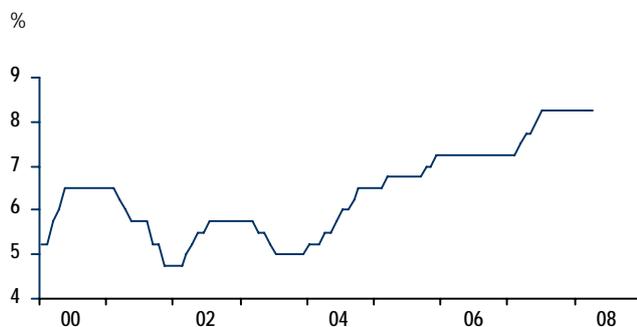


New Zealand economic update

RBNZ leaves rates unchanged as expected

The RBNZ left the official cash rate (OCR) steady at a record 8.25%, citing upside risks to inflation and downside risks to economic growth. RBNZ Governor Bollard mentioned that one key risk to the economic outlook is the persistently strong NZD, up 4% vis-à-vis the US dollar this year. The stronger currency will help curb inflation pressure, but will also serve to dampen export growth.

New Zealand: RBNZ official cash rate



Governor Bollard highlighted that since the central bank's last Monetary Policy Statement in March that economic activity had "weakened more markedly than expected." Indeed, consumer and business sentiment has fallen further, and there have been signs of a further deterioration in the housing market. Weaker global prospects, ongoing financial market volatility, and drought conditions in key agricultural areas, have added to the "uncertain economic environment."

The Governor noted that labour market conditions remain tight, putting upside pressure on wages, commodity prices are elevated, and there is more fiscal stimulus in the pipeline, with the government expected to deliver personal tax cuts ahead of the election (to be held later this year). These factors will, however, keep upside pressure on inflation in the short-term, pressure which will be exacerbated by rising energy and food prices. Furthermore, although not mentioned in today's statement, the RBNZ has said in recent commentary that there will be a large boost to inflation in 2009 and 2010 from the introduction of the emissions trading scheme; thus, inflationary pressures will remain significant for some time.

The RBNZ expects that the "OCR will need to remain at current levels for a time yet." JPMorgan forecasts that the next move in interest rates in New Zealand will be a rate cut in 1Q 2009. Inflation is likely to remain above the RBNZ's 1-3% oya target range this year, leaving little scope for the RBNZ to ease monetary policy settings anytime soon. Still, slower economic growth will help ease inflation pressures over time, with our forecast calling for GDP growth of 1.9% in 2008, down significantly from 3.1% in the previous year.

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