BIRDS EYE VIEW

NEW ZEALAND ECONOMY
COMMENTARY AND PROSPECTS

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THE FRONT PAGE

The New Zealand context sees the authorities fast tracking to reverse last year's premature and mistaken increases in interest rates. The September RB announcement sees the Official Cash Rate at 2.75%, still 25 points above that of a year ago. However, the widely expected OCR cut was not the most significant aspect of September's Reserve Bank Monetary Policy Statement.

The far more significant aspect was the somewhat jaw-dropping downgrade in the economic forecast picture that the Reserve Bank now paints.

Three months ago the RB expected GDP growth in the coming year (to March 2016) to average 3.2%. It now expects this to be 2.1%. Consequently, an unemployment rate of 6.1% is expected for March next year, compared to the 5.3% expected just 3 months ago.

Nevertheless, the exchange rate adjustment is expected underpin stronger exports, with the net trade (exports minus imports) contribution turning significantly positive at 2.1% – compared to the expected negative (of -2.1%) three months ago. On a TWI basis the NZ$ is now some 10% below that of a year ago, although noticeably still only 5% down against the A$. Despite financial sector commentators continuing their hawkish tone as to inflation, CPI, PPI and core retail sector prices remain flat or even below year-earlier levels.

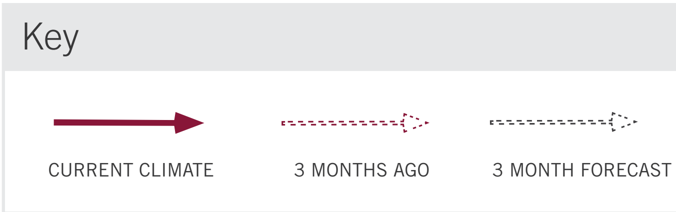
And now, with demand pressures easing, there remains a strong case for further reductions in the OCR.

In addition, with the government accounts in a sound position, fiscal policy is in a position to help out monetary policy. With many commentators now apparently unashamedly Keynesian in the context of advocating counter-cyclical fiscal policy, much needed education, transport, and local government infrastructure could be accelerated at a time of low public sector borrowing costs.

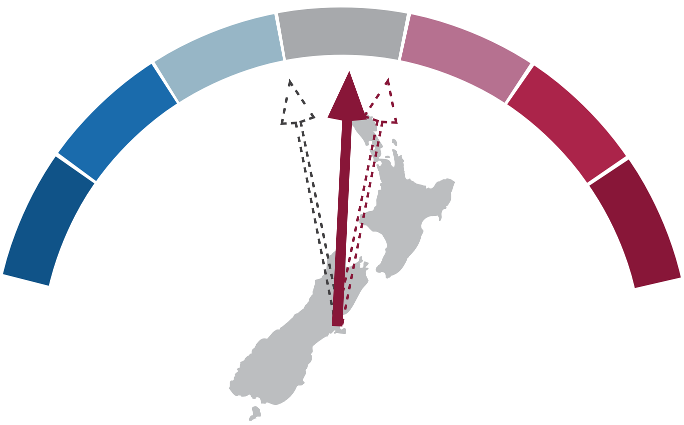
These revisions reflect the heightened level of uncertainty, driven in part by global market jitters. The picture suggests a further 25-points OCR cut early next year, which fully reverses the premature, ill-advised and mistaken hikes imposed last year.

THE TEMPERATURE

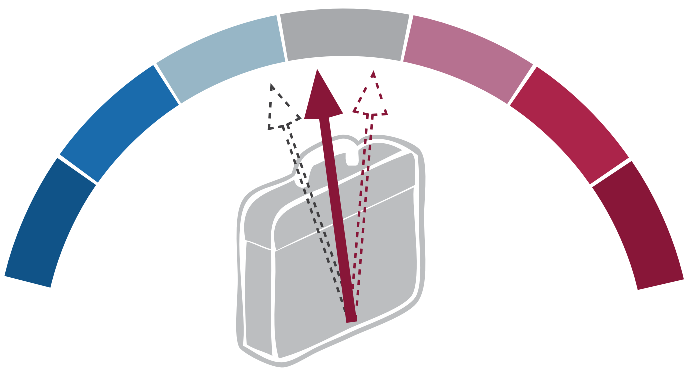
WHAT YOU MUST KNOW



NZ SALES CLIMATE



NZ JOB CLIMATE



FISCAL AND MONETARY POLICY

- Official interest rates set to fall further.
- Government accounts sound
- Now is time to accelerate infrastructure investment.

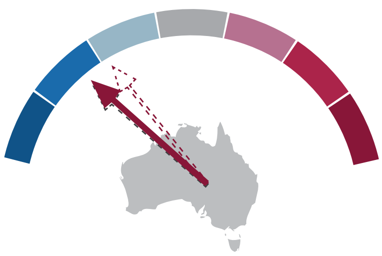
THE TEMPERATURE

WHAT YOU SHOULD KNOW

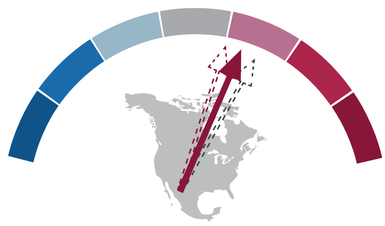
Key

CURRENT CLIMATE | 3 MONTHS AGO | 3 MONTH FORECAST

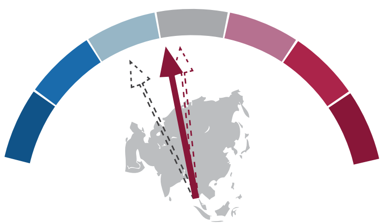
SALES CLIMATE AUSTRALIA



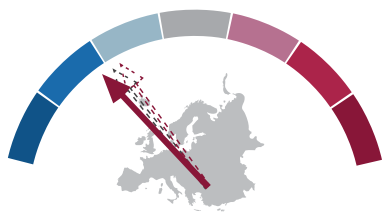
SALES CLIMATE UNITED STATES



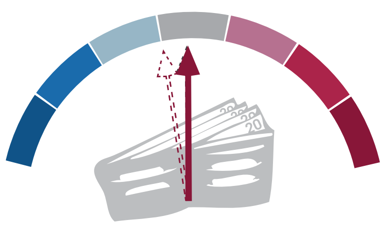
SALES CLIMATE ASIA



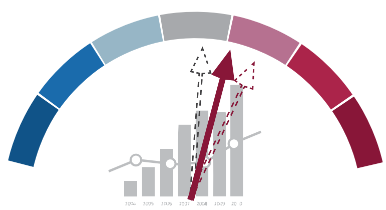
SALES CLIMATE EUROPE



WAGE GROWTH



INVESTMENT PLANS



WHAT WE DON'T KNOW YET

GLOBAL

- China, China, China?
- Where will uplift for Europe's pedestrian recovery come from?
- Will the US Federal Reserve stick to its pledge to increase interest rates in face of global market volatility and China uncertainty?

FISCAL POLICY STANCE

- Will focus on fiscal surplus continue?
- Will options for tax cuts begin to dominate narrative?

DOMESTIC FACTORS

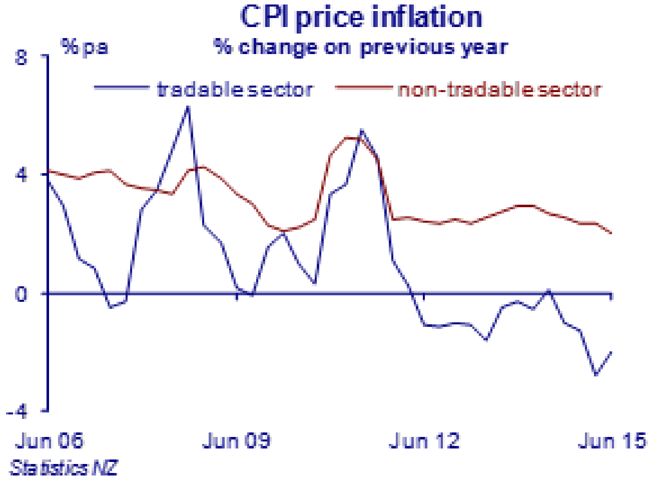
- Will RBNZ continue to see inflation risks around every corner?
- How will banks respond to at-risk loans to housing and farming sector?
- Where to for Auckland house prices?

