

NEW ZEALAND ECONOMICS ANZ MARKET FOCUS

28 June 2010

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SOVEREIGN WATCH PART III

ECONOMIC OVERVIEW

Last week's data provided confirmation that the rebalancing of the New Zealand economy is underway. While the economy has been on expansion mode for more than one year, we are only halfway through making up for the output lost during the recession. We continue to take heart from the mix to growth as opposed to growth itself. This week sees the release of data pertaining to the medium-term outlook, notably commodity prices and business sentiment, with the RBNZ credit data expected to show an economy still in deleveraging mode. The entry of vehicle fuels and electricity into the Emissions Trading Scheme (ETS) on July 1 will add to some volatility in quarterly inflation readings over the remainder of 2010.

SOVEREIGN DEBT UPDATE INCLUDING ASIA

We have updated our earlier analysis on Sovereign Debt to include updated data from the latest OECD Economic Outlook, and to include the major countries of Asia. We use the same methodology, and where possible the same datasets as we have in earlier analyses. Our analysis again highlighted that the major vulnerabilities lie in Europe.

MONTHLY INFLATION GAUGE

Our monthly inflation gauge increased by 0.1 percent in May, following a 1.2 percent increase in April. Large price falls for a number of components partly offset price increases for electricity and telecommunications. Price levels from the gauge have been trending up and point to more pricing power than is typically the case for this stage of the economic cycle. With increases in government charges and a hike in GST looming, the gauge will provide a timely means of monitoring the impact on pricing trends within the economy.

INTEREST RATE STRATEGY

Term interest rates continue to fall, mirroring strong rallies in global rates following a very dovish FOMC statement. This caused further curve flattening, with 10 year swaps around 5.5 percent, their lowest level in over a year. While GDP data suggests gradual momentum is building, a better undertone appears to be developing locally. But questions are starting to be raised about global growth (excluding China) as fiscal support wanes. It all muddies the water somewhat beyond Q3 in terms of whether the RBNZ will be raising rates as quickly as what's priced in. We doubt this tension will be resolved soon.

CURRENCY STRATEGY

The NZD/USD is holding above 0.70 cents, though further grinds higher will be hard fought. Investors may be starting to fret about the pace of the global economic recovery, but strong terms of trade gains, the smallest current account deficit in over twenty years and positive yield advantage continue to run in the NZD's favour. Recent price action suggests it will not be the usual "risk on" versus "risk off" plays in the near term, but the NZD is still susceptible to any bout of risk aversion.

ECONOMIC OVERVIEW

SUMMARY

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THIS WEEK'S EVENTS

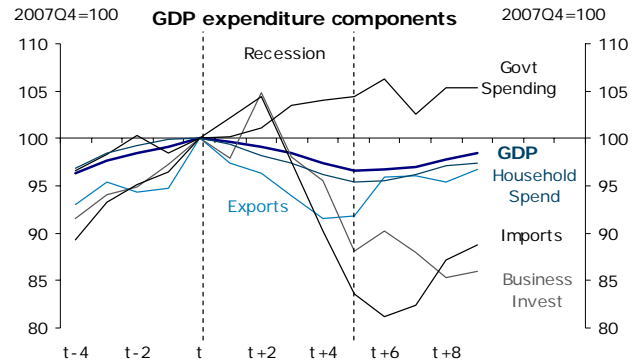
- **National Bank Business Outlook - June** (Monday, June 28, 3:00pm).
- **SNZ Building Consents - May** (Tuesday, June 29, 10:45am). A slight pullback for residential consents is likely. Non-residential consent issuance should start improving.
- **RBNZ Credit Aggregates – May** (Tuesday, June 29, 3:00pm). We expect the process of balance sheet repair to continue for a while yet.
- **ANZ Commodity Price Index - June** (Thursday, July 1, 3:00pm).

WHAT'S THE VIEW?

Last week's data provided confirmation that the rebalancing of the New Zealand economy was continuing. The expansion in March quarter GDP was close to the economy's trend rate, and continues the recovery in activity that began in the June quarter last year. The composition of growth was uneven, but the rotation of activity towards the earning side of the economy is a welcome development.

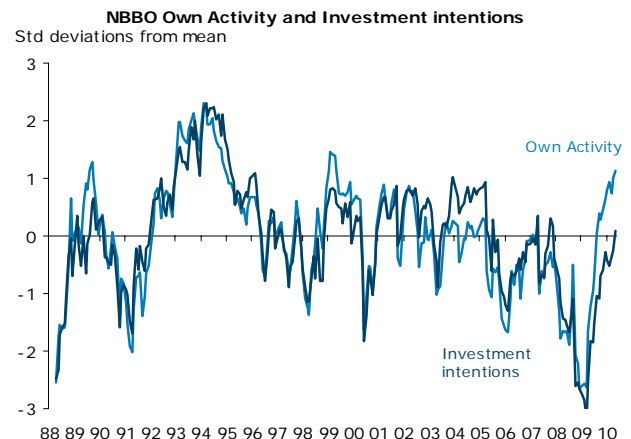
More than one year has passed since the New Zealand economy emerged from recession. However, we are only around half-way through recouping the output lost during the recession. Economic activity in most sectors remains below pre-recession levels, with higher government spending volumes being the notable exception. This level gap is a key reason why for many people the current recovery does not feel like one of substance. It is also why we are stopping short of calling the recovery an economic upswing, despite four quarters of positive growth. But nonetheless we still take encouragement from where we are heading, given the boost to

economic activity provided by tax cuts, strong commodity prices and the higher terms of trade.



