RESERVE BANK
OF NEW ZEALAND

Monetary Policy Statement

September 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 31 August 2012. Policy assessment finalised on 12 September 2012

1 Policy assessment

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

New Zealand's economic outlook remains broadly consistent with that described in the June *Monetary Policy Statement.*

New Zealand's trading partner outlook remains weak. Several euro-area economies are in recession and Chinese growth has slowed. The risk of significant deterioration in the euro area persists.

Domestically, the Bank continues to expect economic activity to grow modestly over the next few years. Housing market activity continues to increase as forecast, and repairs and reconstruction in Canterbury are expected to further boost the construction sector. Offsetting this, fiscal consolidation is constraining demand growth, and the high New Zealand dollar continues to undermine export earnings and encourage substitution toward imported goods and services.

Underlying annual inflation, which recently moved below 2 percent, is expected to settle near the mid-point of the target range over the medium term.

It remains appropriate for the OCR to be held at 2.5 percent.

Alan Bollard

Governor

2 Overview and key policy judgements

New Zealand's economic outlook remains broadly consistent with that described in the June *Statement*. Our trading partner outlook remains weak, with the risk of significant deterioration in the euro area still apparent. Domestically, the economy continues to recover slowly from the 2008/09 recession. While this recovery is encouraging, some spare capacity persists and inflation is low. Indeed, partly driven by falls in food prices, annual headline inflation declined to only 1.0 percent in the June quarter 2012. Inflation is expected to settle near the middle of the target range over the medium term.

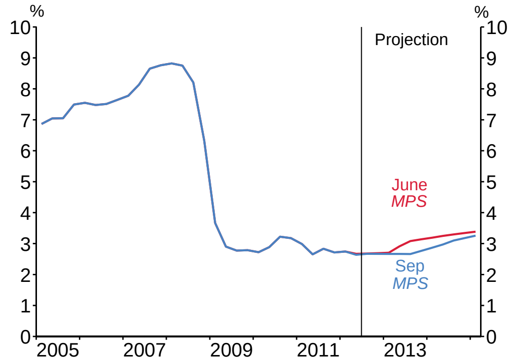
New Zealand's GDP growth has been quite sluggish over recent years. Aggregate GDP has taken some time to recover its pre-recession level – certainly much longer than after the 1990/91 and 1997/98 recessions – and the unemployment rate has held near its recessionary high. Despite the stimulus from very low interest rates, underlying inflation recently moved below 2 percent.

Despite these weak general conditions, there have been some positive developments over the past three months. Export commodity prices appear to have stabilised, reflecting to some extent severe drought in the United States and its impact on international grain prices. March quarter GDP growth (which reflected a temporary boost from favourable climatic conditions) was stronger than had been estimated. Housing market and retail spending data have also picked up further since the June *Statement*.

However, headwinds for the economic outlook are still evident. Most obviously, the trading partner outlook remains weak. Many euro-area economies are in recession and Chinese growth continues to slow. Domestically, the unemployment rate remains elevated and the high New Zealand dollar continues to undermine export earnings and encourage substitution toward imported goods and services.

Consistent with recent developments, the 90-day interest rate continues to be projected to remain low over the forecast horizon (figure 2.1).

Figure 2.1
90-day interest rate



Source: RBNZ estimates.

There are three key factors influencing the outlook. These are:

- The Bank continues to expect that trading partner growth will remain modest. However, there is a small but concerning risk that international conditions turn out much weaker than assumed.
- New Zealand fiscal policy is forecast to tighten markedly over the projection horizon, dampening aggregate demand.
- Repairs and rebuilding in Canterbury are expected to substantially boost construction sector activity. Since the June *Statement*, reconstruction activity has become more apparent in the economic data.

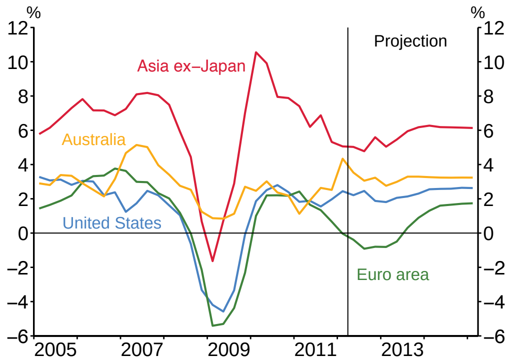
The global outlook

New Zealand's trading partner outlook remains weak. The Bank continues to predict below-*Consensus* global growth. The risk of a more severe outcome remains. The cost of bank funding relative to the 90-day interest rate is expected to remain elevated over the projection due to ongoing strains in overseas funding markets.

In the euro area, while developments over the past three months have been interpreted by markets as relatively positive, it is by no means clear that the risk of significant economic deterioration has been eliminated. Until euro-area government debt is on a sustainable medium-term path the risk of rapid changes in market sentiment will persist.

The Bank continues to expect euro-area activity to contract over the coming year. Beyond this, only modest recovery is forecast (figure 2.2). Growth in the United States economy continues to be modest. However, its near-term outlook is subject to considerable uncertainty and downside risk, related to the substantial fiscal tightening that is currently legislated to occur at the start of next year. In China, economic data continue to soften, with GDP growth falling further. Falling investment growth has reduced global demand for industrial commodities, with Australia's terms of trade suffering as a result.

Figure 2.2
Trading partner growth
(annual)



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

Importantly, the ability to support global activity using conventional policy levers is quite limited. Many advanced economies already have policy interest rates at or near zero, and public debt has already increased markedly since the global financial crisis.

Fiscal consolidation

In New Zealand, consistent with *Budget 2012*, fiscal consolidation is expected to have a substantial dampening influence on demand growth over the projection horizon. This consolidation will, all else equal, lead to a lower OCR than would otherwise be the case.

Since around the middle of the previous decade, the shift from operating surpluses to operating deficits offered significant support to demand, but did lead to a sharp rise in government debt. Over the past year or so, attempts have been made to curb public expenditure. However, the fiscal costs associated with the Canterbury earthquakes meant that the fiscal deficit and government debt enlarged further in fiscal year 2011.

Budget 2012 signalled an intention to bring the fiscal balance back to surplus in the 2014/15 year. The current deficit will partly shrink as an automatic consequence of the economic recovery. However, most of the projected improvement is expected to come via tighter discretionary fiscal policy. Public consumption expenditure, while forecast to increase modestly, is expected to trend lower as a share of the economy over the projection. In addition, positive inflation will see effective tax rates increase over time, negatively affecting household disposable incomes and constraining private consumption.

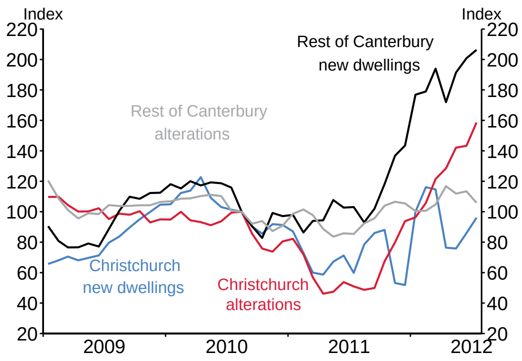
Reconstruction in Canterbury

Repairs and rebuilding in Canterbury are expected to substantially boost construction sector activity over the projection horizon. The Reserve Bank continues to assume repairs and reconstruction of about $20 billion (in 2011 dollars) will occur. Various constraints mean reconstruction will take many years. Nonetheless, residential and non-residential construction are still likely to increase markedly over the projection, adding to GDP growth.

Since the June *Statement*, reconstruction activity has become more apparent in the economic data. Consents for alterations and additions – the component of the consent data that will most likely capture substantial repairs – have picked up in Christchurch. These are about 60 percent above their pre-earthquakes level. In addition, consents for new dwellings elsewhere in Canterbury are more than double their pre-earthquakes level (figure 2.3, opposite). Such consents will be capturing rebuilding in Kaiapoi – which was substantially damaged by the first major earthquake in September 2010 – as well as any displaced Christchurch residents who have relocated to the city fringes. Consents for commercial buildings have also increased. The recently established plans for the redevelopment of the central city will assist with rebuilding decisions.

Such a pick-up, while encouraging, remains small relative to the total reconstruction required. There is a long way to go and the eventual size and timing of reconstruction remain highly uncertain. In the near term,

Figure 2.3
Dwelling consents issued in Canterbury
(seasonally adjusted, three-month moving average, August 2010=100)



Source: Statistics New Zealand.

it is an open question as to how much any further pick-up in reconstruction will be offset by reduced demolition and emergency repair activity.

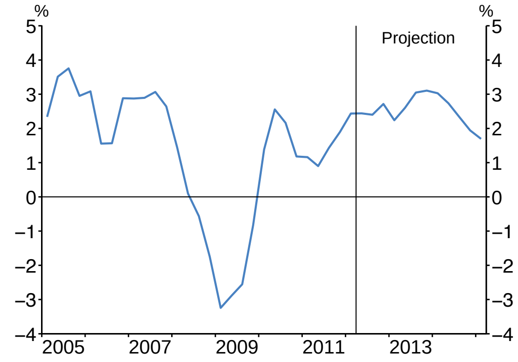
As discussed in the June *Statement*, the repair-driven nature of the upcoming construction cycle will make it look quite different to that typically observed. New Zealand construction cycles are usually demand led, with increased demand for housing pushing up the price of existing homes. As existing houses become expensive relative to the cost of building, residential construction increases. The wealth effect from increased house prices flows through to increased retail spending, resulting in house prices, residential investment and private consumption moving together.

