RESERVE BANK
OF NEW ZEALAND

Monetary Policy Statement

March 2012[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 24 February 2012. Policy assessment finalised on 7 March 2012

1 Policy assessment

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

Inflation has settled near the middle of the Bank's target range, and inflation expectations have fallen.

The domestic economy is showing signs of recovery. Household spending appears to have picked up over the past few months and a recovery in building activity appears to be underway. That recovery will strengthen as repairs and reconstruction in Canterbury pick up later in the year. High export commodity prices are also helping to support a continuing recovery in domestic activity.

Policy actions from a number of central banks have boosted global confidence. While encouraging, financial market sentiment remains fragile and risks to the global outlook remain. Furthermore, the easing in global monetary policy and resultant recovery in risk appetite has contributed to a marked appreciation in the New Zealand dollar.

While helping contain inflation, the high value of the New Zealand dollar is detrimental to the tradable sector, undermines GDP growth and inhibits rebalancing in the New Zealand economy. Sustained strength in the New Zealand dollar would reduce the need for future increases in the OCR.

Given the medium-term outlook for inflation, it remains prudent to hold the OCR at 2.5 percent.

Alan Bollard

Alan Bollard

Governor

2 Overview and key policy judgements

The risk of a significant near-term deterioration in global economic conditions has moderated since the publication of the December *Statement*. Substantial policy measures have driven a noticeable recovery in global sentiment, which has contributed to a marked appreciation of the New Zealand dollar. This appreciation is likely to place further downward pressure on inflation, lowering the outlook for the OCR relative to the December projection.

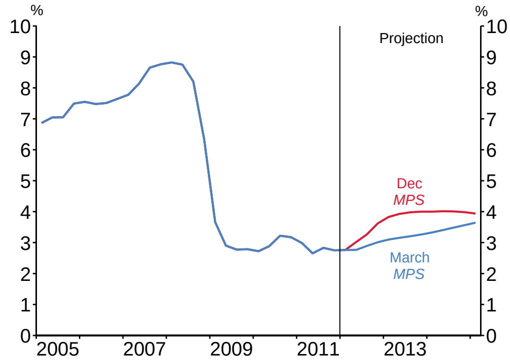
At the time of the December *Statement*, the Bank was very concerned that the European sovereign debt crisis could deteriorate further, and that this crisis would have a large negative effect on the New Zealand economy. Since then, policy actions by several agencies and central banks have reduced that risk.

The European Central Bank's (ECB) longer-term refinancing operation (LTRO) provided the largest boost to market confidence. This action improved funding conditions for banks globally. The ECB also reduced its policy rate and relaxed its collateral requirements. In addition, political leaders agreed to measures to enforce closer economic and fiscal integration in Europe, and have negotiated a further support package for Greece. Against this backdrop, the ability of troubled sovereigns to issue debt has improved substantially. Elsewhere, both the Bank of England and the Bank of Japan extended their quantitative easing programmes. In the US, the Federal Reserve extended its expectation to maintain the federal funds rate near zero. Furthermore, both the Reserve Bank of Australia and the People's Bank of China eased monetary policy. These policy measures have substantially improved market sentiment. Equity markets have recovered and global commodity prices have increased.

While this improvement is welcome, the easing in global monetary policy and recovery in global risk appetite has caused the New Zealand dollar to appreciate substantially. On a TWI basis, the New Zealand dollar has appreciated by almost 7 percent since the December *Statement*. This appreciation has occurred at a time when New Zealand's export commodity prices have tracked sideways. There is a risk that this dislocation continues. Major central banks are likely to continue to expand their balance sheets, which could weaken their currencies further.

While the strong New Zealand dollar is helping contain inflation, its high level is detrimental to the tradable sector. Based on the assumption that the exchange rate slowly depreciates over the next few years, all else equal, the Bank expects to modestly increase the OCR over the projection horizon (figure 2.1).

Figure 2.1
90-day interest rate

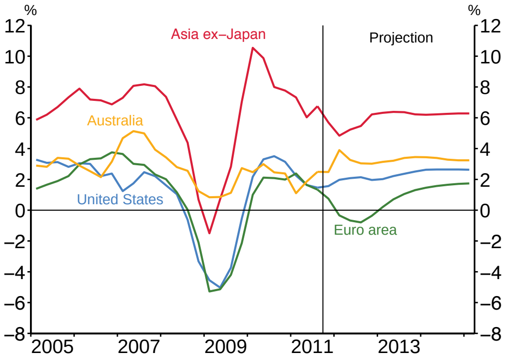


Source: RBNZ estimates.

There is no guarantee that the recent ECB policy measures will have a lasting impact on confidence. Financial market sentiment remains fragile and conditions could change rapidly; the LTRO does not address the euro area's structural challenges. Ongoing fiscal austerity and growth-enhancing reforms are necessary to put government debt on a sustainable path in a number of economies. Reforms are also necessary to address the competitiveness and productivity disparities that underlie macroeconomic imbalances across the region. Any adjustment costs associated with reform will weigh on euro-area growth over the projection horizon (figure 2.2, overleaf).

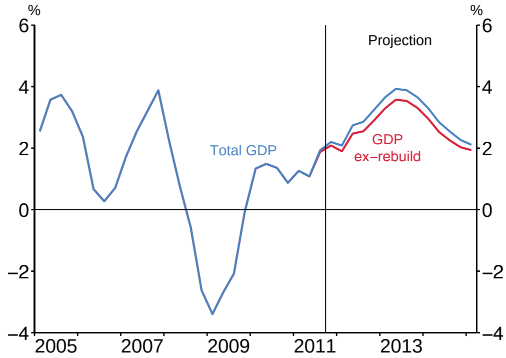
Fiscal consolidation will also weigh on medium-term growth in the US economy. Most commentators expect spending to be reduced and taxes increased to some degree from early next year, although consolidation in coming years is likely to be milder than the sharp contraction implied by current law. Retail spending and house building are also likely to remain weak in the US as households keep trying to reduce debt.

Figure 2.2
Trading partner GDP growth
(annual)



Source: Haver Analytics, RBNZ estimates. 'Asia ex-Japan' includes China, Hong Kong, India, Indonesia, Malaysia, The Philippines, Singapore, South Korea, Taiwan and Thailand.

Figure 2.3
GDP growth
(annual)



Source: Statistics New Zealand, RBNZ estimates.

Turning to the New Zealand economy, household spending appears to have picked up over the past few months. Retail spending volumes increased strongly through the second half of 2011. While a degree of this pickup was undoubtedly related to the Rugby World Cup, continued growth in expenditure since the tournament suggests some broader-based increase in spending by New Zealanders. In addition, housing turnover and consent issuance have risen modestly for the past year or so. House prices also rose slightly in 2011.

The projections continue to assume household spending will grow only modestly. High household debt is expected to hold back spending as households attempt to reduce debt. Weak credit growth, which has been well below that implied by turnover in the housing market, gives weight to this assumption.

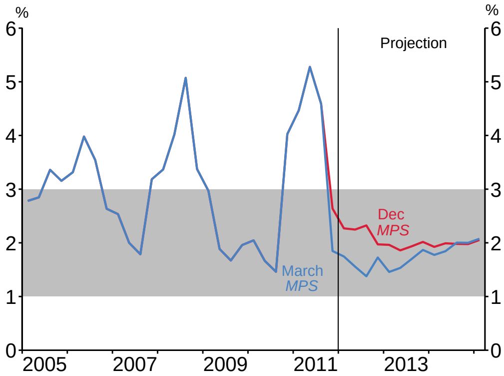
The pace of GDP growth is expected to pick up (figure 2.3). An increase in construction sector activity is an important aspect of this improvement. As discussed in box C, repair and reconstruction activity in the Canterbury region is expected to increase over the next few years.

CPI inflation was weaker than expected in the December quarter 2011. While much of this downside surprise related to idiosyncratic factors, strength in the New Zealand dollar also contributed. Recent appreciation in the exchange rate is likely to further dampen imported inflation in 2012.

Offsetting this, international oil prices have increased markedly in the past month. This increase appears to have been largely driven by supply concerns related to growing tensions in the Middle East. The projections assume oil prices will moderate soon.

Looking further forward, GDP growth is expected to eliminate current spare capacity over the coming year, causing underlying inflationary pressure to pick up from its current subdued level. A modest increase in the OCR, along with a slight rise in average bank funding costs, offsets this such that annual CPI inflation remains contained throughout the projection (figure 2.4).

Figure 2.4
CPI inflation
(annual)

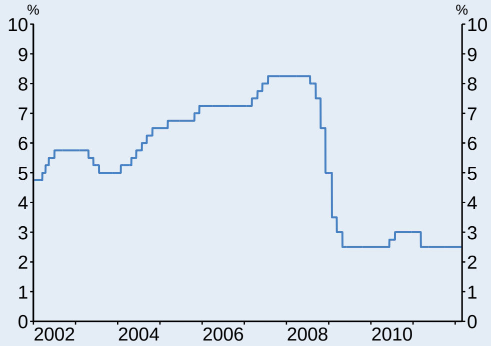


Source: Statistics New Zealand, RBNZ estimates.

Box A
Recent monetary policy decisions

The OCR has been held at a record low 2.5 percent for the past year. The Bank believed such a low rate was appropriate given the sluggish growth in the New Zealand economy through this time, the potential for the Canterbury earthquakes to have a very adverse economic impact and the risk of deterioration in our Western trading partner economies.

Figure A1
Official Cash Rate



Source: RBNZ.

The Bank had been conscious of upside risks to inflation when setting policy. In particular, surveyed inflation expectations increased dramatically in 2011 following the October 2010 increase in the rate of GST. The Bank judged that inflation expectations would increase only temporarily and that surveyed expectations would fall noticeably once the effect of the GST change dropped out of the annual CPI figure.

As it has turned out, inflation expectations declined markedly in the recently released Survey of Expectations, supporting the Bank's judgement. Deterioration in the global outlook further supported the Bank's decision to maintain a low OCR.

