

# ASB Quarterly Economic Forecasts

## The only way is up?



- The economy stabilised in Q2 and is in the process of gradually recovering.
- Economy will remain vulnerable until business and export activity take baton from households.
- RBNZ likely to lift OCR in 2010Q2, notwithstanding persistent NZD strength vs. USD and GBP.

The world is starting to wake up from its synchronised recession, and in a pleasant development NZ is one of the earlybirds. The NZ economy began to stabilise over Q2 after a sizable dip in the 6 months that followed the escalation of the global financial crisis. Over the past year global debate has turned from will the financial system survive, to what impact will the financial meltdown have on the global economy, to what sort of recovery are we going to have.

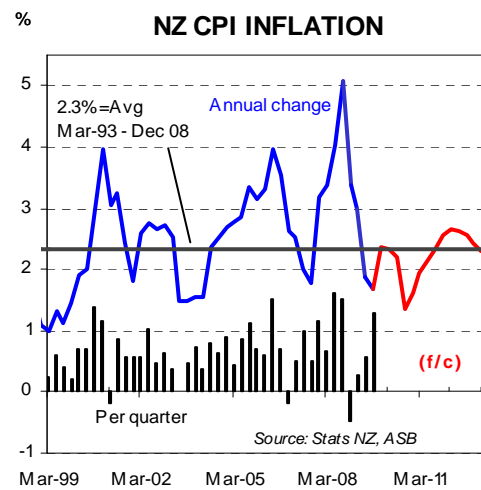
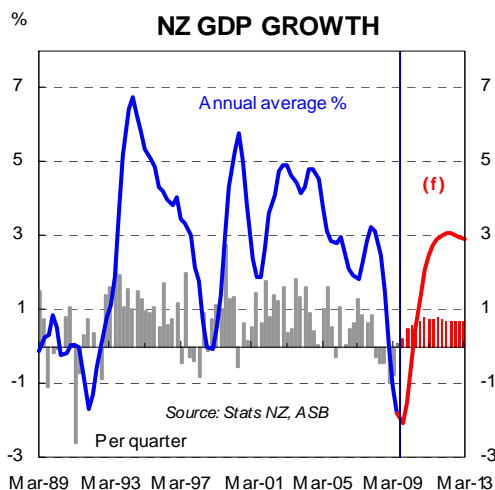
At present global manufacturing exporters are seeing a revival of production after being hit as retailers cut back orders to run down inventories. Just as Asia was hit hard initially by the inventory cycle, it is now recovering as orders resume. Fiscal stimuli in numerous countries have also helped stabilise domestic demand, including 'cash for clunkers' schemes in Germany and the US. Very low interest rates have certainly had a positive impact in Australia and NZ judging by renewed strength in housing markets.

The next stage of recovery will need to be more self sustaining, as the impact of fiscal and monetary stimuli will fade. Recovery will also be taking place against a background of reduction in leverage. So far, debt creation has been handed to governments as households step back from borrowing and repair their balance sheets. The next phase, reducing governments' debt build-up, is going to be a longer process and one that sees governments switch from boosting spending to curbing it.

NZ's recovery is initially being led by households through buying houses and blowing dust out of wallets, with an expected lift in housing construction to join in. But momentum from these areas can't be sustained indefinitely: durable recovery hinges on export earnings improving and businesses having good reason to spend on capital expenditure. Until those drivers kick in recovery will remain fragile and vulnerable.

For NZ the exchange rate is likely to remain an ongoing challenge. The lift this year is unhelpful for NZ's export sector. However, much of the move – and the current level – can be explained by NZ's relative fundamentals. At present the whole world is trying to have an export-led recovery, but the whole world can't have a currency devaluation to make life easier. NZ's economy and financial system have performed better than many. In this publication we look at the relative fundamentals driving the NZD and conclude that its recent level is broadly in line with them. Going forward the NZD is likely to remain relatively rangebound around average levels against several key exchange rates, but ongoing weakness in the US dollar is likely to keep the NZD/USD firm for some time yet.

NZ isn't out of the woods yet given the still-challenging global environment and one-trick pony nature of NZ's expected recovery in the short term. But to date it is encouraging how well NZ has held up during the most severe economic firestorm of the post-war period.



**Nick Tuffley** – ASB Chief Economist – 649 374 8604 – [nick.tuffley@asb.co.nz](mailto:nick.tuffley@asb.co.nz)  
**Jane Turner** – Economist – 649 374 8185 – [jane.turner@asb.co.nz](mailto:jane.turner@asb.co.nz)

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## NZD: The Flighty Bird

For this quarter's special topic we look at the fundamental drivers of the NZ dollar's current level and some additional contributors to exchange rate volatility.

Normally when NZ economic growth is weak the NZD would be lower, buffering the economy. On NZ's fundamentals alone, many would indeed expect a lower NZD. Further, the general consensus (which we agree with) is a lower NZD would be far more ideal for NZ's economic recovery. But exchange rates are relative, and the influences on the NZD cannot be looked at solely from a NZ perspective. The specifics surrounding the opposing currencies also matter – particularly at the moment. NZ has fared better than many countries through an extremely turbulent time. Much of the NZD's apparent strength can be explained by the unenviable economic situations of others. The better way of looking at the situation is not so much the NZD being strong but both the US dollar and the Pound being extremely weak.

Is there is solution to NZ's current foreign exchange quandary? No silver bullet stands out. Sustained weakness in the USD and Pound are driven by deep-seated economic problems those respective governments are struggling to solve.

Alternative currency arrangements, such as an often-mentioned currency union, have their costs to consider against the benefit of reducing some currency volatility. But NZ can focus economic policy on reducing the influence of NZ-specific factors on the NZD, particularly by reducing the amplitude of the household spending cycle. Such policies would also be consistent with promoting a more sustainable mix of economic growth.

### Fundamental drivers of the NZD

Exchange rates are the relative values of two currencies, hence the relative fundamentals are what matter for exchange rates. Growth and interest rate differentials, as well as strengthening commodity prices, are key fundamentals that influence the NZD.

