NEW ZEALAND ECONOMICS
ANZ MARKET FOCUS

12 July 2010

INSIDE

NZ ECONOMICS TEAM

Cameron Bagrie
Chief Economist
Telephone: +64 4 802 2212
E-mail: Cameron.Bagrie@anz.com

Khoon Goh
Senior Markets Economist
Telephone: +64 4 802 2357
E-mail: Khoon.Goh@anz.com

David Croy
Senior Interest Rate Strategist
Telephone: +64 4 576 1022
E-mail: David.Croy@anz.com

Mark Smith
Economist
Telephone: +64 4 802 2199
E-mail: Mark.Smith2@anz.com

Steve Edwards
Economist
Telephone: +64 4 802 2217
E-mail: Steve.Edwards@anz.com

Kevin Wilson
Rural Economist
Telephone: +64 4 802 2361
E-mail: Kevin.Wilson@anz.com

TAPAS ON THE TABLE

ECONOMIC OVERVIEW

The overall spirit of recent domestic data releases is consistent with a sedate recovery path. We view this as a positive sign for it foretells of deleveraging and the penny dropping in terms of the long (but necessary) rebalancing journey the economy is embarking upon. We are becoming increasingly convinced that the RBNZ will pause later this year, even though a couple more interest rate hikes still look odds on in 2010, despite a levelling out in growth momentum. If there is a caveat surrounding any pause, it rests with the supply-side capacity of the economy and how fast we can grow without hitting capacity constraints. This week's data is expected to show a housing market that is still struggling and a modest increase in consumer spending, with the key Q2 CPI release showing inflation in the middle of the target band. The latter tells us the economy does not have the surfeit capacity, or scope on the inflation front, to embark on a strong above trend growth phase.

FINANCIAL CONDITIONS UPDATE

Global growth concerns have risen to the fore of late, with increasing talk of a double dip scenario in the US. We present our updated financial conditions indexes for NZ, Australia and US, and also introduce a newly created one for the Eurozone.

JUNE 2010 QUARTER CPI PREVIEW

We expect a 0.6 percent quarterly increase, with annual CPI inflation edging to 2.1 percent. Large positive contributions are expected from tobacco, electricity, transportation and the usual seasonal influences. In an underlying sense, inflationary pressures are expected to remain contained with non-tradable inflation excluding one-offs anticipated to increase by 0.5 percent. Furthermore, if food prices for the June month (published Tuesday) significantly undershoot our expectations, we are likely to revise our pick to 0.5 percent. Price increases due to government policy changes are expected to contribute to sharply increasing quarterly CPI reads over the next two quarters, causing annual CPI inflation to approach 5 percent by year end.

MONTHLY INFLATION GAUGE

Our monthly inflation gauge rose by 0.2 percent in June, following a 0.1 percent increase in May. For the June quarter, our inflation gauge rose by 1.6 percent, though we do not expect the official CPI non-tradable inflation to rise by that much, when reported later this week.

INTEREST RATE STRATEGY

Pessimism has given way to cautious optimism. But correlation across markets remains high, suggesting that sentiment is fickle still, and may swing yet again. Nonetheless, the whole episode has been useful in the sense that it was a reminder not to get too caught up in the moment. The NZ (and global) recovery is progressing, it's just patchy and gradual, but it was always going to be. In the absence of a calamity, in this environment the trend outlook for interest rates is higher.

CURRENCY STRATEGY

Last week was a very positive week for the global economy and NZ's major trading partners. In contrast the local newsflow was weaker than expected. Yet, the NZD still tracked higher. This points to offshore themes and sentiment continuing to dominate, and for the NZD to stay near the top of its recent range.

EFFECTIVE EXCHANGE RATE UPDATE

We present an update of our real effective exchange rate (REER) measures across New Zealand's main export industries.

ECONOMIC OVERVIEW

SUMMARY

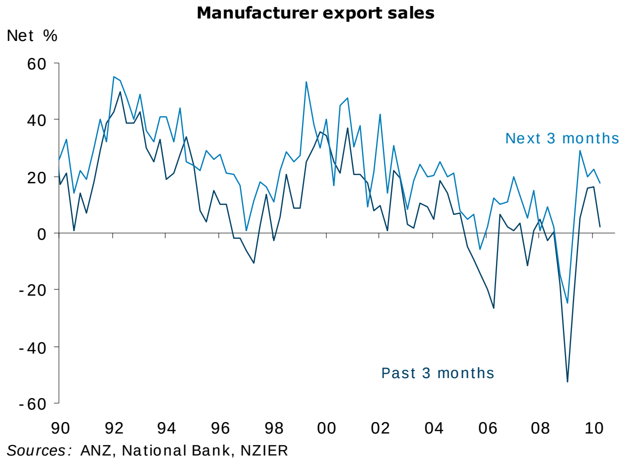
The overall spirit of recent domestic data releases is consistent with a sedate recovery path. We view this as a positive sign for it foretells of deleveraging and the penny dropping in terms of the long (but necessary) rebalancing journey the economy is embarking upon. We are becoming increasingly convinced that the RBNZ will pause later this year, even though a couple more interest rate hikes still look odds on in 2010, despite a levelling out in growth momentum. If there is a caveat surrounding any pause, it rests with the supply-side capacity of the economy and how fast we can grow without hitting capacity constraints. This week's data is expected to show a housing market that is still struggling and a modest increase in consumer spending, with the key Q2 CPI release showing inflation in the middle of the target band. The latter tells us the economy does not have the surfeit capacity, or scope on the inflation front, to embark on a strong above trend growth phase.

THIS WEEK'S EVENTS

- **SNZ Food Price Index – June** (Tuesday, July 13, 10:45am). Partly on account of retail discounting, food prices have been falling over the past two months. We expect an unwinding of some of the price discounting, resulting in a greater than 1 percent monthly rise for June.
- **REINZ Housing Market Statistics – June** (Wednesday, July 14, 10:00am). We expect house sales and prices to fall, and for the days to sell to rise, in what is a quieter than normal winter. Despite the *Budget* uncertainties now out of the way, there is no sign of pent up demand being unleashed.
- **SNZ Retail Trade – May** (Wednesday, July 14, 10:45am). We anticipate a monthly increase of 0.6 percent for headline retail sales, with core retail spending to increase by 0.7 percent.
- **BNZ–Business NZ PMI – June** (Thursday, July 15, 10:30am). After reaching a multi-year high in April, NZ's PMI fell in May and we forecast a further decline in June, in line with global trends.
- **SNZ Consumers Price Index – Q2** (Friday, July 16, 10:45am). Positive contributions from tobacco, electricity and transportation will offset lower food prices and contribute to a 0.6 percent quarterly increase. Annual CPI inflation will rise slightly to 2.1 percent.

WHAT'S THE VIEW?

The Q2 NZIER *Quarterly Survey of Business Opinion* (QSBO) was a mixed bag, **but the overall spirit of the survey was weaker than what we (and most) were expecting.** If a typical cyclical rebound is underway, we would normally see evidence of firming investment intentions, a recovery in profitability and an improvement in activity in those sectors that were hardest hit during the downturn. **These details were largely absent.** Weakness in construction sector activity at present is symptomatic of weak consent issuance, but any prospects for a strong cyclical recovery were dampened with architects reporting a lower volume of work over the next 12 to 24 months. Momentum in the manufacturing sector appears to be easing, after being a standout performer of late. Of some concern was the fall in manufacturing export sales, suggesting the sector is not immune from recent global wobbles.



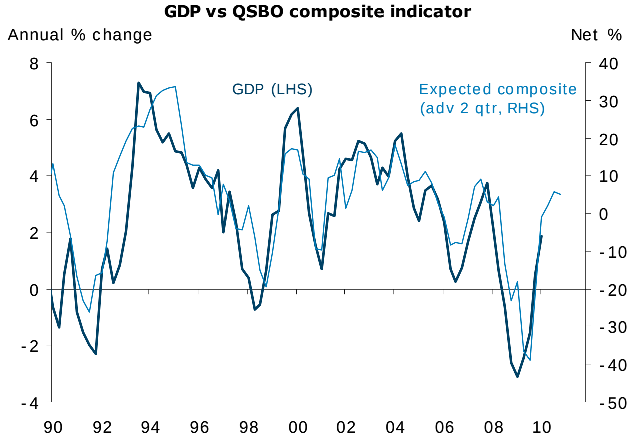
The QSBO results are consistent with modest growth. Certainly an improvement but hardly what you would call a typical cyclical rebound after the deepest and longest recession since the 1970s. The expansion continues to make moderate progress, but firms' activity expectations continue to overshoot reality. It remains a challenging environment for businesses, with small and medium sized enterprises finding the going particularly tough.

The QSBO did not point to a strong rebound in investment, with intentions easing despite high readings for capacity utilisation. With expected profitability easing, a strong investment rebound is not assured. Employment intentions fared better with firms opting to utilise labour to expand output. However, with the economy appearing to be close to approaching capacity

ECONOMIC OVERVIEW

constraints, more investment is needed to boost productivity performance and prolong the expansion. What the lack of investment over the past year and a half means for the supply-side capacity of the economy is uncertain, but weak investment intentions at present certainly do not augur well.