Monetary policy judgements

A key judgement underlying the March projection is that the recent improvement in global sentiment is sustained. That is, the range of policy measures introduced over the past few months have a lasting impact on confidence and that Europe continues to make progress in addressing the sovereign debt problems within the region, without a return to the destabilising pricing-in of disorderly default. For now, market sentiment is remarkably upbeat. However, as the past few years have clearly shown, financial markets can be fickle and the outlook can change rapidly. It will be some time before ECB liquidity injections can be expected to feed into a pickup in bank lending and real activity, given the desire of euro-area banks to rebuild capital and reduce debt, and the still weak demand from households and businesses for loans.

The projection also assumes that the average cost of New Zealand bank funding will increase only modestly over the coming year. For the limited amount of long-term wholesale issuance that has occurred over the past few months, the cost has been considerably higher than at the middle of last year. If sustained, this increased cost of new funding will push up the average cost of funds.

However, domestic retail deposits have been growing more rapidly than bank loans for the past two years. This has allowed the banking sector to reduce its reliance on short-term wholesale funding without having to issue long-term debt. While competition for these deposits has caused term deposit rates to increase in line with the cost of long-term wholesale funding, the shorter-term nature of retail deposits has allowed banks to avoid locking in temporary spikes in the cost of long-term funding. Some of the growth in retail deposits is likely to reflect earthquake insurance payments. Nonetheless, it is still likely that deposit growth will outstrip credit growth in 2012, reducing the need for banks to issue long-term debt.

The March projection forecasts a substantial increase in residential investment over the next few years. Part of this reflects a reconstruction-driven increase in residential investment in Canterbury. But even excluding earthquake repairs, the Bank expects residential investment to increase markedly.

Over the past few years residential construction activity has been surprisingly weak. After a slight recovery in 2010, building activity has trended lower and is currently weaker than in the 2008/09 recession. The rate of house building has been so low that it has failed to keep up with population growth, resulting in an increase in the average number of persons per dwelling. Short-term indicators suggest residential construction will continue to fall short of population growth this year. Beyond this, residential investment plays a noticeable role in the Bank's forecast pickup for aggregate GDP growth. It would be surprising if residential investment continued to lag population growth.

The New Zealand dollar has appreciated markedly since the publication of the December *Statement*. This appreciation is difficult to reconcile with developments in New Zealand's economic environment, having occurred at a time when export commodity prices have tracked sideways. Instead, the exchange rate appears to have been driven upward by a combination of an easing in global monetary policy and recovery in global risk appetite.

The March projection assumes the New Zealand dollar TWI depreciates modestly over the next few years. Should this not occur, all else equal, the Bank would see less need to increase the OCR through this time. While helping contain inflation, the high value of the New Zealand dollar is detrimental to the tradable sector, undermines GDP growth, and inhibits rebalancing in the New Zealand economy.

3 Financial market developments

Overview

Since the December *Statement*, market sentiment has improved significantly. This has largely been driven by a positive response to the ECB's LTRO. The resultant liquidity injection is widely perceived to have significantly reduced the near-term probability of a European bank default. European governments are issuing debt more easily and cheaply than at the end of 2011. Despite these improvements, sentiment remains fragile and conditions could change rapidly. Indeed, extra liquidity does little to address Europe's structural challenges.

Australasian banks have also found it easier to issue debt, although the cost of this funding has been much higher than in recent history. However, funding at these expensive levels has been on a small scale for New Zealand banks. Marginal funding costs are likely to remain high for some time yet, while the average cost of funds will continue to increase gradually as lower-cost funding matures.

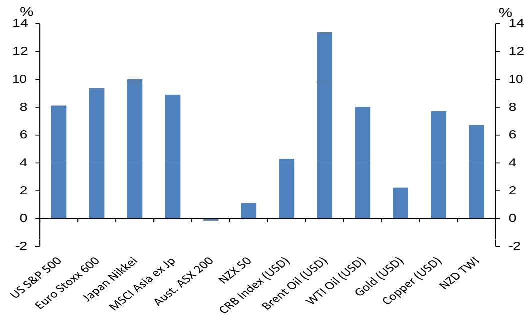
Domestically, average mortgage rates paid continue to fall. Local banks have been reducing fixed mortgage rates since December, despite the increased cost of funds. This suggests some competitive pressures and that banks have some degree of comfort on funding cost pressures at this point.

Improved risk appetite and easier international monetary policy have put significant upward pressure on the New Zealand dollar. This is serving to tighten overall monetary conditions. Despite the stronger New Zealand dollar, market expectations of monetary policy have firmed slightly since the December *Statement*, although market pricing suggests that the first full OCR increase is not expected to occur until early 2013.

International financial market developments

Financial market sentiment has improved significantly since the December *Statement*. This is clearly evident by strength in equity markets, world commodity markets and commodity currencies such as the New Zealand dollar (figure 3.1).

Figure 3.1
Selected price movements
(since December Statement*)*



Source: Bloomberg.

The increase in risk appetite reflects a number of factors, including additional policy measures and a run of better-than-expected global economic data.

The additional policy measures to address the European debt crisis include a significant injection of liquidity to ease funding strains, progress in building firewalls to contain contagion effects from a Greek debt default, ongoing negotiations to reduce Greece's debt burden, and creating a more integrated Europe to put the region on a more sustainable long-term footing.

The ECB's LTRO provided the largest boost to market confidence. On December 21, the ECB lent European banks, against eligible collateral, €489 billion of three-year loans. After accounting for loans maturing or being rolled into three-year loans, around €190 billion of additional lending was injected into the banking system. An even larger financing operation occurred at the end of February.

Since the introduction of this three-year loan facility, European governments have enjoyed strong demand for their bonds, with banks using ECB loans to buy these higher-yielding assets. This has two effects: it improves the profits of European banks and hence their capital positions, and it provides governments with some extra time to reduce their fiscal deficits.

Additional ECB policy measures since the December *Statement* include reducing its key policy rate by 25 basis points to 1 percent, widening acceptable collateral to allow European banks easier access to official funding, and reducing reserve requirements from 2 percent to 1 percent of deposits. This final measure alone released about €100 billion of bank liquidity.

In other policy initiatives, European political leaders agreed to a set of measures to enforce closer economic and fiscal integration. One of the agreed measures was a 'fiscal compact' endorsed by almost all of the 27 European Union (EU) nations. This will mean enforceable fiscal rules will be written into a new treaty (due to be signed in March). The European leaders also endorsed measures related to bailout funds. Euro-area governments pledged €150 billion to increase the IMF's resources. Furthermore, the permanent European Stability Mechanism, which will have a lending capacity of €500 billion (subject to further negotiation), will be launched in July 2012, one year ahead of schedule.

At the time of writing, EU finance ministers have reached a deal on a Greek debt restructuring package. This would increase financing to the Greek government by €130 billion, subject to Greece adopting a series of fiscal and economic reforms to help reduce its public debt. As part of the deal, private sector bond holders face a significant reduction in the value of their Greek debt holdings.

Despite the policy measures, much work still needs to be done to address structural imbalances and fundamental solvency risks in the euro area. The liquidity injections might have simply pushed dealing with solvency issues for European governments and banks into the future. They might also have reduced incentives for governments to cut fiscal deficits and for banks to secure fresh capital. Recent policies offer some breathing space, but much implementation risk and uncertainties remain.

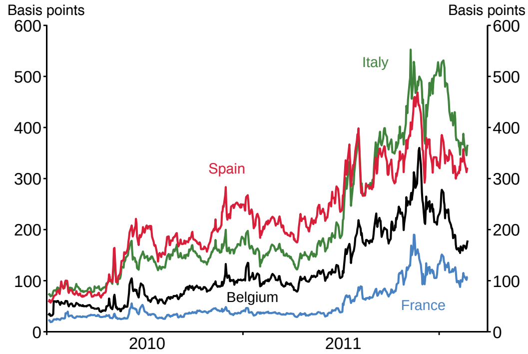
Since December, many other major central banks have attempted to stimulate their economies. Both the Bank of England and the Bank of Japan extended their quantitative easing programmes. In addition, the Bank of Japan adopted an explicit inflation goal of 1 percent to help reinforce its commitment to stimulatory monetary policy.

In the United States, the Federal Reserve extended the period it anticipated keeping the federal funds rate at its current level until "at least late 2014". The People's Bank of China reduced the reserve requirement ratio by 50bp to 20.5 percent, only the second reduction since 2008. The Reserve Bank of Australia (RBA) eased monetary policy by 25 basis points in December, following 25 basis points of easing in November, taking the cash rate to 4.25 percent. While the RBA surprised markets in February by not changing the cash rate, it noted that there would be scope for further easing if demand conditions were to weaken materially.

Financing and credit

The policy measures noted in the previous section have helped to significantly improve funding conditions for European governments and banks. The yield spreads between the debt of troubled European nations and Germany have narrowed significantly since the December *Statement* and recent bond auctions across Europe have been met with healthy demand (figure 3.2).

Figure 3.2
Selected 10-year government bond spreads
(relative to German Bunds)



Source: Bloomberg.

European governments are issuing debt more easily and cheaply than at the end of last year. For example, Spain has been issuing its sovereign bonds in much greater quantities than originally planned. The country has already completed nearly 40 percent of its funding requirements for 2012 and at yields consistently lower than those obtained late last year.

While the fall in peripheral government bond spreads has been welcome, there are signs that investors remain cautious. In particular, there remains continued strong safe-haven demand for German and US bonds.

Turning to bank funding, following the ECB's three-year LTRO, European banks have largely completed their 2012 funding programmes. In addition to accessing ECB funds, banks – even in the troubled nations – have been able to return to the funding market. However, while the improvement in market sentiment and activity levels in funding markets has been substantial, the cost of these funds remains high. There is also little sign of the extra liquidity improving conditions in the real economy, with banks apparently using the liquidity to retain or build up liquidity buffers.

