

ASB Quarterly Economic Forecasts



This too shall pass

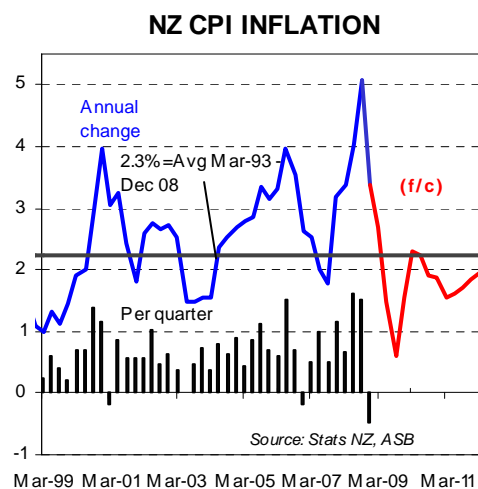
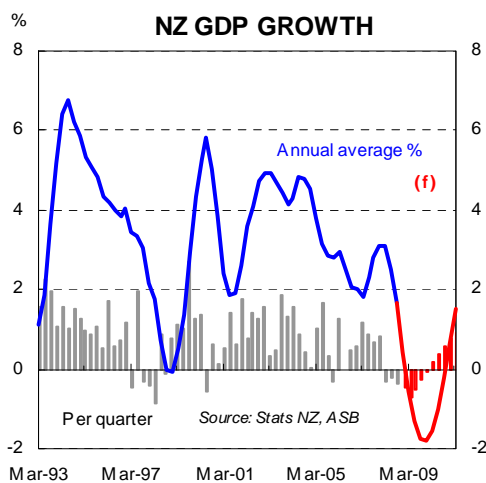
- The global economic impact of the credit crunch is clearer – and looks set to be severe.
- 2009 will be tougher than 2008, as an already-weakened NZ gets buffeted by the global shock.
- Global policy actions will lay foundation for a 2010 recovery.

The title of our latest Quarterly is from a tale retold by Abraham Lincoln. It is essentially a reminder that the good times will not last forever. But it also serves as a reminder that hard times also come to an end.

This year we may need to keep reminding ourselves of that last point. The outlook we paint in this Quarterly is grim: we see a good chance of the NZ economy remaining in recession over 2009 before recovery takes hold. In the last couple of months it has become increasingly apparent that the global fallout of the credit crunch will be severe. Already we have seen Q4 quarterly GDP falls of 1.5% in the UK, 1% in the US and 5.6% in South Korea (that is a quarterly contraction, and is not a misprint!). The slowdown is being described as the worst since the Second World War. The IMF sees global growth of just 0.5% for this year, with developed countries contracting and developing nations growing only modestly. Those forecasts assumed vigorous and co-ordinated government action would take place – an assumption that may not be fully met. For NZ's main trading partners, which are weighted to the developed world, it is conceivable they could collectively shrink up to 1% this year. For your interest we have compiled summaries of past major economic crises around the globe, which give some insight into their causes and their resolution.

With this bleak global backdrop, an already-weakened NZ economy will feel the shockwave. It may not come with the abruptness that industrial Asia is currently experiencing, but it is likely to be noticeable over the course of the year. In response we are seeing a lot of action being taken. The RBNZ has already dropped the OCR to 3.5%, and we judge a finish point of 2% is very conceivable. The NZD has fallen considerably. NZ's fiscal stimulus is already set to be quite significant and further fiscal initiatives are likely to be chosen to maximise their bang for buck. Neither the RBNZ nor the Government can stave off further downturn in 2009. But their actions will take some of the edge off it and sow the seeds for recovery in 2010.

It has been the season for stirring inaugural speeches, so we will start to wrap up with the famous quote from Franklin D. Roosevelt in the depths of the Great Depression: "the only thing we have to fear is fear itself". This year holds a lot of uncertainty, which human beings inherently dislike. Many things will happen that are beyond our individual control. What we do have control over is how we respond to those developments, both in reaction and in anticipation. The challenge we face this year is making our responses the best they can be under the circumstances. We need to focus on pulling through this year, but also focus on where we want to head when we come out the other end. The first involves a degree of caution and prudence. But we also shouldn't lose sight of opportunities to benefit beyond the here and now, such as buying discounted assets, locking in supply contracts at cheap prices, or fixing debt for long terms at low rates. At the very least we can address our fear of the unknown by keeping ourselves informed about what is happening and why.



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General Advice Warning

As this report was prepared without taking into account your objectives, financial situation or particular needs, you should not take any action in reliance of this report without considering your particular circumstances and, if necessary, obtaining professional advice.

The Credit Crisis: How did we get here?

Global imbalances lie behind easy credit access.

The origin of the current financial crisis lies within the growing imbalances between net saver and net debtor countries and strong debt-fuelled growth in housing markets, particularly in Anglo-Saxon countries. The global economy was awash with cash looking for a return and risk became underpriced. This, coupled with woeful credit standards in the US, has created a toxic mess.

Low interest rates stimulate housing boom.

Low interest rates over 2003 further stimulated a US housing boom, with strong growth in sub-prime lending an increasingly important driver. Lending criteria became increasingly lenient, with even government sponsored enterprises Fannie Mae and Freddie Mac underwriting low-doc loans. The separation between the mortgage broker, banks and the securitisation of mortgages also meant the ultimate lenders of money were completely removed from the borrowers. Critically, the incentives were not set up to ensure adequate credit checks were made.

Rising interest rates trigger rise in sub-prime defaults.

Rising interest rates triggered an increase in the sub-prime mortgage default rate. The rise in defaults exacerbated an already weakening housing market. Falling house prices, combined with rising defaults resulted in a decline in value of mortgage-backed securities (the securitisation of mortgages, which are then on-sold to investors, is a common way to facilitate credit growth in the US financial system). As the full extent of the losses associated with these often complex products became realised, investment banks left hold sup-prime securities found themselves in desperate need to either deleverage or recapitalise.