GDP vs QSBO composite indicator

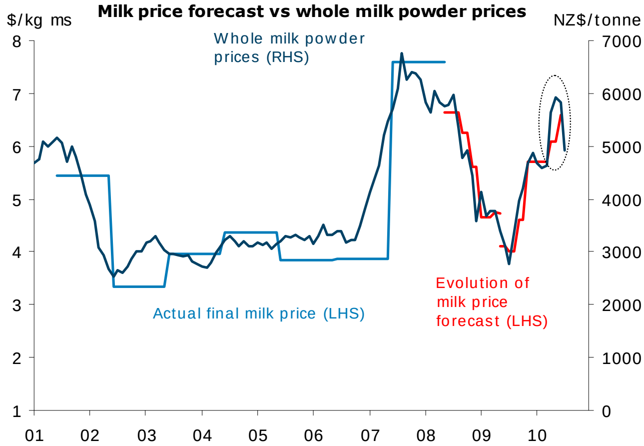


Sources: ANZ, National Bank, Statistics NZ, NZIER

We view the collective message from the QSBO as a levelling out in activity. There remains considerable tension within the broader economy. These tensions manifest in areas such as the desire for growth and for the economy to deleverage. Of course, everyone wants a strong rebound from the recessionary lows. But with inflation in the middle of the band and the QSBO flagging some capacity issues, this doesn't seem in prospect. We also think the tensions are a useful reminder in terms of the process of change the economy must undergo. Suffice to say at present, we think the message from the QSBO is effectively one of levelling out and we do not think that is a bad place to be.

The rising terms of trade have been a major source of support to the economy, but the Fonterra online auction results last week showed that export commodity prices can go down, as well as up. USD prices have fallen by around 20 percent since the April trading event, with the fall in NZD prices not that far behind. “Occular least squares” on the chart below suggests a milk price of $6 per kg/MS is now possible, compared to the current forecast of $6.60 (plus $0.30-$0.50 cents in distributable profit) and earlier talk of something even higher. There is, of course, a long way to go before the end of the season and $6 plus is still good money in the hand, so we’ll reserve judgement. But suffice to say there doesn’t look to be much upside risk at present. And the fall in milk powder prices is a reminder that NZ is not immune to global ructions we have seen of late across equity and commodity markets. **In the absence of a weaker NZD, a softer outlook for export prices would certainly get the attention of the RBNZ.** Next month’s release of the ANZ Commodity Price Index looms as being a crucial event.

Milk price forecast vs whole milk powder prices



Sources: ANZ, Fonterra, Bloomberg

Despite some warning signs (downside risks to the global growth scene, falling dairy prices, weak QSBO read, ongoing deleveraging), it is still hard to see the RBNZ pausing in July. There have been some positives as well, such high consumer confidence. The fact that the RBNZ hiked in June means that they must have another couple of further hikes at least up their sleeve.

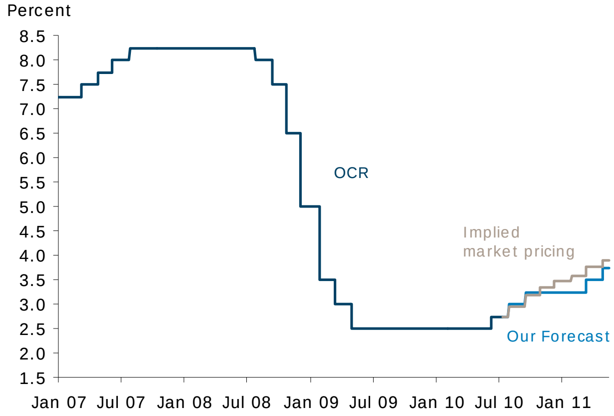
So the case for a pause in July or September would have to be overwhelming to see the decision go that way. We continue to monitor offshore funding costs for NZ financial institutions as a key transmission mechanism from global ructions. While the funding market is fickle and expensive for issuers, it still seems reasonably fluid. A July hike remains pretty close to a done deal in our view, although when we eye up September, we think the odds of a 25 basis point hike sit at around 60 percent. This probability not only reflects our wariness towards the global scene, but also how things like a weak domestic housing market will manifest in the broader economy. The QV property values data released over the weekend shows house prices are clearly falling.

It is hard to imagine we’ll see a series of 25 basis point hikes every six weeks in a falling house price environment. Trying to pick the timing of a pause by the RBNZ probably puts us on a hiding to nothing, so we would encourage our readers to simply focus on the broader spirit: we do not believe there will be a 25 basis point hike at every meeting. The market is now starting to think the same, although it is front-loading the tightening with around 127 basis points of tightenings priced in over

ECONOMIC OVERVIEW

the next 12 months.

OCR and market pricing



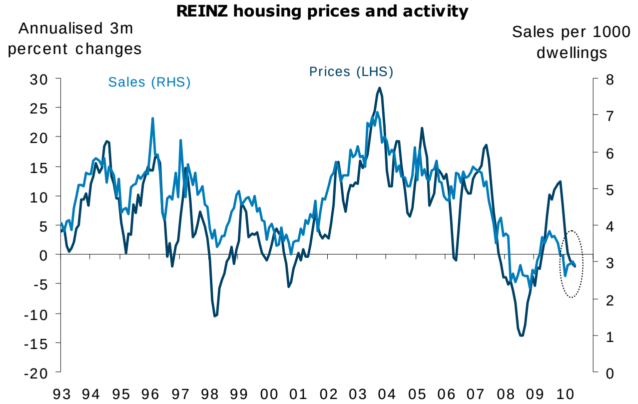
Sources: ANZ National, RBNZ, Bloomberg

If there is a challenge to our idea of a pause, we think it comes from the supply-side of the economy. As we've scribed frequently before, we think potential growth for the NZ economy is currently around 2 percent. This means that the rather lacklustre Q1 GDP growth of 0.6 percent was slightly above potential, and sufficient to start eating into spare capacity. Indeed, the fact that the QSBO's measure of capacity utilisation is above average levels despite the economy only recovering half the output lost during the recession, experienced productivity fell and skilled labour is starting to become harder to find – all point to there being potentially less spare capacity in the economy than initially thought.

Turning to the week ahead, the Q2 CPI release on Friday tops the local data calendar (see our preview on page 8). We expect a 0.6 percent quarterly increase, taking annual CPI inflation to 2.1 percent. The headline number will be boosted by the tax increase to tobacco products, which is expected to add 0.2 percentage points. Offsetting this somewhat are lower food prices. Indeed, with Statistics NZ now set to publish the food price index before the CPI tomorrow, we will get an indication of where the balance of risks to our 0.6 percent forecast lie.

Apart from CPI, the other key local data will be the June housing market report and May retail sales. **The June REINZ housing market report is expected to show a housing market remaining in a state of flux.** As noted earlier, QV data showed that the market is softening, and Barfoot and Thompson data for Auckland was subdued for June. So despite the Budget clearing away the uncertainty that was hanging over the market earlier in the year, there is little evidence of renewed momentum or of pent up demand being unleashed. In fact, it's to the contrary and a sense of caution is expected to pervade. We expect average days to sell to keep nudging up, and the trend in prices to head lower.

REINZ housing prices and activity

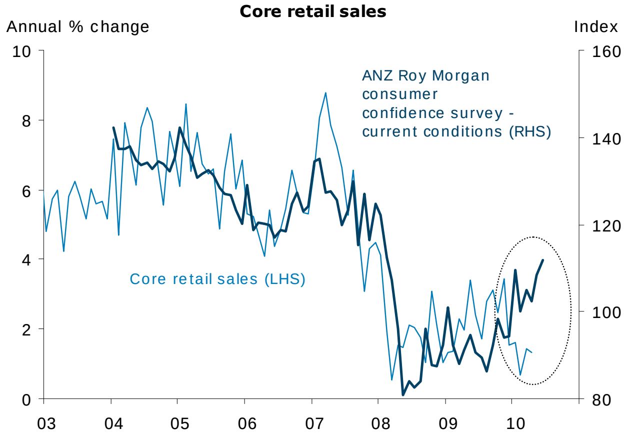


Sources: ANZ, National Bank, REINZ

In terms of the house price data, we'll be paying particular attention to the REINZ House Price Index measure, which has fallen over the past two months and is now 2 percent off its November 2009 peak. We also note that section prices have fallen over 2010 and they are down 17 percent from their mid-2008 peak. Ironically, we take comfort from this sort of trend as weaker section prices is one pre-condition for residential investment to pickup.

Retail trade data for May is expected to show a monthly increase of about 0.6 percent, with core retail increasing by slightly more than this. Retail indicators suggest a wide range of monthly increases and there is some risk of a stronger monthly outturn eventuating given the rebound in consumer sentiment. However, with retail discounting appearing to be widespread, the implications for nominal retail spending are likely to not be as upbeat as implied by the confidence indicators.

Core retail sales



Sources: ANZ, National Bank, Statistics NZ

ECONOMIC OVERVIEW

RECENT LOCAL DATA

- **NZIER Quarterly Survey of Business Opinion – Q2.** General business confidence eased to +28 from +34 in the March quarter. Domestic trading activity over the past three months improved slightly (from -6 to -3), whereas expected domestic trading activity declined from +19 to +16. Economy-wide capacity utilisation firmed slightly to 0.908, but pricing intentions increased sharply to +40 from +27.
- **Fonterra Online Auction – July.** Whole Milk Powder (WMP) prices for the July trading event averaged US$3,224/tonne, a 14.8 percent decline on the June event. NZD prices declined by 17.2 percent, but are 63 percent higher than the July 2009 trading event.
- **SNZ Electronic Card Transactions – June.** Retail Electronic Card Transactions (ECT) rose by 0.4 percent (+4.2 percent y/y), with core ECT retail registering a 0.7 percent increase (+3.6 percent y/y).

