

Market Focus

New Zealand

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ADDRESSING VULNERABILITIES

Page 2: Economic overview

- > GDP and Balance of Payments data last week highlighted vulnerabilities within the NZ economy. A significant structural improvement is still some way off. We'll be paying close attention this week to the RBNZ's potential announcements on bank liquidity. All else being equal, we suspect it will support the idea of wholesale (but not retail) rates remaining lower for longer.

Page 4: Economic comment – forecast snapshot

- > The NZ economy continues to face an elongated adjustment process. Technically we have the economy rebounding in late 2009 from extended weakness, but this will mask regional and sectoral disparities. A respective cyclical and Rugby World Cup induced upswing dominates from mid 2010 and over 2011. But the big picture points to an extended period of relatively weaker growth over a number of years as the economy rebalances. We see a lower NZD as forming a critical part of the rebalancing process.

Page 6: Economic comment – global watch

- > Global data was mixed last week. While it looks as though the US housing market is stabilising, data last week showed this was at a slower pace than expected. On the other hand, US durable goods spending surged higher. Interestingly, the Euro-zone services PMI fell from last month's level and Japanese trade data was weak, showing that green shoots remain vulnerable.

Page 7: Interest rate strategy

- > With Q1 GDP now out of the way, focus turns to how Q2 fared and how close we are to the end of the recession. We expect more signs of stabilisation to appear in the data, but a sustained rebound to still be some way off. Rates look to be stuck in ranges with the 2-year swap yield to trade within a 3.5 to 4 percent range.

Page 8: Currency strategy

- > The NZD remained resilient last week despite a weak Q1 GDP release. This was in part a result of the USD weakening after the Fed left their Quantitative Easing programme unchanged. NBNZ *Business Outlook* is the big local focus but NZD direction will be driven by broader USD moves, with US ISM and non-farm payrolls key.

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ECONOMIC OVERVIEW

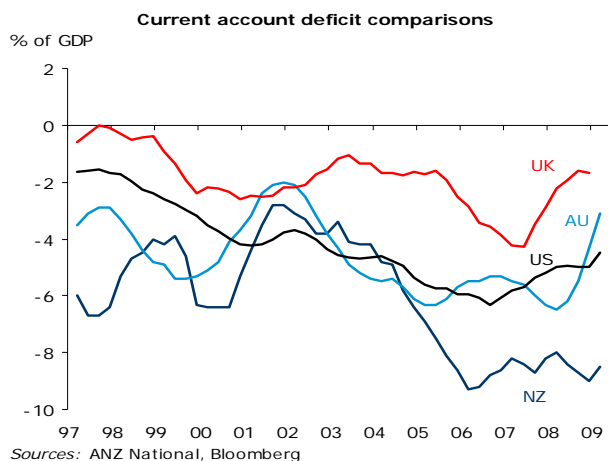
GDP and Balance of Payments data last week highlighted vulnerabilities within the NZ economy. A significant structural improvement is still some way off. We'll be paying close attention this week to the RBNZ's potential announcements on bank liquidity. All else being equal, we suspect it will support the idea of wholesale (but not retail) rates remaining lower for longer.

What's ahead?

- > **May Credit Growth** (Monday 1500 NZST). Household credit growth is likely to remain subdued. However, top of the watch list now is how business and rural lending is performing, with anecdotal reports of slowing sharply.
- > **June NBNZ Business Outlook** (Tuesday 1500 NZST).
- > **June ANZ Commodity Price Index** (Thursday 1500 NZST).
- > **Financial Statement of Government for the Eleven Months Ended May** (Friday 1000 NZST). The accounts are likely to have headed further into the red. However, they should be reasonably close to the *Budget* numbers.

What's the view?

Last week's key domestic data releases confirmed our core views about the path that the economy needs to take. The economy remained mired in recession for the fifth consecutive quarter (and we are at the tail end of the sixth quarter of recession right now and fully expect a seventh). The size of NZ's external position, with a current account deficit of 8.5 percent of GDP and a net international liability position nearing 100 percent of GDP, remains a key source of vulnerability for the economy. And with import volumes collapsing a massive 8.6 percent in the quarter, it is reasonably clear that further progress in narrowing the deficit needs to come from the export side, and this requires a lower currency.



The trouble at present is that the weak global scene is also hampering the ability of the export sector to respond. GDP data showed the manufacturing sector contracting 7.2 percent in the quarter – the largest quarterly fall on record. While lower imports are part of the requirement for the economy to rebalance, there is a limit to how far imports can fall and we fully expect to see imports recover as inventories are rebuilt in late 2009. A sustained turnaround in the external position needs to come from an improvement in export performance, either via volumes or prices and preferably both. This morning's trade figures are somewhat encouraging, with a (record) monthly surplus of \$858 million, driven by higher dairy product and log exports to China. This looks to be partly driven by rebuilding inventories, but may also reflect some structural shifts in terms of where products are being moved to; that is away from recessionary markets and towards growth markets. However, even aside from this, there is still a considerable way to go to see the adjustment in the current account that is required, particularly with the collective global backdrop still weak, dairy subsidies affecting global prices (and still to appear in the trade figures) and the recent appreciation in the NZD doing the tradable sector few favours.

We'll be releasing our latest set of quarterly economic forecasts tomorrow and the dynamics of rebalancing is a critical aspect underpinning our views. Refer to page 4 for a snapshot.