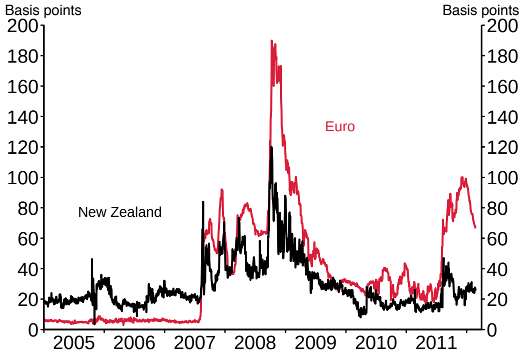
After a hiatus late last year, Australasian banks have accessed long-term wholesale funds this year. However, banks have had to rely more on secured issuance, such as covered bonds, rather than unsecured issuance for which appetite remains limited. Australian banks were very active in their European covered bond programmes early this year, which might have encouraged New Zealand banks to delay issuance until later in the year. A couple of New Zealand banks have had some success in domestic private placements.

Recent issuance of long-term wholesale funding has been at a considerably higher cost than in the middle of last year. With only a small amount of issuance being done by New Zealand banks, a clearer picture of effective marginal funding costs can be gleaned by focusing on Australian bank debt issuance. In broad terms, the cost of issuing five-year wholesale debt by the Australian banks has increased by about 80 basis points over the past six months. This represents a reasonable proxy for the effective increase in marginal long term wholesale funding costs for New Zealand banks. Given long-term wholesale debt accounts for about 20 percent of banks' total funding, this increase is likely to have added about 16 basis points to overall marginal funding costs.

However, because the banks are well funded at this point, issuance at the recent higher effective marginal cost has been rather limited. Credit growth has been weaker than expected and has been far outstripped by deposit growth. These factors have alleviated the need to fund in the expensive long-term debt market.

Local short-term funding markets have fared well through the European debt crisis, especially when compared to the significant boost to funding costs during the Global Financial Crisis (figure 3.3). While New Zealand banks prefer more stable sources of funding, such as

Figure 3.3
Short-term funding spreads bps
(three-month interbank rate less OIS)



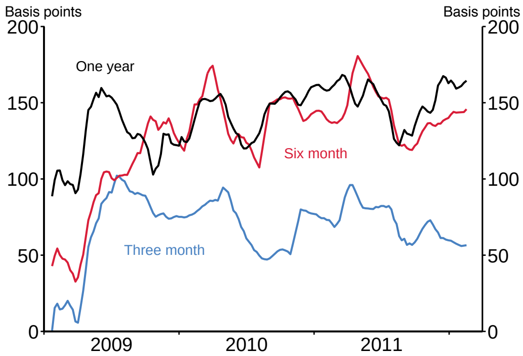
Source: Bloomberg.

domestic retail deposits and longer-term wholesale funding, short-term funding can be readily accessed.

For the past three years, New Zealand banks' retail deposits have become an increasing source of funding at the expense of short-term funding in the wholesale market. This trend means that retail deposits are now the dominant source of funding for New Zealand banks.

The average spread between retail term deposit rates and wholesale rates shifted up significantly from 2007 to mid-2009 but has since stabilised (figure 3.4). Looking at the spreads across maturities, these have decreased at the three-month term, but increased at the one-year term. Indeed, the spread between the one-year term deposit rate and the one-year swap rate is close to the top of its range over the past couple of years. This might indicate a preference by banks for one-year retail funding over shorter-term funding.

Figure 3.4
Spread between term deposit and wholesale rates



Source: interest.co.nz, RBNZ.

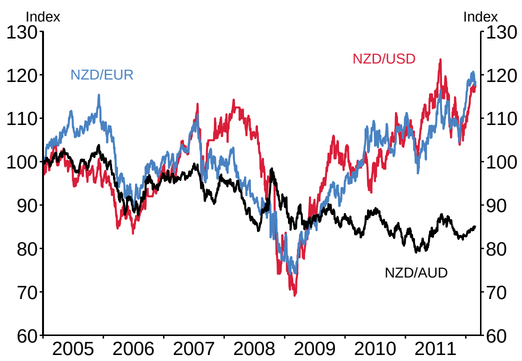
The gap between the increase in deposits and that of bank loans is likely to be a key driver of bank funding costs over coming years. The favourable gap over the past year (some $7 billion in the year to December) has reduced the need for banks to actively seek long-term wholesale funding at expensive levels. That raises the question of how sustainable the gap between deposit and credit growth will be. As the economy recovers, credit growth is likely to lift. Furthermore, strong income growth in the agriculture sector may have temporarily boosted deposit growth. The deposits of insurance payouts related to the Canterbury earthquakes might be a factor that will gradually subside.

Overall, New Zealand banks remain well funded and, while long-term wholesale funding costs have increased significantly, the long-term proportion of total funding is small. Trends in deposit and credit growth as well as developments in the European debt crisis will be crucial in determining the extent to which banks will need to re-price loans over the coming year or two.

Foreign exchange market

The New Zealand dollar has strengthened significantly on most major cross rates since the December *Statement*, with gains of 6 to 10 percent against the US dollar, euro, sterling and yen, and a 3 percent appreciation against the Australian dollar. On a TWI basis the New Zealand dollar has strengthened by just under 7 percent (figure 3.5).

Figure 3.5
Selected New Zealand dollar cross rates
(1 January 2005 = 100)



Source: Bloomberg.

The increase in risk appetite, higher global commodity prices and further policy easing by major central banks have contributed to this strengthening. The strong New Zealand dollar is serving to tighten overall monetary conditions.

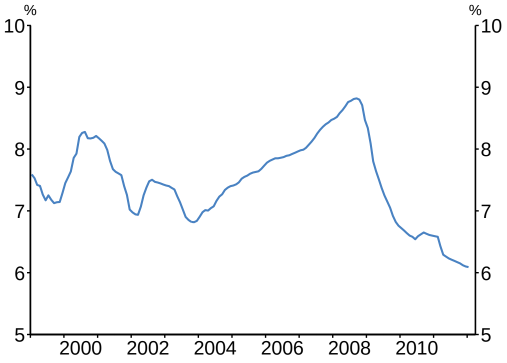
Domestic financial market developments

The deterioration in global sentiment towards the end of last year placed significant downward pressure on New Zealand wholesale interest rates, reflecting expectations about future monetary policy. Rates reached new lows across the yield curve. From mid-December, sentiment improved and rates trended higher. Overnight indexed swap markets show the OCR is expected to remain unchanged, although the timing of expected OCR increases has been brought forward.

All major banks have lowered their fixed-term mortgage rates since the December *Statement*, while floating rates remain unchanged. That mortgage rate reductions have occurred against a backdrop of higher wholesale swap rates and the increased marginal long-term funding costs suggests some competitive pressures in the mortgage market. Furthermore, this signals that banks are reasonably comfortable with funding cost pressures at this point.

Fixed rate borrowers scheduled for re-pricing have continued to enjoy lower interest rates. The effective mortgage rate (EMR), the weighted average interest rate for outstanding mortgages, has declined 6bp to 6.09 percent over the three months to January, and is now 140bp below its post-1999 average (figure 3.6). With most new lending done at lower floating mortgage rates, downward pressure remains on the EMR over the near term.

Figure 3.6
Effective mortgage rate



Source: RBNZ estimates.

4 Current economic conditions

Overview

The impact of the European debt crisis on New Zealand exports has been modest to date. The trade fallout to other trading partners has also been contained, partly because of continued robust domestic demand in Asia. New Zealand's export commodity prices show early signs of stabilisation, having fallen throughout the latter part of 2011.

There is evidence of some behavioural change by New Zealand households over recent years, with the household saving rate returning to positive territory and credit growth subdued, particularly relative to housing turnover. But there are signs that the current high exchange rate is hampering this rebalancing of the economy, and is detrimental to import-competing sectors of the economy.

Domestic economic activity is currently growing at a modest pace. Determining the evolution of underlying growth is particularly difficult at present, with the 2011 Rugby World Cup (RWC) and continued disruption to activity in Canterbury clouding analysis. Nevertheless, there still appear to be slack resources within the economy and inflationary pressures are at present contained.

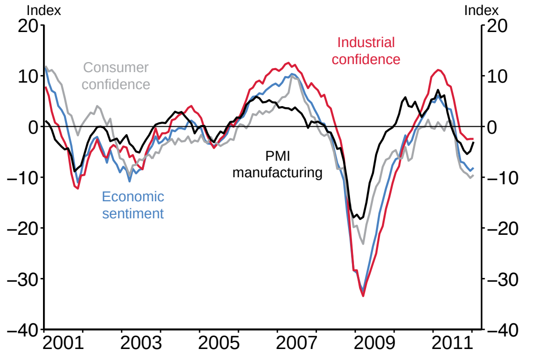
International conditions

Euro-area growth slowed through the second half of 2011 and contracted in the final quarter. Euro-area domestic demand has been in recession since mid-2011, as uncertainty resulting from the continuing debt crisis weighs on confidence and causes businesses and households to postpone investment and spending decisions.

More recent indicators have shown early signs of stabilisation in euro-area activity. This reflects recent policy actions that have alleviated bank and sovereign funding pressures, and progress on resolving regional debt issues. Confidence indicators have stabilised and manufacturing indicators have improved (figure 4.1).

New Zealand's direct trade exposure to the euro area is relatively limited; the euro area purchases less than a tenth of New Zealand's exports. The impact of the deterioration in the euro area is primarily through indirect trade linkages via other trading partners, the consequent

Figure 4.1
Euro-area confidence indicators

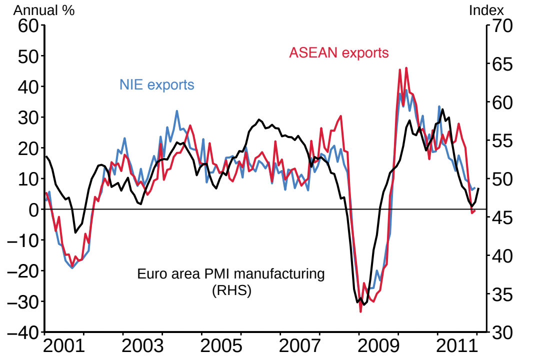


Source: Haver Analytics. Series are shown relative to their mean since June 1997.

effect on commodity prices, and through financial and confidence channels.