Source: ANZ, National Bank, Statistics New Zealand

Whilst activity in most GDP components has recovered since the end of the recession, business investment has been a notable laggard and remains a key missing link in the recovery process. Now there are normal lags at play here but even allowing for them, the response to date has been sluggish. On the positive side, business cashflow should be improving, long-term wholesale interest rates are low, and business sector balance sheets are strong. But against this backdrop, businesses still seem to be mindful of patchiness in some of the growth they are seeing. In addition, fragile equity market sentiment is creating more uncertainty and not assisting the existing value of capital relative to the replacement cost (the so-called Tobin's Q). Lacklustre investment was confirmed by the merchandise trade data for May showing only modest improvement in capital goods imports (to \$530m from the sub-\$500m at the start of the year). This is unlikely to make considerably headway in boosting the productive capital stock and supply-side capacity that will be needed to keep medium-term inflation contained when the expansion becomes more advanced.

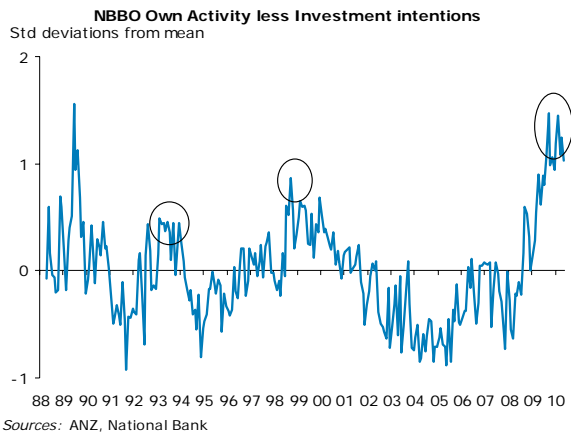


Sources: ANZ, National Bank

ECONOMIC OVERVIEW

Today's June National Bank *Business Outlook* survey will see how business sentiment has fared, given the large number of events that have occurred over the month. We won't go into the detail apart from noting that it will aggregate a lot of information including the *Budget*, Fonterra announcement and equity market gyrations. Hence it'll be a timely barometer of where we stand. We will be paying close attention to investment intentions to see what we noted above.

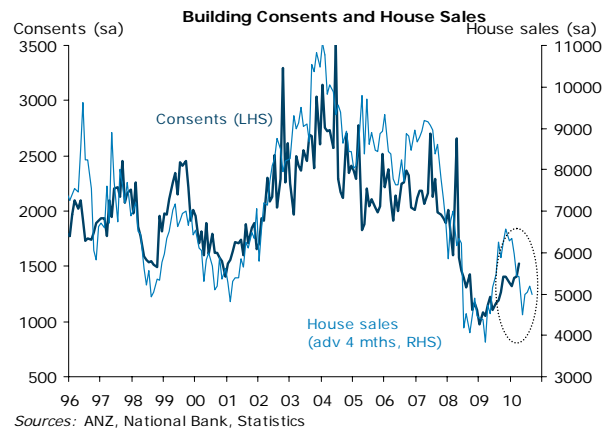
We note one commentator (we won't name names) has been having a go at us over our view that investment intentions have been lagging the pick-up in firms' own activity expectations (who disagrees it is lagging). There are a number of different ways to skin a cat (and we all know that famous adage about lies, damned lies and statistics) but we prefer to focus on the deviation of both investment intentions and firms' own activity expectations from their respective long-term averages (see chart on page 2). We assume both measures follow a normal distribution, and while this can be debated we're only talking semantics in the overall scheme of things. Both have trended up of late but the key point is that the "gap" between the two remains historically high relative to what we have seen in 1993 and 1999 (which were a year ahead of the last quarter of negative GDP during prior downturns).



This week also sees the introduction of stationary energy (e.g. electricity) and liquid fossil fuels into the Government's Emissions Trading Scheme (ETS). The upshot is likely to mean higher consumer prices for petrol and electricity. Both of these goods account for a sizeable chunk of household expenditure (around 8 percent according to the 2006/07 Household Economic Survey), and imply a noticeable inflation impact. Given the widespread use of both inputs, we (nor the RBNZ) do not know what the exact magnitude will be. Our back of the envelope calculations suggest a

0.4 percent first round impact on CPI inflation in the September 2011 year. Of more importance for monetary policy, however, will be the second round impact of the scheme on prices and throughout the economy. The degree of competitive pressures, business margins, and policy credibility of the RBNZ will all have a bearing on the pass-through into final consumer prices. We will continue to closely monitor our Monthly Inflation Gauge (see results for May on page 8) as a timely indicator of the degree of cost-push inflation within the economy. In next week's *Market Focus* we will provide readers with a recap on the ETS, setting out our thinking in this area.

Building consents data this week are expected to highlight the continued recovery in the construction sector. The March GDP data highlighted the discrepancy between the residential and non-residential sectors, with activity in the latter still weak and dependent on government support. Despite the weak housing market, residential construction activity is beginning to recover, providing a boost to growth. Building consent issuance has been trending higher and the RBNZ alluded to support being provided by relatively robust population growth. However, with net permanent and long-term immigration on a declining trajectory and the housing market remaining in limbo, it is not all one-way traffic. We need to be mindful that continuing deleveraging in the household sector could slow the expansion in residential building.



There are some pretty big numbers being speculated for residential investment over the coming year and our own forecast is for a 12.5 percent increase in the 12-months to the December quarter and a further 16.9 percent over 2011. But the bounce needs to be read in conjunction with two facts: there is a base effect the bounce is embarking from and excluding government related work, the non-residential pipeline is looking pretty thin.

ECONOMIC OVERVIEW

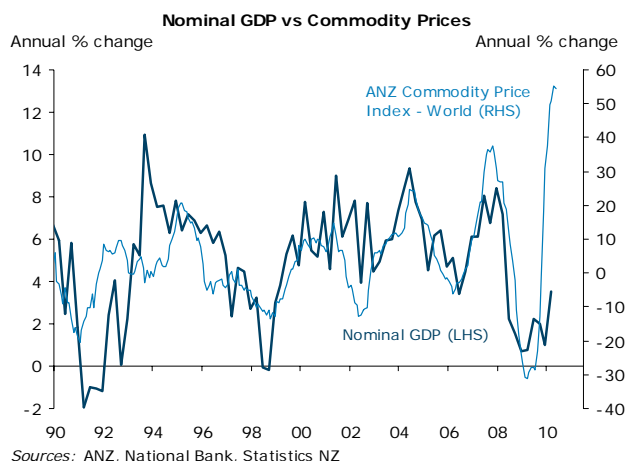
We expect May RBNZ credit aggregates to portray an economy remaining in deleveraging mode. One of the key assumptions underpinning the June MPS projections is that households and firms will continue to consolidate their balance sheets. The reduction in borrowing (relative to income) is helping to place the expansion on a more sustainable footing.

