NEW ZEALAND ECONOMICS
ANZ ECONOMIC OUTLOOK

December 2016

INSIDE

NZ ECONOMICS TEAM

Cameron Bagrie
Chief Economist
Telephone: +64 4 802 2212
E-mail: Cameron.Bagrie@anz.com
Twitter @ANZ_cambagrie

Philip Borkin
Senior Economist
Telephone: +64 9 357 4065
Email: Philip.Borkin@anz.com

David Croy
Senior Rates Strategist
Telephone: +64 4 576 1022
E-mail: David.Croy@anz.com

Kyle Uerata
Economist
Telephone: +64 4 802 2357
E-mail: Kyle.Uerata@anz.com

Con Williams
Rural Economist
Telephone: +64 4 802 2361
E-mail: Con.Williams@anz.com

Sharon Zöllner
Senior Economist
Telephone: +64 9 357 4094
E-mail: Sharon.Zollner@anz.com

CYCLING AROUND

NEW ZEALAND ECONOMIC OUTLOOK

The economy is entering its eighth year of expansion with strong momentum. But natural headwinds are now emerging (capacity pressures, a turn in the credit cycle, tighter financial conditions, stretched asset valuations) that should see growth ease over the course of the year from 3½-4% towards 3%). We view this moderation as healthy. Price pressures are now building – we expect the RBNZ to begin removing stimulus from mid-2018 (but wouldn't rule out earlier).

INTERNATIONAL OUTLOOK

Global growth and inflation are forecast to gradually trend higher, with the baton shifting from monetary to fiscal policy and signs of reflation appearing. We expect a volatile few years. The world is awash with risks and challenges: politics, mispriced risk, excess leverage amidst rising interest rates, demographics (which are slowing growth), poor productivity growth and overvalued asset prices.

PRIMARY SECTOR OUTLOOK

Driven by supply dynamics and renewed Chinese demand the cyclical upturn in international soft commodities has strengthened, with further momentum expected into the New Year. Dairy revenue is lifting despite lower production. Meat and fibre production is also lower, which is expected to support prices. Forestry's good run is expected to extend. Horticulture prices look fairly robust.

FINANCIAL MARKETS OUTLOOK

US Treasury bond yields look set to continue to rise gradually, taking New Zealand long-term rates with them, as global policy tilts from central bank stimulus (bond buying) to expansionary fiscal policy (bond selling). With the OCR on hold, steeper yield curves beckon. We expect the NZD to decline gradually on a TWI basis but more quickly against the USD.

Calendar Years	2013	2014	2015	2016(f)	2017(f)	2018(f)
New Zealand Economy						
Real GDP (annual average % change)	2.4	3.7	2.5	3.5	3.3	2.4
Real GDP (annual % change)	2.0	4.1	2.3	3.6	3.1	2.1
Unemployment Rate (Dec quarter)	5.7	5.5	5.0	4.8	4.6	4.3
CPI Inflation (annual %)	1.6	0.8	0.1	1.1	1.7	2.0
Terms of Trade (OTI basis; annual %)	20.2	-5.0	-3.2	0.4	3.1	0.8
Current Account Balance (% of GDP)	-3.1	-3.2	-3.3	-3.0	-3.2	-3.3
Government OBEGAL (% of GDP)	-2.0	-1.2	0.2	0.7	0.2	1.2
Global Growth (annual average %)						
US	1.7	2.4	2.6	1.5	2.2	2.3
Australia	2.1	2.8	2.4	2.3	2.5	3.2
China	7.7	7.4	6.9	6.7	6.5	6.3
Trading Partners	3.0	3.6	3.5	3.4	3.4	3.6
NZ Financial Markets (end of Dec quarter)						
TWI	77.3	79.4	73.7	76.6	72.1	70.4
NZD/USD	0.82	0.78	0.69	0.71	0.64	0.65
NZD/AUD	0.92	0.96	0.94	0.93	0.94	0.88
Official Cash Rate	2.50	3.50	2.50	1.75	1.75	2.25
10-year Bond Rate	4.7	3.7	3.6	3.4	3.9	4.3

* Forecasts and text finalised 15 December 2016

NEW ZEALAND ECONOMIC OUTLOOK

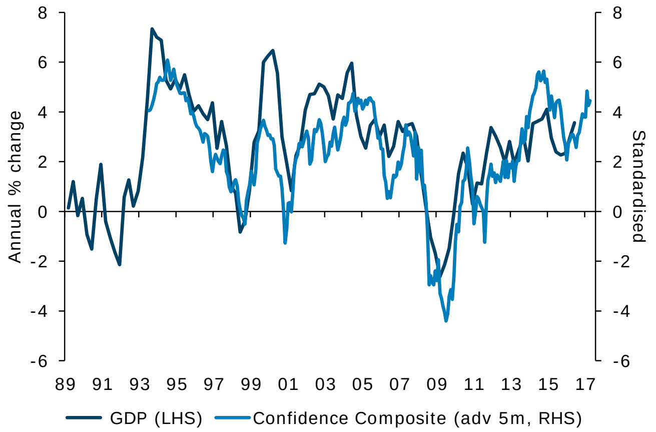
SUMMARY

The New Zealand economy is entering its eighth year of expansion with strong momentum. But natural headwinds are now emerging (capacity pressures, a turn in the credit cycle, tighter financial conditions, stretched asset valuations) that should see growth ease over the course of the year (from 3½-4% towards 3%). That's a natural moderation as opposed to a downturn. We view this moderation as healthy in the context of the country's medium-term stability and its resilience to external shocks. The RBNZ remains on the side-lines for now, although price pressures are now building. We expect the RBNZ to begin removing stimulus from mid-2018 (although we wouldn't completely rule out something earlier).

STEADY AS SHE GOES

As we look towards 2017, the economy is growing briskly. We estimate the economy grew around 3½% over 2016 and forward indicators such as our own confidence composite and financial conditions gauges suggest that a similar pace of annualised growth (if not a little stronger) is on track for at least the first half of 2017.

FIGURE 1. GDP VS CONFIDENCE COMPOSITE



Source: ANZ, Statistics NZ

The drivers of this growth are reasonably familiar, and we expect them to generally persist. Strong population growth on the back of record net migrant inflows is boosting demand. The construction sector pipeline remains large (with the damage resulting from the latest earthquakes creating another source of impetus), even if capacity and capital are becoming increasingly constraining factors. The strengthening labour market is supporting household confidence and consumption, as are historically low borrowing costs. The tourism sector is booming. Prospects in the dairy sector have improved as prices have recovered and non-dairy agriculture sectors continue to perform strongly. The terms of trade looks to be at, or near, its cyclical low, with the outlook now one of modest improvement, supporting national incomes (and income growth).

It must be said that we can identify some worrying signs across the economy. Credit is outpacing income growth and has risen to 152% of GDP. Household debt is 165% of disposable incomes and the household saving rate has fallen further into negative territory. Auckland house prices are through the stratosphere. Productivity growth remains subdued. **Such signals are symptomatic of an economy that is showing late-cycle exuberance, which can typically foreshadow a downturn and/or make the economy more vulnerable to an external shock.** This is precisely what happened prior to the Asian Crisis and Global Financial Crisis. Internal frailties plus a global shock resulted in deep domestic corrections.

However, the economy looks more internally "balanced" this time around.

