NEW ZEALAND ECONOMICS
ANZ MARKET FOCUS

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INSIDE

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KEY MACRO THEMES FOR 2011

ECONOMIC OVERVIEW

Recovering business sentiment suggests the economy is likely to avoid a technical recession in H2 2010, moving towards a base growth rate of around 0.5 percent per quarter. While still sluggish and weighed down by ongoing deleveraging and a number of "niggle factors", this is a solid base growth rate with potential to be boosted by one-offs over 2011. Ahead of the January OCR Review, the focus this week returns to inflation. We expect annual inflation to approach 4 percent, but the QSBO provided reassurance that subdued demand conditions will help limit the spill-over into generalised pricing pressures.

KEY MACRO THEMES FOR 2011

In this article, we outline some of the key themes we see evolving over the year ahead that will play an influential role in New Zealand's economic prospects. While the economy is set to expand, we are not losing sight of the bigger picture. The economy still faces challenges that will cap the magnitude of growth over the next few years, as structural changes come to the fore.

INTEREST RATE STRATEGY

Short end interest rates declined steadily over the holiday period, taking the 2yr-10yr swap curve to its steepest point in over a year. However, almost like clockwork, that all changed early last week as traders returned from holidays, with a generally long market confronted by slightly stronger data. A strong post-flood rally in Australian bonds contributed to the squeeze, with steepeners being unwound contributing to short end paying. Given the cautious tone of the economy, we expect markets to normalise as we head into next week's RBNZ OCR Review.

CURRENCY STRATEGY

Market participants have developed their key themes for 2011. From a NZD perspective a key theme of potential food price inflation delivers a positive spin. Internationally the market is torn between the sovereign risk that is permeating Europe, and a US economy that is showing small signs of recovery but is not quite there yet. In Asia inflation issues are already apparent and the spectre of food price inflation will cause increased concern.

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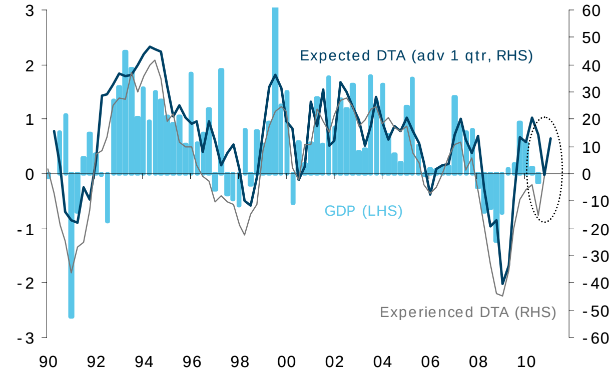
THIS WEEK'S EVENTS

- **REINZ Housing Market Statistics – December** (Tuesday, January 18, 10:00am). Residential sales volumes are expected to rise 2 percent. Prices are likely to trend lower.
- ***globalDairyTrade* online auction – Mid January** (Wednesday, January 19, 6:00am). Whole Milk Powder prices should strengthen to an average of USD $3,800 per tonne.
- **SNZ Consumers Price Index - 2010Q4** (Thursday, January 20, 10:45am). We anticipate a quarterly increase in the region of 2.3 percent, with the headline number boosted by the GST rise.
- **ANZ Roy Morgan Consumer Confidence - January** (Thursday, January 20, 3:00pm).
- **SNZ Retail Trade – November** (Friday, January 21, 10:45am). Retail sales values are projected to increase by 1.2 percent. Core retail trade is expected to increase by 0.4 percent.

WHAT'S THE VIEW?

The Q4 QSBO followed the improvement shown in the National Bank *Business Outlook*. While the recovery in sentiment was widespread it was more apparent across large firms. Disruptions from the Canterbury earthquakes were still evident. The QSBO suggests the NZ economy is likely to escape a technical recession in H2 2010, but more importantly the leading indicators suggest a modest base to growth for Q1 2011 of around 0.5 percent per quarter. **This is still somewhat anaemic and a "grumpy" pace of expansion, but not a bad core to start the year when you consider the one-offs that provide an additional fillip over the year** (earthquake reconstruction and Rugby World Cup).

However, such recovery is still from very low levels. It is far from suggesting the economy is off to the races. For one, expectations in terms of lead indicators need to be matched by reality in the hard data. Second, structural headwinds such as deleveraging remain, and while US data is improving, more concerns are emanating out of Europe and regarding China's inflation outlook and how it is to be reined in. That said, a low base to growth provides a better position to "springboard" from; though, of course, we need to be wary of focusing solely on growth (a change metric) and should not forget the level of activity.



Sources: ANZ, National Bank, Statistics NZ, NZIER

A quick look at other data outturns shows nothing to really alter our core prognosis of a bumpy 2011 but with a gradually improving tone. Rising commodity prices remain a crux of support to the economy. Given the magnitude of floods in Queensland, it's hard to imagine commodity prices turning down soon. However, the November fall in primary sector export values is a reminder that we have to produce the goods before we can sell them. Rainfall over the Christmas period may have relieved drought concerns, but not completely. After falling in October, the number of residential consents (excluding apartments) eased further in November. With the housing market subdued, we do not expect residential activity to strengthen until mid 2011. Non-residential consents spiked higher, but with tighter fiscal policy weighing on future infrastructure spending, signs of a more substantive construction sector recovery may not be evident until later in 2011. And of course retail (electronic card transactions) data for December matched anecdotes of weakness.

All-in-all, a continuation of the string of mixed data that paints a cloudy picture. We expect such schizophrenic outturns to remain for a while yet.

Topical and immediate as the 2011 outlook is, we'd encourage readers to focus on the bigger picture. Pages 4 to 14 detail our key macro themes for 2011

ECONOMIC OVERVIEW

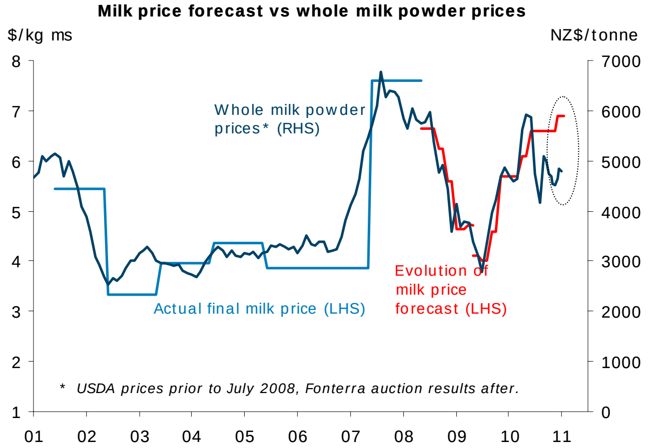
and they contain a mixture of offshore and local influences. **The bottom line is simple: we've turned the corner (albeit modestly) but it'd be heroic to say there won't be any setbacks.**

This week sees the release of key inflation data for Q4. The October rise in GST guaranteed a firm quarterly print, and we are in a similar ballpark to the 2.3 percent increase forecast in the December MPS. Going forward, the key will be the extent to which inflation one-offs from higher GST, and higher food and energy prices affect the medium-term trend for inflation. Locally you can start to see an interesting dynamic open up: commodity prices are providing a huge income boost but the diffusion to the general economy is being restrained by ongoing household and rural deleveraging. In the meantime higher energy and food prices siphon discretionary income!

December REINZ residential sales volumes are expected to show recovery from very low levels. The stand-off between buyers and sellers shows little sign of being resolved, which is limiting the fall in house prices, with prices still overvalued on most metrics.

The *globalDairyTrade* online auction for mid-January is expected to highlight the impact of supply-side concerns. We expect whole milk powder prices to firm to an average of US $3,800 per tonne.

Milk price forecast vs whole milk powder prices

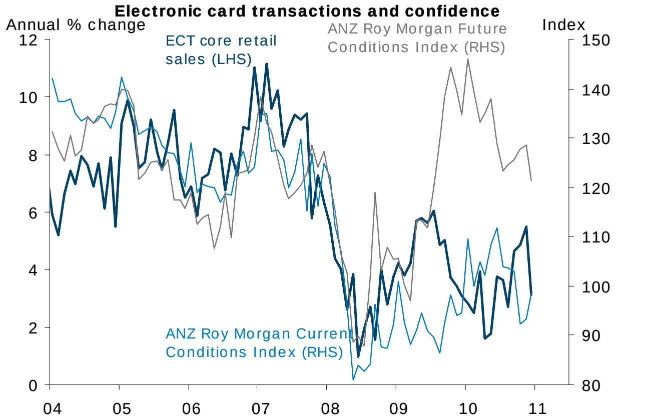


Sources: ANZ, National Bank, Fonterra, Bloomberg

The **ANZ-Roy Morgan Consumer Confidence** report for January will provide an early indication of the household mood. We'll be paying attention, not just because we help produce it, but because it is the first barometer of 2011. Most data we receive is still reporting on 2010, and to be honest, apart from the base effect, it doesn't really matter. Our attention is more squarely focused ahead and on leading as opposed to lagging data.

Retail sales data for November are anticipated to recover somewhat from the October post-GST slump. We expect a monthly increase of 1.2 percent, with the surge in motor vehicle registrations assumed to translate into higher motor vehicle sales. Core retail spending is anticipated to increase by 0.4 percent. The Electronic Card Transaction data showed retail and core retail sales contracting sharply in December, confirming anecdotes of a poor Christmas shopping season. Retail sales volumes are almost certain to have contracted in Q4.

Electronic card transactions and confidence



Sources: ANZ, National Bank, Statistics NZ

RECENT LOCAL DATA

- **SNZ Food Price Index – December**. Food Prices fell 0.8 percent (+4.2 percent y/y).
- **SNZ Merchandise Trade - November.** A monthly trade deficit of $186m was registered, with the annual trade surplus widening to $1.35b.
- **NZIER Quarterly Survey of Business Opinion – 2010Q.** Headline business confidence rose 11 points (to +3 s.a.). Both past and expected domestic trading activity improved (to -1 and +13 respectively s.a.). Investment intentions stabilised marginally above historical averages with expected employment intentions still positive.
- **SNZ Building Consents – November.** The number of residential consents rose 8.8 percent (s.a.), but fell 2.5 percent (s.a.) excluding apartments. The value of non-residential consents (s.a.) rose to $413m from $290m in October.
- **SNZ Electronic Card Transactions - December.** Retail-related electronic card transaction (ECT) spending fell 0.9 percent (s.a). Core ECT spending fell 1.6 percent (s.a.).
- **ANZ Commodity Price Index – December.** Commodity prices registered a 2 percent monthly increase (+23 percent y/y). In NZD terms, commodity prices rose 4.5 percent in December (16.1 percent y/y).