Looking to the week ahead, one of the things that could be a big focus is a potential announcement from the RBNZ in regard to their new rules surrounding the way in which NZ banks source their funds or guidance in regard to liquidity. As noted in the May *Financial Stability Report* "banks need to lengthen the maturity structure of their funding to reduce their vulnerability to offshore market disruptions."

We'll leave the bank speak to the banks, but this sort of dynamic is already one factor driving aggressive competition in the domestic deposit market. From an economic perspective there are a few aspects to keep a close eye on.

First, it is clear the regulatory breeze is blowing stronger around the globe as is natural given recent events. You only have to look at the recent overhaul of the US financial system proposed by the Obama Administration (which still requires Congressional approval), which will give more oversight powers to the Federal Reserve to stamp out excessive risk taking. The challenge to policymakers is to ensure the pendulum does not swing too far. Providing certainty and stability is one thing, but excessive regulation is also an inhibitor of growth. It can be a fine line between the two. Increasingly, central banks are turning to regulation as a means of mitigating systemic risks

in the financial system. But mitigating systemic risks also implicitly means reducing the amplitude of the business cycle. It is ultimately just another form of monetary policy in action, but via a different mechanism. Or put another way: if greater steps are put in place regarding the supply of credit, then there should be less need to directly alter the price.

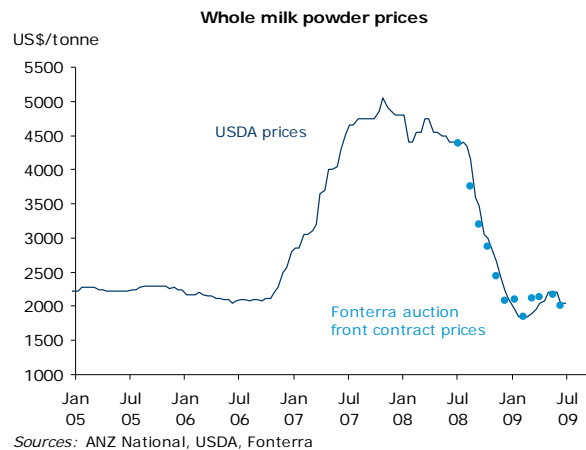
Second, there is an additional cost to securing term funding – particularly given current conditions, which all else being equal will naturally mean higher retail interest rates. This may seem a little perverse but the concept is simple: if you want greater economic certainty and stability (or reduced vulnerability), then there is a price (or margin) to pay for it. If retail related borrowing rates are likely to be biased higher owing to this sort of dynamic, then we'd argue it is another pretty strong reason for the RBNZ to keep the OCR lower for longer to reduce pressure on wholesale lending rates.

Finally, we suspect this will merely intensify pressure and competition for domestic based deposits, which will swing the economic baton further in favour of saving over spending. This is also another factor favouring wholesale rates and the OCR remaining lower for longer, and needing to rise less aggressively (eventually) relative to previous cycles.

The other major event of the week is the National Bank *Business Outlook* (NBBO) survey, which will be closely perused in light of green shoots euphoria. While the GDP data last week was historical, the NBBO survey is forward looking and provides a lot more information on how the economy is tracking. But one of the things we are noticing about the data at present is the tendency for it to move in strings. Overall, the tenor of data remains poor but signs of recovery from precipitous lows are being taken positively. Obviously a key question is whether such improvement can be sustained. We've noticed a startling correlation between the NBBO and key global lead indicators, particularly over the past five years. For example, the own activity measure from the NBBO and the US Philadelphia Fed survey has a correlation of 0.8 since 2003. It may seem spurious but not so if you consider the global forces shaping all. Hence, we'll be keeping a particularly close watch on the survey over coming months, not just from a local perspective, but in terms of potential information about global trends.

We'll also be paying close attention to the next monthly Fonterra on-line auction (Thursday morning). While it only represents a very small proportion of global trade flows, it appears to provide a reasonable gauge on how global dairy prices will fare over the coming month. The last auction showed prices falling in US dollar terms.

With dairy subsidies in place in Europe and in the US, we struggle to see too much of a recovery in global dairy prices in the near-term.



The final pieces of data are the ANZ Commodity Price Index for June, with much of the interest in how NZD prices are performing given the pressures emerging in farm incomes, and the Crown Accounts for the eleven months to May. While the fiscal accounts should have headed further into the red, they shouldn't be too far away from the *Budget* expectations. Tax revenue will be important as it is one of the timeliest indicators of actual activity within the economy, albeit being volatile and susceptible to timing issues.

Internationally this week, it is labour market data that is a clear theme. Employment data is due for release in Japan, Europe and the US. All are expected to show a further weakening in labour markets. In Australia, the main releases will be retail sales, building approvals and the trade balance for May. The ECB are also due to announce an interest rate decision, although the policy rate is expected to be kept at 1.0 percent.

Recent local data...

- > **International Travel and Migration (May):** A net 2,690 people permanently migrated to NZ in the month – the highest number since July 2003. It takes three month annualised flow to 26,400.
- > **Credit Card Spending (May):** Total spending fell by 0.4 percent in the month.
- > **Westpac McDermott-Miller Consumer Confidence (Q2):** The index rose by 10 points to 106.0 indicating that optimists once again outnumber pessimists.
- > **Balance of Payments (Q1):** The annual current account deficit improved from 9.0 percent in Q4 to 8.5 percent.
- > **GDP (Q1):** Production GDP contracted by 1.0 percent in the quarter. This took year on year growth to -2.7 percent.