THE STORY

August briefing forecast confirmed

At our August Briefing we indicated a slowing in growth to around the 2% mark, and further Official Cash Rate cuts for it to reach 2% during the first half of 2016. Events over the past 6 weeks confirm our forecast, with the RB's September Monetary Policy Statement also forecasting growth around the 2% mark, along with a slump in exports this year, but a modest recovery next season.

As the chart indicates, deflation across the tradable sector has placed considerable pressures on business recovery over the past few years. However, monetary conditions – in the form of reduced interest rates and a more appropriate level for the NZ$ - are set to be less constraining over the near term.



ability to continue to underpin (and underwrite) the recovery. The slump in Shanghai share prices has been dramatic, but remember most of this is a correction for the equally dramatic surge over the first half of 2015. Indeed, the Shanghai Composite soared 110% over the nine months to June this year. The nearly 40% slump since that June peak, still leaves Chinese share prices some 40% up a year ago.

Probably more concerning has been the slowing growth in economic activity, with GDP in the June quarter just 7% up on year earlier – a mediocre rise in the Chinese context. And more recent reports are singularly concerning with trade data for the year to August reflecting a worrying slump in China's external trade activity. In particular, exports out of China slid 6% and imports into China slumped more than 14%. These data indicate a sobering negative impact on global demand.

The good news, if you call it that, is that Europe is off the economic headlines for a while at least. With broad agreement as to Greece's debt repayment plan (for now), the focus returns to Europe's economic recovery. According to GDP data, EU-wide growth remains relatively ordinary at an annual 1.6%. Within this figure, German economic activity is ho-hum at 1.6%, the UK shows through as much stronger at

2.6%, while France and Italy remain weak at 1.0% and 0.5%, respectively.

In line with these figures, EU-wide unemployment has only declined marginally through this year to be now 9.5%. Amongst the larger nations, Germany at 4.7% and the UK at 5.6% are relatively low, while jobless in France and Italy are still high at 10.4% and 12.0%, respectively.

In contrast, the United States economic activity continues to expand – with annual growth at a solid 2.7% and unemployment down to 5.1%. However, the relatively low jobless rate has been heavily influenced by large numbers withdrawing from the labour force. Consequently, labour force participation at below 63% remains well below pre-crisis levels of above 66%.

In this context, coupled with renewed uncertainty out of China and US inflation remaining benign (latest annual CPI reading of 0.2%), we don't see the Federal Reserve in any hurry to increase their interest rates. Nevertheless, the banking sector hawks will continue to call for a shift back towards 'normal', ignoring the signals that the current situation remains far from normal.

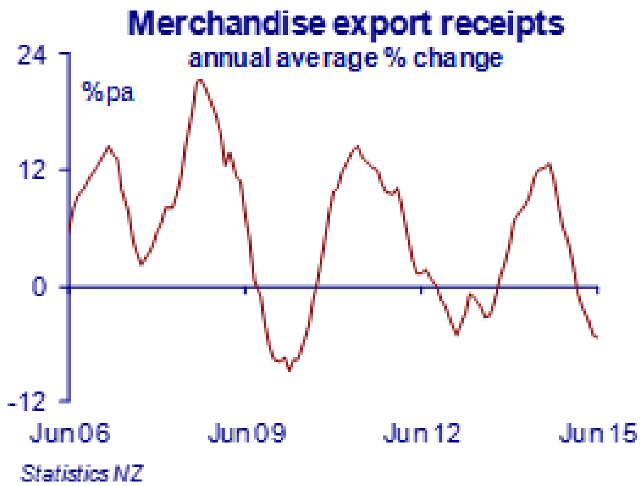
The housing market complication

However, the primary argument against further declines in interest rates is the impetus it may provide to the already over-heated residential property market. Promisingly, the Reserve Bank is now using a wider range of tools to address the financial stability issues raised by resurgent property price speculation.

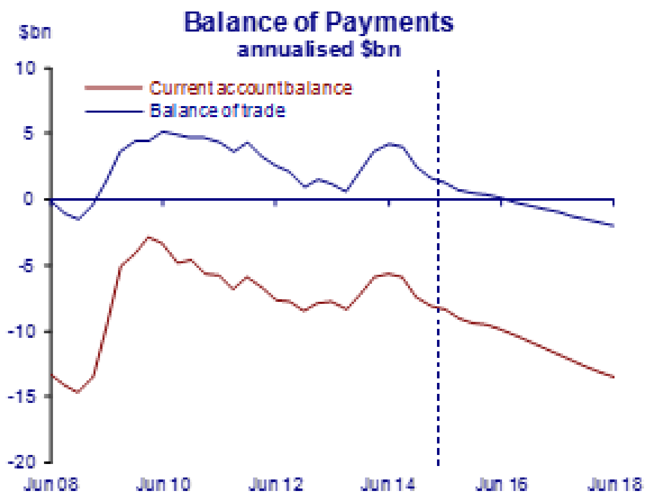
Nevertheless, these tools are going to need help in the form of stricter and more targeted loan-to-value and/or loan-to-income conditions. The disconnect between rental returns and property prices suggests a clear move towards expectation of capital gains rather than investment in property based on expected yields. With investor decisions based on such behaviour, the policy intervention seems obvious. Supply considerations are admittedly important, but increasing supply doesn't seem a relevant response to behaviour based on capital gain expectation. Surely, this is a reflection of excessive demand (as opposed to a shortage in supply).
Of course, if one were allowed to explore much broader dimensions – there may well be a case that the Auckland housing market imbalance is better seen as a job market imbalance in non-Auckland regions.

The tradable sector recovery

Much has been made of New Zealand's perceived dependence on dairy (and, to a lesser extent, log) export revenues. Of course, the challenge to diversify the nation's export sector is not new. But the response of the export sector to a more appropriate exchange rate will be closely watched.



The tourism sector is indeed leading the recovery with a significant surge over the past year, with an estimated 25% spike in revenue. This has helped counter the dramatic decline in dairy (-24%) and forestry (-13%) revenue of the past year.
In addition, meat, wine, kiwifruit, apples, and avocadoes have contributed positive revenue gains to the export picture. We expect further gains over the near term in these export categories. However, the anticipated El Nino cycle this season and accompanying drought will ensure these gains will be modest.



Together, overall exports sector performance remains on par, with exports continuing to hover near the 30% of GDP mark – well below the Government's Business Growth Agenda target of 40% by 2025. Consequently, the deterioration in the nation's annual deficit is also set to continue to reach 5% of GDP by 2018.

The bald facts are

- unemployment (June 2015) at 5.7%; up from 5.5% a year earlier.
- employment growth (June 2015 on June 2014) at 3.0%; down from 3.6% a year earlier.
- net migration (year to August) at +60,290; up from +43,180 a year earlier.

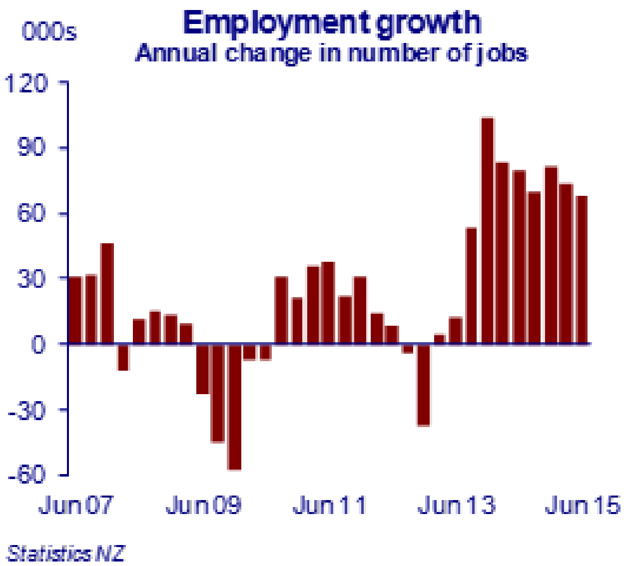
Employment

Recent changes in the pattern of employment change reflect the gradual softening of the employment market.

