Monetary Policy Statement

September 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 28 August 2009. Policy assessment finalised on 9 September 2009.

1 Policy assessment

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

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.

Alan Bollard

Alan Bollard

Governor

2 Overview and key policy judgements

After contracting for the past year and a half, activity in the New Zealand economy is beginning to stabilise. The pace of recovery is expected to be modest, with GDP projected to remain below its pre-recession level until the second half of 2010. Given this subdued outlook, inflation is forecast to remain inside the target range.

We have projected for some time that the New Zealand economy would stabilise through the second half of 2009 and recover thereafter. Recent global and domestic developments give us more confidence in this view.

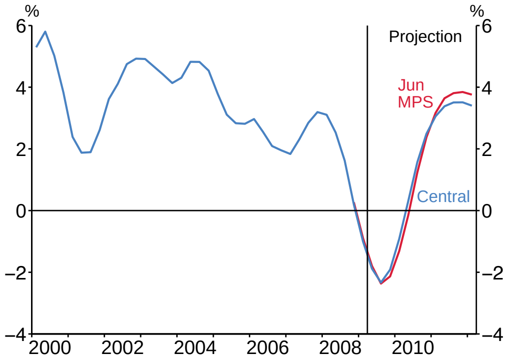
Over the past few months, activity in Asia has rebounded from the sharp contractions seen through the latter stages of 2008 and early 2009. Most noticeably, strong credit growth and fiscal stimulus have seen Chinese GDP bounce back strongly. Recovery in Asia has coincided with an improvement in hard commodity prices. Australia, while clearly benefiting from this, has also recently enjoyed its own fiscal stimulus, with output continuing to expand despite most other developed economies being in recession. New Zealand's export commodity prices have also increased recently, although less noticeably than global commodity prices.

Since the start of the year, activity in the housing market has increased. Although still at levels comparable to previous recessions, housing turnover has risen noticeably from the lows seen through calendar 2008. In addition, house prices have begun to increase, mainly due to unusually low numbers of houses being offered for sale (see box C, chapter 4). Surveys of consumer and business confidence have shown improvement in light of these developments.

Offsetting these developments, the New Zealand dollar has appreciated significantly, suppressing export earnings and encouraging spending on imports. The constraining effect of the exchange rate means that despite now expecting a faster recovery in trading partner growth and domestic demand, our outlook for GDP growth is largely unchanged from that in the June *Statement* (figure 2.1).

While we are more confident than in recent *Statements* that the economy will expand in coming quarters, we also expect the recovery to be sluggish. Many sectors of the economy, while forecast to improve, are recovering from very low levels. Tourist spending, which appears to be nearing a trough, is still expected to be weak for some time. In addition, while export commodity prices should increase, farm profitability, particularly dairy farm profitability, is likely to be poor this season. Furthermore, businesses, while becoming increasingly confident that the worst has passed, are also likely to be cautious in their investment and employment decisions for some time. We continue to believe that the unemployment rate will peak about the middle of next year.

Figure 2.1
Gross Domestic Product
(annual average percent change)

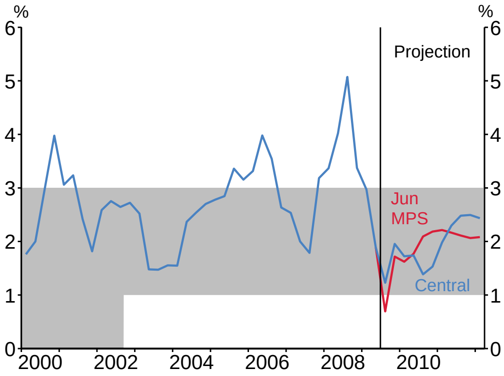


Source: Statistics New Zealand, RBNZ estimates.

Finally, while there is evidence to suggest household spending will increase over the next few quarters, there are also numerous reasons to question the longevity of any increase in spending. Labour income growth is likely to be weak for some time, with employment forecast to fall further and wage growth likely to ease. What is more, consumers are already very indebted, with household credit at almost 160 percent of disposable income. Given this, we continue to believe that house price rises will prove short-lived.

In all, while we expect GDP to increase from here, we believe the pace of recovery will be sluggish. As such, we expect significant surpluses of productive resources to persist over the next few years. This, combined with assumed strength in the New Zealand dollar, is expected to see inflation remain inside the target range over the projection horizon (figure 2.2).

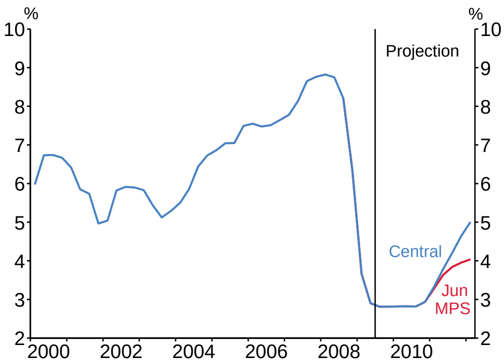
Figure 2.2
CPI inflation
(annual)



Source: Statistics New Zealand, RBNZ estimates.

Consistent with our statement at the time of the July OCR review, we expect the OCR to remain at or below its current level until the latter part of next year (figure 2.3).

Figure 2.3
90-day interest rate



Source: RBNZ estimates.

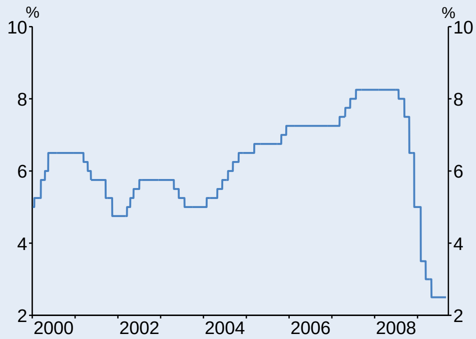
Box A

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 in the OCR was in response to the 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.

In addition, the Bank took a number of steps to enhance its liquidity facilities to improve credit flows, and most recently, communicated its expectation that the OCR will be kept at or below the current level through until the latter part of 2010. These two measures are aimed at helping the transmission of the lower OCR to the interest rates faced by households and businesses.

Figure A1
Official Cash Rate



Source: RBNZ.

The extent to which the New Zealand economy has weakened and inflation pressures abated suggests that rapid and significant monetary policy stimulus has been appropriate.

Monetary policy judgements

If the economy recovers as projected, we would expect to eventually tighten monetary policy. However, the medium-term sustainability of the projected recovery is by no means assured.

Through the second half of 2008 and early 2009 the New Zealand dollar fell sharply. Given signs that the New Zealand economy was contracting sharply, our projections had assumed the currency would continue to depreciate and offer sizable stimulus over the projection horizon.

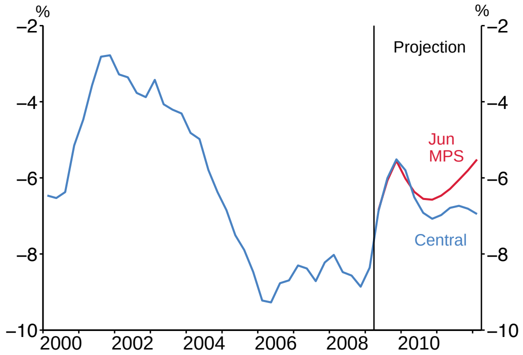
This stimulus meant that future growth looked likely to be driven to a significant extent by improved export earnings. This was expected to see export volumes increase and household incomes improve. Furthermore, currency weakness meant the prices of imported products were expected to be high relative to those produced domestically. As a result, household spending on imports was expected to reduce.

However, since the publication of the March *Statement*, the New Zealand dollar has appreciated strongly. There is uncertainty about what has driven this (see box B), but our judgement is that the appreciation is larger than would be consistent with the modest improvement in New Zealand's economic outlook relative to that of our trading partners.

The stronger currency will act to suppress exports and encourage spending on imports. Indeed, despite improvement in the global outlook, we have revised down our projection for export volume growth. And as mentioned above, activity in the housing market and consumer confidence more generally has improved, suggesting that consumer spending will increase over coming quarters. Furthermore, the high New Zealand dollar has seen imported product prices reduce.

We believe these developments are likely to see New Zealand's trade balance deteriorate over the next few years. Indeed, despite a cyclical reduction in net interest payments to foreigners, we expect the annual current account deficit to settle around 7 percent of GDP through the latter part of the projection (figure 2.4). Beyond this, as domestic interest rates return to more normal levels, there is a risk that the current account deficit returns to the highs of the past few years.

Figure 2.4
Current account
(annual, percent of nominal GDP)



Source: Statistics New Zealand, RBNZ estimates.

A current account deficit of this level would see net international liabilities increase even further, adding to New Zealand's already high external vulnerability. Such a process could only be sustained if overseas creditors were prepared to finance ever growing imbalances. At some point a more marked decline in the exchange rate could occur, prompting rebalancing in favour of the tradable sector.

While our projection assumes households acquire debt less rapidly, there is a risk that credit restrictions, or an increase in the premium charged on offshore funding, forces the household saving rate to improve more noticeably than we forecast. This would assist in constraining the current account deficit.

In addition, the recent improvement in global economic activity could prove short-lived. Much of the improvement seems related to a stabilisation in stock levels. These fell sharply in late 2008 and early 2009. And while the outlook seems clearly better than was feared at the start of the year, New Zealand could still face weaker trading partner growth than we currently project.

The fragility of the recovery plays a noticeable part in the reasoning behind the current stimulatory setting of the OCR in New Zealand. Until the risks and uncertainties about the outlook have acceptably reduced we anticipate keeping the OCR low, hence our repeatedly communicated expectation to keep the OCR at or below its current level until the latter part of next year.

Box B

Interpreting recent New Zealand dollar strength

The New Zealand dollar has continued to strengthen in recent months. The TWI has now retraced close to half of the fall from its highs around 77 in July 2007 to its recent low near 50 seen in March this year.