FINANCIAL CONDITIONS UPDATE

SUMMARY

Global growth concerns have risen to the fore of late, with increasing talk of a double dip scenario in the US. Our financial conditions indexes for NZ, Australia and US suggest some easing in growth is certainly in prospect. But at this stage the movements do not appear to be much more than a levelling out in growth (albeit with downside momentum). Our newly created financial conditions index for the Eurozone suggest that, while austerity measures being implemented will pose a headwind, the region as a whole should continue to post growth in the year ahead, though at a sluggish rate. Our FCI for Australia suggests an easing back of growth towards more sustainable levels, while our FCI for NZ points to a still modest recovery by historical standards.

GROWTH CONCERNS BACK TO THE FORE

Financial markets have shifted their concerns from sovereign debt issues in Europe to the prospect of a sharp slowing in global growth over H2 2010. Recent economic data has certainly disappointed, particularly the slump in US housing market data due to the tax credits expiring. Global PMI readings have also fallen, as the inventory rebuilding cycle looks to have run its course. There is also the issue of austerity measures being implemented across Europe acting as a drag on growth in that region. Unsurprisingly, global equity markets have been hit, though they managed to stage a recovery of sorts late last week.

The big question is whether financial market concerns, particularly over the possibility of a double dip recession in the US, have been overblown. Markets are certainly prone to over-reactions, and there is the popular saying that "the stock market has predicted nine of the last five recessions." To help answer this question, we turn to our proprietary Financial Conditions Indexes[1] (FCI). Regular readers will be aware that we have constructed FCIs for NZ, Australia and the US. We have recently added to that a new FCI for the Eurozone. Another change we have made, purely for presentational purposes, is to rescale the FCIs to the respective economy's GDP growth rates so that they are directly comparable.

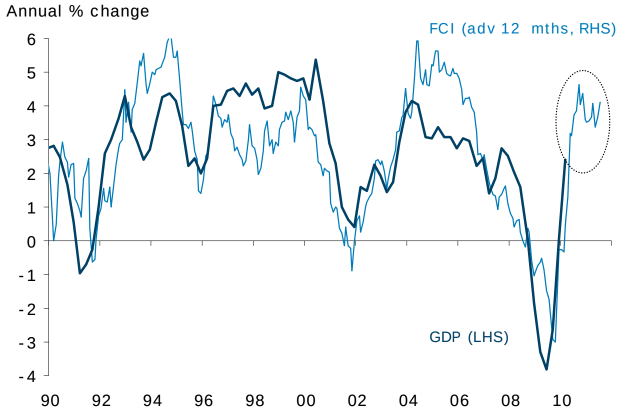
[1] A financial conditions index summarises a range of financial variables into a single series that can be used to predict the future path of the economy. Our FCI includes the currency adjusted for commodity prices or terms of trade movements, interest rates, asset prices, credit growth and proxies for the cost and availability of credit.

US DOUBLE DIP NOT IN PROSPECT

Our US FCI suggests that, while an easing in growth is expected, it is not pointing to a double dip style recession. Equity markets have certainly fallen, and US house prices continue to come under downward pressure, acting to tighten financial conditions. But helping to offset this is a lower USD index (adjusted for terms of trade movements), lower 10-year bond yields and a narrowing in the 2-year swap spread. While there is much focus on the decline in equities, the fall in US 10-year bond yields on the back of safe haven demand should not be downplayed. This has seen US mortgage rates fall by around 20bps in the past month or so, which has led to an increase in mortgage refinancing, freeing up household cashflow.

While overall financial conditions in the US have actually loosened in the past month, we are focusing more on the broad direction. In that regard, our FCI indicates a peak in the growth rate and some moderation is expected. On the face of it, our FCI suggests year-on-year growth of around 4 percent by mid-next year. But we are conscious that actual growth has tended to come in below where our FCI has indicated during past peaks (i.e. 1994-96 and 2004-05). Hence, a more modest growth rate will likely eventuate, though far short of a hard landing.

US GDP vs Financial Conditions Index



Sources: ANZ, National Bank, Bloomberg

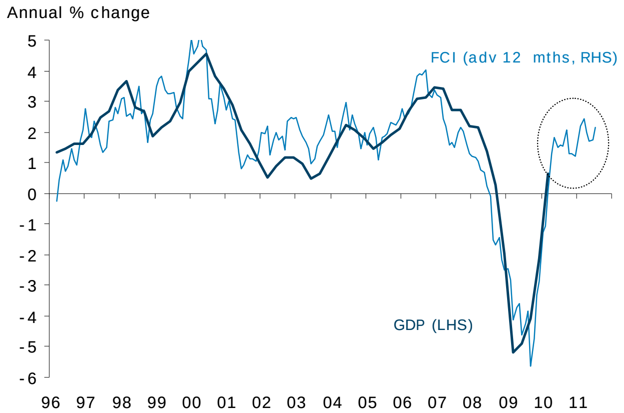
EUROZONE GROWTH SLUGGISH

Given the austerity measures being implemented in Europe, Eurozone growth is likely to be anaemic at best. Our Euro FCI certainly suggests rather sluggish growth in the year ahead, with GDP growth of between 1¾ and 2 percent. A lot of the focus has been on the highly indebted PIGS economies. But the larger Euro members, such as Germany and France, have been performing better. Weakness in the euro has helped loosen financial conditions, which will be beneficial to

FINANCIAL CONDITIONS UPDATE

the export dependent German economy in particular. Indeed, this was reflected in better than expected German export and industrial production data last week. But offsetting that somewhat are weaker equities and higher bond yields due to sovereign debt concerns.

Euro GDP vs Financial Conditions Index

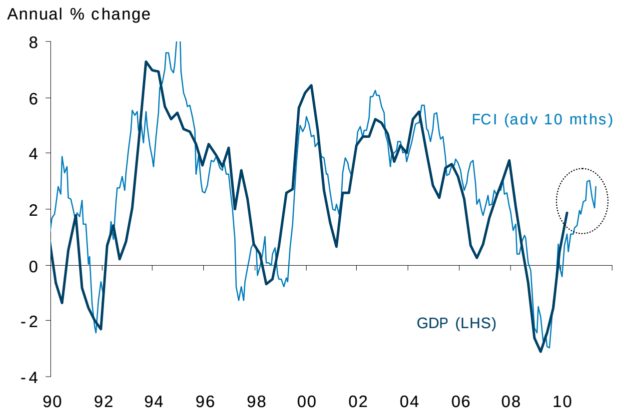


Sources: ANZ, National Bank, Bloomberg

LOWER FIXED MORTGAGE RATES EASES NZ FINANCIAL CONDITIONS A TAD

Our NZ FCI tightened over recent months on the back of weaker asset prices, higher floating mortgage rates and a widening in the CDS spread of the big four Australian banks. However, **the most recent reading showed a slight easing in overall financial conditions**, despite further downward pressure on asset prices and a slight rise in the NZD. The main driver for this has been the fall in fixed rate mortgage rates, on the back of lower swap rates.

NZ GDP vs Financial Conditions Index



Sources: ANZ, National Bank, Statistics NZ

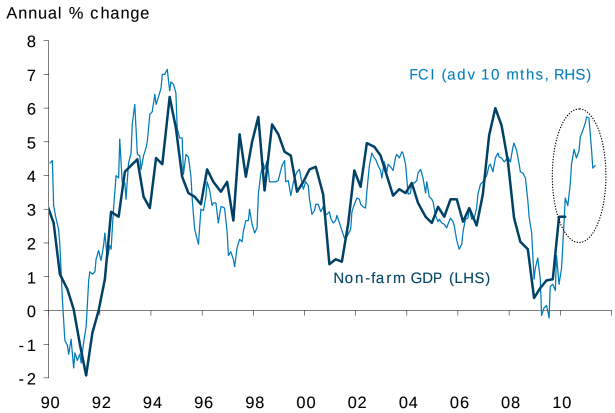
The level of our NZ FCI is consistent with year-on-year growth of around 2½ percent by mid next year, which is a rather modest rate given the depth of the downturn. The latest Fonterra auction suggests that we can expect a correction to NZ's record high commodity prices. And with the RBNZ expected to lift the OCR again in July, floating rates will move up, leading to a tightening in financial conditions.

AUSTRALIAN FINANCIAL CONDITIONS TIGHTENED BUT STILL CONSISTENT WITH ROBUST GROWTH

Our AU FCI has shown a considerable tightening over the past few months, but off a high level. A lot of the tightening occurred via lower equity prices and a widening in the CDS of the big four Australian banks. Higher house prices provided an offset, as did a lower commodity adjusted currency.

But rather than signalling a sharp turn in Australian growth, **our AU FCI indicates that the economy is easing from an unsustainable pace towards one that is closer to trend.** A few months back, the FCI was flagging year-on-year growth of close to 6 percent. Current levels are consistent with growth closer to 4 percent.