The falling commodity prices have hit in two or three main industries. As expected, with the falling dairy payout, there are reductions in the primary industry support services falling by about 4,000. The basic material wholesaling has contracted, no doubt with the coal industry, and the dairy storage.
The number in the professional and technical services industry has declined, and recent announcements by key research organisations like AgResearch indicate that this will continue. This is a concern especially for the ability of our primary industries to adjust to reduced emissions.

There appears to have been some shift of employment from Residential Care to the Social Assistance Services, with little net overall change. There has been good growth in processing and manufacturing, including, somewhat surprisingly Food Product Manufacturing, and also machinery and equipment manufacturing.

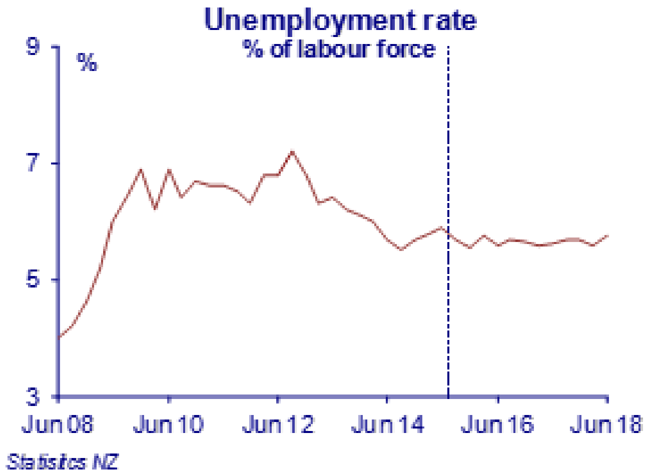
Employment in building and construction continues to grow, and the strong tourism performance has seen employment in Food and Beverage Services increase again quite strongly.



The rate of employment increase has subsided from the 70,000 to 80,000 six months ago, to 67,000, for year ending June 2015.

We expect it to continue easing back towards about 45,000 per annum within the next twelve months. This is still strong, and will be assisted by the easing of the Kiwi exchange rate, and the continuing build in Christchurch of public buildings and the re-builds funded by insurance company payouts now the EQC-funded repairs are mostly complete.

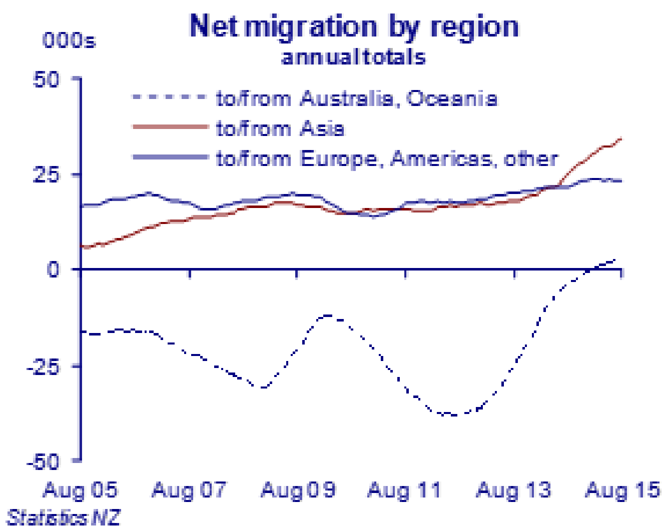
At this rate of increase, the share of migrants entering as students and then joining the labour force later becomes an important factor in whether or not our unemployment rate begins to rise again or not. It could be expected that the unemployment rate will sit in the range 5.5% to 6.5% of the labour force out to the forecast horizon.



Migration

The migrant net inflows have been running at a seasonally adjusted figure of around 60,000 per annum since about September 2014, as shown in the chart. There is some indication of another lift in the July figures, but these flows are historically fickle, so we expect them to stay at about these levels for some time yet.

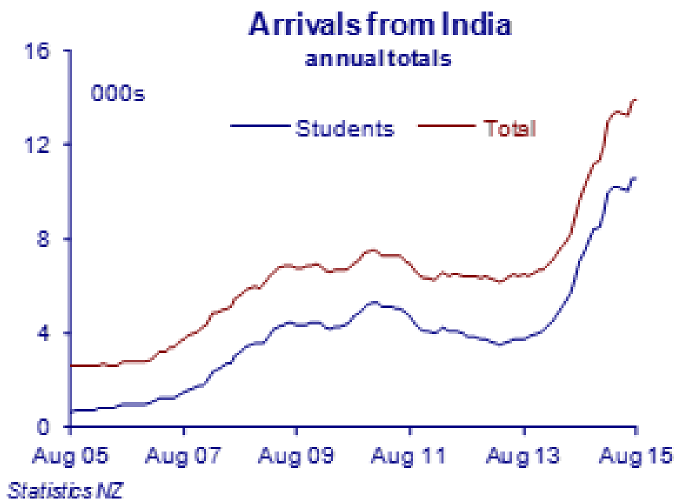
In fact the latest figures to August 2015 indicate that according to our projections system, the total net inflow for calendar 2015 will be about 64,000 people. The nature of the flows, particularly after the Christchurch earthquakes and the subsequent slow-down in the Australian economy, has been erratic. Through much of 2012 the net outflow from New Zealand was over 4,000 per annum, this bounced back to a net inflow of 26,000 in calendar 2013, and further to a net inflow of 51,000 in calendar 2014. So the 64,000 forecast for 2015 is a slowing of this rate.



The causes of the increase in net inflow from about zero in the period 2011 to 2013 to 60,000 now are about equally a reduction in the outflow and an increase in the inflow. The reduced outflow has been a reduction to Australia by over 20,000, and reduced outflow to Europe by about 2,000 (mainly to UK), and reduced to Asia by about 1,000 – presumably students mainly.

The increased inflow has been from Asia by about 15,000, over half from India, and on student visas; about 8,000 from Australia, and 2,000 from Europe, mostly France.

Flows to and from most world regions are reaching a plateau, and this includes the all-important Australia, and also Europe and the Americas. The net inflow from Asia is still growing, but is slowing. As we have noted before, a lot of this impetus is from a very successful drive to attract students from India and also a continuing flow from China. The current annual inflow rate is over 10,500 per year from India, and 5,000 from China. If these inflows stabilised at that level, and all of these students returned to India and China in, say, 3 or 4 years, then the net inflow would reduce by that 15,000 as the outflow became the same as the inflow,



CAPITAL RESOURCES

There are large long-settled populations in New Zealand of people with these ethnicities. At Census 2013 there were 155,000 of Indian ethnicity and 171,000 of Chinese ethnicity. It can be expected that a significant share of these students, as graduates will have become successfully included in the local society and wish to obtain employment here adding to our skill base.

We are forecasting the plateau to continue at around 60,000 to 64,000 per year rate until late in 2015, and then to decline over time as the student inflows and outflows balance out. At that stage in later 2016, together with a re-balancing of the trans-Tasman flows we expect the net flow to ease back, so that the forecast net inflow to June 2017 is expected to be in the range 42,000 to 47,000. It is expected to be closer to a net inflow of 25,000 in the year to June 2018.

Again to provide some perspective, the net inflows to New Zealand in the past have experienced wide fluctuations, and once the net inflow begins to decline it could fall much faster than forecast here. However over the longer period, the net inflow has generally fluctuated around a trend of 10,000 inflow per year, since the 1950s. The flow forecast for 2018, running at 25,000 per year is still a good strong input to the growth of the country.

