



BERL Forecasts

**BRINGING EXPERIENCE AND INDEPENDENCE
TO THE BUSINESS OF FORECASTING**

www.berl.co.nz

Forecast summary	2	Exchange rates.....	14
The picture	3	GDP growth	15
Commentary	4	Inflation	17
Feature		Consumer prices.....	17
Our world has changed, so why does policy remain		Producer and capital goods prices.....	18
in 'normal' mode?	6	Labour Cost Index.....	18
Global situation	7	Government accounts	19
Australia	7	Manufacturing	21
United States.....	7	Building and construction	22
Asia.....	8	Tourism	23
Europe	9	Retail trade	25
Labour market conditions	11	Agriculture	27
Employment.....	11	Dairy	27
Unemployment	12	Meat and wool.....	27
Migration	12	Horticulture	27
Monetary situation	13	Forestry	29
Interest rates	13	External sector	30

THE BERL FORECASTS PANEL

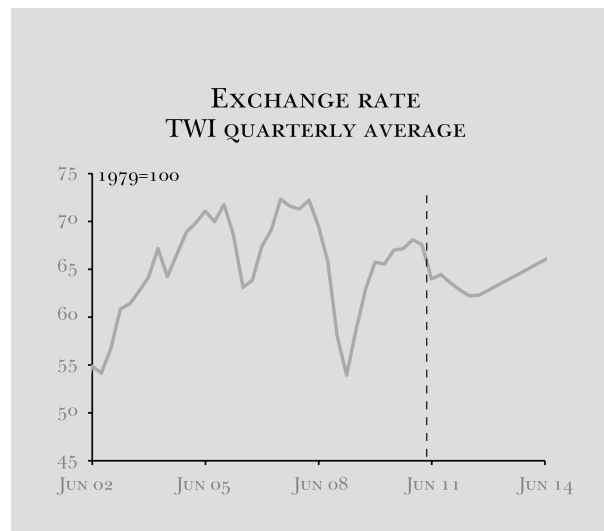
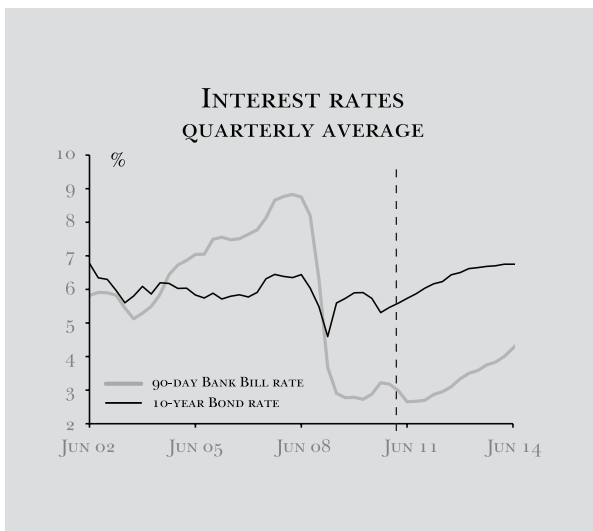
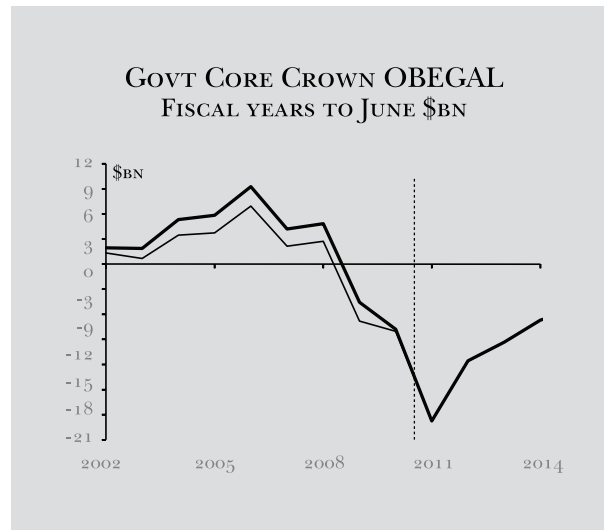
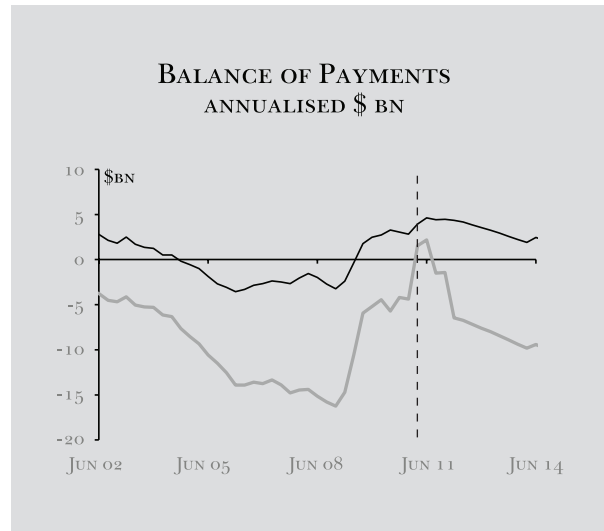
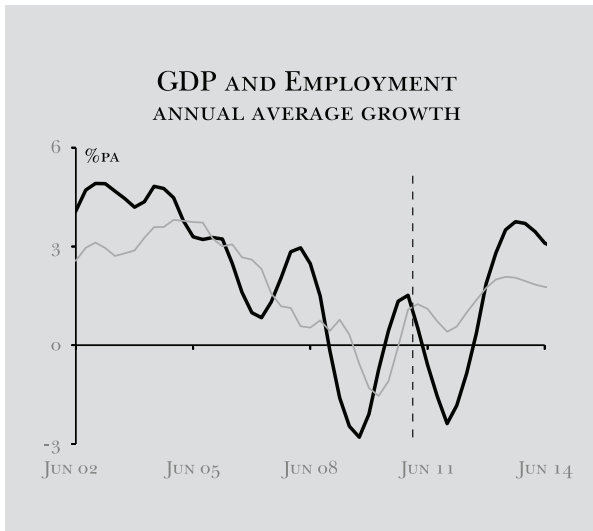
Chief Economist

Ganesh Nana

Contributors

Hugh Dixon, Kelly Dustow, Amapola Generosa
 Jason Leung-Wai, Amanda Lynn
 Wilma Molano, Nathaniel Robson, Kel Sanderson
 Adrian Slack, Fiona Stokes

FORECAST SUMMARY



Detailed data tables (annual and quarterly figures) for the numbers and charts in this document are available to subscribers on request.

THE PICTURE

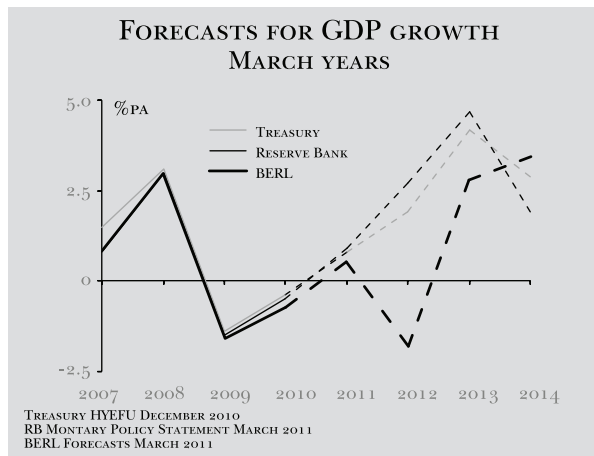
- New Zealand's post-recession recovery has been tentative at best and remains unfinished. Economic activity has yet to return to pre-recession levels, with annual GDP for calendar 2010 below that of 2007.
- Exports, in volume terms, are now above their 2007 levels but by only 3%. Dairy and log exports have led this performance, with manufacturing exports to Australia now benefiting from a favourably competitive exchange rate.
- Business investment also turned up during the latter-half of 2010, but off a very low base. In volume terms, annual business investment remains well below (by 12%) the levels reached in 2007.
- Looking ahead, New Zealand's economic prospects are driven by the need to re-build the physical infrastructure and environment of Christchurch, as well as restore its business and community networks.
- We expect this task to take time to get underway. We are not as optimistic as the official forecasters that expect the rebuilding exercise to have achieved significant momentum in six to nine months time.
- We expect this task to take longer to get underway due to practical requirements, along with regulatory processes and organisational capacity. We do not expect significant momentum for the rebuilding exercise until well into the 2012 calendar year. This will impact on GDP figures for the March 2013 year. Further, we expect skills and capacity constraints to limit the extent of the GDP boost over the forecast horizon.
- The short-term situation, however, remains bleak. Consumer spending is set to continue to be subdued, as employment and income prospects remain uncertain, and government spending is also restrained. Stock accumulation recorded over the latter half of 2010, will unravel through 2011 putting further downward pressure on economic activity.
- Appropriate policy responses to the future economic situation will be critical to medium-term prospects.
- Over zealous attempts to bring the government accounts back into surplus risks a repeat of the 1990 experience. At that time spending cuts drove economic activity down, reduced government revenue and spiralled the government accounts further into deficit.
- And monetary policy responding to inflation caused by construction capacity shortages or external (fuel or food price) events similarly risk prematurely stalling not only the New Zealand economy, but also the rebuilding of the Christchurch and Canterbury communities, economies and businesses.

KEY INDICATORS: FORECAST SUMMARY AND COMPARISONS						
	2009	2010	2011	2012	2013	2014
Real GDP						
March year average % change						
BERL	-1.6	-0.7	0.5	-1.8	2.8	3.5
Reserve Bank	-1.5	-0.5	0.9	2.7	4.7	1.9
Treasury	-1.4	-0.4	0.8	1.9	4.2	2.9
Current Account Balance						
March year % of GDP						
BERL	-8.0	-2.4	-2.9	-2.1	-2.1	0.7
Reserve Bank	-7.8	-2.4	0.2	-3.3	-4.7	-5.1
Treasury	-7.9	-2.4	-2	-4.8	-6.8	-6.6
Export volume growth						
March year average % change						
BERL	-3.5	4.7	1.9	2.1	2.2	3.3
Reserve Bank	-3.5	4.7	1.6	3.4	2.5	2.4
Treasury	-3.4	3.2	1.8	4.5	3	2.8
Private non-hsg investment growth						
March year average % change						
BERL	-8.5	-13.2	13.1	3.5	3.0	4.0
Reserve Bank	-5.1	-9.2	3.7	6.0	15.9	1.6
Treasury	-1.9	-11.4	6.3	12.3	5.1	3.1
Reserve Bank : Monetary Policy Statement, December 2010 Treasury : Half-Year Economic and Fiscal Update, December 2010						

COMMENTARY compiled by Ganesh Nana

The New Zealand economy has struggled to recover from the five-quarter recession recorded from the beginning of 2008 through to March 2009. Since then it has registered two quarters of significant growth - in December 2009 and March 2010. But the other five quarters have recorded quarterly growth figures that are close enough to the margin of error to be considered zero.

Consequently, economic activity has not only stalled but has contracted over the past three years despite the official end of the recession. Thus, average activity levels for the 2010 calendar year were 0.75% below those of the 2007 calendar year, indicating that we have spent the last three years going backwards.



And while several commentators have made much of the 'export-led' recovery, the details indicate that the period can at best be described as including a subdued export performance. Exports have recovered ground lost during the official recession. But in real volume terms, total exports in the 2010 calendar year were only 3% above the total recorded in 2007. This sector cannot rightly be labelled an engine of growth.

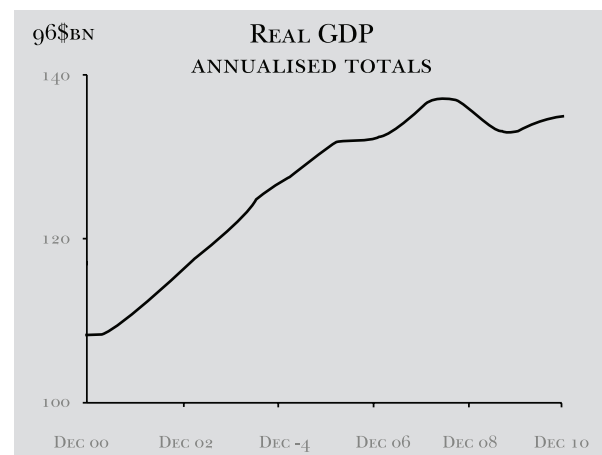
Most telling has been the response of businesses. Private business investment spending in real volume terms plummeted during the early part of the official recession. The latest year indicated a promising recovery in business sentiment, as investment spending surged 10%, but this annual figure hides the longer-term picture. Indeed, despite this latest surge, business investment in real volume terms in calendar 2010 remains nearly 12% down on that of 2007. The implications on long-term productivity of this rundown in machinery, equipment and general capital plant are concerning to say the least.

Of further concern are the figures for the latest December quarter. The latest quarterly growth figure of 0.2% is dominated by a surge in the build up of stocks totalling nearly \$720m (in 95/96 prices). In itself, this change in inventories is the equivalent of 2% of quarterly

GDP growth. In absolute terms this build up of stocks is the largest recorded since the start of the latest GDP data series in 1987. The accumulation of stocks of this magnitude almost certainly foreshadows a period of stock rundown and further suggests muted production activity over the coming months.

This bleak picture is considerably darkened by the February earthquake in Canterbury. The longer-term issues are discussed further in our Feature section. The short-term policy response from the Reserve Bank to cut the Official Cash Rate, while welcome, was aimed more at underpinning mood and confidence than real production activity. Similarly short-term measures including income and business support payments appear relatively piecemeal and marginal.

