credit conditions are also expected to restrict the extent that investment recovers. However, a high New Zealand dollar is muting the cost of imported capital goods, suggesting some upside risk to our investment forecast.

Figure 5.8
Business investment
(excluding computer and intangible assets, percent of trend output)



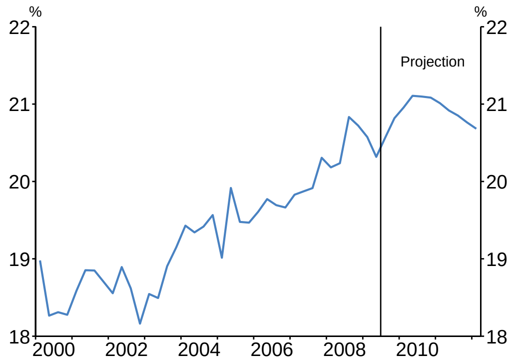
Source: Statistics New Zealand, RBNZ estimates.

Government

Our fiscal projections are based on *Budget 2009*, but have been updated for recent tax outturns and adjusted to reflect our updated macroeconomic outlook. Despite improved prospects for economic activity since *Budget 2009*, tax revenue has been weak, particularly in taxation on corporate and entrepreneurial income. We assume this weakness will persist, contributing to fiscal deficits over the projection.

Government spending volumes are projected to rise further as a ratio of real GDP in the near term, but ease from 2011. This easing is expected to see fiscal policy move to a broadly neutral stance later in the projection.

Figure 5.9
Government spending volumes
(percent of GDP)



Source: Statistics New Zealand, RBNZ estimates.

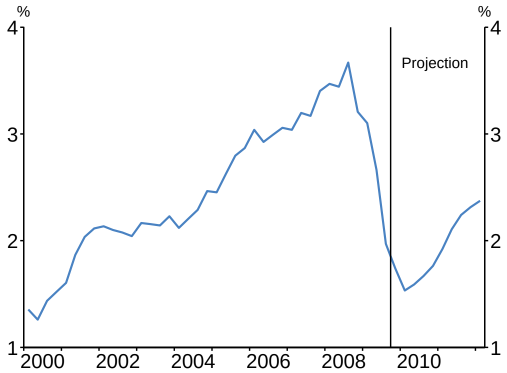
Gross Domestic Product

The forecast recovery in economic activity is broad based. Higher house prices are expected to improve consumer spending. Furthermore, improving trading-partner activity is expected to see export volumes increase, despite our assumption of continued New Zealand dollar strength. As domestic demand recovers, both monetary and fiscal policy are expected to tighten. GDP is forecast to increase by 3 percent in 2010 and 4 percent in 2011 (figure 2.1). Recent surveys of business opinion suggest activity could be even stronger in the near term.

Inflation

The increase in unemployment through 2009 suggests annual LCI wage inflation will fall to below 2 percent in 2010, before rising as the labour market recovers (figure 5.10).

Figure 5.10
LCI wage inflation
(annual)



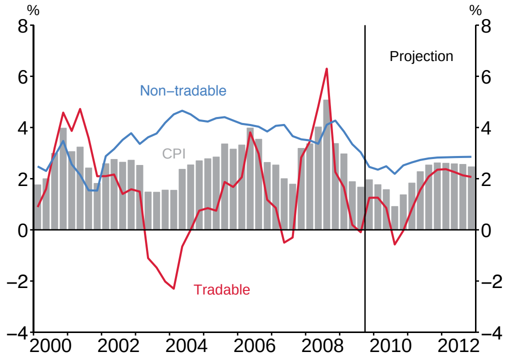
Source: Statistics New Zealand, RBNZ estimates.

Annual consumer price inflation is projected to be weak over the next year, dropping to 0.9 percent in the September quarter of 2010. From 2011, stronger trading-partner demand and higher house prices suggest inflationary pressures are likely to develop. As such, non-tradable inflation is projected to decline to 2.4 percent, before rising towards its long-run average of 3 percent.

While domestic inflationary pressures are robust, a high New Zealand dollar and low import prices suggest tradable prices will fall over the next year – coinciding with the trough in non-tradable inflation.

From 2011, the TWI is assumed to depreciate and import prices rise, resulting in tradable inflation strengthening to above 2 percent. Accordingly, CPI inflation is forecast to rise to 2.6 percent. Beyond this, inflation is expected to moderate (figure 5.11).

Figure 5.11
CPI, tradable and non-tradable inflation
(annual)



Source: Statistics New Zealand, RBNZ estimates.