KEY MACRO THEMES FOR 2011

SUMMARY

In this article, we outline some of the key themes we see evolving over the year ahead that will play an influential role in New Zealand's economic prospects. While the economy is set to expand, we are not losing sight of the bigger picture. The economy still faces challenges that will cap the magnitude of growth over the next few years, as structural changes come to the fore.

One of our key aims in writing this article is to alert our readers to some of the wider economic forces at work, including the inherent tensions that exist within the economic system, and to encourage readers to start thinking about the implications for their own businesses. Ultimately, it is the average rate of growth over a number of years (and volatility around that) that matters, as opposed to what GDP growth will be in a single year. The repercussions of the global financial crisis will continue to be felt for years. Therefore, we would encourage our readers to think about the macro themes we outline below within a five-year time horizon. The themes are:

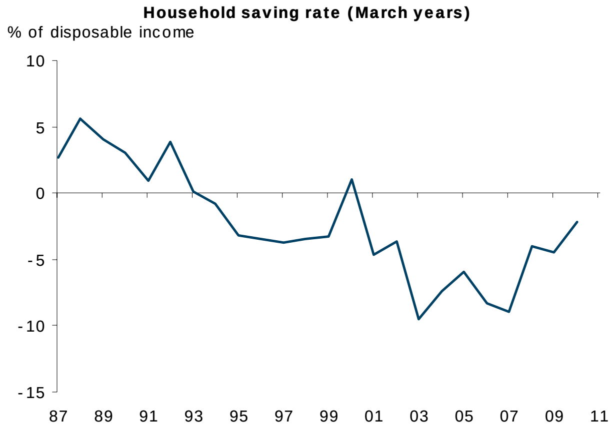
- **Deleveraging.**
- **"Grumpy" growth.**
- **Sovereign risk.**
- **Emerging market inflation.**
- **Demographics.**
- **The one-off factors.**
- **The rural land price outlook.**

From the outset, we should outline that our key baseline assumption is that the worst of the global economic and financial crisis has passed. However, the process of financial system repair is still ongoing and will take time. Banking malaise has been replaced by fiscal challenges with most governments now facing very tough decisions on the spending front. Significantly, we see the global economy embarking on not only a cyclical recovery, but also a period of structural change over 2011 and subsequent years. While the former will take priority as to when policymakers decide on the timing of their exit strategies from extraordinary stimulatory policies (in particular whether the unemployment rate has stopped rising), we must not lose sight of structural aspects to this cycle if we are to learn from lessons of the past. We see a lot of pending tensions between the cyclical and structural forces over the year ahead, as many of our themes highlight.

THEME 1: DELEVERAGING

2010 was dominated by a deleveraging headwind and we expect the same dynamic to be influential in 2011. This is being driven by a combination of factors, including:

- **Necessity**: NZ still has a weak national balance sheet and a housing centric one at that. Standard & Poor's has our sovereign rating on a negative outlook (as does Fitch). The after-effects of the Global Financial Crisis continue to linger. If you want to borrow it costs more, end of story. Relative price signals are shifting towards more export centric growth (though not completely when you see the high NZD/USD exchange rate). But it will take time for behaviour to respond.
- **Structural change**: A stronger regulatory breeze is blowing. The implementation of the core funding ratio for banks (requiring banks to diversify and lengthen the duration of funding and reduce reliance on offshore funding) has fundamentally altered the shape of the retail borrowing (and deposit) curve. The core funding ratio will also act as a constraint on the eventual upswing. The impact of Kiwisaver is being underestimated. Total Kiwisaver funds now stand at $7.1 billion – some will have come from redirected savings but a fair chunk seems new. It's still growing. Encouraging savings is the blueprint for the *2011 Budget*.



- **Behavioural shifts**: Are we seeing a cautious response by households to a cyclical downturn or a more fundamental structural change? We are increasingly leaning towards the latter. Whilst far from across the board – there is still a portion of society wanting to go back to 2007 type behaviour, we're seeing progressive shifts in savings behaviour. The nature of this shift we are witnessing is somewhat generational in that it will take time to generate critical mass.

New Zealand has made considerable progress towards "deleveraging". The household savings rate has improved markedly. The current account deficit has fallen to 3.1 percent of GDP and total net external liabilities (as a share of GDP) has fallen from 90 to 85 percent. We are generating record merchandise trade surpluses. Credit growth across the economy was anaemic through 2010. The rural sector balance sheet is improving, largely courtesy of booming commodity prices.

But, the piper has not yet been paid. While encouraging in change terms, the levels of key structural economic barometers still remain disconcerting. The household savings rate is still negative (though we suspect it may have turned marginally positive in the December 2010 quarter). Total net external debt is similar to levels reported by an array of European nations that feature high in our sovereign risk ranking (refer page 8) – not exactly illustrious company to keep though we have a far stronger fiscal position! Commodity prices are booming but weakness in production owing to harsher climatic conditions has taken away the cream. Rural sector debt is still $48 billion, and benchmarks such as the ratio of debt to commodity prices suggest a way to go.

Such dynamics are part of the wider rebalancing process for the economy as we shift from being a spending centric society to one that has greater backbone. **We seek the holy grail of economics; balanced growth, a dynamic New Zealand last saw in a sustained fashion in the late 60s/early 70s.**

Global forces are also critical here. There is only so much NZ can do alone. Policymakers, in making changes to the depreciation regime for housing and other regulatory changes, are certainly providing different incentives locally. However, we are still subject to global forces. The ability of the economy to deleverage (via the nominal income and serviceability channel as opposed to physical debt repayment) is being greatly assisted by strong commodity prices, which is critically dependent on the Asia growth story. The global economy remains somewhat lopsided, with spending-centric growth in the West and savings / investment-centric growth in the East. Redressing such global imbalances is complementary to New Zealand's savings imbalance: if excess surpluses are being created in one part of the world, they will surely be channelled somewhere where they hold the prospect of generating the highest risk-related return. Yes, NZ alone can make progress addressing our own internal issues, but global forces need to be supportive.

This leaves NZ.Inc the two-bit player at the international roulette table watching tensions between the likes of China and the US. Sensible heads are required. The risk is greater protectionist style policies, particularly if we see a wave of populism, not just in response to trade tensions, but also as a result of fiscal consolidation.

The deleveraging headwind will not be as intense as in 2010 – and will ease as 2011 progresses, but will remain a structural challenge for the economy. This means it will be a hard-luck story if you are involved in retailing or housing but insofar as the economy is concerned looking at the five-year picture, it's precisely what we need to see. **A sustained improvement in structural barometers is a pre-requisite to a full-blown recovery taking hold. We are making progress but we are not there yet.**

THEME 2: GRUMPY GROWTH - THE NEW TREND

Economists and politicians tend to focus on demand. It's easier to see and influence than supply. Unfortunately it is the supply side of the economy – what rate we can grow at in a sustainable fashion without generating the speed wobbles and volatility around that trend-that ultimately matters for our living standards.

Last year we identified five stages in the current economic cycle and they still apply. The **first stage was the "old normal"**, the 2002 (or even as far back as the early 1990s) to 2007 period, where growth was driven by excessive borrowing and risk-taking. This led to asset price bubbles and **unsustainably high wealth-induced spending.** Ironically, the 1990's-2007 period was also referred to as the great moderation in recognition of the period of relative economic stability. **Stage 2 over 2008 and 2009 saw the inevitable purging** that followed such excesses. The great moderation was nothing of the sort. **Stage 3 is the healing or recovery process** that we saw in late 2009 and first six months of 2010, helped by aggressive policy action and an inventory rebuild.

The economy entered stage 4 – which we call transition, around the middle of 2010. We call it transition because normal pro-cyclical forces and drivers of the business cycle such as consumer spending failed to kick-on and take the inventory rebuild into something of substance. **This entails a period of stuttering and "grumpy" growth.**

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The economy is expected to remain in the transition stage for a number of years. Transition will involve a number of dynamics, including:

- **A capped rate of growth as a leveraging (borrowing) tailwind is replaced by a deleveraging headwind.** Real NZ economic growth averaged around 3.5 percent per year between 1992 and 2007. But of that some 0.5-0.75 percent per year was borrowed from the future via channels such as artificially inflated asset values, the wealth effect from rising asset prices, a credit accelerator and associated borrowing where rising asset prices supported more borrowing….and so on. This dynamic is now working in reverse.
- **The re-mobilisation of resources including labour and capital across sectors as a spending-centric model is replaced by more balanced growth.** Across the economy resources need to shift from demand-based sectors to supply-based ones; from retail to farms; from building houses to building factories. But redundant Auckland beauticians are unlikely to want to start milking cows in Southland next week. And an empty CBD clothes shop can't be converted into a food manufacturing plant. Shifting resources around the economy is slow and costly. Changes to the tertiary education system today will take years to manifest in supply-side outcomes. There are no obvious short-cuts, but market signals will see resources move where they are most needed (and hence rewarded) in time.
- **Taking the patient off life support, or the so-called "exit strategies" for monetary and fiscal policy.** Sustained fiscal deficits and low interest rates are untenable. We already saw one bout in 2010 where the market looked for interest rates to move up but this helped choke off the recovery process. Markets are playing a game of "chicken and egg" where low interest rates are needed to support valuations (i.e. equities) but if the equity market is correct about the economy then interest rates should be moving up. It's a tall order to imagine policymakers getting such strategies exactly right, so brace for more volatility ahead, around a lower trend growth rate. The process of fiscal consolidation fundamentally takes more money out of households' pockets than what it gives back via spending and will create a further headwind. A good year will be followed by a poor one. We are not talking booms to busts, but rather a period of sustained grumpy growth: there will be growth, but not at the rates we've become accustomed to, and we'll be working a lot harder to get it. Time is the only true healer.
- **Introducing structural changes** to prevent a repeat of the financial crisis, but also to improve long-run economic performance. The 2010 *Budget* was a step in the right direction. The next five years could be defining in New Zealand's history, and true strategic foresight and vision is required. The challenge here will be the lure of populism. Globally, populism is a worrying trend, as it risks economic reality being forsaken for political expediency. Think back to NZ in the early 1990's and the backlash against the "Mother of all Budgets". Multiply this by perhaps a factor of 3 and you will get an idea the potential for public revolt to fiscal consolidation in a host of countries around the globe.