Mortgage-backed securities lose value.

Exposed investment banks increasingly found themselves in trouble. The difficulties came to a head with the demise of Bear Sterns (bought out by JP Morgan), Lehman Brothers (filed for bankruptcy), and the government bail-out of insurance company AIG as well as Fannie Mae and Freddie Mac.

Exposed investment banks in trouble.

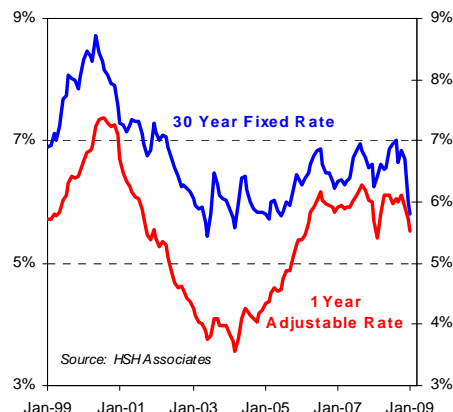
Risk aversion quickly set in. Fear of counter-party risk resulted in the credit markets freezing up in October. This presented additional problems for financial institutions on a 'borrow short-term, lend long-term' business model. These had become popular in UK and Europe (i.e. Northern Rock). Difficulties in sourcing wholesale funding further exacerbated the housing market slump in the UK. In some respects, the UK financial sector is in worse shape, with the UK Government forced into becoming a significant shareholder in several key banks.

Risk aversion freezes capital markets.

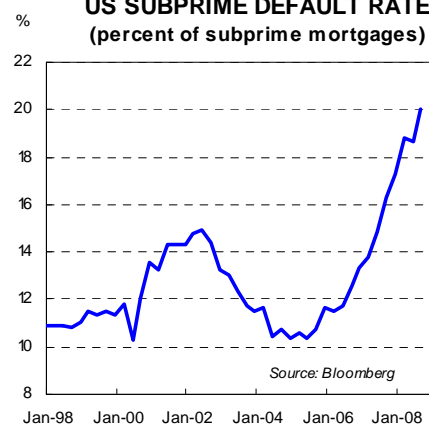
The ultimate recovery, and willingness to lend, lies in the stabilisation of the US housing market, particularly prices and defaults. The same applies in the UK. But this also requires some improvement in credit market conditions. The Federal Reserve is working hard on this front, and has had some modest success in lowering mortgage rates. It will be a slow road to recovery.

Stabilising US housing market key.

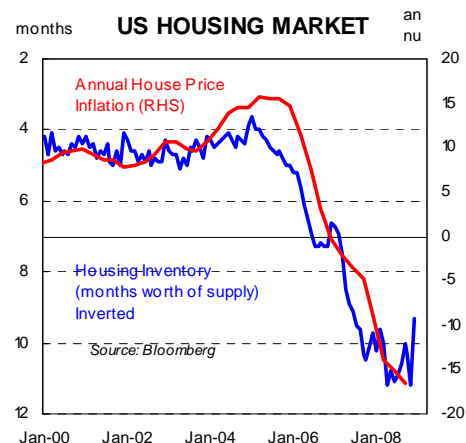
US MORTGAGE RATES



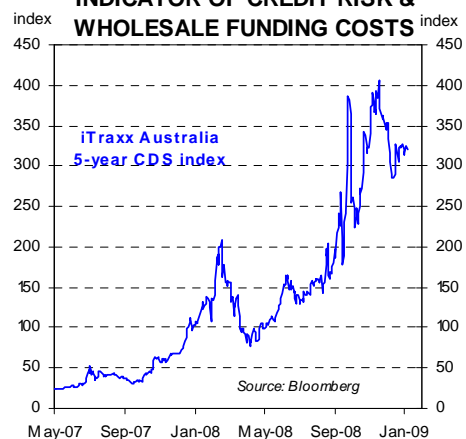
US SUBPRIME DEFAULT RATE (percent of subprime mortgages)



US HOUSING MARKET



INDICATOR OF CREDIT RISK & WHOLESALE FUNDING COSTS



FACTBOX

The Great Depression: shocks of greater magnitude than today.

Roaring '20's ended in tears.

The Great Depression was a global economic downturn which began in 1929. The Depression ended in different countries in the 1930s or early 1940s. Specific causes of the Great Depression are still keenly debated, however key events include: a collapse of the speculative bubble in the US sharemarket; widespread deflation, including commodity prices; dramatic drops in demand and credit; and disruption of trade. The preceding huge US economic boom in the 1920s, which ended with the stock market crash in October 1929, also needs to be taken into account. The global downturn resulted in dramatic drops in output and widespread unemployment in many economies. The Gold Standard of the time placed constraints on policy makers, and this magnified the initial shock of the US share market crash in 1929 and helped transmit problems around the world – particularly deflation. Generally, the earlier a country abandoned the Gold Standard, the earlier its economy recovered.

1930's characterised by widespread unemployment.

.. and massive declines in output.

The major initial contraction in the United States was between 1929 and 1933. Economic output fell nearly 30%, the unemployment rate rose from about 3% to nearly 25%, and prices fell at a rate near 10% per year.

President Roosevelt (elected 1932) largely blamed the excesses of big business for causing the unstable, speculative characteristics of the economy in the 1920s. The New Deal was FDR's remedy, and raised taxes on corporate profits as well as empowering labor unions and farmers. Regulation of the economy was the preferred policy at the time.

International trade shock.

A sharp decline in international trade after 1930 worsened the depression, particularly in countries dependent on foreign trade such as Australia and New Zealand. The US Smoot-Hawley Tariff Act (1930) is seen as a key cause of reduced international trade and a cause of retaliatory tariffs by other countries. Between 1929 and 1933 the physical volume of US exports halved.