The adoption of the Emissions Trading Scheme, while not included in this forecast, is estimated to increase annual CPI inflation by about 0.4 percent in the year to June 2011. If included in our projection, this would accelerate the rise of headline inflation.

Appendix A[1]

Summary tables

Table A

Projections of GDP growth, CPI inflation and monetary conditions

(CPI and GDP are percent changes, GDP data seasonally adjusted)

		GDP Quarterly	CPI Quarterly	CPI Annual	TWI	90-day bank bill rate
2002	Mar	0.8	0.6	2.6	51.6	5.0
	Jun	1.4	1.0	2.8	54.6	5.8
	Sep	1.2	0.5	2.6	53.9	5.9
	Dec	1.6	0.6	2.7	56.4	5.9
2003	Mar	0.3	0.4	2.5	60.6	5.8
	Jun	0.5	0.0	1.5	61.1	5.4
	Sep	1.8	0.5	1.5	62.4	5.1
	Dec	1.3	0.7	1.6	63.9	5.3
2004	Mar	1.6	0.4	1.5	66.8	5.5
	Jun	0.9	0.8	2.4	64.0	5.9
	Sep	0.4	0.6	2.5	66.3	6.4
	Dec	0.0	0.9	2.7	68.6	6.7
2005	Mar	1.0	0.4	2.8	69.6	6.9
	Jun	1.6	0.9	2.8	70.8	7.0
	Sep	0.5	1.1	3.4	69.7	7.0
	Dec	-0.3	0.7	3.2	71.5	7.5
2006	Mar	1.1	0.6	3.3	68.2	7.5
	Jun	0.0	1.5	4.0	62.8	7.5
	Sep	0.5	0.7	3.5	63.6	7.5
	Dec	0.6	-0.2	2.6	67.0	7.6
2007	Mar	1.3	0.5	2.5	68.8	7.8
	Jun	0.8	1.0	2.0	72.0	8.1
	Sep	0.6	0.5	1.8	71.4	8.7
	Dec	0.8	1.2	3.2	71.0	8.8
2008	Mar	-0.3	0.7	3.4	71.9	8.8
	Jun	-0.4	1.6	4.0	69.3	8.8
	Sep	-0.5	1.5	5.1	65.5	8.2
	Dec	-1.0	-0.5	3.4	57.8	6.3
2009	Mar	-0.8	0.3	3.0	53.7	3.7
	Jun	0.1	0.6	1.9	58.4	2.9
	Sep	0.4	1.3	1.7	62.6	2.8
	Dec	0.6	-0.2	2.0	66.0	2.8
2010	Mar	0.8	0.1	1.8	66.5	2.8
	Jun	0.9	0.4	1.6	66.6	2.9
	Sep	1.0	0.6	0.9	66.2	3.3
	Dec	1.1	0.3	1.4	65.5	3.5
2011	Mar	1.1	0.5	1.8	64.5	3.9
	Jun	1.0	0.8	2.3	63.4	4.4
	Sep	0.9	0.9	2.5	62.2	4.7
	Dec	0.8	0.4	2.6	61.2	5.1
2012	Mar	0.7	0.5	2.6	60.5	5.6

[1] Notes for these tables follow on pages 26 and 27.

Table B

Composition of real GDP growth

(annual average percent change, seasonally adjusted, unless specified otherwise)

	Actuals							Projections		
March year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Final consumption expenditure										
Private	4.7	6.5	5.0	4.7	2.8	3.2	-0.8	0.2	2.7	2.1
Public authority	1.3	5.0	3.9	5.1	4.2	3.9	3.2	1.5	2.6	1.7
Total	3.9	6.2	4.7	4.8	3.1	3.4	0.1	0.5	2.7	2.0
Gross fixed capital formation										
Market sector:										
Residential	23.7	14.9	3.1	-5.4	-2.3	5.0	-23.2	-7.6	24.7	10.2
Business	2.8	12.0	11.0	8.1	0.4	4.5	-7.3	-10.1	8.0	11.2
Non-market government sector	14.3	14.5	15.4	-1.5	-5.1	4.8	19.6	10.2	15.5	-4.9
Total	7.8	12.8	9.4	4.3	-0.5	4.6	-8.7	-7.9	11.6	9.2
Final domestic expenditure	4.8	7.8	5.9	4.6	2.2	3.7	-2.1	-1.5	4.7	3.7
Stockbuilding [1]	-0.1	0.2	0.2	-0.4	-0.7	0.6	-0.3	-1.6	1.8	0.0
Gross national expenditure	4.7	7.8	6.3	4.4	1.3	4.7	-2.3	-3.3	6.6	3.8
Exports of goods and services	7.8	1.1	4.9	-0.1	2.9	3.0	-3.2	1.0	2.9	5.7
Imports of goods and services	7.0	12.9	12.4	4.1	-1.5	9.9	-4.6	-10.7	15.3	5.6
Expenditure on GDP	5.0	4.0	3.8	3.1	2.8	2.3	-1.7	0.7	2.7	3.7
GDP (production)	4.9	4.3	3.8	3.0	1.8	3.1	-1.1	-0.3	3.6	3.9
GDP (production, March qtr to March qtr)	4.6	5.3	2.3	2.9	2.4	2.0	-2.6	1.9	4.2	3.4

