NEW ZEALAND ECONOMICS
ANZ MARKET FOCUS

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INSIDE

Economic Overview	2
Labour Market Preview	5
Global Taylor Rules	6
Interest Rate Strategy	9
Currency Strategy	10
Data Event Calendar	11
Data Watch	13
Key Forecasts	14

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CAUTIOUS BELLIGERANCE?

ECONOMIC OVERVIEW

Last week's OCR Review, where the RBNZ took a more guarded line towards the economy, leaves us comfortable calling a pause in the tightening cycle post September. At the same time we acknowledge that the general trend for rates will remain up with elements of belligerence apparent in the text. But with structural headwinds, global fragility and deleveraging the core planks of our economic view, we continue to see an elongated tightening profile with a lower endgame. This week sees the release of key labour market and commodity price data – including the Fonterra online auction. We see them all as remaining consistent with a gradual approach to the removal of policy support.

LABOUR MARKET PREVIEW

We are expecting continuing signs of underlying recovery in the labour market. Q1's barnstorming fall in the unemployment rate means there is a huge risk of payback in Q2. We'll be looking at underlying trends with employment figures as opposed to intra-quarter volatility in the unemployment rate giving a more reliable picture.

GLOBAL TAYLOR RULES

To help provide a guideline for the timing and extent of future monetary policy moves, we have empirically estimated Taylor Rules for each of the major central banks. Our Taylor Rules suggest that policy rates are set to remain at the zero bound for some time in the US and Japan, and the ECB will remain on hold for the foreseeable future. The BoC and RBNZ have rates where they should be, while the RBA and BoE are around 50bps below our Taylor Rule recommended rate. In other words, the risk remains that the RBA could tighten again, while the BoE may well be the next central bank to start lifting rates. Of course, policy needs to be forward looking so in the case of NZ, the bias to rates will remain up. But the real picture across our concurrent estimates is that the RBNZ looks to be headed in the right direction while the RBA may well be behind.

INTEREST RATE STRATEGY

Last week's RBNZ OCR Review shouldn't have been a surprise, but it was. Perhaps it's because the RBNZ have a reputation for being tough on inflation – and so they should – it's good that they are. But at the same time, signs that momentum in the recovery was fading were clear, and it is appropriate to signal that there is less urgency on how quickly rates need to rise. But they need to rise, make no mistake. Near term caution should hold short end rates down. However, long end rates are now at an extreme, and we'd need to see a significant further deterioration in the global outlook to see further movements lower.

CURRENCY STRATEGY

The RBNZ stated last week that recent currency appreciation was inconsistent with the economic fundamentals. This week, the focus will be firmly on the fundamentals as Q2 labour market data and the latest Fonterra auction will be closely watched. We can expect the NZD to trade a choppy but potentially directionless range this week.

ECONOMIC OVERVIEW

SUMMARY

Last week's OCR Review, where the RBNZ took a more guarded line towards the economy, leaves us comfortable calling a pause in the tightening cycle post September. At the same time we acknowledge that the general trend for rates will remain up with elements of belligerence apparent in the text. But with structural headwinds, global fragility and deleveraging the core planks of our economic view, we continue to see an elongated tightening profile with a lower endgame. This week sees the release of key labour market and commodity price data – including the Fonterra online auction. We see them all as remaining consistent with a gradual approach to the removal of policy support.

THIS WEEK'S EVENTS

- **ANZ Commodity Price Index – July** (Monday 2 August, 3:00pm).
- **SNZ Labour Cost Index and Quarterly Employment Survey – June quarter** (Tuesday August 3, 10:45am). Private sector labour cost index (LCI) Salary and Ordinary Time Wage Rates are expected to increase by 0.4 percent in the June quarter (1.4 percent y/y). See our preview on page 5.
- **Fonterra online auction** (Wednesday 4 August, circa 6:00 am). We are not expecting a repeat of the 15 percent fall in USD Whole Milk Powder Prices that eventuated last month. Nevertheless, prices are expected to ease from their average of US$3,224/tonne for the July event.
- **SNZ Household Labour Force Survey – March quarter** (Thursday 5 August, 10:45am). HLFS employment is forecast to increase by 0.4 percent, with stronger growth in working age population and increased labour force participation expected to lift the unemployment rate to 6.3 percent. See our preview on page 5.

WHAT'S THE VIEW?

The RBNZ stuck to their June *Monetary Policy Statement* script of further removing policy stimulus.

However, it is clear that the RBNZ are now a little more guarded on the economic outlook, which they see as having "softened somewhat". And while the near-term growth outlook was described as "respectable", it seems to be a far cry from the 1 percent quarterly growth rates that were forecast in the June *Monetary Policy Statement*.

Rather than pointing to any one area, the RBNZ's economic assessment was softer on a number of fronts. Global prospects have deteriorated (off a stronger base though to be fair), with commodity export prices moderating off record highs. Domestic demand is "subdued" with household spending displaying an element of caution. Moreover, business investment remains very low. While the RBNZ's assessment contained the usual finger pointing at potential second round effects from the temporary jump in inflation courtesy of GST et al, they do not expect a lasting impact on inflation although this remains one risk they will no doubt be monitoring closely.

The more cautious growth assessment by the RBNZ is closer to our current reading on the economy. We were never banking on a typical cyclical recovery, given the number of structural headwinds facing the New Zealand and global economies. Moreover, the softening tone detected from our internal anecdotes and the weakening in leading indicators had put us on alert some time ago that all was not well with the current expansion. That is not to say there is anything wrong with it either, merely that leading indicators are now pointing to a moderate rate of expansion as structural challenges are worked through. Most startling has been the retreat in employment and investment intentions.

While softer in tone we can still see some belligerence by the RBNZ. The review noted not just once, but twice that the July hike was merely easing off the accelerator rather than jamming on the brakes. Part of this was no doubt media PR as raising interest rates is never viewed in a positive light, but it's also a stark reminder that the trend for rates from these levels will continue to be up.

Where to from here for monetary policy? The RBNZ now note that the pace and extent of further OCR increases is likely to be more moderate relative to the track set in June. This resonates with our long held view that the tightening cycle was likely to be more gradual, with the economy not strong enough to withstand a continuation of 25 basis point hikes at every meeting over the next 12 months. The market now appears to have come around to this proposition and in fact market pricing is even below our demure view on how fast interest rates will **move up over the coming nine months. Specifically, the market looks to have hooked on to the caution expressed by the RBNZ but overlooked the belligerence!**