FORECAST SNAPSHOT

The NZ economy continues to face an elongated adjustment process. Technically we have the economy rebounding in late 2009 from extended weakness, but this will mask regional and sectoral disparities. A respective cyclical and Rugby World Cup induced upswing dominates from mid 2010 and over 2011. But the big picture points to an extended period of relatively weaker growth over a number of years as the economy rebalances. We see a lower NZD as forming a critical part of the rebalancing process.

Economic Outlook

The New Zealand economy is rebalancing.

New Zealand's growth model has been domestic centric for the past two decades. This has been reflected in rapid debt accumulation, running persistently large current account deficits, negative savings and excess consumption as households benefited from the positive wealth effect of surging house prices. The economy is now transitioning towards a more balanced model where greater importance is assigned to earnings, exports and savings.

This rebalancing theme weighs heavily within our economic assessment and curtails the economy's ability to grow strongly on average over the forecast period and follow the normal pattern of strong upturns following recessionary periods.

In terms of our key forecast views:

- > We expect the economy to continue contracting until the September quarter, before moving along the bottom of a bathtub (with waves) over the subsequent few months.
- > We expect huge regional and sectoral disparities over the coming year, with the upper north and domestic economy stabilising, but tradable and heartland NZ relatively weaker.
- > While we see signs of domestic stabilisation and recovery, we must not confuse the change with the level. It will take some time before the level of activity returns to previous highs across the domestic economy.
- > We still have a very pro-cyclical upswing forecast from mid 2010 as pent-up demand, policy stimulus and the Rugby World Cup come to the fore. These dynamics need to be respected and we envisage five percent plus growth in 2011. But this upturn is historically short in duration and needs to be read within the context of the deepest economic adjustment since the 1970's. We expect the economy's transition (including resource

allocation) to extend beyond our forecast horizon.

- > The unemployment rate is expected to continue rising, nearing 8 percent.

The global scene

Aggressive action by policymakers has removed systemic risks across the financial system. While encouraging, we struggle to see a historical "V" shaped recovery taking hold, as de-leveraging across the household sector and purging of global imbalances lean against massive policy stimulus.

We still see a lot of tension within the global economy. First-up we need to acknowledge the overwhelming economic stimulus in place. It's unprecedented, and traditionally there would be no debate about a "V" shaped recovery. In fact, we are already seeing some signs of this as inventories are rebuilt as conditions stabilise. Yet at the other extreme we need to remember that stepping aside from financial sector improvement (a necessary but not sufficient condition for recovery) it is household balance sheets in most need of repair in key Anglo-Saxon nations. "Credit" healing has quickly seen markets shift to inflation risks with upwards pressure on global interest (mortgage) rates. At the same time, the global economy is still contracting and pressure on households is intensifying as unemployment rise. Financially vulnerable spots such as Eastern Europe remain, and higher unemployment and falling asset prices are placing additional pressure on the financial system. That means credit availability – the credit channel of monetary policy – will remain restrictive and heavily lean against traditional policy stimulus.

Healing around the globe will only take place via one dynamic, and it's called the passage of time.

Government

Fiscal policy is supporting the economy for now, but is set to move gradually towards a restrictive stance. We expect sustained large deficits and sizeable bond tender programs over the coming years, with the improvement likely to be a slow grind given the economic backdrop.

Currency

We continue to envisage a weaker NZD as forming a critical part of the rebalancing process for the economy. With the NZD/USD somewhat constrained by USD sentiment, a larger part of the adjustment may be borne by the NZD/AUD.

Interest rates

We expect the OCR to remain on hold until late 2010 and policy normalisation to take place over 2011. Long term bond yields are expected to remain biased higher on rising bond issuance.

KEY ECONOMIC FORECASTS

Calendar years	2006	2007	2008	2009(f)	2010(f)	2011(f)	2012(f)
NZ Economy (annual average % change)							
Real GDP	2.0	3.2	0.2	-2.6	1.5	4.6	2.1
Employment	2.4	1.9	0.6	-1.6	-1.0	2.1	2.1
Unemployment Rate (Dec qtr)	3.8	3.5	4.7	7.0	7.8	7.2	6.6
Terms of Trade	-3.0	5.9	2.4	-5.8	-2.8	2.9	1.9
Global Growth (annual average % change)							
United States	2.8	2.0	1.1	-2.8	1.2	2.6	2.9
Australia	2.8	4.0	2.3	-0.3	0.7	3.1	2.9
Japan	2.0	2.3	-0.7	-6.6	1.3	1.5	1.6
China	10.7	11.7	9.1	6.5	8.1	9.6	10.1
Trading Partner Growth	3.7	4.0	1.9	-2.3	1.8	3.3	3.6
NZ Inflation (annual % change)							
CPI Inflation	2.6	3.2	3.4	1.8	2.6	2.4	2.1
Non-tradable Inflation	3.8	3.5	4.3	1.6	2.3	2.8	2.9
Tradable Inflation	1.2	2.8	2.3	1.8	2.9	1.8	1.1
NZ Financial Markets (end of December quarter)							
TWI	68.0	71.6	55.1	54.9	57.0	60.8	64.5
NZD/USD	0.69	0.77	0.56	0.55	0.56	0.61	0.65
NZD/AUD	0.88	0.88	0.83	0.75	0.74	0.76	0.84
Official Cash Rate	7.3	8.3	5.0	2.5	3.0	5.5	5.8
90-day bank bill rate	7.7	8.9	5.2	2.8	3.6	6.0	6.1
10-year bond rate	5.8	6.4	4.9	5.6	6.3	6.7	6.5
Fiscal and External Balance							
Current Account Balance (\$m)	-14,200	-14,300	-16,000	-8,900	-9,400	-10,500	-11,700
as % of GDP	-8.7	-8.2	-8.9	-5.0	-5.2	-5.4	-5.8
Government OBEGAL (\$m)*	7,100	5,900	5,600	-2,900	7,900	-8,500	-8,100
as % of GDP	4.5	3.5	3.1	-1.6	4.5	-4.5	-4.1