However, earthquake reconstruction represents a specific demand to repair and replace existing housing, rather than a broad pick-up in domestic demand or flowing from any increase in wealth. In addition, the concentrated and relatively co-ordinated nature of reconstruction should limit its impact on house prices and construction costs. As such, it seems likely that consumer spending and house prices will be subdued relative to residential investment.

The updated projection

Overall, GDP growth is expected to remain near its current annual pace over the projection (figure 2.4). Population growth, reconstruction in Canterbury, and regular maintenance and repairs are expected to drive a substantial pick-up in construction sector activity

Figure 2.4
GDP growth
(annual)

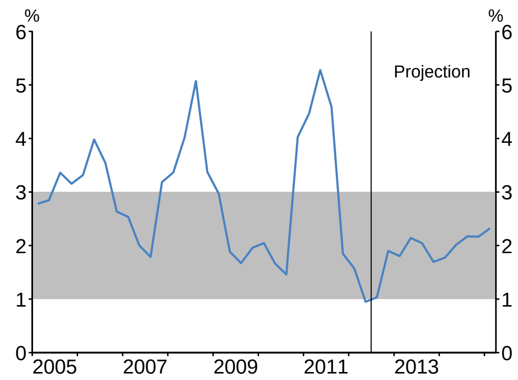


Source: Statistics New Zealand, RBNZ estimates.

over the next few years. Fiscal consolidation, which will dampen growth in both public and private consumption expenditure, is expected to offset this pick-up. Persistent strength in the New Zealand dollar is expected to boost import volumes, further undermining growth in domestic production.

Continued moderate growth is expected to see current spare capacity progressively eliminated. This will lead to a modest pick-up in inflation. Recent stabilisation in commodity prices will see tradable inflation increase from its current low pace, but sustained strength in the New Zealand dollar will limit this pick-up. Overall, headline CPI inflation is expected to settle near the mid-point of the target band (figure 2.5).

Figure 2.5
CPI inflation
(annual)



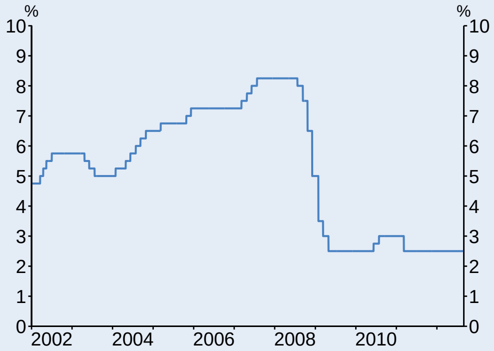
Source: Statistics New Zealand, RBNZ estimates.

Box A

Recent monetary policy decisions

The OCR has been held at the historically low level of 2.5 percent for the past 18 months (figure A1). The OCR was lowered to this level in March 2011 to limit the adverse economic consequences of the Canterbury earthquakes. Since that time, soft global conditions, as well as persistent strength in the New Zealand dollar, have meant that the inflation outlook has remained subdued, and it has been appropriate to hold the OCR at this level.

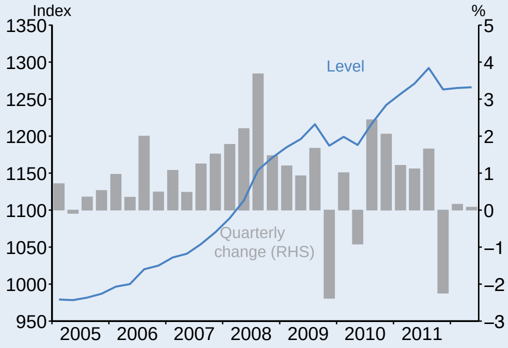
Figure A1
Official Cash Rate



Source: RBNZ.

Despite the low level of the OCR, annual headline inflation fell to 1.0 percent in the June quarter 2012. Falls in commodity prices, including petrol and food, contributed to the low inflation outturn. Food prices corrected sharply lower in the December quarter 2011 (figure A2), reducing headline CPI inflation by 0.4 percentage points. This fall was driven by declines in fruit and vegetable prices, and followed earlier increases associated with the early-2011 Queensland floods.

Figure A2
Food price index



Source: Statistics New Zealand.

Even if such volatility in commodity prices is excluded, underlying inflation is still quite modest. Underlying annual inflation recently moved below 2 percent, and indicators of businesses' pricing intentions and inflation expectations have eased further. Such low inflation supports the Bank's recent decisions to maintain a low OCR.[1]

[1] A more detailed assessment of the Reserve Bank's monetary policy decisions over the last business cycle is available in Assistant Governor John McDermott's recent speech, 'The future of inflation targeting.' Available at http://www.rbnz.govt.nz/speeches/4821934.html

3 Financial market developments

Market sentiment has improved significantly since the June *Statement*, with equity markets showing strong returns and credit spreads narrowing. This improvement reflects a positive view of the Greek election result and strong policy statements by European leaders to address the region's debt crisis. Economic data have been mixed, with a slightly more positive tone in the United States offset by weaker data in Europe and China. Without an accompanying improvement in economic fundamentals, a cautious view on the recent rally in equities and credit seems appropriate.

China has become more of a focus of market attention, given disappointing growth trends, net capital outflows and its perceived financial system fragility. Increasing risks to liquidity within the financial system reduce the ability of Chinese policymakers to respond if growth continues to disappoint.

Improved market sentiment has reduced near-term expectations of easier monetary policy in Australia and New Zealand, and has helped push up commodity-linked currencies. Overnight indexed swaps imply some probability of a modest rate cut to the OCR by early 2013, followed by modest upside risk to the policy rate through much of next year.

Local banks are currently well funded. They have taken the opportunity of improved market conditions to issue long-term debt in wholesale markets, both overseas and domestically, despite little immediate need for liquidity. Marginal funding costs have eased since the June *Statement*, particularly for long-term debt.

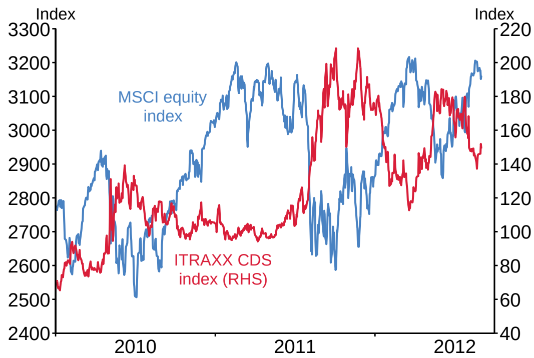
International market developments

Global financial market sentiment was poor leading up to the June *Statement*, with worries about Greece's Parliamentary elections and the health of Spain's banking system in the spotlight. Since then, sentiment has improved significantly, with Greece's newly elected government seen to be committed to staying in the eurozone. Moreover, eurozone finance ministers agreed that Spanish banks would be provided with up to €100 billion of rescue loans. Since then, market sentiment has improved further on some strong statements by European Central Bank (ECB) President Draghi and European politicians on policy measures that commit to keeping the eurozone together.

A more positive flow of economic data in the United States has helped improve market sentiment, although the same cannot be said for activity data of the eurozone or China, which have tended to disappoint.

Improved market sentiment has been reflected in strong gains in world equities and narrower credit spreads since the June *Statement* (figure 3.1). A notable exception to the trend was China, with the Shanghai Composite Index falling to a three-year low as investors questioned the outlook for the Chinese economy.

Figure 3.1
World equity and European credit default swap spread indices



Source: Bloomberg.

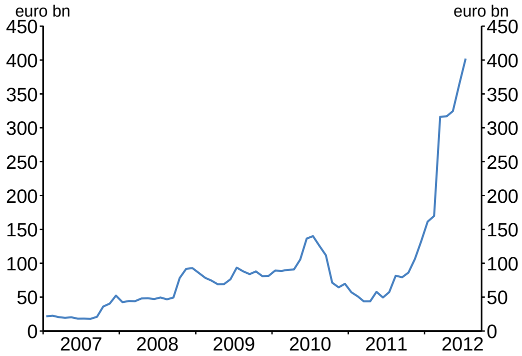
Focusing on the euro-area's debt crisis, ECB President Draghi said in late July that "Within our mandate, the ECB is ready to do whatever it takes to preserve the euro." Later, the ECB outlined the high-level direction of policy, focusing on remedying the transmission of monetary policy across the eurozone. This would involve buying sovereign debt, if necessary, to bring down short-term rates in troubled countries, with strict conditions on countries requesting formal assistance.

Market sentiment has improved in reaction to the prospect of an expansion in ECB policy measures. However, these policies do little to address fiscal and structural issues in the euro-area.

Access to wholesale funding markets remains difficult for Greece. However, the country has been able to avoid another default, with the ECB allowing Greece's central bank to access emergency loans. A team of officials from the European Commission, International Monetary Fund and ECB – the so-called 'Troika' – are set to report on Greece in early October to determine whether Greece's economic reforms and fiscal targets are on track to justify further rescue loans. A bad report would be viewed very negatively by the market and raise the risk of the country exiting the eurozone.

In Spain, capital flight has accelerated over recent months and the country's banks increasingly rely on the ECB for funding (figure 3.2). Government has about €24 billion of debt and interest payment obligations due at the end of October. With the country now having limited ability to raise funds in the market, the consensus view is that it will be forced to request rescue loans from the European bailout funds. A formal request for assistance would then trigger ECB support for Spain's debt in the secondary market, helping to reduce interest rates.

Figure 3.2
ECB lending to Spain's banks



Source: Bloomberg.