In contrast to today, the Fed and the US Government initially did little to prevent the bank failures in the US. Farm prices plummeted in the late 1920s. Farmers suffered as crop prices were too low to allow them to pay off loans. Small rural banks struggled and there were many failures. City banks also suffered. Mistakes included: failing to maintain adequate reserves; investing heavily in the stock market; and making risky loans.

A holiday for banks.

The banking crisis intensified during the transition from President Hoover to Roosevelt. Roosevelt started his first term in the White House on 4 March 1933. By then, fear of more bank failures was causing bank runs. Withdrawals by depositors ran down cash holdings and threatened the entire banking system. On his second day in office, Roosevelt declared a "bank holiday". The holiday closed banks nationwide for four days. Roosevelt was able to put emergency measures in place, and the four-day break also physically halted the runs on banks. By mid-March, banks were up and running again. By 1933, half of US banks had failed or merged with other banks. Banking failures also occurred in Europe.

Great Depression impact in NZ

Trade hit hard.

New Zealand suffered badly during the depression, with overseas trade hit particularly hard. It is estimated that exports nearly halved during the Depression. Wool prices dropped 60%, and dairy prices dropped, albeit by lesser amounts. As well as suffering from a trade downturn, New Zealand's balance of payments was weakened by a large overseas debt burden. National income is estimated to have fallen by 40% over the three worst years of the depression. However the unemployment rate in New Zealand may have been lower than in other countries. The number of unemployed was possibly around 70,000, in a population of 1.5 million. Numbers were not officially counted, and there were no benefit payments. Instead, the unemployed were given so called "relief work". From a welfare perspective, the country was quite unprepared for a major shock relative to today, and entered the depression without any provision for unemployment benefits. The "slump", as it was also known, brought widespread poverty, which led to riots in cities.

Country unprepared for unemployment.

Second World War marked the end on the era.

In November 1935, the Labour Party was elected, with Michael Joseph Savage becoming the first Labour Prime Minister. The new government introduced a comprehensive social welfare system, as well as compulsory unionism. Industrialisation and protection were promoted by government interventions in order to generate jobs (eg. 1938's import controls). By the end of the decade, Peter Fraser had take over the reins from an ailing Michael Savage, and became prime minister in 1940. The Second World War helped an overall recovery and in the early 1950s a wool boom helped the agricultural sector.

FACTBOX

Great Depression elsewhere in the world:

Australia really struggled during the early 1930s, due to a reliance on agricultural and industrial exports. Falling export demand and commodity prices led to wage drops and job losses. Unemployment reached 30% in 1932. An increase in wool and meat prices led to a gradual recovery after 1932. The Japanese economy only shrank by 8% between 1929–31. The Soviet Union was essentially unaffected by the Great Depression, due to the fact the communist country had removed itself from the capitalist world system.

1970's sharemarket shocker.

A sharemarket downturn comparable to today.

The 1973–1974 stock market crash affected all the major stock markets in the world. The economic situation was worsened by the oil crisis which started in October 1973. The Dow Jones Industrial Average benchmark lost over 45% of its value between January 1973 and December 1974. The London Stock Exchange's FT 30 index lost 73% of its value.

Blows to the New Zealand economy.

The New Zealand situation in early 1970s was influenced not only by the oil shock, but also Britain joining the European Economic Community in 1973. The loss of an assured market for agricultural products was a blow to the economy. The strains from the first oil shock of 1973 contributed to the fall of the Labour government in 1975. After the second oil shock, the National government of Robert Muldoon tried to protect New Zealand by so-called 'Think Big' industrial and energy projects, and farm subsidies. The fall of oil prices in the early 1980s undermined the need for the Think Big energy projects. The economy struggled in the early 1980s. Inflation and unemployment became significant problems.

A modern depression: Japan's Lost decade

Japan's economic miracle of the 1980's ended sharply in 1990.

Japan's economic miracle of the 1980s ended sharply in 1990. The combination of high land values and low interest rates led to easy, cheap credit. This fuelled massive borrowing and speculation. In the late 1980s the situation reached a crescendo. Debt was often secured against land, at prices which were unrealisable. Interest rates were raised in an attempt to slow down the speculative frenzy. This led to a crash in the stock market, and a bursting of the property bubble. A large proportion of the debts accumulated in the 1980s turned bad, and the value of land security and shares plummeted. Many banks had to be bailed out by the government. Consolidation took place in the banking sector. Many Japanese firms were burdened with debt, affecting their ability for capital investment. Credit was difficult to obtain, due to the struggling banks, despite interest rates going down to zero.

The 1980s asset price bubble called "baburu keiki" or Bubble Economy describes the period in which real estate and stock prices greatly inflated, to levels which in many cases have still not been revisited. The bursting in the early 1990s was the start of the "lost decade". The Japanese economy dipped in and out of recession all through the 1990s. Japan's annual growth rate in the 1990s decade was less than half of the rate in the preceding decade.

What went wrong in Japan?

Response speed is important.

Slow government response and inefficient, poorly targeted fiscal stimulus were significant contributors to the lost decade. Lack of economic reforms still plague domestic industry, whilst export industries are more efficient and exposed to global competition. Key to an eventual recovery in Japan was the restoration of bank balance sheets. The failure of several US banks and the swift recapitalisation of others is seen as an important contrast between the Japanese situation in the 1990s and the financial crisis of today.

1997- 98 Asian Crisis: A short, sharp shock.

Asian crisis fuelled fears of a worldwide meltdown.

The Asian Financial Crisis began in July 1997, and peaked with fears of a worldwide economic meltdown. The crisis started in Thailand, where the economy was burdened with significant foreign debt. The Thai baht collapsed after the government cut the peg to the USD. The crisis had significant effects, including sharp depreciation of currencies, stock markets, and other asset prices of several Asian countries. Indonesia, South Korea and Thailand were the countries most affected by the crisis. The Korean economy contracted 33.1% in 1998.