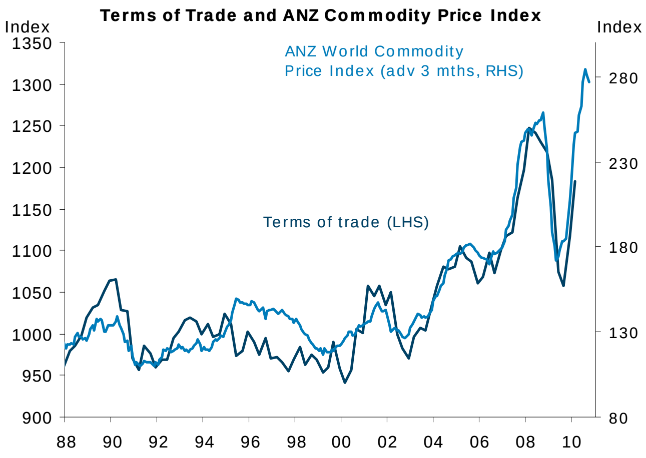
ECONOMIC OVERVIEW

OUR FORECAST AND MARKET EXPECTATIONS FOR RBNZ OCR		
OCR DATES	**OUR FORECAST**	**MKT. PRICING**
Thu 16-Sep-10	3.25%	3.17%
Thu 28-Oct-10	3.25%	3.28%
Thu 9-Dec-10	3.25%	3.38%
Thu 27-Jan-11	3.25%	3.47%
Thu 10-Mar-11	3.50%	3.54%
Thu 28-Apr-11	3.75%	3.61%
Thu 9-Jun-11	4.00%	3.69%

At this stage, we expect the RBNZ to deliver one more hike in September and then pause to assess the landscape. The OCR will undoubtedly move up over time as the RBNZ seeks to get rates closer to neutral. However, the path to normalisation will be an elongated one, no doubt with pauses along the way. One challenge a post-September pause faces is that it effectively rules out moving in October and December. Re-starting the tightening cycle in January (an OCR Review date) is not ideal, effectively leaving March, and this is a long time to pause with rates still well below neutral. But at this stage we're happy to run with that scenario, largely on a wider view of continued global ructions into 2011 as a wall of refinancing hits.

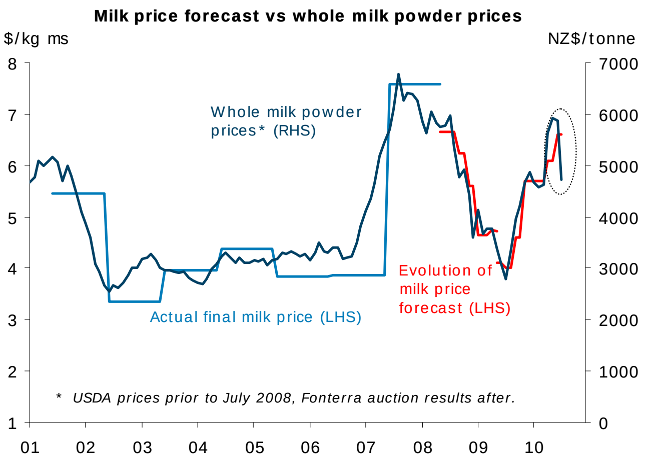
Two pieces of data that will have a key bearing on the RBNZ's policy deliberations will be released this week. We are expecting continuing signs of underlying improvement in the labour market. However, HLFS figures of late have been notoriously volatile, and we can't rule out some statistical payback from the barnstorming Q1 figures. We've pencilled in a rise in the unemployment rate from 6 to 6.3 percent, but remember Q1 showed a fall from 7.1 to 6 percent. From a pure presentational perspective, a rising unemployment rate will present some more PR challenges for the RBNZ heading into the September decision, even though averaging out the first two quarters of the year will no doubt show signs of improvement and respectability, particularly on the employment front.

Key export commodity price data is published this week, with the July ANZ Commodity Price Index out at 3pm today. Earlier Fonterra Auction results had highlighted the probability of further falls in commodity prices. It will be interesting to see if prices for other commodity exports are catching a similar downdraft. Nevertheless, we'll remind readers to look at both the level and the change. We've been at pains to emphasise this when eying data such as building consents – which showed a small rise last week but at a level that still looks terrible. And with non-residential work trailing off there is a construction sector work vacuum fast approaching. Any turn in commodity prices needs to be viewed in conjunction with the level, which remains high and will provide some economic support for the time being.



Sources: ANZ, National Bank, Statistics NZ

On Wednesday morning we will have the results of the monthly Fonterra online auction. This auction is proving to be an important barometer for commodity export prices. Whole Milk Powder prices have been on an easing trend since topping out at just below US$4,000/tonne in April and we expect a small decline from the US$3,224/tonne average in the July trading event. Anecdotally, prices appear to sit around US$3,000/tonne.



Sources: ANZ, National Bank, Fonterra, Bloomberg

If this is the case then **there is a real prospect that Fonterra's milk price forecast of $6.60 per kg of milk solids for the 2010/11 season will be adjusted.** Some quick OLS (ocular least squares) on the chart below suggests downside risks already based on last month's prices and where the currency is. But at this juncture the season has hardly started

ECONOMIC OVERVIEW

so we're coy about making sweeping assessments.

This week is also very heavy in regard to the global data-flow. Q2 US GDP came in below expectations, and the focus now turns to how Q3 is faring. In that regard, the upcoming ISM and non farm payrolls data will be keenly awaited by markets. Closer to home, the RBA meeting tomorrow is widely expected to see them leave the cash rate unchanged at 4.5 percent. The much softer than expected Australian Q2 CPI data out last week mean the RBA will be on the sidelines for the next few months. But our Australian colleagues still expect the RBA to raise the cash rate twice in Q4 to 5.0 percent, and for inflation to be above the top of the target band by the end of next year.

RECENT LOCAL DATA

- **National Bank Business Outlook – July.** Headline business confidence fell 12 points. Firms' own activity expectations fell 7 points to a net 32 percent expecting better activity, with pricing, investment and employment intentions all easing.
- **RBNZ July OCR Review.** The RBNZ increased the Overnight Cash Rate by 25 basis points to 3.00 percent and noted that *"the pace and extent of further OCR increases is likely to be more moderate than projected in the June MPS"*.
- **SNZ Merchandise Trade – June.** A trade surplus of $276m was recorded with the annual trade surplus ($639m) the largest since March 2002. Export values increased by a seasonally adjusted 6.2 percent, whereas imports increased by 2.1 percent.
- **RBNZ Credit Aggregates – June.** Resident private sector credit ex repo declined by 0.3 percent (+0.2 percent y/y). Household (+2.5 percent y/y), Business (-7.4 percent y/y) and Agricultural (+2.7 percent y/y) credit growth remains subdued.
- **SNZ Building Consents – June.** The seasonally adjusted number of residential consents rose by 3.5 percent (+1.7 percent ex-apartments), to be 28 percent up on 12-months earlier. The value of non-residential consents fell by 9.6 percent to $243m, the lowest monthly value since April 2006.

LABOUR MARKET PREVIEW – JUNE 2010 QUARTER

SUMMARY

We are expecting continuing signs of underlying recovery in the labour market. Q1's barnstorming fall in the unemployment rate means there is a huge risk of payback in Q2. We'll be looking at underlying trends with employment figures as opposed to intra-quarter volatility in the unemployment rate giving a more reliable picture.

