Market Focus

New Zealand

27 July 2009

REGIONAL RANKINGS

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Page 2: Economic overview

> Signs of improvement globally are to be respected. Domestically, we are not sure people realise the downstream impact of a struggling dairy sector on the economy. The regional economic out-performers for NZ.Inc from 2003 to 2007 were all dairy-aligned in some shape or form. This is an area we continue to monitor closely. While the RBNZ takes centre stage, other data is expected to reinforce a stabilising theme for the NZ economy. However, at this juncture, attention needs to be paid to the components of growth and whether they are pointing to a sustainable recovery.

Page 4: Economic comment – net migration – some recent trends

> The economy continues to experience support from solid monthly gains in net migration, even if it is still largely a story of fewer departures at present. Two key trends to watch going forward include: work permit approvals (which are easing and portend of fewer arrivals) and the Australian labour market, which is a key driver of emigration. If the latter weakens, we see net migration swelling further.

Page 6: *OCR Review* preview

> We see the RBNZ leaving the OCR unchanged at 2.50 percent. The statement will acknowledge early signs of recovery, but we still see the RBNZ retaining a soft easing bias and committing to keep the OCR at current levels well into 2010. To strengthen this message (and buy-in from the market) we would not be surprised to see references to prudential measures, which are clearly set to play a powerful role going forward.

Page 7: Interest rate strategy

> Interest rates in NZ are likely to remain fairly elevated during the week, ahead of the RBNZ OCR decision on Thursday. We suspect the statement will be designed to contain the recent movement up, but getting follow-through may be challenging given offshore sentiment, notably towards Australia.

Page 8: Currency strategy

> The week ahead is dominated by the RBNZ's OCR decision and it's hard to see the RBNZ not having the currency at least partly in mind when it phrases some of the statement. Offshore, the USD looks set to remain under pressure with a record auction of US Treasuries to come, but the NZD's correlation with equities is softening and we suspect a return to domestic influences is pending. But this may be an August story.

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ECONOMIC OVERVIEW

Signs of improvement globally are to be respected. Domestically, we are not sure people realise the downstream impact of a struggling dairy sector on the economy. The regional economic out-performers for NZ.Inc from 2003 to 2007 were all dairy-aligned in some shape or form. This is an area we continue to monitor closely. While the RBNZ takes centre stage, other data is expected to reinforce a stabilising theme for the NZ economy. However, at this juncture, attention needs to be paid to the components of growth and whether they are pointing to a sustainable recovery.

What's ahead?

> **June Overseas Merchandise Trade** (Tuesday 1045 NZST). A monthly trade deficit is typically recorded in June months. However, we expect a small trade surplus as the weak domestic economy and inventory adjustment continues to weigh on import demand, and NZ exports to China continue to rise.

> **June Building Consent Issuance** (Wednesday 1045 NZST). While the level of consent issuance should remain very low, the recent pick-up in house sales activity should see consents begin to recover.

> **July NBNZ *Business Outlook*** (Wednesday 1500 NZST).

> **RBNZ *OCR Review*** (Thursday 0900 NZST). We expect the OCR to be left unchanged at 2.50 percent. The Bank will reinforce their "low for an extended period" rhetoric. See page 6 for our full preview note.

> **Credit Growth** (Thursday 1500 NZST). A small improvement in housing lending growth is likely. Rural and business lending growth is expected to continue to weaken.

What's the view?

Firstly, we need to once again acknowledge the positive signs of stabilisation that are emerging around the globe. Equity markets have found the turbo-booster, as US earnings results generally surpass expectations. This, in turn, is leading to increased optimism and appetite for risk in other markets. LIBOR-OIS spreads continue to narrow, the TED spread is lower and US corporate bond spreads have also tightened over the past fortnight. The process of financial market healing is well underway with talk rampant of a "V" shaped recovery. If that does eventuate it will be a big V on the down-leg and little v on the recovery side, with the first part of the upswing inversely proportional to the global economy falling off a cliff in late 2008. Beyond that point, challenges remain as consumer de-leveraging extends.

But the main thing that got us thinking over the week was the US earnings results. These have come in better than expected, with reports of three quarters of firms surpassing expectations to date, although this comes on the heels of being rapidly revised lower in preceding months, so you need to take the improvement aspect with a grain of salt. But what has us mulling at present is the productivity driven aspect to the results. The ability of the US economy to respond aggressively in the face of economic turmoil has been the feature of the results. For sure, we don't like the adjustment seen in their labour market to date (with the unemployment rate rising from 5.6 to 9.5 percent in the space of 12 months), but the flipside to this is flexibility, adaptability and productivity. And it's coming through loud and clear in the US, particularly *vis-à-vis* the likes of Europe. Despite the US facing huge structural challenges, this sort of dynamic advocates to us that the US economy will likely be one of the first developed countries out of recession, although of course there remains a large caveat on the pace of recovery.

The NZ earnings reporting season begins shortly (with large bellwether companies generally announcing around the middle of August), and we'll be watching the results closely, but also the guidance (we suspect lacklustre: it is simply not in directors' interest to take an optimistic line) and to what extent earnings are being supported by cost and productivity initiatives. As noted last week, the whole productivity aspect to the cycle is something that is worthy of close attention.

There was little last week to alter our core economic views. Migration data again showed a solid monthly inflow, which will provide some further underlying "bums on seats" support to both the housing market and consumer spending. We provide an update of some of the recent trends in net migration on page 4.

We continue to be struck by the dichotomised regional nuances we are receiving. In aggregate, they still look consistent with the economy emerging from recession. But probably the biggest issue we are pondering at present is the flow-on from the dairy sector to the wider economy, which is undoubtedly playing a role in the rural-urban divergences. We won't bore people with the numbers again in terms of the dairy payout. It's too low relative to cost structures and debt levels, and farm prices are falling – fast.