To date, the indirect impact of weak euro-area activity on New Zealand via its other trading partners has been relatively limited. The strongest channel of euro-area weakness has been via trade to Asia, contributing to a notable weakening in export growth across Asia (figure 4.2). However, improving growth in the US and resilient domestic demand in Asia provide some support to Asian export growth.

Figure 4.2
Asian export growth and euro-area manufacturing activity

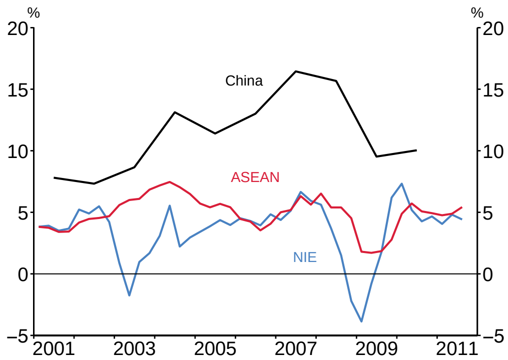


Source: Haver Analytics. ASEAN comprises Indonesia, Malaysia, The Philippines and Thailand. NIE comprises Hong Kong, Singapore, South Korea and Taiwan.

The highest risk of contagion from the European debt crisis to the Australian and US economies is via financial linkages. As detailed in chapter 3, this contagion has been reasonably limited so far, with financial institutions able to access funding, albeit at an elevated cost. That said, current conditions in funding markets could deteriorate quickly if the situation worsens in Europe. Consolidation by European banks has resulted in withdrawal of some of their operations in South-East Asia, although the financial impact has been mitigated to an extent by an increased presence of US and Asian banks. The impact on confidence across trading partners remains limited as households and businesses have generally been focused more on domestic rather than offshore events.

Given the limited spillover to date from euro-area weakness to other trading partners, economic conditions in Asia and Australia remain the key drivers of New Zealand's trading partner activity. Domestic demand within Asia supports export growth throughout the Asia-Pacific region, as well as influencing investment in the resource sector in Australia. Domestic demand in Asia has remained resilient, supported by robust consumption spending (figure 4.3).

Figure 4.3
Consumption growth in China, NIE and ASEAN countries
(annual)



Source: Haver Analytics. ASEAN comprises Indonesia, Malaysia, The Philippines and Thailand. NIE comprises Hong Kong, Singapore, South Korea and Taiwan.

Growth in China moderated through 2011 due to weaker external demand and the lagged effects of previous policy tightening. Nonetheless, Chinese GDP still expanded by a strong 9.2 percent in 2011. Domestic demand in China appears to have remained strong. Real retail sales continue to grow steadily, underpinned by solid wage growth and moderating inflation. Growth in fixed asset investment continues to grow strongly, although it moderated somewhat through 2011. Ongoing urbanisation in China should support consumption and investment in the longer term.

That said, property prices in China appear to have peaked and are declining in the large coastal cities, such as Shanghai and Beijing. While these declines have been mild to date, a larger drop in property prices presents a significant risk to growth in China, as well as in the Asia-Pacific region.

The Australian economy grew at a moderate pace through 2011, despite disruptions from flooding early in the year. The economy is much more closely tied to developments in Asia than in Europe. Resilient domestic demand in Asia continues to support Australian exports and underpins Australia's elevated terms of trade, while investment in the resource sector is boosting headline growth. Conditions in sectors unrelated to mining are weaker, in part due to the high Australian dollar and cautious household consumption.

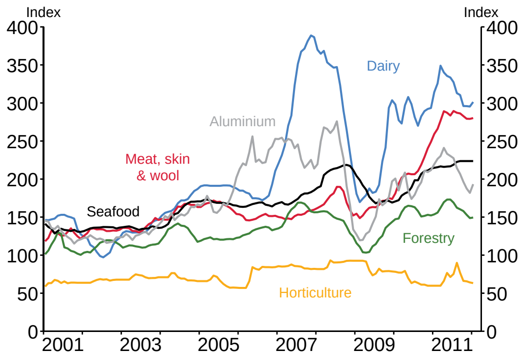
In the US, growth improved through the second half of 2011 as the effects of temporary factors dissipated. Indicators point to continuing, though moderate growth. Conditions in the household sector remain subdued, as house prices are likely to remain low. However, the labour market is now gradually recovering, which should support income and consumption growth.

Inflation in trading partner economies appears to have stabilised following declines in commodity prices through the second half of 2011. Core inflation is likely to be contained due to the slowdown in global growth. Central banks have either cut or kept interest rates on hold in recent months, due to uncertainty around the economic outlook.

Export sector

The softer outlook for trading partner activity weighed on commodity prices over the latter part of 2011 (figure 4.4). Additional downward pressure was provided by more favourable supply conditions both internationally and domestically. Global grain production has increased, boosting milk production worldwide; milk production in New Zealand is on course for a record season.

Figure 4.4
Export commodity prices
(SDR terms)



Source: ANZ National Bank.

The recent appreciation of the New Zealand dollar will reduce the revenue received by exporters, which could translate into weaker capital spending by the primary sector. That said, there have been some recent signs of stabilisation in the world prices of New Zealand's commodity exports, and prices remain at elevated levels. Oil prices have increased sharply recently, in part due to geopolitical concerns.

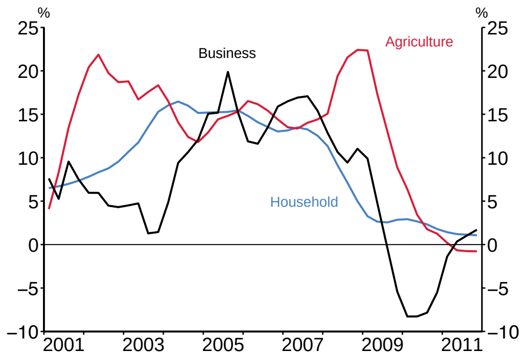
The high New Zealand dollar is affecting trade volumes and production in the tradable sector; goods exports slipped back in the September quarter. Meanwhile, imports increased sharply, as cheaper New Zealand dollar import prices caused households and firms to switch expenditure. This switch is evident in the manufacturing sector, where despite exports exceeding the pre-GFC level, domestic production remains markedly down, suggesting that import-competing manufacturers are struggling.

Household sector

Building consents and house sales have been gradually increasing over the past year. While activity remains well short of the highs preceding the Global Financial Crisis, it is nonetheless markedly improved on the trough. House prices also moved upwards in 2011, and have now almost regained the 2007 peak in nominal terms, although remain some 13 percent below peak in real terms. Given historic relationships, house building is likely to increase in the early part of 2012.

However, credit growth remains subdued (figure 4.5). Total bank credit growth has remained below 2 percent for the past two years. As discussed in box E in the December 2011 *Statement*, this could provide evidence of a change in behaviour by New Zealanders, and a rebalancing of the economy.

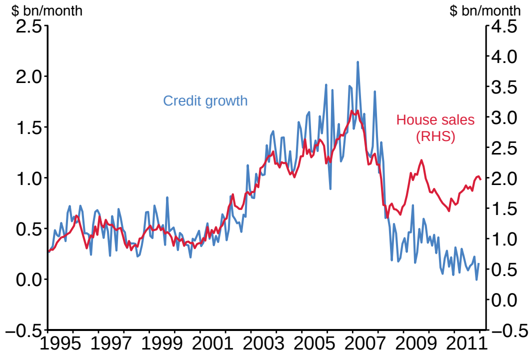
Figure 4.5
Growth in sectoral credit
(annual)



Source: RBNZ.

Evidence of this rebalancing is provided by the breakdown in the traditional relationship between credit growth and house sales. A wedge has developed between the value of housing turnover and the household sector credit growth with which it would typically be associated (figure 4.6).

Figure 4.6
Housing turnover and credit growth



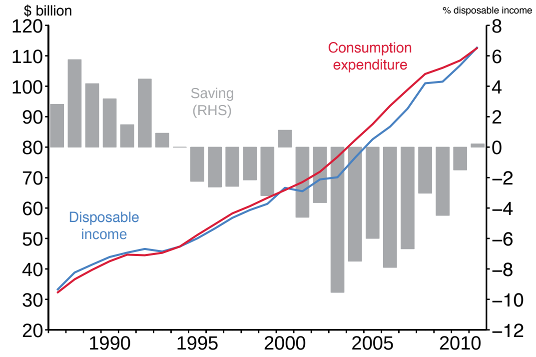
Source: RBNZ, REINZ.

There are several possible explanations for this wedge. First, new homebuyers may have become more cautious over the period and increased the size of their deposits. This would be in keeping with the Reserve Bank's credit conditions survey, which reports a tightening in lending criteria by banks. Similarly, the equity of sellers may have been reduced by the falls in house prices since 2007.

It could also represent households increasing principal repayments on outstanding mortgages. This could arise from households maintaining their mortgage payments as interest charges fell over the past few years. Finally, the wedge could in part be explained by insurance payments following the Canterbury earthquakes. These payments are believed to have been in the order of several billion dollars to date, which may have been used to pay down mortgages until the cost of rebuilding is incurred.

Rebalancing by the household sector is seen in the increase in the saving rate over the past few years. The official household saving rate has returned, just, to positive territory (figure 4.7).

Figure 4.7
Nominal household consumption and disposable income



Source: Statistics New Zealand.

Yet there are some recent signs that households may have reduced their rate of saving, albeit temporarily. Retail sales growth was strong over the second half of 2011, partly a result of RWC spending (see box B). However, the level of expenditure using domestic electronic cards, and strong spending on durables, suggest some near-term strength in consumption. It may be that this current relative strength in consumption reflects recent appreciation in the New Zealand dollar and consequent price reductions by retailers. In which case, any further rebalancing of the economy may be delayed by the current high exchange rate.

Activity

Taking into account the likely effects of the RWC and the high level of stock building, underlying GDP growth was weak in the September quarter, although there may have been some activity displaced by the tournament. A further factor weighing on aggregate activity is the continued disruption in Canterbury. Indicators suggest economic activity in the region has settled at a level below that prevalent before the earthquakes. The retail and hospitality sectors in particular appear affected.

