

NOT TIME TO BE DILLY DALLYING

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- > Eyes turn to the RBNZ this week to see if they will follow their offshore counterparts with an aggressive rate cut. The global backdrop – which is shifting to the second leg, namely the impact on real economies – argues for an aggressive policy move and more to come. Inflation data this week, while elevated, is likely to be overlooked as it is now yesterday's news.

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- > There is no doubt that we will see considerable “structural change” in the future as the demand aspects to the financial crisis are worked through. While still early days, these are likely to include consolidation, regulation, structural shifts in valuations and potential growth, and a further evolution for monetary policy going forward.

Page 5: RBNZ OCR preview

- > We expect the RBNZ to cut the OCR by an unprecedented 100bps to 6.50 percent. We expect the nuances to largely mirror those made by the RBA two weeks ago. Looking forward, we continue to envisage the OCR ultimately ending up below 5 percent.

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- > The US data last week was unequivocally weak. Recession is now generally expected for the second half of this year. Data across Europe and UK also remains subdued, while it was quiet on the data front across Asia.

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- > Market focus returns to economics briefly this week, with Q3 CPI and RBNZ OCR Review. Still, we expect offshore developments to remain the more dominant driver of sentiment for the time being. Confidence remains fickle and tied to equity market performance. We expect this to remain the case until markets calm down, and that could be months away.

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- > Some consolidation in the NZD expected with global markets stabilising somewhat. But a large expected easing from the RBNZ this week will keep any upside probes contained. Focus in currency markets returning towards the real economy, and in this respect, the NZD will continue to underperform especially against the AUD.

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ECONOMIC OVERVIEW

Eyes turn to the RBNZ this week to see if they will follow their offshore counterparts with an aggressive rate cut. The global backdrop – which is shifting to the second leg, namely the impact on real economies – argues for an aggressive policy move and more to come. Inflation data this week, while elevated, is likely to be overlooked as it is now yesterday's news.

What's ahead?

- > **Q3 Consumer Price Index** (Tuesday 1045 NZDT). We expect headline inflation to rise by 1.3 percent, taking annual growth to 4.9 percent. The outlook is improving rapidly given falling commodity prices and weak growth.
- > **September Credit Card Billings** (Tuesday 1500 NZDT). We are expecting another subdued month, particularly with lower petrol prices contributing to lower spending values. The interest-bearing component of outstanding balances is likely to have risen again.
- > **September External Migration** (Wednesday 1045 NZDT). Further stabilisation around the 5,000 annual total is expected. We will be watching tourism inflows closely.
- > **RBNZ OCR Review** (Thursday 0900 NZDT). The global backdrop is the major focus and we expect a 100bp cut in the OCR. Refer to our full preview note on page 5.

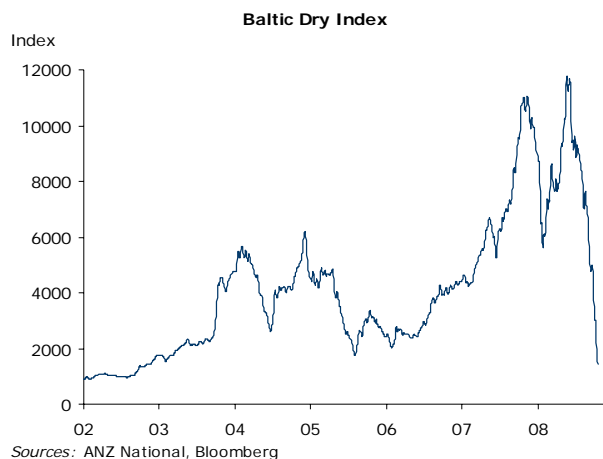
What's the view?

It is difficult to focus on anything other than the global backdrop at present. Last week saw more remarkable moves across markets. After starting the week on a stronger footing following further significant policy measures which included deposit guarantees, partial nationalisations, liquidity injections and rhetoric from policymakers, sentiment turned again later in the week. But it wasn't due to more dire news on financial stability or credit dysfunction, rather we now appear to be entering the second leg – the impact on the real economies and concern over the global growth outlook. This is something we have been forewarning and is a dynamic we expect to linger for some time.

Looking across some financial market indicators, you could argue that the recent policy initiatives are doing what they intended, loosening the gridlock in credit markets, although it remains very early days. Inter-bank interest rates are slowly grinding lower, credit spreads are also narrowing, and the Australian iTraxx index is off its peak. This is all welcome news. But despite these developments, equities generally remain entrenched in a

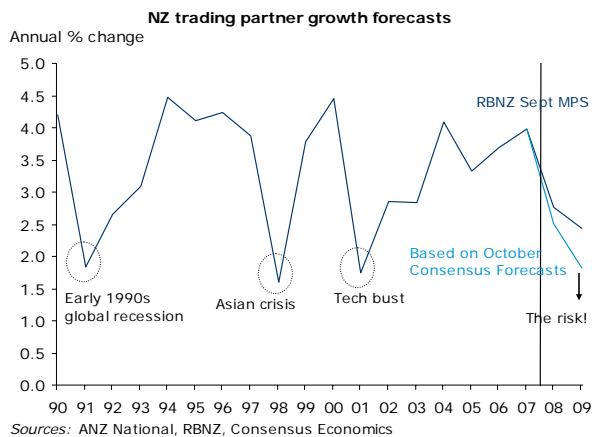
downward, albeit volatile, trend. The improvement seen in credit and inter-bank markets to date is off panic driven extremes in the first place, and still needs to improve a long way. Commodities are under significant downward pressure, with oil prices at a 12 month low, and currencies (apart from the USD and JPY) are falling. Bounces have and will ultimately continue to occur. But it is hard to get overly optimistic about the economic outlook at present.

