ASIA SECURITIES FORUM COUNTRY REPORT

Country: New Zealand

Prepared By: Paul Atmore, CEO New Zealand Financial Markets Association

Date: 6 October 2014

1. EXECUTIVE SUMMARY

New Zealand's economy is expected to grow at an annual pace of 3.7 percent over 2014. Global financial conditions remain very accommodative and are reflected in low interest rates, narrow risk spreads and low volatility across the range of asset classes.

Economic growth continues to be supported by increasing construction activity in both Christchurch and Auckland and the ongoing strength in consumption and business investment. A high level of net migration is adding to domestic demand as well as productive capacity. Economic growth is projected to decline as a result of tightening monetary policy and a reduction in commodity prices. The high exchange rate continues to restrain growth in the traded sectors.

Inflationary pressures although increasing are expected to slow to a more sustainable pace over the next few years, keeping annual CPI inflation contained near the 2 percent target midpoint.

Low volatility across a number of asset classes remains a dominant theme in global financial markets contributing to the strength in global equity markets and a fall in bond yields. Increases in the NZ official cash rate (OCR) has seen short-term interest rates increase and the yield curve flatten. The NZ Trade Weighted Index rose to a record high of just over 82 in early July before falling to 79 by the end of August reflecting the fall in dairy prices.

The trend in lower government bond yields globally has flowed through to New Zealand with the yield on 10-year government bonds falling to 4.07 percent. Issuance of the New Zealand dollar-denominated debt by overseas entities (Kauris, Eurokiwi and Uridashis) has picked up over the last quarter. To the extent that overseas investors have purchased these bonds, this has added to upward pressure on the New Zealand dollar.

2. ECONOMIC PERFORMANCE AND PROJECTIONS

a. Introduction

New Zealand has a small, open economy that operates on free market principles. It has sizeable manufacturing and service sectors complementing a highly efficient export-oriented agricultural sector. New Zealand is highly dependent on the primary sector with commodities accounting for around half of total goods exports. Exports of goods and services account for around one-third of real expenditure GDP.

New Zealand's high proportion of winter sunshine hours and considerable rainfall provide an ideal resource base for pastoral agriculture, forestry, horticulture and hydro-electricity generation.

Hydro-electricity provides a relatively cheap source of energy and has allowed the development of energy-based industries such as aluminum refinement. New Zealand is also a popular overseas visitor destination and tourism is an important source of export income.

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Over the last quarter of a century, the New Zealand economy has changed from being one of the most regulated in the OECD to one of the least regulated. The National Party Government elected in November 2008, re-elected in November 2011 and again in September 2014 now has a significant shift in its mandate with almost enough seats to govern without any coalition partners. The middle to right National Government aims to lift the long-term performance of the economy through six key policy drivers: a growth-enhancing tax system; better public services; support for science, innovation and trade; better regulation, including regulation around natural resources; investment in infrastructure; and improved education and skills.

b. Recent Economic Performance - Background

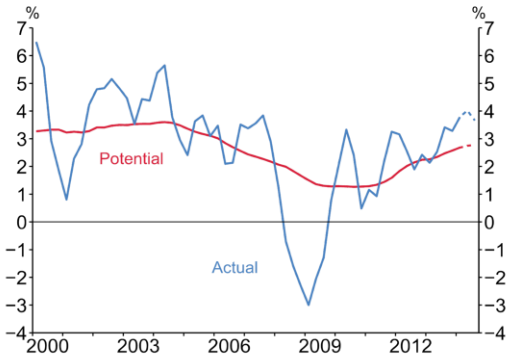
The New Zealand economy entered recession in early 2008, before the effects of the global financial crisis set in later in the year. A drought over the 2007/08 summers led to lower production of dairy products in the first half of 2008. Domestic activity slowed sharply as high fuel and food prices dampened domestic consumption, while high interest rates and falling house prices drove a rapid decline in residential investment. The outlook for the New Zealand economy deteriorated sharply following the intensification of the global financial crisis in September 2008. Similar to experiences across advanced economies, business and consumer confidence plummeted as uncertainty dominated the global financial and economic environment. In addition, local banks' access to funding in overseas markets was temporarily curtailed at the height of the crisis. Subsequent to the GFC as Credit Markets have returned to more normal levels driven by accommodative global financial market conditions, GDP growth has been robust albeit at a slower rate than recent quarters. This partially reflects recent lower commodity prices, rising interest rates and easing housing price inflation. Nonetheless, the economy continues to grow faster than estimated potential output and pressures on capacity have increased. Annual CPI inflation increased to 1.6 percent in the June 2014 quarter.

c. Economic Growth

Growth in the New Zealand's economy has picked up over the past 18 months, and is estimated to be 3.7 percent in the year to September. Growth in output has been exceeding that in supply capacity for some time, (see graph below) and inflationary pressures have been increasing. Nonetheless, growth is projected to slow to a more sustainable pace over the next few years, keeping annual CPI inflation contained near the 2 percent target midpoint.

GDP and estimated potential output growth

(annual, dashed lines represent forecasts)



Source: Statistics New Zealand, RBNZ estimates.