Box B

The economic impact of the 2011 Rugby World Cup

The publication of September quarter GDP provides further information to assess the economic impact of the RWC.

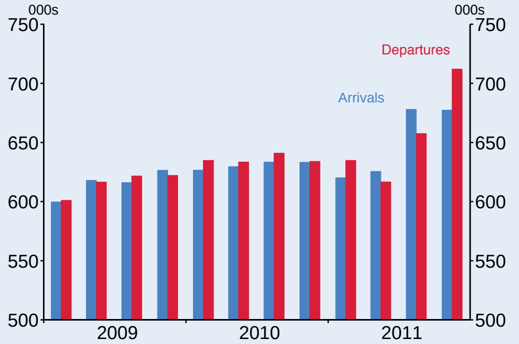
A total of 133,200 visitors arrived in New Zealand between July and October for the RWC. This compares with the Reserve Bank's previous forecast of 95,000 visitors. However, since the almost 40,000 additional tourists were predominantly Australian, who typically stay for shorter periods and spend less money, the overall effect will be muted relative to that implied by a simple comparison of visitor numbers.

Exports of transport services (foreign residents travelling on New Zealand operated flights) increased noticeably in the September quarter. Conversely, exports of travel services (expenditure by tourists in New Zealand) were little changed in the September quarter. These exports are measured using the results from the International Visitor Survey completed at departure. Hence, the majority of measured travel services exports from the RWC will take place in the December quarter, since that is the quarter when the majority of tourists departed (figure B1).

This unusual pattern of arrivals and departures has also affected measured consumption. The method used by Statistics New Zealand to derive consumption is, roughly speaking, to subtract net tourist expenditure from retail sales. Spending in the September quarter by tourists who departed in the December quarter would be consequently deducted from consumption in the December rather than the September quarter. This allocation results in volatile quarterly growth rates of consumption, although the impact on the level of consumption will end in the March 2012 quarter.

Taking into account the higher number of tourist arrivals, total nominal tourist spending on the RWC is estimated to have been $925 million, or 1.8 percent of expenditure GDP. Given that RWC-related expenditure would have likely crowded out other activity, and that hosting and broadcasting rights fees are recognised as imports, the overall net impact on expenditure GDP will be less.

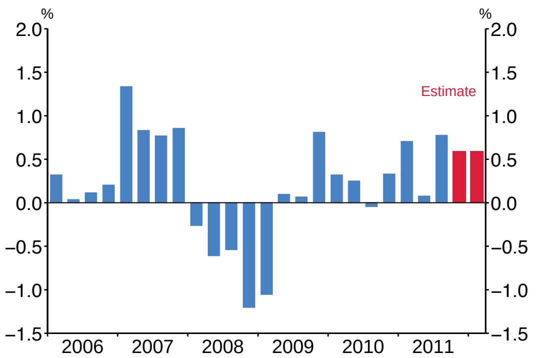
Figure B1
Quarterly visitor arrivals and departures *(seasonally adjusted)*



Source: Statistics New Zealand.

Construction sector activity is currently subdued, with only limited rebuilding in Canterbury at present (see box C). Activity more generally is expected to continue its slow improvement upwards from the recession. GDP growth is estimated to be 0.6 percent in both the December and March quarters (figure 4.8). The relatively sluggish rate of activity growth to date has been insufficient to eliminate spare capacity in the economy.

Figure 4.8
GDP growth
(quarterly, seasonally adjusted)



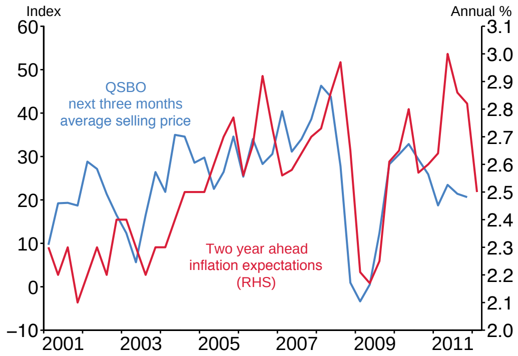
Source: Statistics New Zealand, RBNZ estimates.

Capacity pressures and inflation

Consistent with some spare capacity in the economy, wage pressures have remained contained. Furthermore, inflation expectations moderated in the March quarter following the publication of December 2011 annual CPI inflation, which was the first unaffected by the 2010 increase in GST. These factors suggest a limited degree of inflationary pressure in the economy at present (figure 4.9).

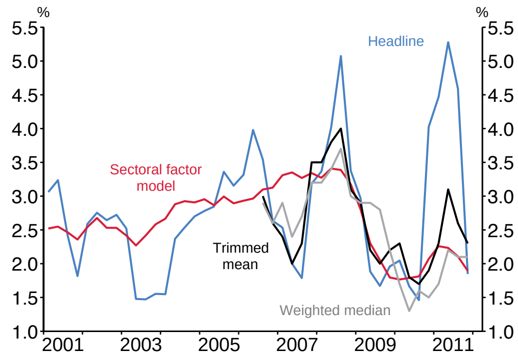
The subdued level of inflationary pressure is further borne out by the December CPI outturn, which at an annual rate of 1.8 percent surprised markedly to the downside. Price reductions were visible across many tradable categories, reflecting the high level of the New Zealand dollar. There were also price reductions in the telecommunications sector. Finally, food prices fell sharply, following the weather-induced spike in the middle of 2011. Taking into account these volatile movements, core measures of inflation suggest underlying inflation around the centre of the target band (figure 4.10).

Figure 4.9
QSBO pricing intentions and RBNZ survey of expectations



Source: NZIER, RBNZ.

Figure 4.10
Headline inflation and ex-GST core inflation measures
(annual)



Source: Statistics New Zealand, RBNZ.

Box C
The Canterbury rebuild

In addition to causing substantial physical damage, the earthquakes in Canterbury continue significantly affect the lives of many New Zealanders. These events, and the resulting rebuild process, will have pronounced effects on the economy for many years to come. This box summarises the Bank's current assumptions regarding this reconstruction process.

Cost of reconstruction

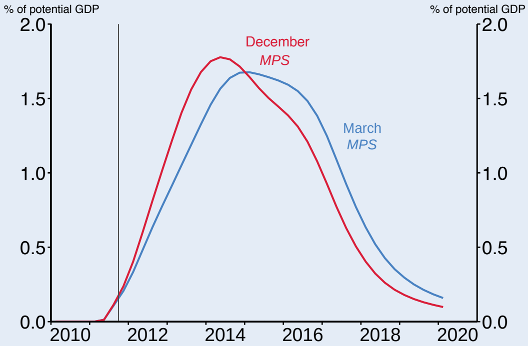
The Bank's working assumption for the total cost of reconstruction remains at $20 billion (in 2011 dollars). The reconstruction of residential properties accounts for the largest share of the total expected cost, but significant work is also required to repair infrastructure and commercial premises. However, the outlook for reconstruction in Canterbury remains subject to a high degree of uncertainty (Bank estimates are rounded to the nearest $5 billion). The activity associated with this process reflects the replacement of damaged buildings and infrastructure, rather than representing a net increase in national wealth.

While the aftershocks in December 2011 and January 2012 were significant events, indications are that a large share of the resultant damage was to structures already badly affected by previous earthquakes. As a result, they are not expected to significantly increase the real cost of reconstruction.

Timing of reconstruction

Although the recent aftershocks are not believed to have increased the real cost of reconstruction, they have added further uncertainty around the timing and pace of the rebuild process. Following these aftershocks, the Bank revised its outlook to assume a more gradual lift in reconstruction-related activity, to account for the expected disruption to the rebuild process (figure C1). Reconstruction activity is still expected to lift during 2012, with further increases over 2013. Residential and essential infrastructure work are largely expected to precede commercial reconstruction. Information received to date is consistent with this timing assumption. While major demolition work is already taking place and there has been a modest rise in earthquake-related building consents in the region, overall reconstruction activity remains fairly subdued.

Figure C1
Reconstruction spending



Source: RBNZ estimates.

In the December *Statement*, it was noted that continued aftershocks and related issues surrounding the provision of insurance had delayed the start of reconstruction. Since December, the availability of coverage for the construction of existing policyholders' homes has improved, subject to a number of factors such as the supporting land being assessed as relatively resilient to future seismic events. Insurance availability for the reconstruction of houses on land deemed more susceptible to future aftershocks remains limited.

5 The macroeconomic outlook

Overview

The risk of a substantial near-term deterioration in global economic conditions has moderated. Nonetheless, trading partner demand is likely to remain weak, weighing on domestic economic conditions. Strength in primary sector incomes should support modest near-term growth. The pace of activity is expected to increase over the medium term, supported by a rise in investment. As domestic activity increases, current spare capacity will be absorbed, boosting inflationary pressure. However, headline inflation is expected to remain within the target band over the medium term.

International economic projection

The outlook for New Zealand's trading partners is for soft but gradually improving growth through 2012 (figure 2.2). The near-term outlook remains dominated by an expectation of continued weakness in the euro area. Recent policy actions in the euro area have alleviated severe near-term risks to growth, but fiscal austerity and structural reform will weigh on the medium-term outlook. Overall, the outlook for global activity is similar to that outlined in the December *Statement.*

The ECB's initial LTRO reduced pressures on bank funding, while also, indirectly, easing funding conditions for governments. This has alleviated near-term risks to activity stemming from further deterioration in monetary and credit conditions. This may be underpinning some improvement in confidence measures, which, if sustained, should result in some recovery in spending and investment. However, the impact of this policy on real activity still depends on the willingness of banks to extend credit to businesses and households.

While alleviating near-term risk, the LTRO does not address longer-term issues facing the euro area. Ongoing fiscal austerity and structural reforms are necessary to place government debt on a sustainable path in a number of economies. Structural reforms are also necessary to address divergences in competitiveness and productivity that underlie imbalances across the region. The undiminished need for both fiscal austerity and structural reform continues to undermine the medium-term growth outlook for the euro area. Even in economies where pressure for consolidation and reform is lower, fiscal restraint is likely.