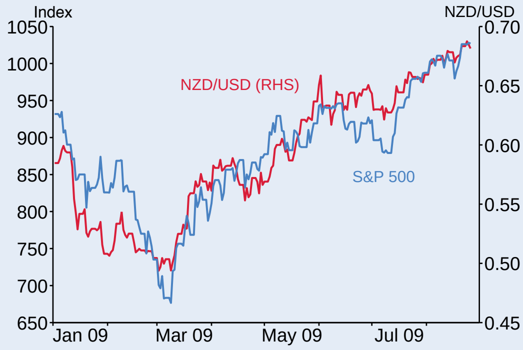
We believe this retracement is larger than can be justified on the basis of developments in the outlook for the New Zealand economy relative to those of our trading partners. It seems gains have been exacerbated by renewed global risk appetite and the relative illiquidity of the New Zealand dollar.

The modest upgrade of our projections for New Zealand growth is significantly less than the increases of about one percentage point in our projections for trading partner GDP growth in both this year and next.

Among the currency pairs that comprise the TWI, the recent strength in the New Zealand dollar relative to the Australian dollar is perhaps the most vivid illustration of gains that are at odds with relative economic developments. This strength has occurred despite a strong rebound in the prices of the industrial commodities that dominate Australia's export basket, relative to the more limited recovery in the prices of the agricultural commodities that comprise the bulk of New Zealand's merchandise exports. Moreover, spreads between New Zealand and Australian interest rates have generally been falling in recent months as markets become increasingly confident that the Reserve Bank of Australia will soon begin returning its policy rate to higher levels.

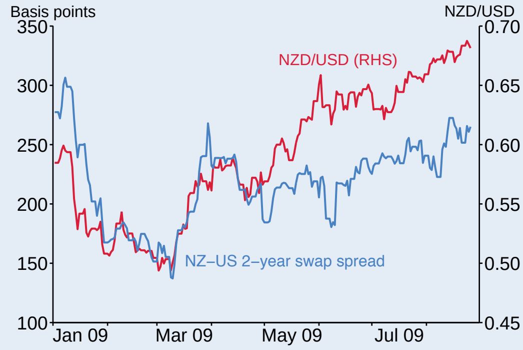
The extent of recent New Zealand dollar strength appears to be a symptom of an almost indiscriminate rush back into risk-taking that has accompanied the recovery in global equity markets. In this regard, the New Zealand dollar has been closely correlated with movements in global equity markets in recent months and appreciated to a greater extent than might have been expected on the basis of movements in interest rate differentials (figures B1 and B2).

Figure B1
New Zealand dollar and the US S&P500 index



Source: Bloomberg.

Figure B2
New Zealand dollar and NZ-US interest rate spread



Source: Bloomberg.

Commodity currencies — those of economies which are significant producers and exporters of basic industrial materials and foodstuffs — have generally posted the strongest gains against the US dollar since the lows in global equity markets in March. With traders seeing these economies as particularly sensitive to global growth developments, increased confidence that the world economy is stabilising and recovering has translated into relatively strong gains in these currencies. This appears to be overwhelming any concerns about the individual circumstances of these economies.

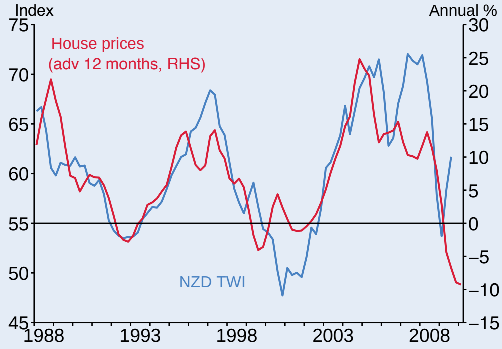
For example, strong gains in the South African rand have been sustained despite the South African Reserve Bank recently surprising the market with a 50 basis point policy rate cut.

In the case of the New Zealand dollar — which has recorded the largest percentage gain of all the commodity currencies since the March lows in global equity markets — its disproportionately large appreciation appears to reflect its relative illiquidity. The small size of the market compared to those of the major currencies means flows have a relatively greater impact on the price.

We are always mindful of the potential for movements in the New Zealand dollar (and markets generally) to convey important information about the outlook for the economy. There has generally been a close association between the New Zealand dollar and house prices over the past 20 years (figure B3). Without claiming a direct relationship between the two, this illustrates the extent to which views about domestic conditions influence the New Zealand dollar. Accordingly, recent currency strength could be interpreted as signalling market expectations that New Zealand is recovering more rapidly than we project.

Whatever explains the currency's strength, it is likely to lead to further deterioration in New Zealand external accounts, undermining the sustainability of the recovery. For the New Zealand economy to continue to 'borrow' its way to growth rather than generating it through export earnings will be difficult to sustain in a post-crisis global environment where the availability of credit is likely to remain relatively constrained.

Figure B3
House prices and the TWI



Source: RBNZ, PropertyIQ.

3 Financial market developments

Overview

Market confidence has continued to steadily improve in recent months. This recovery in risk appetite has been a major driver of developments in global asset markets, coinciding with a broad-based rally in global equity markets. Equity indices have been supported by stronger than expected second quarter company earnings in a number of economies, as well as continued signs of a recovery in economic conditions. Further to this, the upturn in market sentiment has facilitated a further easing in credit market pressures.

This recovery in market sentiment has been a major driver of movements in foreign exchange markets, which is consistent with increased market appetite for risk. In line with developments in major economies, markets have increased expectations of the extent of policy rate tightening expected from the Reserve Bank. This has generally placed upward pressure on wholesale interest rates in New Zealand.

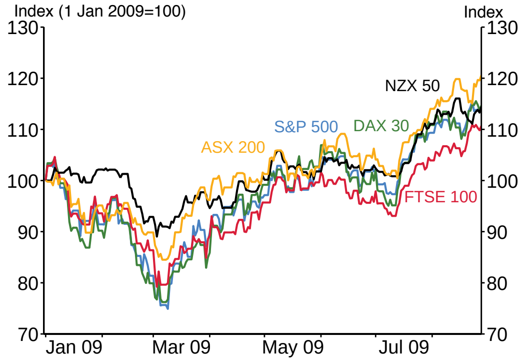
International financial market developments

After a significant deterioration in financial markets since late 2007, financial conditions have steadily recovered in recent months. This has been reinforced by signs of economic stabilisation and has been further supported by substantial fiscal and monetary support in most major economies.

This continued improvement in sentiment has been seen most clearly in global equity markets. Overall, US equity markets have risen a further 4 percent since the time of the June *Statement*, with Australasian and European indices making similar gains (figure 3.1). As well as a more positive global outlook, stronger-than-expected company earnings during the second quarter have further encouraged the rally in global equity indices. For example, of all the firms on the S&P 500, more than 70 percent reported earnings ahead of analysts' forecasts.

The continued increase in investor risk appetite and investor confidence has also facilitated a further easing in conditions in wholesale credit markets. Pressures in money markets have continued to dissipate, with the spread between three-month interbank lending rates and policy

Figure 3.1
Global equity indices

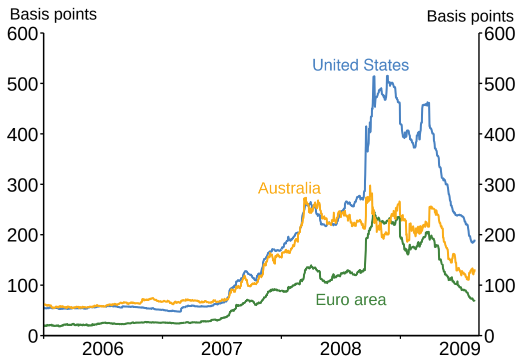


Source: Bloomberg.

rates moderating to levels seen before the bankruptcy of Lehman Brothers in September 2008.

Conditions in longer-term credit markets have also recovered, with corporate bond spreads continuing to fall as market confidence has improved (figure 3.2), resulting in cheaper credit for corporate bond issuers. However, these spreads remain elevated relative to pre-crisis levels, while generally access to credit remains more difficult than in previous years. These conditions suggest relatively tight financial conditions will continue to limit any expansion in economic activity in our major trading partners for some time yet.

Figure 3.2
AA-rated corporate bond spreads



Source: Bloomberg.

However, despite these signs of improvement, sentiment remains fragile and questions remain around the sustainability of the current upturn in financial markets. Cost cutting has been a major driver of the stronger than expected June quarter profits in the US and these same reductions may not be attainable in future quarters to drive earnings growth.

Further to this, part of the recent strong performance in equity markets reflects participants discounting the possibility of further significant deterioration in credit markets and economic activity, rather than a positive view of robust corporate earnings. As evidence of this, companies and sectors which would have been particularly exposed to a more substantial downturn (including the consumer cyclical and financial sectors, along with sub-investment grade rated companies) have seen the greatest increases in stock prices over the past few months.

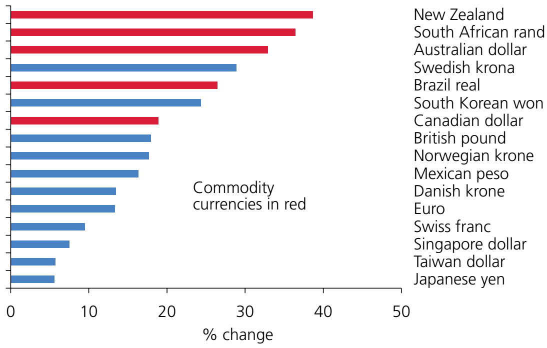
After a substantial easing in monetary policy, central banks have generally kept policy rates unchanged in recent months. A number of central banks have continued with a programme of direct asset purchases, with the Bank of England announcing an increase in the size of its asset purchase programme. However, more generally, the focus for markets has turned to how these unconventional monetary policy measures will be reversed, as signs of economic recovery emerge. In line with this outlook, markets have become increasingly confident of policy rate increases from major central banks, with market pricing implying a high probability of monetary tightening in major economies over the next 6-12 months.