Global data last week was a case in point. The US economy is now generally expected to enter a recession over the second half of this year. It is somewhat ironic that the US real economy has held up better than many to date considering the troubles really started within its shores. To sum up the US data last week, only one word is needed – awful. Retail sales have now fallen for the third consecutive month and are down 1.0 percent on a year ago. Consumer confidence experienced its steepest ever monthly decline in October. The Philadelphia Fed survey came in well below expectations, and industrial production contracted at its sharpest rate in 34 years, falling by 2.8 percent in September. Although the weakness in the latter can be explained almost entirely by Hurricane Ike disruptions and the Boeing strike, it will have a negative impact on what was already looking like a very soft Q3 GDP number (due for release at the end of the month).



But it is not just the US where data was weak. The UK unemployment rate for the three months to August has risen to its highest level since 2000. The latest October *Consensus Forecasts* showed a downward revision to most of our major trading partner's GDP growth, especially for 2009. Based on this latest set, NZ's trading partner growth is set to slow from 4 percent in 2007 to 2.5 percent for 2008, and towards 1.8 percent for 2009. As we mentioned in last week's *Market Focus*, the outcome for the global economy is now binary: the dreaded "R" or something worse. But the fact policymakers have been so active in trying to stabilise markets does leave us in no doubt it will

be the former. Nevertheless, at 1.8 percent for trading partner growth in 2009, this is about the same trough as the early 1990s global recession, the Asian crisis or the tech bust. Considering we are in the midst of a once in 80 year credit event, and consensus tends to lag the cycle, we're in no doubt trading partner growth will be worse than what we experienced during the past three episodes of weakness.



Given this, we still feel comfortable calling an "L" shaped cycle for NZ. In fact, at present we see more downside risk than up. Consider this. The consensus at present is for NZ GDP growth of 0.6 percent in calendar 2008 and 1.3 percent in 2009. Now, as economists it sometimes pays to do the old common sense test on your numbers, and this sort of outturn doesn't sit right with us. Why, when facing a major global event in late 2008, will prospects for 2009 be better than 2008? For now we're calling 0.7 percent growth this year (the train having left the station) and 0.5 percent next year. But the latter is starting to feel decidedly optimistic.

Looking to this week, the RBNZ takes centre stage. We expect the RBNZ to cut the OCR by 100bps on Thursday (refer page 5). The RBA and the coordinated action from some of the major central banks sets the scene for the RBNZ, and we expect them to follow suit. In fact, markets began to toy with the idea late last week that the Bank could go greater than 100bps. In the current environment, you cannot rule anything out. The growth outlook is extremely weak, and inflation now looks set to return to within the policy band by the first half of next year. My how the game has changed!

If we were going to throw something controversial into the mix, it would be that the RBNZ might cut by more than 100 basis points. It sounds outrageous for sure, and the risk is that it is interpreted as a panic move. Yes, we know one of the pillars of the Policy Targets Agreement is to not create unnecessary volatility in rates and the currency et al. But these are also exceptional times. If the RBNZ had delivered a 50 basis point move inter-meeting (which with the benefit of

hindsight given recent global events probably should have happened, although we'll not quibble either way), would there be any debate that the move at the end of the month would be at least 50 basis points? If you need monetary policy to be at "neutral", why dilly-dally around.

The other major data this week is the September quarter CPI. While headline inflation is expected to rise to its highest rate since 1990, it has the potential to be totally overlooked as the inflation story is now well-and-truly yesterday's news. At close to 5 percent, this will also be the peak in this cycle. The data is historical and the medium-term outlook for inflation is improving rapidly. A structural aspect remains within the inflation dynamic including government charges, level versus the change in commodity prices, pressure to recoup lost margins etc. But a rapidly deteriorating global backdrop and weakening domestic picture (notably demand for labour) dominates. Though we expect some wariness towards various structural issues to remain, the stark reality is that financial stability and the flow-on effect from falling asset prices and global ructions should now dominate the RBNZ's reaction function.

The other thing to watch domestically is the growing chorus for some sort of fiscal policy response to global developments. The Australian government has announced a large stimulus package that is estimated to add around 1.0ppt to Q4 GDP growth. While there is less fiscal headroom for the NZ government to do something of similar magnitude, we are watching this space.

Internationally this week, it is hard to imagine anything but more volatility and uncertainty. Data gained a greater focus last week, and the same is possible this week. The major releases are the initial reading on UK September quarter GDP. Following a flat result in Q2, markets now expect a 0.2 percent contraction. The other events of interest will be a host of Chinese data (including GDP, CPI and industrial production), Australian CPI data and RBA minutes from their meeting in early October. The former, like NZ's, will highlight a high headline rate, but again will probably be overlooked as historical, as it is not the major focus for central banks currently. The RBA minutes are likely to, in fact, highlight this point.

Recent local data...

Retail Sales (August): Headline sales rose by 0.4 percent, while core sales were up 0.8 percent.

BNZ-Business NZ Manufacturing PMI

(September): The index rose from 45.7 to 47.0, but remained below the key 50 level.

THE NEXT WAVE?

There is no doubt that we will see considerable “structural change” in the future as the demand aspects to the financial crisis are worked through. While still early days, these are likely to include consolidation, regulation, structural shifts in valuations and potential growth, and a further evolution for monetary policy going forward.

Stepping beyond the global financial crisis, what are the next waves or themes we need to be mindful of once we get past it? Out of major events, we always tend to see various structural shifts, which are invariably influential for decades going forward. The early identification of such themes can be equally, if not more, important in thinking about valuations, opportunities and the like going forward. This is particularly as demand aspects to the financial crisis fade. We offer some preliminary observations below.