AU GDP vs Financial Conditions Index



Sources: ANZ, National Bank, Bloomberg

THE UPSHOT

Our FCIs have shown some tightening in financial conditions over recent months, but are more in line with a moderation and levelling out in growth momentum as opposed to something more ominous. Of course a key factor behind this has been the rally we have seen in longer-dated yields, which in effect is a sign that the market has taken note and provided an offset to the tightening in financial conditions delivered elsewhere (e.g. asset prices). Eurozone growth will be sluggish but still positive. NZ's recovery looks to be more muted compared to past cycles. Australian and US growth looks to be pushing down a gear but towards a more sustainable pace. **Over the coming months, we intend to extend our FCI coverage to include the major Asian economies.**

JUNE 2010 QUARTER CPI PREVIEW

SUMMARY

We expect a 0.6 percent quarterly increase, with annual CPI inflation edging to 2.1 percent. Large positive contributions are expected from tobacco, electricity, transportation and the usual seasonal influences. In an underlying sense, inflationary pressures are expected to remain contained with non-tradable inflation excluding one-offs anticipated to increase by 0.5 percent. Furthermore, if food prices for the June month (published Tuesday) significantly undershoot our expectations, we are likely to revise our pick to 0.5 percent. Price increases due to government policy changes are expected to contribute to sharply increasing quarterly CPI reads over the next two quarters, causing annual CPI inflation to approach 5 percent by year end.

CONSUMERS PRICE INDEX – JUNE 2010 QUARTER (DUE FRIDAY 16 JULY, 10.45AM)

CPI Components	Quarterly % change	% -point contrib.	Annual % change
Food	-0.4	*-0.1*	-0.2
Alcohol and Tobacco	3.0	*0.2*	4.9
Clothing and Footwear	1.0	*0.0*	1.5
Housing and Household Utilities	0.7	*0.2*	1.8
Household Contents and Services	0.2	*0.0*	-1.4
Health	1.1	*0.1*	4.1
Transport	1.2	*0.2*	7.0
Communication	0.0	*0.0*	-1.6
Recreation and Culture	-0.6	*-0.1*	-0.7
Education	-0.3	*0.0*	4.5
Miscellaneous Goods and Services	0.7	*0.1*	1.1
All Groups	**0.6**	***0.6***	**2.1**
Tradables	**0.2**	***0.1***	**1.5**
Non-tradables	**0.9**	***0.5***	**2.5**

We expect a 0.6 percent quarterly increase in the CPI, taking annual CPI inflation to 2.1 percent. **The increase in the quarterly CPI is expected to be driven by a near 9 percent increase in cigarettes and tobacco prices, due to a rise in tobacco excise taxes on 29 April.** This will add around 0.2 percentage points to the quarterly CPI increase. Higher fuel and electricity prices, higher prices for vehicles and a seasonal rise in airfares and apparel are expected to make positive contributions. Other modest price increases are expected to be scattered throughout the CPI regimen, and to be more evident in the services sector.

Partly offsetting contributions are anticipated to come from lower food prices (largely on account of lower prices for meat and fresh fruit and vegetables), and seasonal falls in accommodation and package holiday costs. **We expect the weak retail environment to also contribute to additional retail discounting.** The Q1 CPI outturn did show some evidence of retail discounting for consumer durables and we expect more of the same in Q2. A key downside risk to our forecast will be from more aggressive retail discounting than we had assumed.

Lower food prices are expected to contribute to a modest 0.2 percent quarterly increase for tradable CPI. In the absence of lower food prices, quarterly tradable inflation would be 0.4 percent. We are assuming a strong monthly increase in food prices for the June month (published tomorrow). If this does not eventuate, our Q2 CPI quarterly pick will ease to 0.5 percent, the same as forecast by the RBNZ in the June MPS.

Excluding the impact of the tobacco excise tax, we anticipate a 0.5 percent increase for quarterly non-tradable inflation. But non-tradable prints always seem to have one-offs from quarter to quarter, so we must not lose sight of the headline, which we expect to come in at 0.9 percent. This will leave the annual rate of non-tradable inflation low at 2.5 percent. But firming inflation expectations and a falling unemployment rate portend of rises ahead.

Inflation is set to move considerable higher over 2010. This is mostly on account of government policy, with the ETS, vehicle licensing fee increases and a rise in GST expected to temporarily boost quarterly consumer price inflation over the remainder of 2010. **The key for monetary policy will be the extent to which these administered price increases spill over into generalised inflationary pressure.** To date competitive pressures are holding firms back from pushing through increases. The latest QSBO showed that past price increases were steady at +13. However, surveyed pricing intentions have spiked higher and if businesses see scope to pass on cost increases (and even rebuild margins) we may see a broadening in inflationary pressure.

FINANCIAL MARKET IMPLICATIONS

The RBNZ detailed three critical judgements in the June MPS, namely (a) the extent to which the economy continues to deleverage, (b) the impact of the spike in inflation on wage setting and price setting behaviour and (c) developments in Europe and the global scene. **Thursday's CPI release may invoke a bit of noise on the day, but we think it is these judgements that hold sway.** We see potential downside risk to our 0.6 percent forecast. One clear message from the CPI though, is that inflation has receded during the recession but has not been crushed. This in turn means less scope to grow above trend for a length of time without seeing inflation pressures emerge.

MONTHLY INFLATION GAUGE

SUMMARY

Our monthly inflation gauge rose by 0.2 percent in June, following a 0.1 percent increase in May. For the June quarter, our inflation gauge rose by 1.6 percent, though we do not expect the official CPI non-tradable inflation to rise by that much, when reported later this week. Our inflation gauge is likely to be high in July given some notable price increases such as electricity prices due to the ETS and vehicle registration fees, not to mention the GST increase on 1 October. Near term non-tradable inflation will stay high throughout this year. We will continue to monitor our gauge closely to see if one-off government policy changes are leading to spill over into generalised price increases.

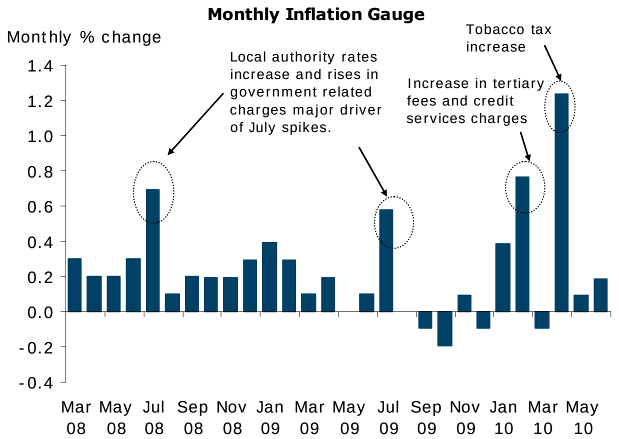
MONTHLY INFLATION SUBDUED IN JUNE

Our Monthly Inflation Gauge is intended to provide a timely indication of broad trends in CPI non-tradable inflation. While designed to be as comparable as possible to the official quarterly non-tradable CPI, differences in methodology and coverage mean the gauge will not exactly mirror the official series. However, it is proving to be a useful indicator of the broad direction of domestic inflationary trends.

The 0.2 percent increase in our monthly inflation gauge for June follows the 0.1 percent increase in May. Of the eight groups, five recorded monthly increases, two registered no change and one recorded a fall in the month. The biggest increases were recorded for insurance, housing group and professional services. For the latter, there were larger than usual increases for health related services. Domestic air and sea transport also recorded price rises. The only notable decline in prices during the month was for alcoholic beverages. This reflected specials that were being advertised at the time when our survey was done.

While our inflation gauge was benign over the past two months, **given the sharp 1.2 percent increase recorded in April due to the tobacco tax increase, our inflation gauge for the quarter average has risen by 1.6 percent.** This is the strongest quarterly increase since we began compiling the series, and points to a strong non-tradable CPI print when the official CPI data is released this week. However, we do not expect the official data to be as high, and are expecting an outturn closer to 1 percent.

We have already noted some large price increases for July already, especially for vehicle registration and licensing fees, which rose by between 10 and 45 percent from 1 July. We note that electricity prices will also increase due to the ETS, and July is the month when local authority rates increases occur. These all point to a large spike in our gauge for July, and sets up another large non-tradable inflation print for Q3. Of course, with GST rising from 1 October, this also means Q4 non-tradable CPI will also stay high. **We will monitor our gauge closely in the coming months to see if a more generalised spill over in pricing behaviour occurs.**



Source: ANZ

	Monthly Inflation Gauge (Index)	Monthly Inflation Gauge (m/m%)	Implied Inflation Gauge (q/q%)	Actual non-tradable CPI (q/q%)
Feb-08	1000			
Mar-08	1003	0.3		1.1
Apr-08	1005	0.2		
May-08	1007	0.2		
Jun-08	1010	0.3	0.6	0.9
Jul-08	1017	0.7		
Aug-08	1018	0.1		
Sep-08	1020	0.2	1.1	1.3
Oct-08	1022	0.2		
Nov-08	1024	0.2		
Dec-08	1027	0.3	0.6	0.8
Jan-09	1031	0.4		
Feb-09	1034	0.3		
Mar-09	1035	0.1	0.9	0.7
Apr-09	1037	0.2		
May-09	1037	0.0		
Jun-09	1038	0.1	0.4	0.5
Jul-09	1044	0.6		
Aug-09	1044	0.0		
Sep-09	1043	-0.1	0.6	1.0
Oct-09	1041	-0.2		
Nov-09	1042	0.1		
Dec-09	1041	-0.1	-0.2	0.1
Jan-10	1045	0.4		
Feb-10	1053	0.8		
Mar-10	1052	-0.1	0.8	0.5
Apr-10	1065	1.2		
May-10	1066	0.1		
Jun-10	1068	0.2	1.6	

INTEREST RATE STRATEGY

SUMMARY

Pessimism has given way to cautious optimism. But correlation across markets remains high, suggesting that sentiment is fickle still, and may swing yet again. Nonetheless, the whole episode has been useful in the sense that it was a reminder not to get too caught up in the moment. The NZ (and global) recovery is progressing, it's just patchy and gradual, but it was always going to be. In the absence of a calamity, in this environment the trend outlook for interest rates is higher.