**Growth.** NZ has experienced a significant downturn, but one that has been milder in magnitude than in many other countries. Since the crisis intensified in September last year the NZ economy contracted by under 2%, less than most of NZ's key trading partners experienced. NZ has registered (marginally) positive growth in the same quarter as the early rebounders, and ahead of the US and UK. The growth outlook for 2009 puts NZ at the stronger end (though more middle of the pack for 2010). The NZD tends to appreciate when the global economy is *expected* to improve, and the past six months has seen 'green shoots' springing up.

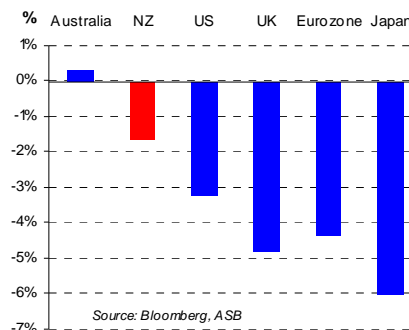
**Interest rates.** In NZ rates are very low by historical standards, but are still substantially higher than what investors can earn in the large economies. The traditional 'carry trade' involved borrowing Japanese yen at very low rates and investing in the higher rates available in the likes of NZ and Australia. Now there is the potential to borrow in not just yen but USD and Pounds. And global fund managers may be tempted to allocate cash to a country that pays higher interest rates and has a currency that is not under pressure.

*Fundamentals: it's all relative*

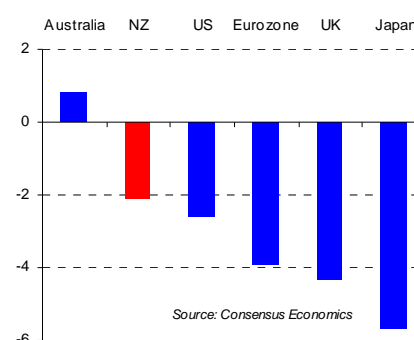
*NZ recession comparatively shallow*

*Relative interest rates, money magnet*

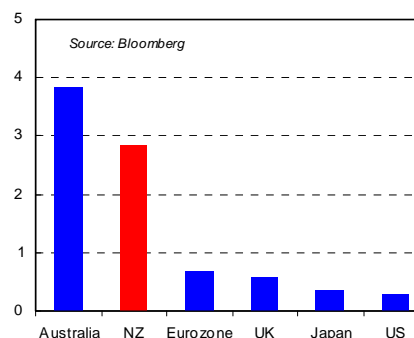
CUMULATIVE CHANGE IN GDP SINCE Q3 2008



2009 GDP GROWTH (Consensus Forecast)



90 DAY BANK BILL & 3 MONTH LIBOR



*Commodity prices, dairy's recent out performance*

**Commodities.** Prices for commodities in general, including some of NZ's key exports, have lifted sharply. Higher commodity prices are a signal that NZ's economic performance is likely to lift, and the NZD often rises and falls in coincidence with prices. In doing so the NZD smoothes out commodity price returns, taking the cream off the top in the good times but shoring up weaker prices in the bad times. Over recent months NZ export commodity prices have outperformed broader commodity prices, further supporting the NZD.

*Compared to average? Depends what NZD is against*

**Assessing the NZD's strength**

Where is the NZD sitting relative to the above influences? We have used two approaches: a qualitative assessment of where the NZD sits, taking into account various factors, and an estimate of current 'fair value'.

**Qualitative assessment.** The NZD is currently slightly below its respective 10-year average against the AUD, and around average against the euro and yen. It is substantially higher than average against the USD and the GBP. Arguably the fundamentals suggest the NZD should be a bit weaker relative to the AUD but higher against the EUR and, particularly, the yen.

*US and UK structural woes worse than NZ's economic problems*

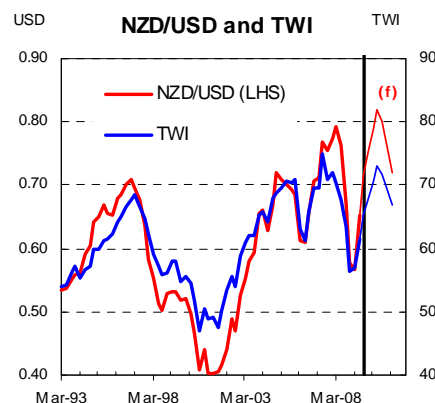
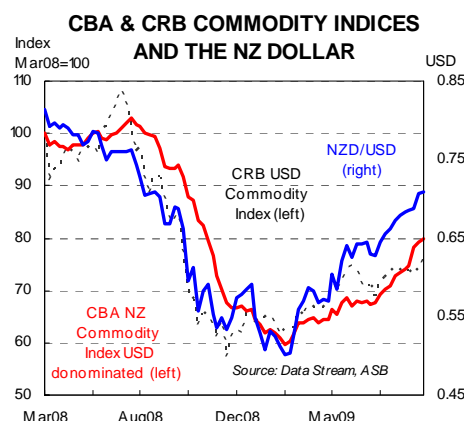
NZD's relative strength against the GBP and USD is likely a function of not just interest rate differentials and commodity prices but also the deep structural problems facing the US and UK.

The financial systems in both those countries are in need of serious reconstruction (the systems in Australia, NZ and Japan have been relatively robust). Both the US and UK are debtor nations that are increasing their public debt dramatically, and have been the biggest users of quantitative easing policies (electronically creating money). Moreover, the USD is being affected by nervousness over its future reserve currency status.

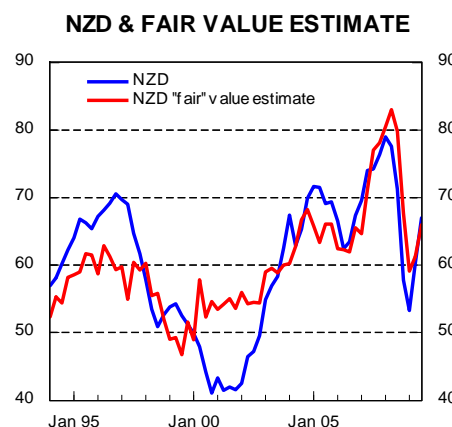
Although some individual cross rates are slightly above or below where fundamentals imply, the NZ Trade Weighted Index is only 10% above its 10-year average. That above-average level dovetails with the relative strength of NZ's fundamentals – or more correctly the dire fundamentals of some countries on the other side of the coin.