We note:

- **External imbalances are contained**. At around 3% of GDP, the current account deficit is low by historical standards. It has also failed to widen meaningfully, despite ongoing expectations that it would, hinting that there is a structural element to this improvement. Net external debt, while still high at 56% of GDP, is well below where it peaked in 2008 (84%). In addition, the maturity profile of that debt has lengthened, reducing (but not totally eliminating) exposures to global funding markets.
- **We have a housing boom but not a consumption equivalent.** Typically the two go hand in hand and that drives up inflation, bringing the RBNZ into play. Higher interest rates then drive a housing downturn. At present, consumption per capita is growing only modestly. Houses are not being used like ATMs as they were prior to 2008.
- **Domestic inflation pressures are contained.** Household spending restraint, together with structural deflationary forces, has capped domestic inflation pressures (although perhaps a turning point is now underway). Importantly, that means the RBNZ is not actively trying to slow the economy as is often the case at this point in the cycle.
- **The regulatory framework has been tightened.** The RBNZ is taking a far more active role in responding to housing risks than it has done in the past. It is on its third round of LVR restrictions, which have improved banking system resilience and are showing clear signs of cooling the rampant property market.

NEW ZEALAND ECONOMIC OUTLOOK

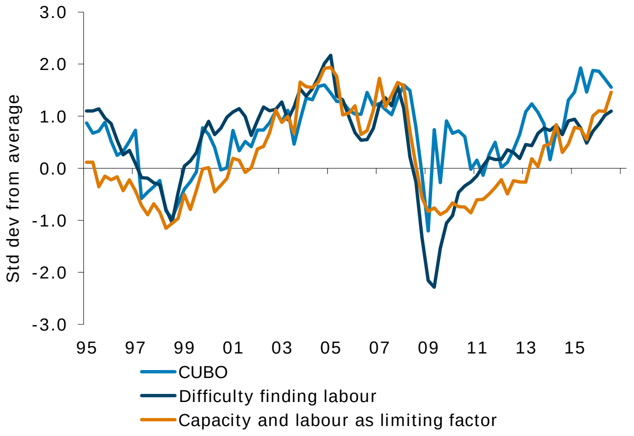
- **Financial institutions are actively leaning against the top of the cycle.** In part this is because of funding pressures (banks need more deposits), but also natural business decisions. Banks are tightening lending standards and increasingly rationing credit. While that will have some growth consequences, it lessens the risks of a nasty future correction that another year or two of strong credit growth would have generated.

The above themes do not eliminate the business cycle entirely nor make the economy bullet-proof. In fact, one of the core elements of our economic forecasts is that growth will begin to moderate from the latter part of 2017 as some natural headwinds emerge. It's just that we believe the economic environment at present is one where the odds of that moderation in growth turning into a full-blow economic downturn are lower than they have been in the past.

Key reasons growth is expected to moderate include:

- **Capacity is becoming increasingly strained.** Finding skilled labour is now the biggest problem facing firms, according to our Small Business Microscope. The unemployment rate is at 4.9% and forecast to continue falling despite expectations of ongoing strong labour supply growth (persistent net migrant inflows). Wage growth is forecast to lift gradually as a result. While not limited to construction, these pressures are most pronounced in that sector and associated construction cost inflation is now calling into question the viability of some projects. While work to repair the damage from the latest central New Zealand earthquakes provides another key boost to demand, resources will ultimately need to shift from elsewhere to accommodate it. It will therefore elongate the cycle, as opposed to intensify it.

FIGURE 2. INDICATORS OF RESOURCE PRESSURES

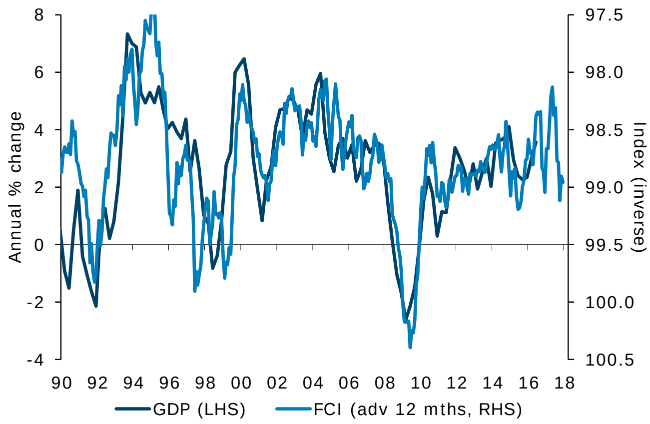


Source: ANZ, NZIER

- **The credit cycle has turned.** In part due to regulatory changes (LVR restrictions), but also reflecting questions of sustainability (already-high indebtedness) and the bank funding environment (credit rationing and deposit competition), credit growth is now slowing. We expect it to slow further towards 5%-6%, a rate more comparable with income growth and far more sustainable over the longer run.

- **Financial conditions have tightened.** While providing a supportive signal for growth over the next 12 months or so, conditions have tightened recently on equity and house price softness and recent interest rate moves.

FIGURE 3. NZ GDP VS FINANCIAL CONDITIONS INDEX



Source: ANZ, Statistics NZ

- **The housing market is cooling**. Turnover has fallen and price growth has moderated. On a 3m/3m basis, nationwide price growth cooled to just 1.1% in November, which is down from over a 6% rate only a few months earlier. For some of the factors listed above (financial conditions, credit cycle) we do believe this cooling will persist, removing a source of tailwind for consumer confidence and services sector activity.

But ultimately we are talking about activity growth slowing from a gallop to a canter. It is also the kind of moderation we view as healthy in order to avoid widespread excesses (which typically emerge at this point in the cycle). Our calendar year forecasts show GDP growth averaging a similar pace in 2017 (3.3%) as we estimate was experienced over 2016, but within that sequential annualised growth is forecast to ease from close to 4% over the first part of the year towards 3%, with that moderation continuing into 2018.

Private consumption is forecast to continue expanding at a solid pace. We forecast real growth of around 3½% in both 2016 and 2017, which is

NEW ZEALAND ECONOMIC OUTLOOK

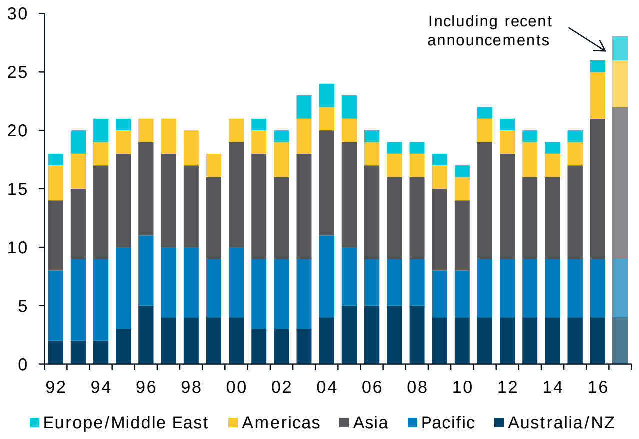
historically strong, though more modest on a per capita basis. Earlier net wealth gains, strengthening labour incomes, and an improved outlook for non-labour income (farm incomes especially) are driving forces behind this growth.

But relative household restraint is expected to remain a key theme. While our forecasts imply consumption growth lifting towards 1½% in per capita terms, this is still modest by historical standards (especially considering the net housing wealth gains seen). Additionally, our forecasts incorporate a modest lift in the saving rate (towards 1½% of disposable incomes) with the 5-6% estimated growth in household disposable income over the next couple of years slightly outpacing the 5% annual nominal consumption growth expected. It also assumes the ratio of household debt to income caps out shortly, perhaps around 167% (which is still an all-time high of course).

As a share of GDP, investment is forecast to rise further, albeit modestly. Total investment is forecast to expand 4.8% in 2017 after estimated 5.7% growth over 2016, which should see it rise above 25% of GDP. While residential investment growth is forecast to moderate as capacity and capital constraints bite (from 12% annual growth towards 4%), other fixed asset investment is forecast to accelerate. Solid business sentiment and profitability is supportive. But more fundamentally, a tighter labour market (and expectations of the price of labour relative to capital), is expected to see businesses increasingly turn to capital (as opposed to labour) investment as a way to deal with these capacity pressures. Perhaps that will even lay the groundwork for a future improvement in labour productivity growth.