The release of the ANZ Commodity Price Index for June will also provide an early indication of whether recent global ructions are likely to have an impact on prospective export earnings.

NZ.Inc is a major beneficiary of the broad-based increase in commodity export prices. The RBNZ assume the increase in commodity prices is temporary with producers using the proceeds to repair balance sheets. Time will tell if these assumptions are in the ballpark. Mostly as a consequence of higher export prices, nominal GDP increased by 2.5 percent in the March quarter. As export commodity prices have increased strongly in recent months it suggests another few chunky quarterly increases are in prospect. Deleveraging in the rural sector will limit the flow-through from commodity prices to the economy. But even allowing for this, there seems a good pipeline of momentum, with upside risks for 2011 particularly noteworthy.

percent in May (3.7 percent y/y).

- **SNZ Balance of Payments – March 2010 quarter.** A quarterly current account surplus of \$176m was recorded, with the annual current account deficit narrowing to 2.4 percent of GDP (\$4.4bn), the lowest since 1989. An improving trade surplus offset an investment income deficit.
- **SNZ Gross Domestic Product – March 2010 quarter.** GDP increased by 0.6 percent in the March quarter, with the annual growth rate increasing to 1.9 percent. Higher activity in primary (up 1.7 percent), and good producing industries (up 1.0 percent) drove the quarterly increase.
- **SNZ Overseas Merchandise Trade – May.** A trade surplus of \$814m was recorded, with the annual trade surplus narrowing to \$91m. The value of exports climbed by 5.9 percent to \$4.2bn, whereas import values rose by 2.6 percent to \$3.4bn.



RECENT LOCAL DATA

- **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 rose by a seasonally adjusted 1.0 percent (-0.8 percent y/y).
- **RBNZ Credit Card Billings – May.** Total billings in New Zealand increased by 1.9 percent (3.4 percent y/y). Spending on overseas cards increasing by a monthly 2.3 percent (1.2 percent y/y), with spending on domestic cards up by 1.8

SOVEREIGN DEBT UPDATE INCLUDING ASIA

SUMMARY

We have updated our earlier analysis on Sovereign Debt to include updated data from the latest OECD Economic Outlook, and to include the major countries of Asia. We use the same methodology, and where possible the same datasets as we have in earlier analyses. Our analysis again highlighted that the major vulnerabilities lie in Europe.

BACKGROUND

Question-marks continue to surround certain sovereigns. The G20 meeting has highlighted tension between maintaining stimulus or support versus undertaking the inevitable process of fiscal consolidation. The fiscal crisis facing Greece is not an isolated one. As we have noted before, the global financial crisis saw a large chunk of debt being transferred from the private sector to the public sector. A "shuffling" exercise may have mitigated systemic downside risks in 2009, but it has not altered the basic proposition that debt drove the global economy into this jam, and de-leveraging is the only sustainable way out. While the fiscal policy response in the initial stages of the crisis was appropriate, namely to lean on the government's balance sheet and run expansionary fiscal policy, with this comes pending pressure for fiscal consolidation or the so-called fiscal exit strategy.

To help us identify potential areas of susceptibility, **we have constructed a simple indicator of vulnerability and have also provided updates of this over the past few months.** Our indicator looked at both vulnerability (i.e. debt) and proxies for flexibility. Our intention was to come up with a considered but intuitively simple measure of overall risk for each country, recognising that this is precisely the way markets tend to digest data.

Of course, such measures are never going to be sophisticated enough to capture individual country specific aspects (and nor do we profess to be experts towards some nations). However, like most indicators **it is the underlying spirit and trends that are important.**

Our initial analysis highlighted weaknesses in Europe, and placed New Zealand and Australia in a good light. **But one of the limitations of our initial work was that it was limited to OECD countries, which are primarily developed rich countries, and mostly in Europe.** Only two are Asian (Japan and South Korea), and **given NZ's orientation in the Asia Pacific region, the challenge was put to us to include Asia, and we have responded.**

DATA SOURCES

One of the challenges of including Asia was the lack of comparable data, particularly as Japan and South Korea are the only OECD members. However where there were gaps in the OECD data, we were able to find suitable data from the Asian Development Bank, CEIC, and their respective central banks. Where data was sourced from sources other than the OECD, we used the same sources as in our earlier analysis (for example, GDP per Capita was sourced from the IMF). In all cases we used either 2009 data, or the latest available data. Having such a wide range of nations to assess is always going to throw up data challenges so we'll emphasise again that in such a situation it is the underlying spirit of the results that counts.

WHAT'S FAVOURABLE AND WHAT'S NOT

The datasets we analysed this time were similar to those in past analyses.

That is, we follow a two-pronged approach where we look at unfavourable characteristics (mostly relating to debt and imbalances) and favourable dynamics (mostly measures of flexibility). Having favourable characteristics doesn't forgive a country for all its ills, but it certainly affords them time to work them out!