New Zealand had a number of challenges at the time.

At the time, New Zealand was under strain from events starting in 1997: a collapse in demand from crisis-hit Asia; the impact of severe drought; and overlaid on these shocks was the impact of very firm monetary conditions. The shocks, combined with high interest rates and a strong New Zealand dollar in 1996-97, pushed the economy into recession at the end of 1997. The recession was short, and a recovery was underway by late 1998, stimulated by easing monetary conditions combined with tariff reductions and income tax cuts. In 1998 bank bills yields dropped from 9% to 4%, and the TWI eased over 10%.

International economies

Global economic outlook worst since WWII.

The deterioration in the global economic outlook has been exceptionally swift. The financial crisis is now having a very strong effect on the real economy. Global growth is widely expected to be the weakest since World War II, and the situation presents the biggest economic challenge since the Great Depression.

Developed economies in recession.

The US and the UK are most directly affected by the crisis in the banking and financial sector. Both have experienced swift economic disruption. The decline in employment has been extraordinary, with US non-farm payrolls recording job losses of over half a million per month over the past three months.

Transmission to Asia-Pacific swift.

However, more unexpected was the speed of transmission of the slowdown to the Asia Pacific economies. The drop in demand from western economies and the knock-on effects in the supply chain have been surprisingly swift, with several Asian economies contracting sharply in late 2008. The Chinese growth outlook has been rapidly revised down, with well below trend growth expected. Confidence in domestic demand sustaining Chinese economic growth is also waning. In turn, Australia has been directly affected by the sudden collapse in commodity prices.

NZ trading partner GDP to contract.

NZ trading partner growth has been sharply revised down. Since November, growth for 2009 GDP of our 12 main trading partners has been revised down from 1.2% growth to a 0.1% contraction. Further downward revisions are a given, and we expect that growth will end up being closer to a full 1% contraction. 2010 forecasts remain around 'trend rates' due to considerable uncertainty. There are forecasters continuing to expect a strong recovery in economic growth over 2010. However we believe this is more a 2011 story. Economic recessions triggered by financial crises tend to last twice as long as other recessions. We expect to see the 2010 growth outlook to also be revised down over coming months.

Economic recovery will be slow.

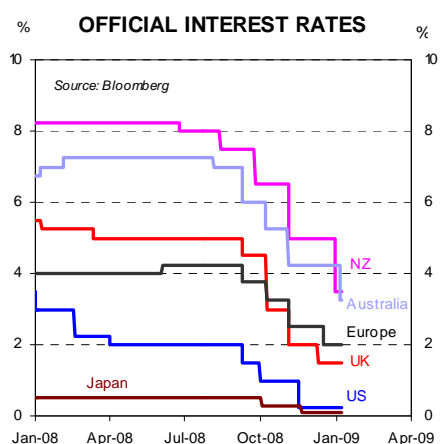
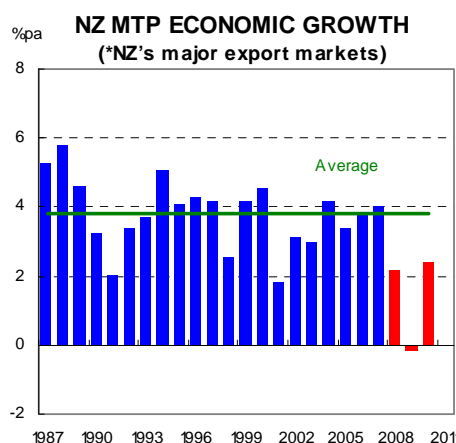
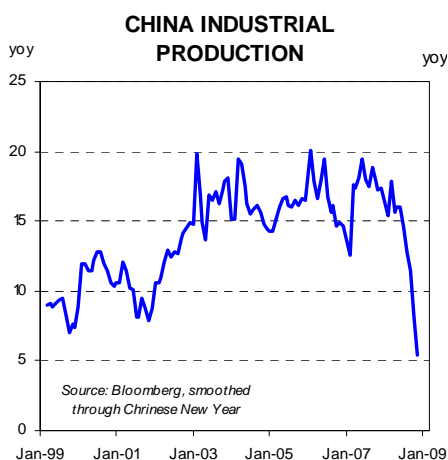
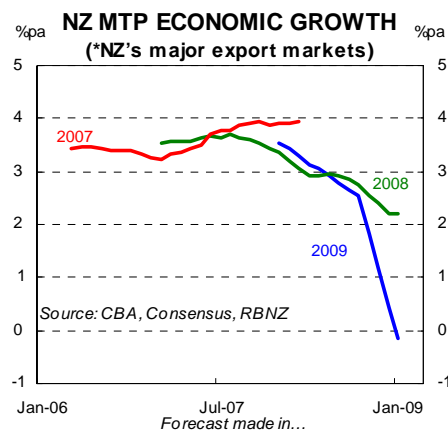
The policy response to the impending synchronised global recession has been almost as swift as the deterioration itself. Monetary policy has been used vigorously in affected countries. Policy rates have been aggressively slashed, and further cuts are likely. Monetary policy has been used at the first line of response, and will be the most effective at dealing with the heart of the problem. Importantly, central banks have not been shy in exploring alternative ways to increase the supply of credit. The Federal Reserve has been aggressively expanding its balance sheet, using its position to lower interest rates across the curve and across different products (i.e. buying mortgage-backed securities to lower mortgage rates). The fiscal response, while equally aggressive, will have a less immediate impact. While fiscal stimulus it will not prevent pain over 2009, it will be important in providing a floor for activity over 2010.

Policy response swift

Monetary policy first line of response.

Other tools useful.

Fiscal policy important for 2010.



The New Zealand Economy

NZ economy in recession over 2008.

Recession to intensify 2009.

Drought recovery buoys dairy export volumes.

But dairy prices extremely weak.

