NEW ZEALAND ECONOMICS
ANZ MARKET FOCUS

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INSIDE

NZ ECONOMICS TEAM

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

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

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

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

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

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

TRADING PLACES

ECONOMIC OVERVIEW

We view recent market ructions as consistent with our “bathtub with waves” cycle. It is the hallmark of the global economy moving to the transition stage following the global financial crisis, something we detailed in our Key Macro Themes article at the start of the year. Key features of the transition stage are a slower rate of trend growth over a number of years, courtesy of deleveraging, the implementation of exit strategies by policymakers and structural changes on the regulatory front. Volatility and uncertainty amidst a moderate pace of recovery is in store for H2 2010. While we still see the RBNZ pausing at some stage later this year, the hurdle has not yet been met, particularly with fixed lending rates falling last week. This week’s key domestic data release is the QSBO. We expect it to show a mixed bag.

MIXED BUSINESS RESULTS IN AGRICULTURE

Pastoral farm business returns (BRs) in 2009/10 and 2010/11 will be highly variable depending on the industry, locality and the level of debt. Higher dairy commodity prices are set to boost revenue in 2010/11 but this comes after one or two years of significantly negative business returns. Sheep and beef farms may have to wait another year and may take longer to recover. We expect farmers to place a high emphasis on debt reduction, and perhaps to put a floor under the rural land market in the next 12 months. A modest boost to the economy from farmer spending is also forecast.

EMISSIONS TRADING SCHEME OVERVIEW

Last week saw the entry of vehicle fuels, industrial processors and electricity to the Emissions Trading Scheme (ETS). With the government subsidising much of the costs, the economic impacts of the ETS during the next few years are likely to be relatively mild. Impacts beyond 2013 are more uncertain and will depend crucially upon what our trading partners do.

INTEREST RATE STRATEGY

Global interest rates edged lower last week, led by the US 2 year Treasury bond, whose yield fell to a record low. Global long-term interest rates are also moving lower, placing downward pressure on NZ interest rates. Liquidity conditions remain fairly stable, although markets are nervous. Widening global credit spreads are having an impact on local spreads, and this remains a key area to watch – as will the public reaction to lower mortgage rates.

CURRENCY STRATEGY

A weekly view in currency trading is becoming a luxury. The themes and drivers change daily, and to be successful, one needs to adapt to this environment. The correlation with the equity market continues to be the underlying consistent factor for the NZD but the correlation is not as sequential as it once was with delays and spikes providing opportunities. The correlation between the EUR and the NZD has fallen as US debt levels continue to grow and the market prefers austerity to the US’s call for more spending and stimulus.

ECONOMIC OVERVIEW

SUMMARY

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THIS WEEK'S EVENTS

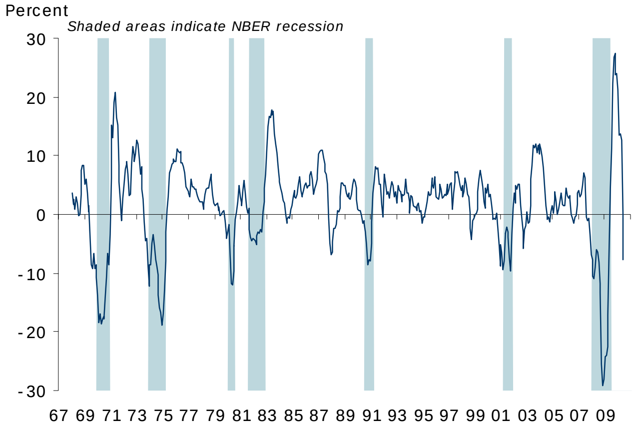
- **NZIER Quarterly Survey of Business Opinion – Q2** (Tuesday, July 6, 10:00am). General Business Confidence and Domestic Trading are anticipated to ease slightly from Q1 levels. Lower livestock slaughtering is expected to translate into an easing in capacity utilisation. Pricing intentions will likely spike higher due to GST changes. We will be on the lookout for whether skills shortages are starting to emerge.
- **Fonterra Online Auction** (Wednesday, July 7, around 6:00am). Given recent trends we expect Whole Milk Powder prices in the July trading event to fall slightly to around US$3,650 per tonne.
- **SNZ Electronic Card Transactions - June** (Friday, July 9, 10:45am). Improving consumer sentiment over their current prospects should drive a 1 percent plus increase in the value of retail transactions.

WHAT'S THE VIEW?

In our January 22 *Market Focus* we outlined our Key Macro Themes for 2010. One of the themes we identified was what we thought would be the five distinct stages in the cycle. The first stage was the so-called "old normal" (2002 to 2007), where growth was driven by excessive leverage and risk taking, which led to asset price bubbles and artificial wealth-induced spending. Stage two saw the inevitable purging that followed such excesses over 2008 and 2009. The third stage was the recovery process courtesy of policy stimulus and an inventory fillip. Stage four was what we referred to as transition where the combination of growth payback (deleveraging), the implementation of so-called exit strategies and various other structural changes (i.e. regulation, leadership versus populism) curtailed the trend rate of growth over a number of years. Stage five was the endgame where the decision taken in the transition stage (good and bad) would determine economic performance over the coming decade.

Recent ructions have increased speculation about prospects for a double dip. Equity bourses remain heavy. The ECRI leading index[1] for the US has fallen sharply and is currently at a rate that has been consistent with recessions in the past. US housing market data slumped. Freight rates as measured by the Baltic Dry Index have fallen by 46 percent since its recent peak in late May, and it looks to be more than simply the addition of new shipping capacity.

ECRI Leading Index Growth Rate



Sources: ANZ, National Bank, Bloomberg, NBER

Credit markets have also been volatile, with credit spreads tending to widen. But key barometers of liquidity remain fairly stable. For example, 5 year credit default swap spreads (or CDSs as they are known, which are analogous to bond spreads) for the "Big Four" Australian banks have widened by around 10bps in the past week. However, USD 3mth LIBOR remains steady, and while there were concerns that the expiry of one of the ECB's long-term refinancing transactions last week may have led to a dramatic spike higher in EURIBOR, in the event the rise was extremely muted. Markets certainly seem nervous, but have not (yet) been overcome by utter panic.

It hasn't all been one way traffic but any "good" news has generally been ignored, with the market focusing and reacting primarily to the

[1] The ECRI leading index is a timely high-frequency indicator of US economic growth based on financial and other data, complied by the Economic Cycle Research Institute.

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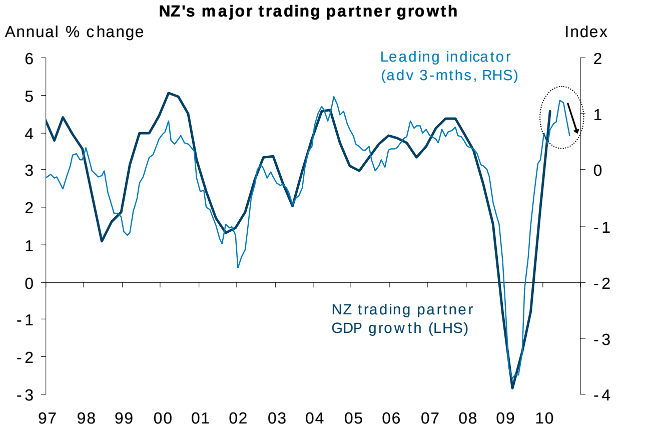
negative data or newsflow. The AUD has been all over the place, which is probably a reasonable proxy for what investors' thoughts are: which is sheer and utter confusion.