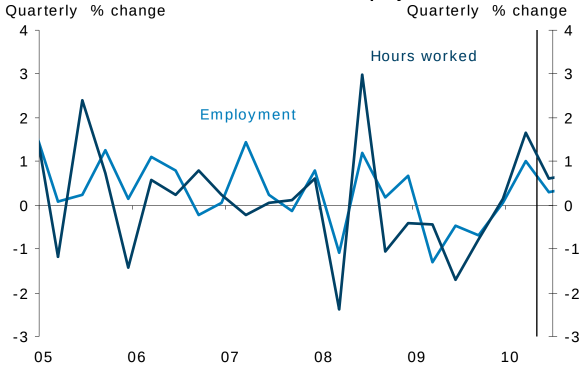
June 2010 quarter expectations		
	Our Forecast	Market
LCI salary and wage ordinary time (private sector)	**+0.4% q/q +1.4% y/y**	+0.4% q/q +1.4% y/y
QES salary and wage ordinary time (private sector)	**+1.0% q/q +1.8% y/y**	+0.7% q/q +1.3% y/y
HLFS unemployment rate (s.a.)	**6.3%**	6.4%
HLFS participation rate (s.a.)	**68.2%**	68.2%
HLFS employment growth	**+0.4% q/q +0.7% y/y**	+0.4% q/q +0.8% y/y

We expect HLFS employment to increase by 0.4 percent, following the 1.0 percent surge in March. HLFS hours worked are expected to increase by 0.6 percent taking the hours worked per employee closer to historical norms from last September's trough. The labour market typically lags the cycle and there is likely to be an element of catch-up. Although we are now on the recovery path, employment and hours worked are anticipated to remain well below pre-recession peaks.

Driving the increase in employment has been the recovery in business sentiment. Surveyed measures of employment intentions from the QSBO suggest continued modest improvement. The National Bank Business Outlook highlights the possibility of a more sizeable Q2 increase, notwithstanding the falls since May. Skill shortages have been increasing but this may be partly a consequence of the strengthening in PLT departures.

An increasing labour force and some statistical noise is expected to drive an increase in the unemployment rate from 6 to 6.3 percent. Recall that the Q1 HLFS showed an outsized fall in the unemployment rate from 7.1 to 6 percent, and this sort of fall has us mindful of some payback. Last week's published data suggest there could be a reasonably solid 18,000 increase in the seasonally adjusted working age population, in spite of net immigration slowing to a trickle. This follows the surprise 1,000 decline in Q1. We are also expecting labour force participation to rise to 68.2 percent of the labour force, with the improving employment outlook expected to attract more people into the labour force.

HLFS hours worked and employment



Sources: ANZ, National Bank, Statistics NZ

Quarterly HLFS outturns have been volatile and there remains a large margin of error around our Q2 picks. In particular, small surprises on labour force participation or employment have the potential to deliver a significantly different unemployment rate from what we expect. We admit that we are "unusually uncertain" on this. Contacts with the recruitment sector clearly point to improvement in H1 2010 relative to H2 2009 and we expect the spirit of Thursday's figures to reflect that when we "average" things out.

The labour market has displayed considerable flexibility in the recent cycle. Hours worked and labour earnings took most of the brunt of the slowdown. Initially we expect the higher demand for labour to be met by an increase in quantities (i.e. employment and hours worked). **As such, wage inflation is expected to remain moderate with a 0.4 percent increase forecast for private sector LCI.** QES private sector ordinary average earnings are expected to display the usual seasonal pattern with an increase of around 1 percent in the June quarter. Partly supporting wage growth is the 2 percent increase in the minimum wage from April. Although the CPI inflation trajectory is clearly rising, by and large the balance of bargaining power is still on the side of employers. Firms are less well placed to accommodate higher wage demands, with surveyed measures of expected profitability easing.

The RBNZ will be closely watching wage settling behaviour and are unlikely to favourably view a stronger outturn for LCI wage inflation than the 0.4 percent assumed in the June MPS. The RBNZ are clearly mindful of the high degree of volatility in the HLFS and any sort of recant on Q1 strength (despite being statistical) is likely to give them some PR headaches looking towards the September decision. Sifting between the tea leaves, the labour market is improving, although clearly not flowing into consumer sentiment.

GLOBAL TAYLOR RULES

SUMMARY

To help provide a guideline for the timing and extent of future monetary policy moves, we have empirically estimated Taylor Rules for each of the major central banks. Our Taylor Rules suggest that policy rates are set to remain at the zero bound for some time in the US and Japan, and the ECB will remain on hold for the foreseeable future. The BoC and RBNZ have rates where they should be, while the RBA and BoE are around 50bps below our Taylor Rule recommended rate. In other words, the risk remains that the RBA could tighten again, while the BoE may well be the next central bank to start lifting rates. Of course, policy needs to be forward looking so in the case of NZ, the bias to rates will remain up. But the real picture across our concurrent estimates is that the RBNZ looks to be headed in the right direction while the RBA may well be behind.

POLICY RULES TO GUIDE THE GLOBAL TIGHTENING CYCLE

The global financial crisis has seen central banks take extraordinary policy action in aggressively cutting interest rates. Some central banks have gone further after hitting the zero bound, employing unconventional policy tools such as quantitative easing. With the worst of the global financial crisis now behind us (though the after effects will continue to be felt for some time), policy normalisation will eventually occur as interest rates cannot stay at historically low levels forever. Indeed, some central banks have already taken the first steps in normalising rates, while others are yet to begin.

In general, policy rules provide a simple framework for thinking about the appropriate monetary policy setting based on the economic backdrop. The most famous policy rule is the Taylor Rule, named after Stanford University economist John B Taylor who first proposed the rule in 1993. There are various ways to create a Taylor Rule and they work better for some central banks than others. But the general principle is that they recommend an appropriate policy interest rate after accounting for the relative importance of inflation or expected inflation, and 'slack' in the economy (such as an output gap or unemployment gap measure).

To help provide a guideline for the timing and extent of future policy tightening, we have empirically estimated Taylor Rules for seven central banks: the Reserve Bank of New Zealand (RBNZ), Reserve Bank of Australia (RBA), US Federal Reserve, European Central Bank (ECB), Bank of Canada (BoC), Bank of England (BoE) and Bank of Japan (BoJ). To proxy the degree of slack in the economy our specification uses an unemployment gap, whereas the inflation term in the Taylor rule is the contemporaneous inflation rate (rather than an inflation gap).

Taylor Rules are useful for modelling a central bank's reaction function. But central banks do not slavishly follow strict policy rules, and there is a lot of judgement involved with each interest rate decision taking into account a range of other influences. In addition, monetary policy is in uncharted waters for many, and central bank reaction functions based on historical experience may not match their future actions.

However, we find that the aggressive steps taken by the central banks during the global financial crisis have generally been in line with what our Taylor Rules were prescribing. For those central banks that have started to tighten policy, our Taylor Rules have tended to mimic actual policy moves quite well. This gives us some confidence that past central bank reaction functions are still relevant in trying to determine the future path for monetary policy.

WHAT ARE OUR TAYLOR RULES TELLING US?

Based on our Taylor Rules, we make the following observations:

- Some central banks have been much more aggressive than others in terms of front-loading the easing cycles during the global financial crisis. For example, the RBA cut rates early and hard relative to the Taylor Rule, but have tightened policy in step with the Taylor Rule recommendations. The US Federal Reserve and BoC cut more aggressively than what was prescribed by their respective Taylor Rules. In the US Federal Reserve's case, the rule turned negative in March 2009, at the time when they engaged in quantitative easing. The ECB and RBNZ on the other hand, were late in easing relative to the Taylor Rule, but the latter made up for it by making very large cuts.
- Our Taylor Rules suggest that policy rates are set to remain at the zero bound for some time in the US and Japan, and the ECB will remain on hold for the foreseeable future. The BoC and RBNZ have rates where they should be.
- Policy rates for the RBA and BoE are around 50bps below where our Taylor Rule suggests they should be. While we now expect the RBA to pause tomorrow given the weaker than expected Australian Q2 CPI data, our Taylor rule suggests

GLOBAL TAYLOR RULES

the risk is still towards higher interest rates. And the BoE may well be the next central bank to start lifting interest rates. Indeed, one BoE monetary policy committee member, Andrew Sentance, has already twice voted for a rate hike.