Foreign exchange markets

Increased global risk appetite has also been the major driver of currency movements in recent months. The US dollar has continued to weaken against most major currencies, including the New Zealand dollar, as a further moderation in safe-haven demand for US dollar assets has encouraged a depreciation of the currency. However, as well as rising relative to the US dollar, the New Zealand dollar has gained ground against most of our trading partner economies. On a trade weighted basis, the New Zealand dollar has appreciated about 5 percent since the June *Statement*.

Increased market appetite for risk has been a major driver of this appreciation, with the New Zealand dollar largely moving in line with the performance of global equity markets on a day-to-day basis (box B, chapter 2). Perceptions of greater sensitivity of commodity exporting countries to the improving global growth outlook have been one additional factor behind the New Zealand dollar appreciation, a factor also supporting other commodity currencies like the Australian and Canadian dollars (figure 3.3).

Figure 3.3
Movements in currencies against the US dollar
(percentage change in currency relative to US dollar since early March)



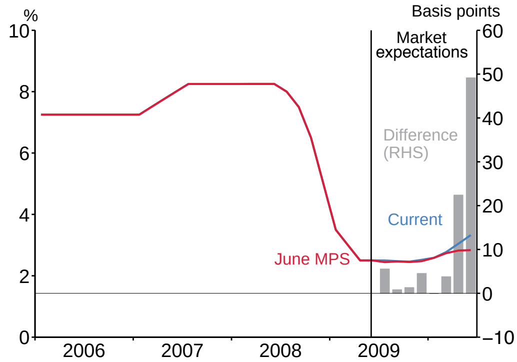
Source: Bloomberg.

Despite the continued recovery in risk appetite, as well as a fall in currency market volatility and increased relative interest rate differentials, demand for longer-term New Zealand dollar denominated securities remains subdued. Issuance of Uridashi and Eurokiwi bonds remains limited, while maturities continue to outpace issuance. Other aspects of Japanese investor demand for New Zealand dollar denominated assets (once a significant driver of New Zealand dollar strength) also remain limited. Japanese investment trust holdings of New Zealand dollar denominated assets have remained relatively static, while long NZD/JPY positions held by margin traders are at low levels.

Domestic financial market developments

In line with most major economies, particularly Australia, markets have increased the extent, and brought forward the timing, of expected increases in the OCR. Overall, the Overnight Indexed Swap market is pricing a risk of OCR increases from December this year, with a total of 110 basis points of increases priced over the next 12 months (figure 3.4, overleaf).

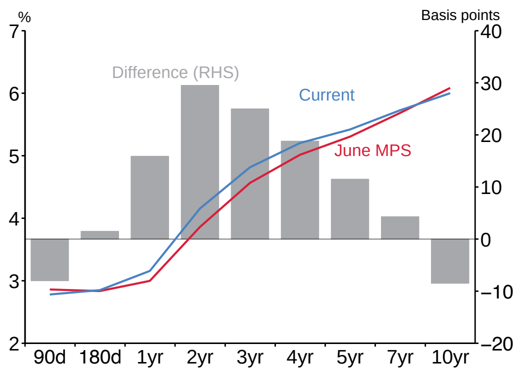
Figure 3.4
Market implied expectations of the OCR



Source: Reuters, RBNZ estimates.

These increased expectations of policy tightening from the Reserve Bank have seen the New Zealand wholesale yield curve generally move higher since the June *Statement*. This upward pressure on interest rates has been most notable in the 1-3 year part of the yield curve (figure 3.5), with the fall in yields at shorter dates reflecting a further moderation in money market pressures (in line with international developments).

Figure 3.5
Wholesale interest rate curve



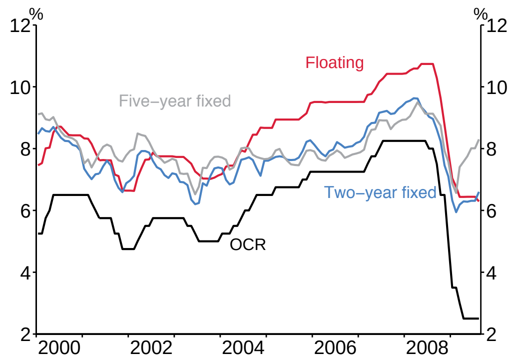
Source: Bloomberg.

Longer-term yields are generally little changed over recent months, against a background of contrasting developments in key offshore markets. US yields have steadily fallen since the June *Statement*, with US fixed income markets encouraged by signs of strong demand at recent US government bond auctions. However, Australian longer-term rates have moved higher, as markets have become increasingly confident that the Reserve Bank of Australia will soon begin returning its policy rate to higher levels. Indeed, the spreads between New Zealand and Australian longer-term interest rates have fallen in line with market expectations, which are for policy to tighten sooner and to a greater extent in Australia than in New Zealand.

Financing and credit

The domestic mortgage curve has steepened, as New Zealand banks have raised longer-term fixed rates, while decreasing floating mortgage rates in some cases (figure 3.6). Overall, a rise in deposit funding costs has outweighed an easing in wholesale funding pressures. In wholesale markets, the cost to banks of issuing government guaranteed debt in offshore markets has moderated in line with the improvement in global credit conditions.

Figure 3.6
Mortgage rates offered to new borrowers

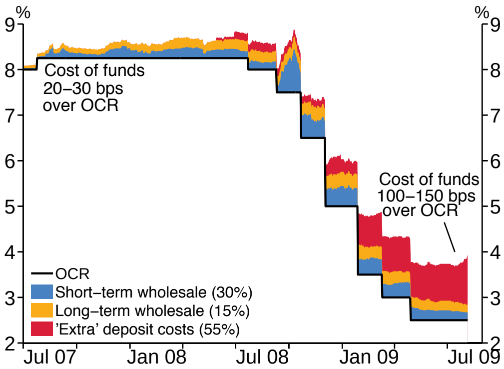


Source: RBNZ.

With deposit funding making up a relatively large share of bank funding costs and deposit costs rising at a faster rate than wholesale funding costs have been easing, we estimate that overall marginal funding costs for the banks relative to the OCR are continuing to rise (figure 3.7).

Figure 3.7

Indicative marginal funding costs relative to the OCR



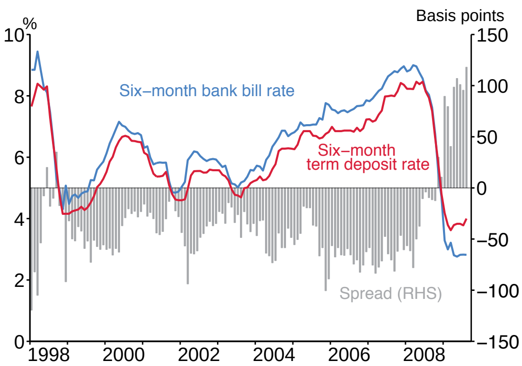
Source: RBNZ estimates.

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.

Increased competition among banks, non-bank deposit takers, and corporate bond issuers for deposit funds have all contributed to the rise in deposit funding costs. Before mid-2008, term deposit rates were typically priced around 50 basis points below wholesale interest rates. However more recently, term deposits are offering interest rates around 100-150 basis points above wholesale yields (figure 3.8). Pressure on banks to maintain or grow a retail funding base — seen as a more stable source of funding during times of crisis — has played a role in encouraging increased competition in this area.

Figure 3.8

Term deposit and wholesale interest rates

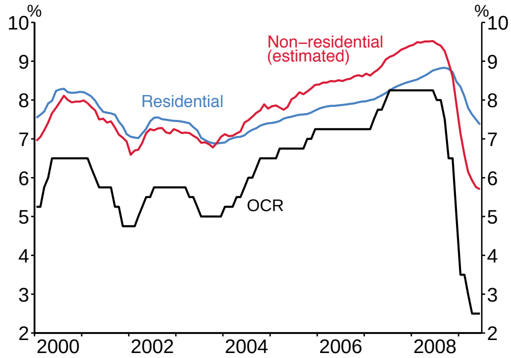


Source: RBNZ, Bloomberg.

Despite rising marginal funding costs, effective lending rates for firms and businesses continue to decline (figure 3.9). The effective mortgage rate (the average rate being paid on outstanding mortgage debt), has fallen over the past year. Further declines are expected over the next 12 to 18 months with the repricing of old mortgages and new borrowers moving onto lower mortgage rates. Business loans are typically shorter-term or variable-rate contracts, which has enabled firms to benefit sooner than households from the fall in short-term interest rates.

Figure 3.9

Effective lending rates by sector and the OCR



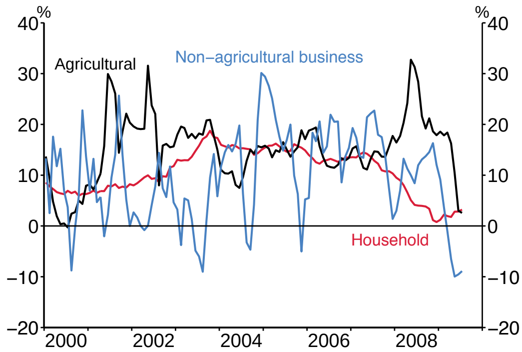
Source: RBNZ estimates.

Annual household credit growth remains low (figure 3.10). This is mostly a consequence of the softness in housing market activity earlier in the year. Furthermore, consumer credit remains weak. With business profitability under continued pressure, lending growth to the business sector has remained weak. Following an extended period of strength, agricultural borrowing growth has eased sharply.

Figure 3.10

Credit growth

(six-month annualised percentage change)



Source: RBNZ.