While tempting to jump on the double dip band wagon, we'll suffice with three quick observations:

- **You don't get out of a global financial crisis in 18 months,** so we shouldn't be surprised to see some palpitations across markets from time to time.
- **There is an element of the blind leading the blind at work.** Lead (soft) indicators have been well correlated with equities for the past three years. Equity markets have come under downward pressure, which results in a softening in the lead indicators, which in turn sets off another round of equity market weakness. This doesn't mean we should slavishly ignore the equity market. But we should also be cognisant of the fact that equities have a bad track record of predicting recessions. Global lead indicators have indeed turned, but so far the easing has been mild when we overlay it on trading partner growth for NZ (although there are undoubtedly lags at play).

NZ's major trading partner growth

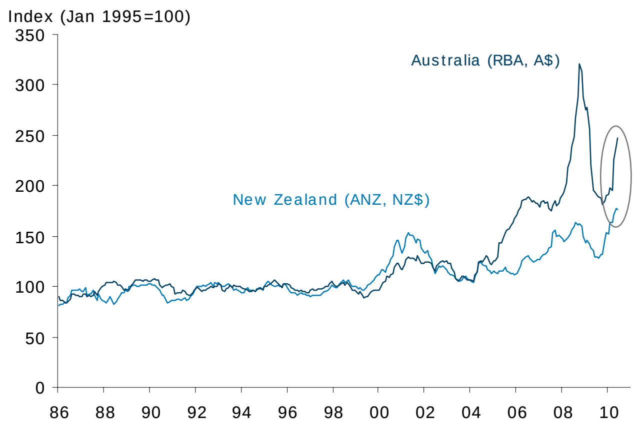


Sources: ANZ, National Bank, Bloomberg

- **We suspect a fair bit of what we are seeing merely reflects the transition stage detailed earlier, as the reality of change sinks in.** Markets naturally seek to push the boundaries in either direction, sometimes to extremes, so now the bears seem to have the upper paw. We'd characterise it more succinctly as people being simply too optimistic a few months back and the danger is that the reciprocal occurs. This doesn't mean we ignore the warning signs. But we have to be aware that the market tends to swing too far in either direction. The spirit of our "bathtub with waves" cycle still seems to apply when we look at the global scene.

The immediate question is what do recent movements mean for the RBNZ? Policymakers tend to have a longer-term perspective compared to financial markets and it is hard to imagine the RBNZ starting the tightening cycle in June without having 3 to 4 more 25bp moves in mind. For the RBNZ, less than one month has passed since the June MPS. Aside from equity market movements and the easing in survey indicators, **not a lot has changed that will significantly alter the RBNZ's view on the economic outlook.** New Zealand's commodity prices dipped slightly in June but are at the second highest month on record (we also note that commodity prices rose in Australia last month). Business sentiment eased in June but still remains at levels consistent with a typical V shaped recovery. Certainly the risk profile (and innuendo) has changed, but not much more than that at this stage.

Commodity Price Indices (local currency terms)



Sources: ANZ, RBA

Looking at the RBNZ's *Statement of Intent*, second on the list was the unwinding of monetary policy stimulus. This had caveats such as "conditions permit" and the "sequencing and pace of withdrawal of policy stimulus will be a particular focus for policy deliberations." **But the message is pretty clear: the trend for rates is up and we shouldn't lose sight of this fact.**

We'll be paying close attention to retail borrowing rates over the coming month. Wholesale swap rates have eased by up to 50bps since early May. However, this has partly been offset by an increase in bank funding costs. Over the past week fixed mortgage rates from all the major banks have fallen, with the key 2-year mortgage rate falling below 7 percent. Ordinarily this would be expected to kick-start the housing market. But with the variable rate currently hovering at around 6 percent,

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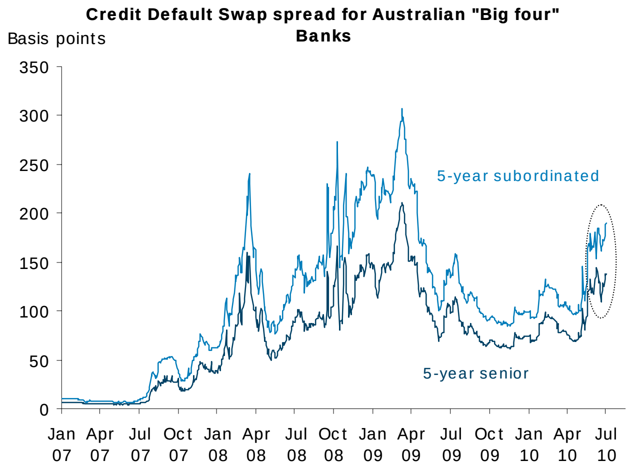
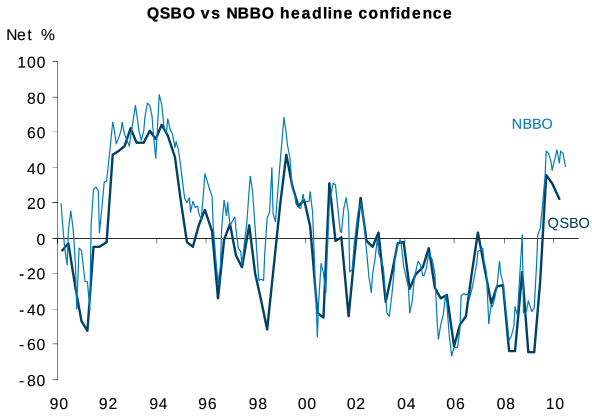
a larger portion of mortgage debt at shorter maturities and earnings growth within the economy near cyclical lows, it may not necessarily signal a return to business as usual nor should it really change borrowing behaviour. But the message is simple: **monetary conditions have still eased.** Part of this has offset tighter financial conditions from elsewhere (we'll be providing an update on financial conditions next week) and the economic framework is responding appropriately. But these developments also need to be read in conjunction with the general spirit of where the RBNZ sees rates going forward and that is up. **So at present we think the hurdle to a pause in July looks to be extremely high.**



Sources: ANZ, National Bank, Bloomberg

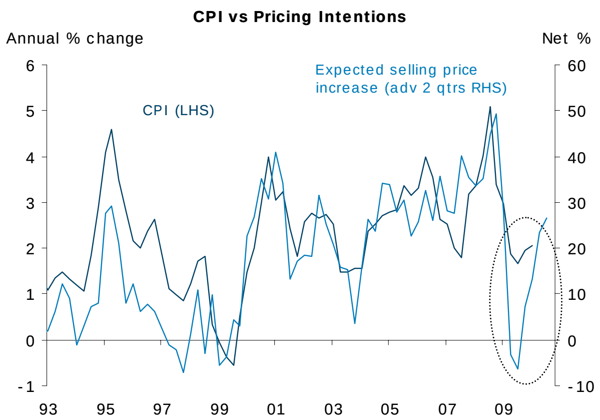
A key area to monitor will be deposit rates. If offshore funding costs continue to rise, there will be even more incentive for financial institutions to grab local deposits. Given that the "pie" on that front is not large (due to our poor saving record), the price (i.e. deposit rates) will have to go up. This could result in higher borrowing rates in future, but the fall we have seen in wholesale rates last week seems to be dominating for now. But it's a space that needs monitoring.