Last week we canvassed through the NBNZ *Regional Trends* report (of economic growth across the regions) for the period from 2003 to 2007 (we remove 2008 as Auckland was in recession and it would bias the results heavily). We were interested in determining which regions led NZ.Inc over the period. So who were the top six? Taranaki, Waikato, Northland, West Coast, Canterbury and Southland (in that order). The common denominator across each: cows (yes even in Canterbury). The direct impact of the farming sector is widely acknowledged, but people do not seem to fathom the open or shut nature of the rural chequebook, and what the pressures in the dairy sector will mean for the agricultural service sector and townships. Even rural-aligned regional house prices outperformed cities over 2003 to 2007.

	Economic growth ranks between 2003 and 2007
Northland	**3**
Auckland	14
Waikato	**2**
Bay of Plenty	13
Gisborne	9
Hawke's Bay	10
Taranaki	**1**
Manawatu/Wanganui	8
Wellington	11
Nelson/Marlborough	12
West Coast	**4**
Canterbury	**5**
Otago	7
Southland	**6**

This leaves us seriously wondering about moving towards an expectation of a "W" shaped cycle for the NZ economy, although we still see it as entirely consistent with our "bathtub with waves" view.

Collectively, there seems a lot of talk about when (or whether) the NZD will return to trading off domestic fundamentals. We see the dairy sector as probably the most integral part of that wake-up call when it comes.

Looking to data and events this week, the RBNZ's *OCR Review* will naturally take most of the limelight. We have little doubt that the OCR will be left unchanged at 2.50 percent (refer to page 6 for our full preview note). The signs of stabilisation both around the globe and locally, as well as clear evidence that inflationary pressures are abating, provide the RBNZ will some time to sit back and assess how their recent aggressive policy stimulus is working. Ultimately though, we still suspect the Bank will maintain an easing bias (although we don't expect them to actually act on it) and are likely to once again highlight that downside risks to the economic outlook still remain.

In terms of the data released, the NBNZ *Business Outlook* survey for July will be important, seeing as it provides a very good lead gauge on the economy. The biggest focus will be on whether the recent improving trend in sentiment has been maintained. We will also be watching for further evidence of the sectoral and regional story discussed above.

The other data released is Overseas Merchandise Trade and Building Consents Issuance for June. The former is expected to record another monthly trade surplus, which is slightly unusual for June months (with deficits typically recorded). Further weakness in imports is likely to be present. But we are also expecting to see a clear compositional story for exports, with Chinese growth relatively strong. Last month was noteworthy for a large increase in dairy and log product exports to China, which is likely to have been largely a stock-building story. We suspect that this continued in June, which should provide support to export levels in the month. However, there have been growing anecdotes over this month of the Chinese re-stocking story coming to an end, and so we will naturally be watching for any early signs of this in the June data. Nevertheless, the annual trade deficit is expected to narrow to around $2.6 billion – the smallest level since early 2003.

We would not be surprised to see an increase in the June residential building consent numbers. The level will remain exceptionally low, and any strength or rebound in the month needs to be interpreted with the base effect in mind. However, the recent pick-up in house sales activity should begin to flow through. The non-residential numbers will remain a key to watch. Government projects have been providing some support but there are growing anecdotes of waning non-residential momentum, and we expect this to be a key trend in 2010.

Internationally this week, the big focus is once again likely to be the US earnings reporting season and whether the trend of positive surprises can be maintained. In terms of data, US durable goods for June and the advanced June quarter GDP release will be watch closely. The latter is expected to still show a contraction, but much less than recorded in Q4 and Q1. In other countries, labour market data in Europe and Japan will be important, as will a business sentiment survey for the former.

Recent local data…

> **International Travel and Migration (June):** A seasonally adjusted net inflow of 1,730 people was recorded in the month. The annual total has now risen to 12,515. Short-term visitor arrivals fell 3.8 percent.

> **Credit Card Spending (June):** Total credit card spending rose by a modest 0.2 percent in the month.

NET MIGRATION – SOME RECENT TRENDS

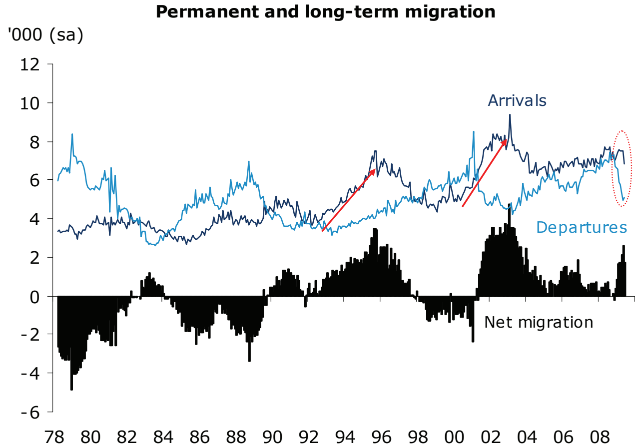
The economy continues to experience support from solid monthly gains in net migration, even if it is still largely a story of fewer departures at present. Two key trends to watch going forward include: work permit approvals (which are easing and portend of fewer arrivals) and the Australian labour market, which is a key driver of emigration. If the latter weakens, we see net migration swelling further.

The NZ economy gained a net 1,730 people in the month of June – the fifth consecutive month where net migration exceeded 1,500. It sees the annual gain rise to 12,515 and the 3-month annualised level rise to an impressive 25,680. This is after annual net migration fell below 4,000 in late 2008. The recent trends in net migration are a positive for the economy in a "bums on seats" type fashion. For an economy that has been in recession for at least 18 months and with the housing market and consumer spending hit hard, this will naturally provide some support to both of these sectors if recent gains are maintained. We dig into the numbers further and look at some of the recent trends.