- The Taylor rule is a 'reduced-form' specification so care must be exercised when interpreting the equation coefficients. Of some comfort is that the coefficients on activity and inflation appear consistent with our priors, with policy interest rates positively related to actual inflation but negatively related to the degree of slack within the economy. In general, policy interest rates tend to be more sensitive to deviations in activity from trend than inflation. Caution is needed when comparing the coefficients across countries, but these highlight some interesting differences. Coefficients for the UK Taylor Rule are larger for contemporaneous inflation and the current unemployment gap. Canadian policy interest rates, by contrast, are more sensitive to the unemployment gap. The RBA and ECB have similar coefficients on contemporaneous inflation, but the former has a larger coefficient on the unemployment gap.

	Inflation co-efficient	Unemployment co-efficient
Reserve Bank of New Zealand	0.89	-0.72
Reserve Bank of Australia	0.24	-1.77
US Federal Reserve	1.15	-1.29
European Central Bank	0.25	-1.05
Bank of Canada	0.15	-1.60
Bank of England	1.49	-2.33
Bank of Japan	0.70	-0.78

- We have explicitly incorporated the impact of higher bank funding costs into our RBNZ and RBA Taylor Rules.[1] We find that a 100 basis points deviation in the floating rate spread from its historical average equates to a 40 basis points change for the RBA, and 90 basis points for the RBNZ.

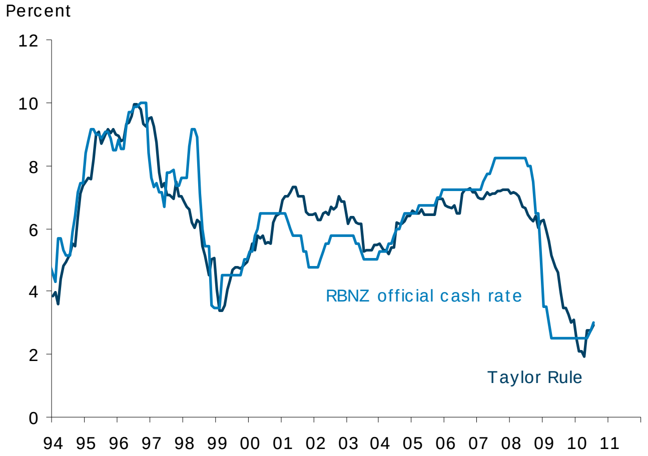
IT IS JUST ONE OF MANY TOOLS

Our Taylor Rules provides a simple and consistent framework for assessing monetary policy, but it should be seen as just one of many tools to influence a central bank's future policy moves. The standard errors around our Taylor Rules vary from around 100 basis points for the RBNZ and US Federal Reserve, to 34 basis points for the ECB. Such uncertainties need to be borne in mind when assessing the Taylor Rule recommendations.

	Current Policy Rate	Taylor Rule Rate	Model R^2	Standard errors (bps)
RBNZ	3.00	2.93	0.68	100
RBA	4.50	5.01	0.75	54
US Fed	0.25	-1.04	0.81	101
ECB	1.00	0.64	0.89	34
BoC	0.75	0.73	0.76	77
BoE	0.50	1.02	0.86	66
BoJ	0.10	-0.99	0.81	75

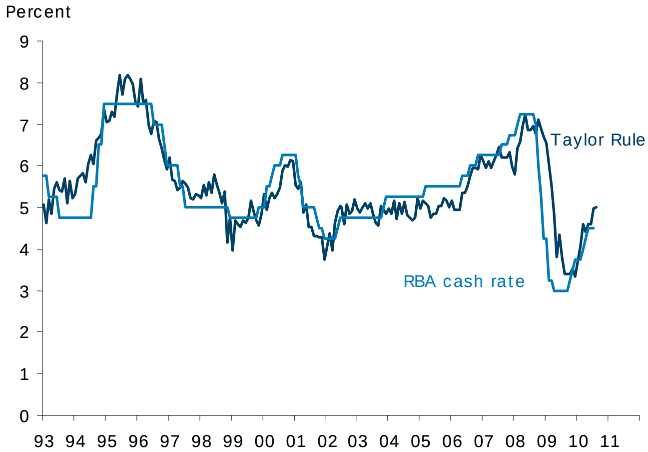
TAYLOR RULE CHARTS

RBNZ official cash rate vs Taylor Rule



Sources: ANZ, National Bank, Bloomberg

RBA cash rate vs Taylor Rule

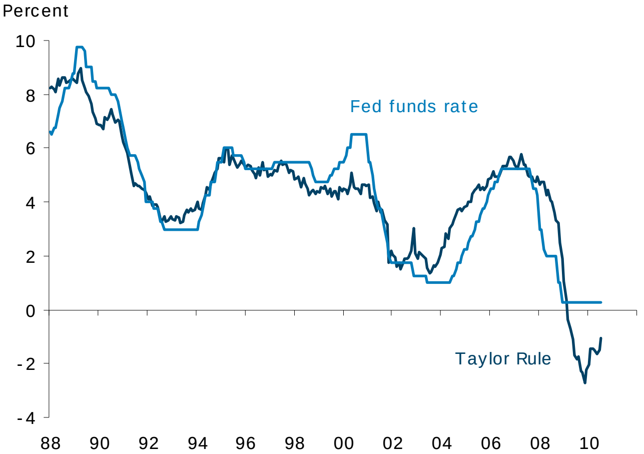


Sources: ANZ, National Bank, Bloomberg

[1] This is done by taking the deviation of the spread between the floating variable mortgage rate and the policy rate from the historical average over the 1994 to 2007 period.