Without doubt, New Zealand's short to medium-term economic prospects are underpinned by rebuilding activity in Christchurch.



In this regard, the official forecasts remain remarkably upbeat as to short-term prospects. In particular, both the Treasury and the Reserve Bank forecasts imply a rapid commencement of rebuilding in Christchurch and a prompt return to business-as-usual thereafter. As the chart illustrates, both official agencies expect positive economic growth over the period to March 2012 (i.e. most of this year), based on the rebuilding of Christchurch gathering pace through the latter half of this year. The year to March 2013 is marked by a period of intense re-building activity around Christchurch taking annual growth to well over 4%, before easing over the final year of the forecast horizon.

We suggest that the timing of the recovery embedded in these forecasts belies the scale of the job in front of us. The enormity of the task of rebuilding a city and a community of 300,000 people is universally accepted and agreed. However, officials and many commentators alike seem to have difficulty in translating this immense task into their pronouncements.

The regulatory approvals processes (even if fast-tracked); the capacity of officials to deal with such processes; agreeing the shape of the new Christchurch; and prioritising the work to be undertaken; are all challenges that will take time to overcome. And then there is the problem of building construction industry capacity. Beyond this is the re-building of the social infrastructure such as business networks, and customer and supplier relationships - that is assuming the business population retains its propensity to remain in Christchurch.

To suggest that these challenges will be rapidly overcome within the next six-to-nine months seems optimistic, to put it mildly. BERL forecasts, while underpinned by the Christchurch rebuild, assume a longer period of subdued activity before such efforts get gradually underway. In particular, we do not see a significant start until the middle of 2012 as practical and regulatory hurdles need to be tackled. Thereafter, the pace of progress is restrained by the lack of construction capacity and labour.

In the interim, specific export industries will pick up and gain momentum, with logs leading the charge along with manufacturing of goods and services to the Australian market taking advantage of a now competitive exchange rate. But the sluggish tourism sector (despite the short-term boost from the 2011 Rugby World Cup) is one factor holding back overall growth. Another factor will be the reduced processing capacity in the wood products and meat sectors. This means these sectors will be unable to take full advantage of favourable prices movements. Subdued consumer spending, as income and employment prospects remain uncertain, and constrained central government spending will see little impetus for growth.

Consequently, we see annual GDP over the March 2012 year to be down by an average 1.8%; before the Christchurch re-build finds some feet and pushes annual GDP growth to 2.8% for the year to March 2013 and 3.5% for the following March year.

In terms of policy responses, there are two risks. Firstly, there is the risk that an over-vigilant Reserve Bank becomes spooked by construction cost increases as the construction sector attempts to gear up again. Such resource-limited cost inflation should not be met by a demand-management OCR approach to fighting inflation. If relative price signals are again restrained from adjusting, then the necessary shift in resources and incentives to acquire skills and training will be negated. This will undoubtedly stifle re-construction efforts as well as jeopardise long-term business sentiment as to remaining (or returning) to Christchurch (or New Zealand, for that matter).

Secondly, there are policy response risks around central government efforts to rapidly return the fiscal accounts to surplus. Despite commentary to the contrary, New Zealand's government debt situation is by no means dire by international standards. Over-zealous cuts to

government spending risk a repeat of 1990, where such cuts compounded subdued economic activity and resulted in worsening the government accounts through further reducing tax revenues. We hope that lesson has been remembered.

SELECTED MONTHLY INDICATORS
3 MONTH TOTAL % CHANGE ON SAME
PERIOD PREVIOUS YEAR

Month	Car registrations	Retail sales (exc mvs)	New dwelling permits	Intermediate imports (exc oil)	Capital imports (plant)	Visitor arrivals	Mach & eqpmt expts	NZBNZ Survey business confidence*	NBNZ Survey own activity*
Feb 10	6.0	3.8	25.4	-29.3	-27.1	4.1	-11.4	na	na
Mar 10	14.3	3.3	25.8	-21.9	-25.9	5.2	-1.7	50.1	41.9
Apr 10	25.8	4.1	32.3	-18.5	-20.4	5.6	-1.7	42.5	38.6
May 10	34.3	4.1	35.4	-13.3	-14.5	3.0	-3.5	49.5	43.0
Jun 10	34.0	3.4	27.7	-8.5	-12.7	1.5	1.4	48.2	45.3
Jul 10	35.4	2.8	23.5	3.3	-12.1	0.5	9.9	40.2	38.5
Aug 10	27.0	2.5	18.4	11.6	-6.5	3.7	15.0	27.9	32.4
Sep 10	23.3	2.0	16.1	5.6	2.4	5.2	18.4	16.4	25.7
Oct 10	18.1	2.0	3.3	2.7	18.2	3.0	13.4	13.5	26.7
Nov 10	15.7	1.5	-10.7	2.4	17.9	1.2	9.9	23.7	30.5
Dec 10	17.2	1.6	-11.5	11.6	18.6	1.0	8.9	33.2	35.3
Jan 11	12.9		-16.1	14.8	15.3	1.1	3.6	29.5	34.5
Feb 11	11.9							na	na

Statistics NZ; NBNZ # net expecting improvement

FEATURE – OUR WORLD HAS CHANGED, SO WHY DOES POLICY REMAIN IN A ‘NORMAL’ MODE? by Dr Ganesh Nana

The first three months of 2011 began with uncertainty as the global economy continued its tentative steps towards recovering from the consequences of financial and sovereign debt crises. Increasing uncertainty took hold with the appearance of political turmoil in North Africa and the Arabian peninsula. Then there was the destructive Christchurch earthquake in February. And then there was a devastating earthquake and tsunami in Japan, with nuclear concerns yet to abate. In this context it doesn't seem too much of an exaggeration to say that our world has indeed changed.

Remarkably, many New Zealand headline writers, commentators and officials seem intent on commenting on whether GDP figures would confirm a double-dip recession. To me, in the above context, data relating to something that happened three months ago just seems irrelevant. Needless to say I have been asked on numerous occasions over the past few months about the possibility of a double-dip recession. My response was, as it always has been, “does it really matter when the core challenges facing the NZ economy remain significantly unchanged?” Yet, somehow it was supposedly newsworthy that there wasn't a double-dip recession.

On reflection, I believe that what many people are really asking is, “when will things get back to normal?” The honest answer to this is “I don't know, because I don't know what normal looks like anymore, let alone when we are going to get there”.

Of course, this uncertainty is much starker in the aftermath of the Christchurch earthquake. And those seemingly impatient for a number on the economic impact of this tragedy are again, I believe, really asking “when will things get back to normal?” And we must admit, again, that the answer is the same – “we don't know, because we haven't got a clear idea of what the new ‘normal’ might look like”.

Despite the clear signals that our world has changed and things won't be ‘back to normal’ for several years, at best, it is equally clear that our headline writers, commentators, officials and policy advisors seem intent on retaining our old policy framework. We had the laughable (well it would have been funny if it wasn't serious) episode where the Governor of the Reserve Bank had to explain why, in the aftermath of a fairly unprecedented event, he discussed options with the Minister. Subsequently, the Governor had to reiterate that this discussion did not change his (the Governor's) decisions.

I've never quite understood why the Governor is allowed to talk to all and sundry, while the myriad of market players and headline writers are allowed to influence the Governor's decisions with their commentaries, yet our own elected leaders are not allowed to exert any influence. But that has been the accepted protocol for the past 20 years. Now, with the country needing leadership (in all meanings of that word), it is surely appropriate for our leaders to converse and, indeed, have an opinion on, an important aspect of economic policy.

Nevertheless, New Zealand's economic commentary seems destined to continue with the language of recessions, inflation and government debt. Already we are being warned that inflationary pressures will accompany a Christchurch construction boom and that the Reserve Bank must stand ready to fight. And the self-imposed imperative to rapidly ‘re-balance’ the government accounts has been reiterated by comments from the IMF.

Curiously, authors of any conventional anti-inflation textbook would have winced at the use of demand-management monetary policy to avert a supply-induced construction capacity shortage relative price change – but perhaps that's getting too technical. And the call to quickly rectify New Zealand's government debt imbalance, when the crown's debt situation is far from desperate by international standards, is equally curious.

Faced with the prospect of a new ‘normal’, one of the worst things we could do is to bury our heads and continue to operate as if the old world rules still hold. One thing is clear, inflation is not the number one problem facing the New Zealand economy – it is not even close to number two, so why do we treat it as such? And government debt is not the number one challenge, and recessions are really only of concern to those who believe short-term economic cycles are more important than long-term sustainable improvements in well-being and livelihoods.

Further, the received wisdom that New Zealand spends too much and doesn't save enough also needs to be relegated as key policy planks. New Zealand's number one challenge is not to spend less. It is not to save more. New Zealand's number one challenge is to earn more. Synonymous with earnings is exports.

Growing income and export earnings must be put top of the economic agenda. If we do not, and continue with the policy prescriptions of yesterday and yesteryear then not only will the task of re-building Christchurch seem overwhelming, it will be truly overwhelming.

GLOBAL SITUATION compiled by Jason Leung-Wai, Hugh Dixon and Wilma Molano

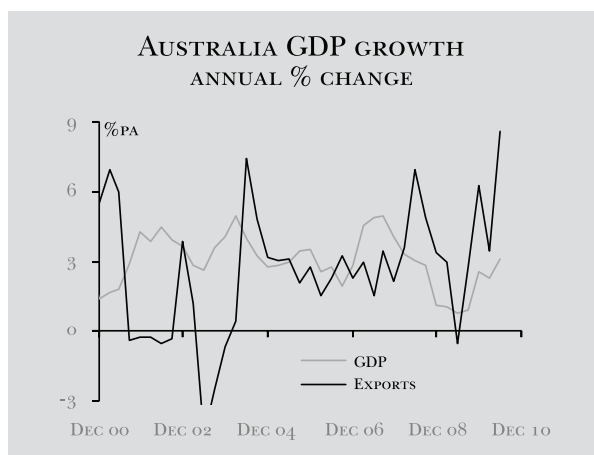
THE WORLD SCENE CONSENSUS FORECASTS

	Real GDP % Change				Consumer Prices % Change			
	2009	2010	2011	2012	2009	2010	2011	2012
Australia	1.3	2.7	2.9	3.7	1.8	2.8	3.1	2.8
China	8.7	10.3	9.4	9.0	-0.7	3.3	4.6	3.0
Hong Kong	-2.8	6.8	5.2	4.8	0.6	2.4	4.3	3.7
India	7.4	8.6	8.2	8.4	12.4	10.3	7.2	6.6
Indonesia	4.5	6.1	6.2	6.4	4.8	5.1	6.8	6.1
Japan	-5.3	3.9	1.4	2.1	-1.4	-0.7	0.2	0.2
Malaysia	-1.7	7.2	5.1	5.4	0.6	1.7	2.9	2.8
New Zealand	-1.6	1.4	1.1	3.8	2.1	2.3	4.3	2.6
Singapore	-1.3	14.5	5.2	5.5	0.6	2.8	4.0	2.6
South Korea	0.2	6.1	4.5	4.6	2.8	2.9	3.8	3.1
Taiwan	-1.9	10.8	4.6	5.1	-0.9	1.0	2.0	2.1
Thailand	-2.2	7.8	4.4	5.0	-0.9	3.3	3.7	3.3
Asia/Pacific	1.5	6.8	5.3	5.5	0.9	2.4	3.2	2.7
North America	-2.4	2.8	3.1	3.2	-0.2	1.6	2.3	2.0
Latin America	-1.9	6.0	4.3	4.2	5.5	7.3	7.4	7.0
Western Europe	-4.2	1.8	1.7	1.7	0.6	1.7	2.3	1.8
Eastern Europe	-5.5	4.2	4.0	4.3	6.6	6.5	6.2	5.7

Copyright Consensus Economics Inc. 2010

AUSTRALIA

The latest economic data from Australia shows that GDP growth in the December 2010 quarter was at 0.7%, which kept the annual GDP growth at 2.7%. The largest industry contributors to this annual increase were the professional, scientific and technical services sector (up 13.0%); agriculture, fishing and forestry (up 28.7%); and the construction sector (up 8.5%). The unemployment rate remained unchanged for the third quarter in a row, sitting at 5.2% in the December 2010 quarter, while the labour force participation rate was at its highest point in the last 20 years, 65.9%.



In December 2010 and throughout January and February 2011, Australia experienced a series of natural disasters caused by extreme weather events.

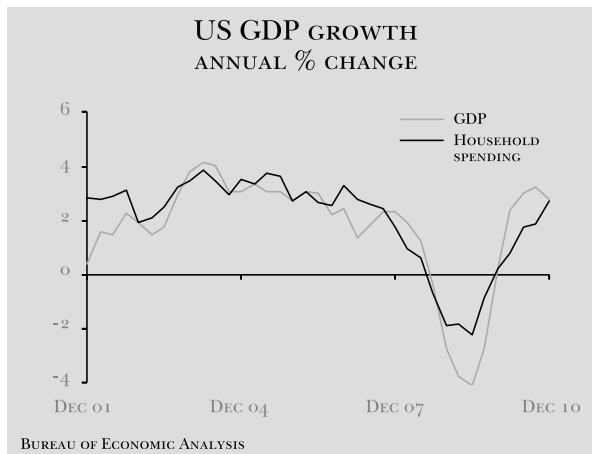
Queensland in particular was badly affected with three-quarters of the state declared a disaster zone after extreme flooding in December 2010 and January 2011, and then Cyclone Yasi hitting the northern part of the state in early February 2011. These weather events caused severe damage to businesses, public infrastructure and private residential homes in Queensland. The full cost of these weather events to the Australian economy will become more apparent with the release of economic data for the March 2011 quarter, but it is expected that GDP growth will be subdued.