Some of the key observations include:

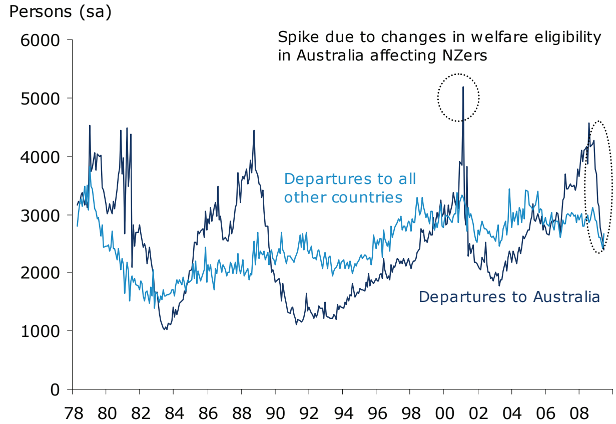
> **It remains a departure story at present.** The key reason for the recent surge in net migration is due to a sharp drop off in the number of New Zealanders choosing to leave. Permanent and long-term (PLT) departures have fallen from around 7,000 per month to around 5,000. This is particularly the case for departures to Australia, which have fallen from a peak of over 4,500 a month to less than 2,500.

Permanent and long-term migration



Sources: ANZ National, Statistics NZ

NZ resident permanent departures

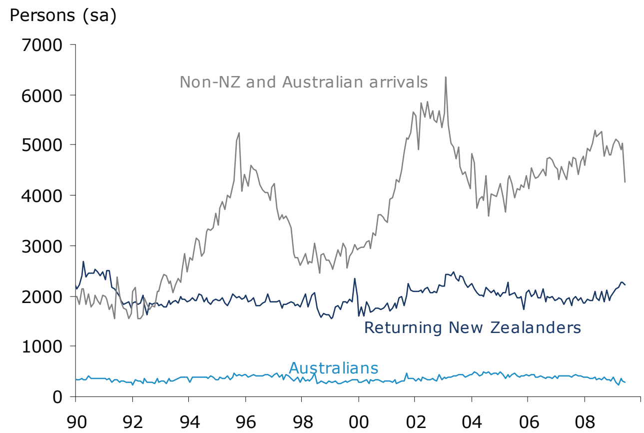


Sources: ANZ National, Statistics NZ

> **There is some evidence of an increased number of returning ex-pats,** but this is not as big a theme as it is being made out to be. The number of New Zealanders returning home has slowly ground higher over the past few months. It is at its highest level since 2003, although is still only around 200 people per month off its trough.

> **This is being offset by less non-NZ and Australian arrivals.** Non-NZ and Australian PLT arrivals fell by nearly 800 people in the month of June. Interestingly, this appeared to be driven by fewer arrivals from North Asia (China) and the Pacific Islands, which together contributed to half of this fall in the month (in seasonally adjusted terms). PLT arrivals from South Africa have also been falling of late and are in fact 46 percent below the levels of June 2008.

Permanent arrivals to NZ



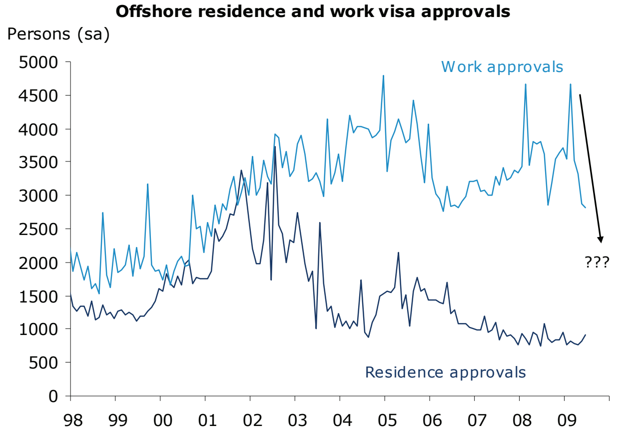
Sources: ANZ National, Statistics NZ

The bigger picture

We wrote a piece on our views on migration in the 27 April edition of the *Market Focus*. Generally our views expressed in this are unchanged. That is, because of this migration cycle being largely driven by fewer departures, the economic impetus will likely be less this time around, and then there is the fact that those arriving are typically bringing less capital than was the case in the past. However, we are also aware of some other factors:

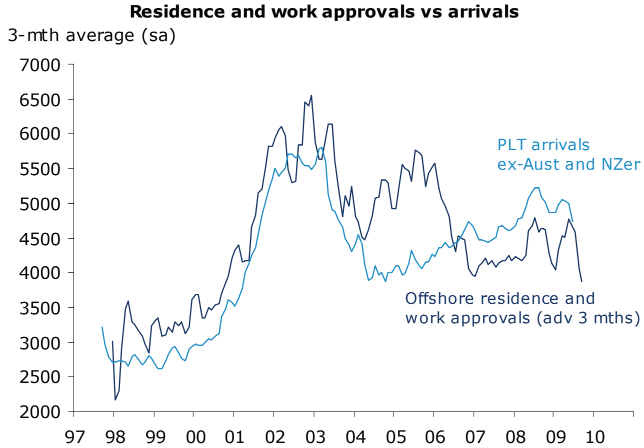
> **The job situation locally should not be forgotten.** Much is being made of the returning ex-pat story (which is not that large at present). But the big risk is that we see a further reduction in the number of non-NZ and Australians arriving as we did in the month of June. Resident and work permit approvals have fallen over recent months and this does suggest that this could be the case. The reality is that if the job situation is equally as bad in NZ as it is in other parts of the globe, then why make the move to NZ or why continue the need to have foreign labour? The number of returning ex-pats would need to rise significantly if it was to offset the potential falls possible from other cohorts.

Offshore residence and work visa approvals



Sources: ANZ National, NZIS

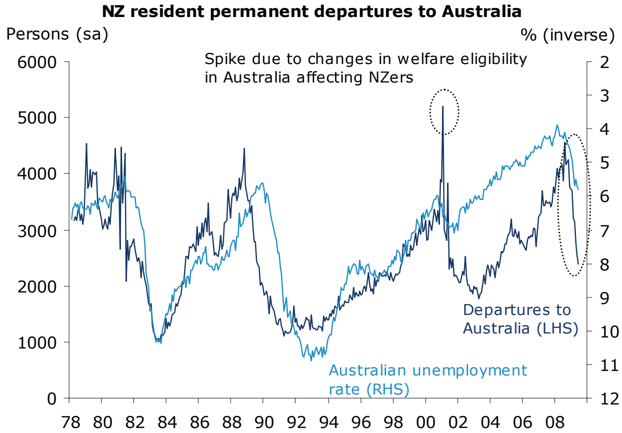
Residence and work approvals vs arrivals



Sources: ANZ National, NZIS, Statistics NZ

> **The big swing factor remains the number of departures and particularly to Australia, which is linked to their unemployment rate.** It is quite easy to envisage the number of NZ resident departures remaining subdued over the coming months given the challenges and uncertainties still present for the global economy. This should provide some natural underlying support to net migration flows. However, what happens if the Australian economy improves (and it arguably has held up better than most other developed nations)? Will those that cancelled their migration plans then decide to reassess? This timing issue is a risk that cannot be ruled out.