Fiscal consolidation will also weigh on medium-term growth in the US economy. A significant amount of fiscal consolidation at the federal government level is currently legislated to occur in the United States from 2013, with the expiry of tax cuts and implementation of automatic spending cuts. Such a sharp consolidation is unlikely to actually occur as it could push the US economy back into recession. More gradual consolidation is more likely, consisting of milder spending cuts and some form of extension to tax cuts.

Recent improvements in US growth and stabilised activity in the euro area should flow through to strengthening export growth in Asia through 2012. In addition, domestic demand is expected to remain resilient, supported by strong labour markets and, in China, by continuing urbanisation.

GDP growth in China is expected to moderate as property tightening measures implemented by the government over the past year weigh on prices and investment in commercial real estate. Export growth is also expected to remain weak through the beginning of the year.

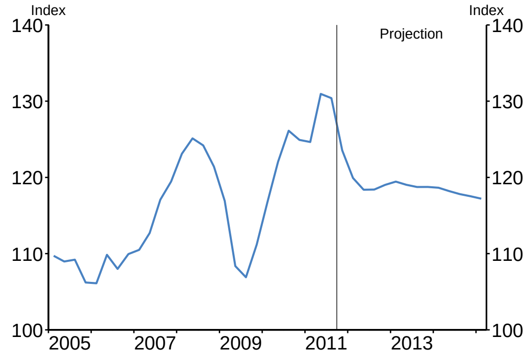
The pace of slowing in the Chinese property sector remains a major uncertainty for the outlook of China and the Asia-Pacific region. A sharp drop in property prices could cause significantly lower domestic demand growth in China, while also dampening growth across other Asian economies for which Chinese domestic demand is a key external support. This would also negatively affect the outlook for the Australian economy. The majority of resource exports from Australia are ultimately used in construction activity in China, and the outlook for Chinese demand has an increasing influence on commodity prices.

Policy makers across Asian economies have much greater capacity to support growth by easing fiscal and monetary policy than authorities in Western economies. In China, a combined fiscal and monetary policy response should largely offset the impact of a modest decline in the property sector, even though it may not offset the full magnitude of a more severe correction.

In Australia, GDP growth is forecast to increase over the coming year. A high level of investment in the resource sector is expected to continue to support domestic demand and export growth. The recent fall in commodity prices is not expected to significantly affect investment decisions. Conditions are likely to remain weaker in non-resource sectors of the economy. In particular, continued Australian dollar strength is likely to further undermine tourism and manufacturing.

Inflation in New Zealand's trading partner economies is expected to moderate over the forecast period, as weaker global demand is expected to translate into lower wage and cost pressures. However, in Asia, resilient domestic demand conditions and loose monetary policy could mean that inflation pressures build relatively quickly as global growth recovers.

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



Source: Statistics New Zealand, RBNZ estimates.

Domestic economic projection

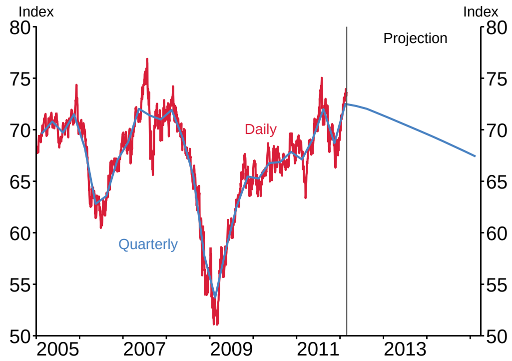
While the risks of significant deterioration in global activity have declined, weak US and European demand is still expected to weigh on domestic activity. At the same time, as discussed in chapter 3, developments in financial markets have also somewhat raised the marginal cost of funding for New Zealand banks. This is assumed to place some pressure on borrowing costs for New Zealand households and businesses over coming quarters. Any such effect is likely to be relatively contained due to competitive pressure in the industry and currently weak growth in credit demand.

Weakness in trading partner demand has caused New Zealand's export prices to moderate somewhat. But these prices are expected to remain strong, particularly as emerging market growth continues to support demand for New Zealand's exports. This will help New Zealand's terms of trade remain favourable (figure 5.1).

In addition, primary sector exports are expected to strengthen through 2012, reflecting strong production following favourable climatic conditions. These factors will support primary sector incomes over the next year.

The New Zealand dollar has appreciated significantly since the December *Statement*. While it is assumed that the New Zealand dollar will depreciate gradually (figure 5.2), the strength in the exchange rate is a factor that will dampen incomes and undermine the competitiveness of New Zealand exporters and sectors competing with imports.

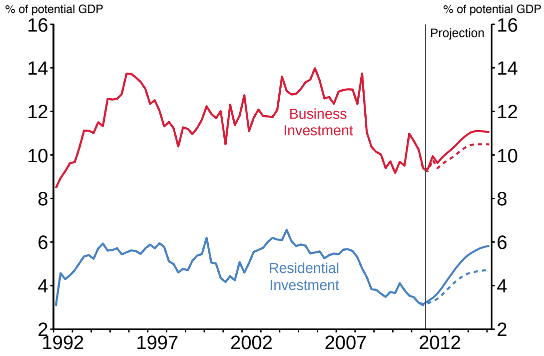
Figure 5.2
New Zealand dollar TWI



Source: RBNZ estimates.

Overall, primary sector incomes are expected to remain elevated in the near term, despite the high exchange rate. This will support economic activity, offsetting weak Western demand. The pace of growth is then expected to pick up over the medium term. A rise in construction sector activity is an important aspect of this improvement. As discussed in box C, repair and reconstruction activity in the Canterbury region is expected to increase over the next few years. This reconstruction activity supports an increase in both residential and business investment (figure 5.3). Overall, the outlook for business investment is relatively subdued, consistent with the outlook for general activity.

Figure 5.3
Investment
(business investment excludes computers and intangible assets, seasonally adjusted).



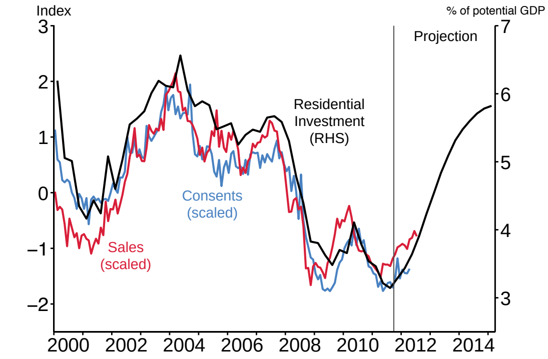
Source: Statistics New Zealand, RBNZ estimates.
Note: Dashed lines exclude direct contribution of rebuild activity.

Excluding reconstruction in the Canterbury region, construction activity is also assumed to rise strongly. Residential investment has remained subdued since the recession, falling as a share of total output over the past few years. There are several factors that may have contributed to this weakness. These include tighter lending conditions, household focus on balance sheet consolidation and general deterioration in confidence.

Housing market indicators suggest construction activity will increase in the near term (figure 5.4). This improvement is expected to continue and remain an important driver of growth over the medium term. Growth in population, along with usual repair and maintenance of houses, is expected to drive this continued recovery in residential investment from low levels.

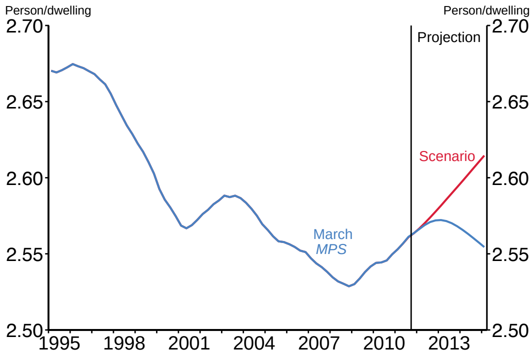
This rise in underlying residential investment is required in order for persons per dwelling to stabilise. Persons per dwelling fell steadily from 1995 until 2008 (figure 5.5). The recession reversed this trend. Continued subdued activity in residential investment would see persons per dwelling continue to rise.

Figure 5.4
Building consents, house sales and residential investment



Source: Statistics New Zealand, REINZ, RBNZ estimates.
Note: Sales and consents data are scaled to residential investment.

Figure 5.5
Persons per dwelling
(seasonally adjusted)

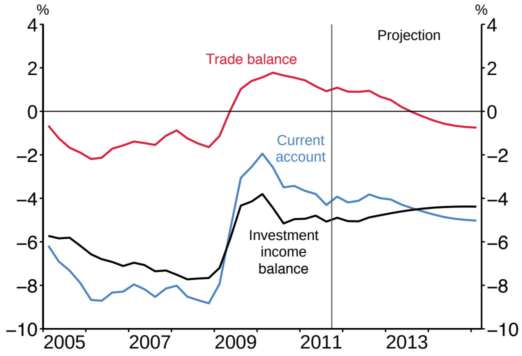


Source: Statistics New Zealand, RBNZ estimates.
Note: Scenario assumes no further growth in residential investment.

While investment is forecast to strengthen, consumption growth is expected to remain subdued. Households have built up a significant amount of debt over the past decade and are expected to undertake a period of consolidation. This, along with weak house price inflation and slightly higher interest rates, is expected to see consumption growth remain modest.

Despite this consolidation in the household sector, external balances are still expected to deteriorate somewhat. A combination of weaker export prices and a rise in imports is expected to drive a deterioration in the trade balance (figure 5.6). This will see the current account deficit increase to about 5 percent of nominal GDP over the next few years.

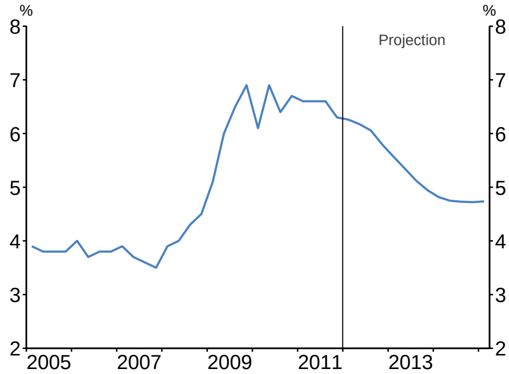
Figure 5.6
Current account balance
(annual, share of nominal GDP)



Source: Statistics New Zealand, RBNZ estimates.