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There have been several key drivers of the pick up in growth over the past 18 months. Reconstruction work continued to accelerate in Canterbury, and building work in Auckland and other regions has increased more recently. High house price inflation continued to support growth in household demand. Net immigration flows rose from near zero over 2012 to an annual rate of 41,000 people in the year to July 2014. Prices for New Zealand's commodity exports rose to record highs through 2013, boosting national income substantially. Throughout the period since the global financial crisis, low interest rates have been supporting the recovery in domestic demand.

Some of these factors will continue to be important over the next two years. Construction output is growing rapidly this year, and is expected to settle at a high level. Net immigration has continued increasing strongly over the year to date, and is expected to settle at a high level. Net immigration has continued, increasing strongly over the year to date. However, house price inflation has moderated. Prices for diary and forestry exports have fallen sharply over the year. The exchange rate remains high and is a drag on growth. Looking abroad, economic growth is uneven across advanced economies, and in aggregate is picking up only gradually. Combined with low global inflation, this outlook means monetary policy in the major advanced economies is likely to remain supportive for some time to come.

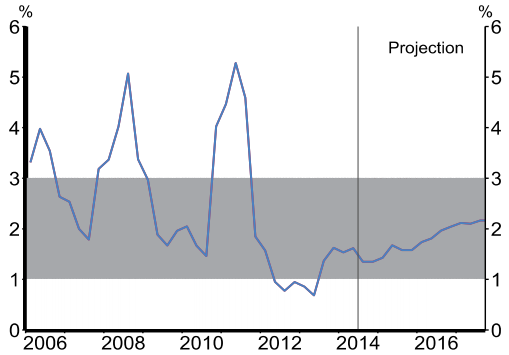
In October 2013, in response to financial stability risks associated with high house price inflation, the Reserve Bank introduced speed limits on high loan-to-value ratio (LVR) mortgage lending, and these have contributed to the slowing in house price inflation. From March to July 2014, with demand and inflationary pressures increasing, the Reserve Bank increased the Official Cash Rate (OCR) by 100 basis points.

There are signs that the OCR increases are starting to have he desired effect of slowing growth in demand to a more sustainable rate, and keeping inflation and inflation expectations well anchored.

d. Inflation and Monetary Policy

CPI inflation has increased over the past year, but remains modest at an annual rate of 1.6 percent in the June quarter. Annual non-tradables inflation is at 2.7 percent with domestic capacity pressure rising, and is especially strong in the construction sector.

CPI inflation
(annual)



Source: Statistics New Zealand, RBNZ estimates.

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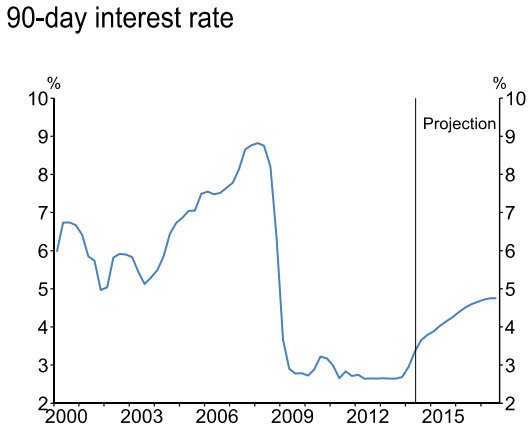
At current levels interest rates are still providing support to demand growth. It is expected that the OCR will need to increase towards a more neutral level for annual CPI inflation to settle around the 2 percent target mid-point and growth to continue at a sustainable pace. Of particular interest at present are how the housing market and domestic demand are developing, how capacity pressure is passing into inflation, and how the exchange rate will respond to falling export prices.



Source: RBNZ

3. FINANCIAL MARKET DEVELOPMENTS

a. Introduction

Low volatility across a number of asset classes remains a dominant theme in global financial markets. This has contributed to continued strength in global equity markets and a fall in bond yields. In addition, generally stable global growth, low inflationary pressures, and easy global monetary policy have all been factors contributing to this.

These international trends have flowed through to New Zealand markets, putting downward pressure on New Zealand interest rates, especially at longer maturities. With OCR increases putting upward pressure on short-term interest rates, the yield curve has flattened.

After the New Zealand dollar trade-weighted index (TWI) rose to a record high of just over 82 in early July, the index fell to around 79 by the end of August. The fall reflects weaker-than-expected inflation and falling dairy prices, which contributed to expectations for fewer increases in the OCR.

Floating mortgage rates have risen over the past quarter, reflecting the 50 basis points of OCR hikes over June and July. By contrast, fixed mortgage rates are only marginally higher, although have moved significantly higher over the past year. In response to relatively low fixed rates, borrowers continue to migrate steadily from floating to fixed-rate mortgages.

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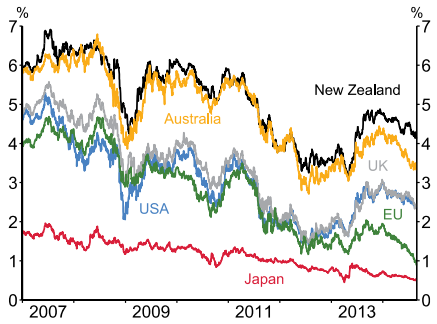
b. Interest Rate Markets

10-year government bond yields



Source: Reuters.