1. Consolidation. Going forward it is all about getting scale, whether that is forced or voluntary. Indeed we are already seeing numerous shot-gun weddings. Large entities are likely to exert market dominance. Smaller entities with limited financial flexibility will find it more difficult to weather the storm, and some consolidation is inevitable. For NZ, which suffers from a lack of scale in a global market, this is likely to be a positive outcome.

2. Asset valuations. The market will find a new “value” for assets over the coming year as we go through an aggressive price discovery process. Stability is coming, but it will remain fragile. Buyers and sellers are finally meeting, but it is still a buyers’ market. Beyond that process we need to think about “new” dynamics. Critical here is the risk free rate, which has risen as a consequence of recent Government guarantees around the globe. This thereby lowers the incentive to put cash to work in real and productive assets. In many ways it’s a classic prisoner’s dilemma, and the by-product will be a suboptimal solution for valuations.¹

3. Regulation. A new regulatory wind is blowing and will be needed to meet the challenges ahead. The recently announced changes in the US are (and should be) the first step in any regulatory response. More regulation is a given, and tighter compliance standards and greater regulatory intervention powers are surely coming. Expect this trend to continue across Europe as well. It is also likely that greater cooperative regulatory structures across geographic boundaries will be part of the evolution.

¹ The “prisoner’s dilemma” can be applied to situations where entities can gain a higher payoff from cooperating. However, in practice, they find it extremely difficult (though not impossible) to coordinate their activities and the resulting outcome is a Pareto-suboptimal solution.

4. From demand to supply. Look beyond the demand aspects of the current credit dislocation and start thinking about the impact on the supply side of the global economy. Scale and consolidation is positive. Regulation, nationalisation, potential protectionism, a higher risk free rate etc. are not. There is a cost to be borne on the real side of the economy from diminished flexibility and imposing a higher certainty premium.

5. Once weak, now strong. Sectors with non-cyclical revenues and those which have already experienced a recent crisis of confidence about their ability to allocate capital to productive enterprises have been actively de-leveraging. These are likely to outperform in a relative sense.

6. Inflation. Inflation rates around the globe are receding with commodity prices falling rapidly and demand waning. Such forces are substantial cyclical forces influencing the outlook for inflation. But consider the following structural aspects:

- > Scale, which brings pricing leverage.
- > Regulation, which brings additional costs.
- > A lower potential growth rate for the global economy; and
- > Policymakers “inflating” away the nominal value of household debt. Remember, it is household balance sheets that enter this cycle in need of repair.

This does not mean we’re set for the inflationary genie to be let out of the bottle. But certainly we’d be more inclined towards slightly higher average inflation outcomes when thinking a decade out. It’s another force taking us back towards a normal and positively shaped yield curve.

7. Monetary policy in a brave new world.

History has seen massive changes in monetary policy. Post WW1, central banks focused on public objectives. Post WW2 we had the swing to fiscal policy and interest rate pegs. Then we had the US-Treasury Reserve Accord of 1951. Inflation in the 1970’s brought in policies based on credible monetary policies. In between it all we’ve had pegs, no targeting, money supply targeting, inflation targeting, nominal income targeting and MCI targeting (by some). The next wave? Asset prices to be included in mandates, which may well manifest via central banks targeting some weighted average of the CPI, producer prices, the GDP deflator and asset prices themselves.

At this stage, it’s fair to say that the list above is far from exclusive, and will no doubt be evolving. But it is these sorts of themes, and the structural changes in the global economy that will emerge from current dislocation, that we now need to start getting our heads around.

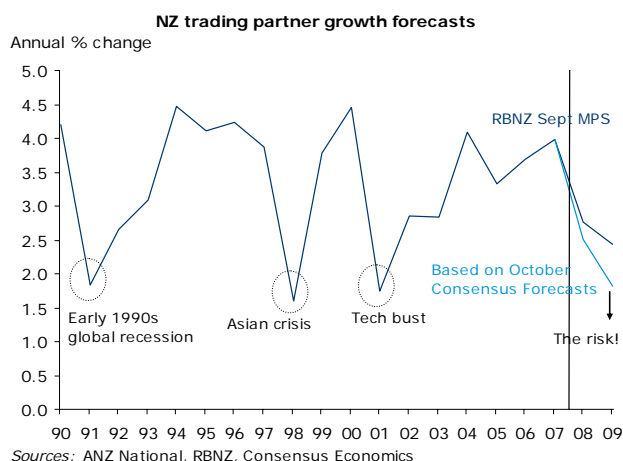
OFFICIAL CASH RATE PREVIEW

(due 9.00am 23 October)

We expect the RBNZ to cut the OCR by an unprecedented 100bps to 6.50 percent. We expect the nuances to largely mirror those made by the RBA two weeks ago. Looking forward, we continue to envisage the OCR ultimately ending up below 5 percent.

Developments have evolved rapidly since the surprise 50bp rate cut at the September Monetary Policy Statement (MPS). Probably the most significant development was the 100bps cut by the RBA. In so far as signals are concerned, that was a huge one, as both nations run sizeable current account deficits, with fortunes heavily dependent on the global economy. Beyond the RBA, the NZ domestic dataflow continues to print weak, with the Quarterly Survey of Business Opinion pointing to a three, or possibly four, quarter recession. And this is prior to feeling the flow-on impact of global developments.

Global developments will obviously be influential. Financial markets have taken a turn for the worse, with inter-bank rates elevated and credit dislocation extending. Governments and policymakers have been forced to act quickly, with bailouts, equity injections, liquidity measures, blanket guarantees of deposits and wholesale borrowing, as well as coordinated interest rate cuts. Even if the measures taken to date globally succeed in stabilising confidence and the financial system, the real economy impact is yet to be fully felt.