MARKET THEMES

- Market fears of a US double-dip recession and a China slowdown look to have been over-done. Expect NZ rates to drift higher as the so-called "risk on" theme takes hold again.
- High correlation across markets suggests there is a lack of discernment. Themes like flexibility and sustainability are likely to emerge soon, and NZ measures up well in this regard.
- Monetary policy remains stimulatory, and is set to be removed, albeit gradually. Furthermore, policy is set to go beyond neutral if history is anything to go by, although this is a long way (read: years) further down the track.

REVIEW AND OUTLOOK

What a difference a week makes. Risk is back on the table, with US bond yields, equity, and commodity markets up every day last week. Panic has retreated, and rational thought is returning. One sign in the region was the shift in expectations in the Australian market, which was pricing in a cut at the RBA's next move. It's now pricing in hikes. But will this be a brief reversal? **Correlation among markets remains very high** and the herd is still travelling as one. **Fresh themes will emerge, and we expect sustainability and flexibility** to be among them. Sovereign debt remains a major issue, but as we look beyond the problem, the real issue lies in how it's tackled.

The swing in global sentiment towards pessimism has also seen pessimism emerge in NZ, and some commentators are calling for a pause to rate hikes. Pauses are likely, but not just yet. **The removal of stimulus remains a key priority for the RBNZ,** and although key barometers like business confidence have softened, they remain positive. This isn't a textbook recovery, but then again, **long term rates below levels associated with earlier recessions isn't normal either.** We continue to be surprised by this – whereas the short end has been unwavering in its eagerness to price in hikes despite global jitters, the long end is in no mood to acknowledge the likely long term direction of the economy, and by implication, interest rates.

PREFERRED BORROWING STRATEGIES

Global market sentiment is fickle, but it's something that borrowers need to come to grips with, as it is having a significant impact on interest rates, and hedging choices. Last week the market consensus was that we were on the brink of a double-dip recession, with rate cuts on the cards in Australia. Such thinking is plainly absurd, and as former Fed chairman Greenspan has noted, what the US is going through is more likely to be a pause, than the early stages of a meltdown. We expect the trend rise in interest rates to resume as sentiment improves, and the reality of a gradual recovery (albeit one punctuated by shocks and surprises) gets priced back into the curve. We strongly believe borrowers should consider what place 5yr and 10yr rates may have in a hedge portfolio below 5% and 5.50% respectively. View the fall in rates with opportunity, rather than caution and suspicion.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔/↓	Recent uncertainty a strong reminder of fragility.
NZ data	↔	Q2 CPI, REINZ and retail sales data this week hold the keys.
Fed Funds / front end	↔	On hold for a while yet.
RBA	↔	The market has started to price rate hikes back in.
US 10 year	↔/↑	10yr UST's reject the advance through 3%.
NZ swap curve	↔/↑	Curve to steepen as the rise in long end yields outpaces the re-pricing of OCR hikes.
Flow	↔	Lower mortgage rates have not enticed much pay flow.
Technicals	↔/↑	Can 10yr sustain <5.5%?

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 29-Jul-10	+22	+20
Thu 16-Sep-10	+35	+44
Thu 28-Oct-10	+61	+59
Thu 9-Dec-10	+77	+72
Thu 27-Jan-11	+99	+84
Thu 10-Mar-11	+110	+101
Thu 28-Apr-11	+121	+114

TRADING THEMES WE FAVOUR AT PRESENT

Short end NZ rates have been less responsive to global sentiment swings than their Australian counterparts, and had started to converge as sentiment faded. Look for AU 12mth OIS to underperform relative to NZ. Similarly, with UST yields now rising, expect NZGS to outperform.

CURRENCY STRATEGY

SUMMARY

Last week was a very positive week for the global economy and NZ's major trading partners. China announced new stimulus plans, Australian data on employment and trade all printed strong and the global equity market was inspired by the thought of a strong earnings season in the US. In contrast the local newsflow (QSBO and Fonterra auction) was weaker than expected. Yet, the NZD still tracked higher. This points to offshore themes and sentiment continuing to dominate, and for the NZD to stay near the top of its recent range.

MARKET THEMES

- Australia and Canada employment frenzy.
- US favours spending. Europe favours saving.
- NZD to follow equities again, washing around in the 0.6800-0.7140 range.
- US earnings season is upon us, giving investors something to focus on. The NZD fortunes will be tied to global equity market moves regardless of the domestic dataflow.

REVIEW AND OUTLOOK

The seesawing investor sentiment continues to frustrate any medium term positioning. From despairing about the possibility of a double dip, investors were back snapping up risk assets last week. The argument for sustainable moves in either direction can be made. But the question always being asked is how fast can the global economy continue to grow without the assistance of government stimulus. The IMF certainly sees better prospects, revising their global growth forecast for 2010 up from 4.2 percent to 4.6 percent. And the Bank of Korea and Bank Negara last week joined other central banks in hiking their official policy rates. Things cannot be all that bad if central banks in Asia are hiking.

The offshore focus will shift towards the US earnings reporting season due to kick off this week. The last quarter's reporting season largely beat market expectations, and many will be hoping for something similar this time around. Equity market sentiment will be closely tied to how the earnings fare relative to expectations, and like it or not, the NZD's near term fortunes will be linked to the wider equity market moves.

Domestically, the Q2 CPI data in NZ is the major focus. We do not expect much surprises in the data, and therefore we are unlikely to see much currency reaction. Indeed, the NZD brushed off fairly soft local data last week (QSBO and Fonterra auction).

The Australian Q2 CPI print at the end of this month is likely to attract far more attention in changing market expectations towards the extent of the RBA pause.

Technically, the 200 day MA for the NZD/USD at 0.7120 has provided a major barrier to the upside and a daily close above 0.7150 would be required for us to be confident we have broken higher. The base at 0.6800 is now key to the down side. The NZD/AUD cross looks set to target 0.8000 again as employment gains in Australia should encourage investment more than the 14 percent reduction seen in the Fonterra July auction.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↔	At fair value now.
Yield	↔/↑	RBA on hold, RBNZ to hike.
Commodities	↔	Dairy price decline last week larger than expected.
Partial indicators	↓	Aussie employment hard to top.
Technicals	↓	Target 0.80.
Sentiment	↔	Still tracking equity market moves.
Other	↔/↓	CPI for NZ and Australia to be next key focus.
On balance	↔	**Range trade 0.78-0.83.**

NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↔/↓	Above structural fair value of 0.66.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↔/↑	RBNZ still set to hike in July. Fed on hold for a long time.
Commodities	↔/↓	Early signs of NZ commodities correcting?
Risk aversion	↔	Changes daily.
Partial indicators	↔/↑	Market concerned about double dip in the US.
Technicals	↔	0.7120 200 day MA has capped.
AUD	↔	0.8850 capping on the topside to date.
Sentiment	↔	NZD more aligned to offshore moves.
Other	↔	US earnings season key to watch over next few weeks.
On balance	↔	**0.6800 – 0.7140 defines the current range.**

EFFECTIVE EXCHANGE RATE UPDATE

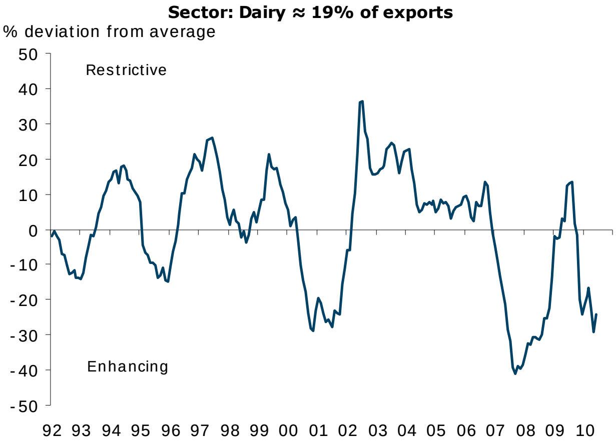
SUMMARY

We present an update of our real effective exchange rate (REER) measures across New Zealand's main export industries. These measures take into account the world prices of our exports (commodity prices in the case of commodity exporters), adjusted for currency movements based on their main destinations. Six of the eight industry groups experienced a more enhancing REER in June, largely due to a lower NZD. Conditions are in enhancing territory for four groups that we monitor, with the REER for dairying, meat and horticulture significantly below historical averages. However the REER remain in restrictive territory for three of the groups.