NZ resident permanent departures to Australia



Sources: ANZ National, Statistics NZ

The bottom line is that there remains a significant amount of uncertainty over the outlook for migration. What the past few months have also shown us is that net migration can change rather quickly.

For a small economy like NZ, swings in migration can have a marked impact on business cycle. Positive support such as the present situation – and despite uncertainty surrounding the sustainability – needs to be respected. Given the history surrounding house price and migration cycles, the RBNZ will no doubt be somewhat wary. With this in mind we were reminded of the RBNZ's submission to the Monetary Policy Inquiry in 2007, which highlighted that *"policies that reduce the cyclicality of migration are useful to monetary policy."* However, in practice, you can't control departures, and there are considerable timing lags over inflows. Hence, in practice, there is nothing really obvious that stands out, although we would not be surprised if discussions were in terms of assessing options. Going forward, we are in no doubt that fiscal and monetary policy will need to work closer together, and migration is an obvious lever the former could pull to assist the latter in certain instances.

The upshot

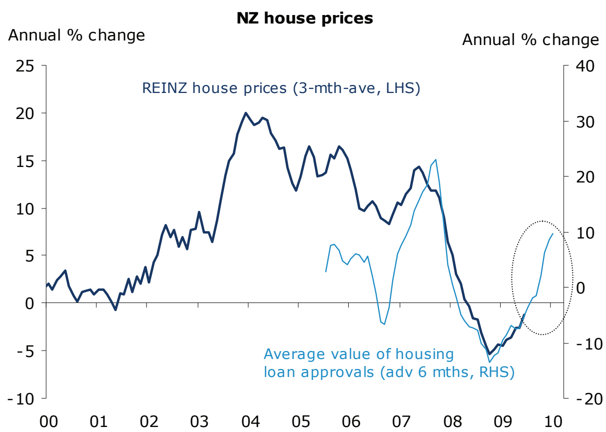
The economy continues to experience support from solid monthly gains in net migration, even if it is still largely a story of fewer departures at present. Two key trends to watch going forward include: work permit approvals (which are easing and portend of fewer arrivals) and the Australian labour market, which is a key driver of emigration. If the latter weakens, we see net migration swelling further.

OCR REVIEW PREVIEW
(due 9.00am Thursday 30 July)

We see the RBNZ leaving the OCR unchanged at 2.50 percent. The statement will acknowledge early signs of recovery, but we still see the RBNZ retaining a soft easing bias and committing to keep the OCR at current levels well into 2010. To strengthen this message (and buy-in from the market) we would not be surprised to see references to prudential measures, which are clearly set to play a powerful role going forward.

The economic picture has improved since the June *Monetary Policy Statement* – albeit off extreme lows. The global economy is showing further signs of stabilisation, and forecasts of NZ's major trading partner growth have started to be revised upwards. The general view is that the US economy is set to expand towards the end of this year. Growth has already started to rebound in some Asian economies, notably China. The RBA, which has been very attuned to global developments throughout the financial crisis, has been more upbeat of late and sees diminished downside risks. While policymakers overseas are still sounding caution over the recovery path, at least the focus has shifted towards the gradient of the recovery as opposed to how much further down the slippery slope there is to go. Improvement is also apparent in global credit markets, with key credit spreads narrowing to pre-Lehman Brothers collapse levels.

On the domestic front, both business and consumer confidence have recovered and net migration remains strong, which will lend support to domestic demand. The housing market continues to strengthen (albeit off lows) and loan approvals suggests further recovery. In addition, there are still further pipeline easings to come as fixed rate mortgages come up for renewal.



Sources: ANZ National, RBNZ, REINZ

Collectively, these are significant changes. However, they also need to be put in perspective. A huge layer of uncertainty remains, and the improvement looks to be one of removing the risk of systemic failure are opposed to something really concrete. Despite encouraging signs, it is not lost on us that central banks continue to talk in very cautionary tones, with the RBA even maintaining a soft easing bias. Reading between the lines there seems little doubt we'll see bumps ahead, but probably within the context of a stabilising to recovering trajectory.

Domestically, financial conditions have tightened, notably via the currency, which is around 6 percent above the RBNZ's June projection (on a TWI sense). Deposit rates continue to track up, which portends of higher borrowing rates. The labour market continues to deteriorate judging from the numbers of people going on the unemployment benefit. The elephant in the room is the dairy sector, which is under considerable pressure, and holds regional prospects with it.

Overall, our view is that conditions have improved sufficiently for the RBNZ not to have to act on their easing bias for now. The economy looks to have found a floor. But there is still uncertainty over the outlook, speed of recovery and structural challenges to warrant keeping the OCR low for some time. We expect to see massive regional divergences opening up over the coming six months, which are broadly the reciprocal of 2008 (i.e. Auckland awful and regional NZ going well). Unfortunately this mix to growth is not consistent with the rebalancing dynamic the economy needs.

When it comes to the content of the statement, the RBNZ Governor's speech two weeks ago is likely to serve as a template. In the speech, the Governor noted that *"Early signs of global recovery have now emerged"*, *"New Zealand looks likely to start recovering ahead of the pack"*, but also noted *"…world growth will be fairly subdued for the next one or two years at least."* We expect the RBNZ to take a leaf out of the RBA's book and maintain a soft easing bias, probably more for strategic reasons that anything else, and for fear of otherwise reinforcing a market that seems hell-bent on pricing in rate hikes from early 2010. In our view the outlook still suggests the OCR will remain *"at or below the current level through until the latter part of 2010",* but to reinforce that message, we would not be surprised to see comments directed towards prudential policy changes, and the role they will play going forward as a means of influencing the business cycle.