* June years, Operating Balance Excluding Gains and Loss

GLOBAL DATA WATCH

Global data was mixed last week. While it looks as though the US housing market is stabilising, data last week showed this was at a slower pace than expected. On the other hand, US durable goods spending surged higher. Interestingly, the Euro-zone services PMI fell from last month's level and Japanese trade data was weak, showing that green shoots remain vulnerable.

Country/ Area	Indicator	Market	Actual	Last	Outturn vs market
Australia	Conference Board Leading Index (Apr_	-	0.7%	0.6%	-
US	Existing Home Sales (May)	4.82M	4.77M	4.66M	Weaker
	House Price Index (Apr) – mom	-0.4%	-0.1%	-1.4%	Stronger
	Durable Goods Orders (May) – mom	-0.9%	1.8%	1.8%	Stronger
	New Home Sales (May)	360K	342K	344K	Weaker
	FOMC Rate Announcement	0.25%	0.25%	0.25%	In-line
	GDP Annualised (1Q F)	-5.7%	-5.5%	-5.7%	Stronger
	Continuing Jobless Claims (w/e Jun-14)	6714K	6738K	6709K	In-line
	Personal Income (May)	0.3%	1.4%	0.7%	Stronger
	Personal Spending (May)	0.3%	0.3%	0.0%	In-line
	PCE Core (May) – mom	0.1%	0.1%	0.3%	In-line
	University of Michigan Confidence (Jun F)	69.0	70.8	69.0	Stronger
Euro-zone	PMI Manufacturing (Jun A)	42.1	42.4	40.7	In-line
	PMI Services (Jun A)	45.6	44.5	44.8	Weaker
	Industrial New Orders (Apr) – mom	0.0%	-1.0%	-0.2%	Weaker
UK	Rightmove House Prices (Jun) – mom	-	-0.4%	2.4%	-
Japan	Tertiary Industry Index (Apr) – mom	2.3%	2.2%	-2.8%	In-line
	Merchandise Trade Exports (May) – yoy	-39.3%	-40.9%	-39.1%	Weaker
	Merchandise Trade Imports (May) – yoy	-41.1%	-42.4%	-35.8%	Weaker
	National CPI (May) – yoy	-1.0%	-1.1%	-0.1%	In-line
	All Industry Activity Index (Apr) – mom	2.1%	2.6%	-1.8%	Stronger
Asia Ex-Japan					
<i>China</i>	Industrial Profits YTD (May) - yoy	-	-22.9%	-37.3%	-
<i>Singapore</i>	CPI (May) – yoy	-0.9%	-0.3%	-0.7%	Stronger
	Industrial Production (May) – mom	-3.0%	-1.6%	25.9%	Stronger
<i>South Korea</i>	Consumer Confidence (Jun)	-	106.0	105.0	-
	Current Account (May) – US\$	-	3633.1M	4247.4M	-
<i>Hong Kong</i>	CPI – Composite Index (May) – yoy	0.3%	0.0%	0.6%	Weaker
	Current Account (1Q)	-	\$40.83B	\$80.25B	-
	Exports (May) – yoy	-19.9%	-14.5%	-18.2%	Stronger
	Imports (May) – yoy	-18.3%	-19.2%	-17.0%	Weaker
<i>Taiwan</i>	Unemployment Rate (May)	5.8%	5.8%	5.8%	In-line
	Export Orders (May) – yoy	-19.3%	-20.1%	-20.9%	Weaker
	Industrial Production (May) – yoy	-19.0%	-18.3%	-20.0%	Stronger
	Benchmark Interest Rate	1.25%	1.25%	1.25%	In-line
<i>Philippines</i>	Total Imports (Apr) – yoy	-	-37.4%	-36.2%	-
<i>Vietnam</i>	CPI (Jun) – yoy	-	3.9%	5.6%	-
	Exports YTD (Jun) – yoy	-	-10.1%	-6.8%	-
	Imports YTD (Jun) – yoy	-	-34.1%	-37.0%	-
	Industrial Output YTD (Jun) – yoy	-	4.8%	4.0%	-

INTEREST RATE STRATEGY

With Q1 GDP now out of the way, focus turns to how Q2 fared and how close we are to the end of the recession. We expect more signs of stabilisation to appear in the data, but a sustained rebound to still be some way off. Rates look to be stuck in ranges with the 2-year swap yield to trade within a 3.5 to 4 percent range.

Market themes...

- > FOMC delivers a largely similar message, with no changes seen to their rates view or their QE programme.
- > Large US note auctions went well last week, despite initial nervousness.
- > Headline inflation virtually non-existent in the US, but investors continue to harbour future inflation fears.
- > NZ Q1 GDP shows economy in a deeper hole than first thought.