[1] Percentage point contribution to the growth rate of GDP.

Table C

Summary of economic projections

(annual percent change, unless specified otherwise)

	Actuals							Projections		
March year	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Price measures										
CPI	2.5	1.5	2.8	3.3	2.5	3.4	3.0	1.8	1.8	2.6
Labour costs	2.2	2.1	2.5	3.0	3.0	3.5	3.1	1.5	1.9	2.4
Import prices (in New Zealand dollars)	-10.7	-10.3	0.6	6.9	0.3	0.6	12.6	-9.9	5.5	12.2
Export prices (in New Zealand dollars)	-15.4	-5.0	5.0	3.5	4.6	12.3	7.0	-12.4	11.5	6.6
Monetary conditions										
90-day rate (year average)	5.9	5.3	6.5	7.3	7.6	8.6	6.7	2.8	3.4	5.0
TWI (year average)	56.4	63.6	67.1	70.1	65.6	71.6	61.6	63.4	65.7	61.8
Output										
GDP (production, annual average % change)	4.9	4.3	3.8	3.0	1.8	3.1	-1.1	-0.3	3.6	3.9
Potential output (annual average % change)	3.4	3.3	3.2	2.9	2.6	2.3	2.1	2.0	2.1	2.2
Output gap (% of potential GDP, year average)	1.1	2.0	2.6	2.7	1.9	2.7	-0.5	-2.8	-1.3	0.3
Labour market										
Total employment (seasonally adjusted)	1.8	3.3	3.7	2.8	2.1	-0.2	0.7	-1.1	1.3	2.2
Unemployment rate (March qtr, seasonally adjusted)	5.0	4.3	3.9	4.0	3.8	3.8	5.0	6.6	6.3	5.3
Trend labour productivity	1.2	1.1	1.0	1.0	1.2	1.3	1.5	1.7	1.8	1.8
Key balances										
Total Crown OBEGAL (% of GDP, year to June)	3.3	3.9	4.7	4.4	3.5	3.1	-2.1	-4.0	-3.4	-2.9
Current account balance (% of GDP)	-3.4	-4.7	-6.7	-9.0	-8.0	-7.8	-7.8	-3.0	-5.6	-6.5
Terms of trade (OTI measure, annual average % change)	-5.6	3.9	5.8	-0.8	1.8	7.8	3.2	-9.4	8.2	-2.4
Household saving rate (% of disposable income)	-10.3	-9.7	-8.2	-12.8	-14.2	-11.0	-13.7	-10.0	-9.3	-8.0
World economy										
Trading partner GDP (annual average % change)	3.2	3.4	3.7	3.8	3.7	4.1	0.3	0.6	3.3	3.8
Trading partner CPI (TWI weighted, annual % change)	2.2	1.4	2.1	2.5	1.9	3.3	1.1	1.3	1.2	1.9