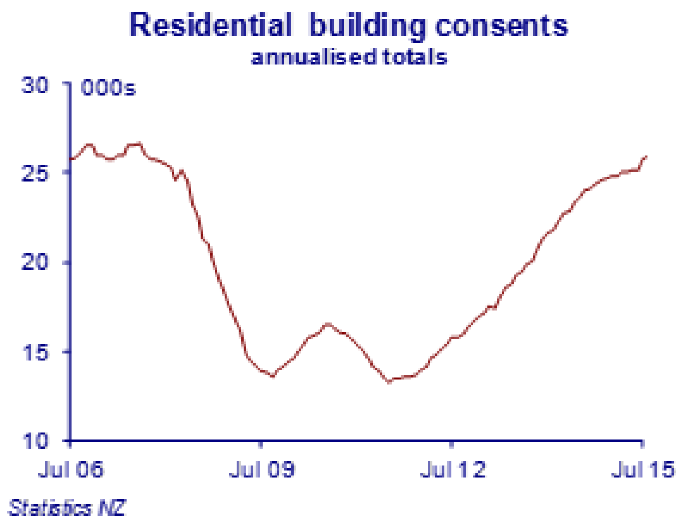
The bald facts are

- TWI NZ$ exchange rate (August average) at 70.3; down from 79.9 a year earlier.
- Government 10-year bond rate (August average) at 3.29%; down from 4.20% a year earlier.
- SME business overdraft rate (August average) at 9.96%; down from 10.45% a year earlier.
- growth in credit to non-agriculture business (July 2015 on July 2014) at 6.7%; up from 4.1% a year earlier.
- growth in number of residential building consents (3 months to July 2015 on 3 months to July 2014) at 9.8%; down from 18.6% a year earlier.
- growth in area of non-residential building consents (3 months to July 2015 on 3 months to July 2014) at -0.3%; down from 4.9% a year earlier.
- growth in real value of non-residential investment spending (June 2015 quarter on June 2014 quarter) at 1.9%; down from 5.6% a year earlier.

Investment and building activity

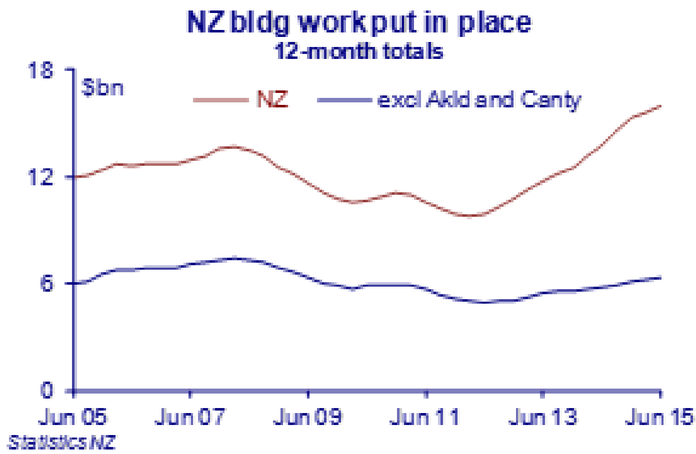
The 12-month running total for residential building consents sat at approximately 25,700 in July 2015. This figure is 8.4% higher than a year earlier and reflects an increase in the number of consents being issued in Auckland and the Bay of Plenty. Consents in these regions are at least 20% higher than a year earlier.

Consents in the North Island were up 12.2% on a year earlier, while residential building consents in the South Island were up 2.3%. Residential building consents over the last 12 months were down in Nelson and the West Coast, which has resulted in this more subdued growth overall in South Island residential consents.



As shown in the left-hand figure above, the 12-month running total for residential building consents has steadily grown since July 2012 when it sat at 15,720 consents issued. The figure on the right hand side illustrates how this growth in consents continues to be driven largely by the Auckland and Canterbury housing markets. In July 2015, the number of residential consents issued for the Auckland Region sat at approximately 8,570 while Canterbury consents sat at just over 7,000. Building work in place data is issued quarterly, with the latest data for the June 2015 quarter. The latest data indicates that we are building houses rather than just consenting for them, and that this building work has been steadily growing. The overall value of new residential building work in the June 2015 quarter is up just over 7% on the same period a year ago; however, this value is not as high as results from the previous quarter due to a slight decline in the value of alterations and addition work.

The figure below focuses on the value of the work that has been put in place, by total New Zealand and by total New Zealand excluding Auckland and Canterbury.



Activity in the non-residential building sector indicates that the number and value of consents for farm buildings has dropped over the last three months and over the last 12 months, while the number of consents for factories, offices and storage buildings is up over the same period. The size of farm buildings that are being consented for has also declined during this period. Together, these figures indicate that a decline in on-farm investment may already be occurring, along with cash flow and business confidence.

However, the focus of policymakers remains very much on residential building activity. The latest Monetary Policy Statement indicates that the Reserve Bank of New Zealand believes the rebuild construction activity in the Canterbury Region has reached a peak, while house building in Auckland will accelerate – probably on the back of property price speculation. This speculation is discussed in more detail as part of our commentary regarding the complications in the housing market.

Money and credit

In July last year, the Reserve Bank increased the OCR to 3.5% while at the same time stating "the level of the New Zealand dollar is unjustified and unsustainable".

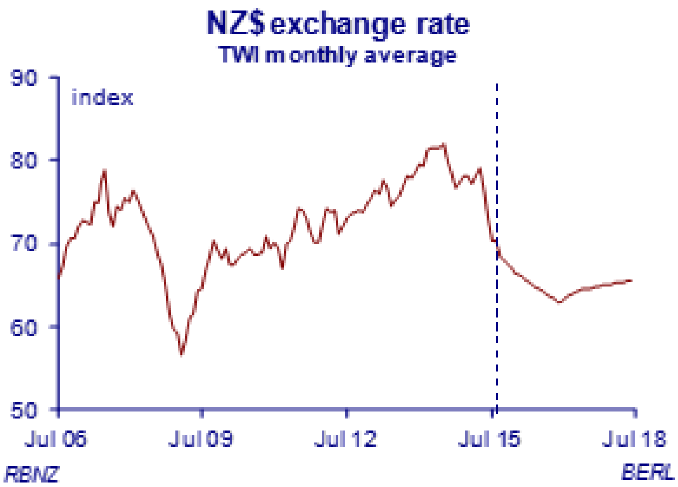
Subsequently, this phrase was repeated by the authorities several times. However, in June this year it was replaced with the NZ$ "... remains overvalued. A further significant downward adjustment is justified."

More recently, following a 14% decline in the TWI exchange rate, this month's Monetary Policy Statement recorded that "While the lower exchange rate supports the export and import-competing sectors, further depreciation is appropriate, given the sharpness of the decline in New Zealand's export commodity prices."

Consequently, we hold to our earlier forecasts if a further NZ$ depreciation. We see the Kiwi sliding another 7-8% (to about 60 US cents and low-to-mid 80 Aussie cents) over the coming 9-12 months. This is further justified with the expected deterioration in the external account continuing over this period.

This combined with further interest rate declines mean an effective loosening of monetary and credit conditions.

The challenge (or risk) is to ensure the lower exchange and interest rates do not translate into unsustainable credit growth and/or inflation. This factor, of course, is probably most visible in the flow through to prices in the Auckland property market. The developing disconnect between growth in nominal GDP and that of money supply (M3), as illustrated, reflects these concerns.

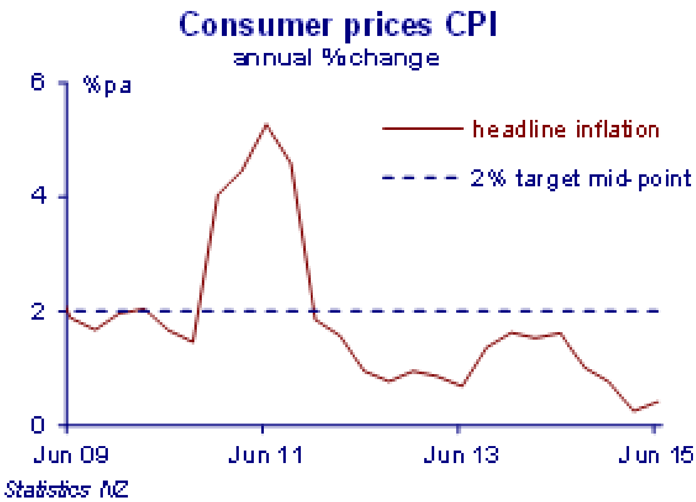


credit exposures and risks. Promisingly, real growth in the non-dairy export sectors as well as planned ongoing infrastructure spending provide a reasonable short-term foundation. In addition, global inflation pressures remain weak suggesting we are in a generalised low-inflation environment.

The clear risk remains that the New Zealand authorities begin (again) to take pre-emptive action to mitigate the 'expected' inflation. We recall that January 2013 saw the Reserve Bank noting that inflation "… remains subdued and is currently just below the bottom of the Reserve Bank's inflation target range… " but expected growth would bring "… inflation slowly back towards the 2% target midpoint." Over the two-and-a-half years since, the CPI has increased at a rate of barely 1% per annum, producer output prices have recorded 0.8%per annum inflation, while core retail price inflation has been negative.

