

## CONTESTABLE VS NON- CONTESTABLE

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### Page 2: Economic overview

- > We continue to look for the OCR to hit sub 5 percent given the global backdrop. This week's data is expected to mirror recent developments and paint a picture of continued weakness in the real economy.

### Page 4: Economic comment – monthly inflation gauge

- > Our monthly inflation gauge, while still experimental, has been providing a good read on the official non-tradable CPI data over the past two quarters. Given the continued focus on domestic inflation pressures by the RBNZ, we will be paying close attention to our gauge for an early indication of trends.

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- > Inflation remains a key concern for the RBNZ despite the deteriorating global picture. We believe inflation will moderate, and still expect the OCR to fall below 5 percent. Given our wariness over the global scene we expect swap rates to fall further across the curve.

### Page 7: Interest rate comment – borrower focus

- > Our long held view that borrowers keep the duration of hedges short has worked out well. Despite an aggressive easing by the RBNZ, we still believe this strategy remains appropriate. We expect the RBNZ to continue cutting rates (albeit not as aggressively as this week!), and for swap rates to keep falling.

### Page 10: Currency strategy

- > The RBNZ is out of the way, so the focus returns to offshore developments. With emerging markets now getting caught in the credit malaise, risk aversion will be the predominant theme in currency markets in the near term. While bounces in the NZD can be expected given the recent sharp moves lower, waning risk appetites will continue to see the NZD trade with a heavy bias.

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## ECONOMIC OVERVIEW

We continue to look for the OCR to hit sub 5 percent given the global backdrop. This week's data is expected to mirror recent developments and paint a picture of continued weakness in the real economy.

### What's ahead?

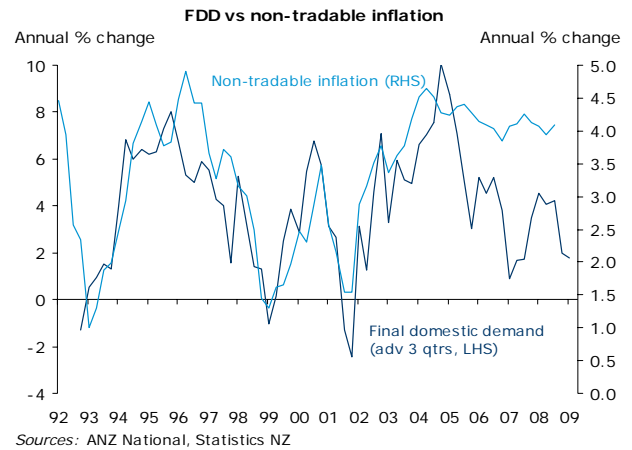
- > **September Overseas Merchandise Trade** (Wednesday 1045 NZDT). The month of September typically records trade deficits and we expect this month to be no exception, with a deficit of \$550 million. The annual deficit is expected to improve again though.
- > **September Building Consents** (Thursday 1045 NZDT). Given four consecutive monthly falls, a rebound is likely. However, the level of residential issuance is expected to remain extremely low.
- > **September Credit Growth** (Thursday 1500 NZDT). Housing credit growth will remain subdued and lending to businesses is also expected to continue slowing.
- > **October NBNZ Business Outlook** (Thursday 1500 NZDT).

### What's the view?

Another week for the history books. The main event was of course the RBNZ's OCR decision. Markets were priced for a 100bp cut, but news that a media conference was to be held after the announcement got the market talking about the prospect of an even larger move. With hindsight, a lot – including us – probably started to read too much into it, and the steady as she goes cut (by steady we mean meeting expectations) suggests clearly that the press conference itself was solely about raising the transparency of monetary policy. The RBNZ is already exemplary in this regard relative to peers, but obviously felt the need to have an even higher standard in the current environment, which is clearly exceptional by historical comparisons.

In terms of the communication from the Bank we saw little to alter our core view that rates will continue to move lower. We maintain our expectation of the OCR printing sub-5 percent. Perhaps the aspect to the Governor's assessment that has got a lot of people talking was the explicit references to pockets of non-tradable inflation, including residual pricing forces from the labour market, construction costs, local authority rates and electricity charges. Certainly the September quarter CPI figures showed a worrying undercurrent across non-tradable, trimmed mean, and weighted median inflation (or whatever core measures you like), although that was of course yesterday's news.

When it comes to the residual pricing forces, we're strongly of the view that they will correct (lower). The HLFS figures due in a couple of weeks will reinforce how quickly the labour market is turning. Easing (collapsing) commodity prices will no doubt remove some of the residual construction cost pressure, and see it track more in line with demand aspects.