4 Recent economic developments

Overview

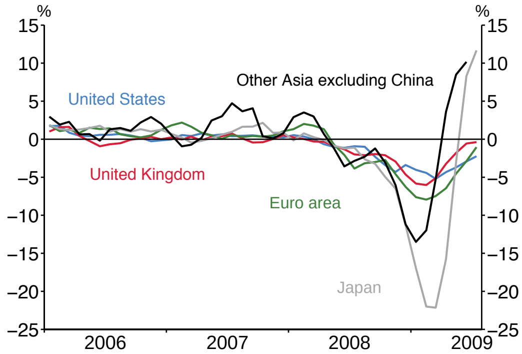
Economic activity in our trading partners appears to be at a turning point. Rebounds in manufacturing sector activity have been evident following very aggressive de-stocking earlier in the year. Expansionary monetary and fiscal policy settings had also supported activity considerably. However, large global economic imbalances remain.

The New Zealand economy also appears to have reached the low point of the cycle. Measures of business and consumer sentiment have improved from depressed levels earlier in the year and are now consistent with aggregate economic activity no longer declining. Housing market activity and house prices have also recovered. With signs that domestic spending is starting to recover, and with the net export position likely to weaken, there is little evidence of the economy rebalancing. Annual CPI inflation is estimated to trough at just above 1 percent in the September quarter.

Recent international economic developments

Along with a recovery in confidence and global risk appetite, we have seen increasing signs that global activity has bottomed out from the very large falls of late 2008 and early 2009 (figure 4.1).

Figure 4.1
Trading partner industrial production
(three-month percent changes, seasonally adjusted)



Source: DataStream, national sources, RBNZ estimates.

- Within Asia, particular strength has been seen in China. Expansionary policy, including a significant easing in lending conditions, has provided considerable support for non-residential investment and household spending. Following very sharp contractions in late 2008 and 2009, activity in Asian economies rebounded in the June quarter as inventories were run down at a slower pace. In some cases, such as South Korea, support has also come from expansionary monetary and fiscal policy.
- The Australian economy has also shown considerable resilience. Recent monetary and fiscal policy easing has boosted household spending and housing market activity. Additionally, Australia's commodity-oriented exports have benefited from the strong recovery in Chinese demand.
- The improvement in economic prospects for other major trading partner economies has been more tentative. June quarter GDP data were mixed, with further declines in economic activity in the US, albeit at a more modest pace. Surveys of business activity point towards continued improvements in GDP in the latter half of 2009. There has also been some improvement in industrial production, partly due to car-scrapping subsidies and other fiscal support measures.

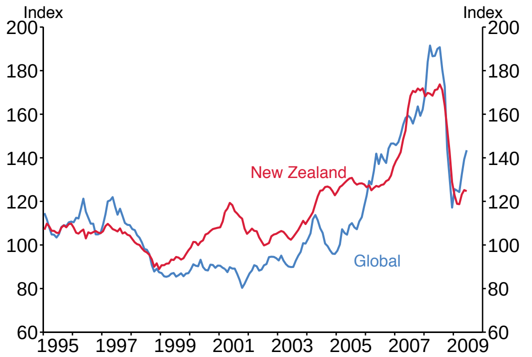
Looking through the effects of the inventory cycle and policy support, underlying conditions remain weak. Beyond the manufacturing sector, final demand in the US and other Western economies is still very soft. In particular, US households continue to face very weak labour market conditions, tight credit, and weaker balance sheets. There is still an excess supply in the US housing market, mortgage delinquency rates remain high, and there are lingering concerns about the health of US and European financial institutions' balance sheets (despite improved earnings reports). Fiscal positions have deteriorated rapidly in some trading partner economies, suggesting that a period of fiscal consolidation will be necessary as private sector demand resumes.

Recent developments in the New Zealand economy

External sector

Commodity prices have risen over the past few months as prospects for the global economy have improved. Price rises for New Zealand's export commodities have been quite broad based and have included forestry, aluminium and meat prices, with climbs in the latter partly a consequence of supply shortages. Most notably, however, prices for dairy products have climbed sharply from the lows seen in July. To date, the recent climb in New Zealand's commodity export price indices has not been as large as for other commodities (figure 4.2). World prices for commodities remain considerably below the heights observed over the past few years.

Figure 4.2
New Zealand export and global commodity prices
(SDR terms)



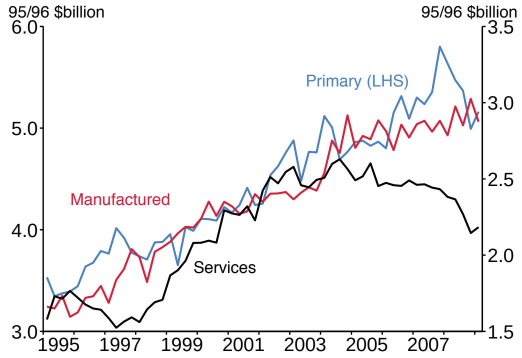
Source: *The Economist*, ANZ National Bank Group Ltd.

Primary exports have continued to recover from last year's drought-induced slowdown in dairy production (figure 4.3). Merchandise trade data since point to further recovery in volumes, driven by the continued running down of dairy inventories and a rebound in forestry exports.

Manufacturing exports were particularly exposed to weaker global demand. While falls in export volumes since the start of the year have been historically large, larger falls were evident in domestic manufacturing activity.

Overseas visitor numbers have recovered slightly from the lows encountered earlier in the year. However, a lower proportion of overseas visitors are from high-spending tourist markets (such as the Asian region), with the H1N1

Figure 4.3
Export volumes
(seasonally adjusted)



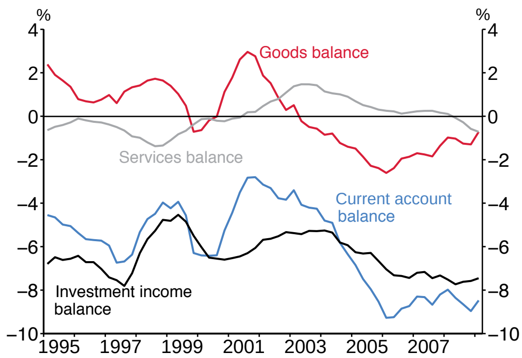
Source: Statistics New Zealand.

virus likely to have been a contributing factor. This points to a slight decline in services exports in the winter months, notwithstanding the large inflows of Australian tourists.

The contraction in consumer and business spending and the running down of inventories have flowed through into sharp declines in import volumes. The weakness in goods import volumes is most evident in capital imports, although consumer and intermediate import volumes have fallen and imports of services are declining.

The narrowing annual goods deficit has contributed to a modest improvement in the current account deficit (figure 4.4).

Figure 4.4
Current account
(annual, percent of nominal GDP)



Source: Statistics New Zealand.

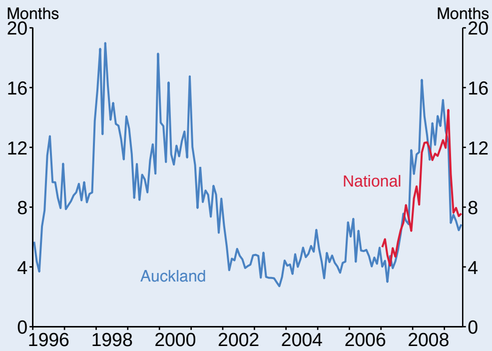
Box C

Why dwelling listings are low

House prices have increased 4.4 percent in the past four months. An unusually low number of dwellings being offered for sale appear to have driven this. We do not expect this low level to persist given the general improvement in housing market conditions.

Low listings have had a significant tightening effect on the housing market. Indeed, various data suggest that the stock of listings has reduced from about 14 months of supply at the start of the year, to only seven months of supply currently (figure C.1). According to realestate.co.nz statistics, the national stock of listings has fallen by about 1,500 dwellings per month for the past six months.

Figure C1
Ratio of dwelling listings to sales



Source: Barfoot and Thompson, REINZ, realestate.co.nz.

We believe three factors are responsible for the unusually low number of dwellings being offered for sale.

First, since the beginning of 2009, the number of people emigrating from New Zealand permanently has fallen by about 1,500 per month. This reduction has meant that about 600 fewer dwellings are being vacated each month, resulting in fewer listings. We expect that the low level of departures will persist until prospects in Australia, or the rest of the world more generally, improve.

Second, the supply of new dwellings has stayed low, despite the improvement in transaction volumes. Currently, the monthly rate of consent issuance for new houses is 400 fewer than would normally occur given the current level of housing turnover. It is expected consent issuance will increase over coming months.

Third, our assessment is that falling house prices have discouraged listings. With prices increasing recently, some discouraged sellers might well offer their properties for sale.

Household sector

In recent months, increasing house prices have improved household balance sheets. Since March, housing turnover has stabilised around 6,000 dwellings per month, considerably higher than year-earlier levels. Measures of consumer sentiment have continued to climb from their 2008 lows.

House prices have lifted off their troughs. The climb appears to be partly attributable to a shortage of listings (see Box C).

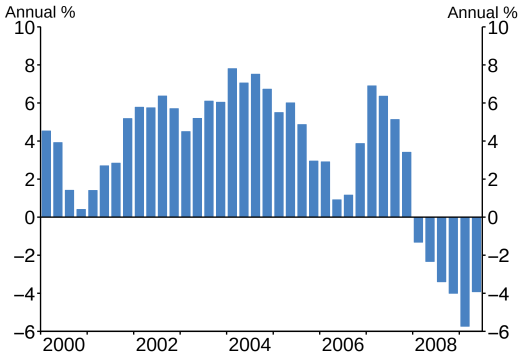
Household disposable incomes have been supported by positive (albeit falling) wage growth and the April personal income tax reductions. With petrol prices and interest rates now lower relative to a year ago, pressures on some households have eased, relieving some of the strain on household budgets. While these influences have improved, slowing growth in labour incomes and increasing concerns over job security seem to be encouraging more caution over spending.

