

# NEW ZEALAND ECONOMICS ANZ MARKET FOCUS

21 June 2010

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## GAME ON

### ECONOMIC OVERVIEW

Last week's domestic centric data was pretty subdued but we're taking it as a positive sign that households are getting their balance sheets in order. The RBNZ will be mindful of the credit channel of monetary policy, and last week finally saw actual borrowing rates start to mirror the OCR rise. This week's data is expected to show a more moderate pace of quarterly growth, but it holds the promise of a more sustainable expansion eventuating. The Chinese announcement on Saturday to allow increased exchange rate flexibility was greeted positively by markets, giving the NZD a boost. However, more needs to be done to alleviate global saving and investment imbalances.

### CHINA SIGNALS RESUMPTION TO RMB APPRECIATION

Exactly one week before the G-20 summit, the People's Bank of China (PBoC) announced in a statement on 19 June that it will enhance the flexibility of the RMB exchange rate but still maintain the existing allowed trading band at +/- 0.5 percent. This statement suggests that the RMB is to resume its appreciation path starting today (21 June), similar to the old exchange rate regime before the global financial crisis erupted in September 2008, thus ending a 23-month peg to the US dollar. This is a small step forward, but details as to how the RMB exchange rate can be more flexible remain to be seen. We think by simply returning to the pre-crisis regime is not an optimal policy and we believe the trading band should be enlarged further.

### DATA PREVIEW

The large investment income deficit is expected to offset a climbing trade surplus, with a small current account deficit expected for the March 2010 quarter. The annual current account deficit will narrow further, but this is likely to be as good as it gets in the current cycle. March quarter GDP is expected to confirm the expansion is continuing, albeit at a slightly more moderate pace. Details are likely to hold out the promise of a more sustainable expansion eventuating.

### INTEREST RATE STRATEGY

Short end rates have held stable while the mid to long end of the curve has rallied hard, substantially flattening the yield curve. Yet recent NZ data has been soft, while global themes have tended to have a positive undercurrent, suggesting the opposite should have occurred. The recent announcement that China will allow more currency flexibility is being viewed positively, and may hone the focus on NZ's extremely low long end rates.

### CURRENCY STRATEGY

China has relaxed its peg to the USD, signalling increased flexibility. While the market has taken the initial movement as positive for risk, subsequent comments suggest any move will be muted and the currency implications are not clear cut when we look at the broader picture. Net on net we expect the NZD to remain in its current trend-line, and once the dust settles wider risk appetites and equities to return as dominant drivers. It's a frustrating market but brace for more oscillating moves.

## ECONOMIC OVERVIEW

### SUMMARY

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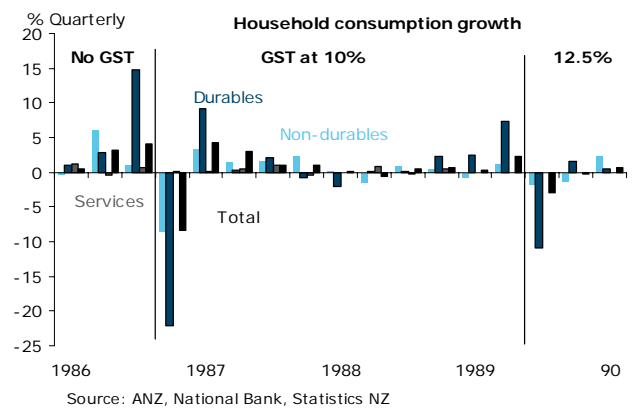
### THIS WEEK'S EVENTS

- **RBNZ Credit Card Billings – May** (Tuesday, June 22, 3:00pm). We expect a small monthly increase given the 0.4 percent increase in retail ECT data for May.
- **SNZ-Balance of Payments – March 2010 quarter** (Wednesday, June 23, 10:45am). We anticipate a quarterly deficit in the region of \$300m with the annual deficit to ease to 2.7 percent of GDP (see our preview on page 8).
- **SNZ-Gross Domestic Product – March 2010 quarter** (Thursday, June 24, 10:45am). A quarterly increase of 0.5 percent is forecast (see our preview on page 8).
- **SNZ-Overseas Merchandise Trade – May** (Friday, June 25, 10:45am). Higher export commodity prices and the normal seasonal pattern are expected to contribute to a trade surplus in the region of \$950m, the fourth consecutive monthly increase. Imports are expected to lift as domestic demand recovers.

### WHAT'S THE VIEW?

Last week's domestic centric data was pretty subdued but we take heart from some of the positive underlying themes. Retail sales came in weak (although a touch stronger than expectations). More timely data (Electronic Card Transactions) suggests an improvement in May. The ANZ-Roy Morgan survey was the first snapshot to take into account the impact of recent developments - including the Budget, June MPS, increasing concerns over European sovereign debt and better than expected Fonterra forecast payout. While overall confidence did ease, households' perceptions of current conditions improved, closing the gap with expectations of future conditions. The ANZ survey is timely as it is the first indicator for June, while the

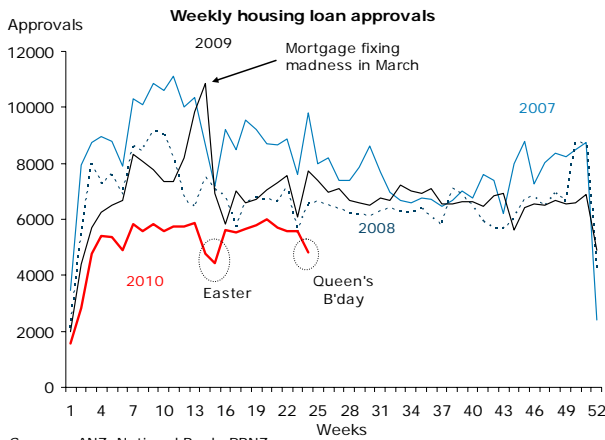
data we are receiving related to May. In particular, it is turning points that are critical to watch in such surveys – especially when there is such a lot going on. Contributing to the improvement in current conditions was a further climb in the proportion of households who thought it was a good time to purchase a major household item. How much this was influenced by the pending increase in GST is uncertain, but historical experience shows more of an impact on durable spending volumes. If consumers are merely bringing forward spending, it suggests the underlying level of confidence is weaker than suggested by the headlines.