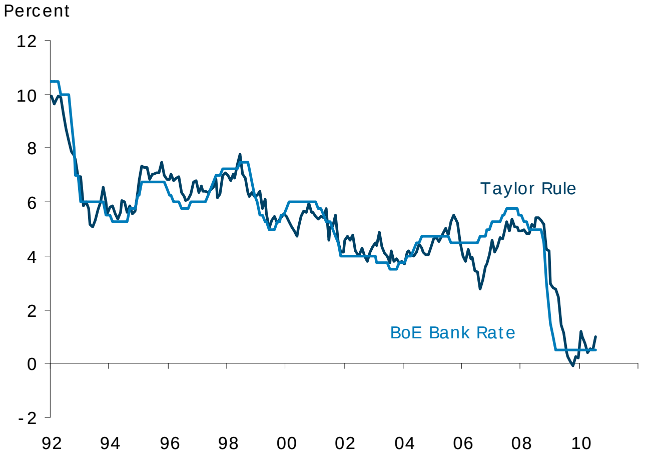
GLOBAL TAYLOR RULES

Fed funds rate vs Taylor Rule



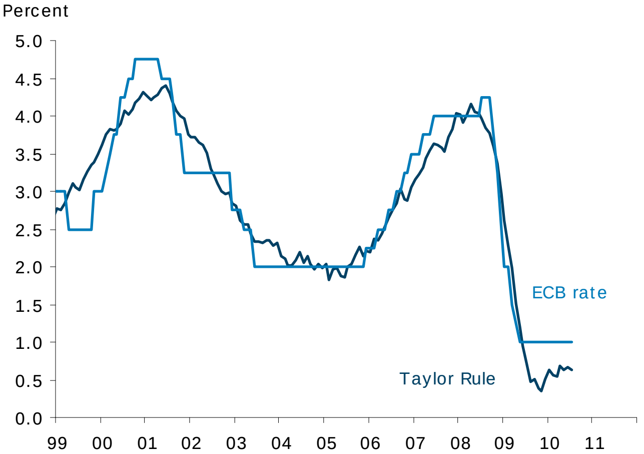
Sources: ANZ, National Bank, Bloomberg

BoE Bank Rate vs Taylor Rule



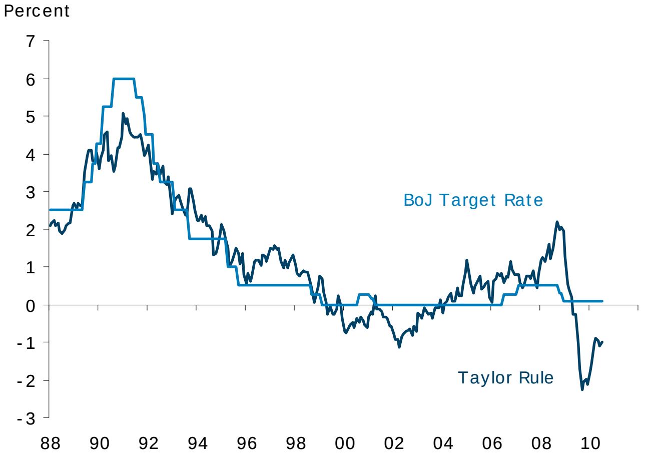
Sources: ANZ, National Bank, Bloomberg

ECB rate vs Taylor Rule



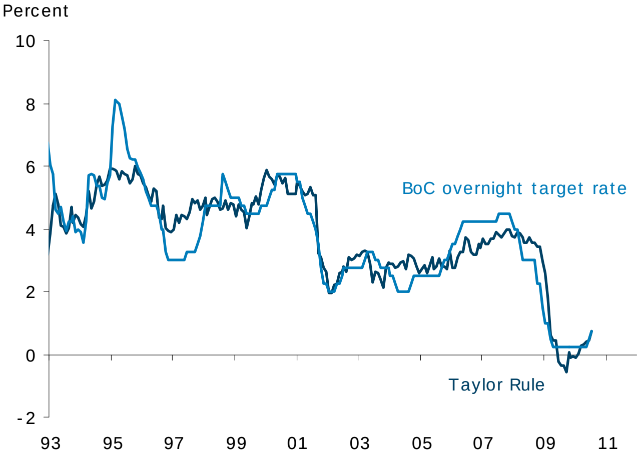
Sources: ANZ, National Bank, Bloomberg

BoJ Target Rate vs Taylor Rule



Sources: ANZ, National Bank, Bloomberg

BoC overnight target rate vs Taylor Rule



Sources: ANZ, National Bank, Bloomberg

INTEREST RATE STRATEGY

SUMMARY

Last week's RBNZ OCR Review shouldn't have been a surprise, but it was. Perhaps it's because the RBNZ have a reputation for being tough on inflation – and so they should – it's good that they are. But at the same time, signs that momentum in the recovery was fading were clear, and it is appropriate to signal that there is less urgency on how quickly rates need to rise. But they need to rise, make no mistake. Near term caution should hold short end rates down. However, long end rates are now at an extreme, and we'd need to see a significant further deterioration in the global outlook to see further movements lower.

MARKET THEMES

- It was not the RBNZ actions, but rather its words that have caused a stir in the market. A guarded stance and specific references to a more gradual series of hikes has sent the market reeling.
- But we'd also note aspects of belligerence in the text in terms of rates moving up over time.
- Bullish market sentiment has been spurred along by softer than expected Australian CPI data, which has changed the RBA policy landscape.

REVIEW AND OUTLOOK

Term interest rates have fallen sharply since last week's OCR Review. It was specific comments regarding the outlook that really caught the market's attention. Indeed, **the Bank noted that "the pace and extent of further OCR increases is likely to be more moderate" than projected in June** – and it doesn't get much clearer than that. This and the generally cautious tone of the OCR Review appear to have caught the market by surprise. As we have noted several times over the past, the market had its sights on the RBNZ delivering a stern series of rate hikes over the next year, as opposed to a more gradual pace. **Now that this has been clarified, it's not surprising that rates rallied. The short end is inextricably tied to the OCR and at the moment, the market is pricing in a fraction less than one hike every two meetings over the next year. This seems pretty fair to us.**

By contrast, there is a limit to how much lower long end rates can go and the fact the RBNZ noted twice that rates are very stimulatory still is a stark reminder where the general trend for rates will be, and that is up. While it is inevitable that these will continue to trade below where they should, given the still upbeat long term outlook they are getting stretched. For example, **7yr swaps are now trading below 5 percent. That's tantamount to the market saying that 3mth BKBM will average below 5 percent for the next 5 years.** It's possible, but only likely if we see another global shock, or the recovery doesn't take hold or credit conditions seize up such that the RBNZ end up severely paring back the degree of tightening that's in store. **The point is, it's not the central scenario.** The recovery may be patchy, but we are muddling through it, and the OCR will inevitably go beyond neutral at some stage.

PREFERRED BORROWING STRATEGIES

We're back to pondering the old conundrum again – fixed rates look tremendously cheap relative to historic levels, but they're still significantly higher than floating rates. So, what do you do? If you have to hedge, the long end looks attractive, and rates have now fallen so far that it is likely that paying fixed for 5-10years will actually turn out to be cheaper in the long run. But at the same time the spread to floating is large, and if cashflow is an issue, sticking to floating makes sense. What seems clear is that floating rates will be low for a little longer yet – even if we do see the OCR back towards neutral in a few year's time.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↓	RBNZ: Extent and pace of OCR rises will moderate.
NZ data	↓	All eyes on HLFS data this week. Recent data has been almost universally soft.
Fed Funds / front end	↔/↓	Bernanke: "unusually uncertain". Says it all.
RBA	↔	Soft CPI data suggests no urgency to raise rates.
US 10 year	↔/↓	10yr USTs still below 3%.
NZ swap curve	↔/↓	Parallel shift lower as both a slower pace and less hikes overall get priced in.
Flow	↔/↓	Clear signs of longs stopping out. Mortgage flow dead.
Technicals	↔/↓	2yr break of 4% significant.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 16-Sep-10	+17	17
Thu 28-Oct-10	+34	26
Thu 9-Dec-10	+48	38
Thu 27-Jan-11	+62	47
Thu 10-Mar-11	+79	54
Thu 28-Apr-11	+85	61
Thu 9-Jun-11	Not forecast	69

TRADING THEMES WE FAVOUR AT PRESENT

We prefer to remain long outright interest rate risk. The bulk of the move lower is behind us, but with two hikes priced in by January still, there is more to come. US rates look to be in no hurry to move higher.