Overall, the acceleration in activity growth will draw on domestic resources and absorb current spare capacity over the next few years. An improvement in domestic conditions will also boost demand for labour. As a result, the unemployment rate is expected to fall over the projection period (figure 5.7).

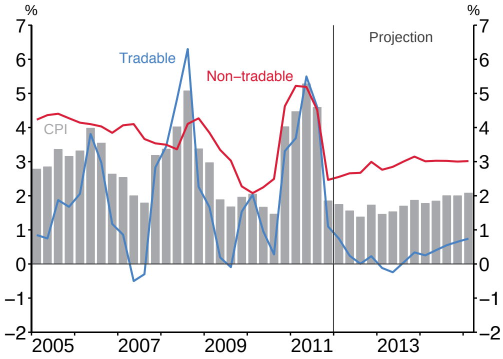
Figure 5.7
Unemployment rate
(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

Inflation is expected to remain modest in the near term (figure 5.8). The recent appreciation of the TWI will continue to dampen tradable inflation for some time. In addition, current spare capacity in the economy will dampen near-term non-tradable inflation. However, inflationary pressures are expected to build over the medium term, as the labour market picks up and capacity pressures rise. The gradual removal of monetary stimulus will provide some offset to this.

Figure 5.8
CPI, tradable and non-tradable inflation
(annual)



Source: Statistics New Zealand, RBNZ estimates

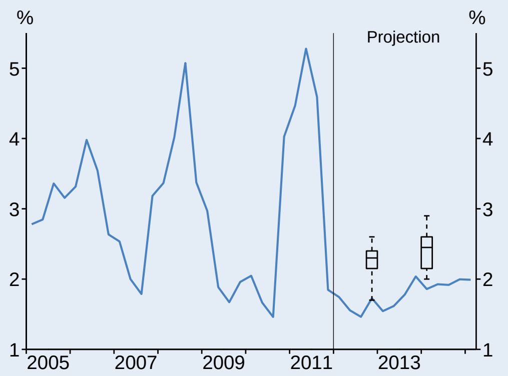
Box D
The Reserve Bank Survey of Expectations – professional forecasters' expectations

The Bank regularly compares its projections against those of other professional economists.[1] Two areas of particular interest, discussed below, are the projections for inflation and GDP. As always, the economic outlook is subject to a degree of uncertainty and forecasts depend on several assumptions. Different views on the economic outlook are possible, as reflected in the range of analysts' forecasts.

Inflation

The Bank's projections for inflation are, on average, lower than those of external analysts (figure D1). Contributing to the Bank's outlook is the assumption that lingering weakness in the global economy will result in subdued imported inflationary pressures. In addition, the current high degree of excess capacity in the economy and the easing in inflation expectations over recent months are expected to dampen non-tradable inflationary pressures.

Figure D1
Inflation forecasts
(annual)



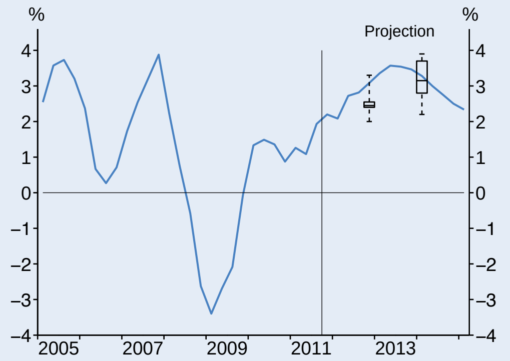
Sources: Statistics New Zealand, RBNZ estimates and survey data.
Note: The distributions of external forecasters' inflation forecasts are shown as box and whisker plots in the above figure.

[1] External analysts' forecasts are collected as part of the Reserve Bank Survey of Expectations, which this quarter was conducted on 8 and 9 February.

GDP

Compared to external forecasters' expectations, the Bank's projection for GDP growth is stronger over the coming year (figure D2). However, for the most part, this apparent difference reflects the more up-to-date data that were available when the Bank's projections were finalised (including data on household spending). At longer horizons, forecasts from the Bank and other agencies are broadly similar.

Figure D2
GDP growth forecasts
(annual)



Sources: Statistics New Zealand, RBNZ estimates and survey data.
Note: The distributions of external forecasters' GDP growth forecasts are shown as box and whisker plots in the above figure.

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
2004	Mar	1.6	0.4	1.5	66.8	5.5
	Jun	0.7	0.8	2.4	64.0	5.9
	Sep	0.4	0.6	2.5	66.3	6.4
	Dec	0.3	0.9	2.7	68.6	6.7
2005	Mar	1.1	0.4	2.8	69.6	6.9
	Jun	1.7	0.9	2.8	70.8	7.0
	Sep	0.5	1.1	3.4	69.7	7.0
	Dec	-0.2	0.7	3.2	71.5	7.5
2006	Mar	0.3	0.6	3.3	68.2	7.5
	Jun	0.0	1.5	4.0	62.8	7.5
	Sep	0.1	0.7	3.5	63.6	7.5
	Dec	0.2	-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	0.8	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	-0.6	1.6	4.0	69.3	8.8
	Sep	-0.5	1.5	5.1	65.5	8.2
	Dec	-1.2	-0.5	3.4	57.8	6.3
2009	Mar	-1.1	0.3	3.0	53.7	3.7
	Jun	0.1	0.6	1.9	58.4	2.9
	Sep	0.1	1.3	1.7	62.6	2.8
	Dec	0.8	-0.2	2.0	65.5	2.8
2010	Mar	0.3	0.4	2.0	65.3	2.7
	Jun	0.3	0.2	1.7	66.8	2.9
	Sep	-0.1	1.1	1.5	66.9	3.2
	Dec	0.3	2.3	4.0	67.8	3.2
2011	Mar	0.7	0.8	4.5	67.1	3.0
	Jun	0.1	1.0	5.3	69.1	2.7
	Sep	0.8	0.4	4.6	72.0	2.8
	Dec	0.6	-0.3	1.8	68.7	2.7
2012	Mar	0.6	0.7	1.7	72.5	2.8
	Jun	0.7	0.8	1.6	72.3	2.8
	Sep	0.9	0.3	1.4	72.0	2.9
	Dec	1.0	0.0	1.7	71.6	3.0
2013	Mar	1.0	0.4	1.5	71.2	3.1
	Jun	1.0	0.8	1.5	70.7	3.2
	Sep	0.9	0.4	1.7	70.3	3.2
	Dec	0.8	0.2	1.9	69.8	3.3
2014	Mar	0.6	0.3	1.8	69.4	3.3
	Jun	0.6	0.9	1.8	68.9	3.4
	Sep	0.6	0.6	2.0	68.4	3.5
	Dec	0.5	0.2	2.0	67.9	3.6
2015	Mar	0.5	0.4	2.1	67.4	3.6

[1] Notes for these tables follow on pages 28 and 29.

Table B

Measures of inflation and inflation expectations

(annual)

	2010			2011			
	Jun	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**
CPI	1.7	1.5	4.0	4.5	5.3	4.6	1.8
CPI components							
CPI non-tradable	2.2	2.5	4.6	5.2	5.2	4.5	2.5
Non-tradables housing component	1.4	1.7	2.7	2.8	3.0	2.9	2.0
Non-tradables ex housing, cigarettes and tobacco	2.2	2.1	4.8	5.1	5.5	5.0	2.5
CPI tradable	1.0	0.3	3.3	3.7	5.5	4.6	1.1
Petrol	9.5	5.8	14.2	17.1	20.1	17.7	11.2
Other inflation measures							
Sectoral factor model estimate of core CPI inflation ex-GST	1.8	1.8	2.1	2.3	2.2	2.1	1.9
CPI trimmed mean (of annual price change) ex-GST	1.8	1.7	1.9	2.3	3.1	2.6	2.3
CPI weighted median (of annual price change) ex-GST	1.3	1.6	1.5	1.7	2.2	2.1	2.1
CPI ex food, petrol and government charges *	1.4	1.0	2.8	3.1	3.4	3.2	1.0
CPI ex food and energy	1.7	1.4	3.1	3.3	3.6	3.2	1.1
GDP deflator (derived from expenditure data)	1.9	2.9	5.8	4.4	4.3	4.3	n/a

	2010			2011				2012
	Jun	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**
Inflation expectation measures								
RBNZ Survey of Expectations - inflation one-year-ahead	2.9	3.9	3.4	2.9	3.1	2.9	2.7	2.2
RBNZ Survey of Expectations - inflation two-years-ahead	2.8	2.6	2.6	2.6	3.0	2.9	2.8	2.5
AON Hewitt Economist survey - inflation one-year-ahead	3.4	5.0	4.3	2.6	3.0	2.8	2.5	2.3
AON Hewitt Economist survey - inflation four-years-ahead	2.5	2.6	2.5	2.4	2.6	2.7	2.5	2.5
NBBO - inflation one-year-ahead (quarterly average)	2.8	3.1	2.9	3.0	3.2	3.3	3.1	n/a

* excludes food items and petrol, as well as government related goods and services. This measure still includes the impact of the rise in GST on non-government related goods and services.