As this *Statement* was finalised, several pending announcements and events had the ability to change market sentiment and increase volatility. These included more details on the European Union's common bank supervision mechanism proposal, Germany's constitutional court decision on the legality of the European Stability Mechanism, and the Troika report on Greece

Of the G7 country central banks, the ECB has been the only one to cut its policy rate since the June *Statement*. Furthermore, in September the bank announced a new bond purchasing programme targeting high short term rates in troubled nations. The aim is to reduce borrowing rates for households and businesses in those countries. For the programme to be activated a troubled nation must sign up to austerity and structural reform measures, which will be closely monitored.

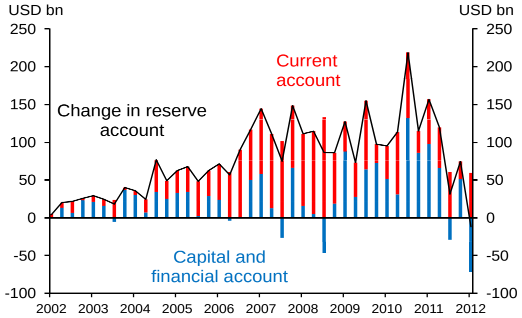
Other central banks continue to signal the possibility of further policy stimulus. In its August policy minutes, the US Federal Reserve signaled the intention to introduce further stimulus measures "fairly soon", unless new data "pointed to a sustainable and strengthening in the pace of the economic recovery".

The Bank of England increased its asset purchase programme by £50 billion to £375 billion in early July and introduced a "funding for lending" scheme, which incentivises participating banks to increase lending to the real economy through the use of cheaper-than-market funding costs. The Reserve Bank of Australia has kept policy unchanged since cutting its policy rate by 75 basis points in the June quarter.

In a sign that economic weakness is spreading to the rest of world, central banks in China, South Korea, The Philippines, South Africa and Brazil have cut policy rates since the June *Statement*.

In China, financial market indicators have shown little sign that the Government's latest stimulus plan has bolstered domestic market sentiment. Steel and iron ore prices have hit two- and three-year lows respectively, and the Shanghai composite equity index has also hit a three-year low. Balance of payments data for the June quarter showed signs of a large net capital outflow, requiring a reduction in the central bank's reserve account for the first time in 12 years (figure 3.3). This could reflect reduced confidence in China's economy or expectations

Figure 3.3
China – balance of payments



Source: Datastream.

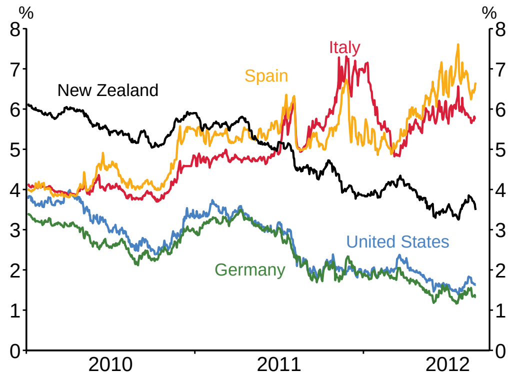
of a depreciating currency. Indeed, the Chinese yuan has softened recently. Net capital outflows in China have drained domestic liquidity in the market, prompting the People's Bank of China to inject increasing amounts of liquidity to prevent a tightening in monetary conditions.

Commodity prices have risen significantly since the June *Statement*, with the CRB and DJ-UBS composite indices both up by more than 11 percent. Higher grain prices have been a key contributor, driven by drought in the United States. Energy prices have also risen strongly. The gains for these components largely reflect supply factors. The benchmark spot Brent crude oil indicator has risen by a substantial 32 percent since its 2012 low at the end of June. Importantly, prices for many industrial commodities have weakened, reflecting a softer outlook for global demand.

Financing and credit

Despite increased risk appetite, government bond yields in the major markets have remained near historical lows. That said, the downward trend seen earlier in the year was arrested, with 10-year rates in the United States and Germany trading in an approximate 50 basis point range and averaging around 1.6 percent and 1.4 percent respectively. New Zealand's government bond market has largely followed global trends. Yields remained low, given widely held expectations that any tightening in monetary policy is a long time away and, in fact, the global bias towards policy over the near term remains one of further easing.

Figure 3.4
Selected 10-year government bond rates



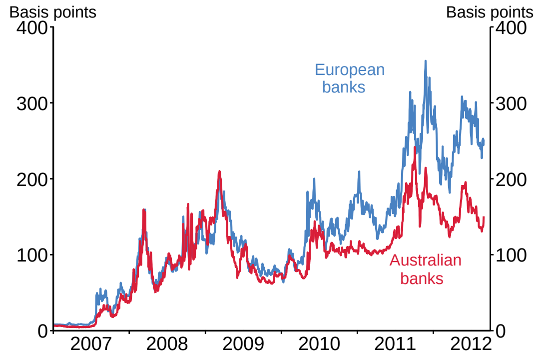
Source: Reuters.

Indeed, the ECB's 25 basis point cut to its main refinancing rate in early July and expectations of a further reduction have helped push interest rates down across the maturity spectrum in Europe. The ECB's resolve to "do whatever it takes to preserve the euro", and its proposed conditional bond purchasing programme designed to achieve that, helped push down yields significantly in the troubled European nations.

Improved market sentiment has fed through into much better funding conditions for banks across the world. In the United States and Europe, bank funding costs have fallen steadily since mid-June. For banks of good credit quality, market contacts suggest that current short-dated funding conditions are the most favourable since the beginning of the global financial crisis. However, low- credit-quality European banks remain dependent on the funding lines provided by the ECB and their national central banks.

More importantly, long-term senior-unsecured debt funding conditions have also improved. Indicative of this improvement, credit default swap spreads have fallen since early June by about 50 basis points for European and Australian banks (figure 3.5). This reverses much of the increase in spreads seen in the first five months of the year.

Figure 3.5
European and Australian bank credit default swap spreads



Source: Bloomberg.

New Zealand banks have found it easier to issue long-term senior debt this year. The total cost of this debt has been declining, more or less in line with the credit default swap spreads noted above. Investors have been attracted by non-European issues and the elevated spreads that were on offer earlier in the year. However, market conditions can change rapidly. An increase in issuance recently reflects an element of banks pre-funding for the next financial year, given that funding conditions could deteriorate on any significant negative news in Europe.

Banks also continue to face stronger deposit growth relative to loan growth. Retail deposits rose by $15 billion in the year to July compared to loan growth of $13 billion. The combination of strong deposit growth and good rates of funding in long term wholesale markets has put banks in a well-funded position – materially ahead of regulatory requirements.

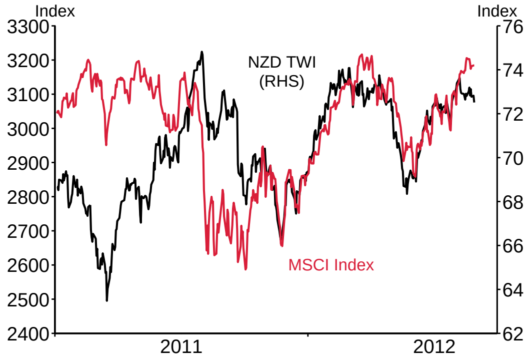
With better access to offshore markets recently, there has been less pressure to aggressively seek retail deposits. Thus, term deposit spreads to wholesale rates have receded from the top of their range seen over the past few years. Overall, marginal funding costs for the major banks have declined modestly over recent months.

Foreign exchange market

The improvement in market sentiment has put upward pressure on the New Zealand dollar since the June *Statement*. On a TWI basis, the New Zealand dollar has appreciated by about 2 percent, ranging from gains of about 3 percent against the US dollar and euro to a modest depreciation against the Australian dollar.

Over 2012, the New Zealand dollar has closely followed market sentiment, with a "risk on" environment putting upward pressure on the currency and a "risk off" environment having an opposing effect. This is illustrated in figure 3.6 which shows the particularly close correlation between the New Zealand dollar TWI and global equities over 2012, whereas the relationship last year was much weaker. Other factors consistent with recent strength in the New Zealand dollar have been rising interest rate differentials between New Zealand and the five countries that make up the TWI and upward pressure on soft commodity prices.

Figure 3.6
New Zealand dollar versus global equities



Source: Bloomberg.

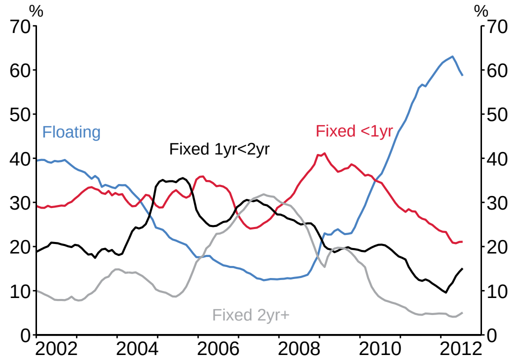
Domestic financial market developments

There has been upward pressure on New Zealand interest rates over the past few months. Leading into the June *Statement*, the overnight indexed swap (OIS) market was pricing in at least a 25 basis point cut to the OCR before the end of the year. Market contacts noted at the time that this reflected global factors ahead of Greece's election, with some investors using the OIS market to hedge against event risk – effectively taking a view that there was a small chance of a significant policy easing over the near term. As risk sentiment improved, the need to hedge against negative developments reduced. At the time of writing there was a slight easing bias priced into the OIS curve, reflecting a small probability of the Reserve Bank cutting the OCR within the next six months. From about March 2013 onwards, a modest chance of the Reserve Bank tightening policy is priced in. This profile of expected rate moves is similar to June, but the amplitude of the moves is much smaller.