After some near-term weakness, net exports are expected to eventually contribute positively to growth. Largely due to weakness in primary good exports (in part weather-related), export growth is forecast to be relatively soft in the near term. However, solid growth in services exports led by tourist spending is a driving force, and while the rate of growth in visitor arrivals and spending has eased most recently, prospects remain strong, with additional airlines announcing new flights to New Zealand. We estimate that in 2017 29 different international airlines will be flying to New Zealand, which is up from just 19 in 2014.

FIGURE 4. INTERNATIONAL AIRLINES FLYING TO NEW ZEALAND (EX CARGO)



Source: ANZ, Ministry of Transport

PRICE TENSION IS FINALLY EMERGING

The inflation cycle is turning upwards. Base effects from a stabilisation in oil prices alone are expected to see headline inflation return to the RBNZ's target band in Q4 for the first time in over two years. Internationally, China's PPI inflation has lifted sharply, with historical relationships suggesting G7 headline inflation will not be too far behind. Moreover, the recent gains in soft commodity prices should also result in a modest lift in domestic food price inflation after it has remained low over the past year or so. This joins recent lifts in firms' pricing intentions, a stabilisation in near-term inflation expectations, and signs that price increases are broadening as also consistent with this lift in inflation off low levels. In the September quarter, the proportion of the CPI basket recording annual inflation above 2% rose to a four-year high.

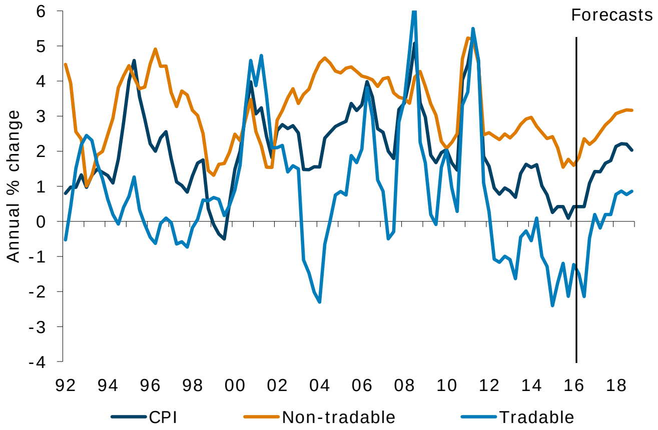
But more fundamentally, inflation pressures are building (and are expected to continue to build) as the economy increasingly butts up against capacity headwinds. Those pressures are already apparent in the construction sector (and construction costs), but they are forecast to broaden with the economy continuing to expand at an above-trend pace and wage inflation lifting. There has been much debate about whether the traditional relationships between capacity and inflation still exist (the Phillips curve). While those relationships do appear to have changed, we don't believe they have completely disappeared.

Deflationary pressures remain and will cap the magnitude of inflation build-up. On a TWI basis, the NZD is elevated and is expected to remain strong. The global economy (even with reflationary signs right now) is still mired in excess capacity and high levels of leverage. Disruptive technologies are increasingly becoming the norm and impacting firm margins even

NEW ZEALAND ECONOMIC OUTLOOK

though the productivity benefits are not directly apparent in the data (strangely). These forces should continue to cap price gains overall.

FIGURE 5. HEADLINE, TRADABLE AND NON-TRADABLE INFLATION



Source: ANZ, Statistics NZ

Nevertheless, we continue to see inflation rising from here. After returning to the target band in Q4, headline inflation is forecast to reach 2% by early 2018. Non-tradable inflation is forecast to have risen above 3% over the same period.

We expect the RBNZ to start gradually removing stimulus by mid-2018. We forecast 50bps of OCR hikes over 2018, lifting the cash rate to 2.25%. However, we currently see the risk skewed towards earlier action and would not completely rule out RBNZ hikes in the second half of 2017.

OUR FORECASTS CRUCIALLY ASSUME THE FOLLOWING:

- **The global economy remains on an even keel.** Our global growth forecasts (discussed on page 6) outline a view of further modest improvement over the years ahead, with an ongoing gradual lift in the likes of global bond yields and the USD as the world transitions from monetary policy to fiscal support. Markets are certainly trading a global reflation theme right now. But considerable risks remain. Leverage is high, particularly in emerging markets, a situation which becomes increasingly challenged in a higher-yield and stronger-USD world. An increased focus on politics (and the populist backlash apparent) represents a new paradigm for markets. Ultimately we believe asset prices will need to reflect a higher level of uncertainty and risk, and higher interest rates. And ironically, history has taught us that in a world of fragilities, leverage, misallocated capital and mis-pricing of risk, higher yields have ultimately brought about lower ones.
- **Households continue to show restraint.** As mentioned, our forecasts assume modest per-capita consumption growth and a lift in household saving. But there is a risk that after years of strong house price growth, behaviours of old return and a housing boom is followed by a consumption one. Certainly, the 1.9% q/q lift in private consumption in Q2 hinted that that could be a possibility. That would represent a vastly different backdrop for the likes of the current account deficit (larger), domestic inflation pressures (higher) and the RBNZ (possibly behind the curve).
- **The credit and housing markets continue to cool.** We do not assume a crunch in credit in our forecasts – far from it. But we do assume that both credit and house price growth will moderate to a more sustainable pace. If not, and ratios such as credit to GDP or house prices to income continue to rise from already elevated levels (in short, we see another year or two of strong credit growth), that would lead us to lift our near-term growth numbers but lower our projections for 2018 and 2019 with greater odds of a full-blown downturn.
- **The economic fallout from the latest earthquakes proves to be modest.** The direct impact from the quakes looks set to be modest, perhaps denting activity growth a touch in Q4 and Q1 given disruption to freight/transport routes and perhaps a small impact on the tourism sector. And while we are inclined to think that the damage bill (and fiscal cost) will be at the upper end of current estimates, that should also prove manageable given reinsurance cover and a solid starting point for the fiscal accounts. However, history unfortunately reminds us that the potential for large aftershocks (even occurring sometime after the initial quake) remain, which could alter that picture quite quickly.

INTERNATIONAL OUTLOOK

SUMMARY

Global growth and inflation are forecast to gradually trend higher, with the baton shifting from ultra-stimulatory monetary policy to fiscal policy and signs of reflation appearing across the commodity complex. However, uncertainty is high and we expect a volatile few years. The world is awash with numerous risks and challenges: politics, courtesy of the 'anger' vote, mispriced risk, excess leverage amidst rising interest rates, demographics (which are slowing growth), poor productivity growth and overvalued asset prices.

IS REFLATION FOR REAL?

There are increasing signs that the global industrial cycle has turned. The aggregate global PMI is at its highest level since August 2014, and gains are broad-based across developed and emerging markets. Asian trade, while still lacklustre, has at least stabilised and global CPI inflation is lifting, due in large part to the recovery in energy prices. But broader commodity prices have risen too. Market-based measures of inflation expectations are well off their lows and together with expectations of fiscal expansion (in the US especially) markets are running with a reflation theme.

We expect this theme to continue. US growth is forecast to continue at a respectable pace. Australian growth (beyond near-term weakness) is expected to remain solid, with the drag from the wind-back in mining investment at an end. Emerging Asian growth is forecast to be stronger in 2017 and while Chinese growth is moderating, it continues to be of the 'soft-landing' variety.