CURRENCY STRATEGY

SUMMARY

The RBNZ stated last week that recent currency appreciation was inconsistent with the economic fundamentals. This week, the focus will be firmly on the fundamentals as Q2 labour market data and the latest Fonterra auction will be closely watched. We can expect the NZD to trade a choppy but potentially directionless range this week.

MARKET THEMES

- Fonterra auction will be closely watched to see if last month's 15 percent decline is a one-off or the start of a trend.
- Do the EUR and GBP have more gas in the tank as Greece bond auction goes well and focus drifts to the US budget deficits?
- The NZD/AUD crosses looks close to equilibrium around 0.8000.
- US Fed's Bullard reopens the case for more QE.

REVIEW AND OUTLOOK

The dovish RBNZ last week took the wind out of the rampant NZD sails. The local economy has shown signs of easing momentum over the past 2 months, but compared to other developed countries our issues look manageable. The trade balance suggests NZ has continued to benefit from our proximity to Australia and Asia, alongside high commodity prices. Economic growth may be more moderate, but at least the economy continues to rebalance.

The interest rate market has rallied aggressively since the RBNZ decision. Only around 80bps of hikes are now priced in over the next 12 months. But while the yield differential has narrowed somewhat against the US, NZD/USD still has good support between the 0.7100/0.7170 zones.

Helping hold the NZD up is the fact that the USD continues to come under downward pressure. US Q2 GDP was below expectations, and St. Louis Fed President James Bullard's concerns about deflation suggest the FOMC may have to do more to provide support for the US economy – which means engaging in further quantitative easing. The currency market will digest Bullard's comments, along with the successful Greek auction, strong German exports and impressive UK GDP data, as being supportive of the EUR and may look for a further push higher in the single currency to potentially as high as the 200 day moving average near 1.3550.

As we noted in the past two weeks, the NZD/EUR and NZD/GBP crosses both now look to have medium term tops in place. Both failed retests during the week, which coincided with a continuation of improving European data. A break of 0.5485 in EUR/NZD will target 0.5250 whereas NZD/GBP could drift as low as 0.4170

The NZD AUD cross has reached our target at 0.8000 finally and we now see the cross as neutral. Further moves lower will be dependent on the relative labour market performance, for which the NZ data is out this week and Australia's will be released next week.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	**DIRECTION**	**COMMENT**
Fair value	↔	Fair value at present.
Yield	↔	RBA on hold, RBNZ to hike possibly one more time.
Commodities	↔	Copper prices have improved, Fonterra this week key.
Partial indicators	↓	Watch labour market data: NZ this week, AU next week.
Technicals	↓	Major support at 0.7940 but no momentum in market.
Sentiment	↔	Still tracking equity market moves.
Other	↔/↓	RBA decision tomorrow keenly eyed.
On balance	↔	**Range trade 0.78-0.83.**

NZD VS USD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	**DIRECTION**	**COMMENT**
Fair value – long-term	↔/↓	Above structural fair value of 0.66.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↔/↑	US not hiking for a while.
Commodities	↔/↓	Fonterra this week critical.
Risk aversion	↔	Focus drifting off Europe. But still following equities.
Partial indicators	↔/↓	NZ data weak of late.
Technicals	↔/↓	0.7100-0.7400 range trade.
AUD	↔	Election to see AUD sidelined.
Sentiment	↔	NZD more aligned to offshore moves.
Other	↔/↓	Market no longer short NZD.
On balance	↔/↓	**Little reasons to buy USD.**

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
2-Aug	AU	AiG Performance of Mfg Index - JUL	- -	52.9	11:30
	AU	TD Securities Inflation MoM% - JUL	- -	0.30%	12:30
	AU	TD Securities Inflation YoY% - JUL	- -	3.60%	12:30
	AU	HIA New Home Sales (MoM) - JUN	- -	-6.40%	13:00
	JN	Labor Cash Earnings YoY - JUN	0.70%	-0.20%	13:30
	CH	HSBC Manufacturing PMI - JUL	- -	50.4	14:30
	NZ	**ANZ Commodity Price - JUL**	**- -**	**-1.20%**	**15:00**
	AU	RBA Commodity Index SDR YoY% - JUL	- -	43.00%	18:30
	AU	RBA Commodity Price Index Au - JUL	- -	91.3	18:30
	GE	PMI Manufacturing - JUL F	61.2	61.2	19:55
	EC	PMI Manufacturing - JUL F	56.5	56.5	20:00
	UK	PMI Manufacturing - JUL	57	57.5	20:30
3-Aug	US	ISM Manufacturing - JUL	54	56.2	02:00
	US	ISM Prices Paid - JUL	54.5	57	02:00
	US	Construction Spending MoM - JUN	-0.50%	-0.20%	02:00
	NZ	**Private Wages Inc Overtime QoQ - 2Q**	**0.40%**	**0.30%**	**10:45**
	NZ	**Private Wages Exc Overtime QoQ - 2Q**	**0.40%**	**0.30%**	**10:45**
	NZ	**Average Hourly Earnings QoQ - 2Q**	**0.50%**	**-0.40%**	**10:45**
	CH	China Non-manufacturing PMI - JUL	- -	57.4	13:00
	AU	Retail Sales s.a. (MoM) - JUN	0.40%	0.20%	13:30
	AU	Building Approvals (MoM) - JUN	2.00%	- -	13:30
	AU	Retail Sales Ex Inflation(QoQ) - 2Q	0.70%	0.10%	13:30
	AU	Building Approvals (YoY) - JUN	16.00%	26.60%	13:30
	AU	RBA CASH TARGET - AUG	4.50%	4.50%	16:30
	UK	PMI Construction - JUL	58	58.4	20:30
	EC	Euro-Zone PPI (MoM) - JUN	0.40%	0.30%	21:00
	EC	Euro-Zone PPI (YoY) - JUN	3.10%	3.10%	21:00
4-Aug	US	Personal Income - JUN	0.20%	0.40%	00:30
	US	Personal Spending - JUN	0.10%	0.20%	00:30
	US	PCE Deflator (YoY) - JUN	1.30%	1.90%	00:30
	US	PCE Core (MoM) - JUN	0.10%	0.20%	00:30
	US	PCE Core (YoY) - JUN	1.30%	1.30%	00:30
	US	Factory Orders - JUN	-0.30%	-1.40%	02:00
	US	Pending Home Sales MoM - JUN	3.70%	-30.00%	02:00
	US	Pending Home Sales YoY - JUN	- -	-15.60%	02:00
	AU	AiG Performance of Service Index - JUL	- -	48.8	11:30
	AU	Trade Balance - JUN	1800M	1645M	13:30
	AU	House Price Index QoQ - 2Q	2.00%	4.80%	13:30
	AU	House Price Index YoY - 2Q	17.20%	20.00%	13:30
	CH	China HSBC Services PMI - JUL	- -	55.6	14:30
	GE	PMI Services - JUL F	57.3	57.3	19:55
	EC	PMI Services - JUL F	56	56	20:00
	EC	PMI Composite - JUL F	56.7	56.7	20:00
	UK	PMI Services - JUL	54.5	54.4	20:30
	UK	Official Reserves (Changes) - JUL	- -	$435M	20:30
	EC	Euro-Zone Retail Sales (YoY) - JUN	0.10%	0.30%	21:00
	EC	Euro-Zone Retail Sales (MoM) - JUN	0.00%	0.20%	21:00
5-Aug	US	ADP Employment Change - JUL	35K	13K	00:15