Across the wholesale swap curve, New Zealand interest rates are slightly higher. Mortgage rates remain largely unchanged since the June *Statement*. Banks remain competitive and they are increasingly targeting good credit-quality borrowers (for example, those with more than 20 percent equity) with lower rates than standard advertised rates.

The floating mortgage rate remains by far the most popular term, with 59 percent of mortgages on floating rates. However, this share has fallen four percentage points since the high in April, owing to reduced short-term fixed rates. With more borrowers shifting to lower fixed interest rates, the weighted average mortgage rate continues to fall to historical lows and is currently 5.84 percent.

Figure 3.7
Composition of outstanding mortgages
(residual maturity for rate set)



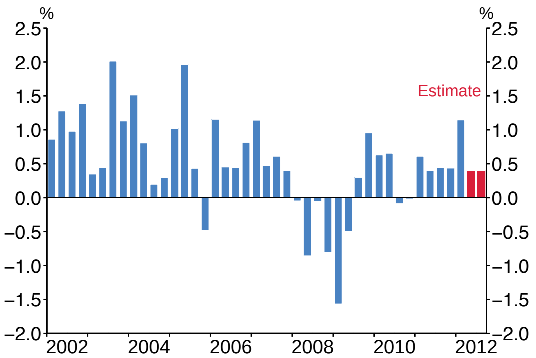
Source: RBNZ.

4 Current economic conditions

The New Zealand economy continues to recover slowly from the 2008/09 recession, with quarterly GDP growth estimated to have averaged 0.6 percent over the past year (figure 4.1). Domestic demand continues to strengthen with the housing market recovering further and household spending picking up. Offsetting this, slowing global growth has weighed on export commodity prices, and the elevated New Zealand dollar continues to erode export earnings and encourage substitution toward imports.

Inflationary pressures in the economy are currently modest with annual CPI inflation at 1.0 percent. Falls in commodity prices and lingering strength in the New Zealand dollar have resulted in subdued tradable inflation. Consistent with some degree of spare capacity, non-tradable inflation is currently below its historical average.

Figure 4.1
GDP growth
(quarterly, seasonally adjusted)



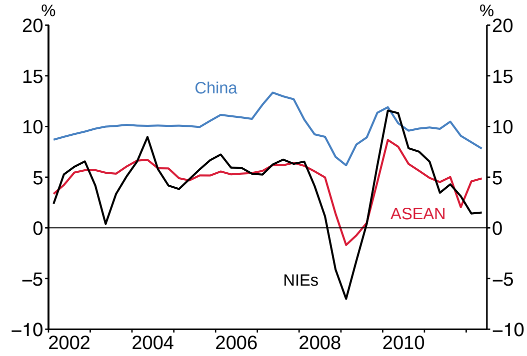
Source: Statistics New Zealand, RBNZ estimates.

External demand

Economic growth in New Zealand's trading partners has slowed over the past year. With the exception of Australia, GDP growth in the majority of trading partner economies is currently below average rates.

Economic expansion in Asia continues to drive New Zealand's overall trading partner growth. That said, in recent months growth in China and the higher-income Asian economies has slowed. This reflects slower domestic demand growth in China, and minimal growth in external demand, primarily resulting from the euro-area downturn. In contrast, domestic demand in the ASEAN region has held up (figure 4.2).

Figure 4.2
GDP growth in China, NIEs and ASEAN
(annual)



Source: Haver Analytics.
Note: ASEAN includes Indonesia, Malaysia, The Philippines and Thailand. NIEs include Hong Kong, Singapore, South Korea and Taiwan.

Mining investment in Australia has increased substantially over the past year, supporting strong growth. Consumption growth has also been strong and the unemployment rate has remained low. In recent months there have been signs of stabilisation in the housing market following a prolonged period of weakness. However, with a high import share of investment and the high Australian dollar motivating high imported consumption, activity in non-mining sectors remains subdued.

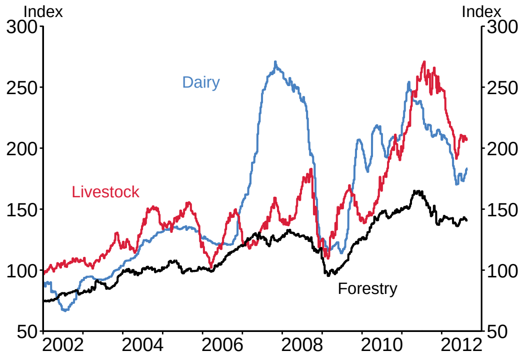
Economic growth in Europe has slowed further over the past year. The euro area contracted in the second quarter, driven by severe weakness in Spain and Italy. The majority of euro-area economies are currently undertaking significant fiscal consolidation. Despite improved financial market sentiment since June, uncertainty about the efficacy of measures to resolve the sovereign debt crisis, and the ability of policymakers to implement a more sustainable euro-area framework, continue to weigh on growth.

The United States economy has continued to grow at a moderate pace. Although the United States does not face the same financial market pressures as Europe currently, the recovery is also being restrained by fiscal consolidation. The housing market has continued to steadily improve, and consumption appears to be growing at trend.

Moderate global growth and spare capacity in the United States and Europe continue to contribute to modest inflationary pressures in New Zealand's trading partner economies. As a result, manufactured import prices remain subdued. Slowing global growth and deterioration in financial markets drove sharp falls in commodity prices in the first half of the year – contributing to further softness in import price inflation.

Global growth in agricultural production was boosted in the early part of the year by favourable climatic conditions in New Zealand and abroad. This compounded the downward pressure on the prices of some of New Zealand's key exports, with dairy and lamb prices moderating from their elevated 2011 levels. In recent months, an easing in growth of global milk production has contributed to a stabilisation in dairy prices (figure 4.3). Concerns about drought in the United States, the worst since the 1950s, are also underpinning global dairy and beef prices. The drought has severely hampered prospects for the US grains harvest, driving a significant increase in the price of key grains such as corn and wheat. As a consequence, feed prices will increase sharply and this is likely to restrain the growth of US cattle herd numbers and dairy milk production (due to the heavy reliance on grain feed) leading to upward pressure on international beef and dairy prices.

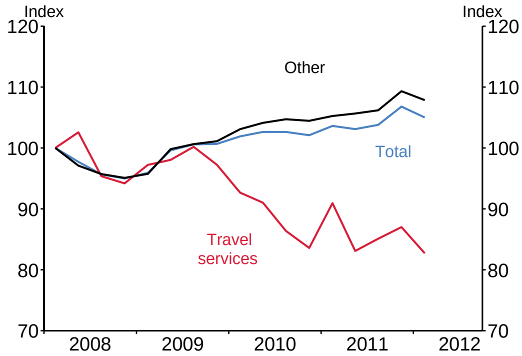
Figure 4.3
Export commodity prices
(US dollar terms)



Source: ASB Bank.

Lingering strength in the New Zealand dollar continues to erode export receipts and hamper the competitiveness of the tradable sector more generally. While total export volumes continue to grow, largely supported by strength in primary sector exports, exports of travel services remain weak (figure 4.4). In part, this is due to the strong New Zealand dollar eroding the spending power of tourists. Subdued global activity and disruption to South Island tourism caused by the Canterbury earthquakes have also contributed to the weakness.

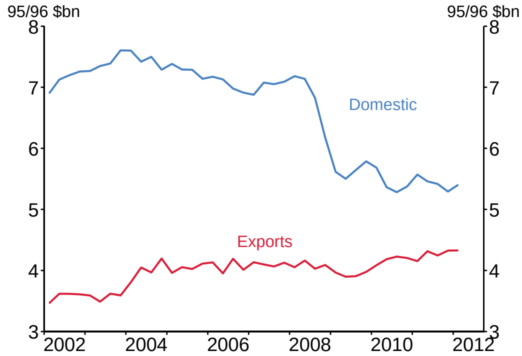
Figure 4.4
Export volumes
(seasonally adjusted, 2008Q1=100)



Source: Statistics New Zealand.

At the same time, the high New Zealand dollar is encouraging continued substitution to imports as it lowers the price of imports relative to domestically produced goods and services. Indeed, import-competing manufacturers who sell into the domestic market have seen their sales volumes decline markedly over the past four years, while manufactured export volumes have held up (figure 4.5). While prolonged weakness in the New Zealand construction sector will have contributed significantly to this divergence, it also appears that the high New Zealand dollar is negatively affecting import-competing firms to a greater extent than exporters. Overall, imports are currently elevated as a share of trend

Figure 4.5
Quarterly manufacturing sales volumes
(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

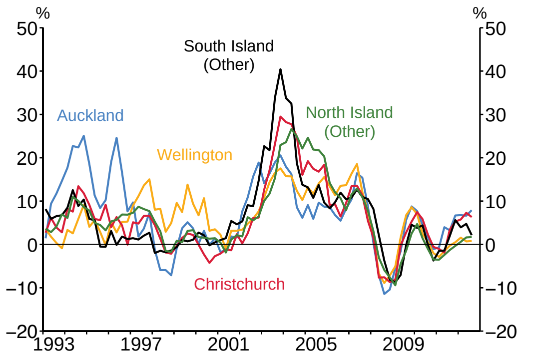
GDP. Persistent strength in the New Zealand dollar and strengthening domestic demand will continue to support imports over the remainder of 2012.