This week the focus on the local data calendar is the QSBO. When we look at the QSBO, it has been somewhat lagging the National Bank Business Outlook in terms of the activity, employment and investment gauges. But time wise we are also mindful that the National Bank survey showed a clear turn in June, and the QSBO survey would have been taken in the second half of June, which means it is right in the firing line when viewed against global gyrations. Of course we know that domestic factors such as the *Budget* should have been influential, but as we've noted before these so-called soft gauges have been strongly correlated with equity market movements for the past few years. So while we look for some signs of improvement in the QSBO, we also harbour suspicions of continued real sogginess.



Sources: ANZ, National Bank, NZIER

We are looking for a slight easing in headline confidence and the domestic trading activity reading from the QSBO. But the details are likely to be a mixed bag. The headline measure of capacity utilisation has been influenced by swings in primary processing, with the reduction in livestock slaughtering expected to translate into an easing in capacity pressures. Nevertheless, the underlying spirit of the QSBO will be of the economy on the mend. With the labour market recovery underway we will be keeping a close eye on skill shortages, as this will have a bearing on wage pressures and the margin of spare capacity available. Given the large number of recently announced price increases and with GST going up in October, we are likely to see further increases in pricing intentions.



Sources: ANZ, National Bank, Statistics NZ, NZIER

Global dairy prices have been on the decline since mid-May and we expect this theme to be evident on Wednesday's Fonterra online auction. Whole Milk Powder (WMP) prices for the July trading event are likely to ease towards US$3,650 from around $3,800 in the June trading event.

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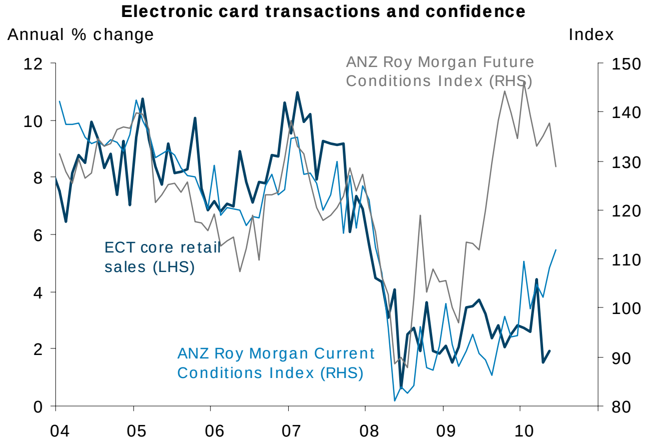
Electronic Card Transaction (ECT) data for June are expected to show continued improvement. Monthly figures can be volatile but we anticipate a monthly increase in retail ECT spending of more than 1 percent. With the GST increase likely to have encouraged some bringing forward of consumer spending, household earnings growth will need to improve to deliver a sustained improvement.



Sources: ANZ, National Bank, Statistics NZ

The key offshore event this week will be the RBA interest rate announcement tomorrow. A no change is widely expected, but the statement will provide important insights into the RBA's thinking about recent global market gyrations. The Australian employment report on Wednesday will also be one worth watching, particularly for the likely impact on NZ's net immigration which has been easing off quickly. Further strong labour demand in Australia resulting in a drop in their unemployment rate will only entice more kiwis to move across the ditch, putting further downward pressure on net migration.

RECENT LOCAL DATA

- **National Bank Business Outlook – June.** Headline business confidence and firms' own activity expectations fell 8 and 6 points respectively to plus 40 and plus 39. Employment, profitability and investment intentions all eased.
- **SNZ Building Consents – May.** Residential consent numbers fell by 9.6 percent in seasonally adjusted terms (-9.5 percent ex-apartments) to be 11 percent up on 12-months previously (+40 percent ex-apartments). The value of non-residential consents fell by a seasonally adjusted 14.5 percent to $268m to be 39 percent lower than in May 2009.
- **RBNZ Credit Aggregates – May.** Private Sector Credit (R) ex-repo increased 0.3 percent (0.5 percent y/y). Household credit rose by a monthly 0.2 percent (2.7 percent y/y) with agricultural credit growth easing to 3.3 percent y/y and the decline in business credit easing to 7.8 percent y/y.
- **ANZ Commodity Price Index – June.** Export commodity prices fell by 1.2 percent but are 53 percent above levels 12-months earlier. New Zealand dollar prices eased by 0.2 percent (+37.3 percent y/y).

MIXED BUSINESS RESULTS IN AGRICULTURE

SUMMARY

Pastoral farm business returns (BRs) in 2009/10 and 2010/11 will be highly variable depending on the industry, locality and the level of debt. Higher dairy commodity prices are set to boost the revenue on dairy farms in 2010/11 but this comes after one or two years of significantly negative business returns. Sheep and beef farms may have to wait another year and may take longer to recover from consecutive negative BRs between 2005 and 2010. We expect farmers to place a high emphasis on debt reduction, and perhaps to put a floor under the rural land market in the next 12 months. A modest boost to the economy from farmer spending is also forecast.

INTRODUCTION

Our rural economist has been travelling over the past few weeks and provides his general update on the state of the rural sector.

BUSINESS RETURNS

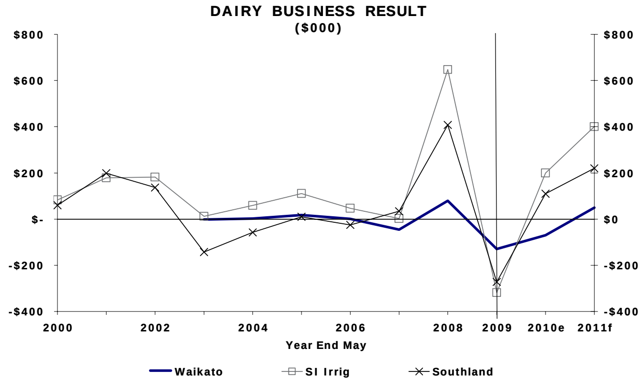
Financial results in the pastoral sector from the past two years depend both on what industry one is talking about and in what geographic location. Much analysis of farm business profitability focuses on gross margins or economic farm surplus or maybe even net profit. They are all helpful but fail to look at the real bottom line – what was the result for the financial year after <u>all</u> costs including what the owner had taken for living expenses, life insurance and tax? We call this the business return (BR). Specifically, the BR is gross farm profit less the sum of farm working expenses, interest, depreciation, living expenses, life insurance and tax. Depreciation is included as the business should be spending the depreciation allowance if it is to maintain depreciating assets (mostly plant and machinery).

To facilitate analysis we make a number of assumptions. We assume there is only one family owning the enterprise being modelled regardless of the scale of the business. That may overstate the BR for the larger scale farms but does provide a guide to the trends in BRs. The analysis is supported by data from several farm accounting firms and a farm consultant.

DAIRY

Dairying in Northland, the Waikato and the Bay of Plenty in the 2009/10 season has been difficult to put it mildly, due to the low advance payments for milk because of the initial very low forecast payout ($4.50/kilogram milk solids (kg ms)) combined with a summer/autumn drought: the BR will be two consecutive seasonal losses.