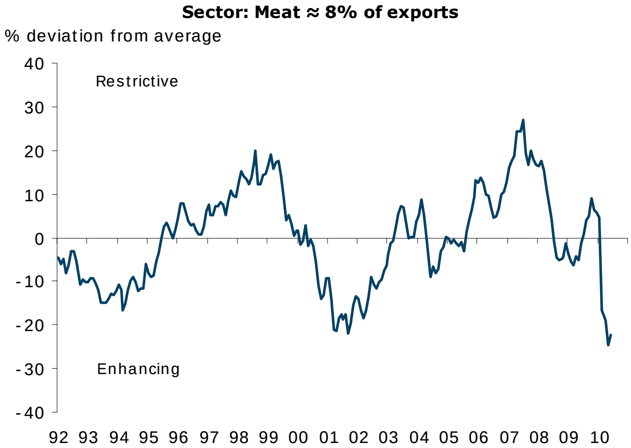
LOWER NZD ENHANCES CONDITIONS FOR MOST GROUPS

Largely due to the NZD falling against the USD, Yen and Sterling, six of the eight industry groups experienced a more enhancing REER in June. The largest move into trade enhancing territory was for crude oil, seafood and horticulture, with the latter two groups benefiting from a lift in export commodity prices. A more sizeable fall in dairy export prices contributed to the exchange rate for dairying moving into slightly less enhancing territory, whereas the higher NZD/AUD resulted in the effective exchange rate for manufacturing remaining broadly unchanged from May.

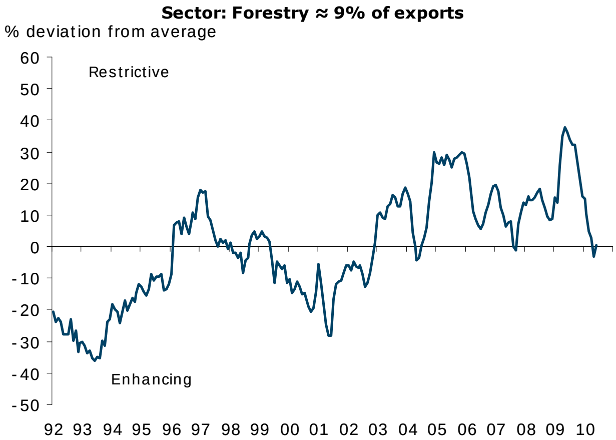
Conditions are in enhancing territory for half of the groups we monitor. REERs are in enhancing territory for dairy, meat, seafood and horticulture. Those for forestry are in slightly restricted territory, with the REER in more restrictive territory for services, manufacturing and crude. **Compared to a year ago, REERs have improved for four of the eight groups.** The most striking improvement has been for dairy, meat and forestry. **With the NZD having fallen by around 5 percent against the USD since the start of the year, the buffering role of the NZD will become more important should commodity prices start to correct from current high levels.**