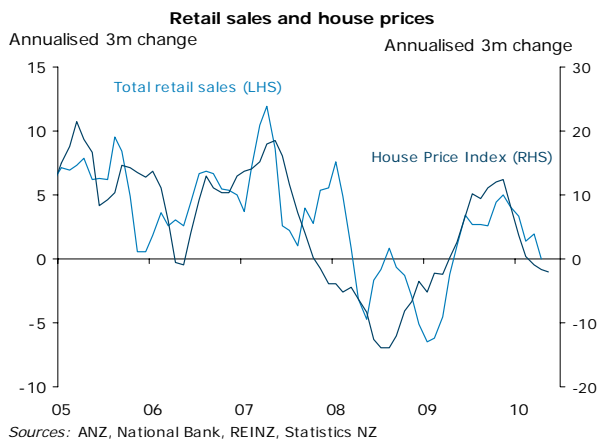
**Housing market figures were also soft.** While house prices themselves were static to down in May, **residential section prices are clearly falling.** They are down 17 percent from their peak on the stratified measure although residential section prices are highly volatile given the low number of sales. **Lower land prices are a critical part of stimulating residential building activity.** If we look at the housing loan approvals data for June (and post the Budget uncertainty) things still look pretty stagnant.

**So far the aggregate picture looks pretty consistent with an underlying improving trend but relative caution on behalf of households.** The latter is a theme the RBNZ has been keen to emphasise. Effective mortgage rates are set to move higher (see last week's Market Focus). They will no doubt temper the ability of indebted households to continue repairing balance sheets. However, expanding income growth as economic prospects firm and tax cuts will more than offset this. With the housing market, a key barometer for two thirds of economic activity, moving listlessly, spending power needs to come out of earnings as opposed to the wealth effect. We suspect the latter is actually acting as a handbrake at present given the wealth destruction over the past two years.

## ECONOMIC OVERVIEW



On a different note, we saw some delayed flow-on from the move in the OCR to actual borrowing rates, but most of the majors followed the lead of one bank last week. The latter point is key: **the RBNZ needs to be mindful of the credit channel of monetary policy and where actual borrowing rates are set as opposed to the OCR level per se.**



**This week sees the release of important activity and trade data for the March quarter (see our preview on page 8).** We are expecting March quarter GDP to confirm continuing economic expansion, albeit at a slightly more moderate pace. However, details will highlight the promise of a more sustainable expansion eventuating. We are assuming that economic activity will accelerate more strongly and broaden in the second half of this year which is consistent with the spirit of the RBNZ's June MPS projections, which have quarterly growth rates of around 1 percent until late next year.

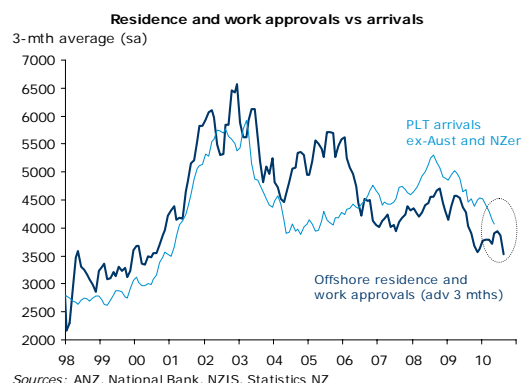
**Wednesday's balance of payments data are anticipated to highlight the poor saving record of NZ.Inc. (see page 8).** Despite a large trade surplus, New Zealand's high levels of external debt and foreign ownership are expected to deliver a sizeable investment income deficit, as has been the

norm in recent years. As RBNZ Governor Bollard noted last week overall indebtedness can affect perceptions of fragility and NZ's huge net external liability position remains somewhat problematic.

The saving and investment imbalances within the New Zealand economy are a reflection of what is occurring globally. **On that note, the weekend announcement by the People's Bank of China (PBOC) that it will end the 23-month peg and will enhance the flexibility of the Renminbi (RMB) exchange rate is a positive step towards alleviating global economic imbalances.**

However, as the next article by our Head of China Economics Li-Gang Liu notes, details of how much flexibility the Chinese authorities will allow remains to be seen, with the PBOC not tolerating a large-scale appreciation, given the weakness of the EUR. The PBOC are expected to tolerate a gradual appreciation path, with the RMB expected to strengthen by 3 percent against the USD by the end of 2010 and by more than 5 percent over 2011. This is a small step forward, but exchange rate policy will need to be complemented by measures to encourage greater domestic spending in saving rich countries, while policies need to encourage greater saving and export activity in those with high external deficits.

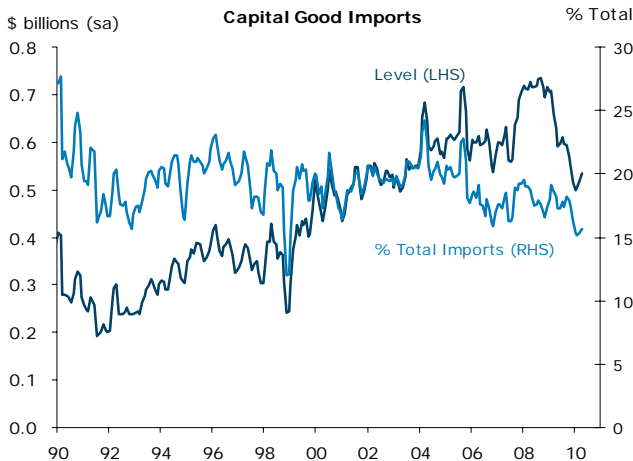
**Today's migration data for May confirmed the slowing population inflow from net immigration is continuing and is set to provide less stimulus to the NZ economy.** After running at an annualised rate of over 20,000, net migration has eased to an annualised inflow of 8,000 persons over the last three months. **We still expect positive albeit modest net migration gains over the year ahead, but the risk is clearly to the downside.** The sharp pick-up in departures could still have further to run, especially with the Australian labour market still performing strongly. However, a better performing NZ labour market, not to mention tax cuts from 1 October, could yet tempt some New Zealanders from heading overseas.



## ECONOMIC OVERVIEW

**Credit card billing data for May is anticipated to show a small positive monthly increase**, which will confirm that the recovery in retail spending remains gradual. We expect retail spending to pick-up in the coming months as the benefits from the higher terms of trade filter through the economy, though there will be volatility as consumers seek to beat the October 1 GST increase.

- **SNZ External Migration – May.** Net monthly PLT immigration increased by a seasonally adjusted 250 persons, with the annual net inflow slowing to 17,967 persons. Visitor arrivals fell by a seasonally adjusted 4.2 percent (+1.0 percent y/y).



Sources: ANZ, National Bank, Statistics NZ

**External trade data is anticipated to show a large monthly surplus.** The climbing terms of trade are playing a key role, with the value of monthly exports expected to make further ground. Imports are forecast to be boosted by the lower NZD/USD and by improving domestic demand.