Review and outlook

Swap yields fell across the curve last week, but most of the decline was driven by offshore moves rather than by the local dataflow. Indeed, NZ rates underperformed the US market, which rallied as much as 30bps last week compared to the 3-14bp rally in the NZ curve. The NZ Q1 GDP release was weaker than market expectations. Yet, the rally on the back of the release was subdued considering the reasonably large miss of -1.0 percent actual versus expectations of -0.7 percent. The post GDP rally even ran into paying interest later in the day, an indication that the market is already long and unwilling to commit further to long positions.

With Q1 likely marking the low point in the economic cycle and signs of stabilisation in the dataflow expected to emerge, there is a limit to how much further rates can rally, despite the RBNZ's lower for longer mantra. But profit taking and a lack of receiving interest could easily see yields move higher, particularly if there is a selloff offshore. As such, we see NZ rates in range-bound mode, with the 2-year swap yield to trade within a 3.5 to 4.0 percent range. The OIS market may have pushed out the timing of the next hike by a month, but the aggressive tightening profile inherent in the bank bill futures pricing is still at odds with the RBNZ's stance. We continue to look for the market to converge more towards to the RBNZ view. But this will take time.

In the week ahead, the National Bank *Business Outlook* is the key domestic focus but it will be offshore developments that will drive the NZ rates market. Chicago PMI, ISM and non-farm payroll

releases out of the US will give rates and bond markets plenty to chew on.

Borrowing strategies we favour at present

Our favoured strategy remains unchanged, which is to stay floating. With hikes, in our view, being prematurely priced into the curve, you will be paying a premium to fix at current levels. Of course, the risk is that all the "green shoots" being talked about start to blossom, and the RBNZ is indeed forced to normalise policy quicker and faster than envisaged, causing yields to rise further. Though this is not our core view, and the weak Q1 GDP number certainly reinforces the lower for longer message on rates, those who fear such an outcome could consider gradually extending duration now to lock in still relatively low rates.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ / OCR	↔	On hold with easing bias. Hikes still a long way off.
NZ data	↔/↑	Q1 GDP marks the low point. Data should show mild pick-up from here.
Fed Funds/ front end	↔	Market might look for early hikes but Fed firmly on hold for extended period.
RBA	↔	Easing bias but no urgency to move.
US 10 year	↔	Looks to be trading a 3.5% to 4% range.
NZ swap curve	↔/↑	Flow and positioning suggest mild steepening in the near-term.
Flow	↔/↓	Uridashi issuance should see some much needed receiving interest.
Technicals	↔	2-year swap looks to be range trading for now.

Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 30-Jul-09	-5	-6
Thu 10-Sep-09	-6	-6
Thu 29-Oct-09	-9	-6
Thu 10-Dec-09	+5	+1
Thu 21-Jan-10	+12	+5
Thu 11-Mar-10	+24	+17
Thu 29 Apr-10	+27	+24

Trading themes we favour at present

Weak Q1 GDP reinforces the RBNZ's lower for longer view. Market pricing is yet to fully grasp this but we believe they will eventually. We continue to see value in going long outright in the March and June bank bill futures, and look for the 2s10s curve to flatten towards 200bps.

CURRENCY STRATEGY

The NZD remained resilient last week despite a weak Q1 GDP release. This was in part a result of the USD weakening after the Fed left their Quantitative Easing programme unchanged. NBNZ *Business Outlook* is the big local focus but NZD direction will be driven by broader USD moves, with US ISM and non-farm payrolls key.

Market themes...

- > The USD on the backfoot again post FOMC and PBOC comments regarding alternative reserve currency.
- > Risk aversion measures continue to fall.
- > A big week on the data front in the US – green shoots still rising?

Review and outlook...

A worse than expected NZ Q1 GDP release failed to dent the NZD late last week. The NZD's resilience was largely a result of the USD being on the back foot following the FOMC announcement that saw no change in the Quantitative Easing programme. Further comments from the PBOC regarding the need "to create an international reserve currency that's delinked from sovereign nations" did an already weak USD no favours. In this environment, it was difficult for the NZD to gain any downside momentum.

Risk aversion measures remain subdued with the VIX index trading below 26, at levels not seen since August 2008. Currency volatility itself has also trended lower in recent weeks. This has led to a pick up in risk appetite as demonstrated by CFTC FX Speculative Positioning Data that shows net longs in the NZD have sharply increased to levels not seen since early 2008. Equity markets themselves had a nervous week but managed to remain in narrow ranges. It would seem that only several days of large falls would unseat the recent improved risk appetite.

With a lot of focus being placed on the Uridashi maturity profile in coming months, early signs are that investors still have an appetite to chase relatively higher yields in NZ. Last week saw the announcement of a NZD 400 million Eurokiwi with a 2 year maturity. It is worth noting that this issuance did also see receiving in the NZ rates market pushing yields lower – at the margin a potential drag on the NZD.

The NZD's uptrend remains intact and with stop losses building around the 0.6500 and 0.6600 level from those who went short after last week's GDP - the topside is vulnerable. This is exacerbated by the fact that it would appear that the USD seems

likely to remain weak. Support is now seen around the 0.6260 level where the daily uptrend comes in.