Current weak business investment is also a concern, as it will slow down the necessary transition. Investment is usually one of the first growth components out of the blocks in a recovery. Investment today provides the production capacity and productivity growth for tomorrow. What is holding it back? While interest rates are low, investment is driven by confidence in future prospects, and the availability of credit. And both of these factors are still in headwind territory. That said, we believe the worm has turned, and expect a rebound in investment from the middle of this year. However, it will take time for this to enhance New Zealand's productivity and productive capacity. In the meantime we believe sustainable growth in the economy is currently only around 2 to 2.5 percent a year.

The speed of growth during the transition phase will differ by country. Dynamics such as population and productivity will of course be influential, but two other metrics are worthy of note. The first is the national balance sheet – how indebted the nation is. The weaker the balance sheet, the greater the deleveraging headwind holding back near-term growth. NZ is somewhat saddled here by our sins of the past. The second is your natural endowment: things like corporate culture, productivity trends and resource base – does the country provide products the global economy wants? NZ looks solid on the second category (we believe food prices are on a structural uptrend), but weak on the first, with a dismal productivity growth record to boot. But other developed nations such as the UK look weak on both fronts, so things could be worse. The resource base is largely a given, so the challenge for NZ now is to work harder and smarter to exploit what looks to be some remarkable opportunities in

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the future. Thankfully, commodity prices look to have shifted to a higher plane, so the hard work for NZ.Inc is not simply about working smarter, its about getting (and exploiting) a better relative price via our terms of trade. But this will take time, for it involves considerable cultural shifts.

THEME 3: SOVEREIGN RISK

The first leg of global repair process in regard to the Global Financial Crisis centred on liquidity. Swift action via interest rate cuts, quantitative easing (not once but twice), fiscal policy support, various guarantees etc averted Armageddon and stabilised the banking system, a precursor to economic healing. **But such action (and an effective shift in terms of whose balance sheet the debt was domiciled) has not come risk free or without challenge, nor has it addressed the issue of solvency in a number of areas.** Particular attention is now being drawn to various sovereigns and the sustainability of policy settings. Regardless of where the debt is domiciled, ultimately the healing process still requires a sustained period of deleveraging, with attention now centring on government debt.

Although many countries have taken steps to address their debt problems, overall debt levels remain unsustainably high. Addressing the issue can be achieved via three broad options.

- Option A: Aggressive fiscal restraint.
- Option B: Someone (i.e. bondholders) takes a haircut; or
- Option C: Grow or inflate your way out.

All options contain pitfalls or difficulties. Option A is politically difficult (i.e. selling cuts in government spending to the electorate) and risks creating a deeper downturn. Option B risks further destabilising markets and the banking sector. Option C seems politically appealing, but has long term consequences, and would undo much of the good work of the last 20 years. The bottom line – there is no silver bullet. Worse still, all options create an environment conducive to populism and self interest as opposed to the wider interest.

The problem is, it’s not just the so-called PIGS that have high levels of government debt, so too do the major economies. In fact, **every single G7 government carries debt in excess of 70 percent of GDP**, and many have ageing populations. Big countries are being given the benefit of the doubt for now, but markets are less tolerant of small peripheral countries, as we have seen in Europe.

With refinancing requirements in Europe increasing over 2011, the focus on sovereign debt is only going to intensify. We estimate that Eurozone governments need to refinance in the order of €560bn of debt in 2011, the most since the inception of the euro, and around 10 percent more than the 2010 total. The true figure could be close to a trillion. **Although New Zealand seems to be well insulated from what is going on in Europe, markets are flexing their muscles. Our sovereign debt levels are low by comparison, but we have significant offsets such as high total external debt.** Like the Europeans, the NZ government faces a funding task, with the government slated to raise $13.5bn of bonds over the next two years. This is achievable – indeed, the government raised $13.45bn over 2010. But the point is, there’s no let up in the pace of issuance, leaving no room for complacency. Bottom line is that the balance of power now resides with the investors and savers: if you want to borrow, there will be a cost, so we see credit spreads remaining wide and the market will remain very discerning in regard to pending sovereign risk factors.

We derive a proxy for sovereign risk by looking at a mixture of negative (i.e. debt metrics) and favourable characteristics (i.e. economic flexibility) by country. We collected comparable statistics across 38 countries, where possible from the same source. Datasets are then categorised as “unfavourable” and “favourable”. **The unfavourable datasets we examined included the level of government debt, the budget deficit, external debt, current account balance and the unemployment rate – things that markets worry about.**

Favourable datasets included things like GDP per capita, population, a qualitative measure of economic freedom, and exchange rate regime – things that afford governments a degree of flexibility, acting as an offset to unfavourable characteristics. Once characterised, each dataset is then standardised and weighted.

Negative unfavourable scores are added to positive favourable scores to arrive at an overall vulnerability score, with the most vulnerable countries having the lowest (generally negative) overall scores.

The table overleaf summarises the results. Nations are ranked according to the overall score, which is the net of the unfavourable and favourable numbers. The unfavourable ranking is ranked best to poorest,

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so a low rank is bad. A high rank is good on the favourable column.

Country	Overall Score	Overall Rank	Unfav. Rank	Fav. Rank
Norway	41.1%	1	38	2
Switzerland	24.7%	2	28	1
Australia	20.7%	3	27	5
Denmark	16.5%	4	24	3
Singapore	16.3%	5	32	15
Taiwan	10.4%	6	37	26
Canada	10.4%	7	20	6
Sweden	10.3%	8	22	8
New Zealand	**9.3%**	**9**	**21**	**9**
Luxembourg	9.1%	10	18	7
Japan	5.3%	11	16	10
United States	4.2%	12	9	4
Hong Kong	3.5%	13	30	22
Czech Republic	0.7%	14	26	19
China	-0.3%	15	35	31
Finland	-3.1%	16	15	13
Germany	-3.4%	17	23	18
Korea	-5.8%	18	33	34
Austria	-7.2%	19	14	16
Malaysia	-7.8%	20	36	36
Poland	-9.3%	21	19	21
Netherlands	-9.9%	22	13	17
Thailand	-10.6%	23	34	37
United Kingdom	-11.7%	24	5	11
India	-15.5%	25	17	29
Philippines	-16.6%	26	29	35
Iceland	-16.8%	27	6	14
Hungary	-17.7%	28	11	24
Indonesia	-20.1%	29	31	38
Italy	-20.5%	30	10	27
Vietnam	-20.8%	31	25	33
Belgium	-22.6%	32	7	20
Slovak Republic	-22.8%	33	12	30
France	-24.6%	34	8	23
Ireland	-30.5%	35	1	12
Spain	-36.3%	36	2	25
Portugal	-36.5%	37	4	28
Greece	-47.4%	38	3	32

A couple of clear trends are notable.

- **Europe dominates the problem end** of the scale. This leaves us with a negative bent towards the EUR/USD over the coming year.
- **The US and UK rank poorly on the unfavourable column, but are somewhat rescued by favourable characteristics.** This does not eliminate the issues, rather gives them more time to work them out.
- **If you're going to go on a borrowing spree, you better have something going for you. Italy, for example has much higher debt than Portugal, but it's a member of the G7, being bigger, richer, and more developed**. This is precisely why (for now at least) the world's largest borrower – Uncle Sam – whose 2009 Budget deficit was larger than Australia's GDP – is able to continue borrowing, even in the current environment.
- **NZ is reasonably placed.** It ranks mid table for unfavourable characteristics but has an above average ranking for favourable characteristics. Of course we can't be complacent. We have positive offsets, but these tend to be qualitative (floating exchange rate, political stability). **When it comes to hard core offsets, we rank low in the income stakes, and are a tiny country. And because we can't do much to change these offsets, we need to focus on keeping the negatives to a minimum**. Put simply, this means borrowing less, putting government spending in a virtual straightjacket. Furthermore, the lack of fiscal headroom in turn puts less pressure on monetary policy (less need to raise rates).

The final conclusion from our analysis is that the sovereign debt crisis is far from over. Our cross country peer analysis doesn't show it, but the base data does. For example, **overall government debt fell by just 1 percent on average across the 38 countries we surveyed, and with the exception of Iceland and Hungary, the only countries that cut their overall debt by more than 10 percent were those that had debt of less than 50 percent of GDP in the first place**. Indeed, of the countries with debt of 50 percent of GDP or more, Italy and Portugal improved the most, but they only managed to cut debt by 8 and 5 percent respectively. But that still leaves overall debt to GDP at 116 and 81 percent respectively – hardly something to be proud of. Similarly, budget deficits fell by just 0.4 percent of GDP on average, and unemployment fell by just 0.1 percent on average. **The bottom line: things are hardly on the mend in a meaningful way.**

THEME 4: EMERGING MARKET INFLATION

New Zealand has been quick to exploit the opportunities provided by the rise of emerging Asia. Demand from these countries has been a key driver of higher prices for the food we sell. But the flip side of new opportunities is new vulnerabilities: our economic fortunes are now more closely tied to this region than ever before. And **while their long-term growth trajectory looks good, the next**

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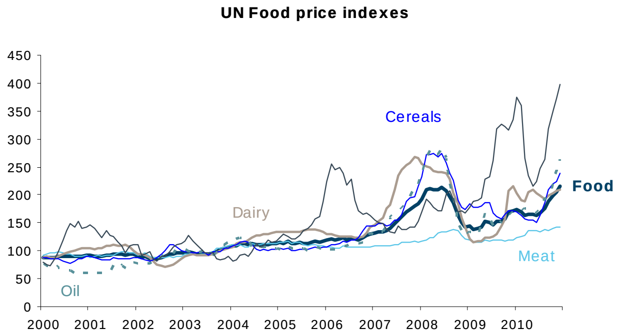
year or two could be challenging, potentially causing volatility in the NZ economic cycle as well.