However, considerable uncertainties and risks remain:

- **Financial conditions have tightened.** This is especially true in the US, where expectations for fiscal expansion have buoyed yields and the USD. The Fed is lifting rates. That will have growth consequences, even if fiscal policy may offset it, at least partly.
- **The world remains highly indebted.** The IMF estimates that the ratio of total global debt to GDP has never been higher, at over 225%. That is not only a headwind for future growth, but highlights vulnerabilities to global shocks and higher interest rates. Emerging markets have experienced the strongest growth in debt.
- **International politics.** The contract between society and politicians is being rewritten. New policy agendas will unfold. Countries facing the anger vote will turn less globalised and more inward-focused. New Zealand tried that in the 1970s; it didn't have a happy ending. It's not good for productivity or growth, though positive for inflation. It also represents a new paradigm for markets. Asset prices need to reflect a higher level of uncertainty and risk.
- **Distortions from aggressive monetary policy easing remain.** The Fed is tightening while the ECB is loosening and the BoJ targets zero yields. Cheap money fosters mispricing of risk and capital misallocation. Asset prices have been buoyed by extremely low borrowing costs. At some stage the piper will be paid.
- **The shift from monetary policy to fiscal support faces challenges.** Markets have been buoyed by expectations, particularly in the US, that fiscal policy will turn very expansionary. In many ways it is desirable; monetary policy arguably went too far. But fiscal policy faces constraints. There are lags and debt levels are high (US total public debt is 105% of GDP). Good fiscal policy is about better micro-economics, but political capital is at a premium for many, meaning the desire for necessary reform is low.
- **Structural weaknesses across Europe and Japan remain and China remains somewhat of an enigma.** Europe is still mired with lacklustre growth and elevated unemployment. Its banking system remains fragile. Japanese growth is forecast to barely accelerate, remaining below 1%. While China is adjusting, corporate leverage is extreme.

So while the recent signs of reflation are welcomed and expected to continue, we remain circumspect over prospects. Many risks and uncertainties remain.

Calendar Years (annual average % change)	2012	2013	2014	2015	2016(f)	2017(f)	2018(f)
United States	2.2	1.7	2.4	2.6	1.5	2.2	2.3
Australia	3.6	2.1	2.8	2.4	2.3	2.5	3.2
Japan	1.7	1.4	-0.1	0.6	0.7	0.7	0.8
Euro Zone	-0.9	-0.2	1.2	1.9	1.6	1.7	1.6
China	7.8	7.7	7.4	6.9	6.7	6.5	6.3
Trading Partner Growth	3.3	3.0	3.6	3.5	3.4	3.4	3.6

PRIMARY SECTOR OUTLOOK

SUMMARY

The cyclical upturn in international soft commodities has strengthened with further momentum expected into the New Year. Supply dynamics and renewed Chinese demand for certain products are the main drivers. Dairy revenue is lifting with gains in international prices offsetting lower production. Meat and fibre production is also lower, which, combined with other sector-specific dynamics, is expected to support prices. Forestry is experiencing a good run, which is expected to extend. Horticulture prices look fairly robust, but crop sizes currently look set to be more variable in 2017.

The cyclical upswing in soft commodity prices that started earlier in 2016 has strengthened in recent months. Much of the improvement has been driven by supply corrections (due to weather and impacts of earlier low returns on output), helping to balance out market fundamentals. Chinese imports have strengthened for certain products too, helping returns for dairy, forestry, kiwifruit and sheepmeat in particular. But it hasn't been one-way traffic, with wool exports to China suffering badly since June.

There feels like there could be further upside to the cyclical upswing in 2017 from a better global outlook, ongoing tight supply in certain sectors and the general improvement in commodity price sentiment. **But equally, many challenges remain** with high stocks of a range of key foodstuffs (both direct substitutes and as inputs into competitor systems), a higher USD against key emerging markets pressuring import affordability, more competition and the trade risks emanating from a regime change in the US.

We will be closely watching the trading relationship between the US and China for soft commodities as to how things might swing. Non-tariff trade barriers are likely to be the first form of any deterioration in relationships. There are a number of possible outcomes from a tit-for-tat trade war between the two. These range from a general trade recession (negative for all commodity prices) to improved opportunities and less competition for a range of New Zealand products into China and the broader Asian region due to reduced US access.

The extent of USD strength is a must watch. This could help farm-gate returns, but equally reduce affordability in lower income/emerging markets, leading to reduced international prices. This is especially the case for highly indebted economies and/or those with a strong dependence on external trade i.e. Mexico, Singapore, Thailand and Turkey.

Prospects for dairy revenue in 2016/17 have risen, with gains in global prices offsetting the fall in production. Cool and wet conditions, especially in the North Island, have curtailed peak milk production, raising prospects total supply could be more than 5% lower in 2016/17. This, combined with tight global milk supply elsewhere and renewed Chinese interest, has substantially lifted prices.

Looking forward we expect some improvement in supply dynamics, which will help stabilise international prices. Higher global farmgate prices are now filtering through, along with the onset of warmer conditions in New Zealand, and European seasonality. Combined with demand moderation from China (partly seasonal), New Zealand powders being more expensive than those of other origins, the Europe Commission beginning to sell down some of its stockpile, and USD strength, some heat is expected to be taken out of prices sometime in the New Year.

We expect a dairy payout of $6.25/kg/MS in 2016/17. This takes cash-flow into positive territory.

In the meat & fibre sector we are more optimistic on the price outlook in 2017 than most. Local supplies of beef, sheepmeat and venison are all expected to be tighter due to past reductions in breeding stock numbers and the dairy herd. This is expected to increase procurement pressure on meat processors, especially with fairly solid seasonal conditions in most major breeding regions and low inventory levels. Furthermore, beef prices and prospects in the broader Asian and local markets look solid. In sheepmeat markets, while the UK (21% of lamb receipts) is a struggle, due largely to the higher NZD/GBP, other markets are more positive. For venison, diversification into alternative markets such as the US continues to pay dividends and reduce exposure to the euro. The one major underperformer is wool, due largely to reduced interest from China (50% of exports in 2015/16) for a range of reasons.

Earlier indicators are mixed for horticulture crops. Green kiwifruit supplies will be lower in 2017 due to a substantially reduced bud break. This raises prospects of prices bouncing back to between $5.50 and $6.00 per tray. The bud break for Gold varieties appears less variable, and with more orchards canopies reaching maturity, production is on track for another lift. The industry is focused on maintaining a Gold price above $8/tray. The Marlborough viticulture sector has seen some wine loss and infrastructure damage from the latest earthquakes. Proactive management is expected to see infrastructure issues (i.e. storage tanks) addressed before the 2017 vintage. Very early indicators of the 2017 vintage range from average to slightly below 2016. A large export pipfruit crop of 360,000 tonnes is expected.

The forestry sector is experiencing one of its best stretches in at least 20 years. With Chinese demand remaining firm from more infrastructure/housing activity and reduced harvesting of native forests, export demand is expected to remain robust. Domestically, booming construction activity is set to continue supporting the demand for lumber.

FINANCIAL MARKETS OUTLOOK

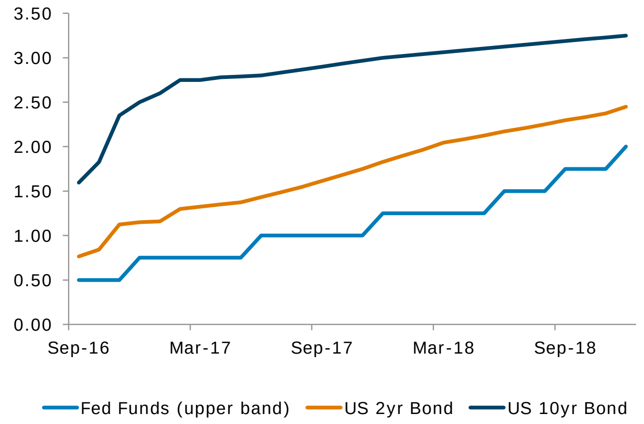
SUMMARY

US Treasury bond yields have broken higher, bringing an end to a 35-year bull run. It is natural for markets to expect yields to rise as global policy tilts from central bank stimulus (bond buying) to expansionary fiscal policy (bond selling), but we do not expect this to give way to a full-blown bear market. Rather, we expect bond yields to rise gradually, taking New Zealand long-term rates with them. With the OCR on hold, anchoring the short end, steeper yield curves beckon. In currency markets, we expect the NZD to decline gradually, with USD strength driving the NZD/USD lower more rapidly than NZD/AUD and the other major NZD crosses.