However, there has been some regional variation in BRs. By way of contrast, dairy farming on well irrigated land in Canterbury or on farms in South Otago and Southland had a marvellous grass year with production up five to ten percent on the previous year. The BR will be very strong but it needed to be after a substantial loss in 2008/09.



Source: ANZ, National Bank

The Waikato averaged data is based on a farm that ordinarily could be expected to produce 115,000 kg ms, which is broadly representative of a large number of dairy farms in the northern region. The Canterbury farm is large scale (370,000 kg ms) and the Southland farm sits in the middle at 180,000kg ms.

The larger scale businesses had a very good result year end 2008 but a larger than might be expected negative business return in year end 2009. An increase in the amount spent and an increase in unit costs of that spend in 2007/08 rolled into the following year. Margins were badly squeezed regardless of how they are calculated. The bounce back in for the year end 2010 is also large. The Waikato model business result typifies the effects of two consecutive droughts.

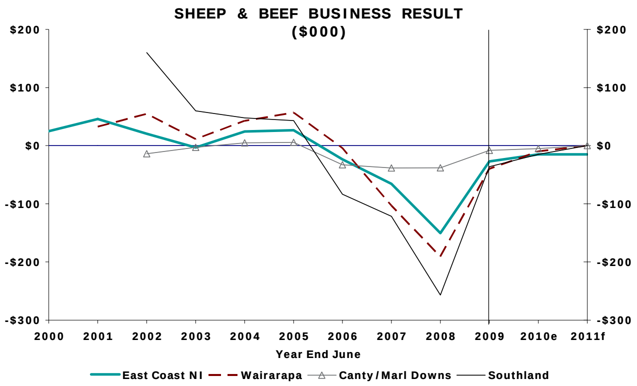
The forecast increased returns from dairying in 2009/10 and 2010/11 ($6.40 and $6.90/kg ms respectively for milk supplied to co-operatives) is anticipated to put the BR back in the black on farms that have not been drought effected – provided expenditure is not allowed to run away again.

SHEEP AND BEEF

A prolonged mid summer/late autumn drought again featured in the Waikato, Hawke's Bay, Marlborough and South Canterbury. Central Otago fared badly in 2009/10 with a cold dry/drought spring followed by a summer drought that then became an extended autumn drought. **The outcome for 2009/10 is forecast to be another negative BR.**

MIXED BUSINESS RESULTS IN AGRICULTURE

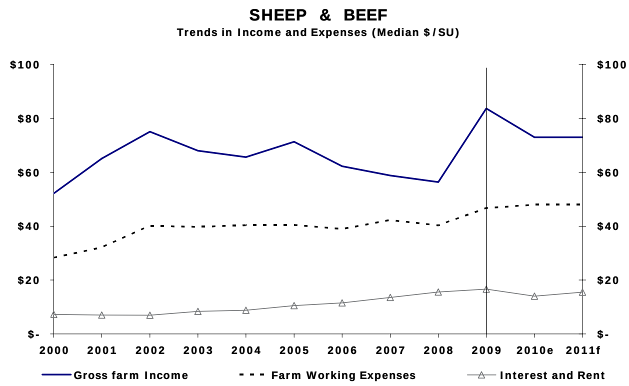
That adds to the three or four consecutive, and increasingly negative, BRs between 2005 and 2008.



Source: ANZ, National Bank

While BRs are likely to be down, the causes vary by region. The BRs of the two North Island examples reflect the effect of cumulative droughts and three years of low lamb prices between 2006 and 2008. The large negative BR in 2008 on the larger scale Southland farm in part reflects a 13 percent reduction in lambing percentage from spring storms.

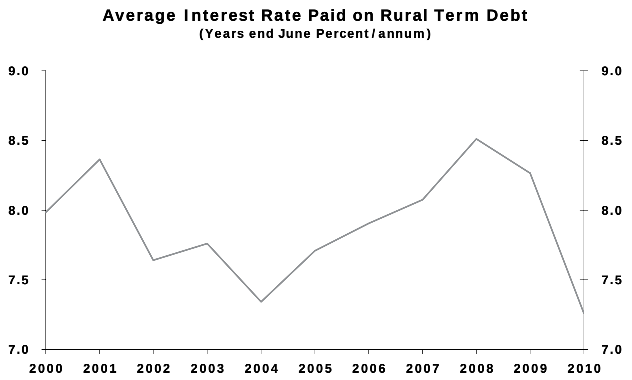
Both industries on average, have been struggling with a margin squeeze since 2002.



Source: ANZ, National Bank

The sharp jump in sheep and beef revenue over 2001 and 2002 was accompanied by an increased spend and an increase in unit costs, the same as the dairy industry. **Those costs never fell back to where they were for either industry.** That is not to say the increased spend is wasted. A lot of deferred and preventative maintenance was completed. That does help the ability to hold expenditure on these items should that become necessary.

The doubling of the amount paid in interest per kg ms or stock unit from 2000 is more a result of increased debt not higher interest rates. On average, interest rates have fluctuated between 7.3 and 8.5 percent in the period under discussion.



Source: ANZ, National Bank

Farmers have made a good job of managing interest rate risk by getting into, and now out of, fixed term borrowing.

DEBT

A disconcerting feature of both sectors is the level of accumulated debt. The farmer price for milk sent to a co-operative now needs to be very close to $6/kg ms for a breakeven BR.

An average lamb price of $82/head in 2008/09 still resulted in a negative BR for the busy one farmer Canterbury/Marlborough down-land farm which had no major adverse weather events. That model is considered representative of the trends on average sheep and beef farms in localities other than those shown on the graph.

OUTLOOK

Current prices and the outlook for in-market prices are positive for New Zealand pastoral products. But exchange rates, high on and off-farm costs relative to income and debt servicing give highly variable business results. That observation applies both within and between industries.

IMPLICATIONS

Farmers in both sectors will be sharply focused on reducing debt to get a greater degree of comfort back in the business. Reserve Bank of New Zealand data shows that is already happening with agricultural debt at the end of May still $500m less than the peak of $40.7b in September 2009

It is anticipated that there will only be a modest increase in discretionary expenditure by farmers in the local economy.

Another question is "Will land values rebound on the back of improved revenue to dairy

farmers?" Our view is no they will not. Buyers are honing in on the cash result of the proposition and the return on capital/equity earned. While the numbers look better now than one year ago, they are still not at the hurdle rate for many buyers. The lift in dairy revenues will add confidence to the market and will mostly only help turn-over. That in it-self may stop rural land prices falling further.

Cash flows remain tight for heavily indebted farmers. They may have moved from critical care to respite care but still have some way to go before they progress to being outpatients or are discharged altogether. Restructuring for some would speed up that process.

EMISSIONS TRADING SCHEME OVERVIEW

SUMMARY

Last week saw the entry of vehicle fuels, industrial processors and electricity to the Emissions Trading Scheme (ETS). The scheme is designed to make users of greenhouse gas intensive goods and services pay for more of the costs. With the government subsidising much of the costs, the economic impacts of the ETS during the next few years are likely to be relatively mild. Impacts beyond 2013 are more uncertain and will depend crucially upon what our trading partners do.