Unfavourable characteristics (equally weighted) include:

- Gross government debt adjusted for FX reserves as a % GDP
- Government budget balance as a % GDP
- Unemployment rate
- Current account as a % GDP
- Gross external debt as a % GDP

Favourable characteristics (equally weighted) include:

- GDP per capita
- Population
- Economic Freedom score
- Political Instability score
- Currency flexibility score

The only major change was the statistic used to measure debt. Because net government debt figures were not available for many Asian countries, we used gross government debt adjusted for foreign reserves. This adjustment was necessary because most Asian governments hold significant FX reserves, providing a significant offset to their debt. For example, Singapore's gross government debt is around 109% of GDP, but its FX reserves amount to around 96% of GDP. This was the only way of getting a meaningful net debt statistic for Asia, but when we compared this figure for the OECD's net debt statistic for the OECD countries, the adjusted number for every OECD

SOVEREIGN DEBT UPDATE INCLUDING ASIA

country except Hungary overstated the extent of the debt. This excluded non-reserve assets (such as sovereign wealth funds), and as a result, some countries (Finland, South Korea, Luxembourg, New Zealand, Norway and Sweden) were disadvantaged by this, as their net debt was negative (i.e. they had net assets) but their debt adjusted for reserves was positive. However they all scored well elsewhere and this did not trip them up.

We also placed a cap on external debt at 250 percent when we standardised the data so as to iron out any distortions. Had we not done this, every country's score would have looked reasonable against countries like Iceland, whose external debt is close to 1,000 percent of GDP. Any country with external debt above 250 percent was assumed to have debt of 250 percent.

UPDATE

In this update we use the same basic methodology as we have in past analyses. To reiterate briefly, we start by collecting comparable statistics across all 38 countries, where possible from the same source. This data is then categorised into two groups, which for want of better words, we call "unfavourable" and "favourable". The unfavourable data include things like government debt, budget position, and the unemployment rate – i.e. things that people worry about. The favourable data include things like GDP per capita, population, a measure of economic freedom, and exchange rate regime – i.e. things that may act as offsets to unfavourable characteristics. This list is somewhat limited by the lack of data in some areas but in our view still captures the broad spirit of flexibility or size (giving you time to work things out or before the market gets around to you!). Once characterised, each measure is then standardised, weighted, and summed. Favourable scores range from 0 percent to +100 percent, whereas unfavourable scores range from 0 percent to -100 percent.

We then ranked countries by 3 measures, which are in our results table. **First, we ranked each country on its negative characteristics alone to give an idea of its "raw" vulnerability. We then ranked each country by net score, which was the simple sum of its positive score and its negative score. The third ranking was the most complex. This involved a sliding scale weighting which placed more emphasis on positive factors for countries with large negative scores, but less emphasis on those with a small negative score.** This follows the logic that the larger the negative (or vulnerability) score, the more important it would be to have offsetting

factors, which shows you have the ability to be able to deal with debt. Conversely, **if you have a low debt or vulnerability ranking it seems a little odd to penalise you for having limited flexibility to deal with the issue, when there really isn't any issue to deal with!** Each approach faces limitations. Hence the critical aspect is to focus on the underlying trends.

THE RESULTS

Country	Vulnerability Ranked By		
	Negative Score Alone	Net Score	Sliding Scale
Greece	1	1	1
Ireland	2	4	4
Spain	3	2	2
Portugal	4	3	3
United Kingdom	5	15	11
Belgium	6	6	6
Iceland	7	14	10
France	8	5	5
United States	9	27	22
Italy	10	8	8
Slovak Republic	11	7	7
Hungary	12	11	9
Netherlands	13	16	12
Austria	14	18	13
Finland	15	23	18
Germany	16	21	16
Sweden	17	30	26
Denmark	18	35	31
New Zealand	19	29	25
Canada	20	32	28
Japan	21	28	24
Luxembourg	22	31	27
Poland	23	19	17
India	24	13	14
Switzerland	25	37	37
Vietnam	26	10	15
Australia	27	36	36
Czech Republic	28	24	20
Hong Kong	29	26	23
Philippines	30	12	19
Indonesia	31	9	21
Singapore	32	33	29
Korea	33	22	30
Thailand	34	17	32
China	35	25	33
Malaysia	36	20	34
Taiwan	37	34	35
Norway	38	38	38

SOVEREIGN DEBT UPDATE INCLUDING ASIA

The results confirmed our earlier work - that sovereign debt is primarily a European problem. Greece, Spain, Ireland and Portugal were the most vulnerable according to our analysis, ranking at the top of the vulnerability rankings by every measure. Big and heavily indebted countries like the UK and US compare poorly on negative characteristics alone, but this is offset by significant positives, including high GDP per capita, large economies, economic freedom, political stability and floating exchange rates. As a result they drop significantly down the vulnerability rankings on the Net score or Sliding scale rankings. Once again New Zealand compares well. Indeed, New Zealand is ranked 19th on negative characteristics alone, due to our current account deficit and external debt. However, when offsets are considered, we drop a lot further down the rankings, largely due to economic freedom, political stability and floating exchange rate – valuable offsets given that we are small and have below average wealth and income.

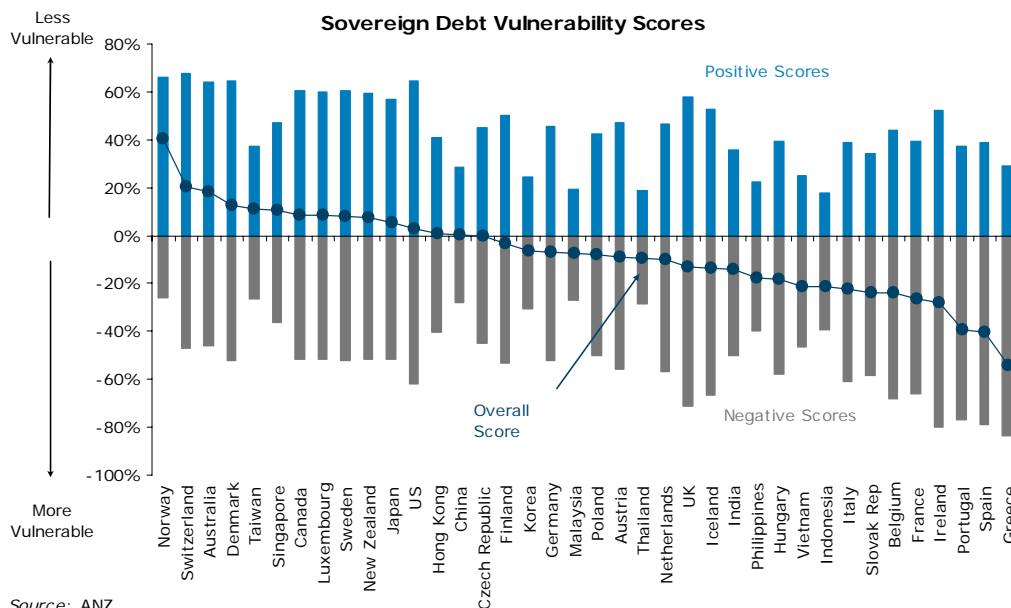
How a country's score is derived is important, and in the chart below, we plot each country's component scores, ranked by overall score, with the least vulnerable to the left, and the most vulnerable to the right. The chart highlights the importance of positive offsets for some countries, like the US and the UK. While both score very poorly against the negative characteristics (courtesy of high debt, large budget deficits and significant imbalances), they scored well against favourable characteristics, with their large populations, high incomes, political stability and floating exchange rates.