Domestic demand

The New Zealand economy is estimated to have expanded 2.4 percent in the year to the September quarter 2012. Agriculture and primary manufacturing were key sources of growth, reflecting favourable climatic conditions. While the contribution to growth from these sectors is expected to wane over the coming year, domestic demand continues to strengthen. Service sector activity continues to expand and construction activity is expected to increase, albeit from a low base.

The housing market continues to recover. House sales and building consent issuance have increased strongly across the country since the beginning of the year, indicating an increase in residential construction over 2012. Consent issuance in the Canterbury region has increased sharply over the past year, consistent with a pick-up in repairs and building. That said, the current level of reconstruction activity remains low relative to the total rebuilding required. House price inflation has lifted across most regions, though remains modest to date. While there has been some divergence in house price inflation nationally, with house prices increasing faster in Auckland and Canterbury than in the rest of the country (figure 4.6), these divergences are currently not significant relative to history.

Figure 4.6
Annual house price inflation by region
(quarterly, seasonally adjusted)

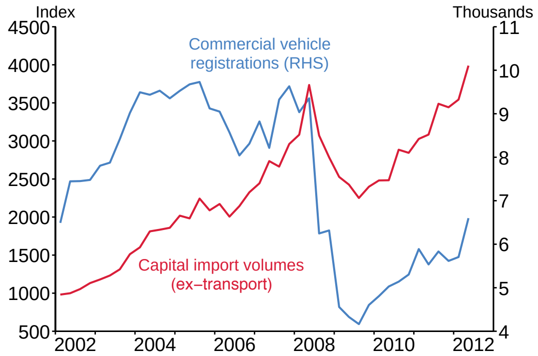


Source: REINZ.

Household spending continues to rise. Growth in retail sales volumes of 4.8 percent in the year to the June quarter 2012 highlights steady spending growth over the past year, despite consumer confidence remaining modest. Around average growth in labour incomes and modest gains in house prices are supporting household spending.

Business indicators point to a gradual improvement in business investment from its current subdued level. An increase in capital imports and a sharp pick-up in commercial vehicle registrations in the first half of the year indicate some increase in firms' capital and transport investment (figure 4.7). Surveyed investment intentions, which sit near historic norms, also point to higher capital investment.

Figure 4.7
Business investment indicators
(quarterly, seasonally adjusted)



Source: Statistics New Zealand.

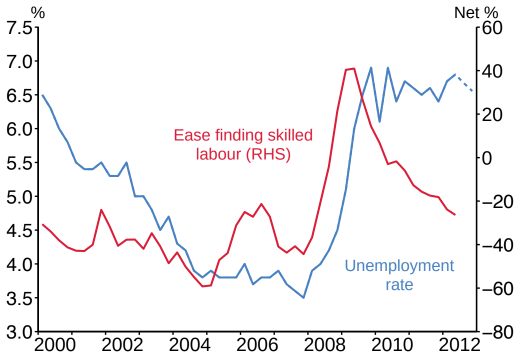
Capacity pressures and inflation

Survey measures of capacity pressure indicate a continued elimination of spare capacity in the economy. Firms have reported increasing difficulty in finding staff with suitable skills, despite the unemployment rate remaining elevated (figure 4.8). Consistent with these developments, annual wage inflation has lifted to around average levels in recent quarters.

Annual headline CPI inflation declined to 1.0 percent in the June quarter 2012. This low level of inflation was driven by sharp declines in imported commodity prices over the past year, especially food and fuel. Lingering strength in the New Zealand dollar and soft global conditions have further dampened tradable pressures.

These factors will contribute to low inflation through the second half of 2012, though the dampening impact from fuel and food are expected to dissipate.

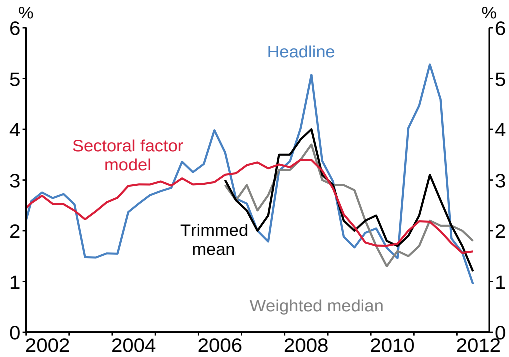
Figure 4.8
Unemployment rate and QSBO ease in finding skilled labour



Source: Statistics New Zealand, NZIER, RBNZ estimates.

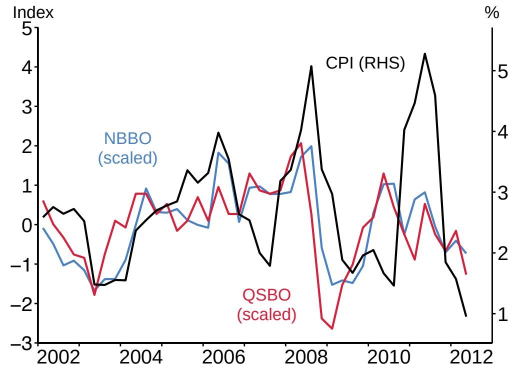
Looking through commodity price volatility, underlying inflationary pressures, while modest, are not as low as headline CPI suggests. Core inflation measures remain around or below 2 percent in annual terms (figure 4.9), consistent with some degree of spare capacity in the economy.

Figure 4.9
CPI inflation
(annual, excluding GST)



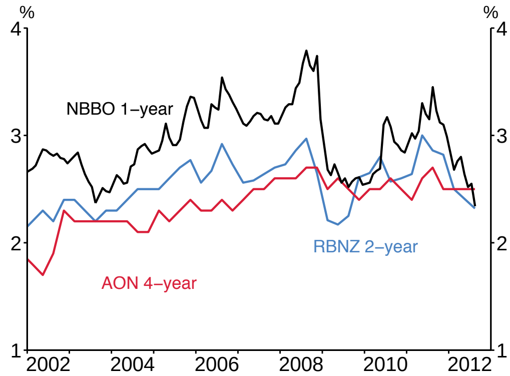
Source: Statistics New Zealand, RBNZ.

Figure 4.10
Firms' pricing intentions and annual CPI inflation



Source: Statistics New Zealand, ANZ National Bank Ltd, NZIER.

Figure 4.11
Inflation expectations
(annual)



Source: RBNZ, ANZ National Bank Ltd, AON Hewitt economist survey.

Consistent with recent low inflation outcomes and the gradual pace of economic growth, firms' pricing intentions have eased (figure 4.10). In addition, surveyed inflation expectations have continued to moderate and have fallen considerably over the past year (figure 4.11).

Although inflationary pressures are currently modest, there are signs that pressures are building in some parts of the economy. In particular, construction cost inflation has picked up, albeit from low rates, as housing market activity continues to increase.

5 The macroeconomic outlook

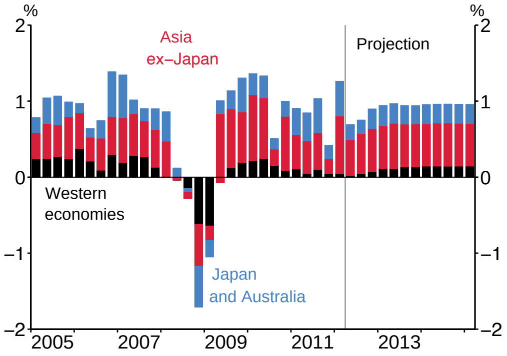
Trading partner activity is expected to grow at a below-average rate over the next year or so, before increasing modestly over the medium term. This subdued external outlook is expected to weigh on domestic activity, while an increase in residential investment is expected to see the economy grow at a steady pace over the projection horizon. Fiscal consolidation and weak consumption growth will weigh on growth over this period. Inflationary pressures are expected to increase somewhat such that inflation settles near the middle of the target band over the medium term.

International economic projection

Trading partner activity is expected to grow at a below-average rate over the next year or so, before increasing modestly over the medium term.

Asia is projected to account for the majority of aggregate trading partner growth over the projection horizon (figure 5.1). However, Chinese GDP growth is likely to be somewhat weaker than in the past, due to lower trend growth and continued subdued demand from Western export markets. Weak external demand is likely to continue to restrain growth in high-income Asian economies, such as South Korea and Taiwan. In contrast, the less industrialised Asian economies, including Indonesia and Thailand, are expected to continue to grow strongly.

Figure 5.1
Trading partner GDP growth
(seasonally adjusted, bars indicate contributions to quarterly growth)



Source: Haver Analytics, RBNZ estimates.
Note: Western economies comprise the United Kingdom, the United States, Canada and the euro area. Asia ex-Japan includes China, Hong Kong, India, Indonesia, Malaysia, The Philippines, Singapore, South Korea, Taiwan and Thailand.

The Australian economy is expected to continue to perform well. The high level of investment aimed at increasing resource production is likely to continue over the coming year or so. As investment in the resource sector slows over the medium term, new drivers will be required for aggregate GDP growth to remain robust. Resource export volumes are expected to increase as additional capacity is brought into production. However, a recovery in non-mining investment, particularly residential construction, is less certain.

Modest economic growth in the United States is expected to continue. While growth is being supported by easy monetary policy, tightening fiscal policy is restraining demand. Uncertainty about the package of government spending cuts and tax increases scheduled for early 2013 is adversely affecting consumer and business sentiment. Most analysts expect that the currently legislated fiscal tightening will not occur in full. However, it remains a key risk.