Throughout the rest of 2011, a rebound is expected due to the extensive rebuilding efforts in Queensland and businesses beginning to operate at pre-flood levels again. However, the extent of this rebound may be limited due to the redirection of consumption within the economy rather than the creation of new economic activity. The reason for this? A new tax introduced on those earning over A\$50,000 who live outside the affected disaster areas. This tax will help pay for the rebuild.

UNITED STATES

The United States economy is still on the slow road to recovery. GDP in the December 2010 quarter increased by 0.8% compared to the September 2010 quarter, taking annual growth in GDP to 2.8% in the December 2010 quarter. While this is a positive result, it is actually a decline from the annual growth rate seen in the September 2010 quarter of 3.2%.

Household spending has continued to improve, up 2.7% annually. However, the December 2010 quarter saw the first reduction in private domestic investment since the September 2009 quarter. Despite this reduction, private domestic investment still remains high and in the December 2010 quarter it was actually up 9.6% over the December 2009 quarter.



Of bigger concern to politicians in the US is the state of the labour market. Unemployment remains at 9.6% and the share of the population in the labour force has continued to fall. This is common during recessions when some people who are unemployed give up searching for work, go back to university or training colleges, or retire early. This decline usually reverses during recoveries but not this time. Since the recession ended in mid 2009 the share of the population in the labour force has kept sliding and in the December 2010 quarter it stood at 64.4%.

The most positive news coming out of the US labour market at the moment is from the manufacturing sector. In the year to February 2011, 189,000 new jobs have been created, an increase of 1.6%. While this may seem like a low rise in job numbers, it is the highest annual gain in manufacturing jobs since the late 1990s. The vast majority of this new employment is in manufacturing items for domestic business or overseas customers, such as computers, machinery, electronic equipment and heavy duty trucks.

ASIA

CHINA

In the fourth quarter of 2010, China's GDP grew despite a series of tightening measures put in place by Beijing. This resulted in an annual rise in GDP of 9.8% compared to the year earlier. Inflation also rose in December, up 4.6% from the year earlier but 0.5%-points lower than the 5.1% increase registered in November. The inflation rate for 2010 stood at 3.3%, above the 3% target for the year set by the Government in early March. The producer price

index (PPI), a measure of inflation at the wholesale level, registered a year-on-year increase of 5.5%.

The latest data released by the Japanese government reveals that China has now eclipsed Japan as the world's second largest economy, after the United States. Japan, Asia's undisputed economic kingpin for more than four decades, is now saddled with deflation, weak domestic demand and massive debt while China continues to expand rapidly on the back of a manufacturing and export boom.

INDIA

Between October and December 2010, India's economy grew 8.2% compared to the same period a year earlier. Those sectors that registered significant growth in the third quarter of 2010 compared to the same period in 2009 included the agriculture, forestry & fishing sector, up 8.9%; construction up 8.0%; trade, hotels, transport & communication up 9.4%; and the financing, insurance, real estate & business services sector up 11.2%. The growth rates in mining & quarrying; manufacturing; and community, social & personal services was estimated at 6.0%, 5.6% and 4.8%, respectively during this period.

In 2010, the Indian economy rebounded robustly from the global financial crisis - largely because of strong domestic demand - and growth exceeded 8% year-on-year in real terms. Merchandise exports, which account for about 15% of GDP, also returned to pre-financial crisis levels.

An industrial expansion and high food prices, resulting from the combined effects of the weak 2009 monsoon and inefficiencies in the Government's food distribution system, fuelled inflation. This peaked at about 11% in the first half to 2010, but has gradually decreased to single digits following a series of central bank interest rate hikes. The Indian Government has sought to reduce its deficit to 5.5% of GDP in the 2010-11 financial year down from the 6.8% experienced in the previous fiscal year.

JAPAN

The Japanese economy has been stagnant for more than a decade, but the December 2010 quarter was the first contraction in GDP seen in the last five quarters. GDP shrank by 0.3% in the December 2010 quarter compared to the previous quarter, slightly less than the 0.5% fall expected by the markets. Analysts largely blamed this weakness on the expiration of government incentives to buy low-emission cars in September 2010, which resulted in private consumption declining by 0.8%. Business investment during the period rose by 0.5%. But both of these measures were weaker than previously estimated, this resulted in the quarter-on-quarter annualised growth rate being downgraded to -1.3% from -1.1%.

Prior to the 11 March 2011 earthquake and tsunami, analysts expected a recovery in the Japanese economy this year due to stronger exports to China and other parts of fast-growing Asia offsetting the persistently weak domestic demand. In the first quarter of 2011, industrial production had risen along with inventories signalling that manufacturers were turning upbeat about the global outlook. However, this planned increase in outputs has now been stalled by rolling power cuts and the widespread destruction wreaked by the natural disaster.

Economic experts worldwide have varying views regarding the future of Japan's economy after the March 11 earthquake and tsunami. Some commentators are watching regions that were not physically damaged but are connected through networks to the disaster site. The electricity grid, for example, is a network that could spread the negative impact of the natural disaster throughout the country, and generate a significant macroeconomic impact. According to some estimates, about 7% of Japan's electricity generating capacity has been lost so far. That might be manageable - but several nuclear power stations are still in major danger.

Other economists, however, are saying that this natural disaster may prove less consequential in economic terms than the Kobe earthquake because of where it happened. The northeast region is not as large a manufacturing hub as western Japan. So the economic impact in the long term might not be as great. We can only watch and wait to see what happens, but everybody would like to see Japan, the "land of the rising sun", shine again.

HONG KONG

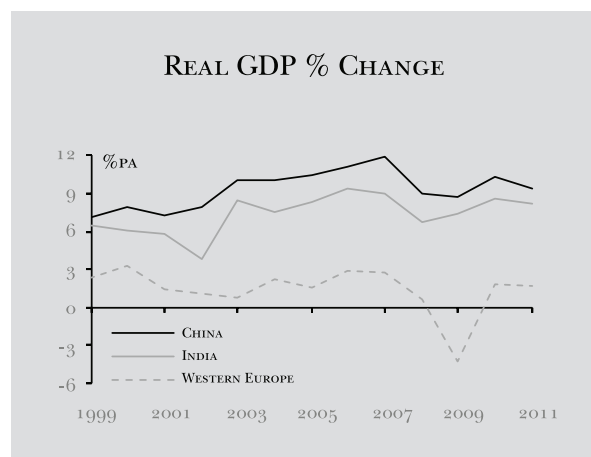
GDP in Hong Kong grew by 1.5 percent in the December 2010 quarter compared to the previous quarter. Hong Kong's open economy left it exposed to the global economic slowdown, but its increasing integration with China, through trade, tourism, and financial links, helped it recover more quickly than many observers anticipated.

The total value of goods and services trade, including the sizable share of re-exports, is equivalent to more than 400% of GDP. The Hong Kong government is promoting the Special Administrative Region (SAR) as the site for Chinese renminbi (RMB) internationalization. Hong Kong residents are allowed to establish RMB-denominated savings accounts; RMB-denominated corporate and Chinese government bonds have been issued in Hong Kong; and RMB trade settlement is allowed. The territory far exceeded the RMB conversion quota set by Beijing for trade settlements in 2010 due to the growth of earnings from exports to the mainland. RMB deposits grew to roughly 3.6% of total system deposits in Hong Kong by October

2010, an increase of over 250% since the beginning of the year. The Government is pursuing efforts to introduce additional use of RMB in the Hong Kong financial markets and is seeking to expand the RMB quota for 2011.

EUROPE

EUROZONE



Europe continues to plod along, with the Euro area GDP up 0.3% in the December 2010 quarter. On the year, GDP increased by 1.7 percent. In terms of the larger economies, Germany remains its saving grace. GDP in Germany was up 4.0% on the year, while in France and Italy, annual GDP was 1.5% and 1.3% respectively.

Meanwhile unemployment in the Euro area stood at 9.9% in January 2011. Unemployment was lower than the average in the Netherlands (4.3%), Austria (4.3%) and Luxembourg (4.6%); while Spain (20.4%), Latvia (18.3%) and Lithuania (17.4%) had the highest rates.

Inflation in the Euro area in February 2011 was 2.4%, up from 2.3% in January. In February 2011, annual inflation was highest in Romania (7.6%), Estonia (5.5%) and Bulgaria (4.6%) and lowest in Ireland (0.9%), Sweden (1.2%) and France (1.8%). Germany's inflation rate sits at 2.2%.

Construction outputs were up by 1.8% in January 2011, although outputs were still down 4.5% on the previous year. Annual construction outputs are being led by Germany (55.4%), Poland (11.1%) and Sweden (10.0%).

Industrial production was up by 0.3% in the month to January 2011 and by 6.6% in the year to January 2011. Annual industrial production rose in all member states, with the highest increases registered in Estonia, Slovakia and Lithuania. German industrial production has increased by 11.1% on the year.

UNITED KINGDOM

While confidence in the manufacturing sector (BDO Optimism Index) has risen to a seven month high in February 2011, at 95.5 it is still below the 100 mark, which signals sustainable economic growth. Growth remains sluggish.

After four quarters of growth, UK GDP contracted by 0.6% in the December 2010 quarter, bringing annual GDP growth to 1.5%. While production output and government expenditure was both up 0.7% all other groups fell. Construction output fell by 2.5%, service industry output was down 0.7% and household expenditure fell 0.1%.

The unemployment rate for the three months to January 2011 was 8.0%, up 0.1% on the quarter. Total unemployed increased to 2.53 million people, the highest figure since 1994. On the other hand the employment rate for 16-64 year olds fell slightly to 70.5%.

Meanwhile CPI annual inflation increased again to 4.0 percent in January 2011, driven by the continued increase in crude oil prices. However, the increase also included the rise in Value Added Tax (GST) in January to 20 percent.

LABOUR MARKET CONDITIONS compiled by Kel Sanderson

EMPLOYMENT

The labour market is being buffeted from all angles and the future resulting track for employment is almost anybody's guess. Almost!



As at 21 February 2011 our take on the employment situation was that it was finely balanced. The general economic climate was flat, but construction was expected to provide a balancing positive. Macro-economic interventions including the increased interest rates mid-2010 and relatively tight government spending was still squeezing activity out of the economy. However, there was an expectation that a construction lift in the first quarter 2011 would come as some reconstruction from Canterbury's September earthquake finally began. Also net inward migration was still positive at a rate of about 10,000 per year and was expected to underpin a firming of house construction. This may have just averted the dive back into negative, from a brief period of positive employment growth mid-2010.

Then came 22 February. From a forecasting point of view we now have two problems. The first one is to forecast what will actually happen. The second is to realise that in Christchurch, Statistics NZ will have

extreme difficulty locating and collecting their survey information. It is unlikely that we shall be able to actively track for some time what is happening there in terms of employment of householders (the Household Labour Force Survey); and the number of filled jobs in the employing firms (the Quarterly Employment Survey).

The main factors driving employment change over the next year or so are now expected to be the general downturn continuing and driven harder because of the workplaces and jobs lost in central Christchurch. These numbers could be of the order of 1% to 1.5% of New Zealand's employment. The hoped for construction in Canterbury on the September destruction will be back to the drawing board, and some time before any volume of construction starts in Christchurch.

Finally, the net migration inflow is likely to turn into a net outflow, as people from Christchurch and Canterbury leave, not only for Timaru and Auckland etc, but for overseas. Into this mix, we can still see some employment generated in mid-to-late 2011 by Rugby World Cup 2011. By the last quarter in 2011 we can expect the construction activity in Canterbury and Christchurch to be growing.

The strength of the construction stimulus will require higher relative prices in that sector to attract the necessary workers and capital gear. This will no doubt be seen as inflationary (which a relative price change is not), and trigger the RBNZ to OCR increases. At the same time the government is indicating fiscal tightening to balance Christchurch expenditure.

By the end of 2011 perhaps things may not be too different from the beginning of 2011. The macro-economic interventions will continue to bring softness in the employment market, but construction should be forcing through some moderate employment increases.

LABOUR MARKET INDICATORS 000S PEOPLE							
June quarter	2009	2010	2011	2012	2013	2014	2015
Full-time employment	1,652	1,669	1,669	1,699	1,736	1,768	1,800
Part-time employment	514	497	497	502	506	510	514
Total employment	2,166	2,166	2,166	2,201	2,242	2,278	2,314
FTE employment growth %	-1.2	0.6	0.0	1.7	2.1	1.8	1.7
Unemployment	134	155	171	156	143	138	134
Official unemployment rate %	5.8	6.7	7.3	6.6	6.0	5.7	5.5
Labour force	2,300	2,321	2,337	2,357	2,384	2,416	2,448
Participation rate %	68.2	67.8	67.7	67.6	67.7	67.8	67.9
Not in labour force	1,073	1,100	1,116	1,128	1,138	1,147	1,156
Working age population	3,372	3,421	3,453	3,485	3,523	3,563	3,604

Statistics NZ and BERL calculations

BERL Forecasts

We are forecasting zero employment change in the year to June 2011, but recovering to 1% by 2012, and then between 1.5% and 2% out to 2015.

UNEMPLOYMENT

The unemployment rate for the second half of 2010 had increased to 6.7% of the labour force. The effect of the Christchurch earthquake coming on a slack economy is expected to drive unemployment over 7% in the June quarter 2011. The data for the March quarter may be a little confusing, given that survey information from Christchurch will be incomplete.

We then expect unemployment to come back into the 6% range in 2012, and to sit in the range 5.5% to 6% out to the forecast horizon in 2015. These are relatively low figures given that we expect macro-economic interventions to cause a subdued economy over this period. However with net inward migration expected to be low or negative early in the period, there are fewer people expected to enter the labour force, and this will restrict the increase in the number unemployed.