The bald facts are

- growth in value of electronic transactions (August 2015 quarter on August 2014 quarter) at 5.9%; up from 3.9% a year earlier.
- growth in core retail sales values (June 2015 quarter on June 2014 quarter) at 5.5%; up from 3.2% a year earlier.
- government operating balance before gains and losses (11 months to May) at +$1.2bn; up from -$1.1bn a year earlier.
- core retail price inflation (June 2015 quarter on June 2014 quarter) at -0.6%; down from 0.2% a year earlier.
- consumer price inflation (June 2015) at 0.4% per annum; down from 1.6% a year earlier.



Inflation

Inflation, as measured by the Consumer Price Index (CPI), was 0.4% higher in the June 2015 quarter than in the March 2015 quarter. The CPI was also 0.4% higher in the year to June 2015.
The Reserve Bank of New Zealand's current target is to keep the future annual CPI inflation at between 1% and 3% on average over the medium term, with a focus on keeping future average inflation near the 2% target midpoint. The latest figures imply that inflation has been at or below the bottom end of the range for the last four quarters. They also show that it has been below the midpoint for 15 successive quarters, i.e. since the end of 2011.

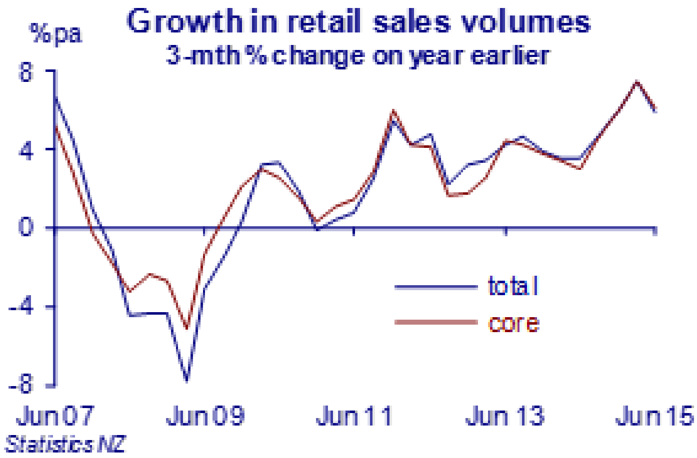
Nonetheless, the Reserve Bank's September Monetary Policy Statement stated their expectation of CPI inflation moving to the middle of the 1% to 3% range by during mid-to-late 2016.

The Bank expects the main driver of higher inflation to be the lower exchange rate, which is likely to push up the price of imports. The Trade Weighted Index for the New Zealand dollar exchange rate is projected to fall to 65 by mid-2016, from an average of 76 during the June 2015 quarter. The drop in global oil prices that occurred at the start of 2015 will also disappear from the inflation rate calculation by early 2016. Based on past experience, the Bank also expects the fall in the exchange rate to increase tradable inflation by 3.5 percentage points over the next year.

Retail

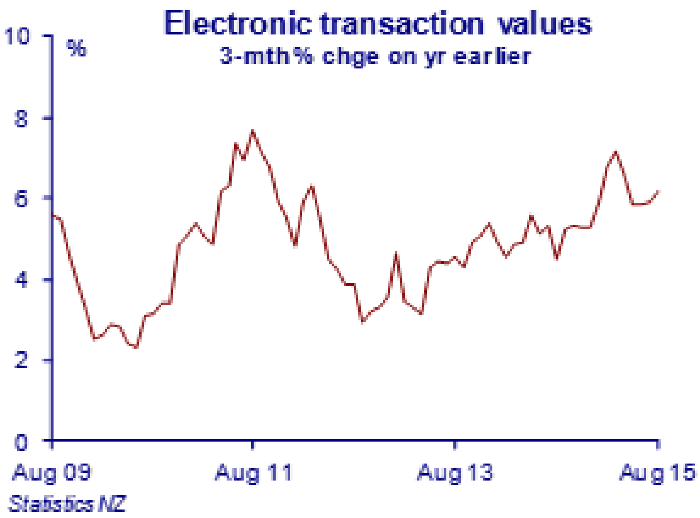
At the retail level, sales are set to face a fairly flat outlook over the remainder of the year as sales values and volumes come off the high seen in March this year. Total and core retail price inflation fell over the 12-month period to June at -1.4% and -0.4% respectively.

Core spending (which excludes motor vehicle and related expenditure such as fuel), has slipped sharply since March, though this is not surprising given the seasonal trend of retail sales peaking in the December quarter, dropping back in the March and again in the June quarters, before picking up again in the September quarter.



Retail sales did jump in July though this was largely led by an increase in clothing sales during the winter season.

While the chilly weather spelled a somewhat warmer winter for apparel retailers in July, it was less rosy for other retailers. The June quarter saw total retail sales hit by recent bad weather and a slip in consumer confidence, particularly as the uncertainty from recent dairy price fallouts filtered through with farmers tightening their spending; more evident in the rural regions where the dairy farms are located. Electronic transaction numbers continued their upward trend with at nearly 1.25 billion transactions in the 12 months to August. Of this, approximately



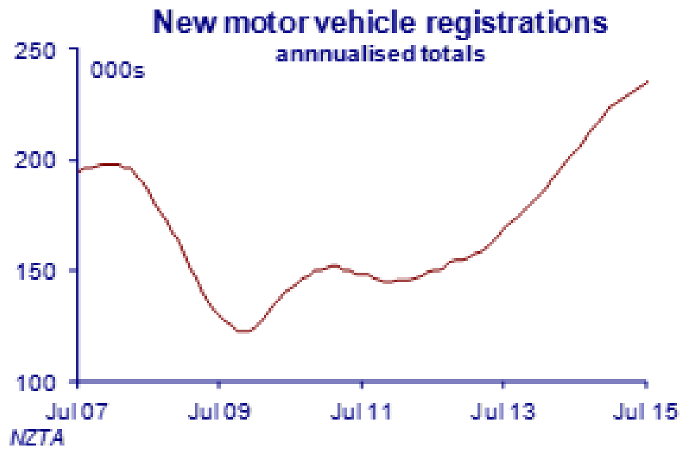
1.07 billion, or 86% was attributed to core industries (i.e. excluding motor vehicle and related transactions e.g. fuel).

The value of electronic card transactions was also on the rise, particularly so in the 3 month period to August for motor vehicles, up 13% compared to the same period in 2014. Durables (which include goods such as appliances and electronic goods) on the other hand, grew at a more subdued pace of 6% over the same period.

Meanwhile the 12-months to August saw consumables electronic card transaction values, which includes food and liquor retailing, grow 5.6%, while hospitality saw the strongest growth over the same period of 9.8%.

Fuel transaction values have steadily been declining since January 2014 in the face of declining fuel prices though this may pick up with prices rising again in recent months; fuel transaction values were 7% lower in the year to August on the previous year. Motor vehicle related expenditure transactions (i.e. including fuel) came in second after consumables in terms of percentage growth terms over the year to August, with 9.7%.

While volumes and values of electronic card transactions have been steadily increasing, the pace of growth may be set to slow with contractionary consumer confidence, combined with the decline of the Kiwi dollar in recent months which makes imports more expensive.



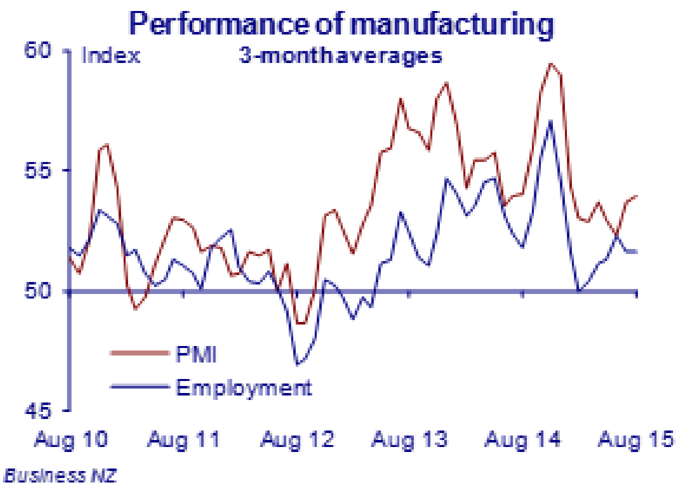
The increase in car registrations has been bolstered by a burst of rental vehicle purchasing during August, a little ahead of that industry's usual fleet upgrading months of September to November. Another boon for vehicle owners is the new safety tier system for annual car licensing (i.e. car registration) which will see savings for light passenger vehicles. Depending on the type of vehicle, licensing fees will fall on average by 41%, while ACC levies on petrol will fall by 3 cents a litre. In addition, the new vehicle market in particular is very competitive at the moment keeping prices stable. That particular market looks set to expect further growth, though at a slower rate.