However, it is the non-contestable pockets of inflationary pressure that are more troublesome. It's a simple equation. The more inflationary pressure from these aspects, the greater the inflationary (and hence growth) sacrifice required from contestable or cyclical pockets of the economy. Government charges rose by 2.7 percent in the September quarter – the largest quarterly increase since September 2003. We can't help but think that the RBNZ was really throwing the issue of continued expected inflationary pressure from such pockets as needing wider acknowledgement. Demand linked inflation will of course be judged by demand itself, but non-contestable inflation needs another judge, and that's where public opinion comes in.

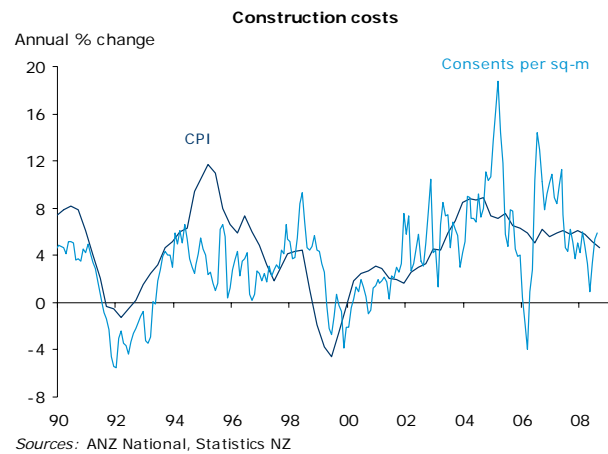
Ultimately though, domestic inflation concerns aside, it will still be global developments that will feature strongly on policy deliberations going forward. The savage sell-off in emerging markets at the end of the week (equities, bonds and currencies) mark a further spreading of the credit contagion beyond the developed economies. Fears of another default by Argentina, S&P downgrading Russia's rating outlook to negative, and some former Eastern bloc economies seeking financial aid from the IMF, will spark further volatility in financial markets. Foreign reserves are reportedly being run down as central banks try to support their beaten up currencies. One interesting aspect is that unlike the last Latin American debt crisis, the developed world has its own problems to deal with and cannot provide the usual lifeline.

While issues of financial stability for emerging markets will of course be important, the big focus (just like for their developed nation counterparts)

will be the impact on real economies. Given that the developed world is now effectively in recession, we doubt emerging market countries can remain immune. Remember, these economies were looked towards earlier this year as the shining light and the likely saviour of global growth over the next 2 years. Those lights have dimmed over recent weeks. In fact, signs are already surfacing that these economies are being affected. Chinese annual GDP growth has slowed to 9.0 percent. While this obviously is nothing to be ashamed about, it is the slowest rate since 2003. Japanese export data this week was well below expectations and given Asia's reliance on exports, this has raised concerns about growth in the region next year.

Looking at the local data this week, while none of it is first-tier data, there will be some interesting aspects we will be focusing on. The first, in the September trade data on Wednesday, is whether we begin to see the capitulation in imports we have been expecting for some time. While import growth has indeed slowed, it has not been anywhere near the extent one would have expected given the weakness in the domestic economy. This has resulted in a considerable build up in inventory levels. Lower oil prices, and also a pull back in oil volumes (given the reasonable surge last month) are also expected to contribute to lower imports in the month. Nevertheless, September typically records a trade deficit, and this month is likely to be no different. We expect a deficit of \$550 million.

The other domestic data is on Thursday, with September building consents, credit growth, and the October NBNZ *Business Outlook*. The former should show a rebound for residential consent issuance after four consecutive monthly falls. In seasonally adjusted terms, the level of issuance is at its lowest level since the mid-1980s. Considering the economy is now around 70 percent larger, issuance is probably more accurately described as being near record lows. It confirms that the construction sector is set to remain a considerable drag on economic prospects over the next 12 or so months. Of interest will be how commercial consent issuance is tracking. The past few months have shown signs that activity in this sector is also easing (which is not a major surprise given the drying up in mezzanine-related finance) and we suspect that it will be the next leg to show significant weakness. Finally we will also be watching the value of consents issued per square metre as another proxy for construction costs. To date, it has shown some stickiness (just like the CPI measure has). It is another pricing gauge that we will be monitoring closely, particularly given the RBNZ's signalling out of construction costs in their assessment.



The NBNZ business confidence survey will be the first survey received that should capture most of the recent (offshore) developments, enabling us to gauge whether the signs of stabilisation in earlier confidence measures will be sustained. It is also the first piece of information released relating to the December quarter.

Internationally, the US Federal Reserve interest rate decision will get plenty of attention, with markets expecting a 25bp cut. The Bank of Japan is also announcing a rate decision, but no change is expected from them. On the data front, a key release will be the advanced reading on US Q3 GDP, where a contraction is expected. Over in Europe, the German IFO business sentiment survey will also provide an important read on the Eurozone's largest economy.

### Recent local data...

#### Electronic Card Transactions (September):

Total retail ECT sales were flat in the month, while core sales fell by 0.4 percent.