INTRODUCTION

As part of New Zealand's climate change obligations under the Kyoto Protocol (1997), the New Zealand government adopted an Emissions Trading Scheme (ETS) in 2008. The scheme was modified by the current government in November 2009.

By placing a charge on the emission of greenhouse gases the Scheme is designed to make users pay for more of the costs and to encourage the development of more environmentally sustainable processes and technologies.

HOW DOES IT WORK?

The ETS is a cap and trade system. Companies emitting or producing products that emit greenhouse gases will have to obtain New Zealand Units (NZU). Similarly, parties that earn emission units via the planting of forests will be able sell their NZU. These units are intended to be comparable with units traded internationally, allowing parties to be able to buy or sell units offshore.

The New Zealand ETS includes most sectors producing greenhouse gas emissions with few exceptions. Participants will include oil companies, meat and dairy processors, and large industrial processors, although individual forestry owners have some recourse for claiming NZU from the government. Unlike other counties, agriculture is to be included in the New Zealand ETS.

WHAT ARE OTHER COUNTRIES DOING?

The reference level for emission reductions under the Kyoto Protocol is 1990, with most industrialised countries (known as Annex 1 parties) required to reduce emissions by 2012. New Zealand's target was to keep emissions over the 2008/12 period at 1990 levels.

With 2012 fast approaching, and much of the growth in global emissions coming from emerging economies, **recent efforts have concentrated on putting in place a binding set of long-term targets for emission reductions.** Given the competing interests, post Kyoto negotiations have not met with much success. The 2010 Copenhagen Accord signalled the intention to limit the increase in global temperatures to 2 percent per annum but offered no concrete details on how this was to be achieved. Those counties that have announced emission reduction targets have made them non-binding. Depending on what other economies do, the 2020 target for New Zealand is a reduction of between 10 and 20 percent from 1990 levels. Longer-term aspirations in New Zealand and overseas are even more ambitious.

Table 1: Non-binding emission targets

Country (% global emissions)	% change since 1990	Year ETS adopted	Non-binding reduction relative to 1990 levels	
Annex 1			**2020**	**2050**
NZ (0.2%)	23%	2008	10-20%	50%
Australia (1.4%)	30%	>2012	4-24%	50%
Canada (1.9%)	26%	>2012	3%	50-65%
EU-27 (13%)	-9.3%	2005	20-30%	
US* (18.3%)	17%	No US wide scheme	Back to 1990	80%
Japan (3.5%)	8%	>2012	8% domestic reductions	55-80%
Other				
China (20.3%)	121%	Agree to make some efforts on equity basis and sharing responsibilities/capabilities		
India (5.1%)	80%			
Brazil (2.7%)	55%			

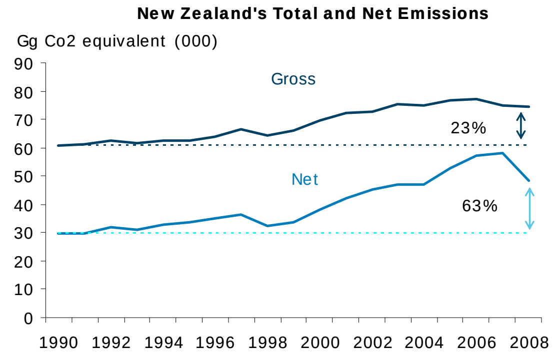
* Yet to ratify the Kyoto Protocol.
Source: Ministry for the Environment, ANZ, National Bank.

HOW IS NEW ZEALAND FARING?

Estimates for the 2008 calendar year place New Zealand's Greenhouse Gas total emissions at around 23 percent above 1990 levels, slightly below the increase in resident population (26 percent).

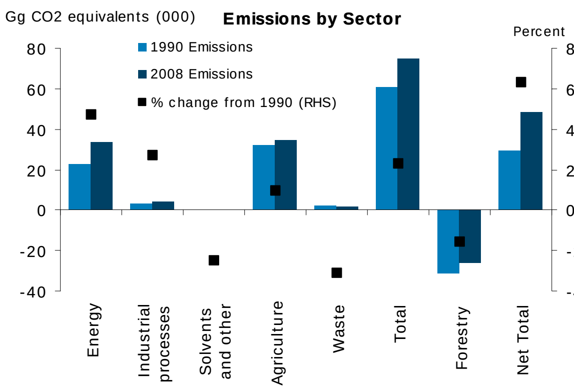
Net emissions (which take into account the offset by planting forests) have climbed by more than 60 percent, largely on account of deforestation since 1990. However, emission credits from forestry have picked by considerably since 2006.

EMISSIONS TRADING SCHEME OVERVIEW



Source:Ministry for the Environment, ANZ, National Bank

The strongest growth since 1990 has been in energy sector emissions (which includes electricity and fossil fuels used in transport) which have increased by nearly half. This is not surprising considering the size of the New Zealand economy has increased by roughly two-thirds. Much of our new electricity generation capacity since 1990 has also come from non-renewable sources. Emissions from the agricultural sector have increased at a more sedate pace (9 percent).



Source: Ministry for the Environment, ANZ, National Bank.

ETS TIMETABLE

To ease the transition for New Zealand businesses, sectors that emit greenhouse gases will be gradually entered into the scheme.

Table 2: ETS Timetable

Sector	Commencement of Obligations
Forestry	1 Jan 2008
Stationary energy, industrial processes (incl. coal, gas, geothermal)	1 July 2010
Liquid fossil fuels	1 July 2010
Waste	1 Jan 2013
Agriculture	1 Jan 2015

Source: Ministry for the Environment.

Forestry has been in the ETS since 2008, with stationary energy (e.g. electricity), industrial processors and liquid fossil fuels joining the scheme last week[2]. Agriculture is set to enter the scheme in 2015.

WHO PAYS FOR IT?

To ease the transition for affected businesses the government is introducing a transitional period. Until the end of 2012 participants in the ETS will only surrender one NZU for every two tonnes of emissions or pay the government a fixed price of $25 (effectively $12.50 per tonne). If the price of carbon is higher, the government will fund the difference.

After the transitional period ends, businesses will need to surrender one NZU per tonne of emissions and pay the relevant market rate. This will reflect the global market price for emission units.

The spirit behind the ETS is that if sectors can pass on the cost of NZU to consumers they are not eligible for government assistance. However, the government will provide NZU to trade exposed sectors that cannot pass on the cost. This allocation of NZU will gradually be phased out after the sectors enter the scheme. For example, agriculture will receive NZU covering 90 percent of emissions in 2016, with allocation to be gradually cut to half of agriculture sector emissions by 2050.

WHAT ARE THE ECONOMIC IMPACTS

Already we are seeing the impact of the ETS on consumer prices, with petrol increasing by 3c/l and some electricity companies increasing charges by 3 percent. With many of these companies yet to determine the costs of the ETS, there could be more increases to come. We estimate the direct CPI contribution in the September 2011 year will be in the order of 0.2 percentage points. Moreover, other price increases are likely as firms using fuel and electricity as inputs adjust their pricing structures. This is likely to add a further 0.1 percent to the CPI impact. **In total, this equates to a 0.3 percent first round impact on CPI inflation** which is consistent with the estimates in the June MPS. Assuming a NZU price of $25/t, a similar inflation impact is anticipated for the 2013 calendar year.