Inflation across emerging markets, particularly in China, could be one of the big global economic stories of 2011. Food prices are increasing sharply, due to negative supply shocks hitting a background of structurally increasing demand.

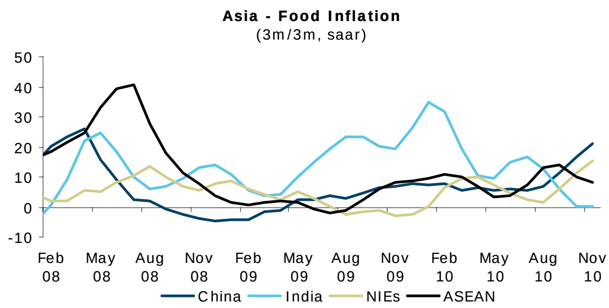


Source: UN Food and Agriculture Organization

But there is more than just that going on, with ex-food inflation also picking up in recent months across emerging economies.

For a timely measure of what is happening with emerging market inflation it is useful to look at "momentum", annualised inflation over the past three months, rather than annual inflation. There are two key messages that jump out from these charts:

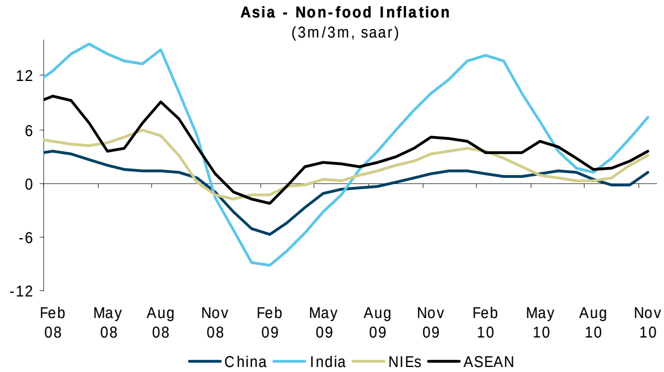
- **Food price inflation across EM Asia, outside of India, is rising. In China it's rising fast**, even though disruptions to food supplies have been much smaller than in 2008.



Sources: CIEC, ANZ Asia Economics. NIEs: Hong Kong, South Korea, Taiwan, Singapore. ASEAN: Indonesia, Malaysia, The Philippines, Thailand, Vietnam.

- **Non-food inflation is picking up across emerging Asia.** China's non-food inflation may look benign so far, but watch this space. The seasonally adjusted annualised rate (saar) of housing-related inflation was over 20 percent in November. Household inflation expectations are at their highest in over a decade.

Is inflation likely to get out of control? Most Asian central banks were quick to raise interest rates, as the region rebounded from the global financial crisis. The marked exception has been China. Increasing interest rates in China would place more upward pressure on the Renminbi. But something must be done: high inflation would be a big political problem in China, with its poor hit hard by food price rises, and individuals' savings vulnerable. So the authorities have been trying second-best alternatives (reserve ratios, lending targets, price controls, releasing food stockpiles, cracking down on speculators, new taxes), but with limited success. To quote Milton Friedman, "inflation is always and everywhere a monetary phenomenon", and China's money supply has increased by more than 50 percent in the past two years. Real interest rates have plummeted. Without vigorous conventional anti-inflationary measures, prices in China are therefore likely to rise by more than in other emerging markets.



Sources: CIEC, ANZ Asia Economics

What are the key risks going forward? Inflation in China won't necessarily harm the rest of the world too much: a smaller trade surplus resulting from reduced competitiveness may even help its manufacturing rivals. But what is a major risk is that tackling inflation will bring about a nasty crunch, as policymakers have painted themselves into a corner with the combination of a policy-induced massive surge in bank lending over the past two years, and their exchange rate policy. Higher interest rates would imply ever more desperate exchange rate intervention. Bad debts could skyrocket. The real-estate bubble could pop. China's stimulus package was particularly blunt and appears to have led to a huge misallocation of resources. Such experiments seldom end well. A deep Chinese recession would be much more painful than a bit of inflation, not only for China but for the global economy.

China faces its own idiosyncratic dilemma, but

KEY MACRO THEMES FOR 2011

inflation across emerging markets as a whole is likely to be a feature of 2011. And even if governments have the full range of policy tools at their disposal and are willing to use them, battling inflation is just not growth friendly. Brace for a bumpy ride.

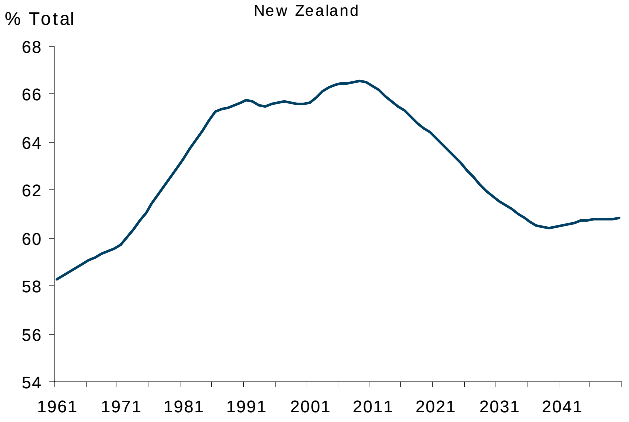
The secular trend for commodity prices and outlook for NZ.Inc still looks positive. But the laws of economics have not been repealed. Unfettered rises in commodity prices carry with them the emergence of associated imbalances such as inflation. In a perfect world we'd see more orderly shifts in things such as commodity prices. Alas, the world (and markets) is far from orderly. This will create tremendous challenges for the business cycle, across Asia in particular. For NZ this means accepting the opportunities but not overlooking the associated risks that comes with a rising exposure and dependence.

THEME 5: DEMOGRAPHICS

The population structure is aging. New Zealand's resident population is projected to increase by nearly one quarter to more than 5 million persons by 2050. The number of persons aged 65 and over is projected to double (to 1.2 million). While there are considerable country differences, this shift is also evident in most other OECD countries and some of the developing world.

New Zealand is generally well placed compared to our trading partners. The world's population is expected to increase by nearly one-third by 2050, underpinning the importance of food production. This will bring opportunity to the likes of New Zealand. The age structure of our population is also generally lower than the OECD norm, with a higher share of under 35s.

Population aged 15-64
New Zealand



Sources: ANZ, National Bank, Statistics NZ

But our working age population (persons aged 15-64) is still projected to shrink in relation to the total resident population until stabilising from about 2030. This means fewer people will be working to support those not working. Or put another way, NZ is currently close to a demographic "sweet spot" and things will only get more challenging from here. Actually, the sweet spot was passed about five years ago! Ironically, this sweet spot has occurred during a period of rising household and external indebtedness.

When thinking about the implications there are a number of different angles including:

- **The fiscal cost.** Government spending per person is typically twice as high for a person aged over 65. The first of the baby boom generation are soon eligible for National Superannuation, and health expenditures are typically higher for this cohort. A narrower tax base will squeeze revenue, but raising taxation on income is not a viable option given increasing global competition for workers. The fiscal burden also emphasises the importance of households having to make more provision for retirement saving.
- **A lower labour share of population**. Annual percentage increases in our working age population are above one-third of the increase in total population over the next 20 years. Increasing our GDP per capita will mean working smarter with the available labour that we have.
- **The impact on spending patterns.** Baby-boomers were the major beneficiaries of the pre-GFC asset price boom and their balance sheets generally remain sound. With this generation less frugal than their Depression-influenced parents, there is a temptation to cash in on this wealth, and spend the kids' inheritance.
- **The intergenerational wealth transfer.** As they near retirement, baby boomers will be looking to convert their assets into income. Unless asset values (we are thinking mostly housing and rural land) return to more "normal" levels in relation to income and their income generating capacity, buyers will be forced to fund more of the retirement plans for their elder peers. Something has to give.
- **The transfer of knowledge.** High rural land prices have complicated succession planning, with the risk of the vast store of rural expertise being lost. Succession for huge parts of the economy is a hidden issue.

All are worthy topics but we've chosen to take a window of opportunity angle. The reasoning is simple. Theme 1 highlighted the economic imperative regarding getting our national balance sheet in order. At the same time NZ appears to be sitting on the pot of gold at the end of the rainbow in terms of our natural endowment and structural changes in global trading patterns (read: the growing importance of Asia).

Demographics in effect put a time limit on that process of change. We have a choice. Act early to improve our national savings and get external debt under control when we are relatively young, or choose to do nothing and face a heftier bill when you are less able to afford it. Of course, demographic issues could be mitigated by people working longer, immigration policies, and changes to the superannuation regime (though ruled out at present, it seems inevitable). But such tweaks do not change the basic philosophy behind what needs to happen: supporting a different demographic structure requires (a) balance sheet weakness to be addressed and (b) money squirreled away (both fiscally and by households). Neither will be achieved in a low growth environment. Speed, as opposed to complacency, is of the essence. **A failure to act decisively today will only magnify the intensity of what is likely to be tougher decisions in the future.**

THEME 6: ONE-OFF FACTORS

Our view of a stronger 2011 is based on a number of favourable tailwinds that will replace some of the "niggle" factors that weighed down economic activity over 2010. This is amidst a 5-year transition period of lower trend growth as savings are rebuilt and resources are shifted towards the income generating part of the economy from the spending side.

Earthquake Related Reconstruction

The September 4 magnitude 7.1 Canterbury earthquake and subsequent aftershocks caused widespread economic disruption to the region in 2010. The destruction of housing and productive capital stock caused around $5bn (2.5 percent of GDP) worth of damage, some of which will not be recouped by insurance.