By contrast, countries like Malaysia and Thailand sit mid table, thanks to their negative overall scores. But they have very little debt (hence a small negative score) so the fact that this is offset by an even smaller positive score doesn't matter much, as they don't have a major problem in the first place.

THE BOTTOM LINE

Ultimately it is a combination of unfavourable and favourable characteristics that are most important for markets. Favourable characteristics do not forgive ills but they do give greater flexibility in terms of the pending adjustment process. Despite the EU/IMF rescue package, there are clearly significant challenges ahead, with a huge amount of concentration and contagion risk in the euro area. This is expected to accentuate pressure on the euro, and bias the USD upwards as the surprise package of 2010. Including Asia in our analysis does not change this prognosis we made in February.

With markets now turning to points of differentiation (as opposed to the "trend is your friend" strategy of 2009), sovereign debt is once again a major fundamental. Not only is it set to be de-stabilising, particularly for currency and debt markets, but it will ultimately force discipline and difficult choices. Key question marks will surround whether private sector de-leveraging and balance sheet repair has progressed sufficiently that the same adjustments can manifest in the public sector without destabilising the former. We continue to view such tensions as consistent with our "bathtub with waves" shaped cycle.



Source: ANZ



MONTHLY INFLATION GAUGE

SUMMARY

Our monthly inflation gauge increased by 0.1 percent in May, following a 1.2 percent increase in April. Large price falls for a number of components partly offset price increase for electricity and telecommunications. Price levels from the gauge have been trending up and point to more pricing power than is typically the case for this stage of the economic cycle. With increases in government charges and a hike in GST looming, the gauge will provide a timely means of monitoring the impact on pricing trends within the economy.

MONTHLY INFLATION EASES IN MAY

The 0.1 percent increase in the ANZ Monthly Inflation Gauge for May follows a 1.2 percent increase in April, the highest monthly increase in the history of the series. Quarterly inflation in the three months to May (1.4 percent) was the highest in the series' history.

Of the eight groups within the gauge, four recorded monthly increases, two registered no change and two recorded a monthly fall.

Higher prices for electricity, telecommunication services, and recreational and sporting services were major contributors to the monthly increase in the gauge. There were a few small monthly increases for a number of components, including rents, accommodation, credit services, and vehicle and life insurance.

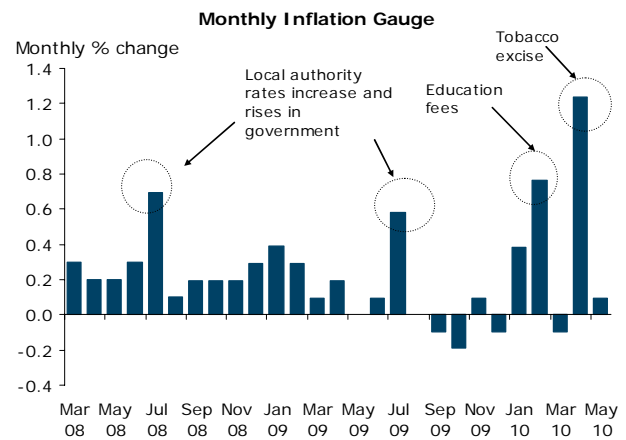
The major downward pressure for the gauge was provided by large falls in the prices of a few components, namely beer, medical services and cultural services. There were also a few small price falls scattered throughout the gauge. In most cases, however, price falls in these components were insufficient to offset price increases that had occurred over the previous few months.

The ANZ 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 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.

We remain suspicious that there is more pricing leverage in pockets of the economy despite economy-wide measures suggesting some remaining spare capacity. With government related charges set to impact in the coming months, the gauge will be a timely barometer of inflationary trends on the non-

contestable part of the economy. The gauge will also provide timely confirmation of the impact of the October increase in GST on consumer prices.

We are also concerned that the inability of supply-side capacity to keep pace could lead to a broadening in domestically generated pricing pressures at a relatively early stage of the economic expansion. The gauge will prove to be a useful way of assessing the impact on prices within the economy, particularly in sectors where resource bottlenecks are more likely to occur.



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	0.0		
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		



INTEREST RATE STRATEGY

SUMMARY

Term interest rates continue to fall, mirroring strong rallies in global rates following a very dovish FOMC statement. This caused further curve flattening, with 10 year swaps around 5.5 percent, their lowest level in over a year. While GDP data suggests gradual momentum is building, a better undertone appears to be developing locally. But questions are starting to be raised about global growth (excluding China) as fiscal support wanes. It all muddies the water somewhat beyond Q3 in terms of whether the RBNZ will be raising rates as quickly as what's priced in. We doubt this tension will be resolved soon.

MARKET THEMES

- The FOMC statement makes it clear that US monetary policy will be on hold for some time, with no change likely until well into 2011. This is a positive for bond markets, which had been contemplating the timing of the "exit strategy".
- The NZ market continues to price in high odds of successive rate hikes over the next year. We still think there's plenty of uncertainty beyond the next 2-3 hikes, and a pause is likely.