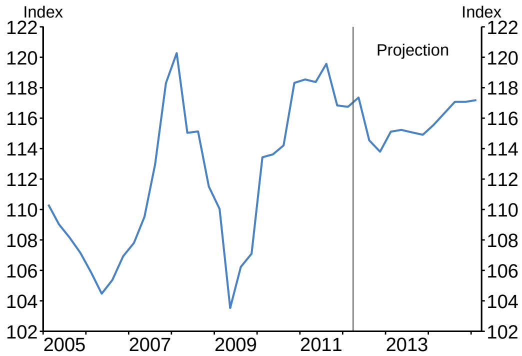
Euro-area output is projected to decline until around the middle of 2013, beyond which growth is expected to remain low. On the basis of recent data and the balance of risks, we continue to project euro-area growth at below *Consensus* rates. Fiscal consolidation is expected to continue to weigh on growth over the projection. Uncertainty about the ability of policymakers to deal effectively with the financial and economic imbalances among euro-area economies is also likely to continue to weigh on confidence and spending. In this regard, recent moves by euro-area policymakers to solidify the Economic and Monetary Union are encouraging, but this process is likely to move only gradually.

Domestic economic projection

The subdued global outlook is expected to weigh on domestic activity through a number of channels. While our direct trade exposure to Europe is relatively small, indirect trade effects through our larger trading partners will put downward pressure on export earnings abroad. Weaker international incomes will also dampen tourist expenditure. Uncertainty regarding the global outlook is likely to dampen domestic confidence, potentially restraining business investment and hiring. Global uncertainty is also likely to see funding margins for New Zealand banks remain elevated.

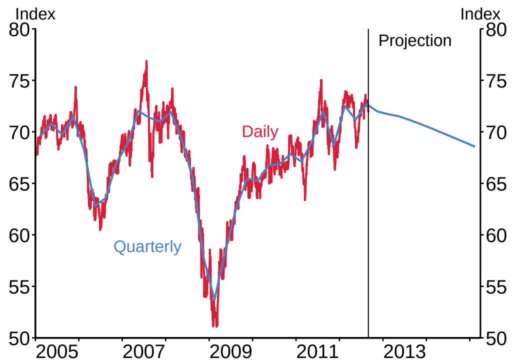
As discussed in more detail in Chapter 4, New Zealand's export commodity prices appear to have stabilised. Over the medium term, New Zealand's export prices are expected to increase gradually, supported by continued demand from Asia. This, coupled with a gradual increase in import prices, will see the terms of trade remain elevated over the projection horizon (figure 5.2). Over this period, the New Zealand dollar TWI is assumed to depreciate gradually (figure 5.3).

Figure 5.2
SNA terms of trade
(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

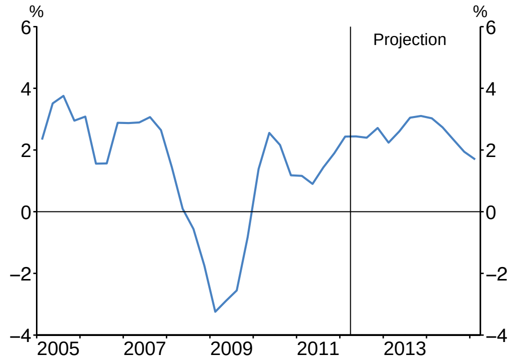
Figure 5.3
New Zealand dollar TWI



Source: Statistics New Zealand, RBNZ estimates.

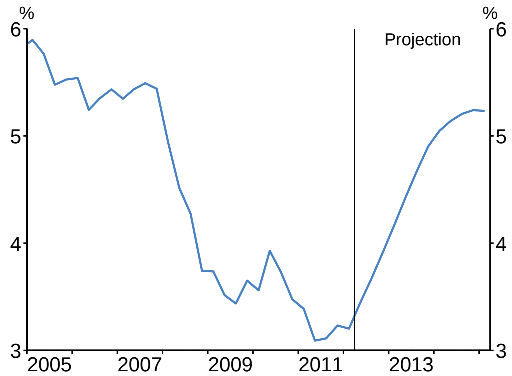
GDP growth is expected to remain near its current annual pace over the projection (figure 5.4). An important driver of domestic activity is a substantial rise in residential investment over the forecast horizon, from currently low levels (figure 5.5). Population growth, a gradual improvement in the labour market and regular maintenance of housing are expected to drive a recovery in nationwide residential investment.

Figure 5.4
GDP growth
(annual)



Source: Statistics New Zealand, RBNZ estimates.

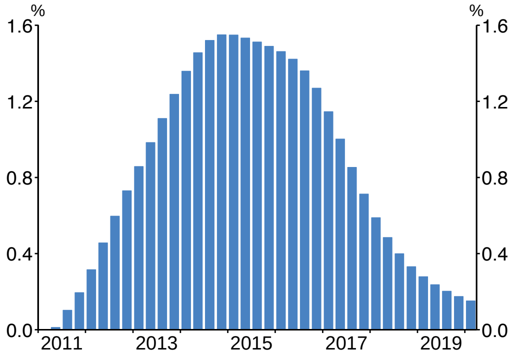
Figure 5.5
Residential investment
(seasonally adjusted, share of potential GDP)



Source: Statistics New Zealand, RBNZ estimates.

In addition, reconstruction activity in Canterbury will boost both residential and business investment over the projection. It is assumed that about $20 billion (in 2011 dollars) of assets damaged in the earthquakes will be repaired or replaced, with reconstruction peaking in 2014 (figure 5.6). Infrastructure and minor residential repair work is currently under way, and major repairs and rebuilds are expected to pick up over the next year. Commercial repair and reconstruction activity are also under way, and recently established plans for the redevelopment of the central city are expected to assist with businesses' investment decisions. Commercial reconstruction is expected to continue over the next decade.

Figure 5.6
Canterbury rebuild profile
(seasonally adjusted, share of potential GDP)

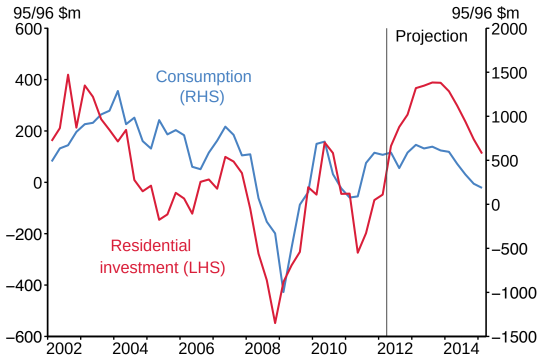


Source: RBNZ estimates.

The eventual cost of reconstruction may be higher than the $20 billion currently assumed. Some assets, even those outside of Canterbury, will be repaired or built to a higher standard to meet higher earthquake-strengthening requirements. There may also be discretionary improvements when assets are replaced.

However, consumption growth is expected to be more modest than what would normally be associated with such a large increase in residential investment activity (figure 5.7). A significant portion of the projected increase in residential investment reflects the replacement of damaged assets, rather than being motivated by house price inflation or gains in wealth as with previous periods of strength in residential investment.

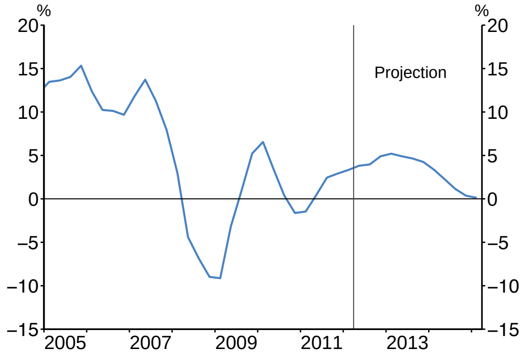
Figure 5.7
Residential investment and household consumption growth
(annual change)



Source: Statistics New Zealand, RBNZ estimates.

Weak house price inflation is expected to see consumption growth remain modest (figure 5.8). Households are also expected to remain relatively cautious in their spending, given their relatively high debt levels and a highly uncertain external environment.

Figure 5.8
House price inflation
(annual)



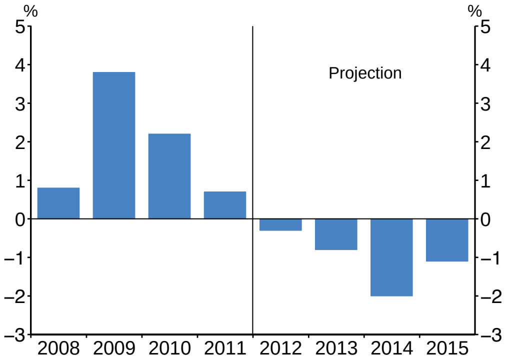
Source: Property IQ, RBNZ estimates.

Private consumption growth will also be limited by fiscal consolidation. The Government aims to return to surplus by the 2014/15 fiscal year, through a combination of reduced spending growth and an increase in revenues. The latter is expected to occur through a pick-up in domestic activity and higher indirect taxes. These taxes increase the price level, and will therefore also reduce consumers' real disposable incomes.

As increases in government revenue limit growth in household consumption, declines in government spending will also dampen overall activity in the economy. Government spending is expected to decline in real terms over the next 18 months, before increasing gradually over the remainder of the projection. Within this, an improving labour market is expected to result in lower transfer payments over the period. The net result of lower government spending and higher revenues is a negative cumulative fiscal impulse of about 4 percent of nominal GDP over the projection (figure 5.9).