A global recession next year is now our central scenario. Consensus forecasts for NZ's trading partner growth are now materially below what was assumed at the September MPS. Consistent with prior recessions, we will no doubt see further downward revisions to those growth forecasts as the normal lags pan out. Casting our eyes back to the last such recession (1998), the 90-day rate fell 500bps in six months!

Weaker global growth is, in turn, seeing downward pressure on commodity prices, although we need to acknowledge that while the rate of change is fast, the level of commodity prices still remain high by historical standards. But clearly the combination of a poor global backdrop, weak domestic economy, and collapsing commodity prices has hugely changed the medium-term outlook for inflation. This gives the RBNZ considerable scope to aggressively front-load the easing cycle, particularly given the restrictive starting position.

The bottom line is that exceptional times call for exceptional responses, in this case an unprecedented 100bp rate cut. Such a move will still leave the OCR slightly above neutral. This is particularly the case when credit conditions remain tight, asset prices are falling and inflation pressures are easing. **The market is similarly expecting a 100bp move,** and at the time of writing was starting to err towards the potential for an even larger move, although commentator expectations are split between a 75 and 100bps move.

In terms of the communication itself, we expect it to be similar in nuances to the RBA's last statement. Expect some focus on wholesale funding costs, tighter credit conditions, and the downside risks to global growth. And in a similar vein to the RBA, the RBNZ will want to avoid letting the market get too carried away in terms of aggressively pricing in future rate cuts. While the door to further moves will be left open, the size will likely be downplayed somewhat.

Looking forward, global developments will continue to dominate. Inflation concerns are receding fast and we'd argue is of secondary importance for now. Although Q3 inflation is expected to peak near 5 percent, this data is largely historical. A stagnant economy will see domestic inflation pressures ease. And the sharp falls in commodity prices to date have been enough to offset any inflationary impact from a falling currency. In this respect, the medium-term inflation outlook has greatly improved compared to the RBNZ's September projections. In fact, if commodity prices continue to weaken, inflation may end up returning to the mid-point of the target band much sooner than expected.

Financial market implications

The market is already fully priced for a 100bp easing, and has another 50bp priced in for December. For our part, we will be on the lookout for any mention of whether the expected overall decline in interest rates has altered. But the reality is that once the OCR decision is over, the interest rates and currency markets will be dictated to by offshore developments once again.

GLOBAL WATCH

We present a table of global data outturns over the past week given the significance of the international backdrop at present. The US data last week was unequivocally weak. Recession is now generally expected for the second half of this year. Data across Europe and UK also remains subdued, while it was quiet on the data front across Asia.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	PPI (Sep) – mom	-0.4%	-0.4%	-0.9%	In-line
	Advance Retail Sales (Sep)	-0.7%	-1.2%	-0.4%	Weaker
	Empire Manufacturing (Oct)	-10.0	-24.6	-7.4	Weaker
	Business Inventories (Aug)	0.5%	0.3%	1.1%	Weaker
	CPI (Sep) – mom	0.1%	0.0%	-0.1%	In-line
	Industrial Production (Sep)	-0.8%	-2.8%	-1.0%	Weaker
	Philadelphia Fed (Oct)	-10.0	-37.5	3.8	Weaker
	NAHB Housing Market Index (Oct)	17	14	17	Weaker
	Housing Starts (Sep)	872K	817K	872K	Weaker
	University of Michigan Confidence (Oct P)	65.0	57.5	70.3	Weaker
Europe	ZEW Survey (Economic Sentiment) (Oct)	-57.5	-62.7	-40.9	Weaker
	Industrial Production (Aug) – mom	1.2%	1.1%	-0.2%	In-line
	CPI (Sep) – mom	0.1%	0.2%	-0.1%	In-line
UK	CPI (Sep) – mom	0.4%	0.5%	0.6%	In-line
	DCLG House Prices (Aug) – yoy	-1.1%	-3.4%	-0.3%	Weaker
	Jobless Claims Change (Sep)	36.0K	31.8K	35.7K	Stronger
Asia Ex-Japan					
<i>China</i>	Exports (Sep) – yoy	20.0%	21.5%	21.1%	Stronger
	Imports (Sep) – yoy	22.9%	21.3%	23.1%	Weaker
<i>South Korea</i>	Export Price Index (Sep) – mom	-	4.6%	-1.4%	-
	Import Price Index (Sep) – mom	-	2.3%	-4.4%	-
	Unemployment Rate (Sep)	-	3.1%	3.2%	-
<i>India</i>	Cash Reserve Ratio	-	6.50%	7.50%	-
<i>Indonesia</i>	Money Supply – M2 (Aug) – yoy	-	12.6%	14.0%	-
<i>Thailand</i>	Customs Exports (Sep) – yoy	-	19.4%	14.9%	-
	Customs Imports (Sep) – yoy	-	39.4%	26.9%	-
<i>Singapore</i>	Retail Sales (Aug) – mom	-0.4%	0.9%	-0.3%	Stronger
	Non-Oil Domestic Exports (Sep) – mom	2.0%	-0.8%	1.9%	Weaker
<i>Malaysia</i>	Manufacturing Sale Value (Aug) – yoy	-	15.1%	16.2%	-
Japan	Domestic CGPI (Sep) – mom	-0.6%	-0.4%	-0.1%	Stronger
	Consumer Confidence (Sep)	29.9	31.8	30.5	Stronger
	Industrial Production (Aug F) – mom	-	-3.5%	-3.5%	-
	Tertiary Industry Index (Aug) – mom	-0.9%	-1.4%	1.2%	Weaker
Australia	NAB Business Confidence (Sep)	-	-8	-7	-
	NAB Business Conditions (Sep)	-	-1	-3	-
	Westpac Leading Index (Aug) – mom	-	-0.1%	0.1%	-
	Import Price Index (3Q) – qoq	-	5.0%	1.4%	-
	Export Price Index (3Q) – qoq	-	13.8%	13.5%	-

INTEREST RATE STRATEGY

Market focus returns to economics briefly this week, with Q3 CPI and RBNZ OCR Review. Still, we expect offshore developments to remain the more dominant driver of sentiment for the time being. Confidence remains fickle and tied to equity market performance. We expect this to remain the case until markets calm down, and that could be months away.