Table C

Composition of real GDP growth

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

	Actuals						Projections				
March year	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Final consumption expenditure											
Private	4.4	4.4	2.5	3.3	-1.1	0.3	2.1	2.3	3.2	2.6	1.1
Public authority	4.5	4.9	4.4	4.7	4.2	0.2	3.7	1.5	-0.1	-0.2	0.6
Total	4.5	4.5	2.9	3.6	0.1	0.3	2.5	2.1	2.4	1.9	1.0
Gross fixed capital formation											
Market sector:											
Residential	2.8	-5.3	-1.6	4.9	-23.2	-13.0	4.2	-10.9	27.4	29.8	13.1
Business	10.9	10.1	-2.0	8.7	-5.8	-10.9	9.7	3.2	4.9	9.9	5.1
Non-market government sector	10.8	6.5	-6.7	-10.5	20.4	-8.5	-15.4	0.4	4.0	4.1	4.1
Total	8.9	6.3	-2.2	6.7	-7.8	-11.1	6.9	0.8	8.0	12.9	6.6
Final domestic expenditure	5.6	5.0	1.6	4.4	-1.9	-2.4	3.4	1.8	3.7	4.5	2.4
Stockbuilding[1]	0.2	-0.5	-0.7	0.6	-0.1	-1.8	1.6	1.0	-0.8	0.2	-0.0
Gross national expenditure	6.0	4.7	0.7	5.4	-2.0	-3.8	4.9	2.4	2.8	4.6	2.4
Exports of goods and services	4.9	-0.1	3.0	3.4	-3.0	4.9	1.7	2.0	2.1	1.7	2.3
Imports of goods and services	12.4	4.2	-1.5	10.3	-4.1	-9.5	10.4	5.3	4.2	5.2	2.3
Expenditure on GDP	3.5	3.3	2.1	3.0	-1.5	1.0	2.1	1.3	2.1	3.4	2.4
GDP (production)	3.8	3.2	0.8	3.0	-1.5	-0.9	1.2	1.8	3.1	3.7	2.4
GDP (production, March qtr to March qtr)	2.5	2.4	1.7	2.2	-3.4	1.3	1.3	2.1	3.7	3.3	2.1

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

Table D

Summary of economic projections

(annual percent change, unless specified otherwise)

	Actuals							Projections			
March year	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Price measures											
CPI	2.8	3.3	2.5	3.4	3.0	2.0	4.5	1.7	1.5	1.8	2.1
Labour costs	2.5	3.0	3.0	3.5	3.1	1.3	2.0	2.3	2.0	1.9	2.1
Import prices (in New Zealand dollars)	0.6	6.9	0.2	0.3	12.1	-8.5	3.7	-1.1	1.1	3.3	4.1
Export prices (in New Zealand dollars)	5.0	3.3	4.3	11.8	6.5	-8.6	10.6	-4.9	0.7	2.6	2.8
Monetary conditions											
90-day rate (year average)	6.5	7.3	7.6	8.6	6.7	2.8	3.1	2.7	2.9	3.2	3.5
TWI (year average)	67.1	70.1	65.6	71.6	61.6	62.9	67.1	70.6	71.8	70.0	68.2
Output											
GDP (production, annual average % change)	3.8	3.2	0.8	3.0	-1.5	-0.9	1.2	1.8	3.1	3.7	2.4
Potential output (annual average % change)	3.2	2.8	2.2	1.8	1.5	1.0	1.3	1.5	2.1	2.3	2.2
Output gap (% of potential GDP, year average)	2.8	3.2	1.8	2.9	-0.1	-2.0	-2.0	-1.7	-0.8	0.6	0.8
Labour market											
Total employment (seasonally adjusted)	3.7	2.8	2.0	-0.3	0.7	-0.1	1.7	0.8	2.6	2.7	1.2
Unemployment rate (March qtr, seasonally adjusted)	3.9	4.0	3.9	3.9	5.1	6.1	6.6	6.3	5.6	4.8	4.7
Trend labour productivity	0.9	0.8	0.7	0.5	0.4	0.4	0.4	0.6	0.8	0.9	1.0
Key balances											
Government operating balance (% of GDP, year to June)	4.7	4.4	3.5	3.1	-2.1	-3.4	-9.5	-6.0	-2.6	-1.4	-0.7
Current account balance (% of GDP)	-6.2	-8.7	-8.0	-7.9	-7.9	-2.0	-3.7	-4.3	-4.1	-4.8	-5.1
Terms of trade (OTI measure, annual average % change)	5.8	-0.8	1.8	7.8	3.2	-9.1	12.3	1.4	-5.9	-0.0	-0.9
Household saving rate (% of disposable income)	-6.0	-7.9	-6.7	-3.0	-4.5	-1.5	0.2	0.1	0.1	0.9	2.2
World economy											
Trading partner GDP (annual average % change)	3.8	3.8	3.8	4.3	0.1	1.2	4.4	3.1	3.5	3.9	3.9
Trading partner CPI (TWI weighted, annual % change)	2.1	2.4	1.9	3.3	0.9	1.7	2.2	2.1	1.7	2.0	2.0

Notes to the tables

CPI	Consumer Price Index. Quarterly projections rounded to one decimal place.
TWI	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	The interest yield on 90-day bank bills.
World GDP	RBNZ definition. 16-country index, export weighted. Seasonally adjusted.
World CPI inflation	RBNZ 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.
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 Reserve Bank 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.
Quarterly percent change	(Quarter/Quarter$_{-1}$ - 1)*100
Annual percent change	(Quarter/Quarter$_{-4}$ - 1)*100
Annual average percent change	(Year/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 Reserve Bank staff during the projection round

Air New Zealand Limited

AMI Insurance Limited

Barfoot & Thompson Limited

Canterbury Development Corporation

Council of Trade Unions

Debtworks (NZ) Limited

Earthquake Commission New Zealand

Employers and Manufacturers Association (Northern) Inc

EziBuy Limited

Fletcher Building Limited

Foodstuffs South Island Limited

Fulton Hogan Limited

Golden Bay Cement Company Limited

Hawkins Construction Limited

IAG New Zealand Limited

Kelly Services (New Zealand) Limited

Mainfreight Limited

Ministry of Economic Development (Tourism)

Motor Trade Finances Limited

New Zealand Retailers Association

New Zealand Transport Agency

Noel Leeming Group Limited

Paymark Limited

Port of Tauranga Limited

Smiths City Group Limited

Snowy Peak Limited

The Warehouse Limited

Appendix C
Reserve Bank statements on monetary policy

OCR unchanged at 2.5 percent

8 December 2011

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

Reserve Bank Governor Alan Bollard said: “As foreshadowed in the September *Statement*, global conditions have deteriorated. Continuing difficulties related to sovereign and bank debt in a growing number of European economies have resulted in high levels of volatility in financial markets. There has also been a softening in international economic activity, including in the Asia-Pacific region.

“Global developments are having some negative impact on New Zealand, though to date it has been limited. Business confidence has declined and investment spending is likely to remain weak for some time. In addition, tightness in international markets means funding costs for New Zealand banks will increase to some degree over the coming year.

“There remains a high degree of uncertainty around the global outlook and, as discussed in the scenario in this Statement, there is a risk that conditions weaken further.

“Domestically, economic activity continues to expand, though at a modest pace. Although off their peaks, export commodity prices remain elevated. In addition, the depreciation of the New Zealand dollar provides some support for the tradable sector of the economy. Over time, repairs and reconstruction in Canterbury will also provide a significant boost to demand for an extended period.

“Annual headline inflation is estimated to have returned within the Bank’s 1 to 3 percent target band in the December quarter. Underlying inflation continues to sit close to 2 percent. In addition, wage and price setting pressures have remained contained.

“Given the current unusual degree of uncertainty around global conditions and the moderate pace of domestic demand, it remains prudent for now to keep the OCR on hold at 2.5 percent.”

OCR unchanged at 2.5 percent

26 January 2012

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

Reserve Bank Governor Alan Bollard said: “Since the time of the December *Statement*, financial market sentiment has improved slightly, with increased liquidity in European financial markets. However, the global economy remains fragile and risks to the outlook remain.

“World prices for New Zealand’s export commodities have remained elevated but the recent appreciation of the New Zealand dollar is reducing exporters’ returns. The European debt crisis has also increased the cost of international funding, which will likely pressure funding costs for New Zealand banks over the coming year.

“In the domestic economy we continue to see modest growth. Over recent months there have been signs of a limited recovery in household spending and the housing market. Further ahead, repairs and reconstruction in Canterbury will also provide a significant boost for an extended period, though there may be further delays resulting from the aftershocks.

“Reassuringly, inflation pressures have remained well contained. Inflation has declined and now sits below 2 percent.

“Given ongoing uncertainty around global conditions and the moderate pace of domestic demand, it remains prudent to keep the OCR on hold at 2.5 percent.”

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	10 December 2009	2.50
6 December 2000	6.50	9 June 2005	6.75	28 January 2010	2.50
24 January 2001	6.50	28 July 2005	6.75	11 March 2010	2.50
14 March 2001	6.25	15 September 2005	6.75	29 April 2010	2.50
19 April 2001	6.00	27 October 2005	7.00	10 June 2010	2.75
16 May 2001	5.75	8 December 2005	7.25	29 July 2010	3.00
4 July 2001	5.75	26 January 2006	7.25	16 September 2010	3.00
15 August 2001	5.75	9 March 2006	7.25	28 October 2010	3.00
19 September 2001	5.25	27 April 2006	7.25	9 December 2010	3.00
3 October 2001	5.25	8 June 2006	7.25	27 January 2011	3.00
14 November 2001	4.75	27 July 2006	7.25	10 March 2011	2.50
23 January 2002	4.75	14 September 2006	7.25	28 April 2011	2.50
20 March 2002	5.00	26 October 2006	7.25	9 June 2011	2.50
17 April 2002	5.25	7 December 2006	7.25	28 July 2011	2.50
15 May 2002	5.50	25 January 2007	7.25	15 September 2011	2.50
3 July 2002	5.75	8 March 2007	7.50	27 October 2011	2.50
14 August 2002	5.75	26 April 2007	7.75	8 December 2011	2.50
2 October 2002	5.75	7 June 2007	8.00	26 January 2012	2.50
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 the remainder of 2012 and into mid-2013:

2012	
Thursday 26 April 2012	OCR announcement
Thursday 14 June 2012	*Monetary Policy Statement*
Thursday 26 July 2012	OCR announcement
Thursday 13 September 2012	*Monetary Policy Statement*
Thursday 25 October 2012	OCR announcement
Thursday 6 December 2012	*Monetary Policy Statement*
2013	
Thursday 31 January 2013	OCR announcement
Thursday 14 March 2013	*Monetary Policy Statement*
Thursday 24 April 2013	OCR announcement
Thursday 13 June 2013	*Monetary Policy Statement*

Dates for 2013 are provisional, subject to confirmation in August 2012.

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