The used vehicle market also remains relatively buoyant. Auction house Turners' recent $2.5 million purchase of a Christchurch property to accommodate its growing truck and machinery business is but one indicator that in the used industrial vehicle market at least, the outlook is still quite promising.

Manufacturing

The latest monthly data (August) from the Performance of Manufacturing (PMI) survey indicates that the manufacturing industry remains solidly in expansion mode.

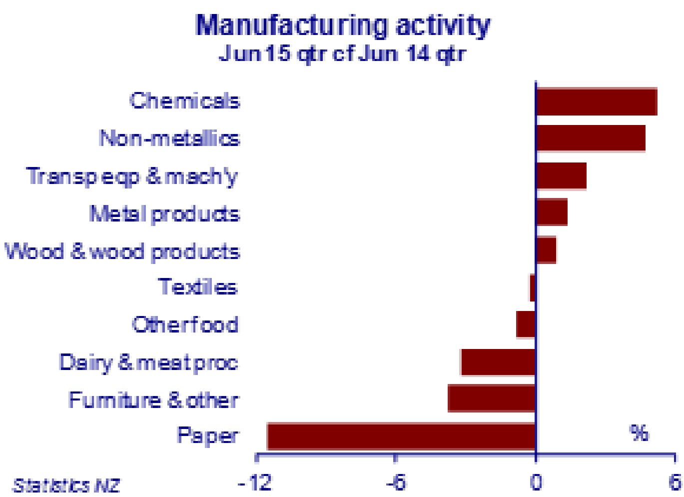
The three-monthly average for the PMI in August stood at 53.9, just up from the three-monthly average in July of 53.7. This observation is reinforced by the three-monthly averages for the production, employment, and new orders sub-indexes, which have all been above 50 since October 2013.



Manufacturing production in the Canterbury region is currently higher than the national average. This has been the case for a number of months, and reinforces the importance of the Christchurch rebuild to the heightened levels of economic activity currently being enjoyed. The Otago region, in contrast, has had some highs and lows – with a three-monthly average as high as 66.4 in December 2014, to a low of 42.6 in April 2015.

The latest survey of manufacturing activity from Statistics New Zealand provides another indicator of what is happening in the manufacturing sector and how other sectors are positively influencing manufacturing activity. For example, if we compare the latest quarter (June 2015) with the same quarter last year (June 2014) it can be seen that dairy and meat processing are down, along with furniture and paper production, but the manufacturing of chemicals and non-metallic goods is up.

Non-metallic goods includes the manufacturing of glass, bricks and blocks, lime and cement (including ready-mix concrete), and insulation materials. These are all materials used in the building construction industry – along with metal and wood products.



Overall, manufacturing sales volumes increased by less than 1% year-on-year in June 2015, but if we exclude meat and dairy processing this growth increases to 1.6% year-on-year. Dairy and meat processing sales volumes were down 3.2% year-on-year but sales volumes from chemical manufacturing and non-metallic manufacturing were up 5.2 and 4.7% respectively.

The impact of a lower exchange rate may begin to be more evident in the sales volumes presented in the next survey of manufacturing - across categories such as textiles and transport machinery and equipment – but we don't expect to see this flow through to log and dairy export prices just yet. With low interest rates and an ongoing inflow of migrants, we expect households will continue to spend and this will positively impact on manufacturing businesses that focus on the domestic market. But confidence in the rural sector remains subdued, and dairy farmers may cut costs, including the delay of capital expenditure on plant and equipment such as tractors, and the use of technical services. This lack of confidence may balance out the ongoing spending of households in our urban centres, and cause business confidence to pause if not drop.

ABROAD AND BEYOND

The bald facts are

- growth in merchandise export receipts (July 2015 quarter on July 2014 quarter) at 2.1%; down from 4.4% a year earlier.
- growth in merchandise import payments (July 2015 quarter on July 2014 quarter) at 2.3%; down from 4.8% a year earlier.
- growth in services export revenue (June 2015 quarter on June 2014 quarter) at 20.4%; up from 1.4% a year earlier.
- growth in China GDP (June 2015 quarter on June 2014 quarter) at 7.0%; down from 7.5% a year earlier.
- growth in Australia GDP (June 2015 quarter on June 2014 quarter) at 2.0%; down from 2.8% a year earlier.

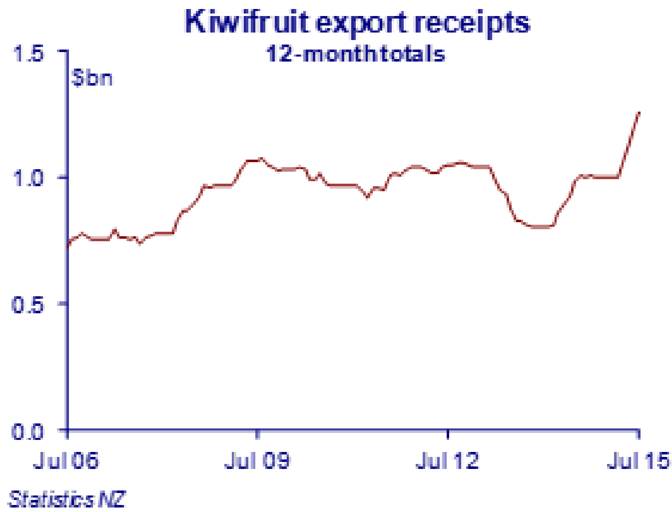
Exports, including tourism

Recent months has seen the strength of services exports solidify, while the goods (merchandise) export sector has weakened further. The dominant player in the latter has been tourism, while the former has been driven primarily by the fortunes of the dairy sector. Nevertheless, within the 5% slump (or $2.5billion) in merchandise revenues over the past year, have been some noticeable gains.

Goods (merchandise) exports

Promisingly, meat, wine, kiwifruit, apples, casein, fish, and wool have recorded considerable revenue increases over the past year. Of course, anticipated drought conditions will likely impact on future volumes of primary produce, with a consequential impact on receipts.

However, gains in terms of NZS$ returns from the lower exchange rate will work to counter some of this effect. Indeed, it is pertinent to note that the exchange rate decline over the past six months will only now begin to flow through to revenues. That is, much of the gains recorded to date have been in the face of a difficult exchange rate environment. This robustness augurs well.



In particular, kiwifruit gains this season of about 28% in value terms have arisen mainly from a 20% surge in volumes as the industry recovers from the damaging PSA virus. In contrast, the close to 15% surge in meat receipts results from a welcome 12%

recovery in prices. And the 7% revenue gain from wine was on the back of another 10% surge in volumes exported.

While one would ordinarily expect a huge gain across the export sector when there is a double-digit percentage depreciation in the exchange rate, the anticipated drought as well difficulties in external markets will take some gloss off this outlook. Nevertheless, the subdued dairy situation is not the only story in town.

Services exports

Even more upbeat is the picture for services; in particular, tourism. The latest 12 months sees tourism revenue up 28%, with annual visitor numbers up nearly 8% to over 3 million.
More tourists are coming to New Zealand and they are spending more while they are here. This has created something of a boom in the tourism sector that is helping to keep the economy growing.
According to the Accommodation Survey, the number of international guest nights was 14.4 million during the 12 months to July 2015. This was 7.3% higher than in the 12 months to July 2014. The number of international guest nights increased in every region of the country, but the increases were greatest in Canterbury (up 12. 3%), Southland (up 11.6%) and the West Coast (up 11.5percent).

Separate data from the International Visitor Survey show that total expenditure by international visitors was $8.7 billion in the year ended June 2015. This was $1.911 billion, or 28% more than during the year to June 2014. This increase was not simply because there were more visitors; the visitors also spent more. The average spend per visitor in the year to June 2015 was $3,240. This was 19% more than the average of $2,720 in the year to June 2014.