MIGRATION

We were already tracking a reduction in the net inward flow of migrants as a result of people staying home in our source countries in the Northern Hemisphere, and a re-emergence of more Kiwis emigrating to Australia, and points beyond.

Even the December quarter 2010 seemed to show some further increased migrant outflow, perhaps partly due to the September Canterbury earthquake. We now expect the increased outflow, especially from Christchurch, and possibly some reduced inflow from earthquake-averse potential migrants to result in, at best, a zero net migrant inflow in coming months.

In the second half of the year we can expect some Rugby World Cup spectators to come together with a permit to stay. This may be enough to give us a small net migrant inflow. However thereafter we forecast minimal net inward migration out to about 2013.

The prospect then depends on the extent to which we have adopted an imaginative, positive direction as a country. If we continue our control-and-cut mentality, we can expect to sink back into the migrant outflows we saw in the second half of the 1990s. If, on the other hand, we are by then seeing some positives like the 'new' Christchurch/Canterbury; the new 'Unleashed' Auckland; and the dynamic Maori economy with its dairy and seafood developments we may as a result see New Zealand retaining and attracting a strong net migrant inflow. This migrant retention, attraction and net inflow was a key driver of the economic growth from 2001 to 2006.

PERMANENT AND LONG-TERM MIGRATION 000S PEOPLE							
Year ended June	2009	2010	2011	2012	2013	2014	2015
Gross migrant inflow	88.3	82.3	84.0	80.0	82.0	85.0	85.0
Gross migrant outflow	75.7	65.8	84.0	80.0	74.0	74.0	74.0
Net migrant inflow	12.5	16.5	0.0	0.0	8.0	11.0	11.0

Statistics NZ

BERL Forecasts

MONETARY SITUATION compiled by Dr Ganesh Nana

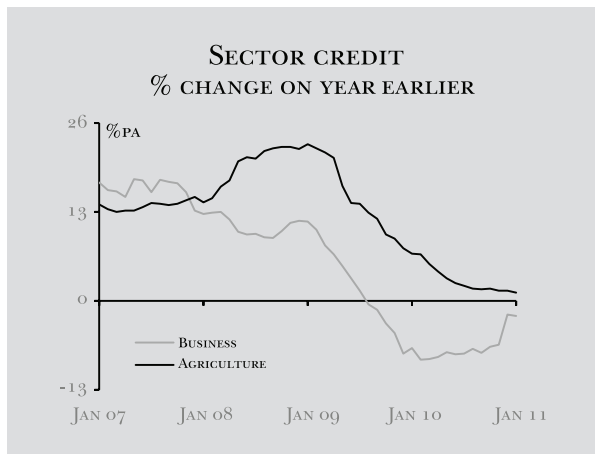
Monetary conditions continue to impose a constraint on economic activity. This month's recent reduction in the Official Cash Rate (OCR) is clearly designed to bolster mood and confidence rather than providing significant relief for businesses. While the Christchurch earthquake made the decision to cut the OCR inevitable, the fragility of the recovery of already being acknowledged. Consequently, official rates are unlikely to rise over the next 12 months.

However, for businesses the focus remains just as much on access to credit, as well as its price.

Credit supply figures indicate that funds available for businesses continues to contract, with January more than 2% down on year earlier, which was itself nearly 7% down on January 2009. Two consecutive years of contracting credit supply to businesses is almost unprecedented.

And while credit available to the agriculture sector continues to grow, the rate of growth has declined to be almost negligible. The distinction between the agriculture and the business sectors is notable. This potentially arises from NZ banks willingness to assist the farming sector given the banks own concerns about its exposure to this heavily indebted sector.

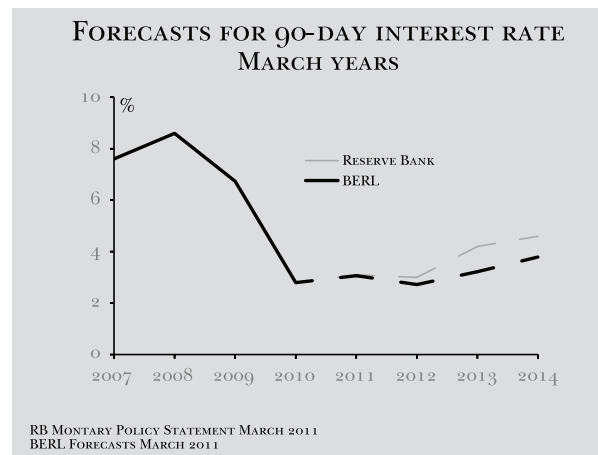
With ongoing caution being exercised by lenders, coupled with the likely diversion of funds towards Japan weighing on international flows, we are not optimistic of a significant turnaround in this credit situation.



Despite the sombre economic outlook, the Reserve Bank (RB) and money market commentators will remain preoccupied by the apparent presence of inflationary pressures. In particular, world oil prices trends are going to translate to further upward pressure on fuel prices in New Zealand. This could be made worse if the NZ\$ declines in response to deteriorating public sector and national deficits and debt. Nevertheless, we trust the Reserve Bank will acknowledge the futility of responding to these price pressures through higher interest rates.

Similarly, higher interest rates in response to increasing construction costs (for materials and labour) as the rebuilding of Christchurch commences would also be highly inappropriate. Not only are such cost increases inevitable, they would be the reflection of a sound market mechanism operating to attract and reallocate resources to the construction industry. Without this relative price response there would be little signal (or incentive) for construction capacity to increase, with the re-building phase being significantly stifled as a result.

INTEREST RATES



The middle of February saw 90-day rates around the 3.2% mark, signalling little expectation of any increases over the short term. Immediately after the earthquake, rates fell quickly to near 2.9%. Since then they have declined further to around 2.6% following the 50-point OCR cut. The RB's Monetary Policy Statement accompanying the cut indicates 90-day rates for the March 2012 year averaging 3%, and 4.2% for the March 2013 year.

This would suggest OCR increases towards the end of calendar 2011, consistent with their expectation of the Christchurch rebuilding gathering momentum in six months time. BERL forecasts are for such increases to be later, in line with our expectations of the timing of Christchurch construction activities and overall growth profile.

We note the RB expressed more than the usual words of caution when advising as the interpretation of their forecasts. Clearly, the unknowns are far greater than New Zealand has experienced in recent times. This, we would argue, is all the more reason to err on the side of caution when deciding monetary policy.

The RB's benchmark indicator of business rates (the 'business base lending rate') has remained in double digits. Having peaked at 12.4% during the middle of 2008, it had declined to just on 10% early last year. However, this rate turned back up during the latter-half of 2010 with the latest (February) figure at 10.24%.

Prospects are for this rate to dip into single digits over the coming year in line with overall rates.

EXCHANGE RATES

The NZ\$ strengthened over the last days of 2010 and the first weeks of 2011, reflecting ongoing weakness in the US\$. From about 73.5 US cents (67.2 on the TWI, or trade-weighted index) in mid December, the NZ\$ averaged over 76 US cents during January and reached 78 US cents in early February.

The NZ\$ fell from about 76.3 to 74.7 US cents immediately following the February 22 earthquake. This took the trade-weighted index (TWI) from 67.9 to 66.5. The NZ\$ weakened further to 73 US cents over early March, especially as international markets responded to the Japan earthquake by pricing the Yen higher and further depressing the US\$. However, the NZ\$ has again turned upwards and is back close to 75-76 US cents mark.

This volatility, while not unusual, does not indicate a significant downgrade is in line for the NZ\$ despite the fragility of the NZ economic situation and outlook. Clearly, international markets remain pre-occupied by global events (Japan and oil). The ongoing weakness of the US\$ along with likely re-insurance funds flowing to NZ could well act to underpin the NZ\$ over the short term.

A positive to the exchange rate picture for NZ is the cross-rate with the Australian \$. The NZ\$ has now been significantly below 80 Australian cents for more than six months now. This is no doubt welcome news for manufacturing exporters to the Australian market, as well as for the struggling tourism industry.

We see room for a further gradual weakening (as measured by the TWI) as our weak growth picture continues, but do not expect a significant downgrade for the NZ\$ as world markets remain occupied by bigger issues. Of course, as is always the case with exchange rates, the many unknowns could easily swamp (in either direction) any movements necessitated by the economic 'fundamentals'.

MONETARY PRICES QUARTER AVERAGE

Quarter	TWI Jun 1979=100	90 day bank bill rate %	10 yr govt stock yield %	1st mortgage housing rate %	Business base lending rate %
Mar 10	65.3	2.73	5.90	5.90	10.02
Jun 10	66.7	2.88	5.73	5.98	10.02
Sep 10	66.9	3.22	5.31	6.31	10.23
Dec 10	67.8	3.18	5.46	6.39	10.38
Mar 11	67.0	2.99	5.59	6.24	10.10
Jun 11	64.9	2.65	5.73	6.00	9.75
Sep 11	66.1	2.67	5.87	6.00	9.68
Dec 11	65.2	2.70	6.03	6.00	9.63
Mar 12	64.4	2.87	6.17	6.17	9.77
Jun 12	63.8	2.95	6.23	6.25	9.85
Sep 12	63.8	3.10	6.43	6.10	9.85
Dec 12	64.4	3.33	6.50	6.33	10.08
Mar 13	64.9	3.50	6.62	6.50	10.25
Jun 13	65.5	3.58	6.65	6.58	10.33
Sep 13	66.0	3.75	6.68	6.75	10.50
Dec 13	66.6	3.83	6.70	6.83	10.58
Mar 14	67.1	4.00	6.75	7.00	10.75
Jun 14	67.6	4.25	6.75	7.25	11.00

RBNZ

BERL Forecasts

GDP GROWTH compiled by Amapola Generosa

GDP growth is expected to be much slower over the coming year. The second earthquake to hit Christchurch, and the crisis faced by Japan, (New Zealand's fourth-largest trading partner), have knocked out New Zealand's slim prospects for faster-paced economic growth in 2011. A general gathering of momentum focussed on the Christchurch re-build underpins our forecast for a recovery through calendar 2012.

We have downgraded our GDP growth forecasts for New Zealand. GDP is likely to see a contraction in the year to March 2012, dropping by 0.9%; compared to a 0.4% expansion in the year to March 2011. The economy is set to gain some momentum in the year to March 2013, and push towards higher growth in the year to March 2014. The overall lower growth forecast is based on general uncertainty in early 2011, compounded by domestic and international tragedies, subdued export revenue growth, weak domestic spending, and restrained government expenditure.

Looking at the detail, New Zealand had a slow expansion of production towards the final quarter of 2010. On a year on year basis, GDP was up 1.5% in the year to December 2010. This is more solid than the 2.1% decline in the year to December 2009, but is noticeably lower than the 2.8% growth seen over the 2007 calendar year. Indeed, despite the growth in the latest year, overall economic activity for 2010 (as measured by GDP) was below that of three years earlier.

GDP growth in 2010 fell short of many commentators' earlier expectations largely due to weak domestic demand. This weak growth performance was well entrenched over the middle of 2010 and preceded the September earthquakes, which exacerbated the

already sluggish economic growth. The economy appears to have lost momentum following premature suggestions of an export-led recovery early this year. The increase in production in most sectors has been weak compared to the December quarter in the previous year. New Zealand has to channel much of its resources to reconstruction and rebuilding damaged infrastructure, and to lift the confidence of the household and business sectors.

On the expenditure side, domestic spending is still weak as households and businesses remain cautious. Growth in consumption spending has been restrained, growing less than half-a-percent in each of the last five quarters. Retail sales values for the December 2010 quarter were flat, down 0.1% compared with the September 2010 quarter. Moreover, consumer confidence slumped to its lowest in the past five quarters, slipping to 108.3 points in the December 2010 from 120.3 points in the September 2009 quarter.

Government expenditure also declined as the government looked to cut costs, in an effort to extricate itself from a credit watch list. Government investment is down 9.6% on a year ago, while consumption growth slipped from 2.2% in the September quarter to 0.3% in the December 2010 quarter. Given these trends and the ballooning fiscal deficit, it is clear that government will not be the driver of any recovery.

With growth in household spending looking less optimistic, much is expected of the business and external sectors of the economy. Business confidence in New Zealand has resumed an upward trend, increasing by 8% in the December quarter of 2010. This boost in the sector was led by the agricultural sector, which has benefitted from

GDP EXPENDITURE ANNUAL AVERAGE % CHANGE							
Year ended March	2009	2010	2011	2012	2013	2014	2015
Private consumption	-1.1	0.3	1.7	0.5	1.5	2.1	2.6
Housing investment	-23.4	-13.1	1.9	-7.9	25.1	32.4	2.3
Other investment	-8.5	-13.2	13.1	3.5	2.4	2.6	2.6
Govt investment	9.1	1.2	-5.6	5.7	17.8	12.5	3.2
Government consumption	4.2	0.3	2.0	0.6	1.2	1.2	1.2
Gross National Expenditure GNE	-1.9	-3.9	4.3	0.5	3.7	4.1	2.5
Exports	-3.5	4.7	1.9	2.1	2.2	3.3	3.5
Imports	-4.2	-9.5	11.5	6.4	4.8	5.1	2.4
Gross Domestic Product GDP	-1.6	1.1	1.2	-1.8	2.8	3.5	2.8
<i>Statistics NZ</i>	<i>BERL Forecasts</i>						

soaring global commodity prices of dairy products. But, with the wake of a crisis in Japan, a major importer of New Zealand's cheese, milk and casein, as well as two top export earners, forestry and aluminium, we expect export volumes in the next months to wane. In a recent Fonterra online auction, dairy prices fell sharply following the events in Japan. Still, economists are optimistic about the long-term outlook for New Zealand's top export commodities like dairy, meat, logs and timber, aluminium, and wine. Export volumes might fall, but relatively high export prices and stable world demand are likely to hold up export receipts.