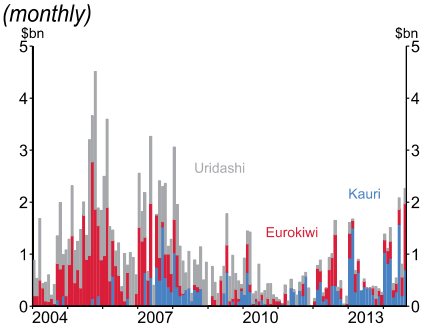
The trend of lower global government bond yields has flowed through to the New Zealand. From the RBNZ's June *Statement* until the end of August, the yield on 10-year New Zealand government bonds fell by 38 basis points to 4.07 percent. Over the same period, yields on Australian 10-year government bond yields fell by 53 basis points to 3.29 percent. The spread between the New Zealand 10-year rate and the United States 10-year rate has narrowed slightly to around 173 basis points, while the spread to the Australian 10-year rate has widened from 58 to 78 basis points.

Issuance of New Zealand dollar-denominated debt by overseas entities (Kauris, Eurokiwis and Uridashis) has picked up over the past quarter. To the extent that overseas investors have purchased these bonds, this has added upward pressure to the New Zealand dollar. Total issues have averaged NZ $1.3 billion per month in 2014, above the $650 million average for 2013. However, this is still well below the mid-2000s average of over $2 billion per month. The increase in issuance this year has been aided by the rise in New Zealand yields compared with global yields and ongoing appetite for higher yielding fixed interest investments.

Following a period of steady decline, global credit spreads stabilised over recent months, with the spread for investment grade credit hovering at just over 100 basis points. The global 'junk' bond market recently suffered a minor setback as retail investors withdrew funds, but higher spreads then attracted institutional fund flows. After trending lower since mid-2012, bank-funding margins have stabilised over recent months at an estimated 40 basis points over the OCR. Long-term wholesale rate spreads have fallen significantly since the Global Financial Crisis and European Sovereign Debt Crisis, but have stabilised over the past few months. After contributing to falling funding costs since 2012, the spread to the OCR on retail term deposits has flattened out this year, as deposit growth has slowed.

Gross issuance of Kauris, Uridashis, and Eurokiwis

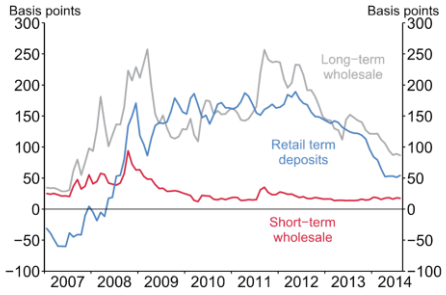
(monthly)



Source: Bloomberg, Reuters, RBNZ.

Marginal bank funding costs

(basis points over OCR)



Source: RBNZ estimates.

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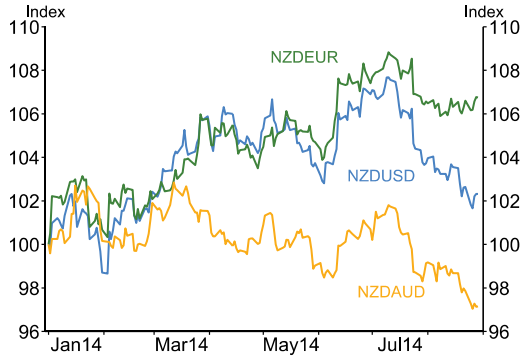
b. Foreign Exchange Market

The New Zealand dollar TWI hit a new post- float high in early July as investors were attracted by New Zealand's relatively high interest rates and strong economic outlook. Since then the New Zealand dollar has weakened for a number of reasons, including lower market expectations for further OCR increases, partly reflecting weaker-than-expected inflation and lower dairy prices, and a strengthening US dollar. The NZD-USD cross rate was around USD 0.8340 at the end of August, similar to where it was at the start of June but down from its peak of USD 0.8835 in July. The New Zealand dollar has also weakened against the Australian dollar and the euro since July. The New Zealand dollar is now around it's lowest cross rate against the Australian dollar for a year, more reflecting expectations of slowing momentum in the New Zealand economy than a pick-up in the Australian economy. Depreciation against the euro has been less than against the Australian dollar and US dollar, with recent weakness in the euro area economy and expectations for further easing from the ECB resulting in the euro weakening against other major currencies.

New Zealand dollar cross rates

(1 January 2014 = 100)



Source: Reuters.

d. Other domestic financial market developments

The overnight indexed swap (OIS) market suggests that a smaller total increase in the OCR is expected than before the June Reserve Bank Monetary Statement. Following a series of weaker-than-expected data outturns, including lower-than-expected inflation, falling dairy prices, and easing house price inflation, markets are pricing in an OCR of 3.97 percent by the end of 2015, compared with 4.20 percent following the RBNZ's June Statement. The OIS market is pricing in a 16 percent chance of another 25 basis point hike by the end of this year. Market pricing suggests the next full 25 basis point hike is expected by April 2015.