[2] The treatment for forestry will depend on whether the forests were planted. Deforestation of pre-1990 forest will require the purchase of NZU to offset the liability. New forests established after 1989 will have the opportunity to enter the ETS and to receive credits, which they will surrender when the forests are harvested.

EMISSIONS TRADING SCHEME OVERVIEW

Household expenditure on fuel and electricity accounts for around 8 percent of household expenditure. The first round effects of the ETS are expected to cost households an additional $190 per annum. **Assuming households trim their spending in other areas to make up the difference, this equates to a -0.3 percent impact on consumption volumes in the September 2011 year and in calendar 2013.**

We don't envisage that the ETS will have a substantial short-term impact on businesses. The proliferation of wind-farms, which now account for 4 percent of New Zealand's total electricity generation capacity, is evidence that price signals will trigger a change in investment patterns. In most cases, however, the shift to greener technologies will take a number of decades to implement. Furthermore the allocation of NZU and the lower fixed price for NZU should also significantly reduce the competitive disadvantage of New Zealand being an early mover. It will also help further allay misplaced concerns in Europe on the carbon footprint of our agricultural produce. Progress in reducing agricultural emissions could enhance New Zealand's standing as a world leader in this field and open up new trading opportunities.

Table 3: Potential economic impacts

	July 2010 NZ$12.50/t	January 2013 NZ$25/t
CPI Impact		
Direct impact	0.2%	0.2%
Indirect impacts	0.1%	0.1%
Total	+0.3%	+0.3%
GDP impact		
Consumption	-0.3%	-0.3%
Investment	+/-	+/-
GDP	-0.2%	-0.2%

Source: ANZ, National Bank.

Impacts beyond the transitional period are harder to assess, with the economic impact depending on the price for NZU. In turn, this will depend on the progress of the major emitters relative to their targets. In the absence of a binding international agreement, there is considerable uncertainty over what the major emitters will do. Moreover, a high and volatile price for carbon could significantly increase the costs being faced by New Zealand households and businesses and could hamper investment activity. Carbon prices in the European Union market are currently hovering around $25/t (13€), but they have fluctuated in a wide range (from 10 to 30€ per tonne) over the last few years.

The ETS is also likely to have a fiscal impact. Before a sector joins the ETS, the government pays for the costs of emissions in that sector. The government also incurs further risk by providing more support to firms and businesses during the transitional phase. Providing support for trade exposed sectors is also likely to prove expensive. Future costs to the crown could rise significantly if emission targets are not met and the price of NZU rises significantly. Commentators have speculated that the net Kyoto liability for New Zealand could climb to around $6bn in such a scenario.

THE BOTTOM LINE

New Zealand is a very low emitter by global standards. What we do will have little bearing on global warming. Nevertheless, taking further steps towards addressing climate change are a positive for New Zealand's Clean and Green image. Changes to the New Zealand ETS move us closer to what our trading partners are doing. This is just as well. Recent **backtracking by Australia, Canada, the US and Japan have illustrated that environmental objectives are not as urgent a priority in less prosperous times.**

Partly as a result of government support the short-term impact of the ETS is likely to be mild. Inflation will move modestly higher, but the impact of the ETS on price and wage setting throughout the economy will be modest. Moreover, second round effects are unlikely to be of paramount importance to the RBNZ. The overall impacts on economic activity are also expected to be relatively modest, with household budgets bearing the brunt.

There remains some uncertainty over the impact of the ETS once the transitional arrangements end in 2013. As the price of carbon will be decided on the global marketplace, the price that New Zealand pays (or earns) will depend on what the major players do. A significantly higher and more volatile emissions price could add to volatility in the economy and could generate more adverse economic impacts. A higher carbon price is also likely to significantly add to fiscal costs and the burden faced by future taxpayers.

INTEREST RATE STRATEGY

SUMMARY

Global interest rates edged lower last week, led by the US 2 year Treasury bond, whose yield fell to a record low. Global long-term interest rates are also moving lower, placing downward pressure on NZ interest rates. Liquidity conditions remain fairly stable, although markets are nervous. Widening global credit spreads are having an impact on local spreads, and this remains a key area to watch – as will the public reaction to lower mortgage rates.

MARKET THEMES

- Fears that the expiry of the ECB's long-term refinancing facility would send LIBOR spiralling higher proved unfounded, but its coverage in the press highlights how nervous the market is.
- The RBNZ's Statement of Intent (SOI) reiterated that unwinding monetary stimulus is a priority. The Bank is also considering the role that macro-prudential policy tools might play.
- After just 6 hikes, the Australian market now expecting the RBA's next move to be a cut. Does that make it more difficult for the RBNZ to hike?

REVIEW AND OUTLOOK

Weak equity market, softer US data, and lower bond yields have some people wondering if this is Global Financial Crisis "Mark II". It might be, but it's far too early to go jumping to conclusions. But to be sure, **a dramatic change in risk appetite and uncertainties over global growth may have an impact on the end-game for monetary policy**. Similarly, the RBNZ is looking into how it can use macro-prudential tools to assist monetary policy, and it is inevitable that the use of these tools will take pressure off the OCR. **However, in the near-term, as the RBNZ reiterated in last week's SOI, unwinding policy stimulus remains a priority**. While recent market volatility and the fact that the Australian market now expects the RBA's next move to be a cut are clearly warning signs, **we still think the hurdle for not hiking later this month remains high.**

It is also worth noting that if the RBNZ does pause later on down the track, **caution will be needed in interpreting why and what a pause means.** Indeed, if increased market stress leads to fewer OCR hikes, **rising margins could more than offset any benefit of the lower than otherwise OCR might provide.**

How households react to lower mortgage rates is key, with some suggesting that this could lead to more RBNZ tightening. **We doubt the RBNZ will respond with a heftier hike in the current environment, for fear of creating a flatter (or even inverse) curve** – this is what led to such significant fixing in the first place, and that's the last thing monetary policy needs. Fixed mortgage rates are lower, but the curve is still steep, making fixing expensive still.

PREFERRED BORROWING STRATEGIES

While recent developments have taken some of the shine out of the near-term outlook, don't lose sight of the big picture – the economy is recovering, albeit slowly. NZ long-term interest rates have been significantly influenced by global developments, and continue to plumb depths that are more consistent with a near permanent recession, as opposed to a gradual recovery. As such we reiterate last week's comments – consider slowly adding to long-term hedges here, especially now that the 10yr is below 5.5%. If cashflow remains tight, consider using forwards.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔/↓	Rate hike expectations look excessive relative to Aussie.
NZ data	↔/↓	Data last week continued the mixed/weaker theme.
Fed Funds / front end	↔/↓	Fed on hold well into 2011.
RBA	↔/↓	Is a rate cut the next move? The market thinks so!
US 10 year	↔/↓	2yr yields have fallen to a record low.
NZ swap curve	↔/↑	Next move looks to be steepening from the front.
Flow	↔/↑	Watch mortgage book flows.
Technicals	↔/↓	2yr en route through 4%?

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

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

TRADING THEMES WE FAVOUR AT PRESENT

NZ rates remain biased downward, but with global yields driving the long end, there's no point putting on a low-beta position in NZ. But the fact that NZ yields have lagged has seen the spread widen towards the year's highs. We also like the short end, and can't understand why the futures strip is pricing in around 5-6 more rate hikes by the end of next year, when the Aussie market is pricing in the next move to be a cut. Yet Australia has had a dream run, and they only hiked 6 times in total.