*NZD in line with estimated current 'fair value'*

**Current fair value.** We have estimated the 'fair value' for the NZD/USD as a function of interest rate and growth differentials and NZ export commodity prices. The concept of fair value is more of a long-run concept based off fundamental factors, and market forces can trigger considerable deviation. Moreover, the estimate will not account for some of the financial system and debt factors just discussed. Nevertheless, our estimate of fair value for the NZD/USD over Q3 sits near the NZD average for that quarter, implying the recent level is largely in line with the variables in the calculation. Interestingly, the NZD undershot 'fair value' during the period of panic, when factors beyond rational drivers dominated.



Currency	10-yr avge	Current	% +/- avge
NZD/USD	0.59	0.7466	26.9
NZD/AUD	0.85	0.8105	-5.0
NZD/GBP	0.34	0.4651	34.9
NZD/JPY	0.66	0.6685	0.5
NZD/EUR	0.50	0.4994	-0.7
TWI	60.91	66.8	9.7



## The issue of huge swings

*Drivers of volatility* There has been a lot of volatility in the NZD over the past year. Much of the NZD swing of the past year can be attributed to the above factors: shifts in the underlying fundamentals (and expectations thereof). We consider some other influences on the swing in the NZD.

*Small economy* **Economic volatility.** NZ's economy is relatively small and not well diversified. It is also subject to the vagaries of the weather. Consequently its economic cycle tends to be more volatile than those of larger economies.

*NZ exposed to capital flight* **Risk appetites and debtor nations.** NZ is heavily reliant on foreign capital: each year NZ needs to borrow or sell off assets to fund its huge current account deficit (which was over \$10 billion in the year to June). The times of panic (October 2008 through to early March 2009) saw the currencies of creditor nations and safe havens (USD, yen, Swiss franc) strengthen. Money went where its owners or managers thought it was safest, which in many cases meant home. It is no coincidence that the NZD dropped more against the yen during the crisis than it did against any of the other major currencies. As a debtor nation NZ is at the mercy of capital flight. Both the NZD and AUD fell sharply during the crisis.

As the world outlook started to improve, investors cautiously put their heads above the parapet and started to invest based on expectations of return. Consequently, the capital flight has reversed. In particular, as risk appetites have improved, the reversal of safe-haven flows has caused the USD to lose ground.

*Liquidity* **Liquidity.** NZ is a small country and, consequently, the NZD is not as liquid as the other major currencies. However, a lower level of liquidity is more an explanation at the margin, not a key driver of the NZD's path. The Australian economy is much larger and the AUD more widely traded, yet the NZD/USD has not swung much more than the AUD/USD over the past two years. The AUD/USD fell 37.5% from peak to trough and rebounded 50.9% to date, whereas the NZD fell 39.6% and rebounded 51.5%.

Currency	08 Peak	Trough	09 Peak	Decline %	Recovery %	Peak to peak %
NZD/USD	0.8156	0.4927	0.7466	-39.6	51.5	-8.5
AUD/USD	0.9776	0.6106	0.9212	-37.5	50.9	-5.8
GBP/USD	2.0302	1.3678	1.6995	-32.6	24.3	-16.3
USD/JPY*	112.22	87.49	101.23	-22.0	15.7	-9.8
EUR/USD	1.6001	1.2458	1.4950	-22.1	20.0	-6.6

\*Quoted inverted, following the convention. In late 2008 the yen strengthened during the peak of the crisis to 87.5 yen to the USD, before weakening again in April to 101.2 yen to the USD. Since then the yen has strengthened against the USD again to 90 yen to the USD – around the levels reached during the most acute months of the crisis. (All figures based of NZ end-of-day closing levels)

## Summary

*Currencies are relative, NZ doing well comparatively* The NZD has risen substantially this year – after falling dramatically when the global financial crisis became acute. The lift is unhelpful for NZ's export sector. However, much of the move – and the current level – can be explained by NZ's relative fundamentals. At present the whole world is trying to have an export-led recovery, but the whole world can't have a currency devaluation to make life easier. NZ's economy and financial system have performed better than many. If you look at currencies as a form of economic triage, NZ is in less dire need of immediate resuscitation via a low currency. That will be of little comfort to many exporters. However, having a low currency at present is more often than not a symptom the economy is in a fair amount of trouble.

*Volatility frustrating, but alternatives can be more costly* Floating exchange rates move around, and in times of economic stress often shift sharply. Managing that volatility is a challenge for businesses. But alternatives to a floating exchange rate have costs as well as the potential benefit of reduced volatility – those costs need to be taken into account. And a floating exchange rate does buffer the economy to some extent.

*Focus on mitigating domestic-sourced volatility* NZ cannot control the vagaries of the global economy, particularly the USD. But it can look harder at ways to dampen the amplitude of the cycle in domestic demand, reducing the need for interest rates to do as much work, hence toning down NZ influences on the NZD. A rebalancing of the economy away from household spending is also necessary for NZ's future prosperity, to which the financial crisis has brought more urgency. Economic policies that encourage households to save more and for resources to be channelled to the productive sectors will kill two birds with one stone.

For more discussion on the pros and cons of different exchange rate regimes, see ASB Economic Note: [NZD: The Flighty Bird](#)

### International

*Economic forecasts stabilise*

*The worst is likely behind us*

Optimism about global growth both in 2009 and 2010 has been improving. *Consensus Economics* releases fresh forecasts on a timely monthly basis, and forecasts have been revised up since mid-year. Importantly, the growth outlook for New Zealand's main trading partners has been improving over the past three months.

The general view is that the worst of the global growth contraction has passed, and data are pointing to economic growth in the second half of 2009 for many economies. Several, including Australia, New Zealand and Japan posted growth in Q2. However, the situation is best described as a stabilising global growth outlook, rather than a robust recovery.

The drop in global economic activity in 2009 is the first annual contraction in the post-war era. The International Monetary Fund forecast global economy will contract by 1.1% this year before expanding by 3.1% in 2010. It will take several years to repair the damage caused by the global downturn. However, the global downturn has so far proved less severe than anticipated earlier this year. Unfortunately, the recovery is expected to be slow and weak by historical standards.