However, **earthquake related construction spending is estimated to add around $4 to $5bn to GDP over the next two to three years.** We estimate about half of this will occur over 2011, particularly over the second half of the year. With a large degree of spare capacity and no immediate need to rebuild, reconstruction work could be more drawn out.

% GDP Impacts	2010	2011	2012+
Tourism	-0.1%	-	-
Balance sheet and higher premiums	-0.2%	-0.2%	-0.2%
Immediate disruptions	-0.2%	-	-
Confidence	-	-	-
Rebuilding	+	+1.25%	+1.25%
Impact	-0.5%	1%+	1%+

Sources: ANZ, National Bank, NZIER, RBNZ, Statistics NZ.

Rugby World Cup

This is big bikkies. **The Rugby World Cup is the third largest sporting event in the world in terms of cumulative television audience and attendance.** It will be the largest grossing event in New Zealand's history, with around 85,000 international visitors expected.

It dwarfs the 2005 Lions tour on most metrics, with ticket sales from the 2011 Rugby World Cup (RWC) expected to generate $270m in revenue compared to $24m in the 2005 event.

Key metrics	RWC 2011	Lions 2005
Duration – days	45	35
Overseas visitors (000)	85	20
Matches	48	11
Tourism earnings ($m)	$400-$500	$130
Ticket sales (m)	1.45	
Estimated Impact (% GDP)	+1.0%	+0.5%

Sources: ANZ, National Bank, Tourism NZ.

After closely examining the impact of major sporting events overseas, including the 2003 Rugby World Cup, we estimate that the 2011 RWC will boost GDP over the second half of 2011 by approximately one percentage point:

- **Tourism earnings from the event are likely to be equivalent to 0.2 percent of GDP.** There are quite sizeable multiplier impacts, with the total impact about three times that. Firms servicing the tourism sector, notably in accommodation, hospitality and retail, are expected to benefit. It will provide a significant boost to a sector that has borne the brunt of the GFC.

- **After having not much to cheer about, New Zealand households are also likely to come to the party.** There is a strong "feel-good" element to spending, and this is likely to be in abundance if the All Blacks are looking good.

There will inevitably be over-crowding at certain venues. However, as the 2011 RWC is occurring during the off peak tourism season (September 9-October 23), the hospitality industry will be well placed to cope with the influx of visitors.

Experience from similar events overseas also shows that some overseas visitors attending major events have stayed after the event. The international media coverage will also provide useful publicity.

Whilst the key final matches are in Auckland, the pool matches will be widely distributed across 13 centres, ensuring the benefits are more geographically distributed. Many overseas visitors will use the opportunity to travel around.

The Upshot

Collectively these two one-offs are expected to add around 2 percentage points to GDP in 2011, with most of this concentrated in the second half of the year. Abstracting from those factors, underlying growth for the 2011 year will be 2-3 percent, an extremely modest rate for this point in the cycle but one we would expect for an economy in transition mode.

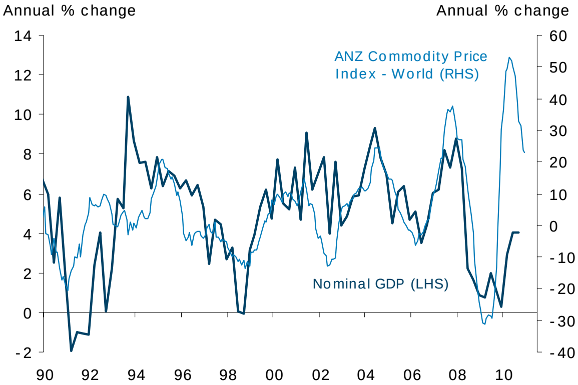
THEME 7: RURAL LAND PRICE OUTLOOK

Commodity prices have gone through the roof. Typically, the attention has tended to focus on the hard commodity basket such as what Australia produces, but what has become clear over the past year has been a broadening in the commodity price story to include softs. The ANZ commodity price index for New Zealand's major exports is showing a 23 percent increase year-on-year, with meat and wool leading the way, followed by the likes of seafood, forestry and dairy.

Strong La Nina weather conditions since the middle of 2010 have caused disruptions and reduced yields for key crops in large producing countries such as Russia, the US and Australia. This is rippling through the grain markets and into other agricultural markets such as dairy production in the EU and US. While weather conditions and various supply issues have been influential, the main longer-term driver resides in strong Asian growth and associated demand for protein. Of course, commodity prices have a tendency to push beyond that justified by such dynamics and we suspect the current bout is no different. Case in point is this has now started to feed into food price inflation in many emerging countries, especially China. As noted in Theme 5, how this is tackled could cause a few ups and downs during 2011. But what is equally clear when you eye things like water issues in China, income and population growth is that the forward-looking 20 year trend for commodity prices will be the reciprocal of the past 30. That is up, not down.

Normally high commodity prices would be flagging a NZ economy that should be off to the races, particularly when you eye the traditional relationship with GDP. Of the 80 largest economies in the world, New Zealand has by far the largest food exports as a share of its economy, at around 7½ percent. Only Uruguay and Argentina come remotely close. And as a relatively rich country, food makes up less than 20 percent of household budgets on average, meaning the income effect dominates. Assuming our own paddocks are not too badly effected by the weather extreme (admittedly a big question), New Zealand stands to do quite nicely.

Nominal GDP vs Commodity Prices



Sources: ANZ, National Bank, Statistics NZ

New Zealand's terms of trade – a barometer of the net economic impact of price changes - is up 20 percent on a year ago. Looking at NZ's historical economic performance a 1 percent shift in the terms of trade has typically been associated with a 0.15 shift in GDP. (NB: the downtrend trend in our terms of trade from 1960 to 1990 meant this channel was negative!). A 20 percent lift and the historical relationship foretells of some pipeline growth. There is normally a lag of around 9 months but what is clear at present is that the relationship has not followed the historical pattern. This raises important questions. Has the relationship broken down, or has something fundamental changed relating to the lag structure? We are more inclined towards the latter.

Why? Well, the diffusion of this economic boost is being seriously curtailed by weakness in rural land prices, which are down 25-30 percent over the last two years. We won't go into the reasons but suffice to say an asset bubble has popped. A credit (and capitalised) accelerator has now turned into a credit decelerator. The greater the pressure on asset values, the more attention shifts to recapitalisation, which diverts spending from the general economy. This is not to say the commodity price story is wrong, but merely that land values advanced far to far in front of it. **Until farm values stabilise and improve we doubt we'll see the diffusion of the terms of trade and commodity prices boost into the general economy.**

Looking at farm values at present relative to the underlying returns suggests we shouldn't be too far off a floor for the likes of dairy, with sheep and beef heading in the right direction.

However, the situation in regard to farm values is complicated by more than simply valuation metrics such as cash-flow, interest rates and investment returns. There are a number of other factors to consider, such as:

- **An asset bubble is unwinding.** Rural land values tripled between 2000 and 2008, increasing from $5,000 to $15,600 per hectare. Credit played a major role, with rural sector debt rising from $11.8 to $42.3 billion (+360 percent). Unfortunately, agricultural returns did not keep up with the scorching pace that was set by credit growth, and farmers' balance sheets got out of whack. During this period the average rate of return for the average sheep and beef farmer declined from 3-5 to 0-½ percent. Dairy returns were on a higher plane but also decreased from an average of 8-10 to 2 percent. Bubbles and busts are non-linear - they tend to extend further in either direction. It takes time for confidence across lenders, borrowers, buyers and sellers to be restored. History suggests that past downturns in rural land values have taken five plus years to recover to their previous peak, we expect this event to be no different.
- **There are microeconomic challenges in the wings.** One notable issue is the demographic structure of the farming community with the average age of the farm owner increasing from 46 in the early 1990's to 54 currently. While this is not dissimilar to many other developed economics, it creates a large number of tensions and issues. These include such things as succession, especially when large sums are involved; appetite for pushing the boat out; labour productivity, with a trade off between experience versus physical skill sets; and the list goes on.
- **There are niggle factors at work such as changes to the foreign investment regime and it's election year**. The risk is that irrational xenophobia becomes an election football. Lacking a sizeable pool of domestic savings you immediately leave a gap in the market in terms of natural buyers. This is not to say the tightened investment regime is bad, rather commonsense needs to prevail. If you are going to tighten foreign ownership rules counter it with greater local savings incentives.
- **Mother Nature keeps playing a key part as always, adversely affecting meat and dairy production over the last three plus years.** It is difficult to make money when production outputs are limited even when prices are high. The 2010/11 season looks badly affected for the sheep industry with total lamb production forecast to decline 7 percent to 19.5 million head, the first time below 20 million head and lowest level ever recorded. Overall New Zealand dairy production should be growing at 5+ percent per year, with the improvements in output per cow and the number of new dairy farms and additional cows added over the last four years. However, 2010/11 year-to-date production is a measly 0.5 percent ahead of last year, hampered by early and widespread dry conditions in the North Island and parts of the South Island.
- **Costs continue to track up inline with strong commodity prices, crimping margins at the farm gate.** On-farm input costs have risen 35-38 percent over the last 10 years, or annualised 3.5 percent, well above the Reserve Bank's inflation target of 1-3 percent. The accumulation of these cost increases led to a cost-price squeeze during the 2007-2009 period. While in the longer-term New Zealand's pasture production system will have a lower cost base over the more intensive systems offshore, in the short-term it prolongs the time before farmer returns normalise and confidence picks-up. Longer-term it also reduces productivity as farmers cut the likes of repairs and maintenance and fertiliser to manage cash-flow which impacts on longer-term production. This can be seen in the sheep and beef sector where

farmers have capped fertiliser expenditure in order to manage costs. As the price of fertiliser has risen by 75 percent since 2000 and total fertiliser expenditure has been held constant at $55 per hectare, the volume has dropped below maintenance to 100 kilograms per hectare.

- **Industry uncertainty beyond the farm-gate** remains in a number of areas. This is particularly the case for the meat and wool industries who still occupy 78 percent of the pastoral land area in New Zealand. Ironically, the more stress on the market in the interim the greater the appetite for change.
- **Regulatory changes** with alterations to the Resource Management Act, water policy, walking access, traceability, biosecurity and animal welfare, to name a few. In addition, let us not forget the introduction of the Emissions Trading Scheme and the inclusion of livestock emissions in 2015, with all these changes weighing on business certainty in one way or another.