Falling global bond rates have put downward pressure on New Zealand interest rates at longer maturities. The two-year swap rate has fallen slightly since the June Statement, while the 10-year swap rate has moved more than 35 basis points lower. Market commentators suggest overseas investors who find New Zealand rates attractive relative to low rates globally have capped swap rates. Offshore bond issuance and Kauri issuance have added further downward pressure on interest rates.

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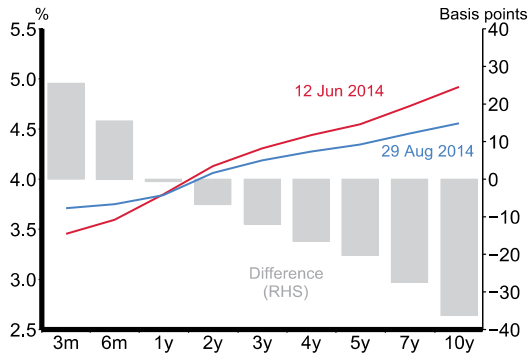
Wholesale bank bill and swap rates

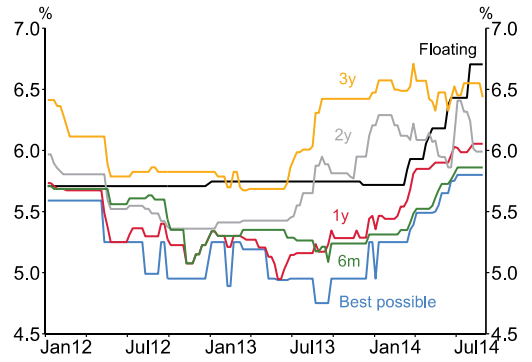


Source: Bloomberg.

Floating mortgage rates have matched the 50 basis point increase in the OCR since before the June Statement. Fixed mortgage rates are in general slightly above where they were at the end of May. The average two-year fixed mortgage rate from the big four banks is currently 5.99 percent, up slightly from 5.95 percent at the end of May. Banks increased their fixed mortgage rates following the June Statement as swap rates rose, but have since cut them again as swap rates retreated. Competition between banks remains strong, particularly at the two-year fix point. Banks have also been competing strongly offering up 'cash-back' offers as part of fixed mortgage rate deals.

While fixed mortgage rates have moved only marginally since the end of May, over the past year rates have risen more substantially. The best possible rate over all durations from the major banks has risen from a low of 4.75 percent in September 2013 to 5.8 percent at the end of August 2014. This fully reflects the 100 basis points of hikes in the OCR this year, much of which was anticipated by markets and thereby priced into the mortgage curve long before the first OCR increase actually occurred.

Average mortgage rates by term and the best possible rate



Source: interest.co.nz, RBNZ estimates

The attractiveness of fixed mortgage rates compared with the higher floating rate is encouraging householders to fix their mortgages. The trend towards fixed rates is not new, with the proportion of mortgage holders on floating rates steadily declining since its peak of 63.0 percent in April 2012 to 29.9 percent in July 2014.

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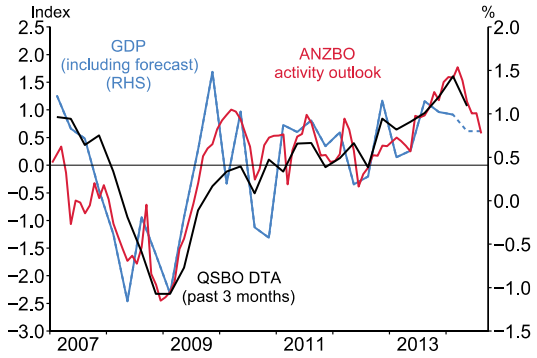
The recent trend has been for borrowers to fix at the longer durations of two or three years. There were about $11.3 billion of mortgage flows into the one-to-three year fixed-rate buckets in the three months to July, up from only $3.9 billion over the same period a year ago. These flows pushed up the average time to re-price mortgages to 10.9 months in July, more than double the low of 4.7 months in 2012.

4. CURRENT ECONOMIC CONDITIONS

a. Introduction

The New Zealand economy continues to grow at a robust pace, but at a slower rate than in recent quarters. This is consistent with recent declines in surveyed business sentiment, that partly reflects declining commodity prices, easing house price inflation and rising interest rates. Nonetheless, the economy continues to grow faster than estimated potential output, and pressures on capacity have increased. Annual CPI inflation increased to 1.6 percent in the June 2014 quarter.

Quarterly GDP growth and businesses' reported activity
(seasonally adjusted)



Source: NZIER, ANZ Bank, NZIER, Statistics New Zealand, RBNZ estimates.
Note: The QSBO DTA and ANZBO own activity outlook are standardised.

b. External demand

New Zealand's trading partners have been growing at a moderate pace, notwithstanding recent volatility in the United States and Japan. The nature of the global recovery has meant that the considerable spare capacity in major advanced economies is being absorbed only slowly.

International prices for New Zealand's agricultural exports have declined further in the past three months and are supporting domestic demand to a lesser degree than at the start of 2014. The ANZ commodity price index has declined by 12 percent since February. These declines have been led by dairy and forestry prices, with meat prices providing a partial offset.