Market themes...

- > Market pricing has now fully embraced a 100bp rate cut this week. Behind the scenes some appear to be calling for a 150bp cut.
- > Liquidity pressures are starting to ease globally and in New Zealand, paving the way for swap rates to move lower, and the curve to steepen.
- > At this early stage of the easing cycle there is considerable scope for interest rates to fall further, especially at the short end.

Review and outlook...

A lack of domestic data saw NZ markets trade in step with global markets, which were buffeted by ill winds blowing in from the financial crisis, and felt most obviously by equity markets. The major impact here has been a front-loading of rate cut expectations. As the table (below right) shows, the extent of cuts hasn't intensified, but the expected pace of cuts has. This seems reasonable – even with a government guarantee on retail deposits, faltering confidence and growing uncertainty can be devastating, and demands a more significant response from monetary policy.

Easing liquidity pressures have seen LIBOR and BKBM fall substantially over the past week, taking pressure off the short end of the swap curve. This significantly reduced the incentive for borrowers to hedge, reduces the negative carry on short end received positions, and paves the way for a substantial steepening in the yield curve. Judging by past cycles, and considering the starting point of the OCR and the potential magnitude of easings ahead, we expect the yield curve to steepen considerably over the next 18 months. However what is likely to be different this time is the extent to which the outright interest rates may fall (i.e. it's shaping up to be a "bull steepener"). With the exception of the 2001 easing cycle, past RBNZ easing cycles have tended to be either short or out of cycle with the global easing cycle. This time it is not – almost every monetary authority is cutting rates, and individuals and firms are de-leveraging. This "perfect storm" should see interest rates fall rapidly, and stay low for some time.

Borrowing strategies we favour at present

Consider trimming the duration of longer hedges. Some forward starting swaps (e.g. 5yr/5yr) have actually risen, providing good opportunities to trim duration into the rally. Otherwise the familiar theme of keeping portfolios flexible and keeping duration short remains appropriate. While swap rates are much more attractive than they were just one month ago, 3mth BKBM has fallen even more rapidly, removing some of the incentive to fix. If at all possible, consider the "doing nothing" strategy. Interest rates are falling fast, and the risk is they fall much faster than anyone expects.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ	↓	100bp cut likely this week, with more to come.
NZ data	↔	Not the focus. No data last week, Q3 CPI important.
Fed Funds/ front end	↔/↓	Fed likely to cut rates and stay on hold for a long time. Liquidity pressures easing.
RBA	↔/↑	The market is probably ahead of the RBA now.
US 10 year	↔/↓	Bounce higher in US long end yields unsustainable.
NZ swap curve	↓	Steepening to continue, perhaps aggressively.
Flow	↔	Steepteners may encounter profit takers.
Technicals	↔	Extreme volatility. Offshore events remain dominant.

Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 23-Oct-08	-93	-107
Thu 4-Dec-08	-146	-155
Thu 22-Jan-09	-168	-196
Thu 5-Mar-09	-214	-215
Thu 23-Apr-09	-217	-223
Thu 4-Jun-09	-226	-225
Thu 30-Jul-09	-243	-230

Trading themes we favour at present

At this stage of the cycle it is extremely difficult to argue against yield curve steepeners, so it's a case of picking entry levels. Given our expectations of a more aggressive easing cycle than what's priced in, we'd use any retracement to get involved. From an outright perspective, we think the mid/long end of the curve has the best potential – it won't move as far as the short end, but it carries a higher duration. There's also scope for a more extended cycle to be priced in, and that's more of a mid curve story given what's already priced into the short end.

CURRENCY STRATEGY

Some consolidation in the NZD expected with global markets stabilising somewhat. But a large expected easing from the RBNZ this week will keep any upside probes contained. Focus in currency markets returning towards the real economy, and in this respect, the NZD will continue to underperform especially against the AUD.

Market themes...

- > Libor rates drifting lower, helping ease credit concerns somewhat.
- > Global disjoint: inter-bank rates improving (marginally) but Baltic dry collapses – reinforces real and financial economy divide.
- > Focus starting to return towards economic data, which was poor out of the US.
- > Sentiment still fragile, sparking bouts of risk aversion related moves.

Review and outlook...

Currency markets remain volatile, though less so compared to the previous week. Ranges remain wide, with big figure moves during trading sessions common. Nonetheless, there appears to be some early signs that the government interventions to date are starting to get the credit wheels turning. Libor rates are starting to drift lower, and while still elevated, are at least moving in the right direction. Strictly speaking we think there is more volatility to come, but within a generally improving trend.

The currency market is at a crossroads of the interaction between the financial and real economy. For the past few weeks, the key driver has been purely the former. But focus is now starting to shift towards the impact on the latter. This was no more apparent than last week when inter-bank lending rates started to free up but the Baltic dry index continued to collapse. We think the currency market's focus between the financial and real aspects are broadly matched for now.

The focus for the NZD this week returns to domestic developments. Tuesday's Q3 CPI is unlikely to provide much excitement, as the market will treat this as old news. However, we can expect an asymmetric reaction, with a strong or in line print being largely ignored, but a softer result being interpreted as giving the RBNZ more room to front load the easing cycle.