THE END OF THE BOND BULL MARKET AND THE POLICY TILT TOWARDS HIGHER YIELDS

Having spent the better part of 35 years in a broad bull market, US 10-year Treasuries – widely considered to be the global bellwether bond – have broken higher in yield and look to have entered a new era. From here, we expect US (and global) bond yields to continue trending gradually higher as the US Federal Reserve continues tightening and US growth remains solid. US interest rates are the major driver of local long-term interest rates, and as they go higher, NZ long-term rates will go higher too. Specifically, our forecasts assume the US 10-year yield ends 2016 at 2.5%, rises to 3% by the end of 2017 and 3.25% by the end of 2018.

FIGURE 1: ANZ US INTEREST RATE FORECASTS



Source: ANZ, Bloomberg

Tilts in the global policy mix also support the notion that the lows are in and that bond yields will continue to trend gradually higher over coming quarters. As easy fiscal policy (typically characterised by higher government spending, increased bond issuance and thus higher interest rates) takes over from easy monetary policy (typically characterised by low interest rates – and in recent years, bond buying), it is intuitive to expect there to be upward pressure on interest rates. The direction of policy in a world where the 'anger' vote is shifting the political landscape will be less globalised and more inward focused. That's bad for productivity but positive for inflation.

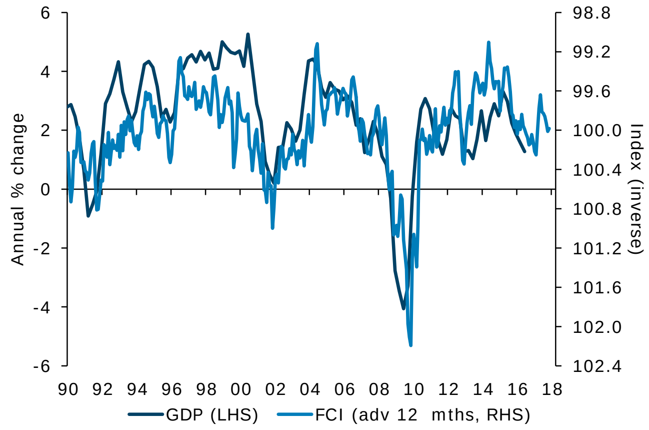
However, while higher yields are technically enough to call the end of the bull market, **our forecasts are not consistent with a traditional bear market, and instead are consistent with a period of muddling through**, characterised by mildly rising yields and a steeper yield curve.

Our 'muddle through' thesis is based on three main arguments:

First, it's important to note that while the US Federal Reserve has embarked on a monetary policy tightening cycle, Japan and Europe have not. We expect the federal funds rate to be lifted three more times by the end of 2017. In contrast, we expect the BoJ and the ECB to maintain policy as is, with the former committed to maintaining 10-year JGBs at a yield close to zero, as we note below. Moreover, the fiscal 'swing' post the US presidential elections is also assumed to be far larger in the US than in Japan or Europe. While domestic pressures suggest US bond yields will continue to rise, with less upward pressure on Japanese or European bond yields, relative value considerations will limit how far US yields can actually go.

Second, we note that US financial conditions have tightened. Markets have assumed that dramatic US fiscal expansion is a given despite already-stressed fiscal ratios, a sharply stronger US dollar, and the rapid rise in US bond yields already observed. Investors have had plenty of time to adjust to the recent rise in yields, and we believe this was a factor exacerbating the rise in bond yields in the immediate aftermath of the US elections. This suggests that the bulk of the adjustment to political realities in the US is behind us.

FIGURE 2: US FINANCIAL CONDITIONS VS GDP



Source: ANZ, Bloomberg

FINANCIAL MARKETS OUTLOOK

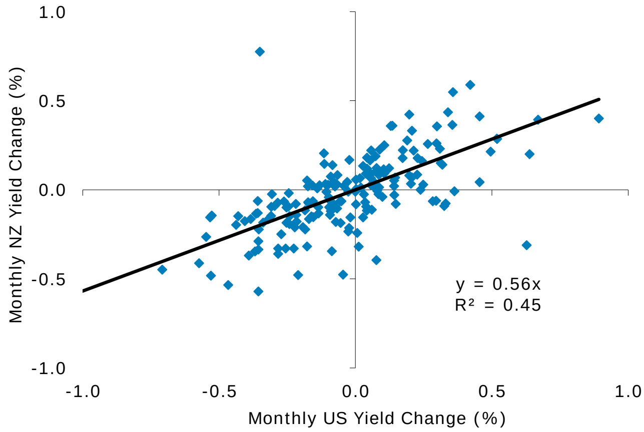
Finally, we are mindful of the starting point of US government indebtedness. According to the Federal Reserve Bank of St Louis, total US public debt stood at 105% of GDP in Q2, up from 64% in Q1 2008. Although this has, to an extent, been offset by US private sector de-leveraging, private sector leverage has also increased dramatically in emerging markets. Moreover, the duration of US public debt has risen sharply. Together, this has dramatically increased the market's sensitivity to higher bond yields, and is likely to limit how high US bond yields can go.

Collectively, these factors suggest that US yields will move higher, but in a far more gradual fashion than has been observed during past cycles. Anticipation of upcoming Fed hikes is also expected to see the yield curve steepen, taking the US 2s10s spread to around +145bps by March. Beyond that point, the yield curve is assumed to flatten gradually as the Fed actually delivers on those hikes. By contrast, our forecasts assume Japanese 10-year bonds will hold steady at around zero as the Bank of Japan engages in 'yield curve control'. This policy is aimed at keeping 10-year JGB yields at what the Bank of Japan describes as "more or less zero percent".

LONG-END RATES BIASED MILDLY HIGHER

Higher US bond yields are expected to drive New Zealand long-end yields higher too, given the high correlation between the two markets.

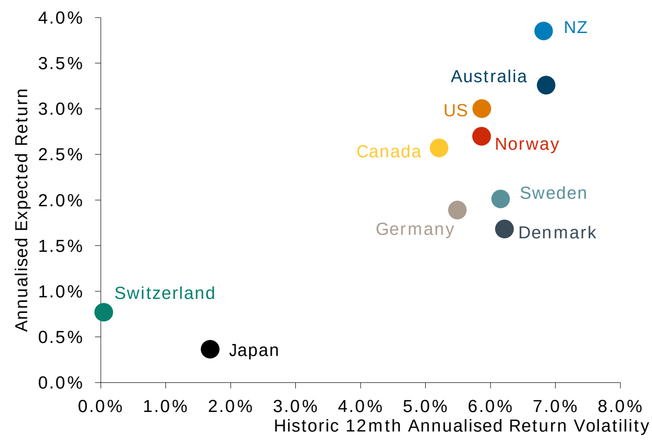
FIGURE 3: MONTHLY CHANGES IN NZ AND US 10 YEAR BOND YIELDS SINCE 2000



Source: ANZ, Bloomberg

Specifically, our forecasts have the NZ 10-year bond yield rising to 3.35% by year-end and 3.9% by the end of 2017. While we do see material odds of a near-term snap back (US markets are priced for perfection, and NZ/US spreads have widened, rather than narrowed during the recent sell-off), we expect dips to be shallow, drawing out strategic sellers. The risk-seeking behaviours of the past few years that have fuelled the search for yield have given way to fear and defensiveness. New Zealand interest rates benefitted enormously during the indiscriminate global bond market "race to the bottom" as investors chased yield at all costs. However, as we emerge into this new era of defensiveness, we expect there to be payback as investors pay as much attention to volatility (and currency performance) as they do to expected returns. In short, whereas over the past few years, all eyes were on the y-axis of Figure 4, all eyes are now on the x-axis (and the left-hand end, not the right-hand end).