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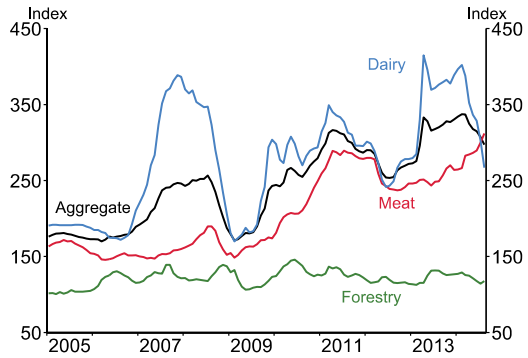
Export commodity price indices

(world terms)



Source: ANZ Bank.

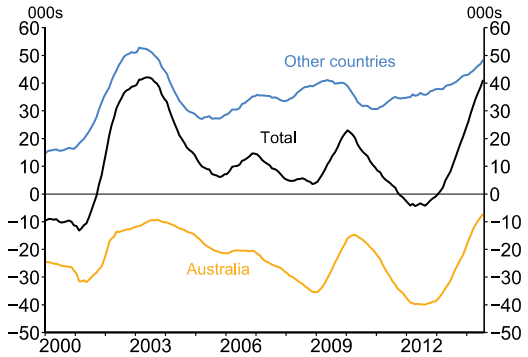
Dairy prices have fallen by 45 percent in GlobalDairyTrade auctions since peaking in February. While global dairy supply has increased, an important reason for the recent falls appears to be a build up of inventory in China. These inventories are expected to clear in coming months, with underlying consumer demand for dairy products in China remaining robust. In contrast, much of the 7.5 percent decline in forestry prices since April (as measured in the ANZ Commodity Price Index) appears to be a response to softening demand from China, related to the slowdown in the Chinese property sector.

With slow growth in major economies, and New Zealand's prospects relatively strong, net immigration has risen further in recent months and is providing increasing support for housing and consumer demand. Over the past year, net immigration has boosted New Zealand's population by 41,000 people (0.9 percent). Arrivals have picked up in recent months, after reductions in departures had played the greater role in the early part of the migration cycle.

Trans-Tasman flows are a key part of the net immigration story, although arrivals from other countries are becoming increasingly important. About 70 percent of the total increase in net immigration between July 2012 and July 2014 was a result of fewer departures to Australia and an increase in arrivals from Australia. A key factor behind trans-Tasman flows is increased slack in the Australian labour market as Australian mining investment slows.

Permanent and long-term net immigration flows

(annual total)



Source: Statistics New Zealand.

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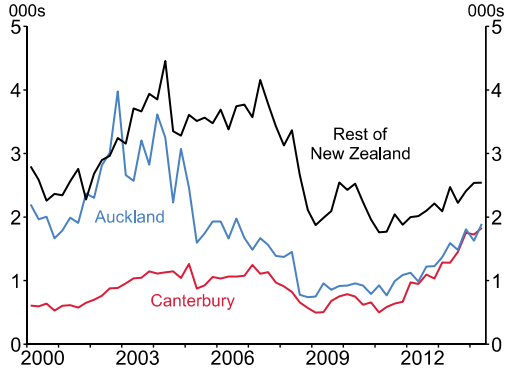
c. Domestic demand

Construction output has grown at an annual average rate above 12 percent in the year to March 2014. Further increases in residential consent issuance point to strength through the middle of 2014. The number of new dwelling consents issued in the three months to July was 18 percent higher than over the same period in 2013, underpinned by strong growth in both Canterbury and Auckland.

Number of new dwelling consents

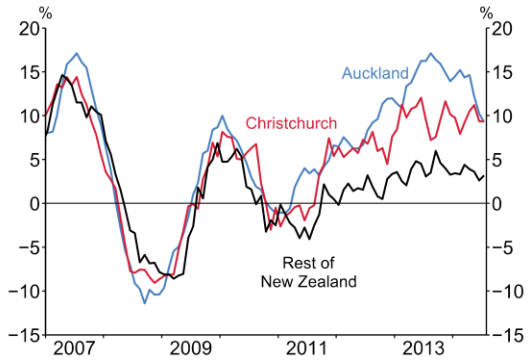
(quarterly total)



Source: Statistics New Zealand.

Stratified house price inflation by region

(annual, 3 month moving average)



Source: REINZ, RBNZ estimates.

Monthly house sales

Source: REINZ.

Strong business confidence has translated through to increased investment. Real business investment rose by 10 percent in the year to March 2014. Surveyed investment intentions remain above long-term averages and point to further growth in business investment over the remainder of 2014, albeit at a more gradual pace. The volumes of mechanical and electrical machinery imports have increased 5 and 9 percent respectively over the past six months, and the number of commercial vehicle registrations is at historically high levels.