CURRENCY STRATEGY

SUMMARY

A weekly view in currency trading is becoming a luxury. The themes and drivers change daily, and to be successful, one needs to adapt to this environment. The correlation with the equity market continues to be the underlying consistent factor for the NZD but the correlation is not as sequential as it once was with delays and spikes providing opportunities. The correlation between the EUR and the NZD has fallen as US debt levels continue to grow and the market prefers austerity to the US's call for more spending and stimulus.

MARKET THEMES

- Soft data suggests Chinese growth is slowing, now that the inventory rebuild is complete.
- US favours spending. Europe favours saving.
- NZD to follow equities again washing around in the 0.6600-0.7140 range.
- What will the RBNZ make of lower mortgage rates given they have just increased the OCR?

REVIEW AND OUTLOOK

Last week's much awaited US non-farm payrolls data rounded out a week of disappointments, and along with weak housing data, was just the latest sign that the US economy is slowing fast. Reaction to the data was muted, mainly because the market had anticipated the weak number. The question is, whether it was anticipated or not, if the inventory rebuilding cycle is now complete, where will final demand come from now? More importantly for markets, what does this lack of demand mean? Does it provoke a policy response? **It is clear from comments by various Fed officials and from political posturing at the G20 meeting that the US sees spending and QE as a way out, whereas Europe favours fiscal austerity**. Both paths have very different implications for growth and risk assets. Those favouring austerity have the moral high ground, and markets assume they will win. **How this debate is resolved is critical**.

NZD is now trading in a well defined slowly declining trading channel. The top of the range looks very secure, protected by the 200 day MA at 0.7130 and the top of the channel, currently at 0.7210. The downside is now at 0.6550. Support currently comes in at 0.6860 and **a break lower will target the recent lows. Conversely, a move above 0.6970 is required before the market would consider the top side a threat**.

Equity and commodity markets will be the drivers this week. **The Fonterra online auction result should be more influential than the RBA announcement.** Indeed, the market expects a very neutral RBA stance, with domestic inflation pressures offsetting a deteriorating global outlook.

The NZD/AUD cross looks set to continue its 0.8000/0.8250 range-trade. Changes to the Australian resources tax has had a minimal effect, but most consider it to be AUD positive in the short term. The NZD still looks too high versus the AUD on a yield basis, and we still favour being short the cross above 0.8200.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↔	At fair value now.
Yield	↔/↑	RBA on hold, RBNZ to hike.
Commodities	↔/↑	NZ commodity prices eased a tad but still high.
Partial indicators	↔/↓	NZ data improving. Australia's still good.
Technicals	↓	Resistance above 0.83 major.
Sentiment	↔/↑	Global growth concerns weigh more on AUD.
Other	↔	Mining tax back down AUD positive.
On balance	↔	**Range trade here.**

NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↔/↓	Getting closer to 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	↔	Fickle.
Partial indicators	↔/↑	NZ data continues to improve.
Technicals	↔	0.6860 support one to watch.
AUD	↔	Struggling.
Sentiment	↔	NZD just following offshore moves.
Other	↔/↑	Is US weakness returning?
On balance	↔	**Follows the herd.**

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
5-Jul	AU	AiG Performance of Service Index - JUN	- -	47.5	11:30
	AU	TD Securities Inflation MoM% - JUN	- -	0.50%	12:30
	AU	TD Securities Inflation YoY% - JUN	- -	3.70%	12:30
	AU	ANZ Job Advertisements (MoM) - JUN	- -	4.30%	13:30
	GE	PMI Services - JUN F	54.6	54.6	19:55
	EC	PMI Services - JUN F	55.4	55.4	20:00
	EC	PMI Composite - JUN F	- -	56	20:00
	UK	PMI Services - JUN	55	55.4	20:30
	EC	Euro-Zone Retail Sales (YoY) - MAY	- -	-1.50%	21:00
	EC	Euro-Zone Retail Sales (MoM) - MAY	0.50%	-1.20%	21:00
6-Jul	**NZ**	**NZIER Business Opinion Survey - 2Q**	**- -**	**+22**	**10:00am**
	AU	Trade Balance – MAY	- -	134M	13:30
	AU	RBA Cash Rate Decision – JUL	4.50%	4.50%	16:30
	JN	Leading Index CI - MAY P	99	101.7	17:00
	JN	Coincident Index CI - MAY P	101.2	101.3	17:00
	UK	New Car Registrations (YoY) – JUN	- -	13.50%	/2010
7-Jul	CA	Building Permits MoM – MAY	-0.50%	5.40%	00:30
	AU	AiG Perf of Construction Index - JUN	- -	53.2	11:30
	JN	Official Reserve Assets - JUN	- -	$1041.3B	11:50
	AU	Foreign Reserves - JUN	- -	42.6B	18:30
	EC	Euro-Zone GDP s.a. (QoQ) - 1Q F	0.20%	0.20%	21:00
	EC	Euro-Zone GDP s.a. (YoY) - 1Q F	0.60%	0.60%	21:00
	GE	Factory Orders MoM (sa) - MAY	0.00%	2.80%	22:00
	GE	Factory Orders YoY (nsa) - MAY	24.60%	29.60%	22:00
8-Jul	CA	Ivey Purchasing Managers Index - JUN	64	62.7	02:00
	US	Fed's Kocherlakota Speech on Policy, Regulation -			07:35
	JN	Foreign Buying Japan Bonds	- -	-¥376.2B	11:50
	JN	Foreign Buying Japan Stocks	- -	-¥183.8B	11:50
	JN	Machine Orders (MoM) - MAY	-3.50%	4.00%	11:50
	JN	Current Account Total - MAY	¥1435.7B	¥1242.1B	11:50
	JN	Adjusted Current Account Total - MAY	¥1514.6B	¥1379.6B	11:50
	JN	Trade Balance (BoP Basis) - MAY	- -	¥859.1B	11:50
	JN	Japan Money Stock M3 YoY - JUN	2.40%	2.30%	11:50
	AU	Employment Change - JUN	- -	26.9K	13:30
	AU	Unemployment Rate - JUN	- -	5.20%	13:30
	AU	Full Time Employment Change - JUN	- -	36.4K	13:30
	AU	Part Time Employment Change - JUN	- -	-9.4K	13:30
	AU	Participation Rate - JUN	- -	65.10%	13:30
	GE	Trade Balance - MAY	13.5B	13.4B	18:00
	GE	Imports SA (MoM) - MAY	3.00%	-7.30%	18:00
	GE	Current Account (EURO) - MAY	10.5B	11.8B	18:00
	GE	Exports SA (MoM) - MAY	3.50%	-5.90%	18:00
	UK	Industrial Production (MoM) - MAY	0.40%	-0.40%	20:30
	UK	Manufacturing Production (MoM) - MAY	0.40%	-0.40%	20:30
	GE	Industrial Production MoM (sa) - MAY	0.70%	0.90%	22:00
	GE	Industrial Prod. YoY (nsa wda) - MAY	9.20%	13.30%	22:00
	UK	BOE Asset Purchase Target - JUL	200B	200B	23:00
	UK	BOE Interest Rate Decision - JUL	0.50%	0.50%	23:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA / EVENT	MKT.	LAST	NZ TIME
8-Jul	EC	ECB Interest Rate Decision - JUL	1.00%	1.00%	23:45
9-Jul	CA	New Housing Price Index MoM - MAY	0.30%	0.30%	00:30
	NZ	**NZ Card Spending (MoM) - JUN**	**- -**	**0.4**	**10:45**
	GE	Consumer Price Index (MoM) - JUN F	0.10%	0.10%	18:00
	GE	CPI - EU Harmonised (MoM) - JUN F	0.00%	0.00%	18:00
	GE	CPI - EU Harmonised (YoY) - JUN F	0.80%	0.80%	18:00
	GE	Consumer Price Index (YoY) - JUN F	0.90%	0.90%	18:00
	UK	Total Trade Balance (GBP/Mln) - MAY	- -	-£3263	20:30
	UK	PPI Input NSA (YoY) - JUN	- -	11.20%	20:30
	UK	PPI Output n.s.a. (YoY) - JUN	5.70%	5.70%	20:30
	UK	PPI Output Core NSA (YoY) - JUN	- -	4.40%	20:30
	CA	Net Change in Employment - JUN	20.0K	24.7K	23:00
	CA	Unemployment Rate - JUN	8.10%	8.10%	23:00
	CA	Full Time Employment Change - JUN	- -	67.3	23:00
	CA	Part Time Employment Change - JUN	- -	-42.5	23:00
	CA	Participation Rate - JUN	- -	67.3	23:00