Financial market implications

At the time of writing, the market had around 3bps of easing priced in, and economists are near unanimous on a pause. With policymakers becoming clearly frustrated by the rising currency, we expect the statement itself to be designed rather soothingly for fear of igniting the NZD (or market pricing for further hikes) further.

INTEREST RATE STRATEGY

Interest rates in NZ are likely to remain fairly elevated during the week, ahead of the RBNZ OCR decision on Thursday. We suspect the statement will be designed to contain the recent movement up, but getting follow-through may be challenging given offshore sentiment, notably towards Australia.

Market themes…

> An extended sell-off in Australian rates due to elevated core inflation and stops being triggered on longs as the recovery story gains momentum.

> Migration numbers last week reinforce housing related stimulus.

> Ongoing upside surprises in the US equity reporting season, while only relative to previously downgraded expectations maintained selling pressure in global rates.

Review and outlook

Again good news from US earnings results led to continued payside pressure in global rates. There was also other data that suggested gradual improvement in global economies as UK retail and US housing starts both surprised to the upside. In Australia, core CPI came in as expected but is still very elevated at 3.6 percent yoy. This is falling but still rather elevated considering this is at the end of a major global recession and as a result there is increased expectation in the market that the RBA could hike rates as early as the start of the year.

With little local data out last week, the NZ market followed offshore moves and in particular our short end has taken to largely tracking movements in Aussie's 3 year futures. A speech on Tuesday (NZ 3pm) by RBA Governor Stevens could see upside pressure being maintained in Aussie rates. On Wednesday we have building permits, which are probably about due to show timid signs of recovery, given their correlation with existing house sales, which have been steadily improving.

Generally flows in the NZ swap market have been light and flattening pressure has been the developing theme. This has been led by speculators looking to pay the increasingly risky short end (2y) while receiving the relative safety of long end (10y) where high implied forward rates provide some comfort. For example 1y out of 7y is currently 7.00 percent.

In addition, mortgage paying has been normal with 1 and 2 year the preferred maturities, while the Uridashi/Eurokiwi flows have been lighter than expected given the massive maturity profile during July. The NZ 2y swap has headed above the 3.90 percent level it had previously struggled to break and it still looks like a test of 4 percent is possible. While there is no doubting the housing market is better, leaving the RBNZ wary, we suspect they'll try to contain the rate market's bias to rise for now. But getting follow through may prove difficult in the absence of a major shift in offshore sentiment.

Borrowing strategies we favour at present

Floating rates remain the cheapest part of the curve, and rate hikes still look to be at least 12 months away. As such, our favoured strategy is still to go floating, or simply roll a series of short fixes rather than to fix for a longer period. Consideration can also be given to the use of options as a way to hedge further out. For example, Interest Rate Caps provides protection against rate rises but allows full participation in lower floating rates, for a premium.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ / OCR	↔	On hold. Hikes a way off.
NZ data	↔/↑	Further signs of stabilisation expected in the dataflow.
Fed Funds / front end	↔	Recent FOMC statement should hold rates within levels but data/equities could test.
RBA	↔/↑	Elevated core inflation and quick rebound potentially a problem, suggesting RBA could be first to hike rates.
US 10 year	↔	Expect more choppy moves.
NZ swap curve	↔	Look for curve flattening pressure to remain and 2yr to test 4%.
Flow	↔/↓	Ongoing offshore interest to buy NZGS.
Technicals	↔	5yr at key levels with risk that it breaks to the topside.

Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 30-Jul-09	-4	-2
Thu 10-Sep-09	-4	-2
Thu 29-Oct-09	-1	0
Thu 10-Dec-09	+1	+8
Thu 21-Jan-10	+14	+10
Thu 11-Mar-10	+18	+20
Thu 29 Apr-10	+33	+25

Trading themes we favour at present

We still favour the 2/10's flattener especially given the risk for growing payside to emerge in the shorter end of the curve if recovery signs continue. This trade should also perform if Dr Bollard is a little bit more upbeat in the OCR and continues to voice concern about household indebtedness as per his recent speech, even though we expect the overall tone to be reasonably guarded.

CURRENCY STRATEGY

The week ahead is dominated by the RBNZ's OCR decision and it's hard to see the RBNZ not having the currency at least partly in mind when it phrases some of the statement. Offshore, the USD looks set to remain under pressure with a record auction of US Treasuries to come, but the NZD's correlation with equities is softening and we suspect a return to domestic influences is pending. But this may be an August story.

Market themes…

> USD – still out of favour.

> RBNZ – what's the thinking?

> NZDAUD – trade the range.

Review and outlook…

US earning results and forward looking guidance have exceeded somewhat lowered expectations, adding to the view in some quarters that the worst is over, thereby supporting the commodity bloc. Bernanke's testimony to Congress did no favours for the USD as he showed no inclination to withdraw monetary support anytime soon. The USD Index continued to lose ground, giving up nearly 1 percent over the week. It has now broken an uptrend that had been in place since July 2008.

The week ahead will see strong headwinds continue for the USD. To start with, flight-to-safety support for the USD has long disappeared. Risk appetite continues to improve with the VIX index starting the week lower again, at around 23. Added pressure on the USD will come this week from the record Treasury auctions in the 2, 5 and 7 year maturities. A total of US$115 billion in supply will test USD appetites. While it is difficult to go against the spirit of this, better-than-expected earnings numbers in the US are also partly a function of the nation's flexibility and signs of better productivity. These are actually USD positive but being overlooked for now. We have serious question-marks about Europe on this front, which will eventually manifest in the growth differential between the two regions.