Fiscal consolidation will see government debt as a share of GDP stabilise over the medium term. In addition, only modest household spending growth will see the household saving rate increase. However, the large increase in residential (and, to a lesser extent, business) investment more than offsets these improvements,

Figure 5.9
Fiscal impulse
(share of nominal GDP)

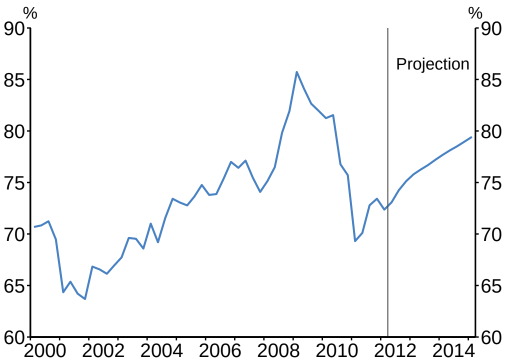


Source: The Treasury, *Budget 2012*.

resulting in a current account deficit that widens to nearly 6 percent of nominal GDP in 2013.

Insurance claims related to the Canterbury earthquakes have resulted in a large decline in net foreign liabilities over the past 18 months. Outstanding insurance claims stood at 5.9 percent of nominal GDP in the March 2012 quarter. These external insurance payments will be used to provide resources, some of which will be imported, for reconstruction in Canterbury over the medium term. As a result, net foreign liabilities will gradually increase (figure 5.10).

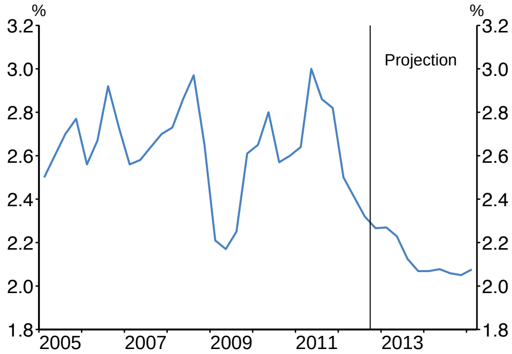
Figure 5.10
Net foreign liabilities
(share of nominal GDP)



Source: Statistics NZ, RBNZ estimates.

Fiscal consolidation and the decline in consumption growth over the medium term enable residential investment to increase rapidly without placing significant pressure on spare resources. Consistent with this, non-tradable inflation is expected to increase only modestly over the medium term. In addition, inflation expectations have declined sharply following their post-GST increase high, and are expected to remain well anchored over the projection horizon (figure 5.11).

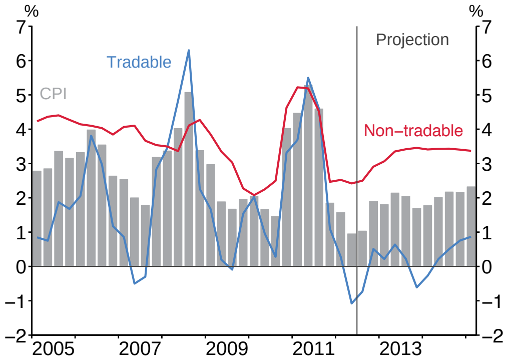
Figure 5.11
2-year-ahead inflation expectations
(annual)



Source: RBNZ estimates.

Tradable inflation pressures are expected to increase as the New Zealand dollar TWI eases off its current highs over the projection. However, the soft outlook for global activity implies that the increase in tradable inflation will be modest. Headline CPI inflation is expected to settle near the middle of the target range over the medium term (figure 5.12).

Figure 5.12
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 seasonally adjusted)

		GDP Quarterly	CPI Quarterly	CPI Annual	TWI	90-day bank bill rate
2004	Mar	1.5	0.4	1.5	66.8	5.5
	Jun	0.8	0.8	2.4	64.0	5.9
	Sep	0.2	0.6	2.5	66.3	6.4
	Dec	0.3	0.9	2.7	68.6	6.7
2005	Mar	1.0	0.4	2.8	69.6	6.9
	Jun	2.0	0.9	2.8	70.8	7.0
	Sep	0.4	1.1	3.4	69.7	7.0
	Dec	-0.5	0.7	3.2	71.5	7.5
2006	Mar	1.1	0.6	3.3	68.2	7.5
	Jun	0.5	1.5	4.0	62.8	7.5
	Sep	0.4	0.7	3.5	63.6	7.5
	Dec	0.8	-0.2	2.6	67.0	7.6
2007	Mar	1.1	0.5	2.5	68.8	7.8
	Jun	0.5	1.0	2.0	72.0	8.1
	Sep	0.6	0.5	1.8	71.4	8.7
	Dec	0.4	1.2	3.2	71.0	8.8
2008	Mar	-0.0	0.7	3.4	71.9	8.8
	Jun	-0.9	1.6	4.0	69.3	8.8
	Sep	-0.1	1.5	5.1	65.5	8.2
	Dec	-0.8	-0.5	3.4	57.8	6.3
2009	Mar	-1.6	0.3	3.0	53.7	3.7
	Jun	-0.5	0.6	1.9	58.4	2.9
	Sep	0.3	1.3	1.7	62.6	2.8
	Dec	1.0	-0.2	2.0	65.5	2.8
2010	Mar	0.6	0.4	2.0	65.3	2.7
	Jun	0.7	0.2	1.7	66.8	2.9
	Sep	-0.1	1.1	1.5	66.9	3.2
	Dec	-0.0	2.3	4.0	67.8	3.2
2011	Mar	0.6	0.8	4.5	67.1	3.0
	Jun	0.4	1.0	5.3	69.1	2.7
	Sep	0.4	0.4	4.6	72.0	2.8
	Dec	0.4	-0.3	1.8	68.7	2.7
2012	Mar	1.1	0.5	1.6	72.5	2.7
	Jun	0.4	0.3	1.0	71.2	2.6
	Sep	0.4	0.5	1.0	72.7	2.7
	Dec	0.7	0.5	1.9	72.0	2.7
2013	Mar	0.7	0.4	1.8	71.7	2.7
	Jun	0.8	0.7	2.1	71.5	2.7
	Sep	0.8	0.4	2.0	71.1	2.7
	Dec	0.8	0.2	1.7	70.7	2.8
2014	Mar	0.6	0.5	1.8	70.3	2.9
	Jun	0.5	0.9	2.0	69.9	3.0
	Sep	0.4	0.6	2.2	69.5	3.1
	Dec	0.4	0.2	2.2	69.0	3.2
2015	Mar	0.4	0.7	2.3	68.6	3.3

[1] Notes for these tables follow on pages 24 and 25.

Table B

Measures of inflation and inflation expectations

(annual)

	2010		2011				2012
	Dec	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**
CPI	**4.0**	**4.5**	**5.3**	**4.6**	**1.8**	**1.6**	**1.0**
CPI components							
CPI non-tradable	4.6	5.2	5.2	4.5	2.5	2.5	2.4
Non-tradables housing component	2.7	2.8	3.0	2.9	2.0	2.4	2.2
Non-tradables ex housing, cigarettes and tobacco component	4.8	5.1	5.5	5.0	2.5	2.2	2.1
CPI tradable	3.3	3.7	5.5	4.6	1.1	0.3	-1.1
Petrol	14.2	17.1	20.1	17.7	11.2	3.7	0.2
Other inflation measures							
Sectoral factor model estimate of core CPI inflation ex-GST	2.0	2.2	2.2	2.0	1.8	1.6	1.6
CPI trimmed mean (of annual price change) ex-GST	1.9	2.3	3.1	2.6	2.1	1.7	1.2
CPI weighted median (of annual price change) ex-GST	1.5	1.7	2.2	2.1	2.1	2.0	1.8
CPI ex food, petrol and government charges *	2.8	3.1	3.4	3.2	1.0	1.5	1.0
CPI ex food and energy	3.1	3.3	3.6	3.2	1.1	1.6	1.2
GDP deflator (derived from expenditure data)	7.1	4.3	4.5	3.1	0.6	0.4	n/a

	2010		2011				2012	
	Dec	**Mar**	**Jun**	**Sep**	**Dec**	**Mar**	**Jun**	**Sep**
Inflation expectation measures								
RBNZ Survey of Expectations - inflation one-year-ahead	3.4	2.9	3.1	2.9	2.7	2.2	2.0	2.0
RBNZ Survey of Expectations - inflation two-years-ahead	2.6	2.6	3.0	2.9	2.8	2.5	2.4	2.3
AON Hewitt Economist survey - inflation one-year-ahead	4.3	2.6	3.0	2.8	2.5	2.3	2.2	2.0
AON Hewitt Economist survey - inflation four-years-ahead	2.5	2.4	2.6	2.7	2.5	2.5	2.5	2.5
NBBO - inflation one-year-ahead (quarterly average)	2.9	3.0	3.2	3.3	3.1	2.7	2.7	n/a

* 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	2.7	3.4	-1.7	0.4	1.6	2.0	2.6	2.8	1.3
Public authority	4.6	4.7	4.1	5.2	4.6	0.2	0.3	0.4	-0.9	-0.2	0.6
Total	4.5	4.5	3.0	3.8	-0.3	0.3	1.3	1.6	1.8	2.1	1.2
Gross fixed capital formation											
Market sector:											
Residential	2.3	-5.0	-1.9	1.6	-22.5	-12.0	3.7	-11.7	22.3	27.8	11.8
Business	10.2	10.3	-3.4	10.4	-7.9	-14.5	9.4	2.6	8.9	8.5	5.1
Non-market government sector	10.8	6.4	2.2	-10.7	27.8	-5.1	-13.6	-12.3	-3.5	4.1	4.1
Total	8.3	6.6	-2.7	7.0	-8.5	-13.3	6.2	-0.9	9.9	11.4	6.3
Final domestic expenditure	5.4	5.0	1.5	4.6	-2.4	-2.9	2.3	1.1	3.5	4.2	2.4
Stockbuilding[1]	0.2	-0.5	-1.2	1.2	-0.5	-1.3	1.3	0.7	0.1	-0.3	-0.1
Gross national expenditure	5.9	4.7	0.2	5.9	-2.4	-3.7	3.1	2.5	3.2	3.8	2.3
Exports of goods and services	4.9	-0.1	3.0	3.4	-3.0	4.8	2.0	1.9	1.3	1.9	2.2
Imports of goods and services	12.2	4.3	-1.5	10.4	-4.3	-9.3	11.0	6.1	3.4	4.4	2.6
Expenditure on GDP	3.5	3.3	1.6	3.6	-1.9	1.0	0.2	1.0	2.5	3.0	2.2
GDP (production)	3.6	3.3	2.2	2.5	-1.4	-1.2	1.8	1.7	2.4	2.9	2.2
GDP (production, March qtr to March qtr)	2.3	3.1	2.9	1.4	-3.2	1.4	1.2	2.4	2.2	3.0	1.7