Notes to the tables

CPI	Consumer Price Index. Quarterly projections rounded to one decimal place.
TWI	RBNZ. Nominal Trade Weighted Index of the exchange rate. Defined as a geometrically-weighted index of the New Zealand dollar bilateral exchange rates against the currencies of Australia, Japan, the United States, the United Kingdom and the euro area.
90-day bank bill rate	RBNZ. Defined as the interest yield on 90-day bank bills.
World GDP	Reserve Bank definition. 12-country index, export weighted. Seasonally adjusted.
World CPI inflation	Reserve Bank definition. Five-country index, TWI weighted.
Import prices	Domestic currency import prices. *Overseas Trade Indexes*.
Export prices	Domestic currency export prices. *Overseas Trade Indexes*.
Terms of trade	Constructed using domestic currency export and import prices. *Overseas Trade Indexes*.
Private consumption	*System of National Accounts*.
Public authority consumption	*System of National Accounts*.
Residential investment	RBNZ definition. Private sector and government market sector residential investment. *System of National Accounts*.
Business investment	RBNZ definition. Total investment less the sum of non-market investment and residential investment. *System of National Accounts*.
Non-market investment	RBNZ definition. The *System of National Accounts* annual nominal government non-market/market investment ratio is interpolated into quarterly data. This ratio is used to split quarterly expenditure GDP government investment into market and non-market components.
Final domestic expenditure	RBNZ definition. The sum of total consumption and total investment. *System of National Accounts*.
Stockbuilding	Percentage point contribution to the growth of GDP by stocks. *System of National Accounts*.
Gross national expenditure	Final domestic expenditure plus stocks. *System of National Accounts*.
Exports of goods and services	*System of National Accounts*.
Imports of goods and services	*System of National Accounts*.
GDP (production)	*System of National Accounts*.
Potential output	RBNZ definition and estimate. Refer to Conway, P and B Hunt (1997), 'Estimating Potential Output: a semi-structural approach', *Reserve Bank of New Zealand Discussion Paper*, G97/9.
Output gap	RBNZ definition and estimate. The percentage difference between real GDP (production, seasonally adjusted) and potential output GDP.
Current account balance	*Balance of Payments*.
Total employment	*Household Labour Force Survey*.
Unemployment rate	*Household Labour Force Survey*.
Household saving rate	*Household Income and Outlay Account*.

Government operating balance	Operating balance before gains and losses. Historical source: The Treasury. Adjusted by the RBNZ over the projection period.
Labour productivity	The series shown is the annual percentage change in a trend measure of labour productivity. Labour productivity is defined as GDP (production) divided by *Household Labour Force Survey* hours worked.
Labour cost	Private sector all salary and wage rates. *Labour Cost Index*.
Real gross domestic income	The real purchasing power of domestic income, taking into account changes in the terms of trade. *System of National Accounts*.
Quarterly percent change	$(\text{Quarter}/\text{Quarter}_{-1} - 1)*100$
Annual percent change	$(\text{Quarter}/\text{Quarter}_{-4} - 1)*100$
Annual average percent change	$(\text{Year}/\text{Year}_{-1} - 1)*100$

Source: Unless otherwise specified, all data conform to Statistics New Zealand definitions, and are not seasonally adjusted.
Rounding: All projections data are rounded to one decimal place.

Appendix B
Companies and organisations contacted by RBNZ staff during the projection round

A.E. Tilley Ltd
Anton's Seafoods Ltd
Auckland Chamber of Commerce
Auckland Regional Transport Authority
Barfoot & Thompson
Blue Sky Meats Ltd
Christchurch International Airport
Clelands Construction Ltd
Colliers International New Zealand Ltd
Employers & Manufacturers Association
Federated Farmers of NZ (Inc)
Financial Services Federation
Fisher & Paykel Healthcare Corporation Ltd
Foster Construction Ltd
Freear Philip Limited
GE Consumer Finance Ltd
Greenlea Premier Meats Ltd
Greens Industries Ltd
H & J Smith Ltd
Heritage Hotel Queenstown
JJ Limited
Kiwi Discovery Shop Ltd
Kiwibank Ltd
KordaMentha
Lichfield International Ltd
Lyttelton Engineering Ltd
Lyttelton Port of Christchurch Ltd
McDonald's Restaurants (New Zealand) Ltd
Mace Engineering Ltd
Macpac Ltd
Mainzeal Property & Construction Ltd
Meco Engineering Company Ltd
Millbrook Resort Ltd
Motor Trade Association
Nelson Pine Industries Ltd
Nelson Tasman Chamber of Commerce
New Zealand King Salmon Ltd
Noel Leeming Ltd
NZ Bloom Ltd
NZ Ski Ltd
Paymark Ltd
Port Nelson Ltd
Port Taranaki Ltd
Postie Plus Group Ltd
PricewaterhouseCoopers
Property Council New Zealand
Recruitment & Consulting Services Association
Southland Building Society
Staples Rodway Ltd
Tait Electronics Ltd
Talbot Plastic Ltd
Talleys Group Ltd
The Helicopter Line Ltd
Transfield Worley Ltd
Tru-Test Ltd
TSB Bank Ltd
Tyco Safety Products Ltd
Veda Advantage Ltd
Villa Maria Estate Ltd
Westfield (New Zealand) Ltd
Weston Milling Ltd
Windsor Engineering Group Ltd
Yunca Group Ltd

Appendix C
Reserve Bank statements on monetary policy

OCR unchanged at 2.5 percent

10 September 2009

The Reserve Bank today left the Official Cash Rate (OCR) unchanged at 2.5 percent.