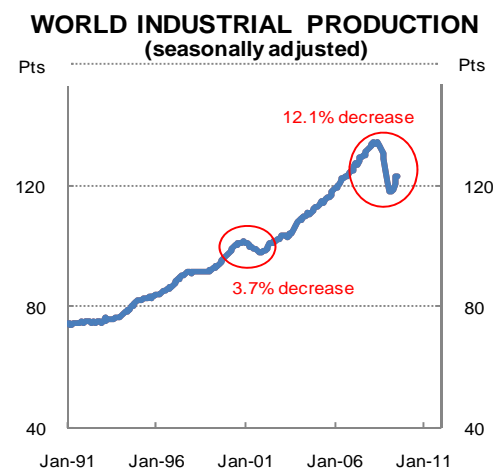
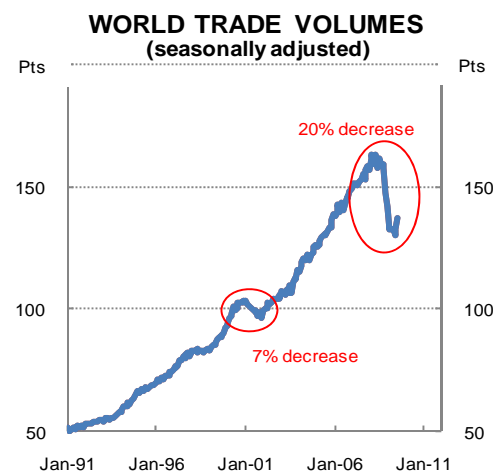
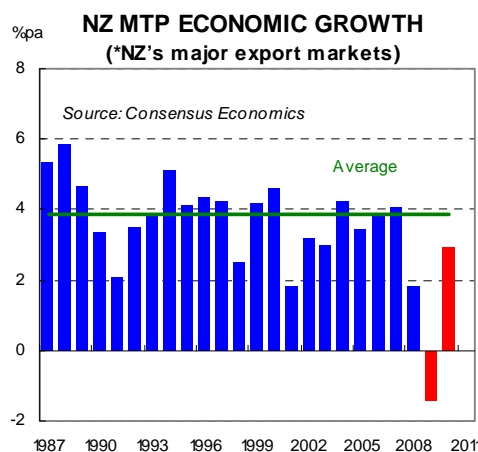
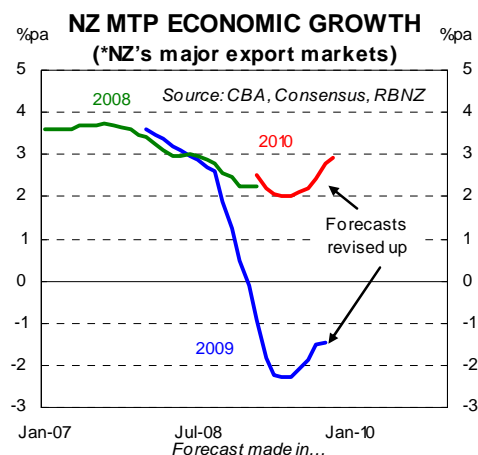
*Trade and industrial production lift out of the trough*

World trade volumes peaked in April 2008. After easing gradually in the initial stages, trade volumes dived sharply from October 2008 to May 2009 when they troughed. The total decline was 20.1%, the sharpest fall in the 28-year history of history available. Recent trade developments corroborate with other evidence the global economy is entered into recovery mode. Over the past two months world trade volumes have risen. July's 3.5% rise is the largest monthly increase in more than 5 years. Since the trough, world trade volumes have risen by 5.2%.

World industrial production peaked in March 2008. A mild contraction – similar in magnitude to the 2000-01 decline – occurred up until October 2008. Following the peak of the financial crisis production dived precipitously before troughing in March 2009. Since then, global industrial production has lifted 4.1%.

*China critical to future global growth*

China is a critical component of future global growth. China's annual growth rate troughed at 6.1% in Q1, but has subsequently picked up to around 8% in Q2, reflecting a positive response to huge fiscal stimulus. Trade remains down significantly on pre-crisis levels. In September, Chinese imports were down 16% and exports were down 22% on year-ago levels. Chinese exports won't recover until the economies of China's trading partners, particularly the US and Europe, improve further. Until then, weak exports will be a threat to China's outlook.



*China's demand impulse*

An improvement in import demand from China is important for many countries, including Australia and New Zealand. China is Australia's largest export destination and ranks 3<sup>rd</sup> for New Zealand (behind Australia and the USA).

Consumption equates to 35% of China's economy (much smaller than 70% for the US economy). Although internal demand from Chinese consumers is growing, China is still heavily reliant on exporting products to the western world's consumers. China's investment sector equals approximately 38% of China's GDP, and this sector is important to monitor, as it is largely responsible for demanding Australia's base metal and bulk commodity exports (and lifting global commodity prices).

The US, UK and European economies contracted in Q2. However, indicators of future growth have improved and are pointing to growth resuming in the second half of 2009. Confidence surveys are improving, manufacturing indices are finally pointing to a lift in activity, and housing markets appear to be stabilising. The *Consensus Economics* forecasts in September expected the US economy to contract 2.6% in 2009, and then expand 2.4% in 2010. The Euro zone economy is expected to contract 3.9% this year, and then expand by 1% next year.