The residential buildings aspect is likely to be a positive contributor over the next year as rebuilding efforts take place in Christchurch. Broadly, this effect will add to overall GDP growth over the medium term. However, there are issues raised on the supply-side, particularly on the capacity of the economy to meet the demand for required labour and skill to rebuild a major tourist destination in the country which has an estimated 9 to 10% share of New Zealand's GDP and employment, respectively. Labour market demand was weak (the number of full-time equivalent employment is up 0.2%), with filled jobs in the construction sector slipping further (down 5.6%) in the year to December 2010.

The forecast for GDP growth suggests that 2011 might not be a rosy and rallying year for the New Zealand economy. Bid for a faster-paced growth depends on a multitude of factors and the economy's ability to manage the risks to global growth and export prices. The most complex of the factors that are likely to stimulate recovery and expedite growth in New Zealand in the medium – term is its absorption capacity once rehabilitation efforts in Christchurch are underway. This capacity depends on several factors including the availability and quality of the labour force and the required infrastructure, the efficiency at which investments and funds are used, and the overall institutional and policy environment. The real challenge therefore is how various sectors involved in the whole process can promptly, efficiently and effectively use the resources to get recovery in the right track.

INFLATION compiled by Jason Leung-Wai

Unlike most commentators on the New Zealand economy, BERL is not so concerned about inflation. We accept that there are upward pressures from petrol prices and commodity prices, and high headline numbers on food prices. However, beyond the petrol pump and the energy sector, the New Zealand economy is not in any state for businesses to be able to pass much, if any, of these higher costs to the New Zealand consumer. This is borne out when looking more closely at the price indices. Most of these indices don't include the latest round of petrol price increases, which will push prices up slightly. We have incorporated them into our medium term forecasts, where we expect the CPI measure to peak at 5.4% in September 2011 before easing back to between 2.2% and 2.5% by June 2012.

The headline numbers are slightly misleading as the annual increases in the consumer and food price indices include the GST price rise in October 2010. Taking GST out of the equation the CPI drops to well within the target range at around 2.0%, and the food price index is at around 3.0%.

Chances are that petrol prices have overshot at their current level (of around \$2.20 as we go to press). While we don't expect prices to hit \$2.50 in the near future, we do believe they are likely to settle above \$2 a litre for 91 unleaded.

Petrol prices will be inflationary. However, there is little to suggest that the consumer is willing or able to accept higher prices – particularly when you consider the plight of our retail sector. Producer prices are starting to increase again (up around 4.0% on the year), although the Capital Goods Price Index has seen a fall in prices over the last year. Most consumers (including businesses) are focusing on paying down rather than incurring further debt.

The following table shows the changes in the six price indices for the latest quarter or month, and the annual change.

INFLATION INDICES	QUARTERLY (MONTHLY) MOVEMENT	ANNUAL MOVEMENT
Consumer Price Index Dec 10 quarter	2.3%; up from 1.1%	4.0%; down from 2.0% previous yr
Capital Goods Price Index Dec 10 quarter	-0.7%; up from 0.1%	-0.3%; down from 2.3% previous yr
Producer Price Index (outputs) Dec 10 quarter	0.2%; down from 1.2%	4.3%; up from -3.6% previous yr
Producer Price Index (inputs) Dec 10 quarter	0.9%; down from 0.7%	4.4%; up from -3.2% previous yr
Labour Cost Index (Salary & Wage) Dec 10 quarter	0.5%; no change	1.7%; down from 1.8% previous yr
<i>Food Price Index (monthly)</i>	<i>0.1% (Feb); 1.8% (Jan); -0.8% (Dec); -0.6% (Nov); 2.2% (Oct); 0.7% (Sep)</i>	<i>5.3%; up from 0.7% previous yr</i>

CONSUMER PRICES

Annual CPI hit 4.0% in the December 2010 year. However, the 2.3% quarterly rise included the effects of the GST increase to 15%. If we factor in the 2.2% impact of GST (as suggested by StatsNZ), then the increase on the quarter is only 0.1 percent, and annual CPI increase is only 1.8%.

Aside from the GST increase, the major upward pressure on prices in the December quarter came from transport (up 4.3%), and food prices (up 2.1%). Higher transport costs (international air transport) also affected recreation and culture prices, which rose 2.9%. On the year transport prices were up 6.6% and food prices were up 4.6%. Looking specifically at items, the 14.2% increase in petrol prices (note this is only to December – petrol prices have gone up again since then) is not the only item that increased majorly in price. Cigarettes and tobacco prices were up 17.0%, vegetables were up 15.4%, and milk, cheese, and eggs were up 12.6%.

FOOD PRICES

Food prices were flat again in February (up 0.1%) after a large increase of 1.8% in January. On the year food prices were up 5.2%. Annual prices include the GST increase from 12.5% to 15.0% in October 2010. Taking that out of the equation, food prices were up around 3.0% on the year.

On the year, all food groups were higher. Fruit and vegetables led the way, with prices 10.1% higher than a year ago. This was followed by grocery food (5.4%), non-alcoholic beverages (4.6%) and restaurant meals and ready-to-eat food (4.3%). Looking at individual items – fresh milk was up 9.7%, potatoes were up 47.4%, and lettuce was almost twice the price of a year earlier (91.7%).

PRODUCER AND CAPITAL GOODS PRICES

Producer prices are increasing steadily after falling over 2008 and 2009. However, the increases are slight relative to the heady period of growth between 2004 and 2008.

PPI – OUTPUTS

PPI outputs rose 0.2% in the December 2010 quarter and were up 4.3% on the year to December 2010. The 0.2% increase on the quarter was low relative to 1.2% and 1.1% rises in the previous two quarters. Pushing prices up on the quarter was the wholesale trade index (up 1.7%). Livestock and cropping farming was up 4.4% on the quarter. On the year, the livestock and cropping farming sub-index was up 21.2%.

PPI – INPUTS

PPI inputs rose 0.9% in the December 2010 quarter and were up 4.4% on the year to December 2010. Pushing inputs prices up was the wholesale trade index, which was up 3.3% on the quarter. This was mainly due to increased prices of imported crude oil and natural gas condensate. On the year, the wholesale trade index was up 6.9%.

Dairy product manufacturing prices was the second largest contributor to the quarterly increase in PPI – Inputs prices, increasing by 3.4% on the quarter. This rise was largely a reflection of higher farm-gate milk prices.

CAPITAL GOODS PRICE INDEX

Prices for capital goods remain subdued. The CGPI fell 0.7% in the December 2010 quarter, and decreased by 0.3% in the December 2010 quarter year. The 0.7% fall in the December quarter was the largest quarterly decrease in around 20 years.

The quarterly fall in prices was led by plant, machinery and equipment (down 2.0%), with computer machinery prices down 10.5%. On the year, the plant, machinery and equipment index was down 2.4%.

The residential buildings index has remained largely flat since the December 2008 quarter. In the December 2010 quarter the index was down 0.4% although it was up slightly on the year (0.6%). However, this simply offset the 0.6% fall in prices in the previous year.

Other construction is the only CGPI asset group where prices are increasing, albeit at a significantly lower rate than over earlier periods. This is largely due to government investment in infrastructure and is likely to continue with the reconstruction job required in Christchurch. On the quarter, the other construction index was up 0.4% and on the year the index was up 1.6%.

LABOUR COST INDEX

The Labour Cost Index (salary and wage rates) remained subdued in the December 2010 quarter, increasing by 0.5%. The annual increase is 1.7%, with the private sector (1.9%) seeing higher wage increases than the public sector (1.7%).

The effects of the recession and the current economy on wage rates are telling. For each of the last five quarters, the annual increase has been below 2.0%, well down from the 3% annual increases each quarter between September 2005 and March 2009. Businesses are simply not offering higher wages and are using the current depressed environment as the reason.

GOVERNMENT ACCOUNTS compiled by Adrian Slack

We can expect the budget deficit to worsen and the balancing of the budget to take longer. There will be greater government outlays – for infrastructure, increased welfare payments and to reignite the Census perhaps – plus lower tax revenue from workers, businesses and consumers in the short term.

There are clear signals from the Prime Minister and Minister of Finance that the upcoming budget in May will re-weight expenditure across the Votes. But the signals are that the overall level of expenditure and revenue is unlikely to rise. Two key themes dominate the Government's budget rhetoric: government's debt and recovery expenditure related to the Canterbury earthquakes.

As noted in the Treasury's February Monthly Economic Indicators, the economy was weaker than expected in the December 2010 Half Year Update. This is likely to have suppressed revenue and increased welfare payments. The accounts for the seven months to January 2011, released in March, show that gross debt was almost \$1.5 billion greater than expected at this point, reaching 33.1 percent of GDP, although net debt was as expected at 19.4 percent of GDP. The net debt level remains modest in international terms, but rising government debt continues to be a lightning rod for cost-cutting rhetoric.

We are concerned that knee-jerk comments on cutting expenditure may become a reality that puts both the country's short-term recovery and long-term prosperity at risk. The country requires investment in skills, in private capital and infrastructure. If the country is to have a chance of reaching the Government's own target, regardless of its merits, of matching Australian GDP per capita by 2025, we need to lift New Zealand worker's productivity. The Government's agenda to lift incomes seems to have been lost in the myopic rhetoric of debt control.

Some reassurance has been given over infrastructure spending that has already been scheduled. Infrastructure is a supporting network of services that enables innovative business and growth. It also provides basic functions to communities such as clean water and safe sewerage processing. Public infrastructure must also be supported by a sensible regulatory and policy framework that supports private investment and resources flowing to their most valued use – quite literally in the case of water rights, for example.

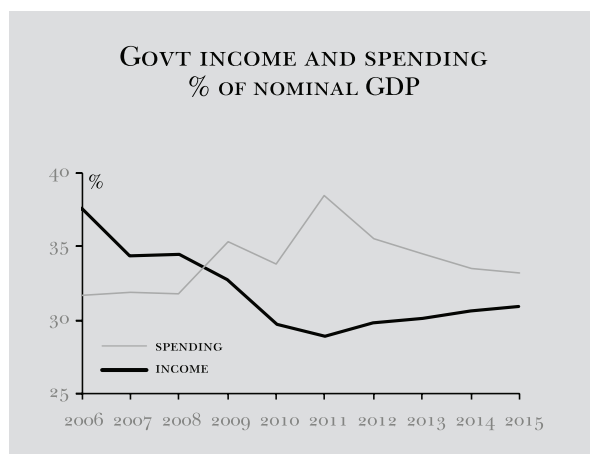
The February 2011 Christchurch earthquake will slow economic activity in the near term through its direct effect on the Canterbury economy and the knock-on effect to the rest of the national economy. The recovery and reconstruction effort is unlikely to get into "full swing" until the later part of 2012, as the City remains largely in an emergency phase, and recovery

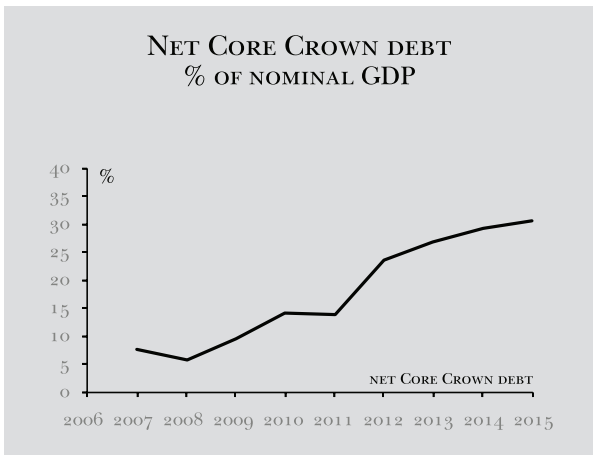
planning and resourcing will take several months to implement.

It is worth reinforcing that Christchurch has been given a cruel blessing. It can plan and build a city for the future in a way that other New Zealand cities may not be able to afford to. Public, private and insurance funds will flow into the City to fund its construction and the scale of the task means the City has been appointed a city planner, or "architectural ambassador", Wellington architect Ian Athfield. In economic terms, the planning, services and infrastructure can incorporate contemporary findings on what urban forms best deliver liveable, sustainable and economically vibrant communities. These forms align well with Christchurch's culture of community hubs or 'high streets', rather than low density urban sprawl with core services located centrally.

The Sendai earthquake in Japan occurred after Treasury's MEI. This will effect one of our largest trading partners, and may result in weaker export volumes as well as poorer returns due to a strengthening Yen. But similar to the recovery pattern here, following the initial shock and downturn, there could be a surge in demand for building materials as the reconstruction gets underway, which will favour New Zealand's forestry sector exports.

We note recent comments from the Minister of Finance relating to Budget deliberations. In particular, the contributions towards earthquake recovery and the cost of leaky homes have been frontloaded into the 2010/11 fiscal year. The Minister has stated, "the Budget this year will reduce new operating spending to around \$800 million to \$900 million a year, from the current allowance of \$1.1 billion". We expect that such cuts will be reallocated to the recovery and leaky homes contributions rather than leading to an overall cut in expenditure. Therefore, we have factored in a net \$4.5 billion increase in expenditure in 2010/11. Based on Treasury's GDP forecasts in the December 2010 HYEFU, net Crown debt would rise to 23.6 percent in 2010/11 and to above 30 percent of GDP by 2013/14.