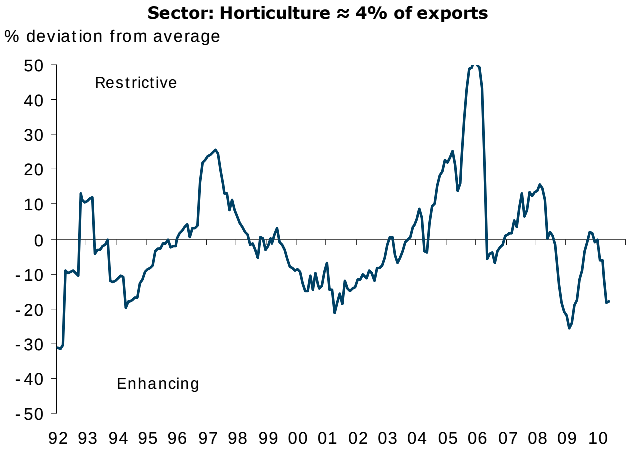
Sources: ANZ, Bloomberg, Statistics NZ



Sources: ANZ, Bloomberg, Statistics NZ



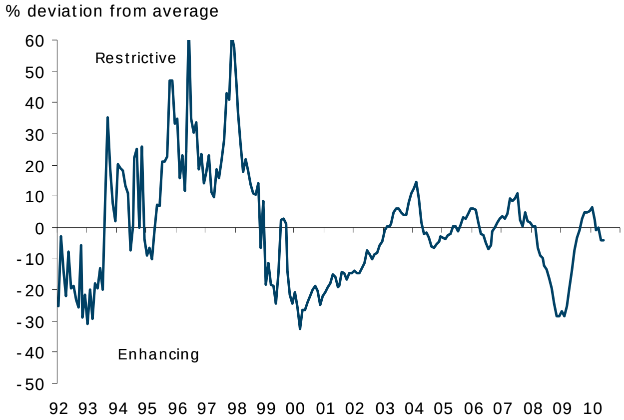
Sources: ANZ, Bloomberg, Statistics NZ



Sources: ANZ, Bloomberg, Statistics NZ

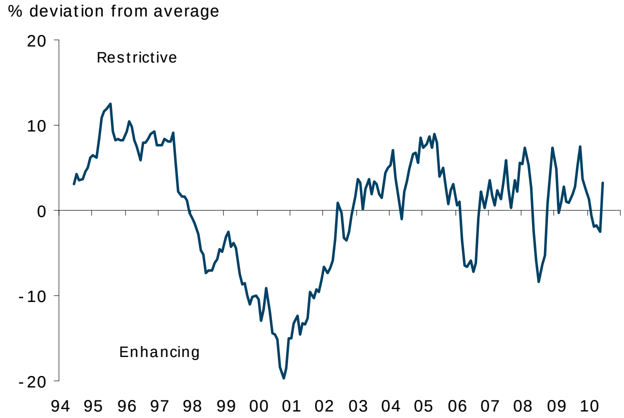
EFFECTIVE EXCHANGE RATE UPDATE

Sector: Seafood ≈ 3% of exports



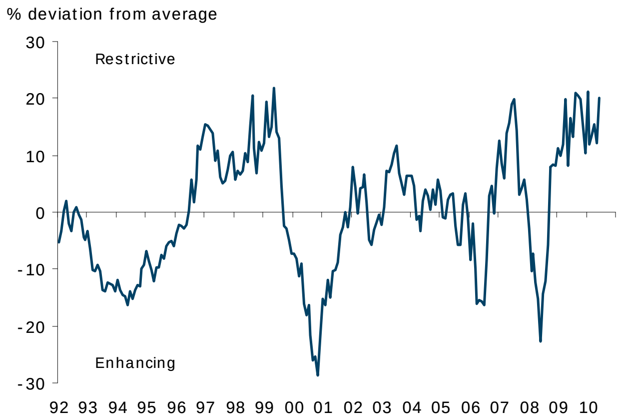
Sources: ANZ, Bloomberg, Statistics NZ

Sector: Manufacturing ≈ 20% of exports



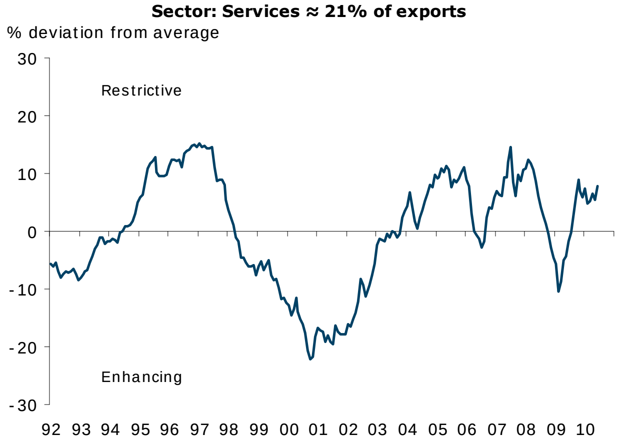
Sources: ANZ, Bloomberg, Statistics NZ

Sector: Crude ≈ 5% of exports



Sources: ANZ, Bloomberg, Statistics NZ

Sector: Services ≈ 21% of exports



Sources: ANZ, Bloomberg, Statistics NZ

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
12-Jul	AU	Home Loans - MAY	0.00%	-1.80%	13:30
	AU	Investment Lending - MAY	- -	1.30%	13:30
	AU	Value of Loans MoM - MAY	- -	0.60%	13:30
	UK	GDP (QoQ) - 1Q F	0.30%	0.30%	20:30
	UK	GDP (YoY) - 1Q F	-0.20%	-0.20%	20:30
	UK	Current Account (BP) - 1Q	-4.5B	-1.7B	20:30
	UK	Index of Services (3mth/3mth) - APR	0.40%	0.20%	20:30
13-Jul	**NZ**	**Food Prices (MoM) - JUN**	**- -**	**-0.70%**	**10:45**
	UK	RICS House Price Balance - JUN	20%	22%	11:01
	AU	NAB Business Conditions - JUN	- -	6	13:30
	AU	NAB Business Confidence - JUN	- -	5	13:30
	JN	Industrial Production (MoM) - MAY F	- -	-0.10%	16:30
	JN	Industrial Production YOY% - MAY F	- -	20.20%	16:30
	JN	Capacity Utilization (MoM) - MAY F	- -	0.00%	16:30
	JN	Consumer Confidence - JUN	- -	42.7	17:00
	GE	Wholesale Price Index (MoM) - JUN	0.20%	0.30%	18:00
	GE	Wholesale price Index (YoY) - JUN	5.50%	6.20%	18:00
	UK	CPI (MoM) - JUN	0.00%	0.20%	20:30
	UK	CPI (YoY) - JUN	3.10%	3.40%	20:30
	UK	Core CPI YOY - JUN	2.80%	2.90%	20:30
	UK	DCLG UK House Prices (YoY) - MAY	10.20%	10.10%	20:30
	EC	ZEW Survey (Econ. Sentiment) - JUL	16.3	18.8	21:00
	GE	ZEW Survey (Econ. Sentiment) - JUL	25.3	28.7	21:00
	GE	Zew Survey (Current Situation) - JUL	-1.2	-7.9	21:00
14-Jul	US	Trade Balance - MAY	-$39.0B	-$40.3B	00:30
	US	Monthly Budget Statement - JUN	-$69.5B	-$135.9B	06:00
	NZ	**REINZ House Sales YoY% - JUN**	**- -**	**-17.20%**	**10:00**
	NZ	**REINZ Housing Price Index MoM% - JUN**	**- -**	**-1.40%**	**10:00**
	NZ	**Retail Sales (MoM) - MAY**	**0.50%**	**-0.30%**	**10:45**
	NZ	**Retail Sales Ex-Auto (MoM) - MAY**	**0.60%**	**-0.20%**	**10:45**
	UK	Nationwide Consumer Confidence - JUN	62	65	11:01
	AU	Westpac Consumer Confidence - JUL	- -	-5.70%	12:30
	AU	DEWR Skilled Vacancies MoM - JUL	- -	-0.30%	13:00
	NZ	**Non Resident Bond Holdings - JUN**	**- -**	**64.10%**	**15:00**
	JN	BoJ Monetary Policy Meeting - JUL			16:00
	UK	Claimant Count Rate - JUN	4.50%	4.60%	20:30
	UK	Jobless Claims Change - JUN	-20.0K	-30.9K	20:30
	UK	Average Weekly Earnings 3M/YoY - MAY	3.00%	4.20%	20:30
	EC	Euro-Zone CPI (MoM) - JUN	0.00%	0.10%	21:00
	EC	Euro-Zone CPI (YoY) - JUN F	1.40%	1.40%	21:00
	EC	Euro-Zone CPI - Core (YoY) - JUN	0.90%	0.80%	21:00
	EC	Euro-Zone Ind. Prod. sa (MoM) - MAY	1.20%	0.80%	21:00
	EC	Euro-Zone Ind. Prod. wda (YoY) - MAY	11.40%	9.50%	21:00
15-Jul	US	Advance Retail Sales - JUN	-0.30%	-1.20%	00:30
	US	Retail Sales Less Autos - JUN	0.00%	-1.10%	00:30
	US	Retail Sales Ex Auto & Gas - JUN	0.20%	-0.80%	00:30
	US	Business Inventories - MAY	0.30%	0.40%	02:00
	US	Minutes of FOMC Meeting - JUL			06:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
15-Jul	**NZ**	**Business NZ PMI - JUN**	**- -**	**54.5**	**10:30**
	AU	Consumer Inflation Expectation - JUL	- -	3.40%	13:00
	AU	New Motor Vehicle Sales MoM - JUN	- -	-3.20%	13:30
	CH	Real GDP YoY - 2Q	10.50%	11.90%	14:00
	CH	Producer Price Index (YoY) - JUN	6.80%	7.10%	14:00
	CH	Purchasing Price Index (YoY) - JUN	11.60%	12.20%	14:00
	CH	Consumer Price Index (YoY) - JUN	3.30%	3.10%	14:00
	CH	Retail Sales (YoY) - JUN	18.80%	18.70%	14:00
	CH	Industrial Production (YoY) - JUN	15.10%	16.50%	14:00
	JN	BOJ Target Rate - JUL	0.10%	0.10%	12:00
	JN	Machine Tool Orders (YoY) - JUN F	- -	138.80%	18:00
	EC	ECB Publishes July Monthly Report - JUL			20:00
	UK	BoE Housing Equity Withdrawal - 1Q	-£3.5B	-£4.0B	20:30
16-Jul	US	Producer Price Index (MoM) - JUN	-0.10%	-0.30%	00:30
	US	PPI Ex Food & Energy (MoM) - JUN	0.10%	0.20%	00:30
	US	Producer Price Index (YoY) - JUN	3.10%	5.30%	00:30
	US	PPI Ex Food & Energy (YoY) - JUN	1.10%	1.30%	00:30
	US	Initial Jobless Claims - 10 Jul	447K	454K	00:30
	US	Continuing Claims - 3 Jul	4500K	4413K	00:30
	US	Empire Manufacturing - JUL	18	19.57	00:30
	US	Industrial Production - JUN	-0.10%	1.20%	01:15
	US	Capacity Utilization - JUN	74.20%	74.70%	01:15
	US	Philadelphia Fed. - JUL	10	8	02:00
	NZ	**CPI (QoQ) - 2Q**	**0.50%**	**0.40%**	**10:45**
	NZ	**CPI (YoY) - 2Q**	**2.00%**	**2.00%**	**10:45**
	JN	Nationwide Dept. Sales (YoY) - JUN	- -	-2.10%	17:30
	JN	Tokyo Dept. Store Sales (YoY) - JUN	- -	-1.80%	17:30
	EC	Euro-Zone Trade Balance - MAY	-0.5B	1.8B	21:00
	EC	Euro-Zone Trade Balance sa - MAY	0.8B	1.4B	21:00
17-Jul	US	Consumer Price Index (MoM) - JUN	-0.10%	-0.20%	00:30
	US	CPI Ex Food & Energy (MoM) - JUN	0.10%	0.10%	00:30
	US	Consumer Price Index (YoY) - JUN	1.20%	2.00%	00:30
	US	CPI Ex Food & Energy (YoY) - JUN	0.90%	0.90%	00:30
	US	Consumer Price Index NSA - JUN	218.288	218.178	00:30
	US	Net Long-term TIC Flows - MAY	- -	$83.0B	01:00
	US	Total Net TIC Flows - MAY	- -	$15.0B	01:00
	US	U. of Michigan Confidence - JUL P	74	76	01:55

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

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

Note: All surveys are preliminary and subject to change.

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: Last week's data confirmed that the expansion remains sluggish, with increasing concerns over the global expansion weighing down on export commodity prices. This week sees the release of housing and retail data, with Q2 CPI inflation to be published on Friday. The July OCR is the key event at the end of this month. For the published Q2 data we expect signs of improvement to be evident with leading soft gauges to continue pointing towards a steady rate of growth for the remainder of 2010.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 13 Jul (10:45am)	Food Price Index -Jun	Up	Partly on account of retail discounting, food prices have been falling over the past two months. Continued strength in food commodity prices suggests rising food prices are in prospect.
Wed 14 Jul (10:00am)	REINZ Housing Market Statistics - Jun	Modest	With the Budget uncertainties out of the way, we expect modest improvement in sales volumes in the coming months. This is unlikely to translate through for June yet though, with prices set to continue moderating.
Wed 14 Jul (10:45am)	Retail Trade Survey – May	Improving	Retail indicators suggest a monthly increase of approximately 0.6 percent. We expect a firming in retail spending over the coming months.
Thur 15 Jul (10:30am)	BNZ – Business NZ PMI - Jun	Tracking	New Zealand followed the global trend, with the May PMI slightly down on April's multi-year peaks. We expect June readings to be slightly down on May.
Fri 16 Jul (10:45am)	Consumers Price Index – Q2	Uneven	Positive contributions from higher oil and electricity prices, the tobacco excise and the usual seasonal pattern will offset lower food prices and contribute to a 0.6 percent quarterly increase.
Wed 21 Jul (10:45am)	SNZ External Migration - Jun	Easing	The trend in net PLT immigration has been easing in recent months, as departures continue to trend up. We expect net PLT immigration of around zero persons in June. While disruptions from European volcanic ash have now eased, a rebound in seasonally adjusted visitor arrival numbers is a month or two away.
Thur 22 Jul (3:00pm)	ANZ-Roy Morgan Consumer Confidence - July	- -	- -
Wed 28 Jul (3:00pm)	National Bank Business Outlook - Jul	- -	- -
Thur 29 July (9:00am)	RBNZ July OCR	+25	We expect the RBNZ to continue the journey of removing policy accommodation.
Thur 29 July (10:45am)	Overseas Merchandise Trade – June	Surplus	We expect a monthly trade surplus of around $600m, the fifth consecutive monthly surplus. The annual trade surplus is expected to rise to around $1bn.
Fri 30th July (10:45am)	Building Consents - June	Up	Much of the 9.6 percent fall in the number of May residential consents should be reversed in June. Sizeable increases in non-residential consent values are anticipated over the next few months.
Mon 2 Aug (3:00pm)	ANZ Commodity Price Index - Jul	- -	- -
Tue 3 Aug (10:45am)	Labour Cost Index and Quarterly Employment Survey – Q2	Improving	Earnings growth is expected to pick-up from decade lows as skill shortages become more acute.
Thur 5 Aug (10:45am)	Household Labour Force Survey – Q2	Gradual	A repeat of the barnstorming Q1 surge in employment is unlikely. We expect a more modest 0.2 increase with hours worked to increase by 0.5 percent. Stronger growth in the labour force sees the unemployment rate rise to 6.3 percent.
On Balance		**Building**	**Recovery continuing**