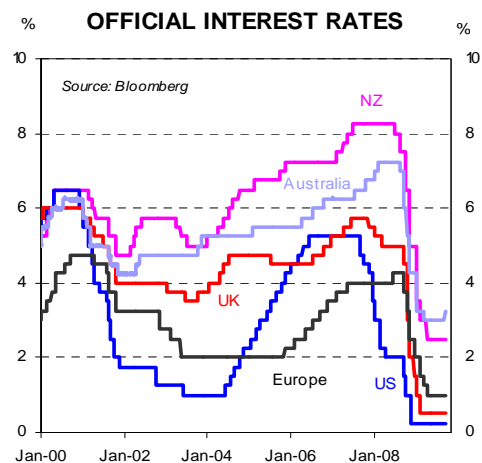
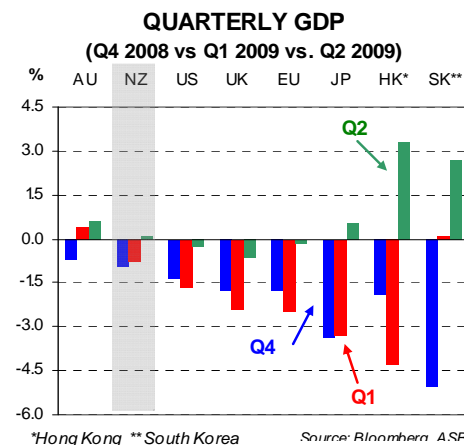
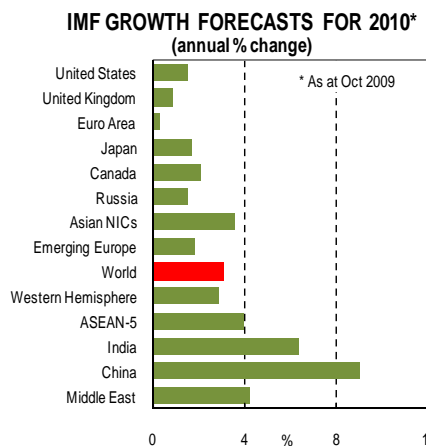
Despite these tentative signs of recovery, unemployment is still on the rise in many economies. Unemployment will likely peak at over 10% in the US. Eurozone unemployment rose to a more than 10-year high of 9.6% in August and will likely worsen further, hurting the prospects for a strong economic recovery. Elsewhere, a weak labour market is also a feature of the near-term outlook: U.K. unemployment is 7.9% and Japan's is 5.8%. Eurozone members Spain (19.3%) and Ireland (13.0%) are struggling. New Zealand and Australia's 6% and 5.7% respective unemployment rates are comparatively healthy. High unemployment around the world contributes to our expectations of a weak economic recovery.

Across the Tasman, Australia has avoided recession, and posted growth in the first two quarters of 2009. Substantive policy action by the Reserve Bank of Australia and the Federal Government have been effective. Australia is New Zealand's top export destination and source of tourists. The relative health of the Australian economy is a big positive for New Zealand's prospects. In addition, the NZD/AUD exchange rate is one of the few at an export friendly level. The positive outlook for the Australian economy has prompted RBA to start lifting its cash rate to a less stimulatory level. Other central banks will be much slower to follow suit.

*US, UK and European economies contracted in Q2*

*Global unemployment is on the rise*

*Australia skirts recession*



## The New Zealand Economy

*NZ economy pulls out of year-long recession*

The New Zealand economy contracted 3% over 15 months during the worst global downturn since WWII. The initial stages of decline were led by agriculture and construction, triggered by drought and slowing in the housing market. However, as the financial crisis and global recession intensified, the decline spread to retail, manufacturing, wholesale trade, transport and storage industries. While the economy has recently stabilised, the recovery is likely to be muted compared to historical experience.

### Global prospects improve

*Global economy outlook improves, lifts commodity prices*

The global outlook has improved over recent months, with forecasts for global growth revised up on the back of confidence that the worst has now passed for the global economy. New Zealand's main trading partners' GDP is forecast to contract by 1.4% over 2009, then grow by 2.9% over 2010. While growth is still well below trend, the outlook is more robust than our expectations 6 months ago. Consistent with the increased optimism, New Zealand's export commodity prices have picked up off their lows (although remain weak).

### NZD weighs on export sector

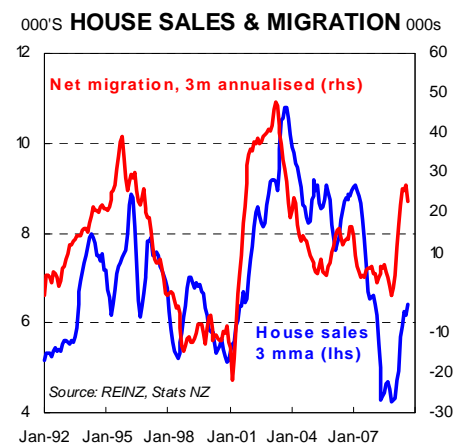
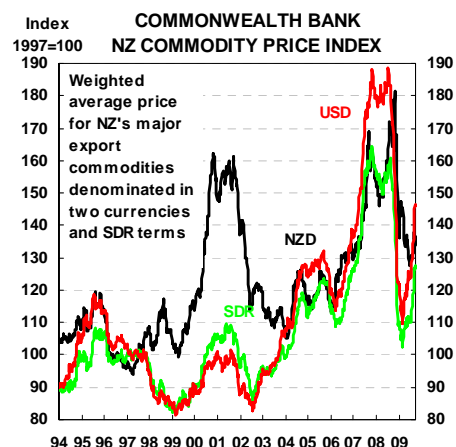
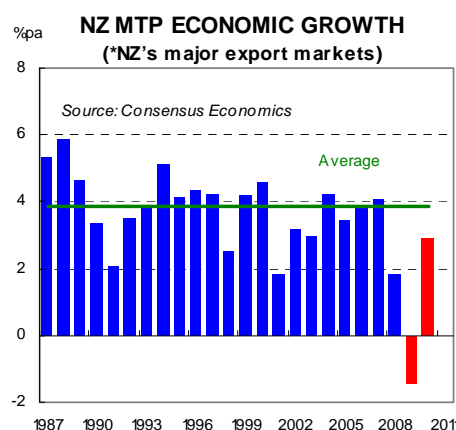
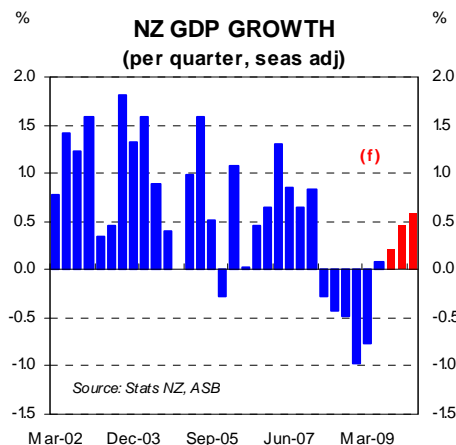
*Export sector continues to struggle with high NZD*

Despite the recent improvement in the global economy, the export outlook remains very subdued. The depreciation in the New Zealand dollar earlier this year proved to be short lived, leaving a missed window of opportunity for many exporters. Despite the weak local economic outlook, the New Zealand dollar is likely to remain strong against the greenback and pound. The recovery in dairy volumes (following the previous year's drought) has been a key source of growth for NZ exports. With dairy production moving into a new season, the underlying weakness in broader export demand is likely to become more apparent. Exports of services are also likely to remain subdued, as the tourism industry struggles to contend with fewer arrivals from the US, Europe and Asia.

