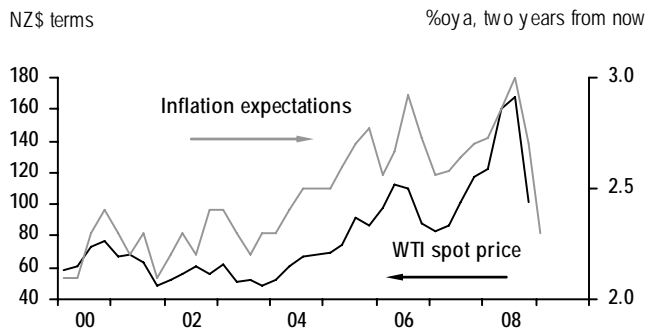


## New Zealand economic update

### RBNZ inflation expectations

According to the RBNZ, inflation expectations fell in New Zealand in the March quarter. The survey of 64 business managers showed that inflation is expected to average 2.3% in two years' time, down from 2.7% in 4Q08 and 3.0% in 3Q08. The survey also showed that business managers expect inflation in one years' time to average 2.2%, down from 2.8% previously.

New Zealand: RBNZ inflation expectations and crude oil price



With our forecast calling for six straight quarters of negative growth in New Zealand, we expect that inflation expectations and actual inflation will moderate significantly during 2009. The official measure of inflation eased sharply in 4Q08 to 3.4%oya, a sharp contrast to the 18-year high of 5.1% recorded in 3Q. We believe, though, that headline inflation probably peaked in the September quarter and will ease back toward the RBNZ's 1-3% target range in early 2009 as the weaker economy reduces pressure on resources.

Easing inflation expectations, the problematic global economic and financial market outlook, sagging domestic house prices, and the falling terms of trade, provide ample scope for the RBNZ to continue easing policy assertively. We recently changed our forecast to include a 100bp cut to the cash rate in March and a terminal cash rate of 2%, with downside risks. In our view, the cash rate may fall below 2% if the global economic outlook deteriorates even further and/or the significant fiscal and monetary policy stimulus being delivered fails to have a substantial impact on domestic demand before year-end.

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