ECONOMIC FORECASTS AND INDICATORS

	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
GDP (% qoq)	0.3	0.9	0.6	**0.7**	**1.5**	**-0.1**	**1.1**	**1.3**	**1.6**	**0.5**
GDP (% yoy)	-1.5	0.5	1.9	**2.5**	**3.7**	**2.7**	**3.2**	**3.9**	**4.0**	**4.6**
CPI (% qoq)	1.3	-0.2	0.4	**0.6**	**1.1**	**2.8**	**0.6**	**1.0**	**0.8**	**0.5**
CPI (% yoy)	1.7	2.0	2.0	**2.1**	**1.9**	**4.9**	**5.2**	**5.6**	**5.3**	**3.0**
Employment (% qoq)	-0.7	0.0	1.0	**0.2**	**0.4**	**0.6**	**0.6**	**0.7**	**0.6**	**0.4**
Employment (% yoy)	-1.8	-2.4	-0.1	**0.6**	**1.7**	**2.2**	**1.8**	**2.3**	**2.5**	**2.3**
Unemployment Rate (% sa)	6.5	7.1	6.0	**6.3**	**6.0**	**5.6**	**5.4**	**5.0**	**4.9**	**4.9**
Current Account (% GDP)	-3.2	-2.9	-2.4	**-2.9**	**-3.7**	**-2.8**	**-3.0**	**-3.1**	**-2.9**	**-2.9**
Terms of Trade (% qoq)	-1.6	5.8	5.8	**3.9**	**2.4**	**1.0**	**-0.6**	**-0.6**	**0.1**	**-1.0**
Terms of Trade (% yoy)	-14.1	-8.2	-0.2	**14.4**	**19.1**	**13.7**	**6.8**	**2.2**	**-0.2**	**-2.0**

	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10
Retail Sales (% mom)	0.4	0.0	0.8	-0.5	0.7	-0.5	0.5	-0.3	..	..
Retail Sales (% yoy)	-0.5	-0.2	2.4	2.0	2.3	2.4	4.4	2.7	..	..
Credit Card Billings (% mom)	-0.7	0.2	0.8	-1.2	1.5	-0.3	0.7	-1.6	1.9	..
Credit Card Billings (% yoy)	-2.3	-0.3	1.6	1.9	2.7	1.1	5.2	0.7	3.4	..
Car Registrations (% mom)	8.4	0.5	2.2	6.9	-0.7	0.0	5.1	3.0	-3.7	..
Car Registrations (% yoy)	-16.8	-16.8	2.4	0.3	15.9	31.4	31.7	40.5	30.5	..
Building Consents (% mom)	5.5	11.2	0.6	-3.8	-2.7	6.1	-0.2	8.3	-9.5	..
Building Consents (% yoy)	-11.6	26.5	20.3	22.7	35.2	29.9	33.4	32.0	11.1	..
REINZ House Price (% yoy)	6.1	6.0	5.2	9.6	7.7	6.1	7.6	4.7	3.7	..
Household Lending Growth (% mom)	0.3	0.4	0.0	0.2	0.2	0.1	0.2	0.2	0.2	..
Household Lending Growth (% yoy)	2.4	2.6	2.7	2.7	2.7	2.7	2.8	2.7	2.5	..
ANZ-Roy Morgan Consumer Confidence	120.0	125.9	121.5	118.6	131.4	123.6	121.8	121.9	126.0	122.0
NBNZ Business Confidence	49.1	48.2	43.4	38.5	..	50.1	42.5	49.5	48.2	40.2
NBNZ Own Activity Outlook	32.2	30.5	33.7	36.9	..	41.9	38.6	43.0	45.3	38.5
Trade Balance ($m)	-561.5	-501.5	-280.4	-26.4	271.1	327.8	607.1	665.4	814.2	..
Trade Balance ($m annual)	-1669	-1176	-863	-549	-176	-330	-161	182	91	..
ANZ World Commodity Price Index (% mom)	7.4	4.7	10.9	2.6	0.4	4.0	1.8	5.4	2.8	-1.2
ANZ World Commodity Price Index (% yoy)	-12.9	-1.3	18.2	31.0	37.4	49.8	50.9	55.1	55.0	53.3
Net Migration (sa)	1850	2140	1750	1690	1840	1000	940	730	250	..
Net Migration (annual)	17043	18560	20021	21253	22588	21618	20973	19954	17967	..

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	May-10	Jun-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZD/USD	0.681	0.685	0.711	0.700	0.710	0.720	0.730	0.730	0.720	0.710
NZD/AUD	0.805	0.815	0.810	0.795	0.789	0.783	0.777	0.777	0.783	0.789
NZD/EUR	0.553	0.560	0.563	0.579	0.602	0.632	0.652	0.652	0.643	0.634
NZD/JPY	62.11	60.54	63.09	66.50	68.16	69.84	71.54	73.00	72.00	71.71
NZD/GBP	0.468	0.458	0.472	0.479	0.486	0.483	0.480	0.474	0.462	0.449
NZ$ TWI	66.0	66.6	67.5	68.1	69.3	70.7	71.7	71.8	71.1	70.5
INTEREST RATES	May-10	Jun-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZ OCR	2.50	2.75	2.75	3.25	3.25	3.50	4.00	4.50	5.00	5.50
NZ 90 day bill	2.93	3.13	3.20	3.50	3.50	3.90	4.40	4.90	5.40	5.80
NZ 10-yr bond	5.56	5.34	5.42	5.40	5.40	5.60	5.80	6.20	6.20	6.10
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.25
US 3-mth	0.54	0.53	0.53	0.40	0.35	0.35	0.35	0.60	0.85	1.35
AU Cash Rate	4.50	4.50	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.00
AU 3-mth	4.87	4.92	4.89	5.00	5.30	5.60	6.00	6.00	6.20	6.10

	9 Jun	5 Jul	6 Jul	7 Jul	8 Jul	9 Jul
Official Cash Rate	2.50	2.75	2.75	2.75	2.75	2.75
90 day bank bill	3.00	3.16	3.14	3.16	3.21	3.20
NZGB 11/11	3.70	3.74	3.70	3.69	3.73	3.75
NZGB 04/13	4.37	4.22	4.20	4.19	4.22	4.24
NZGB 12/17	5.28	5.17	5.15	5.15	5.17	5.18
NZGB 05/21	5.49	5.41	5.40	5.40	5.42	5.42
2 year swap	4.29	4.15	4.12	4.11	4.17	4.22
5 year swap	5.11	4.86	4.83	4.82	4.86	4.88
RBNZ TWI	65.3	66.2	65.8	66.0	67.0	67.4
NZD/USD	0.6623	0.6912	0.6861	0.6908	0.7060	0.7104
NZD/AUD	0.8067	0.8189	0.8197	0.8158	0.8087	0.8105
NZD/JPY	60.59	60.76	60.08	60.46	62.38	63.00
NZD/GBP	0.4589	0.4552	0.4538	0.4567	0.4651	0.4690
NZD/EUR	0.5543	0.5511	0.5477	0.5490	0.5581	0.5600
AUD/USD	0.8210	0.8441	0.8370	0.8468	0.8730	0.8765
EUR/USD	1.1949	1.2543	1.2527	1.2583	1.2651	1.2686
USD/JPY	91.49	87.90	87.57	87.52	88.35	88.68
GBP/USD	1.4433	1.5185	1.5120	1.5125	1.5181	1.5147
Oil (US$/bbl)	71.88	72.06	72.06	71.96	74.05	75.46
Gold (US$/oz)	1237.05	1213.23	1209.15	1189.50	1204.28	1197.40
Electricity (Haywards)	5.72	4.38	5.97	8.75	9.71	5.40
Milk futures (US$/contract)	121	#N/A	116	116	117	118
Baltic Dry Freight Index	3514	2216	2127	2018	1940	1902

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.
- ING (NZ) Holdings Limited (ING), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ING and its related companies, including ING (NZ) Limited, 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:

IMPORTANT NOTICE

- Providing cash;
- 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.

NEW ZEALAND DISCLAIMER

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.

Each security (including the principal, interest or other returns of any security) the subject of investment advice given to the investor by the Bank or otherwise, is not guaranteed, secured or underwritten in any way by the Bank or any associated or related party except to the extent expressly agreed in the terms of the relevant security.

This document is provided for informational purposes only and does not constitute an offer to sell or solicitation to buy any security or other financial instrument. No part of this document can be reproduced, altered, transmitted to, copied to or distributed to any other person without the prior express permission of the Bank.

This document is a necessarily brief and general summary of the subjects covered and does not constitute advice. You should obtain professional advice before acting on the basis of any opinions or information contained in it. The information contained in this document is given in good faith, has been derived from sources perceived by it to be reliable and accurate and the Bank shall not be obliged to update any such information after the date of this document. Neither the Bank nor any other person involved in the preparation of this document accepts any liability for any opinions or information (including the accuracy or completeness thereof) contained in it, or for any consequences flowing from its use.

UNITED STATES DISCLAIMER

This document is being distributed in the United States by ANZ Securities, Inc. (Member of FINRA [www.finra.org] and registered with the SEC) ("ANZ S") (an affiliated company of Australia and New Zealand Banking Group Limited ("ANZBG") and the Bank), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this document and wishing to effect transactions in any fixed income securities referred to herein should contact ANZ S 277 Park Avenue, 31st Floor, New York, NY 10172 USA, Tel: 1-212-801-9160, Fax: 1-212-801-9163, not its affiliates.

This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy.

In addition, from time to time ANZBG, the Bank, ANZ S, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZBG, the Bank, ANZ S or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will be directly or indirectly related to specific recommendations or views expressed in this document. ANZBG, the Bank, ANZ S, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.