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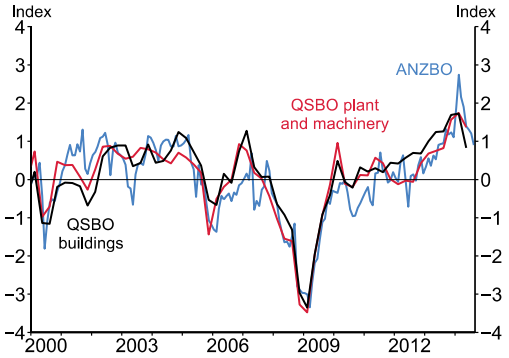
Investment intentions

(standardised, seasonally adjusted)

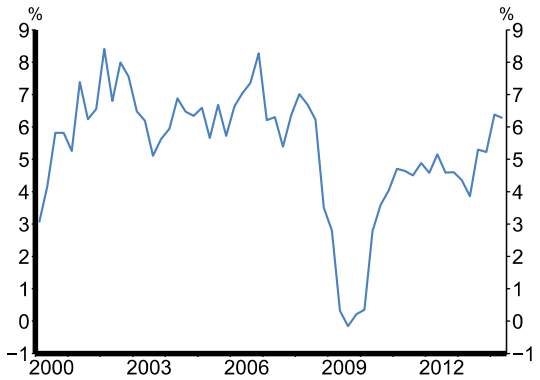


Source: ANZ Bank, NZIER, RBNZ estimates.

Businesses' demand for labour has increased and the improving labour market is boosting household income and supporting spending. Nominal earnings increased at an annual pace of 6.2 percent in the June quarter and consumer confidence remains above average, despite some decline in sentiment in recent months. Retail trade volumes increased at a quarterly rate of 1.2 percent in June. The growth in retail sales volumes points to moderate growth in real consumption through the middle of 2014.

Growth in total gross weekly earnings

(annual)



Growth in real retail sales

(quarterly, seasonally adjusted)

Source: Statistics New Zealand.

5. THE MACROECONOMIC OUTLOOK

a. Introduction

Growth in the New Zealand economy is projected to moderate to a more sustainable pace in coming years. While the boost to growth from construction, net immigration and recent high export prices will wane, domestic demand is expected to become increasingly broad-based and self-sustaining. Consequently, the gradual removal of monetary stimulus is needed to limit inflationary pressures and ensure that annual CPI inflation settles around 2 percent over the medium term.

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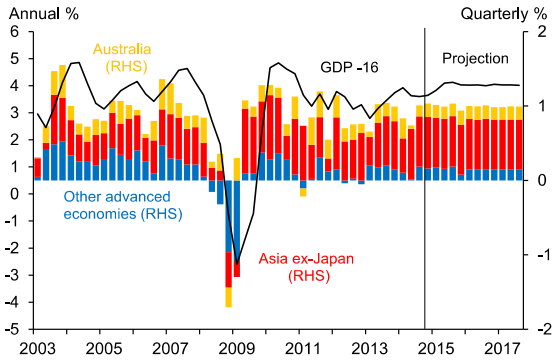
b. External outlook

Economic growth across New Zealand's major trading partners is expected to remain near its average pace over the projection. New Zealand is expected to benefit from its increasing share of trade with the fast-growing Asian economies.

Trading partner GDP growth
(seasonally adjusted)



Source: Haver Analytics, RBNZ estimates.
Note: Asia ex-Japan includes China, Hong Kong, India, Indonesia, Malaysia, Singapore, South Korea, Taiwan, Thailand and the Philippines. Other advanced economies include the United Kingdom, the United States, Canada, Japan and the euro area. GDP-16 is an aggregate of 16 of New Zealand's major trading partner economies.

In China, government stimulus has helped maintain aggregate economic growth around the Government's target rate of 7.5 percent per annum. This is despite the weakening property market, which poses a key risk to economic growth given its linkages to other sectors. Domestic demand will continue to benefit from the process of urbanisation and implementation of the Government's reform agenda, and annual GDP growth of about 7 percent is expected over the next few years.

In Australia, GDP is expected to grow at a below-trend pace until the end of 2015 as the transition from mining investment-driven growth to broader growth continues. Investment in the resources sector is projected to continue to decline in coming years, with rising resource exports providing only a partial offset. Stimulatory policy settings in Australia should support the return to trend rates of growth by boosting other parts of the economy. The unemployment rate is likely to remain near 6 percent over the coming year. Performance of the New Zealand and Australian labour markets is expected to continue to diverge over this time, which could support further net immigration to New Zealand.

Economic growth is strengthening in the United States and the United Kingdom. Monetary authorities are preparing to gradually remove the exceptional monetary policy stimulus of recent years, to maintain growth at sustainable rates and ensure price stability. Rising growth in advanced economies will boost demand for the exports of New Zealand's Asian trading partners, and their incomes. The growth outlook in the euro area and Japan is weaker, and further policy easing is likely. Tension between Russia and Ukraine has affected the fragile recovery in the euro area, and an escalation in tension could slow the expected recovery further.