The RBNZ OCR announcement will be the key this week. Recent comments from Governor Bollard have been taken as being more upbeat by the market, but turbo-charging the currency further is obviously something they remain wary of. We expect language to be very caveated and by-and-large mirror the RBA's soft easing bias nuances. Last Thursday was notably for a sizeable disconnect opening up between equities, risk sentiment and the NZD. This suggests a top is in place, particularly when viewed in conjunction with recent positioning data, which shows the highest number of net USD short contracts since July 2008. But it remains to be seen whether or when the market will return to domestic based fundamentals and actually turn the trend. Wholemilk powder prices dropped a further 5.7 percent in the past fortnight in NZD terms, largely due to the stronger currency. Currency markets are not reacting to this in the short term but it remains an important medium term factor for the NZD.

Technically, the NZD starts the week near resistance at 0.6630 – the top end of last week's range. Firm support will be seen at the 0.6500–15 level where the 200hr moving average comes in, along with a horizontal support line. The NZDAUD is trading within a well defined range, with support at 0.8000 and resistance at 0.8080 to 0.8100. It seems likely that this will continue over the week.

NZD vs AUD: monthly directional gauges

Gauge	Direction	Comment
Fair value	↔	Within the range.
Yield	↓	Yield favours Australia.
Commodities	↔/↓	A robust Chinese economy favours the Australians.
Partial indicators	↔	More NZ than AU data to focus on this week.
Technicals	↔/↓	0.8080 to 0.8100 remains in place as resistance.
Sentiment	↔/↑	Earning season sees improved risk appetite.
Other	↔	Will the RBNZ comment on the NZD?
On balance	↔/↓	**Respect the ranges.**

NZD vs USD: monthly directional gauges

Gauge	Direction	Comment
Fair value – long-term	↔/↓	Above long term average.
Fair value – short-term	↔/↓	Slightly above cyclical fair value estimates.
Yield	↔/↓	Repeat of low for longer from the RBNZ this week.
Commodities	↔/↓	World dairy prices remain under pressure.
Risk aversion	↔/↑	Moving in line with US earnings results.
Partial indicators	↔/↓	Stabilisation in NZ, but is US bouncing back faster?
Technicals	↔	Support at 0.65.
AUD	↔	Watch equity markets.
Sentiment	↔/↑	Improved with offshore developments.
Other	↔/↑	Record US Treasury auctions this week.
On balance	↔	**Ranges for now. Global developments key.**

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
27-Jul	JN	Corp Service Price (Jun) - yoy	-3.3%	-3.0%	11:50
	GE	GfK Consumer Confidence Survey (Aug)	2.9	2.9	18:10
28-Jul	US	New Home Sales (Jun)	352K	342K	02:00
		Dallas Fed Manufacturing Activity (Jul)	-11.0%	-20.4%	02:30
	NZ	**Trade Balance (Jun)**	**215.0M**	**858.0M**	**10:45**
		Imports (Jun)	**3.20B**	**3.10B**	**10:45**
		Exports (Jun)	**3.40B**	**3.96B**	**10:45**
	AU	Conference Board Leading Index (May)	-	0.70%	12:00
		NAB Business Confidence (2Q)	-	-24	13:30
		RBA Governor Stevens Speaks	-	-	15:00
29-Jul	US	S&P/CS Composite-20 (May) - yoy	-17.9%	-18.1%	01:00
		Consumer Confidence (Jul)	49.0	49.3	02:00
		Richmond Fed Manufacturing Index (Jul)	8	6	02:00
		Fed's Yellen Speaks in Coeur d'Alene on US Economy	-	-	04:35
	NZ	**Building Permits (Jun) - mom**	**-**	**3.5%**	**10:45**
		NBNZ Business Confidence (Jul)	**-**	**5.5**	**15:00**
	JN	Retail Trade (Jun) - mom	0.4%	0.1%	11:50
	EC	ECB Publishes Bank Lending Survey	-	-	20:00
	UK	Net Consumer Credit (Jun)	0.3B	0.3B	20:30
		Mortgage Approvals (Jun)	47.0K	43.4K	20:30
		M4 Money Supply (Jun F) - mom	-	-0.2%	20:30
30-Jul	US	Durable Goods Orders (Jun) – mom	-0.6%	1.8%	00:30
		Durables Ex Transportation (Jun) - mom	0.0%	1.1%	00:30
		Fed's Dudley Speaks on Economy to New York Business Group	-	-	00:30
		Fed's Beige Book	-	-	06:00
	NZ	**RBNZ Official Cash Rate**	**2.50%**	**2.50%**	**09:00**
		Money Supply M3 (Jun) - yoy	**-**	**5.6%**	**15:00**
	JN	Industrial Production (Jun P) - mom	2.5%	5.7%	11:50
		BoJ Board Member Noda to Speak in Matsumoto City	-	-	13:30
		Vehicle Production (Jun) - yoy	-	-41.4%	16:00
	AU	HIA New Home Sales (Jun) - mom	-	-5.7%	13:00
		Building Approvals (Jun) - mom	8.0%	-12.5%	13:30
	GE	Unemployment Change (000's) (Jul)	43K	31K	19:55
		Unemployment Rate (Jul)	8.4%	8.3%	19:55
	EC	Business Climate Indicator (Jul)	-2.83	-2.97	21:00
		Consumer Confidence (Jul)	-24	-25	21:00
		Economic Confidence (Jul)	75.0	73.3	21:00

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
30-Jul cont.	EC	Industrial Confidence (Jul)	-30	-32	21:00
		Services Confidence (Jul)	-19	-20	21:00
31-Jul	US	Initial Jobless Claims (w/e Jul-26)	580K	554K	00:30
		Continuing Claims (w/e Jul 19)	6300K	6225K	00:30
	UK	GfK Consumer Confidence Survey (Jul)	-23	-25	11:01
	JN	Jobless Rate (Jun)	5.3%	5.2%	11:30
		Household Spending (Jun) - yoy	0.4%	0.3%	11:30
		National CPI (Jun) - yoy	-1.8%	-1.1%	11:30
		National CPI Ex-Fresh Food (Jun) - yoy	-1.7%	-	11:30
		National CPI Ex Food, Energy (Jun) - yoy	0.6%	-0.5%	11:30
		Housing Starts (Jun) - yoy	-30.6%	-30.8%	17:00
		Construction Orders (Jun) - yoy	-	-41.9%	17:00
	AU	TD Securities Inflation (Jul) - mom	-	0.4%	12:30
		Private Sector Credit (Jun) - mom	0.1%	-0.1%	13:30
	EC	CPI Estimate (Jul)	-0.4%	-0.1%	21:00
		Unemployment Rate (Jun)	9.7%	9.5%	21:00
1-Aug	US	GDP (Annualized) (2Q A) - qoq	-1.5%	-5.5%	00:30
		Personal Consumption (2Q)	-0.5%	1.4%	00:30
		GDP Price Index (2Q)	1.0%	2.8%	00:30
		Core PCE (2Q) - qoq	2.4%	1.6%	00:30
		Employment Cost Index (2Q)	0.3%	0.3%	00:30
		Chicago Purchasing Manager (Jul)	43.0	39.9	01:45