### Population growth underpins demand

*Population growth lifts on fewer departures to Australia*

Over the next year, domestic demand will be underpinned by the recent increase in net migration. The population base has surged on the back of fewer permanent departures to Australia. Rising unemployment in Australia has deterred New Zealanders from relocating over the past 6 months. However, we do not expect the increase in population growth to be sustainable. The Australian economy has fared favourably through out the financial crisis and managed to avoid recession. As the labour market recovers, departures to Australia are likely to resume over the latter part of next year.



*Consumer confidence improves, but still at weak levels*

**Consumer spending stages soft recovery**

The recent lift in consumer confidence points to modest improvement in consumer spending over the next year, albeit relatively soft growth. Labour incomes remain under pressure and households are likely to shy away from big-ticket purchases and instead further consolidate debt. However, the increase in net migration and growing population base should help offset some of the weakness in consumer demand.

**Housing demand recovers, supply short**

Housing demand has remained fairly steady over the past few months. Housing turnover picked up off its lows at the start of 2009, supported by the fall in interest rates and increase in population growth. While housing demand has improved, the supply of houses for sale has been very low. The imbalance has seen prices bid up over the past few months. More recently, there has been some recovery in new listings which we expect will continue. That will restore balance between supply and demand, tempering pressure on house prices. Our long-term view on house prices remains shaped by low affordability and high debt burdens.

**Construction at turning point**

Housing construction has fallen sharply over the past 2 years, although activity now looks to have reached a bottom. Nonetheless, housing construction is likely to remain at very low levels, extending the strain on the industry. Dwelling consents have been slow to respond to the increase in housing demand. Households remain cautious, weighed by uncertainty in the labour market and the increase in longer-term interest rates. A number of property developers have also succumbed to the downturn. The recovery in housing construction is likely to be muted in levels terms.

**Investment outlook recovers**

With the fall in demand, profitability has come under extreme pressure with firms looking to trim costs. Investment intentions dropped sharply over the past year, and already investment has already fallen considerably, primarily in non-residential construction, plant and machinery and transport. Recent business confidence surveys suggest investment intentions have started to recover, although historically there has been a 6-12 month lag between improved profitability and for new investment projects to come online.

**Labour market flexibility**

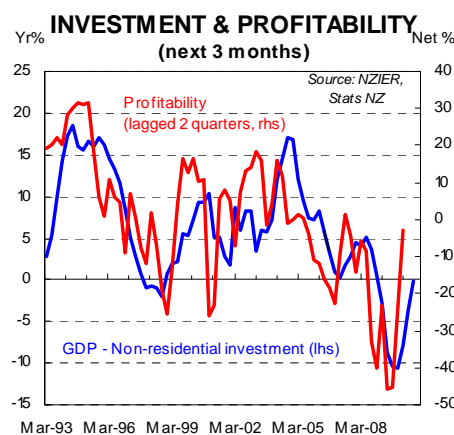
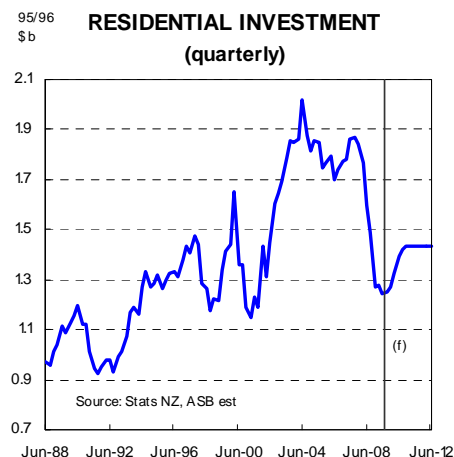
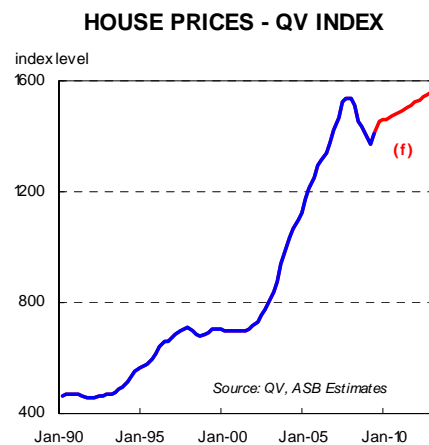
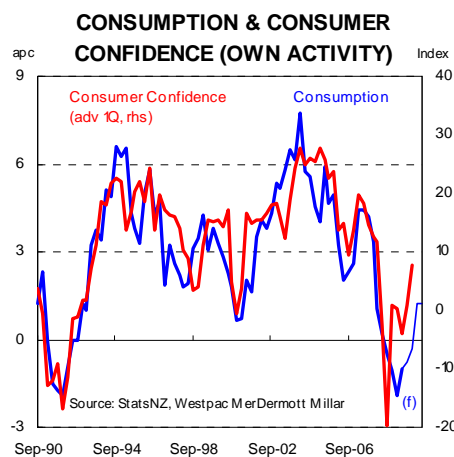
The labour market has fared much better than expected throughout the recession. The labour market has presented more flexibility than seen in previous downturns. Most of the adjustment came through fewer hours worked and lower wage growth rather reducing head count.

*Housing demand improves, supply slow to respond*

*Construction outlook remains subdued*

*Profitability outlook and investment intentions improve*

*Labour market demonstrates flexibility*



*Labour demand improving*

Although there are already tentative signs of improvement in labour demand, the increase in employment over the next year will not be sufficient to absorb the growth in the labour force. Consequently, the unemployment rate will continue to push towards 7%.

**Inflation pressures currently subdued**

*Inflation pressures unwinding faster than expected*

New Zealand's inflation pressures have unwound dramatically over the past few months. Key to this has been the sharp fall in wage inflation, helping reduce cost pressures in the service sector. In addition, there has been a substantial fall in construction cost inflation, led by a correction in raw materials prices combined with a large amount of spare capacity in the construction sector.

*Excess capacity will contain inflation a while longer*

Recent business confidence surveys suggest a large amount of slack remains in the New Zealand economy. Pricing intentions remain weak, held back by low levels of demand. Further, the ongoing rise in the NZ dollar should continue to restrain imported inflation.