The NZDAUD came under pressure late last week and a 'double top' is now in place at 0.8080. We continue to favour this cross lower, with short term targets at 0.7920. Bigger picture targets remain centred around the 0.7500 level.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↔	Within the range.
Yield	↓	Yield advantage Australia.
Commodities	↔/↑	Dairy prices stabilising, CRB on the back foot last week.
Partial indicators	↔/↓	NZ Q1 worse, same for Q2.
Technicals	↔/↓	Double top in place at 0.8080.
Sentiment	↔/↓	AUD well liked.
Other	↔	Watch the issuance space.
On balance	↓	Negatives here but not the focus.

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↔/↓	Above long term average.
Fair value – short-term	↔	At our cyclical fair value range at present.
Yield	↔	Look to be range trading for now.
Commodities	↔	Signs of stabilisation.
Risk aversion	↔/↑	Mild improvement based on VIX and currency vol.
Partial indicators	↓	US data should show further signs of improvement over July.
Technicals	↔	Daily uptrend remains in place. 0.66 the level to watch.
AUD	↔/↑	AUD remains in favour.
Sentiment	↔/↑	Fed not contemplating exit strategies yet.
Other	↓	NZ leading indicators in focus over next few weeks.
On balance	↔	USD weakness theme still the predominant driver.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
29-Jun	NZ	Trade Balance (May)	250.0M	276.0M	10:45
		Imports (May)	3.42B	3.37B	10:45
		Exports (May)	3.70B	3.65B	10:45
		Building Permits (May) – mom	-	11.2%	10:45
		Money Supply M3 (May) – yoy	-	6.9%	15:00
	JN	Industrial Production (May P) – mom	7.0%	5.9%	11:50
		Retail Trade (May) – mom	0.0%	0.7%	11:50
		Vehicle Production (May) – yoy	-	-47.1%	16:00
	UK	Net Consumer Credit (May)	0.3B	0.3B	20:30
		Mortgage Approvals (May)	46K	43K	20:30
		M4 Money Supply (May F) – mom	-	0.2%	20:30
	EC	Business Climate Indicator (Jun)	-3.00	-3.17	21:00
		Economic Confidence (Jun)	71.0	69.3	21:00
30-Jun	US	Chicago Fed Nat Activity Index (May)	-	-2.06	00:30
		Dallas Fed Manufacturing Activity (Jun)	-17.5%	-21.5%	02:30
	UK	GfK Consumer Confidence Survey (Jun)	-25	-27	11:01
		GDP (1Q F) – qoq	-2.1%	-1.9%	20:30
		Current Account (1Q)	-6.7B	-7.6B	20:30
	JN	Nomura/JMMA Manufacturing PMI (Jun)	-	46.6	11:15
		Jobless Rate (May)	5.2%	5.0%	11:30
		Household Spending (May) – yoy	-1.5%	-1.3%	11:30
		Housing Starts (May) – yoy	-27.8%	-32.4%	17:00
		Construction Orders (May) – yoy	-	-25.9%	17:00
	AU	HIA New Home Sales (May) – yoy	-	0.5%	13:00
		Private Sector Credit (May) – yoy	0.2%	0.1%	13:30
	NZ	NBNZ Business Confidence (Jun)	-	1.9	15:00
	GE	Unemployment Change (000's) (Jun)	45K	1K	19:55
		Unemployment Rate (Jun)	8.3%	8.2%	19:55
	EC	M3 (May) – yoy	4.6%	4.9%	20:00
		CPI Estimate (Jun) – yoy	-0.2%	0.0%	21:00
1-Jul	US	S&P/CS Composite-20 (Apr) – yoy	-18.8%	-18.7%	01:00
		Chicago Purchasing Manager (Jun)	39.0	34.9	01:45
		Consumer Confidence (Jun)	55.2	54.9	02:00
		Fed's Bullard Speaks on Fed Exit Strategies in Philadelphia	-	-	04:00
		Fed's Hoenig Speaks at New York University	-	-	08:10
		Fed's Yellen Speaks to Commonwealth Club in San Francisco	-	-	13:00
	AU	AiG Performance of Manufacturing Index (Jun)	-	37.5	11:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
1-Jul cont.	AU	Retail Sales (May) – mom	0.5%	0.3%	13:30
		Building Approvals (May) – mom	3.0%	5.1%	13:30
		RBA Commodity Index SDR (Jun) – yoy	-	-23.3%	17:30
	JN	Tankan Large Manufacturers Index (2Q)	-43	-58	11:50
		Tankan Large Mfg Outlook (2Q)	-34	-51	11:50
		Tankan Non-Manufacturing (2Q)	-27	-31	11:50
		Tankan Non-Mfg Outlook (2Q)	-23	-30	11:50
		Vehicle Sales (Jun) – yoy	-	-19.4%	17:00
	GE	PMI Manufacturing (Jun F)	40.5	40.5	19:55
	EC	PMI Manufacturing (Jun F)	42.4	42.4	20:00
	UK	PMI Manufacturing (Jun)	46.4	45.4	20:30
2-Jul	US	ADP Employment Change (Jun)	-390K	-532K	00:15
		ISM Manufacturing (Jun)	44.5	42.8	02:00
		ISM Prices Paid (Jun)	47.0	43.5	02:00
		Construction Spending (May)	-0.6%	0.8%	02:00
		Pending Home Sales (May) – mom	0.5%	6.7%	02:00
		Fed's Evans Speaks on Credit Crunch, Policy Actions in London	-	-	03:15
	NZ	Fonterra to Announce Outcome of Monthly Milk Powder Auction	-	-	08:00
		ANZ Commodity Price (Jun)	-	2.7%	15:00
	AU	Trade Balance (May)	-125M	-91M	13:30
	UK	PMI Construction (Jun)	46.0	45.9	20:30
	EC	Unemployment Rate (May)	9.4%	9.2%	21:00
		PPI (May) – mom	0.1%	-1.0%	21:00
		ECB Announces Interest Rates	1.00%	1.0%	23:45
3-Jul	US	Change in Non-Farm Payrolls (Jun)	-350K	-345K	00:30
		Unemployment Rate (Jun)	9.6%	9.4%	00:30
		Average Hourly Earnings (Jun) – mom	0.1%	0.1%	00:30
		Initial Jobless Claims (w/e Jun-28)	615K	627K	00:30
		Continuing Claims (Jun-21)	6740K	6738K	00:30
		Factory Orders (May)	0.8%	0.7%	02:00
	EC	Trichet Speaks at ECB Monthly News Conference	-	-	00:30
		PMI Services (Jun F)	44.5	44.5	20:00
		Retail Sales (MoM)	-0.1%	0.2%	21:00
	NZ	Financial Statements of Government as at May 31	-	-	10:00
	AU	AiG Performance of Service Index (Jun)	-	39.9	11:30
	GE	PMI Services (Jun F)	44.3	44.3	19:55
	UK	PMI Services (Jun)	51.5	51.7	20:30