The market is fully priced for a 100bp cut by the RBNZ so it's hard to envisage a material reaction. However, the reality is that even with such a move, there is still more work to do, and in a structural sense the NZD will remain heavy. The main risk of a squeeze at present stems from the AUD, with the

interest rate market now starting to rethink aggressive rate cuts following signs banks are passing on moves to borrowers, and an aggressive fiscal package.

Technically the NZD/AUD cross has put in a lower top at 0.9170 over last week. We expect any top side probes to be confined to the 0.9050 level this week with any break below the 0.8700-0.8750 support zone to produce an accelerated move lower, with 0.8500 seen quickly on the way to 0.8250. The NZD/USD continues to consolidate in a tightening range with breaks of 0.6210 leading to 0.6350 at a minimum, or a break of 0.6080 leading to another test of 0.5940.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Should be lower based on fundamentals.
Yield	↔/↓	RBNZ set for 100bp move this week.
Commodities	↔	Falling across the board.
Partial indicators	↓	NZ indicators still worse.
Technicals	↔	Topside at 0.9050 to hold.
Sentiment	↔/↓	Risk aversion easing but still high.
Other	↔	Baltic dry still collapsing.
On balance	↓	Should be lower but subject to global scene.

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↔	Fair value 0.65 given a structural shift in commodity prices.
Fair value – short-term	↔	Near cyclical fair value and long term average levels.
Yield	↔	RBNZ cuts fully priced. Tone of statement key.
Commodities	↓	Milk futures prices still falling.
Risk aversion	↔	Easing but still elevated.
Partial indicators	↔/↓	Still showing weakness.
Technicals	↔/↓	0.6210 resistance, 0.6080 support.
AUD	↔/↑	Could be set for a corrective move?
Sentiment	↔/↓	Still fickle and fragile.
Other	↓	Focus returning on economic data.
On balance	↔/↓	Near-term short squeeze but overall direction still lower.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
20-Oct	NZ	Performance of Services Index (Sep)	-	-	12:00
	UK	Rightmove House Prices (Oct) – mom	-	-1.0%	12:01
		Public Finances (PSNCR) (Sep)	10.0B	5.1B	21:30
		Public Sector Net Borrowing (Sep)	6.8B	10.4B	21:30
		M4 Money Supply (Sep P) – mom	0.9%	1.40%	21:30
	AU	Preliminary BoP Imports (Sep) – mom	-	-3.0%	13:30
		Producer Price Index (3Q) – qoq	-	-	13:30
	JN	Leading Index CI (Aug F)	-	89.3	18:00
		Coincident Index CI (Aug F)	-	100.7	18:00
	GE	Producer Prices (Sep) – mom	-0.4%	-0.6%	19:00
21-Oct	EU	ECB's Tumpel-Gugerell Speaks in Prague	-	-	01:00
	US	Leading Indicators (Sep)	-0.1%	-0.5%	03:00
		Atlanta Fed's Lockhart To Speak on US Economic Outlook	-	-	05:45
		Fed's Stern Speaks in Escanaba, Michigan	-	-	17:00
	NZ	Food Prices (Sep) – mom	-	2.7%	10:45
		Consumer Prices (3Q) – qoq	1.5%	1.6%	10:45
		Consumer Prices (3Q) – yoy	5.1%	4.0%	10:45
		Credit Card Spending (Sep) – yoy	-	2.5%	15:00
	AU	New Motor Vehicle Sales (Sep) – mom	-	-3.5%	13:30
		RBA Minutes from October Meeting	-	-	13:30
		RBA Governor Stevens Speaks in Sydney	-	-	14:30
22-Oct	NZ	Visitor Arrivals (Sep) – mom	-	-0.5%	10:45
	JN	All Industry Activity Index (Aug) – mom	-1.7%	0.8%	12:50
	AU	Consumer Prices (3Q) – qoq	1.0%	1.5%	13:30
		Consumer Prices (3Q) – yoy	4.8%	4.5%	13:30
		RBA Trimmed Mean (3Q) – qoq	-	1.2%	13:30
		RBA Trimmed Mean (3Q) – yoy	-	4.3%	13:30
		RBA Weighted Median (3Q) – qoq	-	1.0%	13:30
		RBA Weighted Median (3Q) – yoy	-	4.5%	13:30
	UK	BoE Minutes of Interest Rate Decision	-	-	21:30
23-Oct	NZ	RBNZ Official Cash Rate Decision	6.50%	7.50%	09:00
	JN	Merchandise Trade Balance Total (Sep)	¥600.0B	-¥324.0B	12:50
	AU	CBAHIA House Affordability (3Q)	-	105.3	13:30
	EU	ECB Current Account SA (Aug)	-	-1.7B	21:00
		Industrial New Orders (Aug) – mom	0.5%	1.0%	22:00
	UK	Retail Sales (Sep) – mom	-0.7%	1.2%	21:30
24-Oct	US	Initial Jobless Claims (w/e Oct-19)	465k	461k	01:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
24-Oct cont.	US	Continuing Claims (w/e Oct-12)	3,695k	3,711k	01:30
		House Price Index (Aug) – mom	-0.5%	-0.6%	03:00
	GE	PMI Manufacturing (Oct A)	46.0	47.4	20:30
		PMI Services (Oct A)	48.8	50.2	20:30
	EU	PMI Manufacturing (Oct A)	44.0	45	21:00
		PMI Services (Oct A)	47.0	48.4	21:00
		PMI Composite (Oct A)	45.4	46.9	21:00
		ECB's Gonzalez-Paramo Speaks in Madrid	-	-	23:45
	UK	GDP (3Q A) – qoq	-0.2%	0.0%	21:30
		GDP (3Q A) – yoy	0.5%	1.5%	21:30
25-Oct	US	Existing Home Sales (Sep)	4.95M	4.91M	03:00
		Existing Home Sales (Sep) - mom	0.8%	-2.2%	03:00

Key: AU: Australia, EU: 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 domestic economy continues to take a backseat to offshore financial market developments at present. It is these developments that are expected to result in the RBNZ cutting the OCR aggressively this week. Data-wise, September quarter CPI is unlikely to provide much positive inflation news just yet, while the HLFS at the start of next month will confirm the labour market is turning sharply.