#### Consumers Price Index (September quarter):

The quarterly CPI rose by 1.5 percent, taking annual inflation to 5.1 percent.

#### Food Price Index (September):

Food prices rose by 0.6 percent, taking annual growth to 10.8 percent.

#### Credit Card Billings (September):

Billings rose 1.1 percent following a 0.1 percent fall previously.

#### External Migration (September):

A net 10 people migrated in the month. Short-term visitor arrivals fell by 6.0 percent.

**RBNZ OCR Review:** The Governor cut the OCR by 100bps to 6.5 percent.

## MONTHLY INFLATION GAUGE

Our monthly inflation gauge, while still experimental, has been providing a good read on the official non-tradable CPI data over the past two quarters. Given the continued focus on domestic inflation pressures by the RBNZ, we will be paying close attention to our gauge for an early indication of trends.

One of our long standing bug-bears has been the lack of a monthly measure of inflation (the CPI). It is a major gap in NZ's statistical armoury. Having a monthly inflation read allows for a more timely assessment of inflation trends and where interest rates are likely to head. Unfortunately, there seems little appetite across policy circles for producing a monthly CPI series. So we have taken it upon ourselves to fill the void. This in itself is no small ask, particularly for a small team covering all and sundry.

Since early this year, we have been collecting price information on a regular basis (weekly, fortnightly and monthly) through the internet and via direct surveys of bank clients who have kindly volunteered. **For simplicity, we have limited ourselves to a domestic or non-tradable inflation measure.** It should be noted that our monthly inflation gauge will not exactly mirror the official one due to coverage and methodological issues. Our main priority is to come up with a gauge that is timely and able to provide an indication of domestic inflation trends. This will allow us to assess whether inflation pressures remain, or whether they are starting to ease. Our gauge, however, is designed to be as comparable as possible to the official Statistics NZ series.

Our monthly inflation gauge is very much a work in progress. As with any new series, it will be a while before we can confidently assess its value in giving an accurate lead on the official statistics.

Moreover, we need to make sure the series is reasonably stable and not inclined to give off the wall reads.

Thus far, the results from our inflation gauge have been very encouraging. It has been very close (to within 0.1 percentage points) to the actual official non-tradable CPI outturn over the June and September quarters. And on the face of it, the series has not been too unduly volatile (without good cause). Of course, one should not read too much into just two observations. But at least the gauge is off to a good start and has given us some confidence that our sampling and methodology are on the right track (despite not having the advantage of large samples). It is also providing us with some insights into where the domestic inflation pressures are coming from.

	Monthly Inflation Gauge (m/m%)	Implied Inflation Gauge (q/q%)	Actual non-tradable CPI (q/q%)
Mar-08	0.4		1.1
Apr-08	0.3		
May-08	0.3		
Jun-08	0.4	1.0	0.9
Jul-08	1.0		
Aug-08	0.2		
Sep-08	0.2	1.4	1.3

When we look at our monthly inflation gauge over the last three months, which rose by 1.4 percent in the quarter, very close to the official 1.3 percent increase in the non-tradable CPI, we see that the bulk of the rise occurred in the month of July (up 1.0 percent). Increases in local authority rates accounted for a large part of that, as did other increases in government related charges and higher domestic airfares.

But of note is that the monthly increases over August and September have been more muted at 0.2 percent. This is lower than the monthly rises of 0.3 and 0.4 percent between March and June. Whether or not this is early "evidence" of domestic price pressures starting to ease remains to be seen. Certainly, if this trend persists it will be comforting for the RBNZ.

Comments from some of our respondents indicate that they were attempting to push through price increases due to higher input costs. However, some were also reducing their prices due to falling demand. Such a pricing quandary is to be expected in the current environment, and suggests a strong element of the cost-push versus demand-pull tension coming through. Ultimately, for inflation pressure to ease, the latter will need to dominate.

Given the prominence that the RBNZ placed on domestically generated inflation at their OCR statement this week, we will be paying close attention to our monthly inflation gauge and provide periodic updates. As the RBNZ noted, *"the timing and extent of OCR reductions over the coming months will depend on evidence of actual reductions in domestic cost pressures..."*