Inflation should remain comfortably contained by the above factors over 2010. However, by 2011 inflation will be back in the top half of the target band as the domestic-led economic recovery absorbs resources and the NZD restraint on traded goods prices reverses.

**Interest Rates and Exchange Rates**

**Interest rates on the rise**

*Short-term rates lift as risk further rate cuts pass*

Over the past few months shorter-term interest rates have started to rise, while at the longer end interest rates have started to stabilise.

The pick up in shorter-term rates reflects increased confidence the global economy has now stabilised, with central banks shifting away from an easing bias to a more neutral stance (or in Australia, rate increases).

*Longer-term interest rates stable*

However, longer-term swap rates and bond yields have recently stabilised and remain below average levels, suggesting the markets still have some concerns on the strength of the recovery over the next few years.

*Yield curve remains steep*

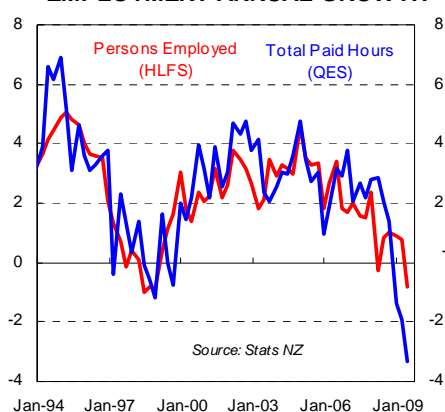
The closing gap between short- and long-term interest rates has seen the yield curve flatten slightly, although it remains steep by historical standards.

**RBNZ shifts towards neutral bias**

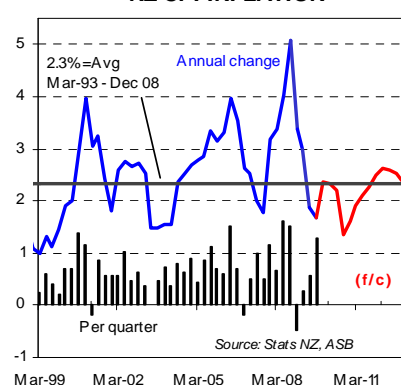
*RBNZ backs off easing bias, market looks to rate hikes early next year*

The RBNZ has backed off its easing bias in recognition of the improved global growth outlook and improvement in domestic demand (particularly in the housing market). Reflecting the need for ongoing policy support, the RBNZ expects to keep the OCR on hold until the latter part of 2010. However, markets are increasingly pricing in an earlier start to OCR hikes. The market has a 25 basis point rate hike almost fully priced in for the January meeting, and 50 basis points priced in for March.

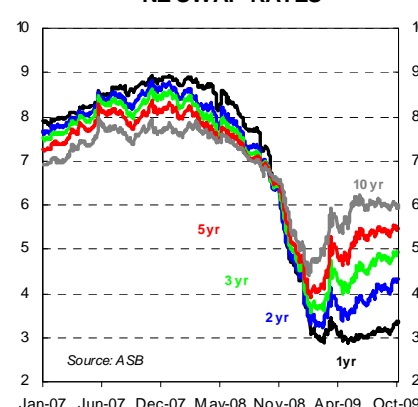
**EMPLOYMENT ANNUAL GROWTH**



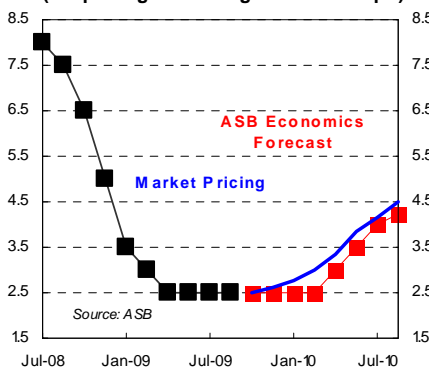
**NZ CPI INFLATION**



**NZ SWAP RATES**



**OCR FORECASTS (vs. pricing of overnight index swaps)**



**RBA gets ahead of the curve**

*RBA sneaks in early rate hike*

Fuelling the view for earlier rate hikes has been the surprisingly early increase in rates by the RBA. With the Australian economy avoiding recession and inflation pressures slow to unwind the RBA have become wary of leaving the cash rate at 'emergency settings'. The RBA is likely to gradually lift the cash rate to 4%, with further hikes above this level likely to be more data dependent. The RBA may pause somewhere between 4-4.5% to further assess the sustainability of the global recovery (in particular once fiscal stimulus fades).

**NZ needs low OCR for longer**

*RBNZ likely to remain on hold till June 2010*

In contrast to Australia, the NZ economy has been more severely hit by the global recession and continues to need support from monetary policy. We expect the RBNZ will continue to hold the OCR at 2.5% until April. However, the RBNZ is likely to engage in a more aggressive withdrawal of policy stimulus once the global and domestic recoveries gather momentum. We expect the OCR to increase to 5.5% by June 2011.

**NZD momentum to continue**

*NZD/USD rise to continue*

We expect the NZD will continue to climb, and have adjusted our forecasts to incorporate a higher peak in the NZ dollar (82 cents in June 2010). Our view on the Kiwi is based on New Zealand's earlier than expected exit from recession, further improvement in the global economy and a continued soft USD outlook.

*Global growth outlook improves*

A number of factors are supporting a firmer global economic outlook: (i) rosier incoming monthly economic data; (ii) rising global equity markets; (iii) solid levels of support for elevated commodity prices; (iv) upward revisions to global GDP growth.