Manufactured and services exports to contract.

Housing market remains weak, prices to continue falling.

Further declines in housing construction.

2008 proved to be a much tougher year than anticipated. The drought-induced recession soon became a retail recession as consumers were hit by rising interest rates, petrol and food prices. The financial crisis intensified in late September/early October, with international credit markets freezing and now driving the global economy into a synchronised recession. At home, the recession intensified and become more broad-based as the year progressed. We expect the recession to continue throughout 2009. Growth will gradually resume over 2010 as the world works through its financial issues.

Global recession hits export sector

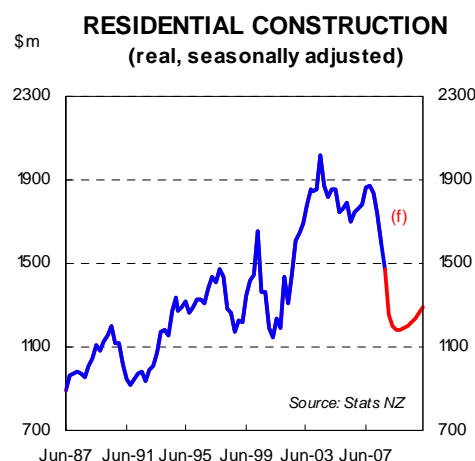
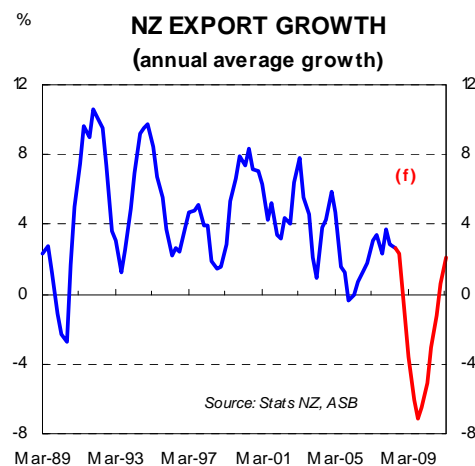
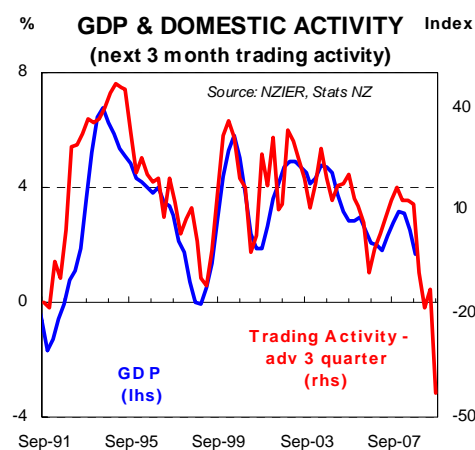
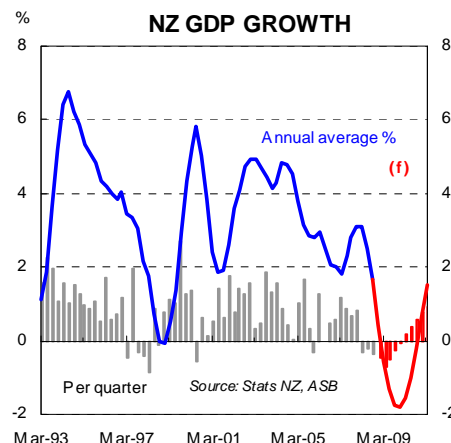
Export volumes fell steadily over 2008, led by the decline in dairy exports as a result of last summer's drought. While exports of dairy will inevitably recover in line with production, prices have fallen dramatically over recent months, which is likely to weigh on overall returns. US dollar dairy prices have fallen back to 2006 levels and Fonterra has revised down its forecast payout for the 2009 season to \$5.10 per kg of milk solid. This compares to the 2008 payout of \$7.90. The outlook for dairy prices remains soft. Asian demand is falling as growth rapidly slows and supply is high due to increased global production in response to rising prices over 2007. Weakening world demand has also led to declines in other commodity prices (such as meat and forestry) although the NZ dollar depreciation has mitigated some of the price declines.

The outlook for the rest of the export sector is bleak. Non-pastoral exports will decline sharply over 2009 as world demand slumps, with manufactured and services exports exposed. The lower exchange rate will provide insufficient offset to weak global demand.

Housing market weakness continues

Despite lower interest rates, demand in the housing market remains weighed down by weak confidence and increased employment uncertainty. House prices have fallen around 8% to date and we expect further declines throughout 2009. House sales data indicate there remains a large supply overhang in the housing market.

Housing construction contracted sharply over 2008 and some further (albeit smaller) declines throughout the first half of 2009 are expected. Falling house prices and weak net migration inflows have reduced the incentives to build. In addition, rising employment uncertainty and higher deposit requirements have dampened the stimulatory effect of lower interest rates. Housing construction should begin a recovery by late 2009/early 2010, underpinned by increased net migration.



Thrifty shoppers

Cash injection to households.

After struggling over much of 2008, households have received a timely cash injection from falling interest rates, falling petrol prices and tax cuts. Nonetheless, consumer confidence and retail spending remains comparatively weak. Rising unemployment, reduced job security and weaker prospects for income growth have seen consumers become more careful with spending decisions. We expect growth in consumer spending to remain weak over the next few years, as households focus more on saving.

But job uncertainty closes wallets.

Business under extreme pressure.

Business investment under pressure

Businesses are under extreme pressure, with confidence plummeting to its weakest levels in the Quarterly Survey of Business Opinion's 1970-onwards history. The weakness is broad-based across different sectors. Businesses report falling levels of activity, falling profitability, investment plans being cut back and employment numbers having to be cut by more than previously anticipated.

Levels of investment likely to be slashed.