What and when is the turning point?

The normal lag between strong commodity prices flowing into the general economy is around 6 to 12 months. It looks a tall order for things to come together in 2011 and the rural cheque-book to suddenly open.

While there is the need for some resolution or improvement in all the factors listed above, in the short-term there are the fundamental investment basics in farmland to align. Here there are two schools of thought about where the bottom in land values might be, governed by different approaches to investing. One is based on comparative yields for investments and the different risk/return/effort profile to gain the return. This is starting to look favourable at the current commodity and interest rate prices and for those who did not accumulate too much debt over the last 10 years.

The other is return on capital, which is governed by the same principles, but the investor usually has a longer time horizon in mind. This is based both on the ability to invest and change the land use, which changes the return and capital value of the land but also the scarcity of land argument, when a longer time horizon is considered. **These dynamics provide a natural floor for land values and history suggests that on average this floor is 20-30 percent down from the peak.** On this basis the market may well be troughing already, although given the other factors listed above and backlog of farms on the market at present, this looks a stretch.

For now, we expect the Mexican stand-off between buyers and sellers to continue into the spring this year, as de-leveraging occurs and farmers focus on catch-up maintenance rather than splashing out on the next door neighbour's property. Weather and pasture conditions and talk of restrictions on foreign ownership are also not helping the market and will only lengthen the time before the market stabilises.

To end the stand-off and see land values increase will require sustained high commodity prices over several years, low interest rates, with a pinch of good weather to lift production and confidence. At present this looks a 2012 story, all things going to plan.

INTEREST RATE STRATEGY

SUMMARY

Short end interest rates declined steadily over the holiday period, taking the 2yr-10yr swap curve to its steepest point in over a year. However, almost like clockwork, that all changed early last week as traders returned from holidays, with a generally long market confronted by slightly stronger data. A strong post-flood rally in Australian bonds contributed to the squeeze, with steepeners being unwound contributing to short end paying. Given the cautious tone of the economy, we expect markets to normalise as we head into next week's RBNZ OCR Review.

MARKET THEMES

- Stop loss paying at the short end remains the dominant flow/theme. But will it last?
- With the RBNZ on the sidelines for much of the year (reminiscent of last year), roll and carry will be major drivers of investment.
- Demand for NZGS bonds at last week's tender was extremely strong. But the government's funding requirement is large too, providing something of an offset.

REVIEW AND OUTLOOK

Interest rates started the year on the back foot, with the 2yr rate at its highest level since late November. Although the rebound in NZIER business confidence was not unexpected given improvements seen in NBNZ Business Confidence, in the event the release triggered stop loss selling by investors motivated by carry over the holidays. This is a typical seasonal pattern, and just as things got overly stretched to the downside, they are now stretched to the upside. Looking ahead, given the benign monetary policy outlook, roll and carry will be influential in shaping trading ranges for 2011, as they were in 2010.

Demand for NZGS bonds has been significant over the past year, enabling the government to sell $13.45bn bonds in calendar 2010, a feat that would once have seemed eye-wateringly impossible. Judging by the success of last week's bond tender, demand remains strong, with the tender attracting bid cover of 2.27 times, despite a record-breaking $950m of bonds on offer. Given the Government's significant funding requirement, these conditions are undoubtedly a boon, particularly given ongoing sovereign credit concerns in Europe (see theme 3). However, unlike in the past, good demand for bonds is unlikely to see swap spreads move back into positive territory. This is because we expect bond demand to be completely satiated by the DMO, thereby offsetting demand. Furthermore, rising food and energy prices have the potential to drive a wedge between the swap and bond markets, with bond investors worried about high headline inflation, and monetary policy expectations (and the swap market) worried about a more moderate tightening cycle.

PREFERRED BORROWING STRATEGIES

We continue to favour maintaining an exposure to floating rates, mindful of the overall economic outlook and the slope of the curve. As the themes we have outlined elsewhere in this document suggest, the recovery is set to be slow and drawn out, and this needs to be reconciled with a swap market that is keen to price in a recovery. Near term monetary policy expectations seem reasonable (with markets pricing in a July start to the rate hike cycle). However the recent squeeze higher in the bellwether 2yr swap rate has seen forward rates like the 1yr/1yr jump to almost 4.4%. That compares to a spot 1yr rate of 3.46%, and thus implies that rates will be around 1% higher in a year's time, which we think is a bit heady. Broadly speaking then, our view has not changed. We prefer to maintain an exposure to floating, and paying option premium as opposed to paying to fix.

GAUGES FOR NZ INTEREST RATES

GAUGE	GAUGE	GAUGE
RBNZ / OCR	↔	Next rate hike June at the earliest. Market pricing fair.
NZ data	↔/↓	Retail sector struggling. NZIER pickup not a surprise.
Fed Funds / front end	↔	Policy remains firmly on hold. But data is picking up.
RBA	↔/↑	Flood poses risks. But market has already moved.
US 10 year	↑	Not just better data, buyers are looking at Europe.
NZ swap curve	↔/↑	Curve flattening looks to have run its course.
Flow	↔/↓	2yr receivers have bottled. Looks to be abating.
Technicals	↔/↓	2yr needs to hold below 4%.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 27-Jan-11	0	0
Thu 10-Mar-11	+1	+1
Thu 28-Apr-11	+5	+4
Thu 9-Jun-11	+15	+14
Thu 28-Jul-11	+27	+26
Thu 15-Sep-11	+39	+39
Thu 27-Oct-11	+51	+55

TRADING THEMES WE FAVOUR AT PRESENT

With the front end of the curve at or close to the point of capitulation, we favour being long the front end, with the 1yr/1yr of the 2yr our preferred points. Similarly, we favour re-instigating steepeners, mindful of better US data of late, and the focus on inflation risks emerging in Asia, and in Australia following the floods.

CURRENCY STRATEGY

SUMMARY

Market participants have developed their key themes for 2011. From a NZD perspective a key theme of potential food price inflation delivers a positive spin. Internationally the market is torn between the sovereign risk that is permeating Europe, and a US economy that is showing small signs of recovery but is not quite there yet. In Asia inflation issues are already apparent and the spectre of food price inflation will cause increased concern.

MARKET THEMES

- Strong soft commodity prices give NZD a positive bias.
- The strong AUD feels very fully priced and a mature trade.
- Sovereign risk in Europe will continue this year undermining EUR.
- US data continues to improve but at a much more subdued pace than previous recoveries.
- Asia (China) inflation concerns will see more aggressive policy actions to stem increases.

REVIEW AND OUTLOOK

The NZD experienced a higher level of seasonal strength during the holiday period than had been expected. While some of this strength was unwound, commentaries suggesting food prices could rise dramatically during 2011 gave the NZD support as the New Year got underway. Expect this theme to continue to provide some support during the next few weeks. Watch this week's Fonterra globalDairyTrade auction for signs of further commodity price strength.

The AUDUSD has now traded either side of parity a number of times and psychological "mystique" is now gone. The AUD now looks very fully priced as the Chinese authorities move aggressively to stem inflation that threatens to become entrenched. In the short term, the extensive flooding in Queensland is diverting (stopping) productive capacity which is expected to negatively impact Australian GDP by up to 1 percent.

Sovereign risk in Europe will continue to be a drag on the EUR but the anaemic nature of US recovery is providing a counterbalance to this risk. Increased positive rhetoric from ECB officials is working well to lend support to the EUR. Indeed there appears to be firm commitment from ECB heads to improve the quantity and quality of the European safety net. US data continues to be a mixed bag but on balance is improving. Together these themes will keep EURUSD range bound between 1.30 and 1.35.

China raised its reserve ratio by 50bps as it continues to battle strong domestic inflation pressures. The spectre of higher food and commodity prices means we will see a more proactive approach from the Chinese authorities in this area. Indeed one of the easiest ways to deal with food inflation would be to let the yuan strengthen. If the authorities do take this approach then expect it to happen quietly and without fanfare.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↑	Below fair value.
Yield	↔/↓	Yields less supportive as NZ growth prospects soften.
Commodities	↑	Soft commodities very strong.
Partial indicators	↓	Downside risk to NZ data this week.
Technicals	↑	Bounced strongly from 0.7400. Momentum up.
Sentiment	↓	Weak NZ data sends sentiment negative.
Other	↑	At historically low levels.
On balance	↑	**0.7650 - 0.7800.**

NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↔/↓	Above structural fair value of 0.67.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↓	Higher US bond yields whereas NZ's turn lower.
Commodities	↑	Soft commodities turn higher.
Risk aversion	↔↑	Positive outlook for equities lends support.
Partial indicators	↔/↓	US data has been getting better apart from payrolls.
Technicals	↔	Rangebound with positive bias.
AUD	↓	AUD sentiment turned bearish.
Sentiment	↓	Weak data still at the fore.
Other	↔	Europe sovereign risk still hasn't gone away.
On balance	↓	**Theme of food inflation lending support despite weak domestic data.**