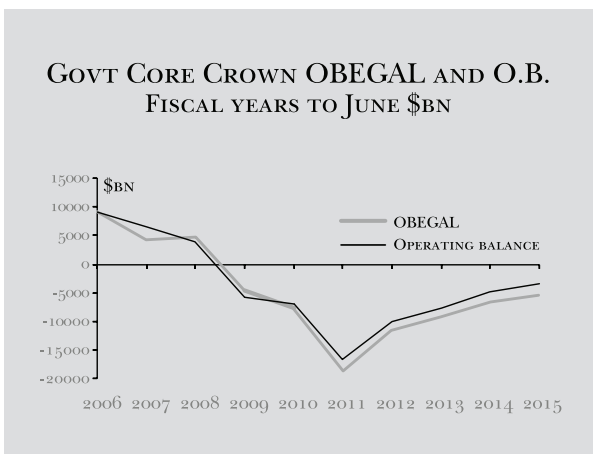


The net effect is to keep the government accounts in deficit out to our forecast horizon of 2015, when we forecast net Crown debt will reach 30.6 percent of GDP. This is a delay on the Minister's recent prediction that it is "more likely that we will return to surplus in 2015/16".

BERL's forecast is more cautious in the near term about the pace of the economic recovery and the timing of the reconstruction stimulus than that of the Treasury or the Reserve Bank. This caution lowers our forecasts of tax revenue, and reflects our lower GDP forecasts. As the economic recovery and Christchurch reconstruction picks up in late 2012 and throughout 2013, we expect direct taxation to pick up strongly.

We anticipate higher unemployment rates than the Treasury across the forecast horizon, and impute higher welfare expenditure in our forecast expenditure track. The frontloading of expenditure in 2010/11 will see a blip in general expenditure and/or health and education expenditure (depending on how the infrastructure expenditure is allocated by Vote). As employment picks up through 2012 and 2013, social security expenditure will slow. However, this slowdown in social security expenditure may be followed by a slight increase as the reconstruction efforts wind down in 2014.

The OBEGAL will hit its nadir in 2011 at over \$18.7 billion. The one-off accrual of reconstruction expenditure will drop out in 2012, so the OBEGAL will come back to around \$11.5 billion. From there it will remain in deficit, but track up to a deficit of around \$5.4 billion in 2015.



MANUFACTURING compiled by Fiona Stokes

Many of our usual surveys have been delayed this quarter. The Statistics New Zealand Economic Survey of Manufacturing for the December 2010 quarter due to be released earlier this month has been delayed until after we go to print. The Business NZ Performance of Manufacturing Index (PMI) has been suspended for the February/March period, and the next release of survey data will be in April. The Employers and Manufacturers Association (EMA) was affected by the Christchurch earthquake and are delaying the release of surveys and survey data. It is unknown, at this stage, when the later two surveys will recommence.

It is also unknown what the results of post-earthquake evaluations will be, how long it will take to repair damage to infrastructure, what repairs are needed to grounds and buildings, and when business will return to "business as usual". The BERL regional database indicates that in 2010, approximately 29,450 Full Time Equivalents were employed in the manufacturing sectors in the Canterbury Region. This is approximately 11% of total employment in manufacturing. The large number of unknowns makes it difficult to forecast the impact the Christchurch earthquake will have on Canterbury or national manufacturing activity over the next quarter, let alone the next 12 to 18 months. So instead, our focus this issue will be on some of the positive areas that have occurred in manufacturing over the last quarter.

Employment in manufacturing has been positive, according to the Household Labour Force Survey (HLFS) for the December 2010 quarter. The latest HLFS indicates that employment in manufacturing increased by 17,500 between the December 2009 and December 2010 quarters. This is good news as this sector has suffered substantial employment losses with businesses closures, restructures, and/or businesses locating their manufacturing offshore.

At an occupation level, there was an increase in the number of people employed as technicians and trades workers (by 6,500), and labourers (by 7,400), and a small increase in machinery operators and drivers (by 500). Looking in more detail at occupations – in the technicians and trades worker category of manufacturing there has been growth in the printing and wood trades, and in the textile, clothing and footwear sectors. There has also been growth in employment among food process workers and miscellaneous factory process workers, and in the number of people operating stationary machines and employed as machine operators. This picture of employment growth is reflected particularly in the increased export volumes of primary products and logs.

Export volume is our second positive area for manufacturing. Export volumes and prices for some of our manufacturing commodities are also looking positive. In the December 2010 quarter, export volumes of machinery and transport equipment were up 17.5% on the previous year despite prices being down 6.2%. While dairy volumes were not quite as high, only 2.5% improvement on the previous year, prices were 25.3% higher.

EMPLOYMENT CHANGE BY INDUSTRY
DEC 10 CF DEC 09



Aluminium volumes and prices are also positive – volumes were 25.2% higher in the December 2010 quarter compared to the previous year and prices were 12.2% higher. This increase in volume seems to have occurred despite production problems at Tiwai smelter in 2010. Good performance in the aluminium market makes concern about the export of aluminium to Japan pertinent. The possible impact of the Japanese earthquake and subsequent tsunami in March on export orders, particularly the order of products like aluminium, logs and wood products, and dairy products like cheese and casein, at this stage remains speculative.

Globally, new orders have been up due to improving market conditions within the countries surveyed in the JPMorgan Global Manufacturing PMI, and a pickup in international trade flows. However, the impact of the earthquake and subsequent tsunami in Japan is a large unknown variable in global manufacturing. Japan is a big supplier of manufacturing inputs – silicon used to make semiconductor chips for example – and many large manufacturing plants such as NEC, Panasonic, Sony and Fujitsu have suspended their production.

The JPMorgan Global Manufacturing PMI sat at 57.8 in February 2011, up from 57.1 in January, and 57.3 in December and 54.6 in November 2010. Growth in global manufacturing activity in the first quarter of 2011 has been predominantly due to an increase in new orders and outputs.

However, the suspension of manufacturing activity in Japan will have a negative impact on this periods market growth, potentially decreasing outputs, increasing input prices, striking a blow to employment. The JP Morgan survey also indicates that manufacturing in the United States may be slowly recovering, but only in certain sectors. Those sectors that manufacture products for industry – such as plant, machinery and equipment – appear to be increasing their production volumes and hiring workers. Those sectors that manufacture consumer or household goods in turn are still struggling with low demand levels because of ongoing household debt and high unemployment.

BUILDING AND CONSTRUCTION compiled by Fiona Stokes

The 4 September 2010 earthquake in Canterbury, commonly known as the Darfield earthquake, damaged residential properties due to liquefaction and lateral spreading. With the notable exception of chimneys and unrestrained masonry walls, only minor damage was sustained. In contrast, the impact of the February 2011 earthquake has clearly been greater with strong ground shaking causing major damage.

After the Darfield earthquake, Fletcher Construction was appointed the project managers in Canterbury to undertake residential repairs where the damage was assessed at between \$10,000 and \$100,000 excluding GST. As project managers, Fletchers established 'hub offices' in communities to oversee the work and act as the conduit between homeowners and contractors. Essentially, their role was to match demand with supply, and employ local independent contractors who are licensed building practitioners (LBP). People on supply include architects, builders and other tradespeople.

Due to the major damage caused by the February 2011 earthquake, most spending on building and construction in the Canterbury Region will now be used in fixing roads, water, and wastewater systems. Once essential infrastructure is fixed, damaged residential properties will need to be assessed and repaired, increasing the number of consents and alterations issued.

We forecast annual alteration consents to total 27,950 in the year to March 2011, and to rise to 34,100 in the year to March 2012. From March 2012 we expect a slight decrease in building construction activity to 33,600 consents in the year to March 2014. The number of alterations to existing buildings will then begin to decrease as the number of consents for new residential buildings increases.

These figures are based on previous historic peaks in building construction activity. The last peak in the building cycle was experienced nationally during the 2006/2007 year. During this period, the monthly totals for alterations peaked at 3,400 and the annual number of consents for alterations was 34,400. Based on this past peak in activity, the three monthly average for building alteration consents could be as high as between 9,000 and 9,200 consents, but this is a conservative estimate due to the unknown nature of the rebuild.

Our forecasts therefore assume that the rebuild in the Canterbury Region gathers momentum fairly rapidly, labour is diverted into this build from other infrastructure projects, and investment spending returns to a pattern resembling "business as usual". The Government has already indicated a willingness to divert resources from infrastructure projects into the rebuild. Also,

Cabinet is considering a temporary housing package for those whose homes have been destroyed or made uninhabitable. However, whether there is capacity within the building construction sector to undertake this substantial rebuild and how quickly that capacity can be mobilised remains uncertain.



Based on employment figures alone it could be argued there is capacity within the building construction industry to undertake the substantial rebuild required in Canterbury. However, the speed and extent to which the connection is made between labour market demand and supply will depend, to a large degree, on the skilled labour that has been lost to infrastructure projects or to overseas during the recent downturn.

Residential building activity throughout 2009 and 2010 was lacklustre at best. Residential building consents during 2009 were at very low levels, so while new residential building consents were well up in 2010 on year-earlier levels, the actual numbers were very sobering. The number of new residential building consents issued in the North Island in the year to January 2011 was just over 10,500 while in the South Island consents were not quite at 5,000.

A shift in resources – capital and labour – is now required, coupled with a relatively rapid response by the industry and government to the rebuilding needs. Our concern and subsequent forecast, therefore, centre around the ability of the labour market to respond to ensure capacity constraints do not occur.

TOURISM compiled by Nathaniel Robson

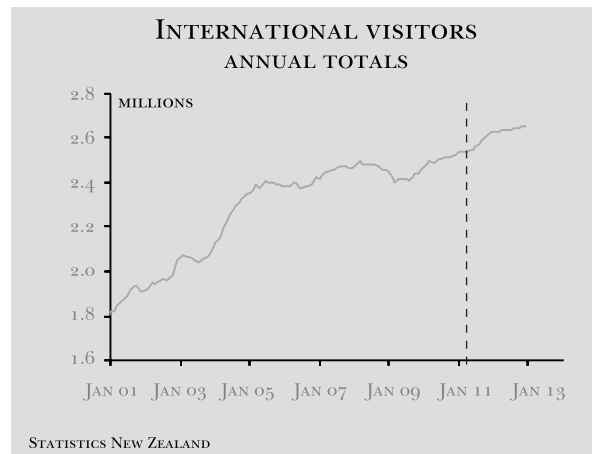
There is a great deal of uncertainty surrounding the medium-term prospects of the tourism sector at present. Tourism service providers, already suffering the lagged effects of the global recession, now face more hard times as a consequence of the natural disasters in Christchurch and Tohoku, Japan. Much of the tourism spending that would have gone to Christchurch is likely to shift to other centres rather than being lost altogether. So the effects of the earthquake will mainly show up in regional data rather than national: service providers in Canterbury and other destinations nearby will bear the brunt of the shock. Nevertheless, nationally the sector will also face macroeconomic consequences from resources being diverted to rebuild Christchurch.

The earthquake and tsunami in Japan is potentially a triple-whammy for New Zealand tourism. The natural disaster itself gives enough reason to expect a downturn in Japanese visitor numbers. But the subsequent nuclear crisis at the power plant in Fukushima will also have ramifications, the extent of which remains unclear at the time of writing. Since Japan is the world's third largest economy, there will also be significant flow-on effects of this disaster to the global economy. The impact on exchange rates and global income are of particular concern to the tourism sector.

Source country	% change (year to January 2011)		
	Total	Holiday	VFR
Australia	2.4	-1.4	1.1
UK	-10.6	-10.5	-12.4
USA	-4.2	-5.4	-8.1
China	31.2	41.0	23.9
Japan	11.3	12.2	-3.1
Germany	-1.3	-2.1	-13.0
Korea	23.8	39.0	11.4
Canada	0.6	-0.6	4.5
TOTAL	2.5	2.8	-1.9

The weakened state of the sector prior to these events can be seen in annual figures for visitor numbers and average spending per visitor. While the total number of visitors to New Zealand rose 2.5% in the 12 months to January 2011, over the same period expenditure per visitor continued to plummet. Average tourism spending was \$2,410 per visitor in 2010, 13% lower than in 2009. The

largest reductions in spending were by visitors from Japan (\$1,100 less) and the USA (\$800 less). Even Australian visitors were spending on average \$200 less during their stay.



Although the table shows growth in visitor numbers for some of our key markets, this is not translating into more tourism export receipts. Especially worrying is the Australian segment – holiday visitor numbers have declined by 1.9%, pulling down the growth in overall Australian visitors. For comparison, in June 2010 the year-on-year growth in Australian visitors was Total: 9.5%, Holiday: 14.8%, VFR (Visiting Friends and Relatives): 6.2%. The sector is quite exposed to this slowdown since Australia provides 38% of our Holiday and 53% of our VFR visitors (45% of Total visitors).

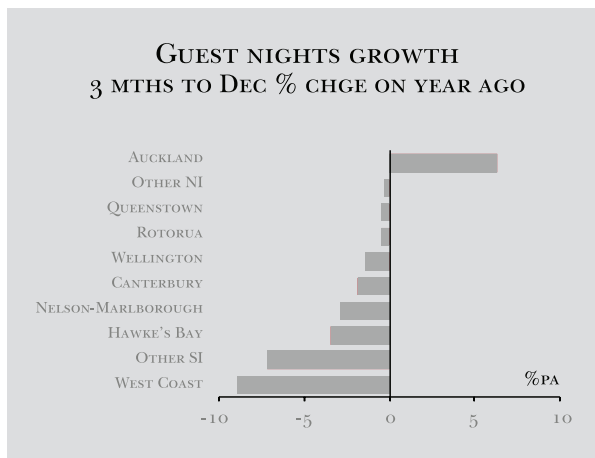
In the year to January 2011, New Zealand received 2.53 million visitors. Until January 2012, visitor numbers will probably rise to over 2.6 million on the back of the Rugby World Cup. Beyond that we expect visitor number growth to be almost flat as the effects of the Christchurch and Tohoku earthquakes come through. The prevailing high NZ\$ and oil prices will exacerbate this demand slump.