Retail sales volumes increased slightly in the June quarter, which was the first quarterly rise in nearly two years (figure 4.5). Contributing to the increase was a rebound in vehicle sales volumes. As yet, there are no perceptible signs that the recovery in housing market activity has flowed into durables consumption. While some recovery in private consumption is expected, this is likely to be gradual, mostly reflecting the subdued labour market outlook.

Lower consent issuance at the start of the year is likely to imply some weakness in residential investment in the middle of the year. High net immigration, the recovery in survey indicators for residential investment and the more recent climb in consent issuance point to some recovery in residential investment toward the end of the year (figure 4.6).

Figure 4.5

Retail sales volume growth

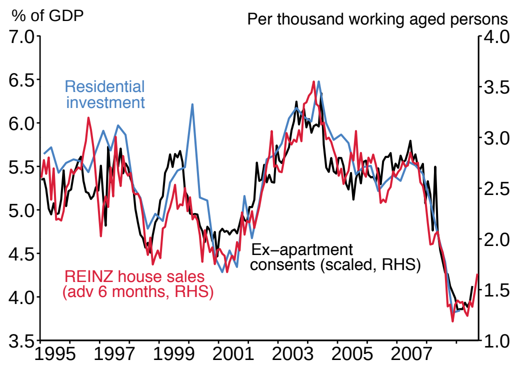


Source: Statistics New Zealand.

Figure 4.6

House sales, ex-apartment consents, and real residential investment

(seasonally adjusted)

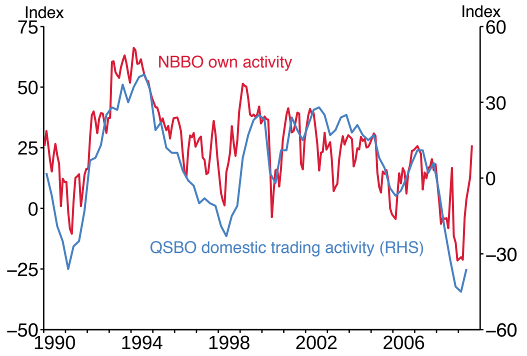


Source: REINZ, Statistics New Zealand, RBNZ estimates.

Figure 4.7

Business outlook for own activity

(seasonally adjusted)

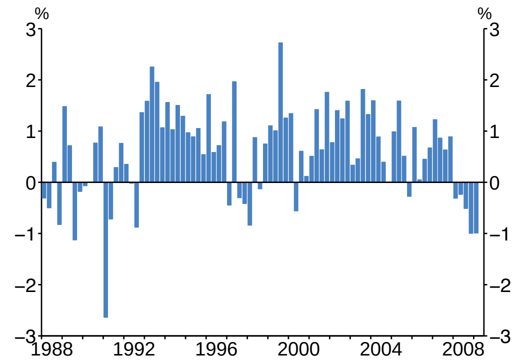


Source: National Bank, NZIER.

Figure 4.8

GDP growth

(quarterly percent change, seasonally adjusted)



Source: Statistics New Zealand.

Business sector and output

Activity expectations have improved markedly in the past few months (figure 4.7). Recovering business confidence has also been evident in steadily improving investment intentions. This follows a period where weaker demand and credit restrictions contributed to declining investment expenditure by firms.

Given the lags between investment intentions and activity, business investment is likely to decline over the middle of the year.

After contracting from the start of 2008 (figure 4.8), it seems GDP might soon recover. Indeed, business sentiment is now consistent with aggregate economic activity no longer declining. For the first time in two years, retail trade volumes increased in the June quarter. Improved consumer sentiment and higher housing market activity since the start of the year also suggest some near-term growth. But economic activity remains patchy, and the foreshadowed recovery is likely to be tentative and modest. This is despite the sizeable contraction in activity that has occurred and the presence of spare resources within the economy.

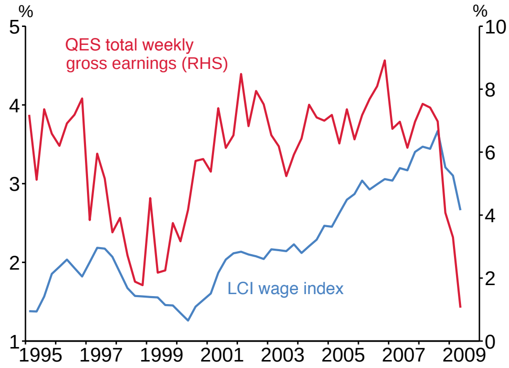
Productive capacity and the labour market

The sharp decline in economic activity has resulted in a significant amount of spare productive capacity emerging. Labour market indicators, including survey measures of skill shortages, suggest further easing in labour market pressures. However, in recent months survey indicators generally point to a pick-up in capacity utilisation.

The economic slowdown has caused the demand for labour to decline sharply over the first half of 2009. A key characteristic of the current economic cycle is the greater flexibility apparent in the labour market. This is evident in the decline in hours worked, which has thus far clearly exceeded the decline in employment. Notwithstanding this, the unemployment rate is now significantly above its late 2007 low.

The easing in labour market pressures has also been highlighted by the sharp decline in wage inflation. The Labour Cost Index increased 0.3 percent in the June quarter, a marked reduction from the peak in wage inflation of 1.1 percent growth in the September 2008 quarter. The majority of firms are giving no, or limited wage increases this year. Subdued wage growth, combined with a marked reduction in working hours, has resulted in a sharp decline in household earnings growth (figure 4.9).

Figure 4.9
Labour costs and wages – private sector
(annual percent change)



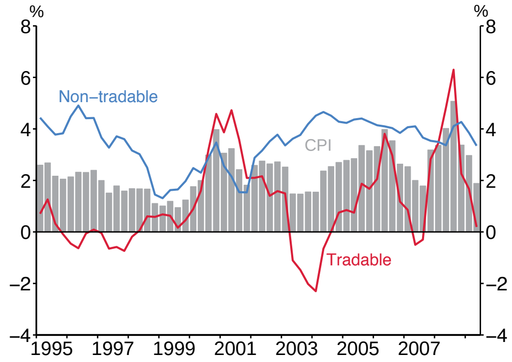
Source: Statistics New Zealand.

CPI inflation

Annual CPI inflation fell to 1.9 percent in the June quarter (figure 4.10). Tradable inflation was slightly stronger than was expected in the June *Statement*, with much of the surprise attributable to higher food prices (despite falls to global food commodity prices). Although wage inflation has declined, stronger construction costs contributed to higher than expected non-tradable inflation.

We estimate annual CPI inflation will fall to 1.2 percent in the September 2009 quarter, which is slightly higher than expected in the June *Statement*. Weather-related increases in vegetable prices contributed to further increases in food prices in July. Stronger petrol prices are also likely to affect tradable inflation, notwithstanding the appreciation of the New Zealand dollar. Near-term estimates for non-tradable

Figure 4.10
CPI, tradable, and non-tradable inflation
(annual)



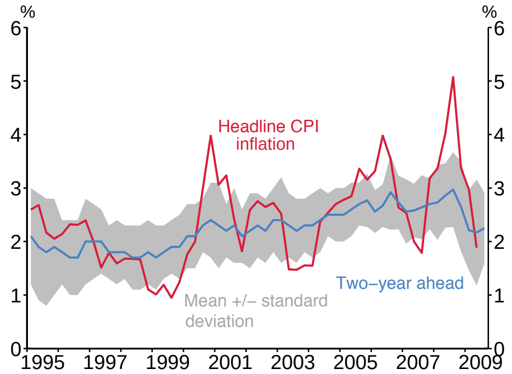
Source: Statistics New Zealand.

inflation are also slightly higher, mostly as a consequence of higher construction costs.

Signs of recovery in the global and domestic economies have contributed to inflation expectations rising slightly. Two-year-ahead inflation expectations rose by 0.1 percent to 2.3 percent in August, down from a peak of 3.0 percent late last year.

Expectations remain consistent with inflation outturns averaging between 1 and 3 percent over the medium term (figure 4.11).

Figure 4.11
Headline CPI and inflation expectations
(annual)



Source: Statistics New Zealand, RBNZ.

Table 4.1

Measures of inflation and inflation expectations

(annual)

	2007	2008				2009	
	Dec	Mar	Jun	Sep	Dec	Mar	Jun
CPI	3.2	3.4	4.0	5.1	3.4	3.0	1.9
CPI components							
CPI non-tradables	3.5	3.5	3.4	4.1	4.3	3.8	3.3
Non-tradables housing components	4.9	4.6	4.0	3.2	2.4	1.5	1.0
Non-tradables ex housing, cigarettes and tobacco components	3.0	3.1	3.1	4.5	5.1	4.8	4.3
CPI tradables	2.8	3.4	4.8	6.3	2.3	1.7	0.2
Petrol	16.9	20.5	25.9	29.3	-4.8	-9.3	-17.0
Other inflation measures							
Factor model estimate of core CPI inflation	3.0	3.1	3.4	3.6	3.1	2.9	2.4
CPI trimmed mean (of annual price change)	3.5	3.5	3.8	4.0	3.1	2.9	2.2
CPI weighted median (of annual price change)	3.2	3.2	3.4	3.7	3.0	2.9	2.9
CPI ex food, petrol and government charges	2.0	1.9	1.9	2.2	2.0	1.9	1.6
CPI ex food and energy	1.8	1.6	1.5	2.1	2.2	2.3	2.1
GDP deflator (derived from expenditure data)	5.9	6.2	3.7	2.1	2.5	2.4	n/a

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

5 The macroeconomic outlook

Underlying our central projection for the medium-term outlook are two key judgements. First, near-term tightness in the housing market is expected to result in higher house prices. This is expected to boost domestic demand, particularly consumption. Second, the stronger outlook for global growth will boost demand for New Zealand's exports and also result in higher world prices. The overall effect on the trade balance is projected to be offset, however, by the assumption that the TWI will remain at current high levels throughout 2010.