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
5-Aug	US	ISM Non-Manf. Composite - JUL	53	53.8	02:00
	NZ	**Unemployment Rate - 2Q**	**6.20%**	**6.00%**	**10:45**
	NZ	**Participation Rate (QoQ) - 2Q**	**68.20%**	**68.10%**	**10:45**
	NZ	**Employment Change (QoQ) - 2Q**	**0.40%**	**1.00%**	**10:45**
	NZ	**Employment Change (YoY) - 2Q**	**0.80%**	**-0.10%**	**10:45**
	UK	New Car Registrations (YoY) - JUL	- -	10.80%	- -
	GE	Factory Orders MoM (sa) - JUN	1.40%	-0.50%	22:00
	GE	Factory Orders YoY (nsa) - JUN	21.90%	24.80%	22:00
	UK	BOE Asset Purchase Target - AUG	200B	200B	23:00
	UK	BOE ANNOUNCES RATES - AUG	0.50%	0.50%	23:00
	EC	ECB Announces Interest Rates - AUG	1.00%	1.00%	23:45
6-Aug	US	Initial Jobless Claims - 31 Jul	455K	457K	00:30
	US	Continuing Claims - 24 Jul	4520K	4565K	00:30
	US	ICSC Chain Store Sales YoY - JUL	- -	3.00%	02:30
	AU	AiG Perf of Construction Index - JUL	- -	46.4	11:30
	AU	RBA Monetary Policy Statement - AUG	- -	- -	13:30
	UK	PPI Input NSA (YoY) - JUL	11.40%	10.70%	20:30
	UK	PPI Output n.s.a. (YoY) - JUL	4.90%	5.10%	20:30
	UK	PPI Output Core NSA (YoY) - JUL	4.50%	4.80%	20:30
	UK	Industrial Production (MoM) - JUN	0.10%	0.70%	20:30
	UK	Industrial Production (YoY) - JUN	1.90%	2.60%	20:30
	UK	Manufacturing Production (MoM) - JUN	0.40%	0.30%	20:30
	GE	Industrial Production MoM (sa) - JUN	0.70%	2.60%	22:00
7-Aug	US	Change in Nonfarm Payrolls - JUL	-60K	-125K	00:30
	US	Unemployment Rate - JUL	9.60%	9.50%	00:30
	US	Avg Hourly Earning MOM All Emp - JUL	0.10%	-0.10%	00:30
	US	Avg Weekly Hours All Employees - JUL	34.1	34.1	00:30
	UK	NIESR GDP Estimate - JUL	- -	0.70%	- -
	US	Consumer Credit - JUN	-$5.6B	-$9.1B	07:00

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

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

Note: All surveys are preliminary and subject to change.

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: Last week the RBNZ stuck to their script and raised the OCR by 25 basis points to 3 percent. While the outlook for growth has "softened somewhat", it was still judged to be "appropriate to continue to reduce the extraordinary level of support". Last week's data confirmed that the economic rebalancing is continuing, but that growth momentum is abating. This week sees the release of key labour market data, which we expect to show some improvement in the demand for labour, but for wage inflation to remain low. Commodity export price data is also anticipated to reflect the moderating tone evident in the global economic outlook. We expect data over the next few weeks to point towards a moderate rate of expansion for Q2, but we will be more focused on what the soft gauges are telling us about Q3.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Mon 2 Aug (3:00pm)	ANZ Commodity Price Index – July	- -	- -
Tue 3 Aug (10:45am)	SNZ Labour Cost Index and Quarterly Employment Survey – Q2	Improving	Earnings growth is forecast to pick-up from decade lows as skill shortages become more acute (though far from severe). We expect private sector salary and wage rates to increase by 0.4 percent q/q (1.4 percent y/y). The number of filled jobs is anticipated to increase by 0.3 percent.
Thur 5 Aug (10:45am)	SNZ Household Labour Force Survey – Q2	Gradual	A repeat of the barnstorming Q1 surge in employment is unlikely. We expect a more modest 0.4 percent increase. Stronger growth in the labour force sees the unemployment rate rise to 6.3 percent.
Tue 10 Aug (10:45am)	SNZ Electronic Card Transactions – July	Damp	June Card spending was supported by higher spending on apparel as the wet winter had an impact. We expect retail values to remain subdued in July.
Thur 12 Aug (10:45am)	SNZ Food Price Index – July	Climbing	The June monthly rise was partly driven by the lagged effects of strengthening meat and dairy commodity export prices. Further price increases are in the pipeline with the rebuilding of retail margins expected to push food prices higher.
Fri 13 Aug (10:00am)	REINZ Housing Market Statistics – July	Battling	Sales volumes and house prices to remain subdued. Low affordability and deleveraging remain formidable headwinds.
Fri 13 Aug (10:45am)	SNZ Retail Trade Survey – Q2	Boosted by discounting	Some bounce back in monthly sales is probable given the weak May figures. Growth in nominal retail spending will be around 0.5 percent in Q2, with retail discounting and lower food prices expected to produce a similar increase in retail volumes.
Thur 19 Aug (10:45am)	SNZ Capital Goods Price and Producer Price Indexes – Q2	Pressure	High export commodity prices will continue boosting producer prices. Implied margins are expected to remain under pressure. Capital goods prices are expected to record a small increase.
Thur 19 Aug (3:00pm)	ANZ – Roy Morgan Consumer Confidence - Aug	- -	- -
Fri 20 Aug (10:45am)	SNZ – External Migration - Jul	Waning	We expect net PLT migration of around zero persons, although there is a risk of a net PLT outflow if departures retain their strengthening trend. Visitor arrivals are expected to recover in seasonally adjusted terms as volcanic ash disruptions recede.
Tue 24 Aug (3:00pm)	RBNZ Survey of Expectations – Q3	Up, down	The Q2 survey was conducted before the hike in GST was announced so we may see a ticking up in one (and possibly) two year ahead forecasts for CPI inflation. Growth expectations are expected to be scaled back given the softness in recent indicators.
On Balance		**Building**	**Recovery continuing but signs of momentum easing.**