Accommodation data from the Ministry of Tourism shows that in the December quarter, all major tourist destinations except Auckland have seen a quarter-on-quarter decline in guest nights: Auckland had growth of about 6% while the West Coast had a decline in guest nights of almost 9%. Rotorua and Queenstown had lackluster quarters, with guest nights down about half a percent in each. Christchurch, Wellington, Hawke's Bay, and Nelson/Marlborough all posted moderate falls in guest nights as well.

Overall guest nights were 1% lower in this December quarter than the last quarter. This was due to the rise in domestic guest nights of 2% being more than offset by a fall in international guest nights of

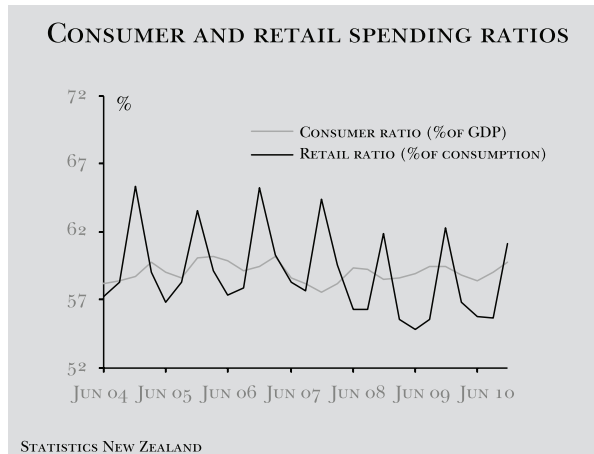
5%. A key component of this was domestic guest nights in Canterbury being up 4% but international guest nights down 8%, for an overall fall of about 2%. Auckland was the only center to see growth in international guest nights, of nearly 2%, which added to its domestic guest nights growth of 10%. Where there was growth, it was mainly hotels that benefited – hotels sold almost 5% more guest nights (in particular 11% more in Auckland) while the other main types of commercial accommodation experienced drops of 3 - 4%.

Tourism service providers clearly face hardship and uncertainty going forward. Due to the second Christchurch earthquake and subsequent announcement that no Rugby World Cup games will be played there, Canterbury guest nights sales will be much lower than expected for the rest of this year at least. Those destinations popular with Japanese tourists (Auckland, Rotorua, Queenstown) are also likely to take a disproportionately large hit from the Tohoku disaster. The timing of the Rugby World Cup will hopefully give the sector breathing space to figure out how to turn the challenges set to emerge beyond the Cup into opportunities.



RETAIL TRADE compiled by Adrian Slack

Should retailers be concerned? Yes. The weak recovery has been halted by the recent Canterbury earthquakes, and consumer confidence has fallen. Retail spending as a proportion of overall private sector consumption expenditure continues to trend down.



Nationally, retail sales turnover was essentially static in the December quarter, falling by a negligible 0.1 percent in seasonally adjusted terms. Volumes fared slightly worse, dropping by 0.4 percent.

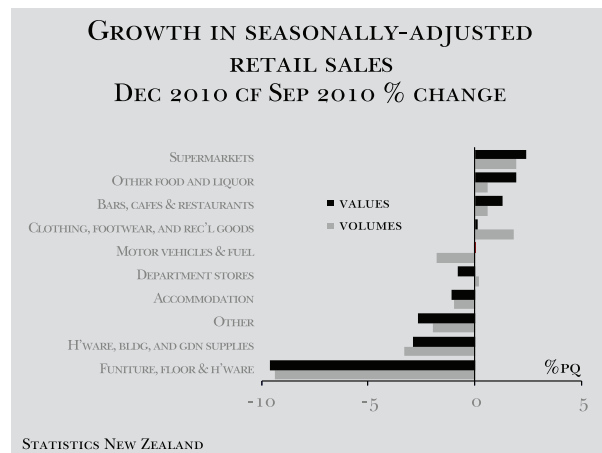
The relatively greater drop in volumes provides evidence of price reductions and margin cutting in recent months in some retail industries. More than three quarters of the 13 core retail trade industries experienced price deflation in the December quarter. However, rising fuel prices ensured resulted in a 3.8 percent increase of the retail price index for the fuel industry.

Scanning across the country, only Auckland saw an increase in seasonally adjusted sales in the December quarter, and this was a modest 0.2 percent rise. However, this rise in values was unlikely to have been matched by a rise in volumes given the extent of retail price deflation having been recorded. The Waikato and the provincial North Island saw the greater falls, of -2.7 percent and -1.9 percent, respectively, while Wellington and Canterbury remained unchanged.

The Prime Minister has continued to express concern over national debt, and has encouraged restraint. He reiterated in late March that he is "worried about New Zealand's overall level of indebtedness and one of the ways to do that is to spend less." In the short term, the recession has forced restraint on New Zealand households, and debt accumulation has slowed.

- The number of housing loan approvals fell by 21.5 percent in the year to February 2011 compared to the previous year, and the value of housing loan approvals was 19.6 percent lower.

- The overall value of house loans in January 2011 was 1.9 percent higher than a year ago, which was around one third of the rate seen in late 2008 (6.8 percent p.a. to September 2008) and one seventh of the rate seen in 2007 (13.7 percent p.a. to September 2007).
- The growth in outstanding credit card balances dropped from a 7 percent average in the five years before the Global Financial Crisis (GFC) to half that (3.5 percent) post-GFC, and further to 2.6 percent growth over the past year.
- EFTPOS sales (via debit cards) appear to have returned to trend, as consumers are still hesitating to load up their credit cards. Spending on credit cards grew by 2.5 percent over the year to December 2010 (which, again, indicates little real or volume growth), while spending on debit cards grew by 5.8 percent.



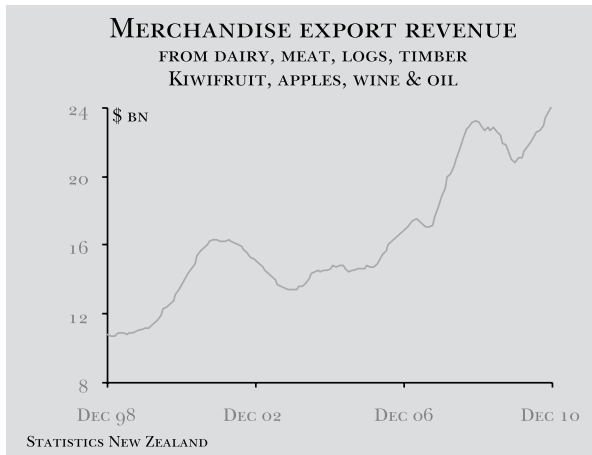
However, consumers' short-term restraint is unlikely to be a solution that is consistent with rising living standards in the long term. A long-term solution has to come from raising incomes to support our desired level of prosperity, rather than lowering debt per se. As we have noted before, this requires a meaningful and sustained change in New Zealander's consumption and saving habits. Saving has to flow to investment in productive assets that support our aspirations of economic prosperity and wellbeing.

While people are now holding on to their jobs, employment growth is unlikely to see strong growth very soon. Combined with a subdued housing market, restraint on building up mortgage and credit card debt, and backed by low consumer confidence, we expect the retail trade sector to face a bleak, but weakly positive, near term. The Rugby World Cup later in the year will provide a temporary boost to the tourism sector, which will benefit the accommodation and food retailing sectors, as well as the flow on to other tourism-related industries.

Over the medium term, the reconstruction in Christchurch will boost some of the construction-related retail trade industries, plus the general recovery will lift employment across the country.

The forecast is for weak growth in retail sales volumes of 0.3 percent in the year to March 2011 quarter, but with a contraction in the core industries of -0.2 percent. We expect core retail sales volumes to grow slowly across 2011. A positive spike coming through in the latter half of the year with the tourism and wider activity generated by the World Cup that will contribute to retail sales volumes growing by 1.0 percent in the year to March 2012. We expect the reconstruction efforts in Christchurch will start to have a positive effect on the retail trade sector towards the latter part of 2012 and carrying on into 2013. This is likely to benefit the core industries (i.e. excluding the vehicle-related retail industries). In the year to March 2013, we forecast an annual 2.3% expansion in volumes across the sector and an annual 2.5% expansion in the core industries.

AGRICULTURE compiled by Kelly Dustow



DAIRY

World demand for milk and dairy products is currently exceeding supply, which is causing the latest increase in prices. Severe weather conditions and increased feed costs are decreasing the ability of supply countries to meet the needs of their own populations, let alone export. Strong international milk prices are impacting on our domestic market, as seen by Fonterra recently stepping in and freezing prices until the end of the year. Despite this seeming like a bold move, it is worth noting that domestic consumption is only about 5% of Fonterra's sales.

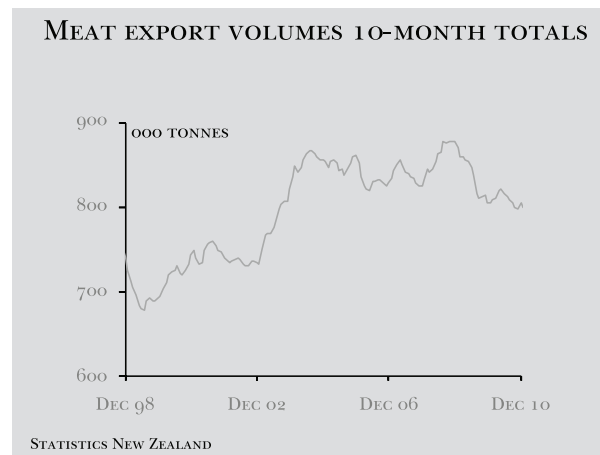
This volatility in supply, and solid demand from China, is also impacting on global dairy trade auctions. Fonterra's 15 March 2011 auction saw the average market price for milk products (anhydrous milk fat, skinny milk product and whole milk product) down 8.2% compared to an auction held earlier in the month. This decrease fuelled speculation that milk product prices are on the decline. However, or should we say despite this drop, milk prices are still extremely high - trading at an average of \$4,443 US\$/metric tonne.

MEAT AND WOOL

Droughts in Argentina, floods in Queensland (which supplies one third of Australia's beef production) and increased feed costs in the United States have resulted in beef and lamb prices skyrocketing. Unfortunately the higher prices have come at a time when countries such as New Zealand have reduced stock levels. Despite this, export receipts for the December 2010 quarter were up 11.5% on the same quarter last year. And with increased input costs, notably petrol and feed prices, a lift in receipts as the industry winds up its season could be just what beef farmers need to increase their margins.

The December 2010 quarter was also an exciting time for the wool industry, with wool export receipts

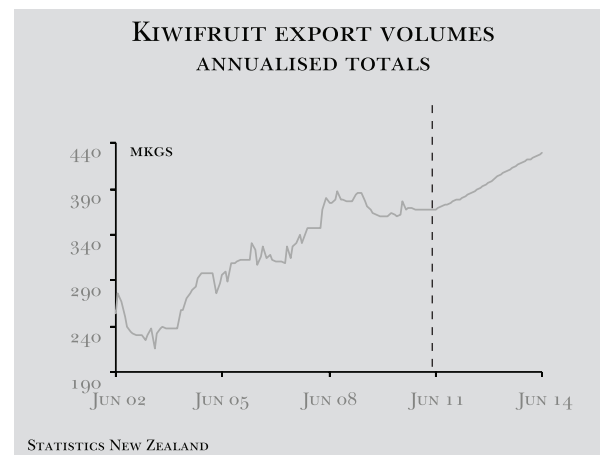
up 40.3%. This was a 20 year record, with prices for clean wool sitting around \$5 to \$6 a kilogramme. The increased demand for wool is largely being driven by wool manufacturers in Europe and the United States. These manufacturers are promoting chemical free residue carpets and need to fill contracts. Prices are increasing due to reduced stock numbers globally and a ban on exporting wool from South Africa because of a recent outbreak of foot-and-mouth disease.



HORTICULTURE

KIWIFRUIT

Export volumes of kiwifruit were up slightly for the year ending January 2011, at 1.7%, but the annual average price was down 7.8%. The industry is already anticipating strong production due to good rainfall and higher temperatures than previous seasons, which is good news after orchards were infected with a vine bacterial disease in November 2010.



With New Zealand's kiwifruit supply looking favourable, short-term demand is also looking positive. Strengthening currencies in both of our

major high-value markets for kiwifruit, Japan and the European Union, should help increase export receipts for kiwifruit in the coming months. However, we expect a slight drop in the annual average price of kiwifruit due to the earthquake and tsunami in Japan, before prices pick up again in subsequent months.

APPLES

With favourable weather conditions in 2011, the apple industry is also expecting an increase in production. However, there are concerns in the industry about the low prices received for apples in recent years and the decrease in planted areas. This concern is supported by export receipts, with export volumes for the year ending January 2011 down 14.3% and prices down 5.8%.

Europe is a key destination for New Zealand apples, and with an easing exchange rate, this should help with the lower prices received.

WINE

New Zealand's wine industry has started harvesting its 'bumper crop' for the 2011 season. With great quality grapes and larger quantities, volumes are expected to increase from last years 266,000 metric tonnes to 300,000 metric tonnes.