REVIEW AND OUTLOOK

Beyond the FIFA World Cup, the key global market event last week was the US FOMC statement. **As expected, the Fed kept the now famous "extended period" phrase in its communiqué.** On its own this gives no clues as to when the Fed might embark on its exit strategy. However the remainder of the statement was more dovish, with references to a weak housing market and financial conditions being less supportive. But what was really interesting was **the Fed's explicit acknowledgement that underlying inflation was trending lower.** For a central bank with a dual inflation and employment mandate, with the unemployment rate at 9.7 percent, this means only one thing – easy policy for some time. Not surprisingly, US treasuries rallied hard last week, spurred on by weaker equity markets, taking New Zealand interest rates with them.

Looking ahead, we'll be watching 3 developments closely. **The first is market attitudes to sovereign credit.** Sovereign CDS spreads have been widening steadily in Europe, with Greek spreads out at a new high last week. **While this has yet to have a major impact on NZ spreads, it is a risk.** **The second is the Australian economy.** A back-down on the resources tax may be good for mining, and thus perhaps for the wider economy, but **how will the government fill the fiscal hole** left by the

removal of the tax. **The third is the front end of the curve.** Barring a major shock, **we think the next 2-3 hikes are as "good as done"** But **we're not so sure about the pace of hikes beyond Q4.** The OCR is heading to neutral, but it's unrealistic to expect it to get there in a straight line this soon after emerging from recession. We expect excessive rate hikes in late 2010/early 2011 to get priced out, **placing downward pressure on short end rates.**

PREFERRED BORROWING STRATEGIES

Given how much monetary policy tightening is priced in over the next 12 months, and how little is priced in beyond that, we see little value in 1-2 year hedges. If anything they overstate the likelihood of rate rises during those terms. However, long end pricing is consistent with an almost permanent recession, with 10yr swaps back at around 5.5%. The OCR may be headed higher slowly, but it is heading higher, and we remain optimistic on NZ's long term outlook. Consider slowly adding to long term hedges here. If cashflow remains tight, use forwards. They're a little more expensive, but the higher rate is offset by what is set to be ongoing low rates for the next year or so as we navigate the patchy early stages of the recovery.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔	OCR heading to neutral, but slowly. Q4 pause likely.
NZ data	↔/↓	GDP data fairly average, confirms sluggish recovery.
Fed Funds / front end	↔/↓	Fed on hold well into 2011 according to US consensus.
RBA	↔/↑	RBA on hold for now, but hikes still likely late 2010.
US 10 year	↔/↓	Yields have rallied hard following FOMC, equity falls.
NZ swap curve	↔/↑	Long end has gone too far. 10yr at 5.5% remains crazy.
Flow	↔	Mortgage paying very light. Nervous shorts about still.
Technicals	↔	10yr could break 5.50%.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 29-Jul-10	+20	+22
Thu 16-Sep-10	+42	+35
Thu 28-Oct-10	+62	+61
Thu 9-Dec-10	+77	+77
Thu 27-Jan-11	+98	+99
Thu 10-Mar-11	+109	+110
Thu 28-Apr-11	+123	+121

TRADING THEMES WE FAVOUR AT PRESENT

NZ 2-5yr steepeners have been stagnant, but we still like them. Consider paying NZ 4mth OIS/receiving 2yr swap on the view that rate hikes beyond October will get priced out.

CURRENCY STRATEGY

SUMMARY

The NZD/USD is holding above 0.70 cents, though further grinds higher will be hard fought. Investors may be starting to fret about the pace of the global economic recovery, but strong terms of trade gains, the smallest current account deficit in over twenty years and positive yield advantage continue to run in the NZD's favour. Recent price action suggests it will not be the usual "risk on" versus "risk off" plays in the near term, but the NZD is still susceptible to any bout of risk aversion.

MARKET THEMES

- Markets still trying to digest what the CNY de-peg really means.
- G20 did not come up with anything new.
- Weak US housing data has some worried about a slowing in growth.

REVIEW AND OUTLOOK

The NZD managed to outperform despite global equities retreating last week. Investors are starting to worry about the pace of the global recovery as stimulus runs off (as evidenced by the weak US housing market data) and austerity measures in Europe kick in. The CNY appreciation last week is also expected to slow Chinese export growth. Yet, in such an environment, you would expect the NZD to retreat. Instead it has pushed higher and is close to the key 200 moving average level of 0.7130.

It remains to be seen for how long more the NZD can de-link from the paring back of risk appetite. Though the US FOMC was slightly more dovish last week, it is not as if yield differentials have moved significantly in favour of the NZD. There are certainly some things going in the NZD's favour, including rising terms of trade, the smallest current account deficit in almost twenty years, and a recovery that is gaining momentum. Yet, the NZD cannot remain immune if there is growing concerns over global growth. NZ's soft commodities have held up remarkably well to date, and this week's ANZ Commodity Price Index will reveal whether it has managed to avoid the sell-off seen in other hard commodity prices.

Recent price action suggests that the market has a lack of conviction and we expect very choppy ranges to continue. There is still uncertainty over what impacts the CNY re-peg will have, and the G20 summit shed no new light for the market. This week's US non-farm payrolls will be the major focus for currency markets. A second monthly

disappointment will likely see the greenback weaken, leading to a higher NZD by default.

Technically, the NZD has held support at 0.7040 and is now trying to gain a foot hold above the important 200 day MA at 0.7130. We expect a choppy range this week. The NZD/AUD cross should be contained in a 0.8000 to 0.8200 range with any developments regarding the new Australian PM's concessions on the mining tax to be keenly awaited.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↔	Close to fair value.
Yield	↔/↑	RBA on hold for now. RBNZ to hike further.
Commodities	↔/↑	NZ commodity prices at record high.
Partial indicators	↔/↓	NZ data improving. Australia's still good.
Technicals	↓	Resistance above 0.83 major.
Sentiment	↔	Still equity related moves.
Other	↔/↓	Watch for Australian mining tax backdown.
On balance	↔	Range trade here.

NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↔/↓	Getting further away from 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	↔	Still fickle.
Partial indicators	↔/↑	NZ data continues to improve.
Technicals	↔/↑	200 day moving average of 0.7130 still key.
AUD	↔	New Australian PM failed to materially lift AUD sentiment.
Sentiment	↔	NZD just following offshore moves.
Other	↔/↑	Is USD weakness returning?
On balance	↔	Maintain the trend.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
28-Jun	UK	Hometrack Housing Survey (MoM) - JUN	- -	0.20%	11:01
	JN	Retail Trade MoM SA - MAY	-0.10%	0.50%	11:50
	JN	Retail Trade YoY - MAY	4.80%	4.90%	11:50
	JN	Large Retailers' Sales - MAY	-2.90%	-3.60%	11:50
	NZ	NBNZ Business Confidence - JUN	- -	48.2	15:00
	EC	Euro-Zone M3 s.a. (YoY) - MAY	0.30%	-0.10%	20:00
	US	Chicago Fed Nat Activity Index - MAY	0.32	0.29	00:30
	US	Personal Income - MAY	0.50%	0.40%	00:30
	US	Personal Spending - MAY	0.10%	0.00%	00:30
	US	PCE Core (YoY) - MAY	1.10%	1.20%	00:30
	GE	Consumer Price Index (YoY) - JUN P	1.00%	1.20%	/2010
	GE	CPI - EU Harmonised (YoY) - JUN P	1.00%	1.20%	/2010
29-Jun	US	Dallas Fed Manf. Activity - JUN	3.20%	2.90%	02:30
	NZ	Building Permits MoM - MAY	- -	8.50%	10:45
	JN	Overall Hhold Spending (YoY) - MAY	0.30%	-0.70%	11:30
	JN	Jobless Rate - MAY	5.00%	5.10%	11:30
	JN	Industrial Production (MoM) - MAY P	0.00%	1.30%	11:50
	NZ	Money Supply M3 YoY - MAY	- -	-3.60%	15:00
	JN	Small Business Confidence - JUN	- -	46.7	17:00
	UK	Net Lending Sec. on Dwellings - MAY	0.8B	0.5B	20:30
	UK	Mortgage Approvals - MAY	51.0K	49.9K	20:30
	UK	M4 Money Supply (YoY) - MAY F	- -	2.80%	20:30
	EC	Euro-Zone Indust. Confidence - JUN	-6	-6	21:00
	EC	Euro-Zone Consumer Confidence - JUN F	-17	-17	21:00
	EC	Euro-Zone Economic Confidence - JUN	98.1	98.4	21:00
	EC	Euro-zone Services Confidence - JUN	3	3	21:00
30-Jun	US	S&P/CS Composite-20 YoY - APR	3.50%	2.30%	01:00
	US	S&P/CS 20 City MoM% SA - APR	-0.10%	-0.05%	01:00
	US	Consumer Confidence - JUN	62.9	63.3	02:00
	UK	GfK Consumer Confidence Survey - JUN	-20	-18	11:01
	AU	DEWR Skilled Vacancies MoM - JUN	- -	1.00%	13:00
	AU	HIA New Home Sales (MoM) - MAY	- -	6.20%	13:00
	AU	Private Sector Credit MoM% - MAY	0.40%	0.20%	13:30
	AU	Private Sector Credit YoY% - MAY	2.40%	2.10%	13:30
	AU	Rismark Aust. Median House PX - JUN	- -	- -	13:30
	JN	Annualized Housing Starts - MAY	0.810M	0.793M	17:00
	JN	Construction Orders (YoY) - MAY	- -	-25.00%	17:00
	UK	Nat'wide House prices sa (MoM) - JUN	0.30%	0.50%	18:00
	UK	Nat'wide House prices nsa(YoY) - JUN	9.00%	9.80%	18:00
	GE	Unemployment Change (000's) - JUN	-28K	-45K	19:55
	GE	Unemployment Rate (s.a) - JUN	7.70%	7.70%	19:55
	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	Total Business Investment(QoQ) - 1Q F	6.00%	6.00%	20:30
	EC	Euro-Zone CPI Estimate (YoY) - JUN	1.50%	1.60%	21:00
01-Jul	US	ADP Employment Change - JUN	60K	55K	00:15
	US	Chicago Purchasing Manager - JUN	59	59.7	01:45