Continued improvement in business sentiment in recent months supports our expectation of a recovery in activity in the near term. However, this is expected to be largely driven by stronger consumption, raising the risk that the recovery may not be sustainable given the indebtedness of the household sector.

Our central projection incorporates deterioration in the trade balance, such that the current account deficit settles at about 7 percent of GDP through the latter part of the projection. Furthermore, we forecast the recovery to be sluggish, with spare capacity expected to remain in the economy over the forecast horizon. Our outlook for inflation is broadly unchanged. We expect annual CPI inflation to remain inside the target range.

House price inflation and household spending

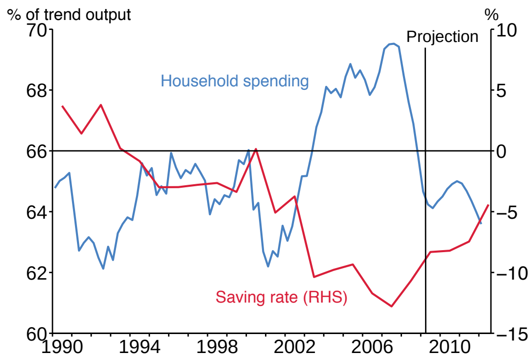
We expect the current tight supply in the housing market – as reflected in the low level of listings – to persist in the short term, supporting an increase in house prices over the remainder of 2009. Beyond that, net immigration inflows are expected to underpin demand for housing. We expect long-term arrivals and departures to track sideways in the near-term before departures increase again in line with the recovery in the global economy.

This demand will be in part offset by an increase in residential investment. Overall, we expect house prices to hold up around current levels for the rest of the forecast period. Both the immigration inflows and stronger house prices are expected to boost household consumption.

That said, the projection for consumption — on a per capita basis — remains weak, reflecting our view that households will still rein in their spending to some degree. Falling employment and subdued wage growth has put pressure on household incomes, mitigated somewhat by lower interest rates.

Over the past five years or so, the substantial increase in household spending – both through increased consumption and purchases of new and existing houses – has led to debt rising to very high levels. We expect debt levels to grow at a slower pace in future with households trimming their spending such that the household saving rate increases later in the projection (figure 5.1). Despite this, the savings rate is still negative over the forecast period, reflecting our expectation that debt levels will continue to increase.

Figure 5.1
Household spending and saving rate
(saving rate as percent of household disposable income)



Source: Statistics New Zealand, RBNZ estimates.

Trading partner activity and the terms of trade

As discussed in chapter 4, economic activity in our trading partners has stabilised. In particular, activity in Asia has bounced back sharply. However growth is expected to be more modest in the second half of this year, with the very rapid pace of lending expansion and infrastructure investment in China unlikely to be maintained. However, developments so far suggest policy measures, particularly in the Asia-Pacific region, will continue to be effective in supporting growth in 2010. Over the medium term, we expect fiscal consolidation and balance sheet adjustment

Table 5.1

Forecasts of trading partner GDP

(calendar year, annual average percent change)

Country	2004	2005	2006	2007	2008f	2009f	2010f
Australia	3.8	2.8	2.8	4.0	2.3	0.2	1.8
Asia ex-Japan*	7.6	6.7	7.5	7.7	4.3	0.2	5.5
United States	3.6	3.1	2.7	2.1	0.4	-2.8	2.1
Japan	2.7	1.9	2.0	2.3	-0.7	-5.6	1.2
Euro area**	1.9	1.8	3.0	2.7	0.6	-4.1	0.8
United Kingdom	3.0	2.2	2.9	2.6	0.7	-4.5	0.8
Main trading partners (trade weighted aggregate)	4.1	3.3	3.7	3.9	1.7	-1.8	2.4

Source: DataStream, RBNZ estimates

* Includes China, Hong Kong, Malaysia, Singapore, South Korea and Taiwan.

** Includes Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Slovenia and Spain.

in Western economies to weigh on the outlook for global growth.

Improving trading partner growth has resulted in a rebound in global commodity prices. We expect continued upward pressure on both New Zealand's export and import prices.

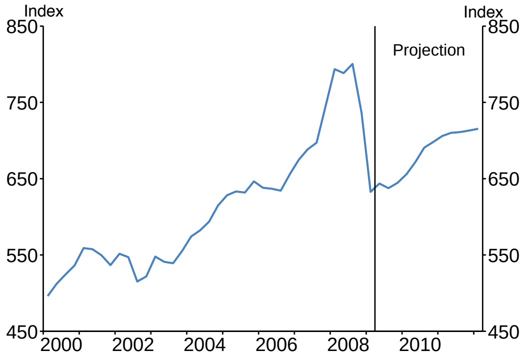
In particular, increased demand from China is expected to underpin the continued increase in the world price of New Zealand's forestry and dairy exports. Meanwhile, low Australasian lamb and US beef production is expected to support the price of our meat exports. Overall, we now predict the world prices of New Zealand's exports to rise from their current level over the coming year, before holding up at these higher levels (figure 5.2)

Similarly, the world prices of hard commodities have increased in recent months. We assume oil prices will rise gradually over the projection (figure 5.3). Outside of oil, we also expect world import prices to increase over the forecast period in line with the improvement in global activity.

Figure 5.2

OTI world export prices

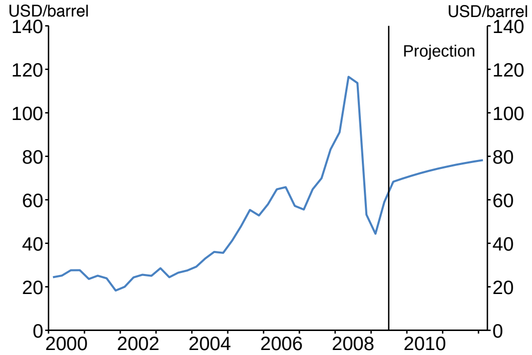
(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

Figure 5.3

Dubai oil price



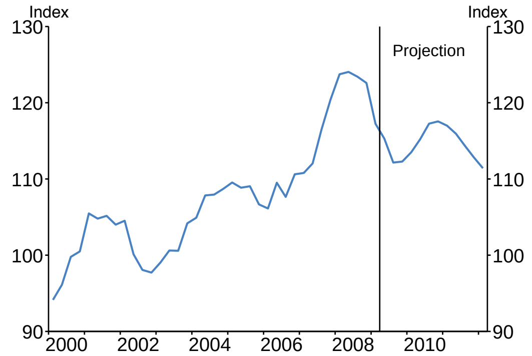
Source: Datastream, RBNZ estimates.

Overall, the improved global outlook drives an improvement in the terms of trade over the coming year. Over the medium-term, the relatively larger increase in import prices means that there is a decline in the terms of trade (figure 5.4).

Figure 5.4

OTI terms of trade (goods)

(seasonally adjusted)

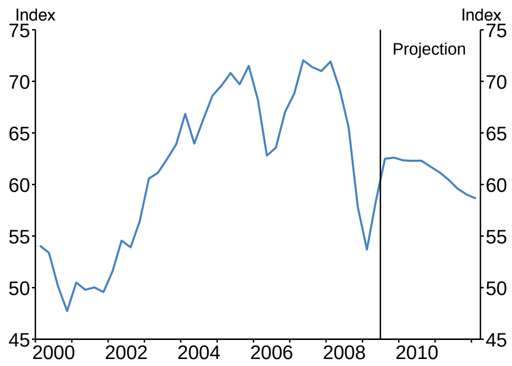


Source: Statistics New Zealand, RBNZ estimates.

Exchange rate

The New Zealand dollar TWI has continued to appreciate over the past few months. We assume it will hold at these high levels over much of 2010. Beyond that, narrowing interest rate differentials with the rest of the world are expected to lead to an eventual depreciation in the currency (figure 5.5).

Figure 5.5
Nominal TWI assumption

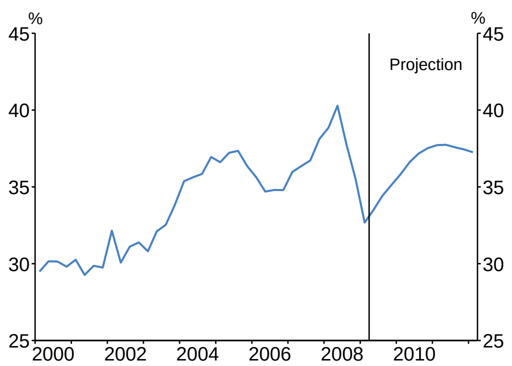


Source: RBNZ estimates.

Trade volumes

In line with the turnaround in consumption spending and recovery in business investment next year we expect a rebound in import volumes. This follows a massive decline in imports over the past year. The higher level of the TWI is also expected to encourage substitution toward imports, and thus provide a further boost to import volumes (figure 5.6).

Figure 5.6
Import penetration ratio
(percent of GDP, seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

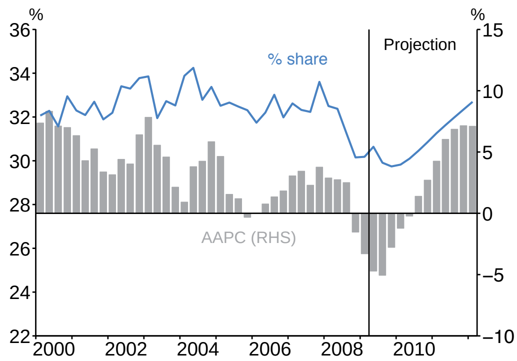
Meanwhile, the improved global outlook is expected to lead to increased demand for New Zealand's exports next year. In particular, manufacturers' export sales expectations have risen, suggesting demand for New Zealand's manufacturing goods might soon recover from current low levels. This is in line with the improvement in manufacturing sectors globally.