**The mix of imports will also provide some clues over the sustainability of the current expansion.**

A pre-requisite to this is that businesses continue to add to productive capital. While it is feasible to temporarily substitute capital for labour, it does not augur well for improving supply-side performance and living standards within NZ.Inc.

### RECENT LOCAL DATA

- **REINZ Housing Market Statistics – May.** House sales fell by a seasonally adjusted 3.6 percent to be 17.2 percent lower than 12-months earlier. Days to sell rose to 43 from 42 in April. Prices (as measured by the REINZ Housing Price Index) fell by 1.5 percent to be 2.3 percent up on a year earlier.
- **Westpac Q2 Consumer Confidence.** Overall confidence rose 4.6 points to 119.4.
- **ANZ-Roy Morgan Consumer Confidence – June.** Consumer sentiment eased 4 points to 122. Current conditions climbed 3.6 points to 111.8, whereas future conditions fell 9 points to 128.8.

# CHINA SIGNALS CHANGE TO RMB APPRECIATION

## SUMMARY<sup>1</sup>

Exactly one week before the G-20 summit, the People's Bank of China (PBoC) announced in a statement on 19 June that it will enhance the flexibility of the RMB exchange rate but still maintain the existing allowed trading band at +/-0.5 percent. This statement suggests that the RMB is to resume its appreciation path starting today (21 June), similar to the old exchange rate regime before the global financial crisis erupted in September 2008, thus ending a 23-month peg to the US dollar. This is a small step forward, but details as to how the RMB exchange rate can be more flexible remain to be seen.

We think by simply returning to the pre-crisis regime is not an optimal policy and we believe the trading band should be enlarged further in order to truly enhance the flexibility of the RMB exchange rate system. We believe more policy actions are still warranted by further widening the RMB trading band in the foreseeable future.

## DETAILS OF THE ANNOUNCEMENT

The People's Bank of China (PBoC) said in a statement on 19 June that it would allow a more flexible RMB exchange rate while still maintaining the existing trading band for the RMB exchange rate. This signals that the central bank is ready to exit from RMB's peg to the USD which has been in operation over the past two years. Key points of the statement are as follows:

1. The PBoC decides to further reform the RMB exchange rate regime and to enhance the RMB exchange rate flexibility on improving internal and external economic conditions.
2. The PBoC thinks the current RMB exchange rate value is close to its equilibrium level. Thus, there is no basis for large-scale appreciation of the RMB. RMB exchange rate would be reflected by the market supply and demand conditions with reference to a basket of currencies.
3. The PBoC is to maintain the +/- 0.5 percent daily allowed trading band.

## OUR INTERPRETATIONS

**Point 1** clearly indicates the PBoC will exit from the pegged rate today (21 June). The central parity rate set at 9:15am will no longer be pegged at 6.83 CNY per USD, and it will be determined by the market

supply and demand conditions. A gradual but volatile appreciation path is expected.

**Point 2** suggests that the PBoC will not tolerate large-scale appreciation, given the substantial weakening of the EUR. We think an up to 3 percent appreciation by the end of this year is still tolerable by the authorities.

**Point 3** implies that the RMB could be more flexible but still constrained within the range of +/- 0.5 percent. We think this is a small improvement, but the current trading band still does not offer much flexibility.

Overall, what's new this time is perhaps that PBoC will probably allow or even encourage more fluctuations of the RMB exchange rate against the USD even within the existing +/- 0.5 percent trading band. If this were to be the case, it would be a small improvement, as the RMB rate had rarely breached the upper or the lower band during the July 2005-September 2008 period. Meanwhile, consistent with the government's approach to policy reforms, this new measure also appears to be very cautious, by taking a number of factors into consideration such as the still uncertain external conditions, China's balance of payments outlook, and enterprises' distaste for volatility of the exchange rate. We think the weekend's announcement can be viewed as an intermediate step. Once the concerns stated are no longer there, we should expect more bold steps, similar to the steps taken before to enlarge the trading band after the initial RMB exchange rate reform in 2005. In addition, we think the current announcement is still largely based on domestic concerns. But external pressures will continue to mount as foreign critics, led mainly by the US Congress, may not be satisfied by the progress taken and will likely ask for more. These pressures also serve to push for further and a gradual widening of the RMB trading band.

## EXTERNAL PRESSURES TO REMAIN

Immediately after the PBoC statement, US Treasury Secretary Timothy F. Geithner and the International Monetary Fund (IMF) issued statements welcoming the move, indicating some tacit agreement might have already been reached even before the PBoC's announcement. Meanwhile, Secretary Geithner is also concerned about "how far and how fast" the RMB will be allowed to appreciate. On the other hand, the US Congressional statements are less convinced with Senator Schumer stating that the reform measures are still "vague".

Although the move is consistent with our expectation that the RMB still had a chance to revalue before the

<sup>1</sup> This article was written by our Head of China Economics, Li-Gang Liu.

## CHINA SIGNALS CHANGE TO RMB APPRECIATION

G-20 summit (26-27 June in Toronto) because of the return of strong export growth and the risks of property market and macroeconomic overheating, we also think the step is a bit too “small” and we are still looking for details as to how specifically the PBoC can enhance RMB flexibility within the constrained trading band of +/- 0.5 percent at a daily basis.

We think the return to the old regime will not be an optimal solution. First, the old regime is not able to appease the external pressures, as there is only a small appreciation maximum of 0.5 percent tolerated initially. As a result, this won't buy good will. Second, the intended flexibility for the RMB exchange rate is also very limited. This will not deter speculators much, either. As a result, China is expected to receive more “hot money” inflows, which will continue to compromise the PBoC's policy objectives in maintaining price stability.

Going forward, we think further policy actions are still warranted to widening the trading band further. To fundamentally do away with the one-way bet on the continued RMB appreciation in the short run, we think the trading band should be as large as up to +/- 2.5 to 3 percent. This will allow enough flexibility for the RMB exchange rate and it will be difficult for speculators to time their exit strategy. Given the overall need for the RMB to appreciate in the long run, the PBoC could allow the RMB to adopt a crawling band exchange rate system with the long-run trend determined by the market supply and demand conditions.