Data collected from arrivals cards shows that, in terms of absolute numbers, 203,018 more international visitors arrived in the latest 12 months compared to the previous 12 months. The data also showed that most of the growth in tourism is coming from established markets. Visitors from China, Australia and the USA accounted for 71% of the additional visitors.

Trade and payments balances

The picture for the merchandise trade balance is undeniably bleak, with the slump in goods exports taking the annual deficit to close to $3 billion. This component of the external accounts is set to worsen over the forecast horizon, as the range of export products struggle to counter the decline in dairy along with difficult external market conditions.

In contrast, the surplus balance on services trade will solidify over the forecast horizon. However, the rate of improvements will ease as volume driven tourism growth inevitably trigger short-term capacity issues.

The annual investment income deficit remains close to the $10 billion mark. Consequently, the external current account deficit is set to gradually grow to an annual $13 billion by 2018, or around 5% of GDP.

The world

United States

The US economy experienced an increase in quarterly GDP of 0.9% in the June 2015 quarter. Annually GDP for the year to June 2015 fell to 2.7%, from 2.9% in March 2015, instead of following the quarterly result and increasing. The decrease in annual GDP has come about due to the June 2015 quarter result being lower than the June 2014 quarter when GDP increased by 1.1% for the quarter.

For the last three years, annual GDP growth in the US has averaged 2.1%. During this period GDP growth in the US has been inconsistent with annual growth bouncing between 0.9 and 2.9%.

On an annual basis the US CPI rose by 0.1% in the year to July 2015, this is continuing the recent trend of low or declining US annual CPI results. This has been mainly due to the decline in gasoline prices, which has mirrored to a large extent the fall in the price of oil.

The August 2015 month saw 173,000 non-farm jobs added to employment market, over the last twelve months an average of 240,000 non-farm jobs per month have been added to the economy. At the same time the unemployment rate has fallen to 5.1% in the August 2015 month.

Forecasts suggest that the US economy will strengthen its current growth pattern over the next two years, with annual GDP growth averaging 2.7%, which combined with unemployment predicted to fall below 5%, will see the US buying more goods and services from the rest of the world.

Australia

Australia has seen a fifth consecutive quarterly decline in its annual GDP growth, which at June 2015 stood at 2.0%, down from 2.3% in March 2014.

While GDP growth has been declining, Australia has managed to stop its rising unemployment, with the unemployment rate in August 2015 standing at 6.2%, unchanged from the previous month.

The signs are pointing to the Australian economy to continue it's slow down, with iron ore prices at almost $50 a tonne, well down on the $100+ a tonne last seen at the start of 2014, low investment in the mining industry, and Chinese GDP growth and imports declining.

Forecasts have Australia bouncing back in 2016 with GDP growth once again growing by almost 3% per annum, and unemployment declining back to 6%.

China, India and Asia

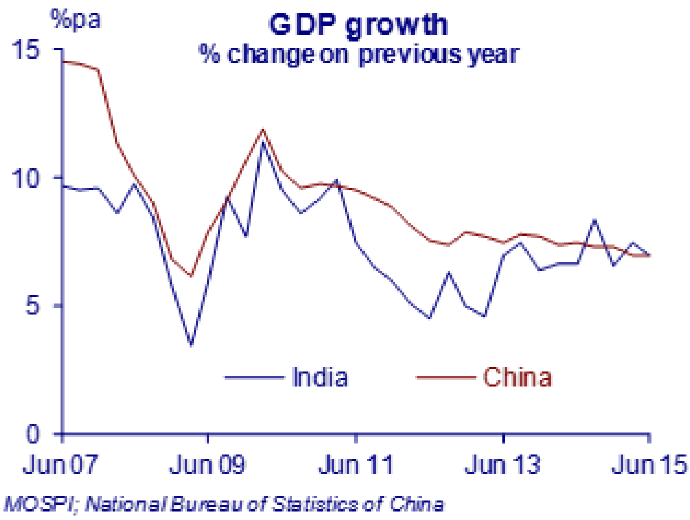
On the 9th July 2015, prices on the Shanghai Stock Exchange (SSE) stopped falling, after they had dropped by 30% since June 12th 2015.

This 30% fall came on the back of a 150% increase in the SSE since June 2014.

In order to stop the drop in SSE prices, the Chinese Government has undertaken a large range of options, including:

- halting hundreds of companies from trading their shares,
- freezing new IPOs,
- pushing stock brokers to buy falling stocks, and
- offering more and easier financing to retail investors who dominate the SSE.

The efforts of the Chinese Government to halt the decline in the SSE is somewhat ironic given that it was a tightening of rules around margin trading, designed to slow the very rapid increase in the market since June 2014, that caused the SSE to go into decline in the first place.



China's faltering economic growth was highlighted further in August 2015, with the Chinese government surprising global markets by devaluing the Yuan by 1.9%. Also, weaker than expected factory activity being reported due to declining domestic and export demand for manufactured goods.

Consequently, the Chinese government in September 2015 announced it will cut its one-year benchmark lending and deposit rates by 25 basis points, as well as reducing reserve requirements by 50 basis points for most of its larger banks.

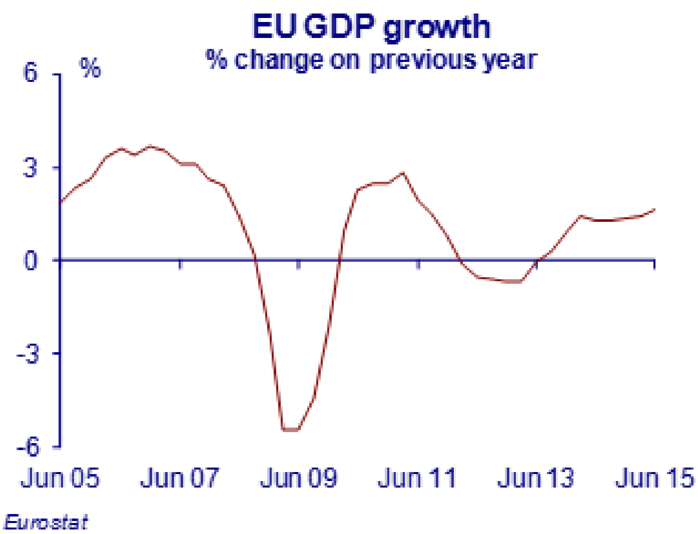
Economic growth in India remains close to the 7% per annum mark. Similarly, growth in the eastern and south-east remains stable.

Nevertheless, repercussions from the recent the Chinese upheaval will be anxiously awaited.

Europe and United Kingdom

The European Central Bank (ECB) is currently spending up to a trillion euros to purchase assets to combat the very low inflation rate currently been seen in the EU. Inflation for the year to July 2015 was at 0.2%. With inflation this low and economies growing slowly, the EU is at risk of an extended period of deflation, which would put the brakes on the current growth being seen in the EU. The ECB is expecting its purchasing program to last for at least 18 months and will only end once the ECB is convinced inflation has been stabilised at around 2%.

The EU, particularly the main members, have continued their slow but sure growth out of the last recession, with an increase of 1.9% for the year. The UK has continued their run of strong positive growth with a 0.7% increase for the quarter, for an annual increase of 2.6% for the year to June 2015. At the same time, Italy has finally dragged itself



out of its recent recession with annual GDP growth at 0.5% for the year, while Germany has seen its annual GDP growth climb back to 1.6% for the year to June 2015, after dropping down to just 1.0% in the year to March 2015.

Forecasts for the Euro zone are expecting that GDP growth for Europe will almost reach 2% in 2016, with GDP growth in Germany climbing back to 1.9% in 2016.

The unemployment rate in EU remains high, though there are signs of improvement. Unemployment in the EU peaked at 10.9% in August 2013. Since then the unemployment rate has declined to 9.5% for the July 2015 month. If this trend continues we could see unemployment rates drop to close to 9% by the end of 2015.