The combination of current uncertainty, falling demand, falling profitability and the lower exchange rate are a triple threat to investment plans. In particular, businesses are likely to cut investment into plant and machinery and buildings. However, providing some offset to the decline in business investment will be government investment through a range of infrastructure projects.

Although govt investment to remains strong.

Swift change in the labour market

Employment through to the end of 2008 was surprisingly resilient; however the pendulum is swiftly swinging in the other direction.

Labour market changes abruptly.

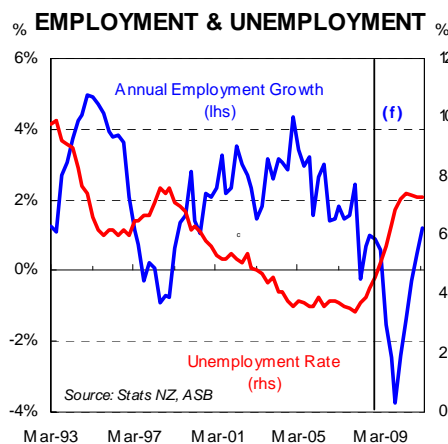
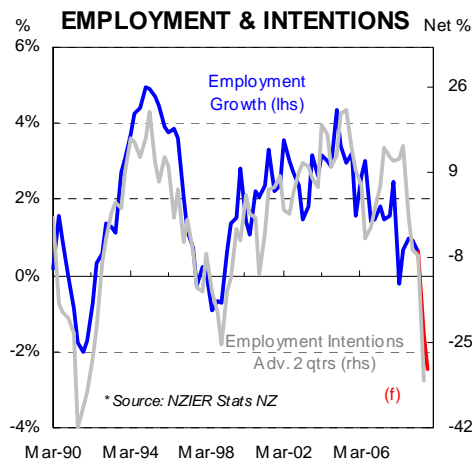
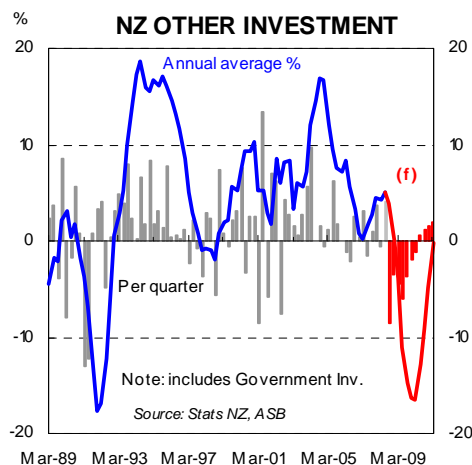
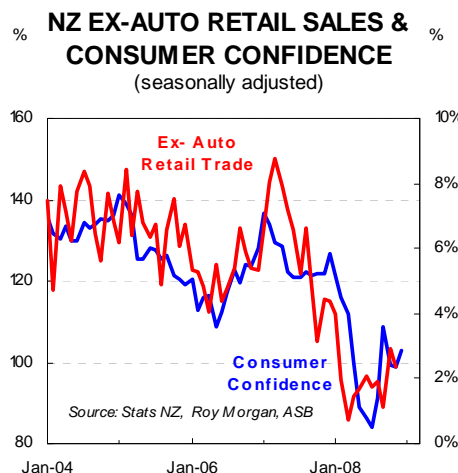
Businesses under pressure to reduce costs.

Businesses are now under extreme pressure and have an increased focus on reducing costs, including reducing head-count, either through active layoffs, or through attrition and a hiring freeze. In addition, the weaker economic environment has increased pressure to limit wage increases, with a weakening labour market likely to increasingly result in capped wages.

Skill shortages ease as employment falls.

The change in the labour market has been exceptionally swift, with firms already noting labour is increasingly easier to find. The QSBO survey suggests that the employment outlook deteriorated faster than firms had expected. Net 30% of firms surveyed expect to reduce staff levels over Q1 – one of the worse results since the early 1990's and consistent with a large contraction in employment in early 2009. By the end of 2009, we expect the number employed in the labour force to be down 3.7% on year-ago levels. As a result the unemployment rate will near 7.5% in mid-2010, from a low of 3.4% in December 2007.

Unemployment to reach 7.4%.



Inflation: a vanishing problem

Inflation to head down...

The swing in the inflation outlook has, like the economic outlook, been substantial. Although the starting point for inflation remains relatively high, sustained downward pressure will bring inflation into the bottom half of the 1% to 3% target band.

...but not without wild swings.

In the short term petrol and food price movements will continue to swing the annual rate around, inducing a marked (and very temporary) fall in headline inflation to below 1%.

Longer term it is the state of the economy that will contain inflation comfortably. This year the RBNZ won't be worrying about high inflation, though at a later date the Bank will start to look ahead to the potential inflationary impact of the domestic and global stimuli coming on stream.

Persistent inflation pressures to abate.

For years the stretched economy generated high and sustained inflation pressures. The housing boom directly boosted inflation through higher construction costs as well as through the wealth effect of higher house prices on consumer spending. Strong wage growth via the tight labour market was not matched by improved productivity growth, upping cost pressures in labour-intensive service sectors.

The unwinding of the construction boom and rapidly weaker labour market, along with sustained margin pressure, will dampen domestic inflation. However, administered inflation (e.g. rates, electricity prices) is likely to remain higher than overall inflation.

Imported inflation muted, despite weak NZD.

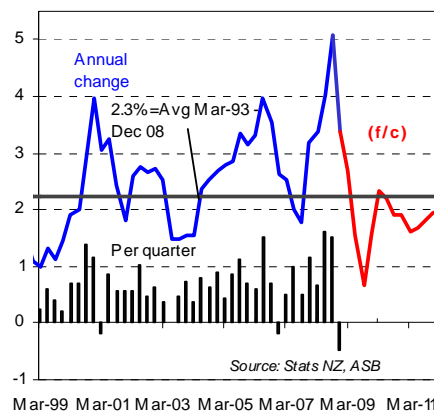
The other side of the coin is the impact of the lower exchange rate on the prices of imported goods. Ordinarily, a depreciation of the NZD of the magnitude we have seen recently would trigger a considerable lift in traded goods inflation. However, this time around the impact is highly likely to be muted. Global manufacturers, facing both reduced demand and lower raw materials costs, will take a knife to their own selling prices. Margins in the domestic supply chain will also be compressed.