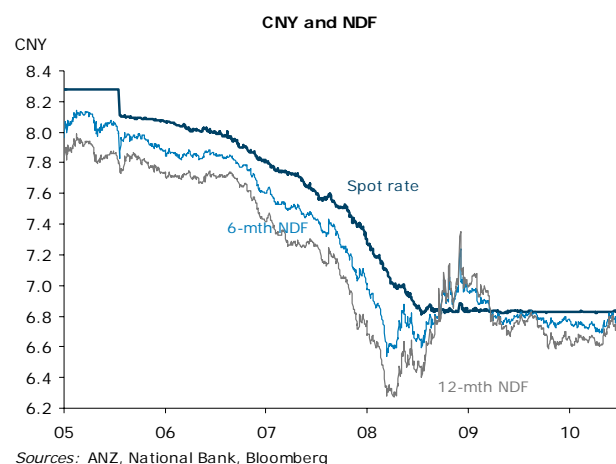
### IMPLICATIONS FOR RMB APPRECIATION

**Onshore Central Parity Rate:** It is likely that today, the central parity rate set at 9.15am (Chinese time) by China's Foreign Exchange Trading System is expected to allow an initial appreciation. The appreciation is likely to be a jump up to 0.25 percent. However, this initial jump is not important, and we think whatever is being set by the authorities will be tested by the market. It is very likely that the market will push the RMB exchange rate to the maximum appreciation tolerated, that is, 0.5 percent. We expect the authorities to intervene to bring it somewhat back away from the upper bound of the band. Indeed, the latest onshore dollar shortage implies that domestic financial institutions have already priced in such a movement based on our calculation using the uncovered interest rate parity conditions.

**Offshore NDF Rate:** Despite the fallback of NDF lately, there is a lot of “catch up” to do for the NDF to strengthen. It is likely the NDF will overshoot and gradually return to its senses while more market

information comes in. Given the PBoC statement that they do not think large-scale appreciation for the RMB is needed, this will act to cap the expectation that a large appreciation will not be warranted. Therefore, we will not expect a substantial overshooting by an over 2 percent swing of the NDF on Monday, either.

We maintain our forecast that the RMB exchange rate is going to appreciate by 3 percent against USD by the end of this year. In addition, the pace of appreciation would be still gradual, but with increased volatility within the current +/- 0.5 percent trading band. Meanwhile, we maintain our forecast that the RMB is to appreciate by 5-7 percent against USD in 2011, with risk biased to the upside. Policy risk remains as the Chinese authorities will likely alter the current trading band, and to implement a crawling band, with the pace of appreciation determined by supply and demand conditions and also with reference to a basket of currencies.



The PBoC announcement will also be positive for Asian currencies in general. AUD and NZD are also expected to be positively affected by the resumption of small-step appreciations of the RMB, re-assured also by the PBoC that the Chinese economy is still on track for strong growth.

### IMPLICATIONS FOR MONETARY POLICY

On China's monetary policy, the exit from the current peg to USD indicates that PBoC will normalise its monetary policy at a faster pace. With the emphasis on flexibility of the exchange rate, we think the PBoC will now be able to use the interest rate tool to help tighten monetary policy. We think that the central bank would focus more on managing inflation expectation by allowing a rate hike in July after the strong Q2 GDP number, and would continue to sterilise the capital inflows via open market operations. Overall, it appears that the PBoC also

## CHINA SIGNALS CHANGE TO RMB APPRECIATION

agrees that a flexible RMB exchange regime will help enhance the effectiveness of China's monetary policies.

### IMPLICATIONS FOR NEW ZEALAND

On the face of it, the move by the PBoC in allowing the RMB to appreciate gradually, alongside earlier steps to slow down their property market through a series of increases to their reserve requirements as well as lending restrictions, can be seen as positive if it is successful in preventing the Chinese economy from overheating.

Provided the steps taken will see sustainable growth in China, this should be seen as positive for commodity prices. Not only will a higher RMB increase China's purchasing power, but the flow-on to higher Asian currencies in general will see the region's purchasing power rise. This should help encourage increased consumption from that region, which in turn should benefit New Zealand exports. China is now New Zealand's second largest export destination (accounting for almost 10 percent of merchandise exports), but the ASEAN-6<sup>2</sup> economies make up an even larger market for New Zealand (around 11 percent of exports). But any gains for New Zealand should be seen over a medium term context, as opposed to any immediate short-term gains.

further with reform of the RMB exchange rate regime and to enhance the RMB exchange rate flexibility.

Starting from July 21, 2005, China has moved into a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. Since then, the reform of the RMB exchange rate regime has been making steady progress, producing the anticipated results and playing a positive role.

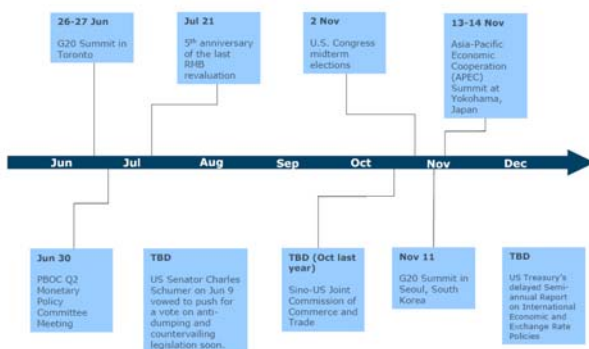
When the current round of international financial crisis was at its worst, the exchange rate of a number of sovereign currencies to the U.S. dollar depreciated by varying margins. The stability of the RMB exchange rate has played an important role in mitigating the crisis' impact, contributing significantly to Asian and global recovery, and demonstrating China's efforts in promoting global rebalancing.

The global economy is gradually recovering. The recovery and upturn of the Chinese economy has become more solid with the enhanced economic stability. It is desirable to proceed further with reform of the RMB exchange rate regime and increase the RMB exchange rate flexibility.

In further proceeding with reform of the RMB exchange rate regime, continued emphasis would be placed to reflecting market supply and demand with reference to a basket of currencies. The exchange rate floating bands will remain the same as previously announced in the inter-bank foreign exchange market.

China's external trade is steadily becoming more balanced. The ratio of current account surplus to GDP, after a notable reduction in 2009, has been declining since the beginning of 2010. With the BOP account moving closer to equilibrium, the basis for large-scale appreciation of the RMB exchange rate does not exist. The People's Bank of China will further enable market to play a fundamental role in resource allocation, promote a more balanced BOP account, maintain the RMB exchange rate basically stable at an adaptive and equilibrium level, and achieve the macroeconomic and financial stability in China.

### Appendix: Key events to watch for RMB revaluation



### TEXT OF PBOC ANNOUNCEMENT

#### Further Reform the RMB Exchange Rate Regime and Enhance the RMB Exchange Rate Flexibility

In view of the recent economic situation and financial market developments at home and abroad, and the balance of payments (BOP) situation in China, the People's Bank of China has decided to proceed

<sup>2</sup> The ASEAN-6 are Singapore, Indonesia, Malaysia, Thailand, Philippines and Vietnam.

## DATA PREVIEW

## SUMMARY

The large investment income deficit is expected to offset a climbing trade surplus, with a small current account deficit expected for the March 2010 quarter. The annual current account deficit will narrow further, but this is likely to be as good as it gets in the current cycle. March quarter GDP is expected to confirm the expansion is continuing, albeit at a slightly more moderate pace. Details are likely to hold out the promise of a more sustainable expansion eventuating.