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 week's data confirmed that deleveraging by firms and households remains ongoing, with business sentiment and export commodity prices easing from historically high levels. This week sees the release of the NZIER QSBO data and Electronic Card Transaction data. The release of inflation data and the July OCR loom. For the published Q2 data we expect signs of improvement to be evident with leading soft gauges to continue pointing towards a steady rate of growth for the remainder of 2010.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 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 but nothing spectacular. 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	- -	- -
Wed 28 Jul (3:00pm)	National Bank Business Outlook - Jul	- -	- -
Thur 29 July (9:00am)	RBNZ July OCR	+25	We expect the RBNZ to continue the journey of removing policy accommodation.
Thur 29 July (10:45am)	Overseas Merchandise Trade – June	Surplus	We expect a monthly trade surplus of around $600m, the fifth consecutive monthly surplus. The annual trade surplus is expected to rise to around $1bn.
Fri 30th July (10:45am)	Building Consents - June	Up	Much of the 9.6 percent fall in the number of May residential consents should be reversed in June. Sizeable increases in non-residential consent values are anticipated over the next few months.
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	0.1	0.3	0.9	0.6	**0.7**	**1.5**	**-0.1**	**1.1**	**1.3**
GDP (% yoy)	-3.1	-2.4	-1.5	0.5	1.9	**2.5**	**3.7**	**2.7**	**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	-2.4	**-2.9**	**-3.7**	**-2.8**	**-3.0**	**-3.1**
Terms of Trade (% qoq)	-2.7	-9.4	-1.6	5.8	5.8	**3.9**	**2.4**	**1.0**	**-0.6**	**-0.6**
Terms of Trade (% yoy)	-5.0	-13.5	-14.1	-8.2	-0.2	**14.4**	**19.1**	**13.7**	**6.8**	**2.2**

	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	-0.3	..
Retail Sales (% yoy)	-1.1	-0.5	-0.2	2.4	2.0	2.3	2.4	4.4	2.7	..
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)	2.2	5.5	11.2	0.6	-3.8	-2.7	6.1	-0.2	8.3	-9.5
Building Consents (% yoy)	-8.7	-11.6	26.5	20.3	22.7	35.2	29.9	33.4	32.0	11.1
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	0.2
Household Lending Growth (% yoy)	2.4	2.4	2.6	2.7	2.7	2.7	2.7	2.8	2.7	2.5
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	2.8
ANZ World Commodity Price Index (% yoy)	-23.1	-12.9	-1.3	18.2	31.0	37.4	49.8	50.9	55.1	55.0
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	0.681	0.714	0.700	0.710	0.720	0.730	0.730	0.720	0.710
NZD/AUD	0.783	0.805	0.816	0.795	0.789	0.783	0.777	0.777	0.783	0.789
NZD/EUR	0.547	0.553	0.576	0.579	0.602	0.632	0.652	0.652	0.643	0.634
NZD/JPY	68.21	62.11	63.83	66.50	68.16	69.84	71.54	73.00	72.00	71.71
NZD/GBP	0.476	0.468	0.474	0.500	0.493	0.486	0.480	0.474	0.462	0.449
NZ$ TWI	68.2	66.0	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	2.75	2.75	3.25	3.50	3.75	4.25	4.75	5.25	5.50
NZ 90 day bill	2.93	3.13	3.14	3.70	3.80	4.20	4.70	5.20	5.70	5.80
NZ 10-yr bond	5.56	5.34	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	0.54	0.53	0.53	0.40	0.35	0.35	0.35	0.60	0.85	1.35
AU Cash Rate	4.50	4.50	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.00
AU 3-mth	4.87	4.92	4.97	5.00	5.30	5.60	6.00	6.00	6.20	6.10

	2 Jun	28 Jun	29 Jun	30 Jun	1 Jul	2 Jul
Official Cash Rate	2.50	2.75	2.75	2.75	2.75	2.75
90 day bank bill	3.02	3.11	3.09	3.13	3.19	3.18
NZGB 11/11	3.74	3.77	3.71	3.67	3.68	3.74
NZGB 04/13	4.42	4.31	4.23	4.17	4.16	4.22
NZGB 12/17	5.34	5.23	5.16	5.12	5.10	5.17
NZGB 05/21	5.56	5.45	5.38	5.34	5.32	5.41
2 year swap	4.40	4.22	4.15	4.15	4.09	4.15
5 year swap	5.25	4.92	4.83	4.83	4.78	4.85
RBNZ TWI	65.8	68.1	67.6	66.8	66.0	66.5
NZD/USD	0.6743	0.7115	0.7038	0.6929	0.6822	0.6944
NZD/AUD	0.8120	0.8129	0.8114	0.8135	0.8153	0.8192
NZD/JPY	61.62	63.62	62.59	61.38	60.19	61.09
NZD/GBP	0.4594	0.4729	0.4663	0.4598	0.4563	0.4577
NZD/EUR	0.5531	0.5749	0.5738	0.5672	0.5584	0.5550
AUD/USD	0.8304	0.8753	0.8674	0.8518	0.8367	0.8477
EUR/USD	1.2191	1.2377	1.2265	1.2216	1.2218	1.2512
USD/JPY	91.38	89.42	88.93	88.59	88.23	87.97
GBP/USD	1.4678	1.5044	1.5094	1.5069	1.4952	1.5173
Oil (US$/bbl)	72.70	78.45	78.26	75.93	75.59	72.95
Gold (US$/oz)	1224.75	1256.10	1239.60	1241.90	1240.30	1208.03
Electricity (Haywards)	4.69	4.60	4.59	4.29	3.91	5.56
Milk futures (US$/contract)	125	122	122	122	120	116
Baltic Dry Freight Index	4041	2482	2447	2406	2351	2280

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:

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- 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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