Global inflation is expected to increase modestly as spare capacity in major trading partner economies is absorbed only gradually. This will help to limit import price inflation in New Zealand, although its impact will be partly offset by an assumed depreciation in the New Zealand dollar TWI, reflecting the adjustment to domestic economic growth and rising interest rates in some of the major economies. The New Zealand

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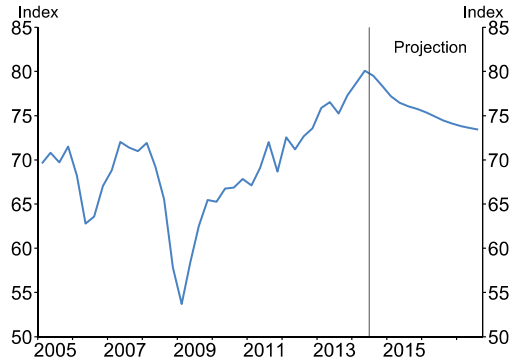
dollar is assumed to remain relatively strong given New Zealand's relatively favourable economic outlook and positive interest rate differentials. While the high New Zealand dollar boosts domestic purchasing power, it will remain a significant headwind for export and import-competing industries.

New Zealand dollar trade-weighted index

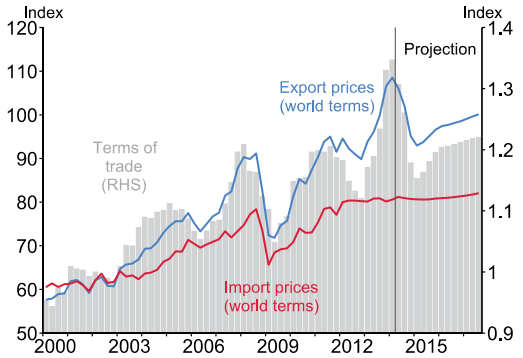


Source: RBNZ estimates.

Demand for New Zealand's exports will continue to increase with global income growth, and with an increasing share of New Zealand's exports going to faster-growing economies in Asia. Strong growth in Chinese demand will remain a key support for soft commodities. Consequently, while prices of New Zealand's export commodities have fallen considerably in 2014 – driven by dairy and forestry – they are expected to recover over the projection. The projected recovery in export prices and subdued import price outlook result in the terms of trade increasing by about 5 percent through 2015, and remaining historically high.

SNA terms of trade and components

(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

c. Domestic Demand

Growth in the New Zealand economy is expected to moderate to a more sustainable pace over the projection, after outpacing estimated growth in potential output for some time.

Strong construction demand will remain a key contributor to economic output over the projection. Construction output is expected to increase strongly over the next year before stabilising about 11 percent of potential output – a similar share to that seen at the peak of the last cycle.

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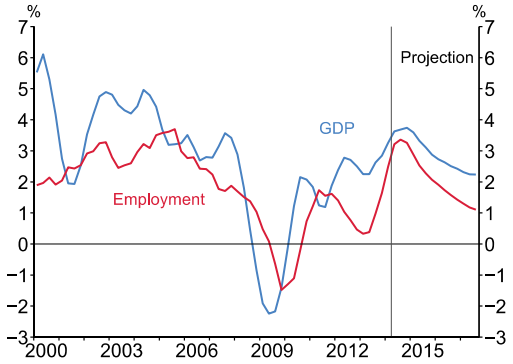
Even as the pace of economic growth eases, conditions for businesses should remain favourable. Business investment is expected to increase at a moderate pace to alleviate resource pressures.

Employment is projected to strengthen in line with GDP. At the same time, growth in labour supply is supported by high net immigration and historically high rates of labour force participation. Overall, employment growth is strong enough to more than absorb the increasing labour supply, resulting in the unemployment rate falling to around 5 percent.

GDP and employment growth

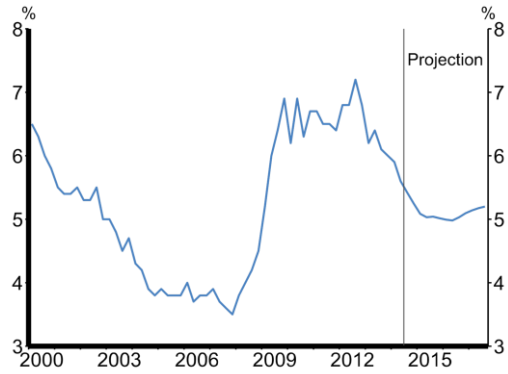
(annual average)



Source: Statistics New Zealand, RBNZ estimates.

Unemployment rate

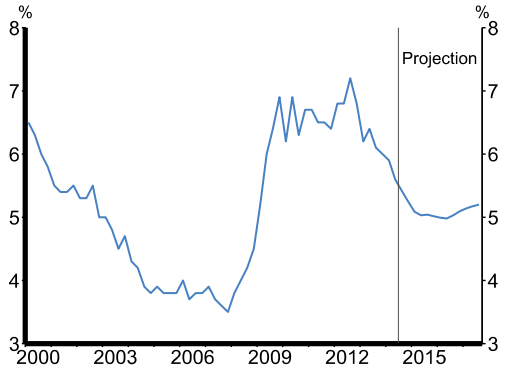
(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

Unemployment rate

(seasonally adjusted)



Source: Statistics New Zealand, RBNZ estimates.