Date	Data/Event	Economic Signal	Comment
Tue 21 Oct (10.45)	Consumers Price Index (Q3)	Elevated	We expect another strong increase for the quarter with the headline rate increasing by 1.3 percent. This takes annual inflation to 4.9 percent. Key will be measures of core inflation and whether housing-related components are weakening.
Tue 21 Oct (15.00)	Credit Card Billings (Sep)	Subdued	We are expecting another subdued month, particularly with lower petrol prices contributing to lower spending values. The interest-bearing component of outstanding balances is likely to have risen again.
Wed 22 Oct (10.45)	External Migration (Sep)	Stabilising, but watch tourism.	An annual base of around 5,000 appears to have formed. Visitor arrivals are now the key component to watch given the weakening global growth backdrop.
Thu 23 Oct (09.00)	RBNZ <i>OCR Review</i>	100bp cut	Given offshore developments in financial markets and the aggressive cut by the RBA, we expect the RBNZ to deliver a cut of similar magnitude. Recent evidence has shown capacity pressure and the labour market easing giving them more confidence to front-load the easing cycle.
Wed 29 Oct (10.45)	Overseas Merchandise Trade (Sep)	Deficit	Another large monthly deficit is expected. However, the annual deficit should continue to narrow. We will be watching for further slowing in imports.
Thu 30 Oct (10.45)	Building Consents (Sep)	Weak	A bounce is likely following another large fall last month, but the level will remain extremely low.
Thu 30 Oct (15.00)	NBNZ <i>Business Outlook</i> (Oct)	-	-
Thu 30 Oct (15.00)	Credit Growth (Sep)	Soft	Housing credit growth will remain subdued and lending to businesses is also expected to continue slowing.
Mon 3 Nov (10.45)	LCI and QES (Q3)	Still strong	Wage growth will remain strong, but this is a typical late cycle dynamic. Recent evidence of easing labour shortages suggests wage growth is close to peaking, if it hasn't already.
Tue 4 Nov (15.00)	ANZ Commodity Price Index (Oct)	-	-
Thu 6 Nov (10.45)	Household Labour Force Survey (Q3)	Very weak	After the surprise surge in employment last quarter, we expect a reverse. The unemployment rate should continue to trend higher.
circa 11 Nov	REINZ House Sales (Oct)	Still weak	Housing market activity is expected to remain subdued. House prices should remain under downward pressure.
Tue 11 Nov (10.45)	Producer Price Indices (Q3)	Close to peak	Further reasonable increases for input and output prices are expected. However, with oil prices now falling and wholesale electricity prices also well off their peaks, the top is near.
Thu 13 Nov (10.45)	Retail Trade Survey (Sep)	Soft	ECT and credit card data will shed some light, but with petrol prices falling, we expect headline sales to remain under pressure.
On Balance		Key issue now is the flow-on from the global scene.	Still a lot of imbalances to work through.

SUMMARY OF KEY ECONOMIC FORECASTS

	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
GDP (% qoq)	0.9	-0.3	-0.2	-0.5	0.5	0.2	-0.1	0.2	0.6	0.7
GDP (% yoy)	3.7	2.2	1.1	-0.1	-0.5	0.0	0.1	0.8	0.9	1.4
CPI (% qoq)	1.2	0.7	1.6	1.3	0.8	0.9	0.9	0.7	0.8	0.7
CPI (% yoy)	3.2	3.4	4.0	4.9	4.5	4.8	4.1	3.4	3.4	3.2
Employment (% qoq)	0.9	-1.3	1.3	-0.6	-0.3	-0.2	0.1	0.1	0.1	0.2
Employment (% yoy)	2.5	-0.2	0.7	0.2	-0.9	0.2	-1.0	-0.3	0.0	0.4
Unemployment Rate (% sa)	3.4	3.7	3.9	4.2	4.7	5.0	5.2	5.5	5.7	5.8
Current Account (% GDP)	-8.2	-8.0	-8.4	-8.7	-9.2	-9.2	-8.4	-7.8	-7.4	-7.3
Terms of Trade (% qoq)	2.9	4.2	-0.5	-1.0	-1.5	-1.3	-0.9	-1.2	-1.0	-1.0
Terms of Trade (% yoy)	8.8	11.6	10.6	5.6	1.1	-4.3	-4.7	-4.8	-4.4	-4.0