Wine receipts for the year ending January 2011 were up 6.6% on the same month last year. However, volumes could have been greater if the industry had not been cautious. The New Zealand Winegrowers has previously called for winegrowers to decrease production to help maintain high prices and protect New Zealand's reputation as a premium wine producer rather than a bulk supplier. And this year's 'bumper crop' is again raising concerns among wine growers as to the effects this will have on the industry. Last year there was a decline in prices due to a wine glut caused by large quantities of wine flooding the market. The industry does not want to see this glut and subsequent decline in prices repeated.



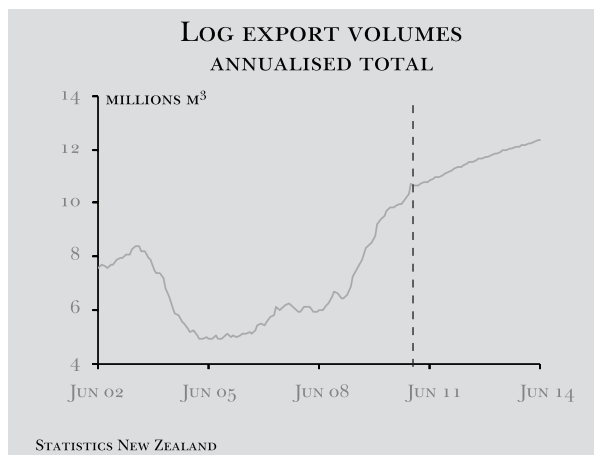
FORESTRY compiled by Wilma Molano

Logs and timber were the third largest merchandise exports in the year ending December 2010 at \$2.3 billion behind dairy and meat. The number one destination of forest exports is the People's Republic of China, which accounted for approximately 58%, by value, of NZ log exports. The China market also accounted for just over 20% of the value of NZ timber exports and just under 20% of pulp exports.

However, Japan is the primary destination for pulp – with this market accounting for nearly 31% by value, and close to 49% by volume, of NZ pulp exports over the latest 12 month period.

Forestry remains the solid contributor to New Zealand's export receipts. Log export volumes are up by 22.3% in the year to December 2010 and by 35.5% for the three months to December 2010 compared to the same quarter last year. A similar picture is true for export values – up by 41.1% in the year to December 2010 and 63.3% for the three months to December 2010.

In real terms, log exports totalled more than 10.6 million cubic metres in the latest year, reaping more than 1.3bn in revenue. This means the industry is well above its previous peak of 8.4 million cubic metres, recorded in the year to June 2003. Similarly, the average export price recorded in the latest year of over \$125 per cubic metre is well above anything previously experienced.



BERL's forecast for logs is as bright. Harvestable forests remain available and with prices where they are there is little incentive to increase logs flowing to further processing as timber, but rather further expansions of logs destined for the raw export commodity trade.

Consequently, we expect log export volumes and receipts to continue growing, especially from China. Looking ahead, logs destined for the Japan market could also expand as construction efforts begin

following the earthquake and tsunami that struck the country. Currently, logs to Japan account for about 7% of NZ log exports (by value and volume) – a far cry from the 40% to 50% share recorded in the early-to-mid 1990s.

TIMBER

Timber export volumes for the year to December were up 9.9%, with the latest three months being 17.8% up on year-earlier levels. Export revenues for the year are up by almost 17%, an increase of 6.8% for the three months to December compared with year earlier.

Unlike logs, the future of timber exports appears not as promising since the prices remain relatively flat. This picture could alter as demand from Japan increases as its re-building effort commences. However, the effect on New Zealand may be light as this market accounts for only about 5% of NZ timber exports by value (a share that was close to a quarter in the mid-1990s). Needless to add, even if prices were to improve, the ability of the industry to respond accordingly may be sorely tested given the rationalising of processing capacity experienced over recent years.

Thus we retain a subdued, although positive, forecast for timber export volumes and receipts.

PULP

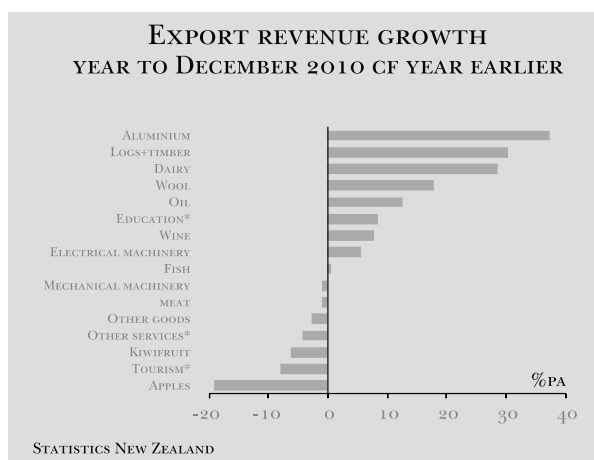
Export volumes for pulp for the year to December were 8.4% down on a year ago. The same trend is true for the three months to December 2010 which is down by 6.4% compared to the same quarter of last year. The increase in pulp export receipts is mainly due to a rise in unit price.

The average export price of over \$750 per tonne for the latest year is just above the previous record highs recorded in 2007. This price surge is welcome, and could well accelerate as demand from Japan adds to global demand for forestry and construction materials. Nevertheless, again, the ability of the sector to respond to these favourable price shifts may be limited given the ongoing impetus for logs.

EXTERNAL SECTOR compiled by Amapola Generosa

With a lacklustre performance in the external sector, volatility of world prices, and uncertainty in economic and political conditions in the global front, hopes for a concerted export-led growth in New Zealand is very much hanging by a thread.

In summary, the current account of the balance of payments (BoP) has experienced some improvement over the past couple of years as spending on imports has dwindled in line with subdued investment and economic activity. The current account deficit for the year to December 2010 totalled \$4.4bn, or 2.3% of annual GDP. However, the latest improvement also includes special accounting entries for reinsurance inflows following the September Canterbury earthquake. Additional entries to account for the February earthquake could well move the annual current account into surplus through this year.



Within the \$4.4bn deficit was the merchandise trade surplus of some \$3.4bn in BoP terms. This is the best figure for almost a decade and follows restrained import spending. Despite the struggling performance from tourism, the balance on goods and services remains in surplus at \$2.8bn for the 2010 year.

Export receipts are up 5.4% in the year to December 2010 with major contributions from aluminium (up 37.7%), forestry (up 30.4%) and dairy (up 28.5%). Growth in these sectors is due to relatively high export prices and strong demand for New Zealand's major export commodities. Wine (up 7.7%) and electrical machinery equipment (up 5.6%) also boosted exports while contributions in fish exports (up 0.5%) was modest over the same period. Other main export commodities plummeted, as receipts fell from December year-earlier levels, with major drops in apples (down 19.2%), kiwifruit (down 6.3%), and tourism (down 7.9% in September 2010 from year-earlier level). Apple and kiwifruit prices had been trailing a downward path compared with previous year prices. Tourism has yet to pick up as key markets like UK and USA consolidate their economies. We expect visitors from Japan to decrease as the country suffers a setback due to the effects of the earthquake and consequent tsunami.

In the three months to December 2010, strong importation is recorded for capital goods: mechanical machinery and equipment (up 20.2%), electrical machinery and equipment (up 11.0%) and vehicle parts and accessories (up 23.3%).

While this quarter had seen strong growth compared with import spending in the same quarter in the previous year, annual change in import spending is still generally weak. Year on year change in capital goods (down 5.6%) is still negative but improved from the December 2009 drop of 16.3%, while intermediate goods (up 6.0%, which is largely crude oil) and consumption spending (up 1.0%) growth had been modest. Digging up the details, movements in the import side had been due to increased importation in key agricultural inputs in the 12 months to December 2010: food residues, wastes and fodder (up 49.4% from \$377m to \$564m); fertilisers (up 10.5% to \$523m); and inorganic chemicals (up 10.9 percent). Although these trends on the import side clearly suggests that businesses (and households) are remaining cautious, spending is slowly picking up signalling confidence in the economy. This is consistent with increases (albeit off a low base) in business investment in the last three quarters of 2010.

New Zealand's current account balance has been fluctuating within a range of 3% to 8% of GDP over the previous five years. This is most concerning given it has occurred over a period of favourable and improving terms of trade (i.e. the prices of our exports relative to the prices of our imports).

Consequently, our net international investment position has deteriorated to a net liabilities totalling \$159bn, or 81.7% of GDP in December 2010 quarter. Subdued prospects for a widespread export surge, coupled with this net liability situation suggests the NZ\$ should weaken considerably. However, this does not appear to be the view of the market, which seems pre-occupied with sovereign debt issues abroad, as well as the ongoing weakness of the US\$.

With the ongoing crisis in Japan, there have been some declines in world prices. Traders are concerned that demand would decline as Japan focused on containing the nuclear crisis and recovering from the disaster. The first round of effects of the recent events in Japan can have negative implications for New Zealand in the short-term as Japan is New Zealand's fourth largest trading partner (about 8% of New Zealand exports goes to Japan). In particular, New Zealand's main exports to Japan are dairy products, aluminium and wood products. However, the second round of effects presents an opportunity for New Zealand's wood and aluminium exports as Japan re-builds. New Zealand's dairy and other food exports could also benefit as other countries subject Japan food products to stringent controls. Although food exports are a small part (US\$4.2 bn) of Japan's overall trade, Asian markets currently supplied by Japan could look to other suppliers like New Zealand.

In summary, the New Zealand external sector is faced with an ongoing difficult trading environment. BERL forecasts a much slower export expansion, with the sector expected to grow modestly in the short term. Uncertainties on the global front, volatile commodity prices, and a stubbornly high and uncompetitive exchange rate remain upper-most in our concerns for this sector.

MERCHANDISE EXPORT RECEIPTS \$M							
Year ended June	2009	2010	2011	2012	2013	2014	2015
Dairy	8,969	8,835	11,486	11,831	12,186	12,673	13,180
Meat	5,664	5,197	5,301	5,354	5,434	5,516	5,599
Wool	579	554	621	621	624	627	630
Fish	1,405	1,349	1,376	1,403	1,431	1,460	1,489
Horticulture	2,258	2,147	2,147	2,224	2,309	2,396	2,487
Alcohol	1,049	1,120	1,232	1,331	1,411	1,481	1,533
Forestry products	3,757	4,072	4,887	5,375	5,644	5,870	6,069
Aluminium	1,024	985	1,330	1,363	1,397	1,432	1,468
Machinery & transport eqpmt	2,823	2,559	2,713	2,835	2,934	3,022	3,113
Petroleum	2,148	2,280	2,849	3,191	3,383	3,535	3,641
Other	10,951	9,542	9,828	10,123	10,457	10,802	11,159
Exports of Goods (fob)	40,627	38,641	43,770	45,652	47,210	48,815	50,369
% change	6.7	-4.9	13.3	4.3	3.4	3.4	3.2
as a % of GDP	21.9	20.4	22.3	22.6	23.4	24.1	24.9
<i>Statistics NZ</i>							<i>BERL Forecasts</i>
MERCHANDISE IMPORT PAYMENTS \$M							
Year ended June	2009	2010	2011	2012	2013	2014	2015
Food	3,802	3,559	3,755	3,905	4,041	4,183	4,329
Petrol & petroleum products	6,711	6,159	7,330	7,806	8,235	8,606	8,950
Non-electrical machinery	5,513	4,581	4,764	4,955	5,252	5,410	5,545
Electrical machinery	4,209	3,381	3,313	3,429	3,618	3,744	3,819
Transport equipment	5,271	4,670	5,043	5,245	5,455	5,646	5,759
Plastics	1,562	1,450	1,537	1,575	1,622	1,671	1,704
Textiles, clothing & footwear	2,314	2,127	2,191	2,248	2,327	2,408	2,468
Other	14,057	12,013	12,920	14,067	15,403	16,295	16,934
Imports of Goods (cif)	43,438	37,940	40,852	43,230	45,954	47,963	49,509
% change	3.6	-12.7	7.7	5.8	6.3	4.4	3.2
as a % of GDP	23.4	20.0	20.8	21.4	22.7	23.7	24.5
<i>Statistics NZ</i>							<i>BERL Forecasts</i>
BALANCE OF PAYMENTS ON CURRENT ACCOUNT \$M							
Year ended June	2009	2010	2011	2012	2013	2014	2015
OT trade balance (fob-cif)	-2,811	701	2,918	2,422	1,256	852	860
BoP conceptual adjustments	3,176	2,555	2,265	2,400	2,400	2,400	2,400
BoP merchandise trade balance	365	3,256	5,183	4,822	3,656	3,252	3,260
Services exports	12,789	12,219	12,308	12,711	13,029	13,355	13,689
Services imports	13,487	12,200	12,875	13,360	13,761	14,156	14,548
Services balance	-698	18	-568	-648	-731	-802	-859
Balance on goods and services	-333	3,274	4,615	4,174	2,925	2,451	2,401
Investment income balance	-10,974	-9,170	-10,826	-11,195	-11,656	-12,138	-12,642
Transfers balance	785	188	8,394	280	280	280	280
Current Account Balance	-10,522	-5,707	2,182	-6,742	-8,451	-9,407	-9,961
as a % of GDP	-5.7	-3.0	1.1	-3.3	-4.2	-4.7	-4.9
<i>Statistics NZ</i>							<i>BERL Forecasts</i>

ISSN 1170-4861

BERL Forecasts

**© All rights reserved. This document may not be copied
or reproduced without the prior written permission of BERL.**

**Prepared and published since 1957 by
Business and Economic Research Limited**

The information, opinions and forecasts set out in this publication are the responsibility of the convener and editor, and not of individual members of the panel. Every effort is made to ensure that the information, opinions and forecasts included in this publication are accurate and reliable. BERL, the convener, editor, panel and staff, do not accept responsibility for any errors or omissions, or for any loss or damage resulting from reliance on, or the use of information, forecasts or opinions it contains.