Economic Research
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Helen Kevans (61-2) 9220-3250
Helen.e.kevans@jpmorgan.com

New Zealand economic update

RBNZ still concerned about inflation

RBNZ Governor Alan Bollard, in a speech to the Wellington Chamber of Commerce today, reiterated that the Bank remains focused on inflation, despite the Governor having delivered a punchy 150bp official interest rate cut less than one week ago. We believe the RBNZ is not even close to the finish of this easing cycle (we forecast a terminal cash rate 175bp below the prevailing rate), but that officials want the market and industry to know that inflation remains a key policy consideration, even though the economy is in recession.

Headline inflation in New Zealand remained elevated in 3Q at 5.1%, more than double the mid-point of the RBNZ's 1-3% target range, owing largely to "sizeable price increases in areas not directly exposed to a high degree of competition, such as local authority rates and electricity prices."

Dr. Bollard said that "concerns over inflation appear to have taken a back seat" for some commentators, many of whom hold the view that lower commodity prices and a slowdown in economic activity will drive inflation significantly lower. He added, though, that inflationary pressures need to be reduced significantly in New Zealand to provide scope for further policy easing; this will require various sectors of the economy to respond to reduced demand. On that note, the Governor singled out the electricity industry and local authorities, suggesting that the electricity industry should not take advantage of its market position and keep lifting rates, and that local authorities "set rates increases below inflation for a change."

After cutting that OCR to 5% last week, the RBNZ forecasts that annual inflation would soon return comfortably inside the target band – it expects annual CPI inflation to trough around 1.5% in 3Q09. Indeed, pipeline pressures and inflation expectations have started to ease and, on our forecasts, annual inflation will fall below the RBNZ's target range by 4Q09.

The rising prospect that inflation will fall significantly over the next year points to the need for more assertive policy easing. We maintain our forecast of a terminal RBNZ cash rate of 3.25%, with the forthcoming fiscal stimulus a key factor preventing even larger rate cuts. The government's fiscal stimulus package should inject about NZ$7 billion into the economy over the next two years, or 4% of GDP.

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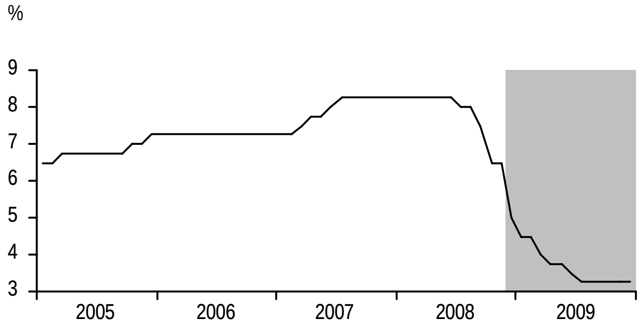
New Zealand: RBNZ official cash rate



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