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
17-Jan	NZ	Food Prices (MoM) - DEC	- -	-0.60%	10:45
	AU	TD Securities Inflation YoY% - DEC	- -	3.90%	12:30
	AU	TD Securities Inflation MoM% - DEC	- -	0.40%	12:30
	UK	Rightmove House Prices (MoM) - JAN	- -	-3.00%	13:01
	UK	Rightmove House Prices (YoY) - JAN	- -	0.40%	13:01
	AU	New Motor Vehicle Sales MoM - DEC	- -	0.20%	13:30
	AU	New Motor Vehicle Sales YoY - DEC	- -	-0.90%	13:30
	JN	Consumer Confidence - DEC	- -	40.6	18:00
18-Jan	NZ	REINZ Housing Price Index MoM% - DEC	- -	1.90%	10:00
	NZ	REINZ House Sales YoY% - DEC	- -	-15.20%	- -
	UK	Nationwide Consumer Confidence - DEC	44	45	13:01
	UK	RICS House Price Balance - DEC	-44%	-44%	13:01
	NZ	Non Resident Bond Holdings - DEC	- -	64.60%	15:00
	JN	Industrial Production (MoM) - NOV F	- -	1.00%	17:30
	JN	Industrial Production YOY% - NOV F	- -	5.80%	17:30
	JN	Capacity Utilization (MoM) - NOV F	- -	-2.30%	17:30
	UK	DCLG UK House Prices (YoY) - NOV	- -	5.50%	22:30
	UK	CPI (MoM) - DEC	0.70%	0.40%	22:30
	UK	CPI (YoY) - DEC	3.40%	3.30%	22:30
	UK	Core CPI YOY - DEC	2.70%	2.70%	22:30
	GE	Zew Survey (Current Situation) - JAN	83.7	82.6	23:00
	GE	ZEW Survey (Econ. Sentiment) - JAN	7	4.3	23:00
	EC	ZEW Survey (Econ. Sentiment) - JAN	16.6	15.5	23:00
19-Jan	US	Empire Manufacturing - JAN	13	10.57	02:30
	US	Total Net TIC Flows - NOV	- -	$7.5B	03:00
	US	Net Long-term TIC Flows - NOV	$40.0B	$27.6B	03:00
	US	NAHB Housing Market Index - JAN	17	16	04:00
	AU	Westpac Consumer Confidence (MoM) - JAN	- -	0.20%	12:30
	AU	Westpac Consumer Confidence Index - JAN	- -	111	12:30
	AU	DEWR Skilled Vacancies MoM - JAN	- -	-1.00%	13:00
	EC	Euro-Zone Current Account nsa - NOV	- -	-2.3B	22:00
	UK	Claimant Count Rate - DEC	4.50%	4.50%	22:30
	UK	Jobless Claims Change - DEC	0.0K	-1.2K	22:30
	UK	Average Weekly Earnings 3M/YoY - NOV	2.20%	2.20%	22:30
	UK	Weekly Earnings exBonus 3M/YoY - NOV	2.30%	2.30%	22:30
	UK	ILO Unemployment Rate (3mths) - NOV	7.90%	7.90%	22:30
	EC	Construction Output SA MoM - NOV	- -	0.00%	23:00
20-Jan	US	Housing Starts - DEC	550K	555K	02:30
	US	Building Permits - DEC	555K	530K	02:30
	US	Housing Starts MOM% - DEC	-0.90%	3.90%	02:30
	US	Building Permits MOM% - DEC	2.00%	-4.00%	02:30
	NZ	Business NZ PMI - DEC	- -	52.7	10:30
	NZ	Consumer Prices (QoQ) - 4Q	2.30%	1.10%	10:45
	NZ	Consumer Prices (YoY) - 4Q	4.00%	1.50%	10:45
	AU	Consumer Inflation Expectation - JAN	- -	2.80%	12:30
	NZ	ANZ Consumer Confidence Index - JAN	- -	112.2	15:00
	CH	Real GDP YoY - 4Q	9.40%	9.60%	15:00
	CH	Consumer Price Index (YoY) - DEC	4.60%	5.10%	15:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
20-Jan	CH	Industrial Production (YoY) - DEC	13.40%	13.30%	15:00
	CH	Retail Sales (YoY) - DEC	18.70%	18.70%	15:00
	JN	Coincident Index CI - NOV F	- -	102.1	18:00
	JN	Leading Index CI - NOV F	- -	101	18:00
	GE	Producer Prices (MoM) - DEC	0.50%	0.20%	20:00
	GE	Producer Prices (YoY) - DEC	4.90%	4.40%	20:00
21-Jan	UK	CBI Business Optimism - JAN	3	2	00:00
	UK	CBI Trends Total Orders - JAN	-1	-3	00:00
	US	Initial Jobless Claims - 42005	425K	445K	02:30
	US	Continuing Claims - 39448	3985K	3879K	02:30
	EC	Euro-Zone Consumer Confidence - JAN A	-12	-11	04:00
	US	Existing Home Sales - DEC	4.86M	4.68M	04:00
	US	Existing Home Sales MoM - DEC	3.80%	5.60%	04:00
	US	Leading Indicators - DEC	0.60%	1.10%	04:00
	US	Philadelphia Fed. - JAN	20.4	24.3	04:00
	NZ	Retail Sales (MoM) - NOV	1.20%	-2.50%	10:45
	NZ	Retail Sales Ex-Auto (MoM) - NOV	0.50%	-1.60%	10:45
	AU	Import price index (QoQ) - 4Q	- -	0.70%	13:30
	AU	Export price index (QoQ) - 4Q	- -	7.80%	13:30
	GE	IFO - Business Climate - JAN	109.9	109.9	22:00
	GE	IFO - Current Assessment - JAN	113.2	112.9	22:00
	GE	IFO - Expectations - JAN	106.5	106.9	22:00
	UK	Retail Sales (MoM) - DEC	-0.20%	0.30%	22:30
	NZ	Money Supply M3 YoY - NOV	- -	1.8%	15:00

Key: AU: Australia, EC: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States CH: China.

Sources: Dow Jones, Reuters, Bloomberg, ANZ, National Bank. All $ values in local currency.

Note: All surveys are preliminary and subject to change.

LOCAL DATA WATCH

Key focus over the next few weeks: Last week's NZIER reading of business confidence suggested a H2 New Zealand recession is likely to be averted but only just. Higher GST is expected to boost the Q4 CPI, but the key for the RBNZ will be how much the subdued domestic demand environment will cap the inflation spill-over into prices and wages. Next week sees the January OCR Review, with the RBNZ expected to stick to their December MPS script. We continue to watch the soft gauges for signs of direction, with forthcoming readings for business and consumer confidence providing insight into the pace of recovery in 2011.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 19 Jan (6:00am)	*globalDairyTrade* online auction	Rising	We expect prices to drift higher on account of supply concerns. The high NZD/USD may act to dilute gains to NZ farmers.
Thur 20 Jan (10:45am)	Consumers Price Index- Q4	GST boost	We expect a 2.3 percent quarterly increase, largely on account of the GST increase. Abstracting from that, we are not expecting to see much genuine upward price pressure.
Thur 20 Jan (3:00pm)	ANZ-Roy Morgan Consumer Confidence	- -	- -
Fri 21 Jan (10:45am)	Retail Trade - Nov	Rising	We expect a monthly 1.2 percent s.a. increase for total retail, with core sales anticipated to increase by 0.4 percent.
Wed 26 Jan (3:00pm)	RBNZ Credit Card Statistics - Dec	Down	Credit card values are expected to mimic the fall in Electronic Card Transactions.
Thur 27 Jan (9:00am)	January OCR	On hold	There is little on the activity front to motivate a move prior to the June MPS. Look for a similar message to the December MPS.
Mon 31 Jan (10:45am)	Overseas Merchandise Trade – Dec	Into the black	We expect a monthly surplus of around \$170m. Commodity price strength is the major influence.
Mon 31 Jan (10:45am)	Building Consents – Dec	Down	Forward indicators, notably REINZ housing and section sales, suggest a decline. Construction sector activity remains weak.
Mon 31 Jan (3:00pm)	RBNZ Credit Aggregates - Nov	Flat	Deleveraging remains ongoing.
Tue 1 Feb (10:45am)	Labour Cost Index – 2010q4	Moving up	Private Sector Salary and Ordinary Time Wage Rates are expected to increase 0.5 percent (1.8 percent y/y).
Tue 1 Feb (10:45am)	Quarterly Employment Survey – 2010q4	Rising	Labour earnings will be underpinned by rising hourly earnings, and small increases in filled jobs and paid hours.
Wed 2 Jan (6:00am)	*globalDairyTrade* online auction	Firm	We expect USD prices to remain underpinned by supply concerns and strong demand.
Thur 3 Feb (10:45am)	Household Labour Force Survey – Q4	Sideways	A 0.2 percent increase in employment is envisaged. The unemployment rate is expected to tick up to 6.5 percent.
Fri 4 Feb (10:45am)	External Migration – Dec	Supportive	We expect a net inflow of approximately 600 persons. The annual inflow is expected to slow to around 10,000 persons.
Wed 9 Feb (10:45am)	Electronic Card Transactions – Jan	Rising	We expect a small increase from weak December levels.
Fri 11 Feb (10:45am)	Food Price Index - Jan	Rising	Strong export commodity prices point to strengthening domestic food prices over 2011.
On Balance		**An improving tone**	**Data for Q4 is likely to see a return to positive growth, but in fits and starts. We continue to look for forward-looking gauges to convey an improving tone.**

KEY FORECASTS AND RATES

	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
GDP (% qoq)	0.2	0.9	0.6	0.1	**-0.2**	**0.5**	**0.8**	**1.0**	**1.7**	**1.5**
GDP (% yoy)	-1.7	0.5	1.8	1.8	**1.5**	**1.0**	**1.3**	**2.2**	**4.1**	**5.1**
CPI (% qoq)	1.3	-0.2	0.4	0.2	1.1	**2.3**	**0.6**	**1.0**	**0.8**	**0.5**
CPI (% yoy)	1.7	2.0	2.0	1.7	1.5	**4.0**	**4.3**	**5.1**	**4.8**	**2.9**
Employment (% qoq)	-0.8	0.0	1.0	-0.2	1.0	**0.2**	**0.3**	**0.4**	**0.6**	**0.7**
Employment (% yoy)	-1.8	-2.4	-0.1	0.0	1.8	**2.0**	**1.3**	**1.9**	**1.5**	**2.0**
Unemployment Rate (% sa)	6.5	7.1	6.0	6.9	6.4	**6.5**	**6.5**	**6.4**	**6.1**	**5.8**
Current Account (% GDP)	-3.2	-2.8	-2.4	-3.0	**-3.1**	**-2.3**	**-2.4**	**-2.1**	**-2.8**	**-2.5**
Terms of Trade (% qoq)	-1.6	5.8	6.1	2.0	3.0	**2.9**	**2.4**	**1.0**	**-0.1**	**-0.8**
Terms of Trade (% yoy)	-14.1	-8.2	0.1	12.7	17.9	**14.7**	**10.7**	**9.6**	**6.3**	**2.6**