Reserve Bank Governor Alan Bollard said: "There is more evidence that the decline in economic activity is coming to an end, and that a patchy recovery is underway.

"This is partly due to recovery in our trading partner economies in the June quarter and these look likely to continue expanding in the short term. Domestically, retail spending appears to have stopped falling, following a rise in net immigration and a pick-up in the housing market over recent months.

"However, the medium-term growth outlook remains weak. We expect household spending to grow only modestly given weak income growth and a reduced appetite to take on debt. Business profits are under pressure because of the low level of activity and the elevated New Zealand dollar; this limits the scope for employment and investment to rebound quickly.

"For growth to be sustained in the medium term there is a need for improved competitiveness in the export sector and a continued recovery of household savings. This rebalancing is required to stabilise New Zealand's external payments position. If the exchange rate were to continue its recent appreciation and/or the recovery in house prices were to undermine the improvement in household savings, then the sustainability of the present recovery will be brought into question.

"Annual CPI inflation is currently well within the target band and is expected to track comfortably within the band over the medium term.

"As we have said previously, the forecast recovery in economic activity is based on monetary policy continuing to provide substantial support to the economy. We expect such support will be needed for some time. As a result, we continue to expect to keep the OCR at or below the current level through until the latter part of 2010."

OCR unchanged at 2.5 percent

29 October 2009

The Official Cash Rate (OCR) remains unchanged at 2.5 percent.

Reserve Bank Governor Alan Bollard said: "There are welcome signs that economic activity is growing again.

"Activity in New Zealand's trading partners continued to rebound during the September quarter and financial market sentiment has improved further. However, there remain significant vulnerabilities and challenges to be worked through in many economies. This process could weigh on global growth going forward.

"In New Zealand, the housing market has reversed some of the decline in prices experienced over the past couple of years and a very gradual increase in household spending appears to be taking place. Government spending is also supporting activity. Business spending, however, remains weak and credit growth is very subdued.

"The high level of the New Zealand dollar has limited the scope for exports to contribute to the recovery, and reinforces a bias towards domestic expenditure. After some short-term correction it is also likely to see the current account deficit begin to widen in the medium term.

"The current composition of growth continues to raise questions about its sustainability. These concerns would intensify if credit growth began to propel stronger domestic demand.

"Annual CPI inflation is expected to continue to track comfortably within the target range over the medium term.

"The forecast recovery in economic activity is based on fiscal and monetary policy continuing to provide substantial support to the economy. We think such support remains appropriate. Further ahead, removing some of the current fiscal stimulus is likely to reduce the work that monetary policy will otherwise need to do.

"In contrast to current market pricing, we see no urgency to begin withdrawing monetary policy stimulus, and we expect to keep the OCR at the current level until the second half of 2010."

Appendix D
The Official Cash Rate chronology

Date	OCR (percent)	Date	OCR (percent)	Date	OCR (percent)
17 March 1999	4.50	4 September 2003	5.00	24 April 2008	8.25
21 April 1999	4.50	23 October 2003	5.00	5 June 2008	8.25
19 May 1999	4.50	4 December 2003	5.00	24 July 2008	8.00
30 June 1999	4.50	29 January 2004	5.25	11 September 2008	7.50
18 August 1999	4.50	11 March 2004	5.25	23 October 2008	6.50
29 September 1999	4.50	29 April 2004	5.50	4 December 2008	5.00
17 November 1999	5.00	10 June 2004	5.75	29 January 2009	3.50
19 January 2000	5.25	29 July 2004	6.00	12 March 2009	3.00
15 March 2000	5.75	9 September 2004	6.25	30 April 2009	2.50
19 April 2000	6.00	28 October 2004	6.50	11 June 2009	2.50
17 May 2000	6.50	9 December 2004	6.50	30 July 2009	2.50
5 July 2000	6.50	27 January 2005	6.50	10 September 2009	2.50
16 August 2000	6.50	10 March 2005	6.75	29 October 2009	2.50
4 October 2000	6.50	28 April 2005	6.75		
6 December 2000	6.50	9 June 2005	6.75		
24 January 2001	6.50	28 July 2005	6.75		
14 March 2001	6.25	15 September 2005	6.75		
19 April 2001	6.00	27 October 2005	7.00		
16 May 2001	5.75	8 December 2005	7.25		
4 July 2001	5.75	26 January 2006	7.25		
15 August 2001	5.75	9 March 2006	7.25		
19 September 2001	5.25	27 April 2006	7.25		
3 October 2001	5.25	8 June 2006	7.25		
14 November 2001	4.75	27 July 2006	7.25		
23 January 2002	4.75	14 September 2006	7.25		
20 March 2002	5.00	26 October 2006	7.25		
17 April 2002	5.25	7 December 2006	7.25		
15 May 2002	5.50	25 January 2007	7.25		
3 July 2002	5.75	8 March 2007	7.50		
14 August 2002	5.75	26 April 2007	7.75		
2 October 2002	5.75	7 June 2007	8.00		
20 November 2002	5.75	26 July 2007	8.25		
23 January 2003	5.75	13 September 2007	8.25		
6 March 2003	5.75	25 October 2007	8.25		
24 April 2003	5.50	6 December 2007	8.25		
5 June 2003	5.25	24 January 2008	8.25		
24 July 2003	5.00	6 March 2008	8.25		