## GLOBAL WATCH

The focus of the global dataflow this week has been on Asia. Chinese GDP growth slowed in the September quarter, coming in below expectations, as did industrial production. Chinese retail sales however, came in stronger than expected. Chinese consumer spending will increasingly be important as an offset to weaker foreign demand for their products as the global economy slows. Surprisingly weak Japanese export data for September has raised concerns about Asian growth prospects, given the reliance on exporting as a driver of growth in many Asian economies. Data on inflation generally printed in line or above expectations, highlighting still elevated inflation pressures around the globe, though this is expected to ease given recent sharp falls in commodity prices.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
<b>US</b>	Leading Indicators (Sep)	-0.1%	0.3%	-0.9%	Stronger
	Initial Jobless Claims (w/e Oct 19)	468k	478k	463k	Weaker
	House Price Index (Aug) – mom	-0.5%	-0.6%	-0.8%	In-line
<b>Europe</b>	Industrial New Orders (Aug) – mom	0.5%	-1.2%	2.0%	Weaker
<b>UK</b>	M4 Money Supply (Sep P) – mom	0.9%	1.4%	1.5%	Stronger
	Retail Sales (Sep) – mom	-0.7%	-0.4%	1.1%	Stronger
<b>Asia Ex-Japan</b>					
<i>China</i>	PPI (Sep) - yoy	9.7%	9.0%	10.1%	Weaker
	Retail Sales (Sep) – yoy	22.8%	23.2%	23.2%	Stronger
	Industrial Production (Sep) – yoy	13.4%	11.4%	12.8%	Weaker
	GDP (3Q) – yoy	9.7%	9.0%	10.1%	Weaker
	CPI (Sep) – yoy	4.6%	4.6%	4.9%	In-line
<i>South Korea</i>	GDP (3Q P) – qoq	0.6%	0.6%	0.8%	In-line
<i>Singapore</i>	CPI (Sep) - yoy	6.6%	6.7%	6.4%	In-line
<i>Vietnam</i>	Exports (Oct) - yoy	-	36.7%	39.0%	-
	Imports (Oct) - yoy	-	42.6%	48.3%	-
<i>India</i>	Wholesale Price Index (Oct 11) - yoy	11.35%	11.07%	11.44%	Weaker
<b>Japan</b>	Leading Index CI (Aug F)	-	89.0	89.3	-
	Coincident Index CI (Aug F)	-	100.6	100.7	-
	All Industry Activity Index (Aug) – mom	-1.7%	-1.8%	0.8%	In-line
	Merchandise Trade Balance (Sep)	574.6B	95.1B	327.6B	Weaker
<b>Australia</b>	PPI (3Q) - qoq	1.2%	2.0%	1.0%	Stronger
	CPI (3Q) - qoq	1.0%	1.2%	1.5%	Stronger
	CPI Trimmed Mean (3Q) - qoq	1.0%	1.2%	1.2%	Stronger
	CPI Weighted Median (3Q) - qoq	1.0%	1.3%	1.0%	Stronger

## INTEREST RATE STRATEGY

Inflation remains a key concern for the RBNZ despite the deteriorating global picture. We believe inflation will moderate, and still expect the OCR to fall below 5 percent. Given our wariness over the global scene we expect swap rates to fall further across the curve.

### Market themes...

- > The fact that the RBNZ delivered its largest ever OCR cut the same week that inflation jumped to an 18 year high speaks volumes about the near-term focus.
- > However inflation still matters and it remains high in certain "non-contestable" sectors. It's crucial that we see moderation in these sectors.
- > The RBNZ broadly endorses market pricing.
- > We continue to be drawn to a long period of household de-leveraging. Market pricing looks "fair", but assumptions about the economy's response look optimistic.

### Review and outlook...

While the market got the 100bp rate cut it wanted from the RBNZ this week, it would appear that the tone of the Bank's comments caught some players by surprise. Even though the downside risks to global and domestic growth drove the decision, and continue to be the dominant issues, the Bank remains concerned about inflation, particularly in the less contestable sectors of the economy. The Bank has flagged more OCR cuts, but they "depend on evidence of actual reductions in domestic cost pressures". Governor Bollard reiterated this at the OCR Review press conference, stating that "the market expects to see further reduction [in the OCR], and we would think that's consistent with what we're seeing, provided we do see these inflationary pressures coming off".

Market expectations for the RBNZ therefore seem reasonable. However, this isn't where we see anomalies or opportunities. It's the market's assumptions about the way the economy is likely to respond to the series of fairly aggressive rate cuts that has caught our eye. Current market pricing seems to be more consistent with a "soft-landing" than an "L" shaped cycle, as evidence in part by the fact that the forward curve starts to indicate rising yields from between three to six months hence. This seems optimistic, and as "realisation" sinks in, we'd expect the mid to long end of the curve to adjust lower in yield. In other words, a "bull steepener".

### Borrowing strategies we favour at present

Keep the duration of hedges short of benchmark. Stay floating for a little longer where possible, awaiting lower rates before fixing. This is now much more palatable given the extent to which BKBM has fallen. Those who need to hedge should consider either the 1yr swap (a good balance of cost saving and flexibility) or extendible swaps (which offer attractive savings relative to market swap rates, but may be extended if yields continue to fall. Please see the *Borrower Focus* section for examples.

### Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ	↓	More rate cuts coming. RBNZ has largely endorsed market pricing.
NZ data	↔/↓	Will come back into focus now that we've had the 100bp rate cut.
Fed Funds/ front end	↔/↓	Fed to cut by 25bps. Liquidity pressures easing.
RBA	↔/↑	The RBA doesn't give the impression of itching to cut.
US 10 year	↔/↓	Volatile, but ultimately heading lower in yield.
NZ swap curve	↔/↓	Will steepen gradually. Will be a typical "bull steepener".
Flow	↔	Steeptenors/longs will encounter profit takers.
Technicals	↔	Extreme volatility. Equity/EM price action dominates.

### Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 4-Dec-08	-55	-41
Thu 22-Jan-09	-96	-84
Thu 5-Mar-09	-115	-96
Thu 23-Apr-09	-123	-117
Thu 4-Jun-09	-125	-116
Thu 30-Jul-09	-130	-111
Thu 10-Sep-09	Not forecast	-111

### Trading themes we favour at present

While we remain of the view that it is difficult to argue against steepeners over the medium-term, we believe they won't perform as well as many expect. This is because we expect to see a "bull steepener" unfold, continuing the trend of the last few months. In the very near-term we expect more profit taking on account of the lack of follow-through since the RBNZ's 100bp cut, so be careful about picking levels. Target +10bps or less to instigate 2yr-5yr steepeners. While we're bullish the long end, it's too much of a global story, and as such it's more efficient to trade that view via US Treasuries.

## BORROWER FOCUS

Our long held view that borrowers keep the duration of hedges short has worked out well. Despite an aggressive easing by the RBNZ, we still believe this strategy remains appropriate. We expect the RBNZ to continue cutting rates (albeit not as aggressively as this week!), and for swap rates to keep falling.

This section is largely a re-print of one of our regular publications – the “*Borrower’s Strategy*”, which we publish fortnightly on a Tuesday. If you would like to be added to the e-mail list to receive it, please contact David Croy on [david.croy@anznational.co.nz](mailto:david.croy@anznational.co.nz)

### Interest Rate View

The rapidly deteriorating economic outlook demands a significant monetary policy response, which the RBNZ acknowledged this week when it cut the OCR by 100bps. While Tuesday’s Q3 CPI data showed a pick-up in inflation and confirmed that core inflation remains sticky, the prospect of a sharp slowdown in growth and consequent closing of the output gap suggests inflation will fall rapidly in 2009. Inflation is high, and there are upside risks, but these pale in comparison to the significant downside risk to growth. We therefore expect the RBNZ to continue cutting rates even while inflation remains high, paving the way for swap rates to fall more quickly than many expect. The yield curve remains consistent with a “soft landing” scenario and hasn’t even started to contemplate the likely “L” shaped economic cycle.

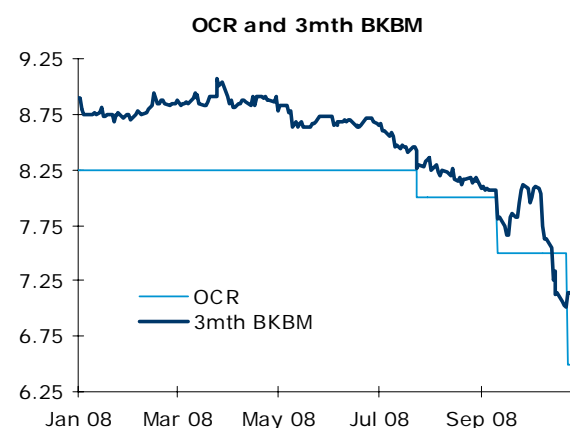
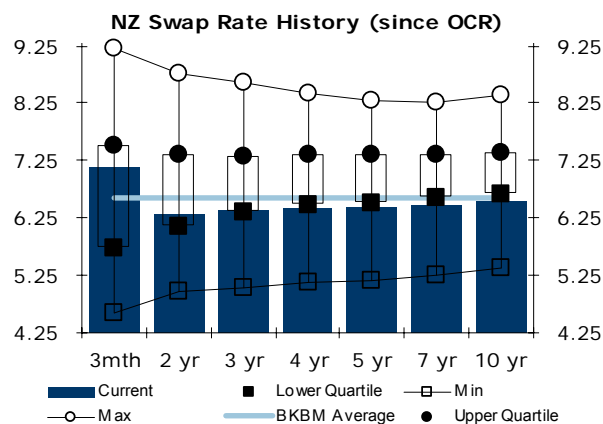
### Strategy

We have long held the view that borrowers should keep the duration of hedges short. We continue to believe this is appropriate. This strategy is paying dividends. Interest rates will move lower once the curve starts to price in an “L” shaped outcome (i.e. one that’s some way off!), so don’t be tempted to add to hedges just because we’ve seen a decent rally. If possible, consider “doing nothing”, and await much lower term rates before extending duration. This is a much more palatable strategy now that BKBM has eased off. Those who do need to add to duration to satisfy limits may wish to consider extendible swaps as part of their overall interest rate risk management programme.