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: The RBNZ's decision is obviously the focus this week, although we expect the OCR to be left unchanged. Leading indicators will continue to be watched closely to help determine how quickly (if at all) the economy is bouncing back. The NBNZ July *Business Outlook* is key in this regard. Labour market data in a fortnight's time should highlight the economic challenges that remain.

Date	Data/Event	Economic Signal	Comment
Tue 28 Jul (10.45)	Overseas Merchandise Trade (Jun)	Positive rebalancing signs	A monthly trade deficit is typically recorded in June months. However, we expect a small trade surplus as the weak domestic economy and inventory adjustment continues to weigh on import demand, and NZ exports to China continue to rise.
Wed 29 Jul (10.45)	Building Consents Issued (Jun)	Rebounding or record lows	While the level of consent issuance should remain very low, the recent pick-up in house sales activity should see consents begin to recover.
Wed 29 Jul (15.00)	NBNZ *Business Outlook* (Jul)	-	-
Thu 30 Jul (09.00)	RBNZ *OCR Review*	On hold	While the RBNZ will remain concerned about market prices and the elevated NZD, we expect them to hold the OCR at 2.50 percent. They will repeat their "low for an extended period" mantra.
Thu 30 Jul (15.00)	Credit Growth (Jun)	Housing improving, but overall credit still weak.	Housing credit growth may start to recover given the improvement in house sales activity. However, business and rural credit growth are likely to remain under pressure.
Tue 4 Aug (10.45)	LCI & QES (Jun qtr)	Softening quickly	While a lagging indicator, wage growth is easing as the economic backdrop and rising unemployment makes it difficult for workers to push for larger wage increases.
Tue 4 Aug (15.00)	ANZ Commodity Price Index (Jul)	-	-
Thu 6 Aug (10.45)	HLFS (Jun qtr)	Continuing to turn sharply	Trends in the number of people signing up for the unemployment benefit clearly shows that the unemployment rate is rising sharply. We expect employment to contract by 0.5 percent and the unemployment rate to rise to 5.5 percent.
Fri 14 Aug (10.45)	Retail Trade Survey (Jun)	Reversal	Following the surge in spending in May – partly driven by earlier spending on winter clothes, we expect a pull-back to have occurred in June, although high food prices will inflate the grocery bill. We expect a small contraction in volumes for the quarter.
Wed 19 Aug (10.45)	Producer Price Index (Jun qtr)	Easing	Input and output prices are both expected to ease in the quarter, largely driven by lower NZD commodity prices.
Thu 20 Aug (15.00)	NBNZ Regional Trends (Jun qtr)	-	-
Fri 21 Aug (10.45)	International Travel and Migration (Jul)	A source of support	Another reasonable monthly net inflow is expected as departures remain subdued. However, the key to watch is whether arrivals of non-NZ and Australians are able to hold up.
On Balance		**Base forming?**	**With Q1 data out of the way, attention now turns to how Q2 and Q3 fared and on signs of green shoots. We expect any recovery to be subdued as we move along the bottom of the bathtub.**

SUMMARY OF KEY ECONOMIC FORECASTS

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
GDP (% qoq)	-0.2	-0.5	-1.0	-1.0	**-0.5**	**-0.3**	**0.0**	**0.3**	**0.8**	**1.2**
GDP (% yoy)	1.0	-0.2	-2.1	-2.7	**-3.0**	**-2.8**	**-1.8**	**-0.5**	**0.8**	**2.3**
CPI (% qoq)	1.6	1.5	-0.5	0.3	0.6	**0.6**	**0.5**	**0.3**	**0.7**	**0.7**
CPI (% yoy)	4.0	5.1	3.4	3.0	1.9	**0.9**	**1.9**	**1.9**	**2.0**	**2.2**
Employment (% qoq)	1.2	0.2	0.6	-1.1	**-0.5**	**-0.9**	**-0.4**	**-0.2**	**0.0**	**0.2**
Employment (% yoy)	0.8	1.1	0.9	0.8	**-0.8**	**-1.9**	**-2.9**	**-2.0**	**-1.5**	**-0.4**
Unemployment Rate (% sa)	4.0	4.3	4.7	5.0	**5.5**	**6.0**	**6.5**	**7.0**	**7.3**	**7.5**
Current Account (% GDP)	-8.4	-8.7	-9.0	-8.5	**-6.8**	**-5.8**	**-5.0**	**-4.8**	**-5.1**	**-5.1**
Terms of Trade (% qoq)	-0.4	-1.0	-1.0	-3.0	**-2.0**	**-2.0**	**-1.4**	**-1.1**	**-0.9**	**0.4**
Terms of Trade (% yoy)	10.7	5.8	1.8	-5.2	**-6.8**	**-7.7**	**-8.1**	**-6.3**	**-5.3**	**-3.0**