Summary Table

SUMMARY	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Forecast	2017 Forecast	2018 Forecast
annual average % change, March years							
GDP (expenditure measure)	2.2	2.9	2.5	3.0	1.8	2.5	2.5
GDP (production measure)	2.2	2.2	2.5	3.2	1.8	2.5	2.5
Private consumption	2.7	2.5	3.1	3.1	2.8	2.5	2.4
Government consumption	1.5	-0.6	2.7	2.8	2.8	1.9	1.8
Housing investment	-0.2	17.7	16.6	12.3	3.8	2.8	2.4
Business investment	7.2	4.3	8.4	4.4	1.7	3.7	2.7
Exports	2.2	3.1	-0.1	4.2	1.8	0.7	2.2
Imports	6.7	1.3	8.1	7.5	4.5	1.2	1.7
June quarters							
Employment (annual % change)	0.1	1.0	3.8	2.9	1.4	1.2	1.5
Unemployment (% of labour force)	6.5	6.2	5.5	5.7	5.5	5.5	5.6
Net migration (annual 000s)	-3,191	7,907	38,338	58,259	42,000	29,000	24,000
annual % change, March quarters							
GDP deflator (average annual % change)	2.1	-0.5	4.2	0.6	1.7	1.3	1.8
Wages (avge hourly earnings)	2.0	1.7	1.6	1.6	1.7	1.8	1.8
Consumer prices (CPI)	1.6	0.9	1.5	0.3	1.0	1.3	1.3
Producer prices (PPI outputs)	1.6	0.1	4.0	-0.5	0.5	1.0	1.0
June years							
Current account balance ($bn)	-7.7	-7.8	-5.7	-8.3	-9.9	-11.7	-13.5
Current account balance (% of GDP)	-3.6	-3.6	-2.4	-3.5	-4.0	-4.5	-5.2
Net international investment position (% of GDP)	-69.1	-69.2	-64.4	-62.2	-64.1	-66.2	-68.5
Government OBEGAL ($bn)	-9.2	-4.4	-2.8	-0.5	0.4	1.2	2.6
Government OBEGAL (% of GDP)	-4.4	-2.0	-1.2	-0.2	0.1	0.5	1.0
average levels, March quarters							
Exchange rate (TWI)	73.5	75.9	80.0	77.9	66.3	63.5	65.2
90-day bank bill rate	2.7	2.7	3.0	3.6	2.4	2.5	2.9
10-year bond rate	4.0	3.7	4.6	3.3	2.9	3.0	3.3
Memo items							
Merchandise export receipts (fob $m, June years)	44,497	43,800	49,073	45,984	46,469	47,305	48,159
Merchandise import payments (cif $m, June years)	45,060	44,159	47,469	48,817	50,717	52,674	54,708
International visitor arrivals (000s, March years)	2,618	2,611	2,752	2,947	3,069	3,154	3,228
Residential new building consents (000s, March years)	14.6	17.4	22.4	25.0	27.0	28.2	28.0
New car registrations (000s, March years)	145.6	158.6	191.2	227.6	238.1	245.0	252.1
Core retail sales nominal (annual % chge, March years	4.4	2.0	3.7	5.1	4.3	3.7	3.1

Labour Market Indicators

Labour market indicators	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Forecast	2017 Forecast	2018 Forecast
June quarter							
Full-time employment (000s)	1,672	1,694	1,760	1,811	1,838	1,861	1,890
Part-time employment (000s)	517	508	522	539	543	549	554
Total employment (000s)	2,189	2,202	2,282	2,349	2,381	2,410	2,444
FTE employment growth (annual % change)	0.1	1.0	3.8	2.9	1.4	1.2	1.5
Unemployment (000s)	155	147	133	143	138	140	146
Official unemployment rate (% of labour force)	6.5	6.2	5.5	5.7	5.5	5.5	5.6
Labour force (000s)	2,377	2,348	2,414	2,492	2,519	2,550	2,590
Participation rate (% of labour force)	69.0	67.5	68.2	68.9	68.0	67.8	67.8
Not in labour force (000s)	1,102	1,129	1,124	1,124	1,186	1,212	1,230
Working age population (000s)	3,446	3,477	3,538	3,616	3,705	3,762	3,820
Migration (annual year to June)							
Gross inflow (000s)	84,402	88,235	100,784	115,655	104,500	93,500	90,500
Gross outflow (000s)	87,593	80,328	62,446	57,396	62,500	64,500	66,500
Net inflow (000s)	-3,191	7,907	38,338	58,259	42,000	29,000	24,000

Merchandise Export Receipts

Merchandise export receipts	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Forecast	2017 Forecast	2018 Forecast
annual $m, June years							
Dairy	11,625	11,319	15,830	12,036	12,072	12,193	12,315
Meat	5,287	5,407	5,798	6,545	6,610	6,703	6,797
Wool	778	680	734	806	808	811	814
Fish	1,494	1,479	1,443	1,493	1,500	1,523	1,545
Horticulture	2,296	2,261	2,402	2,700	2,754	2,817	2,882
Alcohol	1,281	1,302	1,413	1,485	1,514	1,549	1,585
Forestry products	4,476	4,583	5,210	4,684	4,754	4,873	4,994
Aluminium	1,083	942	885	1,024	1,029	1,034	1,039
Machinery & transport eqpmt	2,879	2,534	2,412	2,428	2,462	2,523	2,586
Petroleum	2,329	1,961	1,558	1,173	1,180	1,187	1,194
Other	10,968	11,333	11,388	11,611	11,786	12,092	12,406
Exports of Goods (fob)	44,497	43,800	49,073	45,984	46,469	47,305	48,159
% change	1.4	-1.6	12.0	-6.3	1.1	1.8	1.8
as a % of GDP	21.0	20.2	21.0	19.1	18.7	18.3	17.8

Balance of Payments

Balance of Payments on Current Account	2012 Actual	2013 Actual	2014 Actual	2015 Actual	2016 Forecast	2017 Forecast	2018 Forecast
annual $m, June years							
OT trade balance (fob-cif)	-563	-359	1,604	-2,833	-4,248	-5,369	-6,549
BoP conceptual adjustments	1,666	565	1,619	1,371	1,600	1,600	1,600
BoP merchandise trade balance	1,103	206	3,223	-1,462	-2,648	-3,769	-4,949
Services exports	16,761	16,292	16,640	19,091	19,586	20,076	20,578
Services imports	15,314	15,267	15,676	16,322	16,810	17,218	17,636
Services balance	1,447	1,026	965	2,769	2,776	2,858	2,942
Balance on goods and services	2,550	1,232	4,188	1,307	128	-911	-2,006
Investment income balance	-9,925	-8,529	-9,436	-9,229	-9,660	-10,390	-11,158
Transfers balance	-285	-484	-407	-376	-376	-376	-376
Current Account Balance	-7,660	-7,781	-5,655	-8,301	-9,908	-11,677	-13,541
as a % of GDP	-3.6	-3.6	-2.4	-3.5	-4.0	-4.5	-5.2

Government Accounts

Government accounts	2012 Actual	2013 Actual	2014 Actual	2015 Estimated	2016 Forecast	2017 Forecast	2018 Forecast
annual $m, June years							
Direct taxation	34,780	37,540	39,225	40,840	41,615	42,610	43,790
Indirect taxation	20,305	21,110	22,250	23,225	23,785	24,480	25,280
Miscellaneous revenue	5,485	5,500	5,825	6,005	6,215	6,370	6,495
Core crown revenue	60,570	64,150	67,300	70,070	71,615	73,460	75,565
as a % of GDP	28.5	29.6	28.8	29.1	28.8	28.4	28.0
Social security	22,030	22,740	23,280	23,630	23,925	24,500	25,090
Health	14,160	14,500	14,900	15,085	15,355	15,665	15,945
Education	11,655	12,505	12,300	12,520	12,795	13,025	13,225
General expenditure	17,725	16,945	17,370	17,540	17,805	18,160	18,525
Debt servicing	3,510	3,620	3,620	3,640	3,660	3,695	3,735
Core crown expenditure	69,080	70,310	71,470	72,415	73,540	75,045	76,520
as a % of GDP	32.5	32.5	30.5	30.1	29.5	29.0	28.3
Memo items							
Total crown OBEGAL	-9,240	-4,350	-2,775	-535	360	1,245	2,575
as a % of GDP	-4.4	-2.0	-1.2	-0.2	0.1	0.5	1.0

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