	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10
Retail sales (% mom)	0.7	-0.6	2.8	-1.0	-1.2	0.4	1.7	-2.5	..	..
Retail sales (% yoy)	6.9	3.6	5.6	4.7	2.8	1.8	4.6	0.6	..	..
Credit Card Billings (% mom)	0.9	-1.5	1.9	1.1	-1.2	0.8	0.9	0.6	0.0	..
Credit Card Billings (% yoy)	5.2	0.8	3.5	4.5	2.7	2.1	4.2	4.6	3.8	..
Car registrations (% mom)	5.0	2.6	-4.0	5.5	-6.4	0.0	2.6	-3.7	14.1	-9.1
Car registrations (% yoy)	31.7	40.5	30.5	35.8	16.0	19.0	19.2	9.4	23.5	6.4
Building consents (% mom)	-0.1	8.2	-9.9	1.9	3.1	-17.7	0.8	-1.9	8.8	..
Building consents (% yoy)	32.5	32.4	11.3	26.8	25.8	-3.1	-9.4	-17.4	-8.7	..
REINZ House Price (% yoy)	7.6	4.7	3.7	3.7	2.6	0.9	0.0	-1.4	1.4	..
Household Lending Growth (% mom)	0.0	0.2	0.2	0.2	0.2	0.1	0.2	0.0	..	..
Household Lending Growth (% yoy)	2.9	2.8	2.6	2.6	2.5	2.3	2.3	2.0	..	..
ANZ Roy Morgan Consumer Confidence	121.8	121.9	126.0	122.0	115.6	116.3	116.4	113.6	114.5	112.2
NBNZ Business Confidence	42.5	49.5	48.2	40.2	27.9	16.4	13.5	23.7	33	30
NBNZ Own Activity Outlook	38.6	43.0	45.3	38.5	32.4	25.7	26.7	30.5	35	35
Trade Balance ($m)	608	660	770	221	-186	-430	-454	-224	-186	..
Trade Balance ($m ann)	-160	178	41	593	585	871	978	1256	1350	..
ANZ World Commodity Price Index (% mom)	1.8	5.1	1.2	-1.6	-0.8	-1.4	2.8	3.5	4	2
ANZ World Commodity Price Index (% yoy)	49.5	53.2	51.8	50.1	47.3	38.6	32.9	31.4	24	23
Net migration (sa)	950	770	340	230	900	840	1000	640	630	..
Net migration (annual)	20973	19954	17967	16504	15221	14507	13914	12610	11519	..

Figures in bold are forecasts. mom: Month-on-Month qoq: Quarter-on-Quarter yoy: Year-on-Year

KEY MARKET FORECASTS AND RATES

	ACTUAL			FORECAST (END MONTH)						
FX RATES	Oct-10	Nov-10	Today	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12
NZD/USD	0.767	0.743	0.769	0.73	0.73	0.75	0.74	0.73	0.72	0.71
NZD/AUD	0.779	0.775	0.776	0.73	0.73	0.74	0.74	0.75	0.74	0.75
NZD/EUR	0.550	0.572	0.575	0.56	0.57	0.59	0.57	0.55	0.54	0.53
NZD/JPY	61.62	62.14	63.76	62.1	63.5	66.0	66.6	67.2	67.7	67.5
NZD/GBP	0.478	0.477	0.484	0.47	0.48	0.48	0.47	0.46	0.45	0.44
NZ$ TWI	67.7	68.1	69.1	66.4	67.0	68.6	67.8	67.2	66.1	65.5
INTEREST RATES	Oct-10	Nov-10	Today	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12
NZ OCR	3.00	3.00	3.00	3.00	3.25	3.75	3.75	4.00	4.25	4.50
NZ 90 day bill	3.19	3.20	3.23	3.20	3.70	4.00	4.00	4.40	4.50	4.90
NZ 10-yr bond	5.24	5.66	5.50	5.60	5.90	5.90	5.90	5.80	5.80	5.80
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.50
US 3-mth	0.29	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.85	1.60
AU Cash Rate	4.50	4.75	4.75	4.75	5.00	5.25	5.50	5.75	5.75	5.75
AU 3-mth	4.87	5.04	5.01	5.10	5.20	5.50	5.70	6.00	6.00	6.00

	14 Dec	10 Jan	11 Jan	12 Jan	13 Jan	14 Jan
Official Cash Rate	3.00	3.00	3.00	3.00	3.00	3.00
90 day bank bill	3.18	3.19	3.18	3.18	3.19	3.21
NZGB 11/11	4.07	3.89	3.85	3.83	3.84	3.84
NZGB 04/13	4.79	4.66	4.62	4.60	4.59	4.54
NZGB 12/17	5.66	5.58	5.54	5.52	5.47	5.35
NZGB 05/21	5.83	5.75	5.71	5.69	5.64	5.52
2 year swap	3.83	3.78	3.75	3.78	3.87	3.91
5 year swap	4.75	4.69	4.65	4.61	4.66	4.64
RBNZ TWI	67.4	69.2	69.1	69.0	68.8	69.2
NZD/USD	0.7501	0.7622	0.7592	0.7596	0.7611	0.7703
NZD/AUD	0.7530	0.7644	0.7706	0.7708	0.7657	0.7734
NZD/JPY	62.60	63.30	63.09	63.17	63.16	63.67
NZD/GBP	0.4728	0.4902	0.4881	0.4859	0.4833	0.4866
NZD/EUR	0.5601	0.5898	0.5868	0.5841	0.5809	0.5775
AUD/USD	0.9962	0.9971	0.9852	0.9855	0.9940	0.9960
EUR/USD	1.3393	1.2923	1.2938	1.3004	1.3102	1.3338
USD/JPY	83.46	83.05	83.10	83.16	82.98	82.65
GBP/USD	1.5864	1.5548	1.5555	1.5633	1.5748	1.5831
Oil (US$/bbl)	88.62	88.07	89.24	91.11	91.85	91.39
Gold (US$/oz)	1402.65	1373.87	1376.20	1385.95	1386.30	1377.37
Electricity (Haywards)	22.58	4.94	5.07	4.43	4.33	5.17
Baltic Dry Freight Index	2069	1495	1480	1453	1438	1439
Milk futures (US$/contract)	121	129	129	129	129	129

IMPORTANT NOTICE

NEW ZEALAND DISCLOSURE INFORMATION

The Bank (in respect of itself and its principal officers) makes the following investment adviser disclosure to you pursuant to section 41A of the Securities Markets Act 1988.

The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

Qualifications, experience and professional standing

Experience

The Bank is a registered bank and, through its staff, is experienced in providing investment advice about its own securities and, where applicable, the securities of other issuers. The Bank has been selling securities, and providing investment advice on those securities, to customers as a core part of its business for many years, drawing on the extensive research undertaken by the Bank and its related companies and the skills of specialised staff employed by the Bank. The Bank is represented on many bank, finance and investment related organisations and keeps abreast of relevant issues by running seminars and workshops for relevant staff and having its investment adviser staff attend external seminars where appropriate. The Bank subscribes to relevant industry publications and, where appropriate, its investment advisers will monitor the financial markets.

Relevant professional body

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

Professional indemnity insurance

The Bank (and its subsidiaries), through its ultimate parent company Australia and New Zealand Banking Group Limited, has professional indemnity insurance which covers its activities including those of investment advisers it employs.

This insurance covers issues (including ‘prior acts’) arising from staff fraud, electronic crime, documentary fraud and physical loss of property. The scope of the insurance also extends to third party civil claims, including those for negligence. The level of cover is of an amount commensurate with the size and scale of the Bank.

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

The Bank has a process in place for resolving disputes. Should a problem arise, you can contact any branch of the Bank for more information on the Bank’s procedures or refer to any of the Bank’s websites.

Unresolved complaints may ultimately be referred to the Banking Ombudsman, whose contact address is PO Box 10-573, Wellington.

Criminal convictions

In the five years before the relevant investment advice is given none of the Bank (in its capacity as an investment adviser and where applicable an investment broker) or any principal officer of the Bank has been:

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

Fees

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank’s investment advisers on a specific investment.

Other interests and relationships

When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank’s investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

- ANZ Investment Services (New Zealand) Limited (ANZIS), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ANZIS may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- OnePath (NZ) Limited, as a wholly owned subsidiary of the Bank, is an associated person of the Bank. OnePath and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- Direct Broking Limited (DBL), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. DBL may receive remuneration from a third party relating to a security sold by the Investment Adviser.

Securities about which investment advice is given

The Bank provides investment advice on the following types of securities:

- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

If you wish to pay investment money to the Bank you can do this in several ways such as by:

- Providing cash;

IMPORTANT NOTICE

- Providing a cheque payable to the relevant product or service provider and crossed 'not transferable'; or
- Making an automatic payment or payment through another electronic delivery mechanism operated by the Bank.

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

Record Keeping

The Bank will keep adequate records of the deposit of investment moneys or property and all withdrawals and dealings with such money or property, using the account/investment number allocated to your investment. You may have access to those records upon request.

Auditing

The Bank's systems and operations are internally audited on a regular basis. The financial statements of the Bank and its subsidiaries are audited annually by KPMG. However, this does not involve an external audit of the receipt, holding and disbursement of the money and other property.

Use of Money and Property

Money or property held by the Bank for a specific purpose communicated to the Bank (e.g. the purchase of an interest in a security) may not be used by the Bank for its own purposes and will be applied for your stated purpose. No member of the Bank's staff may use any money or property deposited with the Bank, for their own purposes or for the benefit of any other person. In the absence of such instructions, money deposited with the Bank may be used by the Bank for its own purposes, provided it repays the money to you upon demand (or where applicable, on maturity), together with interest, where payable.

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The Bank does not provide investment advice tailored to an investor's personal circumstances. It is the investor's responsibility to understand the nature of the security subscribed for, and the risks associated with that security. To the maximum extent permitted by law, the Bank excludes liability for, and shall not be responsible for, any loss suffered by the investor resulting from the Bank's investment advice.

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