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: With March quarter numbers now out of the way, the focus again shifts to forward looking indicators. This week's NBNZ *Business Outlook* will be important, as will the NZIER's Q2 QSBO in a fortnight's time.

Date	Data/Event	Economic Signal	Comment
Mon 29 Jun (10.45)	Overseas Merchandise Trade (May)	Rebalancing continues	The trade balance typically records a surplus in May. However, we are expecting this to be larger than normal given a further capitulation in imports.
Mon 29 Jun (10.45)	Building Consents Issued (May)	The bounce	A further pick-up is expected considering the near record low levels and a natural response to an improvement in housing market activity.
Mon 29 Jun (15.00)	Credit Growth (May)	De-leveraging continues	Household credit growth will remain subdued. However, top on the watch list is now business and rural lending growth, which are also showing signs of substantial slowdown.
Tue 30 Jun (15.00)	NBNZ <i>Business Outlook</i> (Jun)	-	-
Thu 2 Jul (15.00)	ANZ Commodity Price Index (Jun)	-	-
Fri 3 Jul (10.00)	Financial Statements of Government for the Eleven months to May	In the red	The accounts are likely to have headed further into the red. However, they should compare reasonably closely with the <i>Budget</i> numbers.
Tue 7 Jul (10.00)	NZIER Quarterly Survey of Business Opinion (Jun qtr)	An improvement in sentiment?	The survey is likely to mirror the latest National Bank <i>Business Outlook</i> and show an improvement in sentiment. However, gauges will remain consistent with an economy that continues to contract.
circa 10 Jul	REINZ House Sales (Jun)	A winter turn?	We are on the lookout for signs of waning momentum as we head into winter. Higher longer-term mortgage rates and a weak labour market remain key headwinds.
Mon 13 Jul (10.45)	Retail Trade Survey (May)	Forming a base	Some evidence is emerging of a base beginning to form in retailing. Higher petrol prices will inflate the headline number.
Thu 16 Jul (10.45)	CPI (Jun qtr)	Not a focus	Annual inflation is expected to ease to below 2 percent. The significant spare capacity now present in the domestic economy should weigh on non-tradable inflation.
Tue 21 Jul (10.45)	International Travel and Migration (Jun)	Solid support	Net migration inflows are expected to remain solid as fewer New Zealanders choose to leave. Visitor arrivals should remain weak.
On Balance		Base forming?	With Q1 data out of the way, attention now turns to how Q2 fared and on signs of green shoots. We expect any recovery to be subdued as we move along the bottom of the bath tub.

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	0.5	0.5	0.3	0.7	0.8
CPI (% yoy)	4.0	5.1	3.4	3.0	1.9	0.8	1.8	1.8	1.9	2.3
Employment (% qoq)	1.2	0.2	0.6	-1.1	-1.0	-0.9	-0.4	-0.2	0.0	0.2
Employment (% yoy)	0.8	1.1	0.9	0.8	-1.3	-2.4	-3.4	-2.5	-1.5	-0.4
Unemployment Rate (% sa)	4.0	4.3	4.7	5.0	5.6	6.4	7.0	7.5	7.7	7.9
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