Focus increasingly on how low inflation will fall.

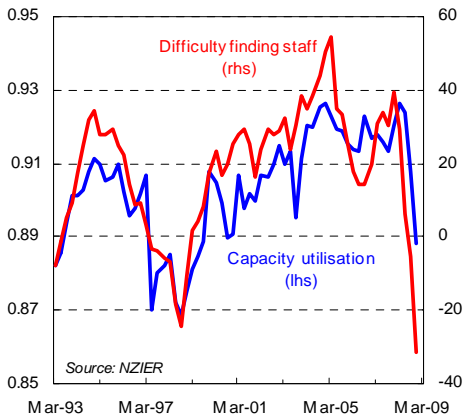
Rather than high inflation, we expect the RBNZ will increasingly focus on how low inflation might get over the next couple of years. Low inflation – or at least the expectation thereof – is a strong signal that the economy is running below its potential and needs boosting. Preventing deflation is just as critical as containing inflation – arguably more so as entrenched deflation is much harder to get rid of. For that reason the inflation target has a floor as well, to spur the RBNZ to maintain a positive rate of inflation.

Deflation is more of a risk for badly affected countries such as the US and UK, in which economic activity is being hit very hard, rather than NZ. Even so, the dramatic chain of global events means the RBNZ hasn't been short of signals to urgently cut interest rates.

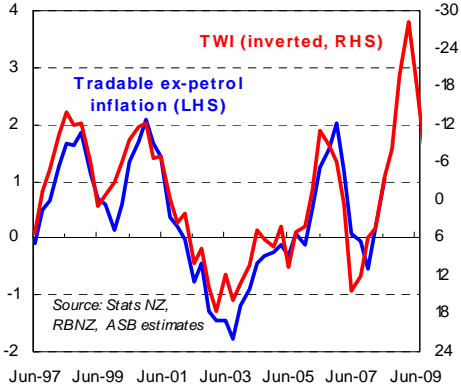
NZ CPI INFLATION



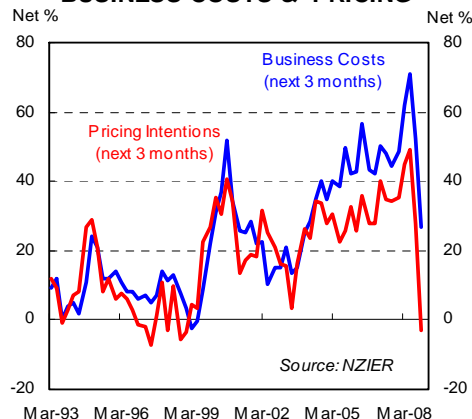
SUPPLY CONSTRAINTS



NZ EX-PETROL TRADABLE INFLATION & TWI



BUSINESS COSTS & PRICING



Interest rates and exchange rates

OCR could finish up at 2% - but outlook remains uncertain.

We expect the RBNZ will continue to cut the OCR in 2009, bringing the OCR down to an eventual finish point of 2% from the current 3.5%. It would be a huge understatement to say there is considerable uncertainty over the exact finish point. It will depend on the degree of stimulus the RBNZ judges is needed. Furthermore, if the OCR were to get close to zero it may start to lose influence over deposit and lending rates. In that case – if additional stimulus is needed – the RBNZ can use other tools, as other central banks have started to.

Borrowers: look to lock in low long-term rates.

For borrowers, we are at or near the point at which shifting floating rate loans into long fixed terms becomes a good option to ensure the dramatic plunge in rates gets locked in for a considerable period (assuming such terms are suitable for individual circumstances). Given huge global issuance of government debt there is no guarantee that the longer-term mortgages will sustain recent levels: more conservative borrowers may now want to consider locking low long-term fixed rates now rather than trying to pick the exact low (see ASB's [Home loan rate report](#))

Depositors: rates are likely to remain low in 2009 but probably rise in 2010.

On the deposit front, the outlook is for further declines in interest rates. We are likely to see sustained low interest rates over 2009, but rates could well start to normalise over 2010. This suggests considering term deposits of sufficient (but not too long a) length to mitigate further declines in the short term.