KEY ECONOMIC INDICATORS

	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09
Retail Sales (% mom)	-1.4	0.0	-0.5	-1.2	0.2	-0.1	0.5	0.8	..	..
Retail Sales (% yoy)	0.7	-4.1	-0.9	-3.7	-6.9	-1.9	-1.7	-2.4	..	..
Credit Card Billings (% mom)	-1.8	-0.8	-2.2	1.6	0.8	-2.8	2.4	-0.4	0.2	..
Credit Card Billings (% yoy)	0.9	-0.9	-3.8	-2.4	-1.9	-4.8	-1.6	-2.4	-2.1	..
Car Registrations (% mom)	-0.9	-19.9	12.9	-14.1	-15.1	8.3	-2.4	-3.1	5.4	..
Car Registrations (% yoy)	-19.9	-34.4	-23.7	-36.5	-44.6	-32.9	-41.0	-33.3	-29.6	..
Building Consents (% mom)	-20.0	3.9	-6.8	-12.8	12.4	-0.9	11.9	3.5	..	..
Building Consents (% yoy)	-43.2	-39.6	-41.5	-51.4	-39.9	-34.3	-56.5	-22.9	..	..
REINZ House Price (% yoy)	-4.3	-4.1	-4.8	-4.4	-2.2	-4.0	-1.4	-2.2	0.0	..
Household Lending Growth (% mom)	0.1	-0.1	0.2	0.2	0.2	0.1	0.2	0.4	..	..
Household Lending Growth (% yoy)	5.8	4.8	4.2	3.8	3.1	2.8	2.6	2.6	..	..
Roy Morgan Consumer Confidence	99.7	99.0	102.9	103.7	98.8	94.7	101.1	104.9	105.3	106.1
NBNZ Business Confidence	-42.3	-43.0	-35.0	..	-41.2	-39.3	-14.5	1.9	5.5	..
NBNZ Own Activity Outlook	-11.4	-14.1	-21.5	..	-20.1	-21.2	-3.8	3.8	8.3	..
Trade Balance ($m)	-994	-594	-341	-102	483	439	319	858	..	..
Trade Balance ($m annual)	-5269	-5234	-5614	-5405	-5165	-4683	-4072	-3044	..	..
ANZ World Commodity Price Index (% mom)	-7.6	-7.4	-7.4	-4.3	-4.6	1.0	2.6	2.8	0.2	..
ANZ World Commodity Price Index (% yoy)	-11.1	-18.3	-24.3	-26.5	-30.7	-31.4	-29.4	-28.1	-27.9	..
Net Migration (sa)	90	-220	380	870	1640	1720	2110	2580	1730	..
Net Migration (annual)	4329	3569	3814	4538	6160	7482	9176	11202	12515	..

Figures in bold are forecasts. mom: Month-on-Month qoq: Quarter-on-Quarter yoy: Year-on-Year

SUMMARY OF KEY MARKET FORECASTS

	Actual		Current	Forecast (end month)						
NZ FX rates	May-09	Jun-09	27-Jul-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
NZD/USD	0.598	0.637	0.656	0.550	0.540	0.540	0.550	0.560	0.580	0.600
NZD/AUD	0.785	0.795	0.803	0.753	0.735	0.730	0.733	0.737	0.734	0.732
NZD/EUR	0.439	0.455	0.461	0.444	0.443	0.450	0.458	0.467	0.475	0.484
NZD/JPY	57.8	61.6	62.2	52.3	52.4	54.0	56.7	58.8	62.1	66.0
NZD/GBP	0.389	0.389	0.399	0.355	0.355	0.360	0.372	0.378	0.387	0.395
NZ$ TWI	57.9	60.3	61.36	54.9	54.3	54.8	56.0	57.0	58.4	59.9
NZ interest rates	May-09	Jun-09	27-Jul-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
OCR	2.76	2.74	2.50	2.50	2.50	2.50	2.50	3.00	4.00	4.50
90 day bill	2.82	2.78	2.79	2.80	2.80	2.80	2.80	3.60	4.50	5.00
10 year bond	5.74	6.24	5.76	5.60	5.70	5.70	6.10	6.30	6.40	6.60
International	May-09	Jun-09	27-Jul-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.25	1.75
US 3-mth	0.66	0.60	0.50	0.50	0.70	0.80	1.25	1.50	2.00	2.50
AU cash	3.00	3.00	3.00	3.00	3.00	3.00	3.00	3.25	3.50	3.75
AU 3-mth	3.19	3.19	3.11	3.30	3.30	3.40	3.80	4.00	4.30	4.60

KEY RATES

	24 Jun	20 Jul	21 Jul	22 Jul	23 Jul	24 Jul
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.82	2.79	2.79	2.77	2.77	2.78
NZGB 11/11	3.86	3.79	3.78	3.85	3.81	3.83
NZGB 04/13	4.86	4.74	4.73	4.81	4.75	4.77
NZGB 12/17	6.00	5.76	5.75	5.81	5.75	5.77
NZGB 05/21	6.59	6.23	6.22	6.27	6.21	6.23
2 year swap	3.86	3.80	3.88	3.93	3.90	3.93
5 year swap	5.38	5.28	5.37	5.37	5.34	5.35
RBNZ TWI	60.5	60.9	61.2	61.3	61.6	61.4
NZD/USD	0.6412	0.6482	0.6551	0.6555	0.6596	0.6554
NZD/AUD	0.8053	0.8036	0.8052	0.8038	0.8066	0.8049
NZD/JPY	61.26	61.37	61.54	61.43	62.09	62.09
NZD/GBP	0.3892	0.3953	0.3965	0.3997	0.4004	0.3975
NZD/EUR	0.4549	0.4577	0.4608	0.4619	0.4634	0.4628
AUD/USD	0.7962	0.8066	0.8136	0.8155	0.8178	0.8143
EUR/USD	1.4095	1.4162	1.4217	1.4192	1.4234	1.4162
USD/JPY	95.54	94.67	93.94	93.72	94.14	94.73
GBP/USD	1.6476	1.6399	1.6524	1.6399	1.6475	1.6489
Oil	68.81	63.56	63.93	64.81	66.10	66.10
Gold	925.25	941.35	948.95	948.85	948.15	949.10
Electricity (Haywards)	15.07	4.82	4.75	4.30	4.33	4.14
Milk futures (US$/contract)	85	86	86	86	86	86
Baltic Dry Freight Index	3751	3511	3455	3407	3355	3345

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.

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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.

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- 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.
- The Bank has a joint venture relationship with ING (NZ) Holdings Limited (ING). ING and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.

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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;
- 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.

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NEW ZEALAND DISCLAIMER

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