Due to the reduced livestock numbers as a result of the 2008/09 drought, the recovery in meat exports is expected to be constrained despite higher global demand. Increased demand for our dairy products is expected to underpin the recovery in dairy exports from late 2009. Overall, we forecast a gradual recovery in exports of New Zealand's agricultural products over the forecast horizon.

Recent tourist numbers lead us to believe the decline in exports of services will be muted over the remainder of 2009. We expect an increase in exports of services in line with the brighter outlook for global activity.

Overall, total export volumes are expected to recover from late 2009 (figure 5.7).

Figure 5.7
Total export volumes
(percent of trend output and annual average percent change)



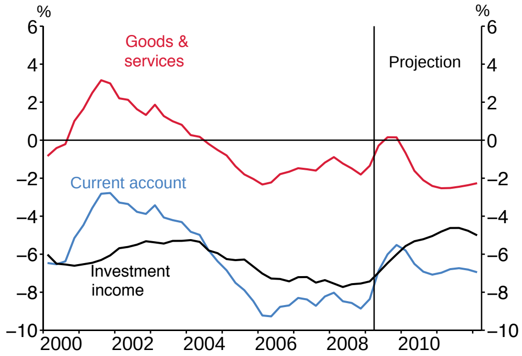
Source: Statistics New Zealand, RBNZ estimates.

The current account

The trade balance improved markedly over the first half of 2009, largely due to weak import demand. The expected turnaround in consumption, spurred by the stronger housing market, and improving business investment, is likely to reverse this gain over the projection. This deterioration will be exacerbated by the high level of the TWI assumed in the projection, which is expected to encourage substitution toward imports.

Offsetting this, we expect the investment income deficit will continue to reduce from current elevated levels, reflecting the weak economy and low domestic interest rates, thus reducing payments to foreign investors. Overall, we expect the current account deficit to settle at about 7 percent of nominal GDP through the latter part of the projection (figure 5.8).

Figure 5.8
Current account, trade and investment income balances
(annual, percent of nominal GDP)

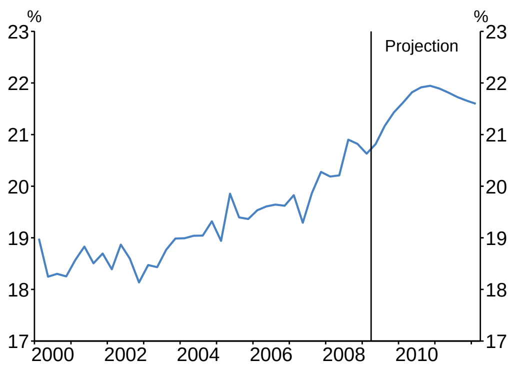


Source: Statistics New Zealand, RBNZ estimates.

Government

We expect fiscal policy to provide substantial support to economic activity over the near term. As set out in *Budget 2009*, government spending is expected to increase over the coming quarters as a result of higher infrastructure spending, and increased transfers arising from the weaker domestic economy.

Figure 5.9
Government spending
(excluding military spending, percent of trend output)



Source: Statistics New Zealand, RBNZ estimates.

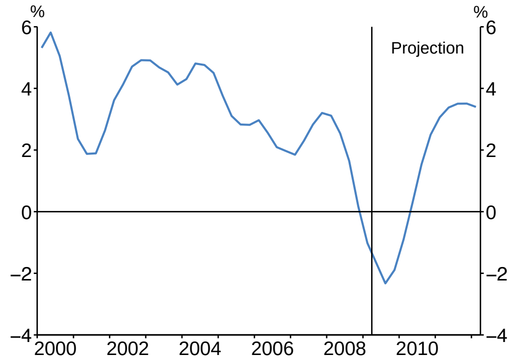
This higher expenditure is forecast to leave the Government's operating balance in deficit over the medium term. As the economy recovers, and measures are taken to reduce the fiscal deficit, government spending as a share of trend output is projected to reduce towards the end of the projection (figure 5.9).

Gross Domestic Product

Recent indicators suggest the New Zealand economy is stabilising. Furthermore, the improvement in business sentiment indicates a recovery over the second half of 2009. As such, we expect annual average GDP growth to trough at -2.4 percent in the September quarter (figure 5.10).

Over the medium term, the construction sector is likely to benefit from public infrastructure spending and recovery in the housing market. Manufacturing output is also likely to rebound, in keeping with the worldwide turnaround. Stronger consumption is expected to benefit the retail and wholesale sectors. As overall activity slowly recovers, annual average GDP growth is expected to reach about 3.5 percent by late 2011.

Figure 5.10
Gross Domestic Product
(annual average percent change)



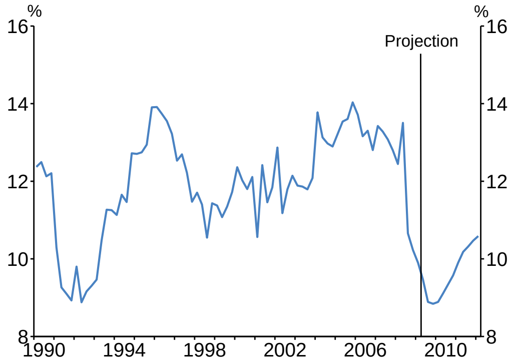
Source: Statistics New Zealand, RBNZ estimates.

Business investment

Given weak demand through the first half of 2009, we expect core business investment to decline over the rest of the year. As a share of output, core business investment is expected to fall to levels similar to those of the early 1990s (figure 5.11).

Looking into next year, business investment is projected to improve modestly. The significant stimulus from low

Figure 5.11
Business investment
(excluding computers and intangible assets, percent of trend output)



Source: Statistics New Zealand, RBNZ estimates.

interest rates and the improving outlook for demand are likely to encourage firms to invest. This is reflected in recent surveys of investment intentions, which have returned to neutral levels. That said, credit conditions are likely to remain tight, particularly for small and medium-sized companies. Overall, business investment is projected to be at historically weak levels, even by the end of the forecast horizon.

The labour market

As discussed in chapter 4, there has been a widespread decline in employment demand across a broad range of industries. We expect firms to continue to reduce staff numbers through to the middle of 2010, with a slow pick-up thereafter.

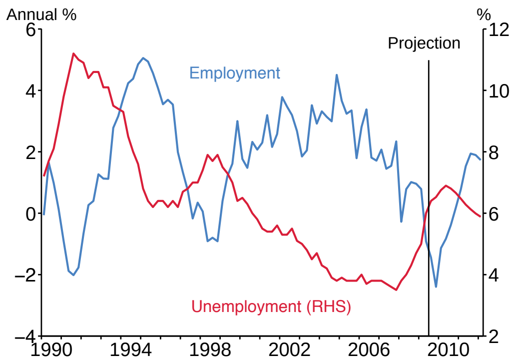
We project the weak employment outlook to continue to drive the unemployment rate higher, reaching a peak of 7.0 percent in the middle of 2010 (figure 5.12, opposite). This would see the unemployment rate 3.5 percentage points above its trough, the largest deterioration since the early 1990s recession.

Beyond reducing staff numbers, firms are looking at other ways of reducing labour costs. We project wage inflation to continue to moderate, in line with the rising unemployment rate, and to remain weak into the medium term.

Inflation

Reflecting this easing in wage inflation and in inflation pressures more generally, we expect non-tradable inflation

Figure 5.12
Employment growth and the unemployment rate
(seasonally adjusted)



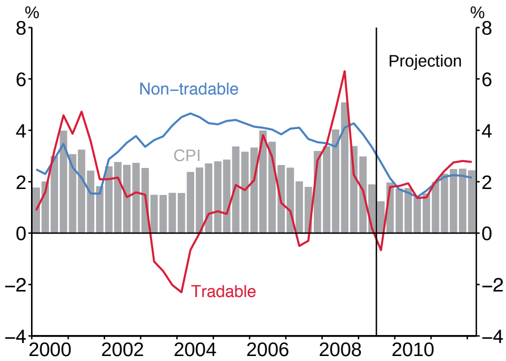
Source: Statistics New Zealand, RBNZ estimates.

to continue to fall over the coming year. Recent strength in housing market activity is likely to limit the extent of easing in resource pressures in the construction sector and thus construction costs more generally. We expect annual non-tradable inflation will recover to 2.2 percent by the second half of 2011.

In the near-term, tradable inflation is expected to be boosted by recent increases in food prices — largely reflecting a poor growing season for vegetables — and international oil prices. Later in the projection, improved global growth is expected to see import prices increase, such that tradable inflation reaches 2.8 percent by the end of the projection.

Overall, we expect annual CPI inflation to increase from the end of this year. It is forecast to remain inside the target range thereafter (figure 5.13).

Figure 5.13
CPI, tradable and non-tradable inflation
(annual)



Source: Statistics New Zealand, RBNZ estimates.