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6. THE SECURITIES MARKET – MAJOR DEVELOPMENTS & PROSPECTS

a. Equity Markets

New Zealand's capital markets are beginning to show the results of a series of well-planned structural changes. In the year to June 30 2014, retail investor ownership in the market rose by 3.1% to 26.4%, which was the first sizable jump since 2006. During the 2014 year to date there has been eleven initial public offerings completed.

While driven partly by the economic environment, the increase in retail participation is also the result of the New Zealand Government's share offer programme, a number of listings, and a renewed interest in equities as an asset class.

An improved regulatory environment has supported this, in particular through the introduction of the Financial Markets Authority in 2011. In addition, the increased savings in New Zealand under the KiwiSaver superannuation scheme introduced by the Government in 2007, with upwards of $17 billion under management, KiwiSaver is expected to grow to over $80 billion by 2026.

Overall, New Zealand ownership of NZX listed companies has increased by 2.1% to 66.9% in the year to 30 June 2014 as foreign investors sold down stakes, reversing the trend we saw in the 2000's, where foreign majority owners tended to take companies private.

In October 2014, investors in NZX listed companies were made up of:

- 23% NZ Managed Funds
- 26% NZ Retail Investors
- 18% NZ Strategic Stakes
- 9% Offshore Strategic Stakes
- 24% Other Offshore Owners

NZX equity markets have a total market capitalisation of close to $82 billion representing around 40% of New Zealand's gross domestic product or GDP. NZX Cash Markets, which encompass the NZX Main Board, Alternative Exchange and Debt Market, are home to a range of businesses. With a total of 258 listed securities, NZX's Cash Markets business includes 166 equity securities, 86 debt securities, and 6 other securities.

NZX's Derivatives Market currently has whole milk powder, anhydrous milk fat, and skim milk contracts. It is made up of monthly contracts, which are listed out 18 months at any one time, and are generally quoted six months in advance.

b. The Capital Markets Taskforce Recommendations

In 2009 the Capital Markets Taskforce released its final report and made recommendations for improving the performance of New Zealand's capital markets. These recommendations were supported by industry and since then, the Government has been working to implement most of the taskforce's recommendations. Progress on these initiatives is summarised in the table below:

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Recommendations the Government is progressing

› Simplifying and standardising product disclosure so that investors have clearer knowledge of what they are investing in	› Developing new disclosure regulations under the Financial Markets Conduct Bill.
› Improving the governance and on-going disclosure of managed funds	• › Ensuring the governance of publicly available financial products is robust. • › New regulations to improve information on KiwiSaver fund performance.
› Broadening the range of high quality equity offerings for retail investors by encouraging partial listings of government-owned companies, agricultural businesses and local subsidiaries of financial services firms	• › Progressing the Government Share Offers. • › Enabling Fonterra's Trading Among Farmers Scheme.
› Broadening the range of quality debt offering on the market	• › Facilitated development of the Local Government Funding Agency. • › Changes to government debt offers.
› Improving the pipeline of entrepreneurial companies	• › Supporting the New Zealand Venture Investment Fund. • › Establishing Callaghan Innovation. • › NZTE services to business. • › Incubator programmes and R&D co-funding.
› Improving the regulatory regime for private companies so that they can effectively access the capability and risk capital they require	› Clarifying and widening exemptions for offers to certain investors.
› Facilitating the development of more lightly regulated exchanges	› Passing legislation to enable the development of intermediate exchanges.
› Fundamentally reviewing the Securities Act in a way that reinforces New Zealand's reputation as an honest and transparent economy	› Passing the Financial Markets Conduct Bill (underpins various initiatives in this report).
› Reviewing the regulatory agencies with a view to consolidating market conduct functions, building scale and expertise and reducing regulatory gaps	› Establishing the Financial Markets Authority.
› Eliminating tax and regulatory biases between different types of investment (for example, property versus financial assets)	› Changes made as part of the Budget tax package.
› Developing a specialist agricultural capital market centre	› Enabling NZX to develop a dairy futures market and Trading Among Farmers.

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c. Outlook

- The peak in the growth cycle is now behind us but we expect it to remain ahead of its potential (non-inflationary) rate. We expect 3.7% growth this year dropping back to 2.7% next year.

- The biggest development has been the decline in international dairy prices. While prices had been expected to fall from the peak early this year, the fall was far greater than anticipated.

- Inflationary pressures remain subdued. In the year to September the annual rate of increase in the Consumer Price Index will be only a little over one percent, close to the bottom of the RBNZ's target range.

- Another interest rate hike in 2014 seems unlikely, unless we see a large and rapid fall in the New Zealand dollar. However, we have not yet seen the peak in the interest rate cycle and expect the RBNZ to resume rate hikes in March 2015.

- The recent significant monetary stimulus from Japan and Europe, and the prospect of more to come, combined with cautious steps towards tightening monetary policy in the US and the UK, has seen a further fall in global interest rates.

- New Zealand fixed income investors are poised for a period of stability in short term interest rates with the RBNZ on hold until March 2015. Longer term interest rates are also likely to be stable.

- At current prices the dairy payout next season could be revised down and the cut in dairy revenues obviously has broad ramifications for the economy, interest rates and the New Zealand dollar.

Ends

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