### Valuation

Interest rates have fallen significantly in the past fortnight, particularly at the short end. The 2 year swap is now the lowest point on the yield curve. All swap rates are now below the long-term average for 3mth BKBM, and swaps of 4yrs or more are now below their respective post-OCR regime lower quartiles. In normal circumstances, borrowers may regard these as signals that from a valuation

perspective, there could be merit in adding to fixed cover. However these aren’t normal circumstances. This interest rate cycle is likely to extend far further to the downside, and as such, we’d caution against extending duration just yet.



The other development worthy of note has been the tremendous fall in 3mth BKBM. This has partly been a response to central bank liquidity initiatives, and to expectations of more aggressive policy easings. As things settle further, and the interbank markets returns to “normal”, BKBM is likely to continue falling gradually, significantly reducing the incentive to hedge, even for shorter periods.

### The Yield Curve

The yield curve has steepened significantly over the past fortnight, largely in anticipation of more aggressive easings this month (which was delivered), and in December. This isn’t unusual – yield curves generally do steepen in the early stages of the monetary policy easing cycle as short end rates adjust to expectations of a lower cash rate. Long end rates, on the other hand, tend to be more stable, as they have often already fallen in anticipation of the easing, which was what created the inverse yield curve in the first place. In a “typical” easing cycle (if there is such a thing), the steepening of the curve is simply a mechanical process where the short end catches up on the long end. And that’s where the problem lies. What if

the long end hasn't adjusted enough? Will the curve still steepen?

The short answer is probably yes – but not in the same way. During a typical easing cycle, long end rates tend to stabilise and often start to rise before the easing cycle is complete, in anticipation of the eventual upswing in economic activity. The implicit assumption here is that monetary policy easing has been effective. For the most part monetary policy will be effective, and there is no realistic counterfactual. But what if monetary policy needs to do more to be effective, or takes longer to be effective? This raises the possibility that assumptions made early on in the cycle will prove to be too optimistic, and the long end will ultimately adjust lower in yield. We believe this is what will occur this cycle. As the RBNZ eases policy aggressively, the yield curve will steepen, but this will be accompanied by lower rates across the curve, not just at the short end – in other words, a “bull steepener”.

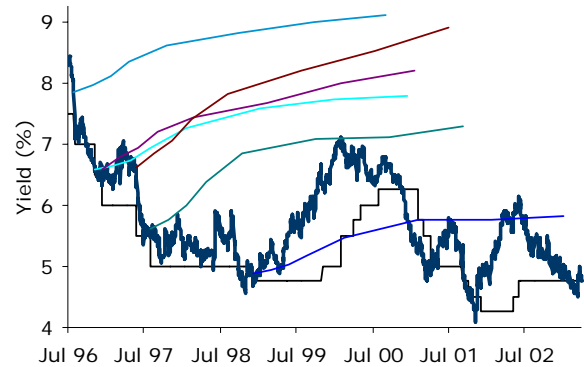
The most obvious anomaly that develops over the easing cycle is the emergence of higher forward rates. Once again, this is a mechanical process – as the yield curve goes through the transition from inverse to positive, forward rates start to move from being below their spot equivalents, to being above them. For example, on August 19th, the 2yr swap was at 7.26 percent, and the 2yr swap 2yrs forward was at 6.80 percent (i.e. 46bps lower). By contrast, today the 2yr swap is at 6.32 percent, but the 2yr swap 2yrs is at 6.53 percent (i.e. 21bps higher). That may seem strange, but not if there is widespread belief that the degree of monetary policy easing that is priced in will ultimately be effective. Put another way, if the market is comfortable with a positive sloped curve, that implies that there is enough easing priced in, and that degree of easing will be effective. We don't believe that is the case. Indeed, we expect the RBNZ to continue cutting rates until the OCR reaches 4.75 percent, which is at least 50bps below what the market has priced in. By paying fixed for a longer term, you are in effect validating these higher forward expectations. Thus if you believe rates are going much lower, it would pay to hold off hedging.

It's not just our expectations that support this view. Analysis of past easing cycles in Australia, NZ and the US shows that markets tend to underestimate the extent of the easing cycle, particularly in the early stages. As the charts on the right show, forward expectations of the 2yr rate the day before each rate cut (as plotted by the coloured lines) tend to be well above where the 2yr rate ends up. This is especially so for near term expectations early in the easing cycle.