**Current account – March 2010 quarter** (due Wednesday 23 June, 10.45am)

Current Account	ANZ	RBNZ	Market
Quarter	-\$300m	- -	-\$275m
Annual	-\$5.1bn	- -	-\$5.1bn
% of GDP	-2.7%	-3.3%	-2.7%

Increasing domestic profitability is expected to offset a climbing trade surplus and deliver a small quarterly current account deficit.

The improving terms of trade will help generate another quarterly goods trade surplus, with the annual goods surplus the largest as a proportion of GDP in 8 years. The services balance is also likely to record a small surplus. However, we expect the continuation of large quarterly investment income deficits. These were temporarily dampened in 2009 by lower profitability and debt servicing costs, and provisioning by the big four Australian banks over structured financial transactions.

**The narrowing in the annual deficit is pleasing but it is likely to be transitory.** Rather than reflecting improving export performance, the weak domestic economy has been the major driver of the narrowing current account deficit. Improving corporate profitability, rising borrowing costs and the strengthening in demand for imports will contribute to a climbing profile of deficits over 2010. The annual current account deficit is expected to lift from its cyclical trough, at just under 3 percent of GDP, before approaching 4 percent by the end of the year.

## FINANCIAL MARKET IMPLICATIONS

**The RBNZ are not sanguine on the current account outlook, with the deficit projected to widen from 3.3 percent of GDP in March to 4.5 percent by the end of the year, and 7.2 percent by early 2013.** A more benign than expected deficit could prompt some market reaction, but the potential for surprise from a wider deficit appears less likely.

## GDP – March 2010 quarter

(due Thursday 24 June 10.45am)

GDP	ANZ	RBNZ	Market
QoQ	+0.5%	+0.8%	+0.5%
YoY	+1.8%	+2.0%	+1.8%
Ann. Ave.	-0.4%	-0.3%	-0.4%

**Headline production GDP is expected to expand by 0.5 percent in Q1, marking the fourth consecutive quarterly increase.** Policy support, the inventory cycle, improving primary sector activity (though not helped by drought conditions), and natural base effects are all supportive factors.

The increase in activity is expected to be reasonably broad based. Part of the quarterly expansion will be driven from continued recovery from sectors that were hard hit during the recession, notably manufacturing and wholesale trade. However, signs of the rebalancing of the economy are expected to be evident, with stronger primary production (despite dry weather) expected. Forestry and mining sector activity are expected to post sizeable quarterly increases as they continue to benefit from strong demand from emerging economies. Firmer residential building is expected to lift construction sector activity. Services sector activity is expected to post a modest quarterly increase (0.3 percent). The pace of expansion within the sector will be mixed. Increasing employment is expected to boost community services output, and higher transport and storage activity is expected. However, weaker real estate volumes and subdued retail spending is expected to weigh down the improvement in services sector activity.

On an expenditure basis, we expect a further positive contribution from inventories. Largely as a consequence of sluggish retail spending, a modest increase in consumption volumes is expected. A small quarterly increase is expected for residential investment volumes. Other investment volumes are expected to register a positive increase for the first time in seven quarters, with lower prices for imported capital machinery expected to boost plant and machinery investment. A small fall is expected for non-residential investment.

## FINANCIAL MARKET IMPLICATIONS

**Downside risks around the RBNZ's 0.8 percent quarterly pick are likely on account of the weaker construction sector data** (released after the MPS forecasts were finalised). However, we expect the Bank will be broadly comfortable unless details of the GDP report point to a markedly different outlook for economic activity over 2010.



# INTEREST RATE STRATEGY

## SUMMARY

Short end rates have held stable while the mid to long end of the curve has rallied hard, substantially flattening the yield curve. Yet recent NZ data has been soft, while global themes have tended to have a positive undercurrent, suggesting the opposite should have occurred. The recent announcement that China will allow more currency flexibility is being viewed positively, and may hone the focus on NZ's extremely low long end rates.

## MARKET THEMES

- While we do expect rate hikes at the next 2 RBNZ meetings, pricing hikes at 3 out of every 4 meetings for the next year feels aggressive.
- New Zealand long end yields have followed their global counterparts lower with vigour. But if the economic outlook is anything like what's priced in, they should be much higher.
- Mortgage rates are now on the rise, with larger rises in variable and 6mth/1yr rates and no change to 2yr+ rates. This flattening of the curve may see some paying, but not much.

## REVIEW AND OUTLOOK

**We've been surprised by the extent of the flattening of the yield curve**, which has taken the 2yr-5yr curve to levels not seen since last February. While curve flattening is typical in the early stages of the tightening cycle, some caution is required. Even if the short end is pricing the outlook fairly (and if anything it's a bit upbeat), **we doubt the OCR's terminal endpoint is around 5 percent as the curve implies. This suggests long end rates are biased higher** – especially if global growth concerns fade.

**Mortgage rates are now on the rise, with increases to floating, 6mth and 1yr rates.** Rates beyond 2yrs remain unchanged, but the step up from floating remains steep. As such, we doubt we will see a rush to fix, particularly as the outright rate is well off its lows. The fact that deposit rates have also risen is also significant: **faced with a steep mortgage curve and rising rates, this strongly encourages deleveraging.**

Looking ahead, this week's Q1 GDP data is likely to dominate price action. **We expect GDP growth of +0.5%q/q**, some way below the RBNZ's expectation of +0.8%. **A result close to our expectations would likely temper the pace of tightening built into the yield curve**, which is reasonably aggressive in the near term with hikes priced in roughly every 3 out of every 4 meetings.

## PREFERRED BORROWING STRATEGIES

Market expectations remain somewhat "topsy-turvy", with strong conviction behind near term RBNZ hikes, with no follow through beyond the end of next year. 90 day bank bill futures are factoring in a +142bp rise over the next year, but thereafter the profiles dips away quickly, with a terminal 90 day bill rate at 5.12%, well below the RBNZ's projections, and any notion of "neutral". This seems complete nonsense to us – while the next 2 rate hikes look fairly certain, how quickly the RBNZ proceed beyond September depends on how sustained the recovery is, and how global growth pans out. But if we look a lot further down the track there is more to be optimistic about, and monetary policy is likely to go beyond neutral. With the curve this steep, any decision to hedge should be done on an opportunistic basis – and with the 10yr below 5.60%, we see some real opportunities to put some long end cover in place. If cashflow is still tight, consider forward starting swaps like the 9yr out of 1yr (around 5.85%), or the 5yr out of 2yr (around 5.80%) and so on.

## GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔	Rate rises steady at first, but a 6%+ OCR beckons.
NZ data	↔/↓	Recent data soft. Q1 GDP this week will set the scene.
Fed Funds / front end	↔	Irrelevant for now.
RBA	↔/↑	RBA on hold for now, but hikes still likely late 2010.
US 10 year	↔/↓	Safe haven demand comes and goes. Yields capped.
NZ swap curve	↔/↓	Flattening has gone way too far. 10yr near is 5.5% crazy.
Flow	↔	Risk of some mortgage paying, but expect it to be moderated by steep curve.
Technicals	↔	Breach of +70bps in 2-5yr curve significant.

## MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 29-Jul-10	+18	+20
Thu 16-Sep-10	+41	+42
Thu 28-Oct-10	+57	+62
Thu 9-Dec-10	+75	+77
Thu 27-Jan-11	+95	+98
Thu 10-Mar-11	+113	+109
Thu 28-Apr-11	+132	+123

## TRADING THEMES WE FAVOUR AT PRESENT

We still like the 2yr-5yr steepener, as per our trade note last week. Unwinding of "topsy-turvy" OCR expectations should steepen the curve off current extremes. We also like NZ short end against AU on the view if the RBNZ has lots of work to do, the RBA is unlikely to be done.

# CURRENCY STRATEGY

## SUMMARY

China has relaxed its peg to the USD, signalling increased flexibility. While the market has taken the initial movement as positive for risk, subsequent comments suggest any move will be muted and the currency implications are not clear cut when we look at the broader picture. Net on net we expect the NZD to remain in its current trend-line, and once the dust settles wider risk appetites and equities to return as dominant drivers. It's a frustrating market but brace for more oscillating moves.

## MARKET THEMES

- China – has anything really changed? It's a step in the right direction, but it was well short of the 5% devaluation some expected.
- Most expect the CNY news to lead to further depreciation of the USD. This makes practical sense but the wider implications are not clear cut.
- With the threat of a big devaluation out of the way, equities will continue to drive direction more than ever.

## REVIEW AND OUTLOOK

China looks to have pulled off something of a PR coup, releasing its announcement of increased exchange rate flexibility on Friday afternoon European time. Not only was market positioning close to square, but the major trading centres were focused solely on the England and USA world cup games that evening, and China seized the moment.

With no change to the width of the trading band and comments from the PBOC that it expects the exchange rate to be "basically stable", the natural expectation was that the CNY will only appreciate by 0.5 % today. This is at odds with the AUD and NZD, which are both over 1% higher in early trading. The reason – this is a positive for global rebalancing, and will encourage equity investment in China, and the US stock markets will benefit from a lower USD.

Debate continues to rage as to whether the slightly higher CNY would reduce China's export efficiency, restrict demand for commodities and hence be a drag for the commodity currencies. We tend to think it will, but of course this move is much less significant than the 5% devaluation many expected. As such it is a positive for AUD and NZD. Indeed, the reality is that China hasn't actually done a lot, and with the status quo largely intact, we will again go back to following equities for direction. Complicating the picture are the implications for the EURUSD. A stronger CNY could relieve pressure on the USD to weaken against the EUR (to stimulate export

growth), or conversely the USD to actually strengthen again non-Asia currencies. Markets are also undecided on what today's move implies for monetary policy. Some say it rules out interest rates moving up, whereas we suspect it is merely setting the scene for all policy mechanisms (including rates) to be used.

It is also worth noting that NZD has broken the big resistance at 0.7040 but should be contained by the 200 day moving average at 0.7130. Look to use either side of this range and wait for equity markets to show direction.

### NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↔	At fair value now.
Yield	↔/↑	RBA on hold, RBNZ to hike further.
Commodities	↔/↑	NZ commodity prices at another record high.
Partial indicators	↔/↓	NZ data improving. Australia's still good.
Technicals	↓	Resistance above 0.83 major.
Sentiment	↔	Equities higher = NZDAUD lower and vice versa.
Other	↔/↓	AUD to consolidate recent weakness.
<b>On balance</b>	↔	<b>Range trade here.</b>

### NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↔/↓	Above our structural fair value estimate of 0.66.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↔/↑	NZ rates moving up before US rates.
Commodities	↑	NZ commodities basket avoided the sell off.
Risk aversion	↔	Libor stabilising.
Partial indicators	↔/↑	NZ data continues to improve.
Technicals	↔/↑	200 day MA of 0.7130 key.
AUD	↔/↑	Back in favours?
Sentiment	↔	NZD just following offshore moves.
Other	↓	Watch the EUR.
<b>On balance</b>	↔/↑	<b>Maintaining current trend line.</b>

## DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
21-Jun	NZ	Visitor Arrivals - MAY	--	-1.80%	10:45
	NZ	New Zealand Net Migration SA - MAY	--	770	10:45
	UK	Rightmove House Prices (MoM) - JUN	--	0.70%	11:01
	UK	Rightmove House Prices (YoY) - JUN	--	4.30%	11:01
	AU	New Motor Vehicle Sales MoM - MAY	--	8.40%	13:30
	JN	Nationwide Dept. Sales (YoY) - MAY	--	-3.70%	17:30
22-Jun	NZ	Credit Card Spending (YoY) - MAY	--	1.90%	15:00
	NZ	Credit Card Spending SA (MoM) - MAY	--	-1.20%	15:00
	EC	ECB Euro-Zone Current Account SA - APR	--	1.7B	20:00
	EC	Euro-Zone Current Account nsa - APR	--	1.3B	20:00
	GE	IFO - Business Climate - JUN	101.2	101.5	20:00
	GE	IFO - Current Assessment - JUN	99.8	99.4	20:00
	GE	IFO - Expectations - JUN	102.7	103.7	20:00
	UK	U.K. Budget Report Published - 22 Jun			00:00
23-Jun	US	Existing Home Sales MoM - MAY	6.50%	7.60%	02:00
	US	House Price Index MoM - APR	0.30%	0.30%	02:00
	US	Richmond Fed Manufact. Index - JUN	20	26	02:00
	EC	Euro-Zone Consumer Confidence - JUN A	-19	-18	02:00
	NZ	Current Account Balance - 1Q	-0.250B	-3.574B	10:45
	NZ	Account Deficit-GDP Ratio - 1Q	-2.70%	-2.90%	10:45
	GE	GfK Consumer Confidence Survey - JUL	3.3	3.5	18:00
	GE	PMI Services - JUN A	54.7	54.8	19:30
	GE	PMI Manufacturing - JUN A	58	58.4	19:30
	EC	PMI Services - JUN A	55.9	56.2	20:00
	EC	PMI Manufacturing - JUN A	55.3	55.8	20:00
	UK	Bank of England Minutes - JUN			20:30
	UK	BBA Loans for House Purchase - MAY	36000	35729	20:30
24-Jun	US	New Home Sales - MAY	410K	504K	02:00
	US	New Home Sales MoM - MAY	-18.70%	14.80%	02:00
	US	FOMC Rate Decision - JUN	0.25%	0.25%	06:15
	NZ	GDP QoQ - 1Q	0.50%	0.80%	10:45
	NZ	GDP YoY - 1Q	1.80%	0.40%	10:45
	JN	Merchnds Trade Balance Total - MAY	¥480.0B	¥742.3B	11:50
	AU	Conference Board Leading Index - APR	--	0.30%	12:00
	AU	Westpac-ACCI Survey of Ind Trends - APR	--	--	13:00
	EC	Industrial New Orders SA (MoM) - APR	1.60%	5.20%	21:00
25-Jun	US	Durable Goods Orders - MAY	-1.30%	2.90%	00:30
	US	Durables Ex Transportation - MAY	1.00%	-1.00%	00:30
	US	Initial Jobless Claims - 19 Jun	460K	472K	00:30
	US	Continuing Claims - 19 Jun	4560K	4571K	00:30
	NZ	Trade Balance - MAY	767M	656M	10:45
	NZ	Imports - MAY	3.43B	3.31B	10:45
	NZ	Exports - MAY	4.24B	3.97B	10:45
	NZ	NZ Trade Balance 12 Mth YTD - MAY	0	161	10:45
	JN	Natl CPI YoY - MAY	-1.10%	-1.20%	11:30
	JN	Natl CPI Ex Food, Energy YoY - MAY	-1.60%	-1.60%	11:30
	CH	Industrial Profits YTD YoY - MAY	--	119.70%	14:00
	GE	Import Price Index (MoM) - MAY	0.20%	2.00%	18:00