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	0.7	-0.2	2.6	67.0	7.6
2007	Mar	1.2	0.5	2.5	68.8	7.8
	Jun	0.9	1.0	2.0	72.0	8.1
	Sep	0.6	0.5	1.8	71.4	8.7
	Dec	0.9	1.2	3.2	71.0	8.8
2008	Mar	-0.3	0.7	3.4	71.9	8.8
	Jun	-0.2	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	-1.0	0.3	3.0	53.7	3.7
	Jun	-0.1	0.6	1.9	58.4	2.9
	Sep	0.1	0.9	1.2	62.5	2.8
	Dec	0.6	0.2	2.0	62.6	2.8
2010	Mar	0.7	0.1	1.7	62.3	2.8
	Jun	0.8	0.6	1.7	62.3	2.8
	Sep	0.8	0.5	1.4	62.3	2.8
	Dec	0.9	0.4	1.5	61.7	2.9
2011	Mar	0.9	0.5	2.0	61.2	3.3
	Jun	0.8	0.9	2.3	60.5	3.8
	Sep	0.8	0.7	2.5	59.6	4.2
	Dec	0.7	0.4	2.5	59.0	4.6
2012	Mar	0.7	0.4	2.4	58.6	5.0

[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	6.6	5.0	4.6	2.8	3.2	-0.7	-0.1	1.7	0.3
Public authority	1.3	5.0	4.1	4.9	4.4	4.0	3.3	4.0	3.5	2.2
Total	3.9	6.3	4.8	4.7	3.2	3.4	0.2	0.8	2.2	0.7
Gross fixed capital formation										
Market sector:										
Residential	23.7	14.9	3.1	-5.4	-2.3	4.6	-22.9	-14.3	25.4	10.6
Business	2.8	11.9	11.1	8.1	0.4	4.4	-7.3	-12.2	9.7	11.0
Non-market government sector	14.3	14.4	15.4	-1.5	-5.2	4.9	19.6	16.0	16.0	-4.9
Total	7.8	12.8	9.4	4.3	-0.5	4.5	-8.6	-10.0	13.0	9.0
Final domestic expenditure	4.8	7.8	5.9	4.6	2.2	3.7	-2.0	-1.7	4.5	2.7
Stockbuilding [1]	-0.1	0.2	0.2	-0.4	-0.7	0.7	-0.3	-0.2	0.7	-0.2
Gross national expenditure	4.7	7.9	6.3	4.3	1.3	4.6	-2.2	-2.2	5.2	2.5
Exports of goods and services	7.8	0.9	4.6	0.0	3.1	2.9	-3.3	-1.2	4.3	7.1
Imports of goods and services	7.0	12.9	12.4	4.1	-1.5	9.5	-4.2	-5.7	10.5	4.0
Expenditure on GDP	5.0	4.0	3.8	3.0	2.9	2.4	-1.7	-0.7	3.0	3.4
GDP (production)	4.9	4.3	3.8	3.0	1.8	3.1	-1.0	-0.9	3.1	3.4
GDP (production, March qtr to March qtr)	4.6	5.3	2.3	2.9	2.4	2.1	-2.7	1.3	3.6	3.2

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	1.7	2.0	2.4
Labour costs	2.2	2.1	2.5	3.0	3.0	3.5	3.1	1.6	1.9	1.8
Import prices (in New Zealand dollars)	-10.7	-10.3	0.6	7.0	0.4	0.7	12.7	-7.8	6.4	11.0
Export prices (in New Zealand dollars)	-15.4	-5.0	5.1	3.6	4.8	12.5	6.8	-10.7	9.7	5.7
Monetary conditions										
90-day rate (year average)	5.9	5.3	6.5	7.3	7.6	8.6	6.7	2.8	3.0	4.4
TWI (year average)	56.4	63.6	67.1	70.1	65.6	71.6	61.6	61.5	61.9	59.4
Output										
GDP (production, annual average % change)	4.9	4.3	3.8	3.0	1.8	3.1	-1.0	-0.9	3.1	3.4
Potential output (annual average % change)	3.4	3.4	3.1	2.8	2.4	2.1	1.9	2.0	2.1	2.1
Output gap (% of potential GDP, year average)	1.0	1.9	2.5	2.5	1.8	2.7	-0.2	-3.0	-2.1	-0.9
Labour market										
Total employment (seasonally adjusted)	1.8	3.3	3.7	2.8	2.1	-0.3	0.8	-1.1	0.8	1.7
Unemployment rate (March qtr, seasonally adjusted)	5.0	4.3	3.9	4.0	3.8	3.8	5.0	6.8	6.5	5.9
Trend labour productivity	1.3	1.1	1.0	1.0	1.1	1.2	1.3	1.5	1.7	1.7
Key balances										
Government operating balance (% of GDP, year to June)	3.3	4.0	4.7	4.5	3.5	3.2	-1.5	-3.1	-3.0	-3.0
Current account balance (seasonally adjusted, % of GDP)	-3.4	-4.8	-6.8	-9.2	-8.3	-8.0	-8.4	-5.8	-7.0	-7.0
Terms of trade (OTI measure, annual average % change)	-5.6	3.9	5.8	-0.8	1.8	7.8	3.1	-7.0	3.0	-2.7
Household saving rate (% of disposable income)	-10.4	-9.8	-9.3	-11.7	-12.8	-10.7	-8.3	-8.2	-7.5	-4.4
World economy										
Trading partner GDP (annual average % change)	3.1	3.3	3.6	3.6	3.6	3.9	0.0	-0.5	2.8	3.4
Trading partner CPI (TWI weighted, annual % change)	2.2	1.4	2.1	2.5	1.9	3.3	0.9	1.0	1.2	1.6

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

Air New Zealand Ltd
Alexander Construction (HB) Ltd
Aoraki Development Trust
Arataki Honey Ltd
Ashburton District Council
Ballantynes Ltd
Bayleys Realty Group Ltd
Business New Zealand
C J Pask Winery Ltd
Canterbury Manufacturers Association
CNS Treasury Ltd
Colliers International New Zealand Ltd
Collins Mitre 10 Ltd
Cookson Boats Ltd
Croys Ltd
Dan Cosgrove Ltd
Electricity Ashburton Ltd
Fairfax New Zealand Ltd
Farmlands Trading Society Ltd
Federated Farmers
Finsec Inc
Fisher & Paykel Appliances Ltd
H G Livingstone Ltd
Hawkes Bay Fruitgrowers Association Inc / Pick NZ
Hawkins Construction Ltd
Hudson New Zealand Ltd
Human Interface Technology Laboratory - New Zealand
Jade Software Corporation Ltd
Kathmandu Ltd
Kermadec Property Fund Ltd
Lion Nathan Ltd
Mainzeal Property and Construction Ltd
Marac Finance Ltd
McKay Hill Lawyers
Meat and Wool New Zealand Ltd
Mitre 10 Ltd
Napier City Council
New Zealand Automobile Association Inc
New Zealand Council of Trade Unions Inc
New Zealand Sock Company Ltd
New Zealand Sugar Company Ltd
Paul Johnston — Chartered Accountant
PGG Wrightson Ltd
Port of Napier Ltd
PricewaterhouseCoopers New Zealand
PrimePort Timaru Ltd
Rank Group Ltd
Rata Industries Ltd
Swanndri Ltd
The Warehouse Group Ltd
Weldwell New Zealand Ltd
Xero Ltd

Appendix C
Reserve Bank statements on monetary policy

OCR unchanged at 2.5 percent

11 June 2009

The Official Cash Rate (OCR) will remain unchanged at 2.50 percent.

Reserve Bank Governor Alan Bollard said: "The economic outlook remains weak both in New Zealand and in other countries. However, there are signs that international economic activity is stabilising, and international financial conditions are improving. We expect the New Zealand economy to begin growing again toward the end of this year but the recovery is likely to be slow and fragile. Many key economic indicators such as unemployment are projected to keep deteriorating well into 2010.

"There remain some material downside risks to activity and inflation, but for the first time in some months we can also identify some clear upside opportunities for activity. One such area is a potential rebound in household spending and residential investment as a result of the rise in net immigration and the pick-up in the housing market. Ultimately, however, we do not think such a rebound in spending would prove sustainable given the soft outlook for employment, wages and farm incomes and high levels of household debt.

"On balance, the risks to activity remain weighted to the downside.

"The recent rise in the New Zealand dollar creates an unhelpful tension with our projections. A stronger dollar at a time of weak global growth risks delaying or even reversing the projected increase in exports, putting the sustainability of recovery at risk.

"Overall, recent developments point to lower inflationary pressure than previously projected. Annual CPI inflation is likely to fall temporarily below the bottom of the target band later this year, but we expect it to return to inside the band by early 2010 and remain comfortably there over the remainder of the projection.

"We have cut the OCR by a large amount over the year. We expect the effects to pass through to more borrowers over coming quarters as existing fixed-rate mortgages come up for re-pricing. Although rising longer-term interest rates overseas are placing upward pressure on longer-term lending rates here, there is room for further reductions in shorter-term lending rates.

"The low OCR and stimulatory fiscal policy are the main sources of support to the New Zealand economy at present. It is likely to be some time before the recovery becomes self-sustaining and monetary policy support can be withdrawn.

"We therefore consider it appropriate to continue to provide substantial monetary policy stimulus to the economy. The OCR could still move modestly lower over the coming quarters. As we said at the time of the April OCR decision, we expect to keep the OCR at or below the current level through until the latter part of 2010."

OCR unchanged at 2.50 percent

30 July 2009

The Official Cash Rate (OCR) will remain unchanged at 2.50 percent.

Reserve Bank Governor Alan Bollard said: "Despite signs of a leveling off in economic activity, the economy remains weak. We continue to expect to see a patchy recovery get underway toward the end of the year, but it will be some time before growth returns to healthy levels.

"The outlook remains highly uncertain. New Zealand's merchandise exports are heavily weighted to soft commodities. As a result, New Zealand has not benefited to any significant extent from the rebound that has occurred recently in global hard commodity prices.

"Overall economic growth is evolving broadly in line with our forecasts in the June *Monetary Policy Statement* as the low OCR and stimulatory fiscal policy take effect. However, looking forward the level of the New Zealand dollar and wholesale interest rates are higher than assumed in our forecasts. The level of the dollar in particular, is not helping the sustainability of future growth, and brings with it additional economic risks.

"The forecast recovery is based on a further easing in financial conditions. If this easing does not occur, the forecast recovery could be put at risk. In these circumstances we would reassess policy settings.

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

"We consider it appropriate to continue to provide substantial monetary policy stimulus to the economy. The OCR could still move modestly lower over the coming quarters. We continue to expect to keep the OCR at or below the current level through until the latter part of 2010."

Appendix D
The Official Cash Rate chronology

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

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 September 2009	*Monetary Policy Statement* and OCR announcement
Thursday 29 October 2009	OCR announcement
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