FIGURE 4: G10 10YR RISK AND EXPECTED RETURNS



Source: ANZ, Bloomberg

NZ SHORT-END RATES ANCHORED BY OCR STABILITY

By contrast, New Zealand short-end rates are expected to remain broadly stable over coming quarters, anchored to the OCR, which we expect to remain on hold until mid-2018. From a purely mechanical perspective, short-end rates look to have over-reacted somewhat, moving to price in a chance of an RBNZ hike in 2017. By the end of November, the 2-year swap was sitting around 0.5 percentage points above the OCR (despite the fact that the TWI was close to a 12 month high), banks had put mortgage rates up rather than down in the weeks following the November *Monetary Policy Statement*, the curve had steepened, and financial conditions had tightened. That said, given the economic and inflation pulse, a hike in 2017 cannot be ruled out and there is now more chance of a hike than a cut going forward.

STRONG DOLLAR AND THE NZD: HOLDING UP BETTER ON CROSSES THAN AGAINST THE USD

Prospects for a firmer USD remain a defining component of our currency projections. The recent rise in the USD has been driven by a combination of economic and political support factors. As noted above, bond yields have moved higher as attention has shifted from central bank stimulus to expansionary fiscal policy. Moreover, a more inward

FINANCIAL MARKETS OUTLOOK

and less globalised US policy mix (which the anger and resentment vote is driving) augurs poorly for productivity growth but positively for inflation, helping push yields higher. But while we are bullish the USD overall, we remain coy about extrapolating trends too far. Cross-currents between whether higher yields signal an end to the liquidity cycle (USD positive) or commodity-led reflation (NZD, AUD positive) remain. The world is awash with leverage and investment misallocation; higher rates (and the speed at which rates have moved up) are toxic to that. Indeed, recent moves in the USD and US interest rates don't just represent a threat to the US economy (as noted earlier via the tightening in US financial conditions); they are also likely to be destabilising in geographies where domestic weaknesses exist. We expect the market to take a more discerning stance with regard to nations with internal vulnerabilities and significant USD debt.

The EUR remains politically pressured and JPY weighed down by the BoJ decision to anchor the yield curve by fixing 10-year JGBs at zero. It's an environment where the USD stands tallest.

Against that backdrop, the NZD sits more in the "middle of the road". Unlike the US, where fiscal policy is coming to the fore and monetary policy is set to tighten, RBNZ policy is on hold and the Government remains committed to a conservative fiscal agenda (but could ease more if it wanted to). Moreover, historically significant legs of support remain in place, even if the USD has become "flavour of the day" of late. On that score, we note the following:

- New Zealand's growth credentials (3-4% GDP growth) still demand respect.
- The current account deficit is stable and commodity prices have lifted.
- New Zealand continues to offer more stable political credentials and a better microeconomic policy platform, which ultimately support growth.
- The allure of yield may have diminished but it still carries some shine.
- There is now a clear risk the next move by the RBNZ is up, with risks skewed to this occurring in 2017 (although our forecast is mid-2018).

Ordinarily, such considerations would leave us more bullish on balance. However, we are mindful that many of the past drivers of NZD performance are losing some of their shine, suggesting that the NZD is now in an era of transition from 'buy on dips' to 'sell on rallies'.

This is driven by:

- Recovering global yields and expectations of yield convergence as the Fed hikes and the RBNZ remains on hold.
- Question marks over whether the global liquidity cycle is coming to an end, leading to more defensive attitudes.
- Acceptance that this is as 'good as it gets' for the local economy; growth is expected to moderate as capacity constraints bite and credit growth eases.
- More attention to volatility and less focus on absolute return.

Against a backdrop of USD strength these factors taken together suggest that the NZD will depreciate. However, the pace of depreciation will be the fastest against the USD, but more gradual against other key currencies (AUD, JPY, EUR etc). As a consequence, the TWI will hold up better than NZD/USD will.

INDIVIDUAL CURRENCY PAIRS

NZD/USD: Least allure. This is the NZD pair where we see the most potential for downside, courtesy of USD strength. But by historic comparison, our forecasts remain elevated, with NZD/USD projected to fall to 0.67 by mid-2017 and 0.64 by December 2017. The NZD still commands respect, but at the moment, while the second derivative for the USD is positive, it is waning for the NZD.

NZD/AUD: Stability. Cyclical relativities are starting to level out with both central banks on hold, both countries in the grip of a commodity rebound and both countries on track for "low 3%" growth. But the gravitational pull towards 0.90 can't be ignored.

NZD/GBP: NZD weakness amid GBP rebound. Our forecasts assume that the worst of the GBP downside shock is behind us, and that all of the negativity associated with Brexit is now priced in. Beyond a near-term period of stability at around 0.57, our forecast of a GBP/USD rebound and a NZD/USD depreciation, drive NZD/GBP around 10% lower by the end of 2018.

NZD/EUR: Eventual decline. NZD/EUR is likely to follow a similar path to NZD/GBP: flattish over early 2017 as NZD and EUR both succumb to USD strength, before declining over late 2017 as EUR/USD stabilises and NZD/USD continues to decline.

NZD/JPY: JPY move complete. We expect USD/JPY to level out at 115, which is only ~1 cent away. As JPY stabilises and NZD/USD weakens, NZD/JPY is expected to decline towards 74.

FINANCIAL MARKETS OUTLOOK

Forecasts (end of quarter)								
FX Rates	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
NZD/USD	0.69	0.67	0.65	0.64	0.64	0.65	0.65	0.65
NZD/AUD	0.93	0.93	0.93	0.94	0.97	0.98	0.94	0.88
NZD/EUR	0.67	0.66	0.64	0.64	0.64	0.62	0.62	0.61
NZD/JPY	79.4	77.1	74.8	73.6	73.6	74.8	74.8	74.8
NZD/GBP	0.57	0.55	0.54	0.54	0.52	0.52	0.52	0.51
NZD/CNY	4.80	4.69	4.58	4.54	4.56	4.65	4.67	4.68
NZ$ TWI	75.6	74.1	72.5	72.1	72.4	72.5	71.8	70.4
Interest Rates	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
NZ OCR	1.75	1.75	1.75	1.75	1.75	2.00	2.25	2.25
NZ 90 day bill	2.04	2.01	2.00	2.00	2.17	2.34	2.51	2.51
NZ 2-yr swap	2.48	2.51	2.57	2.63	2.73	2.83	2.93	2.96
NZ 10-yr bond	3.60	3.65	3.78	3.91	4.00	4.10	4.19	4.25