ECONOMIC FORECASTS AND INDICATORS

	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
GDP (% qoq)	0.3	0.9	0.6	**0.7**	**1.5**	**-0.1**	**1.1**	**1.3**	**1.6**	**0.5**
GDP (% yoy)	-1.5	0.5	1.9	**2.5**	**3.7**	**2.7**	**3.2**	**3.9**	**4.0**	**4.6**
CPI (% qoq)	1.3	-0.2	0.4	0.3	**1.1**	**2.8**	**0.6**	**1.0**	**0.8**	**0.5**
CPI (% yoy)	1.7	2.0	2.0	1.8	**1.6**	**4.6**	**4.8**	**5.6**	**5.3**	**3.0**
Employment (% qoq)	-0.7	0.0	1.0	**0.4**	**0.4**	**0.6**	**0.6**	**0.7**	**0.6**	**0.4**
Employment (% yoy)	-1.8	-2.4	-0.1	**0.8**	**1.9**	**2.5**	**2.0**	**2.3**	**2.5**	**2.3**
Unemployment Rate (% sa)	6.5	7.1	6.0	**6.3**	**6.1**	**5.7**	**5.5**	**5.1**	**5.0**	**5.0**
Current Account (% GDP)	-3.2	-2.9	-2.4	**-2.9**	**-3.7**	**-2.8**	**-3.0**	**-3.1**	**-2.9**	**-2.9**
Terms of Trade (% qoq)	-1.6	5.8	5.8	**3.9**	**2.4**	**1.0**	**-0.6**	**-0.6**	**0.1**	**-1.0**
Terms of Trade (% yoy)	-14.1	-8.2	-0.2	**14.4**	**19.1**	**13.7**	**6.8**	**2.2**	**-0.2**	**-2.0**

	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10
Retail Sales (% mom)	0.1	0.7	-0.5	0.7	-0.5	0.6	-0.3	0.4	..	..
Retail Sales (% yoy)	-0.2	2.4	2.0	2.3	2.4	4.4	2.7	1.9	..	..
Credit Card Billings (% mom)	0.4	0.8	-1.2	1.6	-0.2	0.7	-1.6	2.0	1.0	..
Credit Card Billings (% yoy)	-0.3	1.6	1.9	2.6	1.1	5.3	0.8	3.4	4.5	..
Car Registrations (% mom)	0.3	2.2	6.8	-0.7	0.2	5.2	3.2	-3.5	6.1	..
Car Registrations (% yoy)	-16.8	2.4	0.3	15.9	31.4	31.7	40.5	30.5	35.8	..
Building Consents (% mom)	11.0	0.6	-3.8	-2.6	6.1	-0.2	8.6	-9.5	3.5	..
Building Consents (% yoy)	26.5	20.4	22.7	35.2	29.9	33.5	32.2	11.2	27.7	..
REINZ House Price (% yoy)	6.0	5.2	9.6	7.7	6.1	7.6	4.7	3.7	3.7	..
Household Lending Growth (% mom)	0.4	0.0	0.2	0.2	0.1	0.1	0.2	0.2	0.2	..
Household Lending Growth (% yoy)	2.6	2.7	2.7	2.7	2.7	2.8	2.7	2.5	2.5	..
ANZ-Roy Morgan Consumer Confidence	125.9	121.5	118.6	131.4	123.6	121.8	121.9	126.0	122.0	115.6
NBNZ Business Confidence	48.2	43.4	38.5	..	50.1	42.5	49.5	48.2	40.2	..
NBNZ Own Activity Outlook	30.5	33.7	36.9	..	41.9	38.6	43.0	45.3	38.5	..
Trade Balance ($m)	-501.5	-280.4	-26.4	271.1	327.8	607.5	651.9	768.4	276.2	..
Trade Balance ($m annual)	-1176	-863	-549	-176	-330	-160	169	32	639	..
ANZ World Commodity Price Index (% mom)	4.7	10.9	2.6	0.4	4.0	1.8	5.4	2.8	-1.2	..
ANZ World Commodity Price Index (% yoy)	-1.3	18.2	31.0	37.4	49.8	50.9	55.1	55.0	53.3	..
Net Migration (sa)	2140	1740	1690	1850	1000	950	720	230	70	..
Net Migration (annual)	18560	20021	21253	22588	21618	20973	19954	17967	16504	..

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	Jun-10	Jul-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZD/USD	0.685	0.690	0.727	0.700	0.710	0.720	0.730	0.730	0.720	0.710
NZD/AUD	0.815	0.808	0.802	0.795	0.789	0.783	0.777	0.777	0.783	0.789
NZD/EUR	0.560	0.566	0.557	0.579	0.602	0.632	0.652	0.652	0.643	0.634
NZD/JPY	60.54	62.51	62.84	66.50	68.16	69.84	71.54	73.00	72.00	71.71
NZD/GBP	0.458	0.465	0.462	0.479	0.486	0.483	0.480	0.474	0.462	0.449
NZ$ TWI	66.6	66.8	67.5	68.1	69.3	70.7	71.7	71.8	71.1	70.5
INTEREST RATES	Jun-10	Jul-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZ OCR	2.75	3.00	3.00	3.25	3.25	3.50	4.00	4.50	5.00	5.50
NZ 90 day bill	3.13	3.28	3.27	3.50	3.50	3.90	4.40	4.90	5.40	5.80
NZ 10-yr bond	5.34	5.39	5.33	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	0.53	0.48	0.45	0.40	0.35	0.35	0.35	0.60	0.85	1.35
AU Cash Rate	4.50	4.50	4.50	4.50	5.00	5.25	5.50	5.75	6.00	6.00
AU 3-mth	4.92	4.85	4.78	4.90	5.30	5.60	6.00	6.00	6.20	6.10

	30 Jun	26 Jul	27 Jul	28 Jul	29 Jul	30 Jul
Official Cash Rate	2.75	2.75	2.75	2.75	3.00	3.00
90 day bank bill	3.13	3.28	3.31	3.30	3.28	3.27
NZGB 11/11	3.67	3.80	3.79	3.78	3.70	3.65
NZGB 04/13	4.17	4.29	4.28	4.26	4.19	4.13
NZGB 12/17	5.12	5.16	5.15	5.13	5.07	5.04
NZGB 05/21	5.34	5.43	5.43	5.41	5.36	5.33
2 year swap	4.15	4.23	4.23	4.17	4.07	3.98
5 year swap	4.83	4.82	4.83	4.79	4.71	4.64
RBNZ TWI	66.8	68.1	68.4	68.1	67.6	67.1
NZD/USD	0.6929	0.7277	0.7333	0.7289	0.7239	0.7214
NZD/AUD	0.8135	0.8124	0.8137	0.8159	0.8083	0.8024
NZD/JPY	61.38	63.77	63.75	63.95	63.15	62.32
NZD/GBP	0.4598	0.4707	0.4735	0.4677	0.4636	0.4621
NZD/EUR	0.5672	0.5627	0.5643	0.5606	0.5563	0.5522
AUD/USD	0.8518	0.8957	0.9012	0.8934	0.8956	0.8991
EUR/USD	1.2216	1.2933	1.2996	1.3001	1.3013	1.3065
USD/JPY	88.59	87.63	86.93	87.73	87.24	86.39
GBP/USD	1.5069	1.5460	1.5486	1.5586	1.5616	1.5613
Oil (US$/bbl)	75.93	78.68	78.93	77.46	77.06	78.85
Gold (US$/oz)	1241.90	1193.20	1185.60	1163.65	1166.20	1182.00
Electricity (Haywards)	4.29	6.45	7.31	8.10	9.14	10.74
Milk futures (US$/contract)	122	117	118	117	116	117
Baltic Dry Freight Index	2406	1841	1869	1901	1942	1967

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:

- Providing cash;

IMPORTANT NOTICE

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

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

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

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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