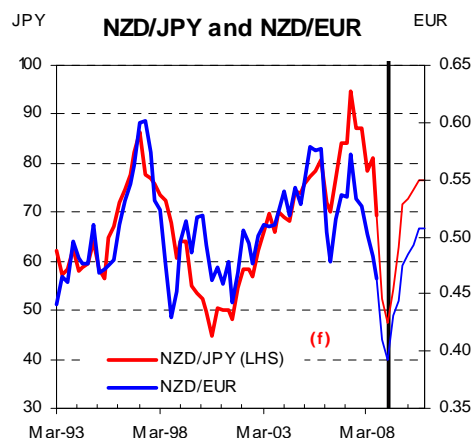
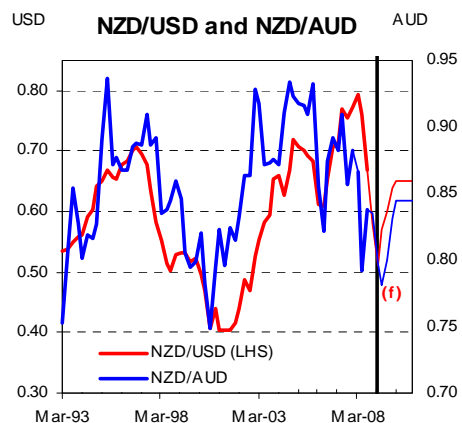
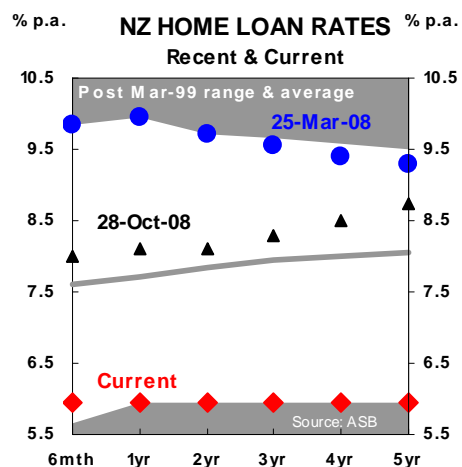
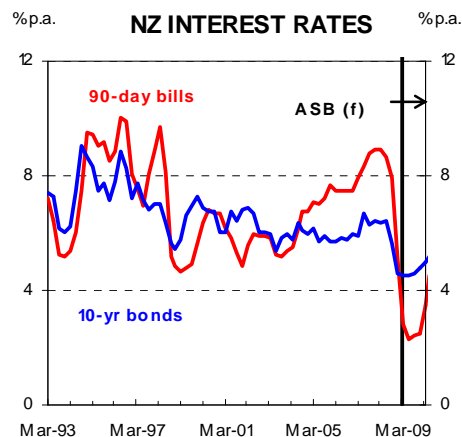
NZD likely to remain under pressure in early 2009....

In the short term the directional risk for the NZD remains down. As ever, the NZD is leveraged into global growth prospects, which in the here and now continue to dim. Our large external imbalance is also coming back to haunt us. Standard and Poors put NZ's foreign currency credit rating on negative creditwatch in response to the imminent switch to large fiscal deficits to match the current account. Several European countries have also either been put on negative watch or already been downgraded. The threat of a downgrade will hang over the NZD in the first half of the year.

...but may start to lift from mid-year on a resumption of USD weakness.

We see scope for the NZD to stage a degree of recovery in the second half of the year. Likely sources of upward pressure for the NZD then are: greater focus on global economic recovery (including NZ); prospect of higher NZ interest rates as the RBNZ looks to unwind the current oversized stimulus; and importantly weakness catching up with the USD and GBP. However, one weight on the NZD will be the ongoing stream of debt the Government will need to issue. Debt issuance will also influence the currencies of many other countries, though NZ has the disadvantage of being smaller – a downward risk for the NZD.

Government debt issuance a downside risk to that view.



ECONOMIC FORECASTS

ASB economic forecasts		Jun-08	Sep-08 << actual	Dec-08 forecast >>	Mar-09	Jun-09	Mar-10	Mar-11	Mar-12
NZ GDP real	AA%	2.5	1.7	0.4	-0.6	-1.3	-1.6	1.5	3.8
private consumption	AA%	2.2	1.1	0.2	-0.2	-0.2	0.6	1.4	2.4
dwelling construction	AA%	-1.6	-8.8	-17.5	-24.9	-28.8	-19.3	4.6	9.4
other investment	AA%	5.1	3.9	0.0	-3.8	-11.1	-16.4	-0.2	8.7
exports	AA%	2.7	2.4	-1.2	-3.5	-6.1	-5.1	2.1	5.0
imports	AA%	9.7	7.6	3.6	-0.5	-6.2	-8.0	1.3	4.6
NZ GDP real	A%	1.0	-0.1	-1.4	-1.7	-2.1	-0.7	2.7	4.0
NZ GDP real	Q%	-0.2	-0.4	-0.5	-0.7	-0.5			
NZ CPI	Q%	1.6	1.5	-0.5	0.0	0.4			
NZ CPI	A%	4.0	5.1	3.4	2.7	1.5	2.3	1.6	1.9
NZ house prices (QV index)	A%	-4.4	-6.7	-8.7	-9.3	-7.5	-3.2	1.7	2.7
NZ unemployment (sa%)	Qtr	3.9	4.2	4.6	5.1	5.6	7.2	7.3	6.3
NZ private sector wages (LCI)	A%	3.4	3.7	3.2	3.2	3.1	2.0	1.7	2.3
NZ current account (\$b)	Yr	-15.0	-15.5	-16.0	-15.9	-15.0	-13.8	-12.1	-11.5
as a % of GDP	Yr	-8.4	-8.6	-9.0	-9.1	-8.6	-8.0	-6.8	-6.2

A% = percentage change since same quarter the previous year
AA% = percentage change for year ending quarter since the previous year

FINANCIAL FORECASTS

ASB interest rate forecasts (end of quarter)	Sep-08	Dec-08 << actual	Mar-09 forecast >>	Jun-09	Sep-09	Mar-10	Mar-11
NZ cash rate target	7.50	5.00	2.50	2.00	2.00	3.00	5.50
NZ 90-day bank bill	7.96	5.11	2.8	2.3	2.4	3.5	5.7
NZ 3-year swap rate	6.92	4.92	3.9	3.8	3.9	4.9	6.5
NZ 10-year gov't stock	5.65	4.62	4.5	4.5	4.6	5.0	6.0
 ASB foreign exchange forecasts (end of quarter)	Sep-08	Dec-08 << actual	Mar-09 forecast >>	Jun-09	Jun-09	Mar-10	Mar-11
USD per NZD	0.668	0.578	0.51	0.57	0.60	0.65	0.65
GBP per NZD	0.371	0.401	0.35	0.38	0.39	0.41	0.41
AUD per NZD	0.837	0.835	0.80	0.78	0.80	0.84	0.84
JPY per NZD	69.5	52.2	47	54	63	73	77
EUR per NZD	0.464	0.411	0.39	0.43	0.44	0.49	0.51
TWI	63.3	56.3	51.7	56.3	59.6	65.0	66.4

<http://reports.asb.co.nz/index.html>

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