KEY ECONOMIC FORECASTS

Calendar Years	2012	2013	2014	2015	2016(f)	2017(f)	2018(f)
NZ Economy (annual average % change)							
Real GDP (production)	2.6	2.4	3.7	2.5	3.5	3.3	2.4
Private Consumption	2.8	2.9	2.7	2.3	3.5	3.4	2.8
Public Consumption	-0.4	1.7	2.7	1.9	2.0	3.1	2.2
Residential investment	13.3	12.9	14.6	5.1	12.4	3.9	-4.4
Other investment	5.2	2.9	9.7	2.0	3.4	5.2	3.2
Stockbuilding[1]	0.1	0.1	0.0	-0.3	-0.2	0.3	0.0
Gross National Expenditure	3.1	3.2	4.4	2.0	3.7	3.9	2.3
Total Exports	1.9	0.8	3.0	7.0	4.0	2.5	2.8
Total Imports	2.8	6.2	7.9	3.7	3.8	3.9	2.7
Employment (annual %)	0.1	2.9	3.6	1.3	5.9	1.9	1.4
Unemployment Rate (sa; Dec qtr)	6.3	5.7	5.5	5.0	4.8	4.6	4.3
Labour Cost Index (annual %)	1.8	1.6	1.7	1.5	1.8	2.1	2.1
Terms of trade (OTI basis; annual %)	-8.9	20.2	-5.0	-3.2	0.4	3.1	0.8
Prices (annual % change)							
CPI Inflation	0.9	1.6	0.8	0.1	1.1	1.7	2.0
Non-tradable Inflation	2.5	2.9	2.4	1.8	2.2	2.9	3.2
Tradable Inflation	-1.0	-0.3	-1.3	-2.1	-0.5	0.2	0.9
Fiscal and External Balance							
Current Account Balance ($bn)	-8.5	-7.1	-7.7	-8.1	-7.7	-8.8	-9.4
as % of GDP	-3.9	-3.1	-3.2	-3.3	-3.0	-3.2	-3.3
Government OBEGAL ($bn)*	-9.2	-4.4	-2.8	0.4	1.8	0.5	3.3
as % of GDP	-4.3	-2.0	-1.2	0.2	0.7	0.2	1.2
NZ Financial Markets (end of December quarter)							
TWI	73.8	77.3	79.4	73.7	76.6	72.1	70.4
NZD/USD	0.82	0.82	0.78	0.69	0.71	0.64	0.65
NZD/AUD	0.79	0.92	0.96	0.94	0.93	0.94	0.88
NZD/CNY	5.12	4.98	4.86	4.45	4.90	4.54	4.68
NZD/EUR	0.62	0.60	0.64	0.63	0.68	0.64	0.61
NZD/JPY	70.8	86.3	93.6	82.5	78.1	73.6	74.8
NZD/GBP	0.51	0.50	0.50	0.46	0.58	0.54	0.51
Official Cash Rate	2.50	2.50	3.50	2.50	1.75	1.75	2.25
90-day bank bill rate	2.69	2.84	3.68	2.75	2.06	2.00	2.51
2-year swap rate	2.67	3.85	3.80	2.85	2.37	2.63	2.96
10-year government bond rate	3.52	4.72	3.67	3.57	3.35	3.91	4.25

[1] Percentage point contribution to growth

IMPORTANT NOTICE

The distribution of this document or streaming of this video broadcast (as applicable, "publication") may be restricted by law in certain jurisdictions. Persons who receive this publication must inform themselves about and observe all relevant restrictions.

1. Disclaimer for all jurisdictions, where content is authored by ANZ Research:

Except if otherwise specified in section 2 below, this document is issued and distributed in your country/region by Australia and New Zealand Banking Group Limited (ABN11 005 357 522) ("ANZ"), on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (collectively, "recipient"). This document is confidential and may not be reproduced, distributed or published by any recipient for any purpose. It is general information and has been prepared without taking into account the objectives, financial situation or needs of any person. Nothing in this document is intended to be an offer to sell, or a solicitation of an offer to buy, any product, security, instrument or investment, to effect any transaction or to conclude any legal act of any kind. If, despite the foregoing, any services or products referred to in this document are deemed to be offered in the jurisdiction in which this document is received or accessed, no such service or product is intended for nor available to persons resident in that jurisdiction if it would be contradictory to local law or regulation. Such local laws, regulations and other limitations always apply with non-exclusive jurisdiction of local courts. Certain financial products may be subject to mandatory clearing, regulatory reporting and/or other related obligations. These obligations may vary by jurisdiction and be subject to frequent amendment. Before making an investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

The views and recommendations expressed in this publication are the author's. They are based on information known by the author and on sources which the author believes to be reliable, but may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this publication and are subject to change without notice; and, all price information is indicative only. Any of the views and recommendations which comprise estimates, forecasts or other projections, are subject to significant uncertainties and contingencies that cannot reasonably be anticipated. On this basis, such views and recommendations may not always be achieved or prove to be correct. Indications of past performance in this publication will not necessarily be repeated in the future. No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided. Additionally, this publication may contain 'forward looking statements'. Actual events or results or actual performance may differ materially from those reflected or contemplated in such forward looking statements. All investments entail a risk and may result in both profits and losses. Foreign currency rates of exchange may adversely affect the value, price or income of any products or services described in this publication. The products and services described in this publication are not suitable for all investors, and transacting in these products or services may be considered risky. ANZ and its related bodies corporate and affiliates, and the officers, employees, contractors and agents of each of them (including the author) ("Affiliates"), do not make any representation as to the accuracy, completeness or currency of the views or recommendations expressed in this publication. Neither ANZ nor its Affiliates accept any responsibility to inform you of any matter that subsequently comes to their notice, which may affect the accuracy, completeness or currency of the information in this publication. Except as required by law, and only to the extent so required: neither ANZ nor its Affiliates warrant or guarantee the performance of any of the products or services described in this publication or any return on any associated investment; and, ANZ and its Affiliates expressly disclaim any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this publication.

If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. ANZ and its Affiliates do not accept any Liability as a result of electronic transmission of this publication.

ANZ and its Affiliates may have an interest in the subject matter of this publication as follows:

- They may receive fees from customers for dealing in the products or services described in this publication, and their staff and introducers of business may share in such fees or receive a bonus that may be influenced by total sales.
- They or their customers may have or have had interests or long or short positions in the products or services described in this publication, and may at any time make purchases and/or sales in them as principal or agent.
- They may act or have acted as market-maker in products described in this publication.

ANZ and its Affiliates may rely on information barriers and other arrangements to control the flow of information contained in one or more business areas within ANZ or within its Affiliates into other business areas of ANZ or of its Affiliates. This document is published in accordance with ANZ's policies on Conflicts of Interest and Information Barriers.

Please contact your ANZ point of contact with any questions about this publication including for further information on these disclosures of interest.

2. Country/region specific information:

Australia. This publication is distributed in Australia by ANZ. ANZ holds an Australian Financial Services licence no. 234527. A copy of ANZ's Financial Services Guide is available at http://www.anz.com/documents/AU/aboutANZ/FinancialServicesGuide.pdf and is available upon request from your ANZ point of contact. If trading strategies or recommendations are included in this publication, they are solely for the information of 'wholesale clients' (as defined in section 761G of the Corporations Act 2001 *Cth*). Persons who receive this publication must inform themselves about and observe all relevant restrictions.

Brazil. This publication is distributed in Brazil by ANZ on a cross border basis and only following request by the recipient. No securities are being offered or sold in Brazil under this publication, and no securities have been and will not be registered with the Securities Commission – CVM.

Brunei. Japan. Kuwait. Malaysia. Switzerland. Taiwan. This publication is distributed in each of Brunei, Japan, Kuwait, Malaysia, Switzerland and Taiwan by ANZ on a cross-border basis.

Cambodia. APS222 Disclosure. The recipient acknowledges that although ANZ Royal Bank (Cambodia) Ltd. is a subsidiary of ANZ, it is a separate entity to ANZ and the obligations of ANZ Royal Bank (Cambodia) Ltd. do not constitute deposits or other liabilities of ANZ and ANZ is not required to meet the obligations of ANZ Royal Bank (Cambodia) Ltd.

European Economic Area ("EEA"): United Kingdom. ANZ in the United Kingdom is authorised by the Prudential Regulation Authority ("PRA"). Subject to regulation by the Financial Conduct Authority ("FCA") and limited regulation by the PRA. Details about the extent of our regulation by the PRA are available from us on request. This publication is distributed in the United Kingdom by ANZ solely for the information of persons who would come within the FCA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FCA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the PRA and the FCA. **Germany.** This publication is distributed in Germany by the Frankfurt Branch of ANZ solely for the information of its clients. **Other EEA countries.** This publication is distributed in the EEA by ANZ Bank (Europe) Limited ("ANZBEL") which is authorised by the PRA and regulated by the FCA and the PRA in the United Kingdom, to persons who would come within the FCA definition of "eligible counterparty" or "professional client" in other countries in the EEA. This publication is distributed in those countries solely for the information of such persons upon their request. It is not intended for, and must not be distributed to, any person in those countries who would come within the FCA definition of "retail client".