[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	1.6	1.8	1.8	2.3
Labour costs	2.5	3.0	3.0	3.5	3.1	1.3	2.0	2.1	2.1	2.1	2.2
Import prices (in New Zealand dollars)	3.7	3.0	2.5	12.0	7.4	-8.4	8.2	-3.3	-6.0	3.2	5.9
Export prices (in New Zealand dollars)	1.3	7.4	0.7	0.4	17.4	-11.1	3.6	-1.8	-4.6	2.8	4.4
Monetary conditions											
90-day rate (year average)	6.5	7.3	7.6	8.6	6.7	2.8	3.1	2.7	2.7	2.7	3.1
TWI (year average)	67.1	70.1	65.6	71.6	61.6	62.9	67.1	70.6	71.9	70.9	69.2
Output											
GDP (production, annual average % change)	3.6	3.3	2.2	2.5	-1.4	-1.2	1.8	1.7	2.4	2.9	2.2
Potential output (annual average % change)	3.3	2.9	2.4	2.0	1.6	1.0	1.2	1.4	1.7	2.0	2.3
Output gap (% of potential GDP, year average)	2.3	2.7	2.6	3.1	0.1	-2.1	-1.5	-1.3	-0.5	0.5	0.5
Labour market											
Total employment (seasonally adjusted)	3.7	2.8	2.0	-0.3	0.7	-0.1	1.7	0.9	1.7	2.6	0.8
Unemployment rate (March qtr, seasonally adjusted)	3.9	4.0	3.9	3.9	5.1	6.1	6.6	6.7	6.4	5.3	4.9
Trend labour productivity	1.0	1.0	0.9	0.7	0.5	0.4	0.5	0.6	0.6	0.7	0.9
Key balances											
Government operating balance (% of GDP, year to June)	4.7	4.4	3.5	3.1	-2.1	-3.4	-9.5	-4.2	-4.1	-1.4	-0.7
Current account balance (% of GDP)	-6.2	-8.7	-8.0	-8.0	-7.9	-1.9	-3.7	-4.9	-5.4	-5.7	-5.2
Terms of trade (SNA measure, annual average % change)	3.3	-1.1	-1.3	8.6	-2.0	-4.7	8.0	1.5	-2.3	0.0	1.5
Household saving rate (% of disposable income)	-6.0	-7.9	-6.7	-3.0	-4.5	-1.5	0.2	-1.0	-2.1	-1.0	0.7
World economy											
Trading partner GDP (annual average % change)	3.8	3.8	3.8	4.3	0.1	1.2	4.3	3.3	3.2	3.6	3.8
Trading partner CPI (TWI weighted, annual % change)	2.1	2.4	1.9	3.3	0.9	1.7	2.2	2.2	1.6	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. System of National Accounts.
Export prices	Domestic currency export prices. System of National Accounts.
Terms of trade	Constructed using domestic currency export and import prices. System of National Accounts
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 Domestic Income	The real purchasing power of domestic income, taking into account changes in the terms of trade. 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)	Gross Domestic Product. 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	$(\text{Quarter}/\text{Quarter}_{-1} - 1)*100$
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 Reserve Bank staff during the projection round

Andar Holdings Ltd
Ashburton District Council
Bayleys Realty Group Ltd
Beca Ltd
Canterbury Development Corporation
Colliers International New Zealand Ltd
Collins Mitre10 Ltd
Croys Ltd
Dan Cosgrove Ltd
Darroch Ltd
Destination Marlborough
Duncan Ag Ltd
Electricity Ashburton Ltd
Employers & Manufacturers Assoc. (Northern)
Flight Timbers Ltd
Forrest Estate Winery Ltd
Fulton Hogan Ltd
G E Capital Ltd
Gibbons Holdings Ltd
Harcourts Group Ltd
Harris Home Fires
Harrison Grierson Consultants Ltd
Highfield Estate Ltd
IDC New Zealand Ltd
J Ballantyne & Co Ltd
KordaMentha
Landcorp Farming Ltd
Loyalty New Zealand Ltd
Mace Engineering Ltd
Macpac Ltd
Macrennie Commercial Construction Ltd
Marlborough District Council
Ministry of Business Innovation and Employment
National Aluminium Ltd
Nelson Pine Industries Ltd
Nelson Tasman Chamber of Commerce
New Zealand Agricultural Machinery Group
New Zealand Transport Agency
Noel Leeming Ltd
NZ Council of Trade Unions
NZ Engineering, Printing and Manufacturing Union (EPMU)
OCG Consulting Ltd
Paper Plus New Zealand Ltd
Paymark Ltd
Port Nelson Ltd
Ports of Auckland Ltd
PwC New Zealand Ltd
PrimePort Timaru Ltd
Rata Industries Group Ltd
Ray White New Zealand Ltd
Smith & Caughey Ltd
Subaru New Zealand Ltd
Tait Communications
Talbot Technologies Ltd
The Neil Group Ltd
The New Zealand Sock Company Ltd
Tyco Fire Protection Products Ltd
Veda Advantage Ltd
Vero Insurance New Zealand Ltd
Wakatu Incorporation

Appendix C
Reserve Bank statements on monetary policy

OCR unchanged at 2.5 percent

14 June 2012

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

Reserve Bank Governor Alan Bollard said: “New Zealand’s economic outlook has weakened a little since the March *Monetary Policy Statement*.

“Political and economic stresses in Europe, along with a run of weaker-than-expected data, have seen New Zealand’s trading partner outlook worsen. Furthermore, there is a small but growing risk that conditions in the euro area deteriorate more markedly than is projected in the June Statement. The Bank is monitoring euro-area developments carefully given the potential for rapid change.

“Increased agricultural production and the weakened global outlook have driven New Zealand’s export commodity prices lower. The resulting moderation in export incomes, although partially offset by depreciation in the exchange rate, will weigh on economic activity in New Zealand. Fiscal consolidation is also likely to constrain demand growth going forward.

“Offsetting these negative influences, housing market activity continues to increase, supported by recent reductions in mortgage interest rates. In addition, repairs and reconstruction in Canterbury are expected to substantially boost construction sector activity in coming quarters. Aggregate GDP growth is projected to pick up slightly to just over 3 percent next year. Given this economic outlook, inflation is expected to settle near the mid-point of the target range.

“It remains appropriate for monetary policy to remain stimulatory, with the OCR being held at 2.5 percent.”

OCR unchanged at 2.5 percent

26 July 2012

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

Reserve Bank Governor Alan Bollard said: “New Zealand’s economic outlook remains consistent with that described in the June *Monetary Policy Statement*.

“New Zealand’s trading partner outlook remains poor, with several euro-area economies in recession. There remains a limited risk that conditions in the euro area deteriorate very significantly. The Bank continues to monitor the situation carefully given the potential for rapid change.

“Domestically, the Bank continues to expect economic activity to grow modestly over the next few years. Housing market activity continues to increase as forecast, and repairs and reconstruction in Canterbury are expected to further boost the construction sector. Offsetting this, fiscal consolidation and the exchange rate are constraining demand growth.

“Underlying annual inflation, which recently moved below 2 percent, is expected to settle near the mid-point of the target range over the medium term.

“It remains appropriate for the OCR to be held 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	8 March 2012	2.50
23 January 2003	5.75	13 September 2007	8.25	26 April 2012	2.50
6 March 2003	5.75	25 October 2007	8.25	14 June 2012	2.50
24 April 2003	5.50	6 December 2007	8.25	26 July 2012	2.50
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 (OCR) announcements. 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.

Announcements are made at 9.00am on the day concerned and are posted to the website shortly after.

2012

25 October 2012	OCR announcement
6 December 2012	*Monetary Policy Statement* and OCR announcement (Media conference and webcast)

2013

31 January 2013	OCR announcement
14 March 2013	*Monetary Policy Statement* and OCR announcement (Media conference and webcast)
24 April 2013*	OCR announcement
13 June 2013	*Monetary Policy Statement* and OCR announcement (Media conference and webcast)
25 July 2013	OCR announcement
12 September 2013	*Monetary Policy Statement* and OCR announcement (Media conference and webcast)
31 October 2013	OCR announcement
12 December 2013	*Monetary Policy Statement* and OCR announcement (Media conference and webcast)

2014

30 January 2014	OCR announcement
13 March 2014	*Monetary Policy Statement* and OCR announcement (Media conference and webcast)
24 April 2014	OCR announcement
12 June 2014	*Monetary Policy Statement* and OCR announcement (Media conference and webcast)

* Please note: this announcement will be held on a Wednesday, as Thursday 25 April is a public holiday.

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