Continued on following page

## DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
26-Jun	US	GDP QoQ (Annualized) - 1Q T	3.00%	3.00%	00:30
	US	Personal Consumption - 1Q T	3.50%	3.50%	00:30
	US	Core PCE QoQ - 1Q T	0.60%	0.60%	00:30
	US	U. of Michigan Confidence - JUN F	75.5	75.5	01:55

Key: AU: Australia, EC: Euro-zone, GE: Germany, JN: Japan, CH: China, 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 the data was focused on the household sector, which illustrated the uneven nature of the current expansion. The focus on balance sheet repair is contributing to subdued household spending, but suggests a more durable expansion is in prospect. This week sees the release of Q1 data for GDP and the Balance of Payments, which will confirm the expansion is ongoing, with improving profitability expected to contribute to a climb in external deficits. For the published Q2 data we expect signs of improvement to be evident and expect the leading soft gauges to continue pointing towards an acceleration of activity towards the end of the year.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 22 Jun (3:00pm)	RBNZ credit card billings- May	Up	ECT data suggests a small monthly increase.
Wed 23 Jun (10:45am)	Balance of Payments – Q1	In the red	An improving trade balance is expected to be offset by another sizeable investment income deficit. The annual current account deficit will reduce to 2.7 percent of GDP.
Thur 24 Jun (10:45am)	Gross Domestic Product – Q1 -	Moderating	A quarterly increase of around 0.5 percent is expected, led by higher primary production, wholesale trade, manufacturing and expansion in some services industries. On the expenditure measure, positive contributions from consumption, inventory accumulation and investment will be partly offset by higher imports.
Fri 25 Jun (10:45am)	Overseas Merchandise Trade – May	Surplus	Lifting global export commodity prices are expected to contribute to another large monthly trade surplus. The lower NZD and stronger demand will boost import values.
Mon 28 June (3:00 pm)	National Bank Business Outlook - Jun	- -	- -
Tue 29 Jun (10:45am)	Building Consents - May	Looking up	A slight pullback for residential consents is likely. Non-residential consent issuance should start improving.
Tue 29 Jun (3:00pm)	RBNZ Credit Aggregates - May	Soft	We expect the process of balance sheet repair to continue for a while yet. Will closely look at business sector lending for a steer on the willingness of firms to borrow.
Thur 1 Jul (3:00pm)	ANZ Commodity Price Index - Jun	- -	- -
Fri 9 Jul (10:45am)	Electronic Card Transactions - Jun	Lifting	The improving labour market and the looming rise in GST should contribute to lifting sales momentum.
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. Prices are expected to remain weak.
Wed 14 Jul (10:45am)	Retail Trade Survey – May	Improving	Electronic Card Transaction data suggests a modest increase for the month. We expect a firming in retail spending over the coming months.
Fri 16 Jul (10:45am)	Consumers Price Index – Q2	Rising	Positive contributions from higher oil and electricity prices, the tobacco excise and the usual seasonal pattern will contribute to a higher quarterly inflation rate from the 0.4 percent increase in March.
<b>On Balance</b>		<b>Building</b>	<b>Recovery continuing nicely.</b>

# ECONOMIC FORECASTS AND INDICATORS

	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
GDP (% qoq)	-0.8	0.2	0.3	0.8	<b>0.5</b>	<b>0.7</b>	<b>1.5</b>	<b>-0.1</b>	<b>1.1</b>	<b>1.3</b>
GDP (% yoy)	-3.1	-2.3	-1.4	0.5	<b>1.8</b>	<b>2.3</b>	<b>3.6</b>	<b>2.6</b>	<b>3.2</b>	<b>3.9</b>
CPI (% qoq)	0.3	0.6	1.3	-0.2	0.4	<b>0.9</b>	<b>0.9</b>	<b>2.8</b>	<b>0.6</b>	<b>1.0</b>
CPI (% yoy)	3.0	1.9	1.7	2.0	2.0	<b>2.4</b>	<b>2.0</b>	<b>5.0</b>	<b>5.3</b>	<b>5.4</b>
Employment (% qoq)	-1.3	-0.5	-0.7	0.0	1.0	<b>0.2</b>	<b>0.4</b>	<b>0.6</b>	<b>0.6</b>	<b>0.7</b>
Employment (% yoy)	0.7	-0.9	-1.8	-2.4	-0.1	<b>0.6</b>	<b>1.7</b>	<b>2.2</b>	<b>1.8</b>	<b>2.3</b>
Unemployment Rate (% sa)	5.1	5.9	6.5	7.1	6.0	<b>6.3</b>	<b>6.0</b>	<b>5.6</b>	<b>5.4</b>	<b>5.0</b>
Current Account (% GDP)	-7.9	-5.6	-3.2	-2.9	<b>-2.7</b>	<b>-3.8</b>	<b>-5.1</b>	<b>-4.4</b>	<b>-4.4</b>	<b>-4.3</b>
Terms of Trade (% qoq)	-2.7	-9.4	-1.6	5.8	<b>5.8</b>	<b>4.0</b>	<b>2.4</b>	<b>0.9</b>	<b>-0.5</b>	<b>-0.7</b>
Terms of Trade (% yoy)	-5.0	-13.5	-14.1	-8.2	<b>-0.2</b>	<b>14.5</b>	<b>19.2</b>	<b>13.7</b>	<b>6.9</b>	<b>2.1</b>