Fiji. For Fiji regulatory purposes, this publication and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this publication.

Hong Kong. This publication is issued or distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered at the Hong Kong Monetary Authority to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong. If in doubt about the contents of this publication, you should obtain independent professional advice.

IMPORTANT NOTICE

India. This publication is distributed in India by ANZ on a cross-border basis. If this publication is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing. Further copying or duplication of this publication is strictly prohibited.

Myanmar. This publication is intended to be of a general nature as part of customer service and marketing activities provided by ANZ in the course of implementing its functions as a licensed bank. This publication does not take into account your financial situation or goals and is not Securities Investment Advice (as that term is defined in the Myanmar Securities Transaction Law 2013). The contents of this publication have not been reviewed by any regulatory authority in Myanmar. If in doubt about the contents of this publication, you should obtain independent professional advice.

New Zealand. This publication is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008.

Oman. This publication has been prepared by ANZ. ANZ neither has a registered business presence nor a representative office in Oman and does not undertake banking business or provide financial services in Oman. Consequently ANZ is not regulated by either the Central Bank of Oman or Oman's Capital Market Authority. The information contained in this publication is for discussion purposes only and neither constitutes an offer of securities in Oman as contemplated by the Commercial Companies Law of Oman (Royal Decree 4/74) or the Capital Market Law of Oman (Royal Decree 80/98), nor does it constitute an offer to sell, or the solicitation of any offer to buy non-Omani securities in Oman as contemplated by Article 139 of the Executive Regulations to the Capital Market Law (issued vide CMA Decision 1/2009). ANZ does not solicit business in Oman and the only circumstances in which ANZ sends information or material describing financial products or financial services to recipients in Oman, is where such information or material has been requested from ANZ and by receiving this publication, the person or entity to whom it has been dispatched by ANZ understands, acknowledges and agrees that this publication has not been approved by the CBO, the CMA or any other regulatory body or authority in Oman. ANZ does not market, offer, sell or distribute any financial or investment products or services in Oman and no subscription to any securities, products or financial services may or will be consummated within Oman. Nothing contained in this publication is intended to constitute Omani investment, legal, tax, accounting or other professional advice.

People's Republic of China ("PRC"). Recipients must comply with all applicable laws and regulations of PRC, including any prohibitions on speculative transactions and CNY/CNH arbitrage trading. If and when the material accompanying this document is distributed by Australia and New Zealand Banking Group Limited (ABN 11 005 357 522) ("ANZ") or an affiliate (other than Australia and New Zealand Bank (China) Company Limited ("ANZ C")), the following statement and the text below is applicable: No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this document in the PRC. Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this document or any other document. This document may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this document relates to the products and/or services of ANZ C, the following statement and the text below is applicable: This document is distributed by ANZ C in the Mainland of the PRC.

Qatar. This publication has not been, and will not be lodged or registered with, or reviewed or approved by, the Qatar Central Bank ("QCB"), the Qatar Financial Centre ("QFC") Authority, QFC Regulatory Authority or any other authority in the State of Qatar ("Qatar"); or authorised or licensed for distribution in Qatar; and the information contained in this publication does not, and is not intended to, constitute a public offer or other invitation in respect of securities in Qatar or the QFC. The financial products or services described in this publication have not been, and will not be registered with the QCB, QFC Authority, QFC Regulatory Authority or any other governmental authority in Qatar; or authorised or licensed for offering, marketing, issue or sale, directly or indirectly, in Qatar. Accordingly, the financial products or services described in this publication are not being, and will not be, offered, issued or sold in Qatar, and this publication is not being, and will not be, distributed in Qatar. The offering, marketing, issue and sale of the financial products or services described in this publication and distribution of this publication is being made in, and is subject to the laws, regulations and rules of, jurisdictions outside of Qatar and the QFC. Recipients of this publication must abide by this restriction and not distribute this publication in breach of this restriction. This publication is being sent/issued to a limited number of institutional and/or sophisticated investors (i) upon their request and confirmation that they understand the statements above; and (ii) on the condition that it will not be provided to any person other than the original recipient, and is not for general circulation and may not be reproduced or used for any other purpose.

Singapore. This publication is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore. In respect of any matters arising from, or in connection with the distribution of this publication in Singapore, contact your ANZ point of contact.

United Arab Emirates. This publication is distributed in the United Arab Emirates ("UAE") or the Dubai International Financial Centre (as applicable) by ANZ. This publication: does not, and is not intended to constitute an offer of securities anywhere in the UAE; does not constitute, and is not intended to constitute the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the United Arab Emirates, the Emirates Securities and Commodities Authority or the United Arab Emirates Ministry of Economy; does not, and is not intended to constitute an offer of securities within the meaning of the Dubai International Financial Centre Markets Law No. 12 of 2004; and, does not constitute, and is not intended to constitute, a financial promotion, as defined under the Dubai International Financial Centre Regulatory Law No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority ("DFSA"). The financial products or services described in this publication are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules. In addition, ANZ has a representative office ("ANZ Representative Office") in Abu Dhabi regulated by the Central Bank of the United Arab Emirates. ANZ Representative Office is not permitted by the Central Bank of the United Arab Emirates to provide any banking services to clients in the UAE.

United States. ANZ Securities, Inc. ("ANZSI") is a member of the Financial Industry Regulatory Authority ("FINRA") (www.finra.org) and registered with the SEC. ANZSI's address is 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 9160 Fax: +1 212 801 9163). Except where this is an FX- related publication, this publication is distributed in the United States by ANZSI (a wholly owned subsidiary of ANZ), which accepts responsibility for its content. Information on any securities referred to in this publication may be obtained from ANZSI upon request. This publication or material is intended for institutional use only – not retail. If you are an institutional customer wishing to effect transactions in any securities referred to in this publication you must contact ANZSI, not its affiliates. ANZSI is authorised as a broker-dealer only for institutional customers, not for US Persons (as "US person" is defined in Regulation S under the US Securities Act of 1933, as amended) who are individuals. If you have registered to use this website or have otherwise received this publication and are a US Person who is an individual: to avoid loss, you should cease to use this website by unsubscribing or should notify the sender and you should not act on the contents of this publication in any way. Non-U.S. Analysts: Non-U.S. analysts may not be associated persons of ANZSI and therefore may not be subject to FINRA Rule 2242 restrictions on communications with subject company, public appearances and trading securities held by the analysts. Where this is an FX-related publication, it is distributed in the United States by ANZ's New York Branch, which is also located at 277 Park Avenue, 31st Floor, New York, NY 10172, USA (Tel: +1 212 801 916 0 Fax: +1 212 801 9163). Commodity-related products are not insured by any U.S. governmental agency, and are not guaranteed by ANZ or any of its affiliates. Transacting in these products may involve substantial risks and could result in a significant loss. You should carefully consider whether transacting in commodity-related products is suitable for you in light of your financial condition and investment objectives.

Vietnam. This publication is distributed in Vietnam by ANZ or ANZ Bank (Vietnam) Limited, a subsidiary of ANZ. Please note that the contents of this publication have not been reviewed by any regulatory authority in Vietnam. If you are in any doubt about any of the contents of this publication, you should obtain independent professional advice.

This document has been prepared by ANZ Bank New Zealand Limited, Level 10, 171 Featherston Street, Wellington 6011, New Zealand,
Ph 64-4-802 2212, e-mail nzeconomics@anz.com, http://www.anz.co.nz