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
01-Jul	US	NAPM-Milwaukee - JUN	- -	65	02:00
	AU	RBA Commodity Price Index Au - MAY	0.50%	- -	04:00
	AU	AiG Performance of Mfg Index - JUN	- -	56.3	11:30
	JN	Tankan Lge Manufacturers Index - 2Q	-3	-14	11:50
	JN	Tankan Lge Mfg Outlook - 2Q	1	-8	11:50
	JN	Tankan Non-Manufacturing - 2Q	-7	-14	11:50
	JN	Tankan Non-Mfg Outlook - 2Q	-3	-10	11:50
	CH	PMI Manufacturing - JUN	53.2	53.9	13:00
	AU	Retail Sales s.a. (MoM) - MAY	0.30%	0.60%	13:30
	AU	Building Approvals (MoM) - MAY	0.00%	- -	13:30
	AU	Building Approvals (YoY) - MAY	32.50%	21.30%	13:30
	CH	HSBC Manufacturing PMI - JUN	- -	52.7	14:30
	NZ	ANZ Commodity Price - JUN	- -	2.50%	15:00
	JN	Vehicle Sales (YoY) - JUN	- -	28.00%	17:00
	GE	Retail Sales (MoM) - MAY	0.40%	1.00%	18:00
	GE	Retail Sales (YoY) - MAY	-0.60%	-3.10%	18:00
	AU	RBA Commodity Index SDR YoY% - JUN	- -	43.80%	18:30
	GE	PMI Manufacturing - JUN F	58.1	58.1	19:55
	EC	PMI Manufacturing - JUN F	55.6	55.6	20:00
	UK	Index of Services (3mth/3mth) - APR	0.40%	0.20%	20:30
	UK	PMI Manufacturing - JUN	57.5	58	20:30
	US	Challenger Job Cuts YoY - JUN	- -	-65.10%	23:30
02-Jul	US	Initial Jobless Claims	455K	457K	00:30
	US	Continuing Claims	4560K	4548K	00:30
	US	ISM Manufacturing - JUN	59	59.7	02:00
	US	ISM Prices Paid - JUN	70	77.5	02:00
	US	Construction Spending MoM - MAY	-0.70%	2.70%	02:00
	US	Pending Home Sales MoM - MAY	-14.40%	6.00%	02:00
	US	Domestic Vehicle Sales - JUN	8.83M	9.14M	09:00
	UK	PMI Construction - JUN	58.5	58.5	20:30
	EC	Euro-Zone PPI (MoM) - MAY	0.30%	0.90%	21:00
	EC	Euro-Zone PPI (YoY) - MAY	3.10%	2.80%	21:00
	EC	Euro-Zone Unemployment Rate - MAY	10.10%	10.10%	21:00
	US	Change in Nonfarm Payrolls - JUN	-110K	431K	00:30
	US	Avg Hourly Earning MOM All Emp - JUN	0.10%	0.30%	00:30
	US	Avg Hourly Earning YOY All Emp - JUN	2.00%	1.90%	00:30
	US	Avg Weekly Hours All Employees - JUN	34.2	34.2	00:30
	US	Unemployment Rate - JUN	9.80%	9.70%	00:30
	US	Factory Orders - MAY	-0.50%	1.20%	02:00

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 weeks data confirmed that the expansion is ongoing, with the current account deficit narrowing to its lowest portion of GDP since 1989. This week sees the release of data that will shape the medium-term outlook, notably business confidence and commodity prices. 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
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	- -	- -
Tue 6 Jul (10:00am)	NZIER QSBO – Q2	Momentum building	Domestic Trading Activity indicators should show a pick-up in the quarterly pace of growth in Q2. Pricing intentions will likely spike higher due to GST changes. We will be on the look-out for whether skills shortages are starting to emerge.
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	Retail indicators suggest a monthly increase of approximately 1 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 multi-year peaks. We expect June readings to be little changed from May.
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.
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	- -	- -
On Balance		Building	Recovery continuing nicely.

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

	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	1.5	-0.3	0.7	-1.6	1.9
Credit Card Billings (% yoy)	0.1	-2.3	-0.3	1.6	1.9	2.7	1.1	5.2	0.7	3.4
Car Registrations (% mom)	-3.6	8.4	0.5	2.2	6.9	-0.7	0.0	5.1	3.0	-3.7
Car Registrations (% yoy)	-18.3	-16.8	-16.8	2.4	0.3	15.9	31.4	31.7	40.5	30.5
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	3.7
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	327.8	607.1	665.4	814.2
Trade Balance (\$m annual)	-2360	-1669	-1176	-863	-549	-176	-330	-161	182	91
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	0.714	0.700	0.710	0.720	0.730	0.730	0.720	0.710
NZD/AUD	0.783	0.809	0.816	0.795	0.789	0.783	0.777	0.777	0.783	0.789
NZD/EUR	0.547	0.542	0.576	0.579	0.602	0.632	0.652	0.652	0.643	0.634
NZD/JPY	68.21	60.43	63.80	66.50	68.16	69.84	71.54	73.00	72.00	71.71
NZD/GBP	0.476	0.465	0.474	0.500	0.493	0.486	0.480	0.474	0.462	0.449
NZ\$ TWI	68.2	65.1	68.3	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	3.14	3.70	3.80	4.20	4.70	5.20	5.70	5.80
NZ 10-yr bond	5.91	5.56	5.48	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	0.53	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	4.97	5.00	5.30	5.60	6.00	6.00	6.20	6.10

	25 May	21 Jun	22 Jun	23 Jun	24 Jun	25 Jun
Official Cash Rate	2.50	2.75	2.75	2.75	2.75	2.75
90 day bank bill	2.93	3.10	3.10	3.09	3.09	3.10
NZGB 11/11	3.61	3.81	3.81	3.78	3.78	3.80
NZGB 04/13	4.31	4.41	4.41	4.35	4.35	4.36
NZGB 12/17	5.29	5.33	5.33	5.27	5.27	5.28
NZGB 05/21	5.53	5.56	5.56	5.50	5.50	5.51
2 year swap	4.22	4.35	4.35	4.31	4.27	4.27
5 year swap	5.16	5.09	5.09	5.05	5.01	5.00
RBNZ TWI	65.2	68.1	68.1	67.9	67.9	68.3
NZD/USD	0.6682	0.7110	0.7110	0.7048	0.7048	0.7124
NZD/AUD	0.8145	0.8069	0.8069	0.8083	0.8083	0.8143
NZD/JPY	60.16	64.57	64.57	63.81	63.81	64.03
NZD/GBP	0.4653	0.4778	0.4778	0.4753	0.4753	0.4754
NZD/EUR	0.5430	0.5720	0.5720	0.5745	0.5745	0.5774
AUD/USD	0.8204	0.8811	0.8811	0.8719	0.8719	0.8749
EUR/USD	1.2306	1.2430	1.2430	1.2267	1.2267	1.2338
USD/JPY	90.04	90.81	90.81	90.53	90.53	89.88
GBP/USD	1.4362	1.4881	1.4881	1.4828	1.4828	1.4985
Oil (US\$/bbl)	68.03	77.18	77.84	77.15	75.90	75.96
Gold (US\$/oz)	1187.25	1259.60	1239.60	1238.95	1237.45	1244.80
Electricity (Haywards)	4.27	4.33	3.79	3.66	3.87	2.81
Milk futures (US\$/contract)	126	123	123	122	123	122
Baltic Dry Freight Index	4187	2601	2547	2515	2502	2501

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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