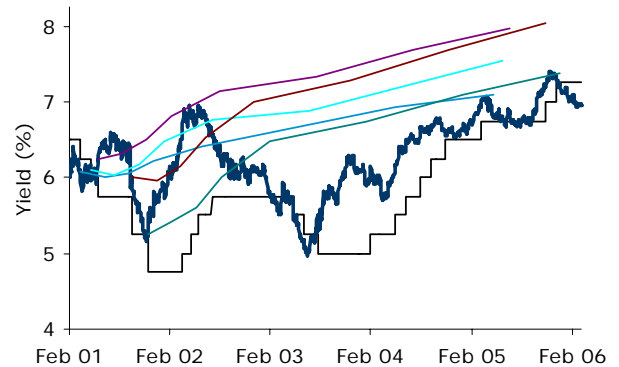
Amongst other things, this reflects optimism that policy will be effective quickly, and increasing term

premiums further out on the yield curve. Whatever the case, it discourages hedging early in the cycle.

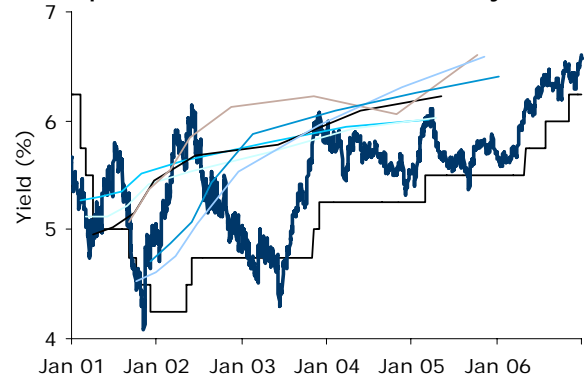
**Cash, 2yr swap & forward pricing 1 day prior to each rate cut: Aust 1996 cycle**



**Cash, 2yr swap & forward pricing 1 day prior to each rate cut: NZ 2001 cycle**



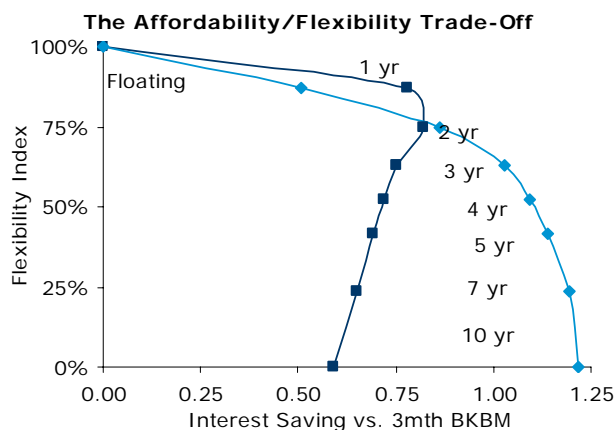
**Cash, 2yr swap & forward pricing 1 day prior to each rate cut: Aust 2001 cycle**





### Flexibility versus Cost

Despite the rapid fall in 3mth BKBM, the cost/flexibility trade-off is a key consideration, and it continues to favour short-dated hedges. As the chart below shows, relative to when we first introduced this analysis in the August 19th issue of the *Borrower's Strategy* (as represented by the light blue plot in the chart below), the savings available today (as represented by the dark blue plot in the chart below) by fixing for 1yr have risen. However the savings available for all other tenors have fallen. Crucially, the savings available for tenors 3 years or more are less than the 2 year tenor, making those longer tenors extremely unattractive if one values flexibility. And we suspect flexibility will be a high priority at the moment, with uncertainty elevated, and interest rates likely to fall further.



### Conclusion and Strategy

Delay hedging if possible, and await lower rates before extending duration. This strategy is paying dividends, and will continue to do so if monetary policy follows the path we expect it to. Should mandates require hedges to be added, keep duration below benchmark, adding swaps 2yrs or less. These offer good savings relative to BKBM, but are sufficiently short and flexible, and can easily be restructured at a later date, at little cost.

Alternatively, consider extendible swaps. These offer a discounted fixed rate in the initial period, in return for giving the bank the right to extend the swap for a longer period should swap rates fall. While it would be inappropriate to hedge solely with extendible swaps, because they mimic the activities of prudent risk managers (i.e. extending duration as rates fall), they can be a useful addition to a portfolio of hedges. For example, at current prices, clients can enter a 1yr/3yr extendible swap at 5.97 percent. This swap has an initial period of 1 year, but is extendible for a further 3 years under certain conditions. In return for a 39bp discount to the current 1yr swap rate (of 6.36 percent), the client gives the bank the right to extend the swap by a further 3 years if the 3 year swap rate is below 5.97 percent in 1 year. While we think that outcome is quite possible (so the client may be exercised), we would expect clients would likely be extending duration as yield fell below 6 percent in any case. In the meantime, clients benefit from the 39bp discount.