Appendix E
Upcoming Reserve Bank *Monetary Policy Statements* and Official Cash Rate release dates

The following is the Reserve Bank's schedule for the release of *Monetary Policy Statements* and Official Cash Rate announcements for 2009:

2009

Thursday 10 December 2009	*Monetary Policy Statement* and OCR announcement

2010

Thursday 28 January 2010	OCR announcement
Thursday 11 March 2010	*Monetary Policy Statement* and OCR announcement
Thursday 29 April 2010	OCR announcement
Thursday 10 June 2010	*Monetary Policy Statement* and OCR announcement
Thursday 29 July 2010	OCR announcement
Thursday 16 September 2010	*Monetary Policy Statement* and OCR announcement
Thursday 28 October 2010	OCR announcement
Thursday 9 December 2010	*Monetary Policy Statement* and OCR announcement

The announcement will be made at 9:00 am on the day concerned. Please note that the Reserve Bank reserves the right to make changes, if required due to unexpected developments. In that unlikely event, the markets and the media would be given as much warning as possible.

Appendix F
Policy Targets Agreement

This agreement between the Minister of Finance and the Governor of the Reserve Bank of New Zealand (the Bank) is made under section 9 of the Reserve Bank of New Zealand Act 1989 (the Act). The Minister and the Governor agree as follows:

1 Price stability

(a) Under Section 8 of the Act the Reserve Bank is required to conduct monetary policy with the goal of maintaining a stable general level of prices.

(b) The Government's economic objective is to promote a growing, open and competitive economy as the best means of delivering permanently higher incomes and living standards for New Zealanders. Price stability plays an important part in supporting this objective.

2 Policy target

(a) In pursuing the objective of a stable general level of prices, the Bank shall monitor prices as measured by a range of price indices. The price stability target will be defined in terms of the All Groups Consumers Price Index (CPI), as published by Statistics New Zealand.

(b) For the purpose of this agreement, the policy target shall be to keep future CPI inflation outcomes between 1 per cent and 3 per cent on average over the medium term.

3 Inflation variations around target

(a) For a variety of reasons, the actual annual rate of CPI inflation will vary around the medium-term trend of inflation, which is the focus of the policy target. Amongst these reasons, there is a range of events whose impact would normally be temporary. Such events include, for example, shifts in the aggregate price level as a result of exceptional movements in the prices of commodities traded in world markets, changes in indirect taxes, significant government policy changes that directly affect prices, or a natural disaster affecting a major part of the economy.

(b) When disturbances of the kind described in clause 3(a) arise, the Bank will respond consistent with meeting its medium-term target.

4 Communication, implementation and accountability

(a) On occasions when the annual rate of inflation is outside the medium-term target range, or when such occasions are projected, the Bank shall explain in Policy Statements made under section 15 of the Act why such outcomes have occurred, or are projected to occur, and what measures it has taken, or proposes to take, to ensure that inflation outcomes remain consistent with the medium-term target.

(b) In pursuing its price stability objective, the Bank shall implement monetary policy in a sustainable, consistent and transparent manner and shall seek to avoid unnecessary instability in output, interest rates and the exchange rate.

(c) The Bank shall be fully accountable for its judgements and actions in implementing monetary policy.

Hon Bill English

Minister of Finance

Dr Alan E Bollard

Governor

Reserve Bank of New Zealand

Dated at Wellington this 18th day of December 2008