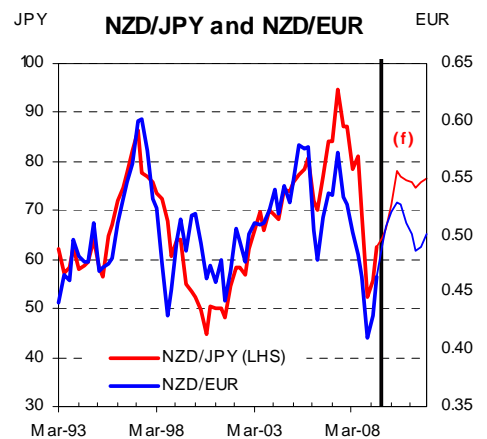
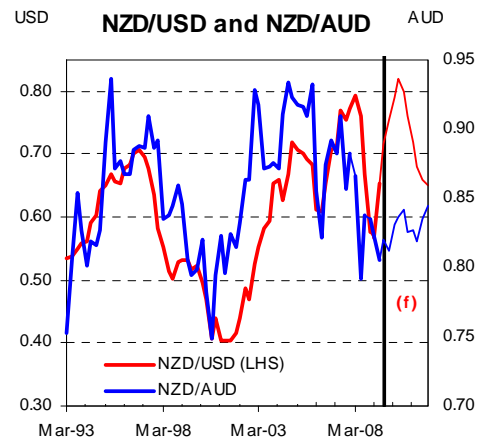
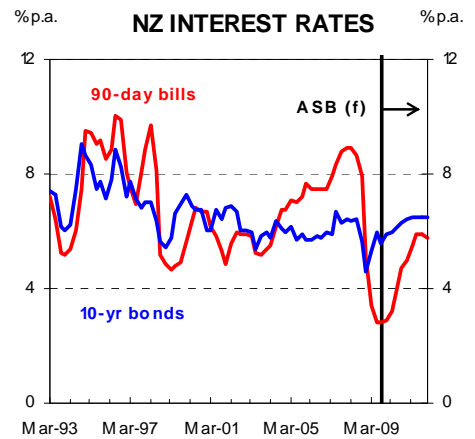
**USD weakness continues**

*USD weakness to continue*

US dollar weakness is expected to continue. The Federal Reserve's commitment to keep interest rates "at current low levels for an extended period" suggests short-end nominal US yields will remain unattractively low. Reserve currency diversification is also likely to occur as low interest rates and US debt issuance continues to erode the attractiveness of US assets, further weighing on the greenback. The fragile sentiment on the USD is unlikely to change until the US economy is strong enough to withstand Fed rate hikes (currently not expected until the second half of 2010).

*NZD to underperform AUD*

Against the Australian dollar, we expect a period of underperformance given the relative interest rate differentials as the RBA engages interest hikes earlier than the RBNZ. The NZ dollar should recover ground against the Australian cross as the RBNZ begins to increase rates.



**ECONOMIC FORECASTS**

ASB economic forecasts		Jun-09 << actual	Sep-09 forecast >>	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Mar-12
<b>NZ GDP real</b>	AA%	<b>-1.8</b>	<b>-2.1</b>	<b>-1.5</b>	<b>-0.6</b>	<b>0.4</b>	<b>1.3</b>	<b>2.0</b>	<b>2.4</b>	<b>3.1</b>
private consumption	AA%	-1.1	-1.2	-1.0	-0.2	0.3	0.9	1.4	1.5	2.0
dwelling construction	AA%	-25.4	-24.8	-17.7	-9.7	-0.8	7.3	10.4	11.5	1.0
other investment	AA%	-8.7	-10.3	-10.7	-7.9	-3.7	-0.2	3.5	5.6	8.8
exports	AA%	-3.8	-3.8	-1.4	0.1	-0.9	-0.9	-1.0	-0.5	4.4
imports	AA%	-12.4	-16.9	-17.3	-13.2	-6.0	0.7	5.8	7.9	6.0
NZ GDP real	A%	-2.1	-1.4	-0.1	1.3	1.8	2.3	2.7	2.9	3.0
NZ GDP real	Q%	0.1	0.2	0.4	0.6					
NZ CPI	Q%	0.6	1.3	0.2	0.2					
<b>NZ CPI</b>	<b>A%</b>	<b>1.9</b>	<b>1.7</b>	<b>2.4</b>	<b>2.3</b>	<b>2.2</b>	<b>1.3</b>	<b>1.6</b>	<b>1.9</b>	<b>2.7</b>
NZ house prices (QV index)	A%	-3.1	1.5	4.4	6.6	4.2	1.7	2.0	2.1	2.5
NZ unemployment (sa%)	Qtr	6.0	6.3	6.3	6.4	6.7	6.7	6.8	6.9	6.6
NZ private sector wages (LCI)	A%	2.7	2.1	1.8	1.5	1.5	1.4	1.4	1.6	2.3
NZ current account (\$b)	Yr	-10.6	-8.2	-5.7	-5.7	-7.0	-7.5	-9.1	-9.6	-10.7
as a % of GDP	Yr	-5.9	-4.5	-3.1	-3.1	-3.8	-4.1	-4.8	-5.0	-5.3

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)	Jun-09	Sep-09 << actual	Dec-09 forecast >>	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
NZ cash rate target	2.50	2.50	2.50	2.50	3.50	4.25	4.75	5.25
NZ 90-day bank bill	2.84	2.81	3.0	3.2	4.3	5.2	5.6	6.0
NZ 3-year swap rate	4.50	4.61	5.2	5.5	5.8	5.9	6.0	6.0
NZ 10-year gov't stock	5.96	5.60	5.9	6.0	6.1	6.3	6.4	6.5
ASB foreign exchange forecasts (end of quarter)	Jun-09	Sep-09 << actual	Dec-09 forecast >>	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
USD per NZD	0.652	0.715	0.76	0.79	0.82	0.80	0.76	0.72
GBP per NZD	0.394	0.448	0.45	0.45	0.46	0.43	0.42	0.40
AUD per NZD	0.806	0.821	0.81	0.83	0.84	0.84	0.83	0.83
JPY per NZD	62.7	64.450	66	71	78	77	76	76
EUR per NZD	0.463	0.490	0.51	0.52	0.53	0.53	0.51	0.50
TWI	61.4	65.2	68.0	70.6	73.2	71.8	69.2	66.9

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

ASB ECONOMICS  
Level 9, 135 Albert Street, Auckland

**ASB GROUP ECONOMICS & RESEARCH** **PHONE** **FAX**

<b>Economics</b>			
Chief Economist	Nick Tuffley	<a href="mailto:nick.tuffley@asb.co.nz">nick.tuffley@asb.co.nz</a>	(649) 374 8604 (649) 302 0992
Economist	Jane Turner	<a href="mailto:jane.turner@asb.co.nz">jane.turner@asb.co.nz</a>	(649) 374 8185
CBA NZ Economist	Chris Tennent-Brown	<a href="mailto:chris.tennent-brown@asb.co.nz">chris.tennent-brown@asb.co.nz</a>	(649) 374 8819

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