	Aug-09	Sep-09	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10
Retail Sales (% mom)	1.2	0.4	0.0	0.8	-0.5	0.7	-0.5	0.5	..	..
Retail Sales (% yoy)	-1.1	-0.5	-0.2	2.4	2.0	2.3	2.4	4.4	..	..
Credit Card Billings (% mom)	1.3	-0.7	0.2	0.8	-1.2	1.4	-0.2	1.4	-1.2	..
Credit Card Billings (% yoy)	0.1	-2.3	-0.3	1.6	1.9	2.7	1.2	6.2	1.9	..
Car Registrations (% mom)	-3.6	8.4	0.4	2.2	6.9	-0.6	0.5	5.7	2.9	..
Car Registrations (% yoy)	-18.3	-16.8	-16.8	2.4	0.3	15.9	31.4	31.7	40.5	..
Building Consents (% mom)	2.3	5.9	11.4	0.4	-3.8	-2.7	6.1	0.1	8.5	..
Building Consents (% yoy)	-8.8	-11.5	26.7	20.3	22.6	35.1	29.8	33.3	32.1	..
REINZ House Price (% yoy)	5.1	6.1	6.0	5.2	9.6	7.7	6.1	7.6	4.7	..
Household Lending Growth (% mom)	0.3	0.3	0.4	0.0	0.2	0.2	0.1	0.2	0.2	..
Household Lending Growth (% yoy)	2.4	2.3	2.6	2.7	2.7	2.7	2.7	2.7	2.7	..
ANZ-Roy Morgan Consumer Confidence	112.3	120.0	125.9	121.5	118.6	131.4	123.6	121.8	121.9	126.0
NBNZ Business Confidence	34.2	49.1	48.2	43.4	38.5	..	50.1	42.5	49.5	48.2
NBNZ Own Activity Outlook	26.0	32.2	30.5	33.7	36.9	..	41.9	38.6	43.0	45.3
Trade Balance (\$m)	-716.6	-561.5	-501.5	-280.4	-26.4	271.1	333.8	589.8	655.8	..
Trade Balance (\$m annual)	-2360	-1669	-1176	-863	-549	-176	-324	-172	161	..
ANZ World Commodity Price Index (% mom)	4.2	7.4	4.7	10.9	2.6	0.4	4.0	1.8	5.4	2.5
ANZ World Commodity Price Index (% yoy)	-23.1	-12.9	-1.3	18.2	31.0	37.4	49.8	50.9	55.1	54.5
Net Migration (sa)	1630	1850	2140	1750	1690	1840	1000	940	730	250
Net Migration (annual)	15642	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	Apr-10	May-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZD/USD	0.727	0.669	0.711	0.700	0.710	0.720	0.730	0.730	0.720	0.710
NZD/AUD	0.783	0.809	0.809	0.795	0.789	0.783	0.777	0.777	0.783	0.789
NZD/EUR	0.547	0.542	0.573	0.579	0.602	0.632	0.652	0.652	0.643	0.634
NZD/JPY	68.21	60.43	64.33	66.50	68.16	69.84	71.54	73.00	72.00	71.71
NZD/GBP	0.476	0.465	0.480	0.500	0.493	0.486	0.480	0.474	0.462	0.449
NZ\$ TWI	68.2	65.1	68.1	68.3	69.4	70.7	71.7	71.8	71.1	70.5
INTEREST RATES	Apr-10	May-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZ OCR	2.50	2.50	2.75	3.25	3.50	3.75	4.25	4.75	5.25	5.50
NZ 90 day bill	2.70	2.93	3.06	3.70	3.80	4.20	4.70	5.20	5.70	5.80
NZ 10-yr bond	5.91	5.56	5.52	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	0.35	0.54	0.54	0.40	0.35	0.35	0.35	0.60	0.85	1.35
AU Cash Rate	4.25	4.50	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.00
AU 3-mth	4.63	4.87	4.92	5.00	5.30	5.60	6.00	6.00	6.20	6.10

	18 May	14 Jun	15 Jun	16 Jun	17 Jun	18 Jun
Official Cash Rate	2.50	2.75	2.75	2.75	2.75	2.75
90 day bank bill	2.91	3.10	3.11	3.11	3.10	3.10
NZGB 11/11	3.83	3.73	3.73	3.78	3.77	3.77
NZGB 04/13	4.58	4.34	4.34	4.38	4.37	4.37
NZGB 12/17	5.47	5.25	5.25	5.30	5.29	5.29
NZGB 05/21	5.70	5.48	5.48	5.53	5.52	5.52
2 year swap	4.45	4.29	4.29	4.31	4.30	4.30
5 year swap	5.31	4.98	4.98	5.04	5.04	5.04
RBNZ TWI	67.2	67.2	67.2	67.1	67.3	67.8
NZD/USD	0.6956	0.6938	0.6938	0.6952	0.6962	0.7058
NZD/AUD	0.7975	0.8086	0.8086	0.8048	0.8099	0.8105
NZD/JPY	64.32	63.51	63.51	63.62	63.56	64.14
NZD/GBP	0.4818	0.4701	0.4701	0.4695	0.4737	0.4754
NZD/EUR	0.5636	0.5677	0.5677	0.5645	0.5672	0.5687
AUD/USD	0.8722	0.8580	0.8580	0.8638	0.8596	0.8708
EUR/USD	1.2341	1.2221	1.2221	1.2315	1.2275	1.2410
USD/JPY	92.47	91.54	91.54	91.51	91.30	90.88
GBP/USD	1.4439	1.4758	1.4758	1.4807	1.4698	1.4845
Oil (US\$/bbl)	70.08	76.84	76.84	77.67	77.67	76.82
Gold (US\$/oz)	1226.25	1232.85	1234.45	1230.35	1234.15	1245.05
Electricity (Haywards)	4.15	4.43	4.24	4.03	4.73	3.60
Milk futures (US\$/contract)	127	122	122	123	123	123
Baltic Dry Freight Index	3882	3115	3020	2893	2784	2694

# 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.

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