	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09
Retail Sales (% mom)	0.4	-1.3	0.0	-0.5	-1.2	0.2	-0.2	0.5
Retail Sales (% yoy)	2.2	0.7	-4.1	-0.9	-3.7	-6.9	-1.9	-1.7
Credit Card Billings (% mom)	1.4	-1.8	-0.8	-2.2	1.6	0.8	-2.8	2.4	-0.4	..
Credit Card Billings (% yoy)	2.5	0.9	-0.9	-3.8	-2.4	-1.9	-4.8	-1.6	-2.4	..
Car Registrations (% mom)	11.6	-1.4	-20.3	14.0	-14.4	-15.2	7.3	-2.4	-3.2	..
Car Registrations (% yoy)	-15.6	-19.9	-34.4	-23.7	-36.5	-44.6	-32.9	-41.0	-33.3	..
Building Consents (% mom)	8.4	-20.0	3.9	-6.8	-12.8	12.4	-0.9	11.9	3.5	..
Building Consents (% yoy)	-28.2	-43.2	-39.6	-41.5	-51.4	-39.9	-34.3	-56.5	-22.9	..
REINZ House Price (% yoy)	-6.1	-4.3	-4.1	-4.8	-4.4	-2.2	-4.0	-1.4	-2.2	..
Household Lending Growth (% mom)	0.2	0.1	-0.1	0.2	0.2	0.2	0.1	0.2
Household Lending Growth (% yoy)	6.6	5.8	4.8	4.2	3.8	3.1	2.8	2.6
Roy Morgan Consumer Confidence	108.6	99.7	99.0	102.9	103.7	98.8	94.7	101.1	104.9	105.3
NBNZ Business Confidence	1.6	-42.3	-43.0	-35.0	..	-41.2	-39.3	-14.5	1.9	..
NBNZ Own Activity Outlook	16.7	-11.4	-14.1	-21.5	..	-20.1	-21.2	-3.8	3.8	..
Trade Balance (\$m)	-1252	-994	-594	-341	-102	483	439	319	858	..
Trade Balance (\$m annual)	-5048	-5269	-5234	-5614	-5405	-5165	-4683	-4072	-3044	..
ANZ World Commodity Price Index (% mom)	-5.1	-7.6	-7.4	-7.4	-4.3	-4.6	1.0	2.6	2.7	..
ANZ World Commodity Price Index (% yoy)	-2.1	-11.1	-18.3	-24.3	-26.5	-30.7	-31.4	-29.4	-28.1	..
Net Migration (sa)	10	80	-240	350	840	1630	1740	2170	2690	..
Net Migration (annual)	4403	4329	3569	3814	4538	6160	7482	9176	11202	..

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

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Apr-09	May-09	29-Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
NZD/USD	0.572	0.598	0.645	0.580	0.550	0.540	0.540	0.550	0.560	0.580
NZD/AUD	0.801	0.785	0.800	0.763	0.753	0.735	0.730	0.733	0.737	0.734
NZD/EUR	0.433	0.439	0.459	0.460	0.444	0.443	0.450	0.458	0.467	0.475
NZD/JPY	56.6	57.8	61.4	56.8	52.3	52.4	54.0	56.7	58.8	62.1
NZD/GBP	0.389	0.389	0.391	0.367	0.355	0.355	0.360	0.372	0.378	0.387
NZ\$ TWI	57.0	57.9	60.8	57.4	54.9	54.3	54.8	56.0	57.0	58.4
NZ interest rates	Apr-09	May-09	29-Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
OCR	3.24	2.76	2.50	2.50	2.50	2.50	2.50	2.50	3.00	4.00
90 day bill	3.12	2.82	2.81	2.80	2.80	2.80	2.80	2.80	3.60	4.50
10 year bond	5.24	5.74	6.05	5.80	5.60	5.70	5.70	6.10	6.30	6.40
International	Apr-09	May-09	29-Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
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	1.02	0.66	0.60	0.70	0.50	0.70	0.80	1.25	1.50	2.00
AU cash	3.00	3.00	3.00	3.00	2.50	2.50	2.50	2.50	2.75	3.25
AU 3-mth	3.08	3.19	3.24	2.90	2.80	2.80	2.80	3.00	3.30	4.40

KEY RATES

	26 May	22 Jun	23 Jun	24 Jun	25 Jun	26 Jun
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.80	2.81	2.82	2.82	2.82	2.81
NZGB 07/09	2.69	2.65	2.65	2.65	2.65	2.58
NZGB 11/11	3.69	3.90	3.85	3.86	3.93	3.88
NZGB 04/13	4.60	4.90	4.85	4.86	4.92	4.87
NZGB 12/17	5.76	6.06	6.00	6.00	6.07	6.02
2 year swap	3.56	3.90	3.85	3.86	3.86	3.84
5 year swap	5.01	5.40	5.33	5.38	5.38	5.38
RBNZ TWI	58.9	60.4	59.7	60.5	60.7	60.8
NZD/USD	0.6184	0.6384	0.6278	0.6412	0.6415	0.6443
NZD/AUD	0.7942	0.7969	0.8010	0.8053	0.8016	0.7991
NZD/JPY	58.57	61.25	59.80	61.26	61.70	61.80
NZD/GBP	0.3892	0.3872	0.3846	0.3892	0.3899	0.3921
NZD/EUR	0.4425	0.4591	0.4529	0.4549	0.4592	0.4588
AUD/USD	0.7786	0.8011	0.7838	0.7962	0.8003	0.8063
EUR/USD	1.3974	1.3906	1.3861	1.4095	1.3969	1.4043
USD/JPY	94.71	95.95	95.26	95.54	96.18	95.92
GBP/USD	1.5890	1.6486	1.6324	1.6476	1.6453	1.6434
Oil	60.51	69.60	67.09	68.81	68.14	69.70
Gold	954.35	933.50	917.60	925.25	936.25	941.85
Electricity (Haywards)	2.01	6.80	7.07	7.33	7.60	7.86
Milk futures (US\$/contract)	85	85	85	85	85	85
Baltic Dry Freight Index	2942	4029	3874	3751	3703	3703

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.
- 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.

Securities about which investment advice is given

The Bank provides investment advice on the following types of securities:

- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

If you wish to pay investment money to the Bank you can do this in several ways such as by:

- Providing cash;
- 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.

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