The Profit Equation

Costs
- Transport
  - Forest to processor/wharf
  - Sea freight costs
- Electricity
- Labour
- Cost of debt
- Regulatory
  - Tax
  - ETS
  - RMA

Revenues
- Dependent on exports
  - Asia of great importance
- Exchange rate
Freight Costs to Edge Higher?

Energy Costs Problematic
Labour Costs Contained

Labour Cost Index
Private sector all salary and wage rates

Consistent with mid-point of RBNZ inflation target

Ann % change

Quarterly

Source: BNZ, Statistics NZ

As Unemployment Remains High

Unemployment Rate

Non-inflationary Rate?

Source: BNZ, Statistics NZ

BNZ

RBNZ Dec 2009 MPS

Forecasts
Rising Cost of Funds a Worry

![Mortgage - Cash Rate Graph](source: BNZ, RBNZ)

Deposit War Passed On

![Marginal Bank Funding Costs Graph](source: RBNZ, BNZ)
Cash Rate to Normalise

NZ Cash Rate

Source: BNZ, RBNZ

Rates Higher Across the Curve

NZ Swap Rates

Source: RBNZ, BNZ
Global Outlook So Much Better

Global Growth Forecasts

Source: Consensus Forecasts, BNZ Forecast Date

Expectations Peaking

Consensus GDP Twelve Month Forecast

Source: Consensus Economics, BNZ
Exports By Destination

Forestry Exports By Destination

Source: Statistics NZ, BNZ

Growth Outlook

New Zealand Trading Partner Growth
Consensus Forecasts

<table>
<thead>
<tr>
<th>Trading Partners</th>
<th>Weights %</th>
<th>GDP Growth (ann avg %)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2008</td>
<td>2009</td>
</tr>
<tr>
<td>Australia</td>
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<tr>
<td>China</td>
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<td>Japan</td>
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<td>South Korea</td>
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<td>-1.2</td>
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<tr>
<td>United States</td>
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<tr>
<td>Other</td>
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<td>NZ Trading Partners</td>
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<tr>
<td>New Zealand</td>
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<td>-1.6</td>
</tr>
<tr>
<td>The World</td>
<td>2.0</td>
<td>-2.2</td>
</tr>
</tbody>
</table>

Source: BNZ
China Dominant

- China
  - Overheating fears
  - Stimulus measures being withdrawn

China’s Share of NZ Exports

Source: BNZ, Statistics New Zealand
Commodities Overdone?

The China Story

China's achievements to date
China's economic growth model has delivered exceptional results to date:

- Average annual real GDP growth of 9.8% over the past three decades.
- World’s 2nd largest economy.
- Just became world’s largest merchandise exporter (from 1% of global trade in 1980 to 9% in 2008).
- World’s largest current account surplus (US$245bn) and holder of foreign exchange reserves (US$2.3tr).

Reason for China’s rapid growth
The model is based on an exceptionally high level of investment with an increasing reliance on exports:

- Fixed asset investment (FAI) makes up almost half of China’s GDP (world’s highest share).
- High productivity growth (from labour & capital).
- China has run this high investment model long and hard.

Drivers of China’s growth model
A unique set of characteristics has allowed China to pursue an investment driven, export led growth model:

- High savings rates by both households and corporate sector provide a cheap funding base for investment.
- Government influenced financial and regulatory system where interest rates, capital movement, and currency are all controlled.
- State owned enterprises (SOE) dominate many strategic sectors of the economy (especially heavy industry).
- Export promotion policies (i.e. “mercantilist” approach).
- Abundant, cheap labour supply.

Limitations of China’s model
- The need to maintain the current growth and its exceptional degree of dependence on investment spending is the Achilles heel of the model.
- This means the growth model is circular, like a cat chasing its tail.
- Over the longer term, the model is unsustainable and will eventually need to be reformed, but this involves structural changes over many years.
- Poorly directed investment spending usually weighs on long term growth rather than precipitating a sudden economic slump.

Future Forestry Finance 2010
Japan Unexciting

- Japan
  - Aging demographics
  - Need for external financing

US A Tad Better

- United States
  - Large deficits
  - Exploding entitlements
South Korea Performing Well

South Korean GDP

Quarterly Source: Datastream, Consensus Economics, BNZ

Consensus Forecasts

% change

South Korean GDP

Annual average

Australia Solid

Australasian GDP

Quarterly Source: Datastream, Consensus Economics, BNZ
Who’s Riskier

Risks Aplenty

- The removal of QE and its impacts (esp in the US)
- The removal of fiscal stimulus
- The timing and extent of future monetary tightening
- Global dependence on the emerging market of China
- The realignment of emerging market currencies
- Ongoing problems in the banking sector
- The possible emergence of asset bubbles
  - Chinese assets
  - Overvalued equities
- High demand for long dated paper
- The role of the inventory cycle
NZ Recovering

Gross Domestic Product

Quarterly % change

Source: BNZ, Statistics New Zealand

Hope for Residential

Residential Construction

% change

Source: BNZ, Statistics NZ
As Migration Inflows Rise

Net Immigration

Source: Statistics New Zealand, BNZ Capital

Though Warning Signs Abound

House Price Inflation And Sales

Source: REINZ, BNZ
Commercial Building Softer For Longer

Non Residential Construction

Annual average %

Quarterly

Source: Statistics NZ, BNZ

Too Much Spare Capacity

NZ Output Gap

BNZ Estimate

%

Quarterly

Source: Statistics NZ, NZIER, BNZ
Currency Pain Nears Completion

New Zealand Dollar

NZD/USD (RHS)

NZD TWI

Forecast

Source: BNZ, RBNZ

Careful What You Mean

Relative NZD Valuations
(as of 3 February 2010)

NZD Crosses

Source: BNZ
NZD/AUD to Appreciate

NZD/AUD

Source: BNZ

Stronger Against the Yen Too

NZD/JPY

Source: BNZ
As Japan Struggles

NZ-Japan Growth Differential

% Diff

Quarterly

Forecast

Source: Consensus Economics, Datastream, BNZ

An Asian Appreciation

NZD/KRW

Forecasts

Source: Bloomberg, BNZ
NZ Risks Aplenty

- Rural land price correction
- Fiscal constraints
- Housing market still overvalued?
- Poor household savings
- High offshore debt levels
- Threat to SMEs
- NZD
- Exposure to Asia (a plus and a minus)
- ETS
- NZ Tax Review

Other Gains To Be Made?

- Value of environmental services
- Sequestration and storage of carbon
- Mitigation of soil erosion
- Maintenance of water quality
- Maintenance of biodiversity
- Landscape values
- Provision of recreational opportunities
- Global changes in wood supply through reducing unsustainably and illegally produced timber products in global markets
Conclusion

- A brightening outlook
- But risks aplenty
- Conservative optimism demanded

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