KEY ECONOMIC INDICATORS

	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08
Retail Sales (% mom)	0.3	-0.7	-1.1	1.3	-1.2	0.9	-0.7	0.4	..	..
Retail Sales (% yoy)	6.3	7.7	-1.0	4.1	1.0	1.5	2.5	-0.9	..	..
Credit Card Billings (% mom)	8.0	8.9	11.8	4.0	11.1	11.0	9.0	3.7	..	..
Credit Card Billings (% yoy)	271.0	275.0	280.0	267.0	281.0	285.0	283.0	287.0	..	..
Car Registrations (% mom)	4.9	-4.5	-13.0	12.5	-14.3	1.3	-7.2	-3.6	10.9	..
Car Registrations (% yoy)	1.7	1.9	-13.2	-1.0	-20.6	-15.9	-27.1	-30.5	-15.6	..
Building Consents (% mom)	3.6	-6.0	-14.5	82.0	-42.1	-13.3	-1.7	-7.9	..	..
Building Consents (% yoy)	-5.4	-17.6	-27.0	29.8	-27.1	-45.5	-34.7	-43.3	..	..
REINZ House Price (% yoy)	4.0	0.7	1.6	-1.1	-1.4	-2.2	-1.4	-5.7	-6.1	..
Household Lending Growth (% mom)	0.7	0.9	0.4	0.4	0.4	0.3	0.3	0.4	..	..
Household Lending Growth (% yoy)	11.9	11.6	10.8	9.9	9.3	8.4	7.7	7.2	..	..
Roy Morgan Consumer Confidence	121.2	116.0	111.7	99.9	89.2	86.5	83.9	91.4	108.6	102.3
NBNZ Business Confidence	..	-43.9	-57.9	-54.8	-49.7	-38.7	-43.2	-20.5	1.6	..
NBNZ Own Activity Outlook	..	2.4	-6.4	-3.8	-4.4	-4.0	-8.2	4.7	16.7	..
Trade Balance (\$m)	-311	243	-43	-293	-169	-215	-808	-750	..	..
Trade Balance (\$m annual)	-4793	-4422	-4526	-4604	-4782	-4479	-4479	-4282	..	..
ANZ World Commodity Price Index (% mom)	-1.4	1.1	2.0	-0.3	0.9	0.0	1.8	-3.3	-4.9	..
ANZ World Commodity Price Index (% yoy)	27.4	26.9	26.9	20.7	18.7	11.6	8.7	3.6	-1.9	..
Net Migration (sa)	120	280	550	500	960	460	810	440	..	..
Net Migration (annual)	4799	4643	4678	4666	4931	4732	5201	4938	..	..

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)						
	Aug-08	Sep-08	20-Oct-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
NZD/USD	0.710	0.677	0.609	0.620	0.640	0.610	0.580	0.560	0.550	0.550
NZD/AUD	0.803	0.822	0.882	0.849	0.889	0.897	0.906	0.933	0.887	0.859
NZD/EUR	0.474	0.470	0.454	0.456	0.478	0.466	0.453	0.452	0.466	0.458
NZD/JPY	77.7	72.1	61.9	63.2	64.6	63.4	62.6	61.6	61.6	63.3
NZD/GBP	0.375	0.375	0.352	0.352	0.370	0.355	0.341	0.335	0.331	0.333
NZ\$ TWI	65.5	63.9	60.4	60.5	62.9	61.3	59.7	59.1	58.6	58.2
NZ interest rates	Aug-08	Sep-08	20-Oct-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
OCR	8.00	7.68	7.50	6.00	5.50	5.00	4.75	4.75	4.75	4.75
90 day bill	8.19	7.97	7.06	6.50	5.80	5.30	5.20	5.10	5.00	5.00
10 year bond	6.13	5.83	5.96	5.40	5.10	5.20	5.30	5.30	5.50	5.60
International	Aug-08	Sep-08	20-Oct-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
US Fed funds	2.00	2.00	1.50	1.50	1.25	1.25	1.25	1.25	1.75	2.00
US 3-mth	2.81	4.05	4.42	2.50	2.00	1.80	1.65	1.75	2.10	2.30
AU cash	7.25	7.00	6.00	5.25	5.00	4.50	4.50	4.50	4.50	4.50
AU 3-mth	7.27	7.32	5.66	5.60	5.40	4.80	4.80	4.80	4.70	4.70

KEY RATES

	17 Sep	13 Oct	14 Oct	15 Oct	16 Oct	17 Oct
Official Cash Rate	7.50	7.50	7.50	7.50	7.50	7.50
90 day bank bill	7.72	7.53	7.35	7.30	7.15	7.14
NZGB 07/09	6.40	5.70	5.84	5.76	5.50	5.50
NZGB 11/11	5.68	5.65	5.87	5.78	5.60	5.60
NZGB 04/13	5.68	5.79	6.00	5.91	5.72	5.73
NZGB 12/17	5.77	5.99	6.14	6.05	5.89	5.90
2 year swap	6.89	6.47	6.49	6.43	6.34	6.34
5 year swap	6.80	6.58	6.58	6.52	6.46	6.46
RBNZ TWI	63.0	59.2	60.9	60.9	60.6	61.1
NZD/USD	0.6588	0.5935	0.6198	0.6174	0.6100	0.6177
NZD/AUD	0.8293	0.9002	0.8773	0.8894	0.9115	0.8893
NZD/JPY	69.79	58.69	63.48	62.57	61.13	62.77
NZD/GBP	0.3697	0.3487	0.3543	0.3544	0.3521	0.3566
NZD/EUR	0.4656	0.4372	0.4535	0.4550	0.4526	0.4588
AUD/USD	0.7944	0.6593	0.7065	0.6942	0.6692	0.6946
EUR/USD	1.4149	1.3574	1.3668	1.3570	1.3479	1.3464
USD/JPY	105.94	98.89	102.42	101.35	100.21	101.62
GBP/USD	1.7818	1.7018	1.7492	1.7422	1.7326	1.7324
Oil	91.49	77.44	81.17	78.69	74.38	69.81
Gold	780.60	866.75	847.80	846.20	842.35	807.95
Electricity (Haywards)	4.20	3.58	3.16	2.14	2.55	3.43
Milk futures (US\$/contract)	127	101	101	101	100	100
Baltic Dry Freight Index	4856	1976	1809	1615	1506	1438

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.
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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.

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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.

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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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