## CURRENCY STRATEGY

The RBNZ is out of the way, so the focus returns to offshore developments. With emerging markets now getting caught in the credit malaise, risk aversion will be the predominant theme in currency markets in the near term. While bounces in the NZD can be expected given the recent sharp moves lower, waning risk appetites will continue to see the NZD trade with a heavy bias.

### Market themes...

- > Poor corporate earnings and weak Asian data spark concerns over real economy prospects.
- > Emerging markets caught in the rip with equities, bonds and currencies savagely sold.
- > Risk aversion intensifies and investors flock to the USD and JPY.

### Review and outlook...

Currency markets are still being subjected to much volatility. Inter-bank rates continue to drift lower, but the FX market's sights have now moved towards concerns over emerging markets. We mentioned that the currency market was at a cross roads of the interaction between the financial and real economy. The financial concerns are still spreading, and we are getting increasing signs that the real economy is being affected. Recent corporate earnings results have been disappointing, and data out from Asia is slowing.

With no real improvement in financial markets as yet, and concerns only increasing over the health of the global economy, risk aversion will continue to dominate currency markets in the near term. To be fair, the price action we have seen this week across currency markets largely reflects wholesale liquidation and repatriation out of risky assets, particularly in emerging markets, into safe haven assets. As such, flows and panic will continue to drive currency movements.

The risk is always that we get a snapback at some point after the extreme movements we have seen in recent times. But it is equally difficult to see when such moves will unwind. We could still have some way to go yet in terms of the unwinding of the Yen carry trade and the repatriation of funds out of emerging markets. Hence, further Yen and USD strength cannot be ruled out.

With the RBNZ now out of the way, the focus for the NZD will be on offshore developments. Waning risk appetites will continue to see the NZD trade with a heavy bias, especially with commodity prices still falling. The NZDAUD cross continues to frustrate. With the official cash rate differential between NZ and AU now narrowed to 50bps, and growth prospects for the latter bleaker than the

former, the cross should be lower. But currency markets are not trading based on fundamentals at present. With the AUD still being used as a play on global growth and commodity price concerns, the cross will continue to be elevated on AUD weakness.

Technically, the NZD has broken out of the recent triangle but has consolidated recent losses only in a very oversold environment. Suspicion is that the downside momentum is waning. We look for a break of the recent 0.5800-0.6025 trading range to give longer term direction. NZDAUD maintains the current range with major support at 0.8720 and lower resistance at 0.9050. We still prefer the down side break leading to a fast move to 0.8500.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Should be lower based on fundamentals.
Yield	↔/↓	Official interest rates differential narrowed.
Commodities	↔	Falling across the board.
Partial indicators	↓	NZ indicators still worse.
Technicals	↔	Resistance at 0.9050.
Sentiment	↔/↓	Risk aversion intensified.
Other	↔	Baltic dry, gold, commodities all falling.
<b>On balance</b>	↓	<b>Should be lower but subject to global scene</b>

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	↔/↓	Now above cyclical fair value level.
Yield	↔	RBNZ validates market pricing.
Commodities	↓	Milk powder prices still falling.
Risk aversion	↔/↓	Rising.
Partial indicators	↔/↓	Still weak but inflation pressure still remain.
Technicals	↔/↓	Support at 0.5800.
AUD	↔/↑	Could be set for a corrective move?
Sentiment	↔/↓	Weak.
Other	↓	Focus on emerging markets.
<b>On balance</b>	↔/↓	<b>Near-term short squeeze but overall direction still lower.</b>

## DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
27 Oct	<b>NZ</b>	<b>Public Holiday in NZ for Labour Day</b>	-	-	-
	JN	Corp Service Price (Sep) - yoy	-	1.4%	12:50
	EU	Euro-Zone M3 s.a. (Sep) - yoy	8.5%	8.8%	22:00
		ECB's Tumpel-Gugerell Speaks in Milan	-	-	22:30
	GE	IFO - Business Climate (Oct)	91	92.9	22:00
		IFO - Current Assessment (Oct)	97	99.8	22:00
		IFO - Expectations (Oct)	85	86.5	22:00
28 Oct	EU	ECB's Trichet Holds A Speech in Madrid	-	-	02:55
	US	New Home Sales	455K	460K	03:00
		New Home Sales MoM	-1.1%	-11.5%	03:00
	JN	Large Retailers' Sales	-	-2.2%	12:50
		Retail Trade (Sep) - mom	-	0.7%	12:50
		Vehicle Production (Sep) - yoy	-	-10.9%	17:00
	AU	NAB Business Confidence (3Q)	-	-8	13:30
	GE	GfK Consumer Confidence Survey (Nov)	1.5	1.8	20:10
29 Oct	<b>NZ</b>	<b>Merchandise Trade Balance (Sep)</b>	-	<b>-750M</b>	<b>10:45</b>
	UK	M4 Money Supply (Sep F) - mom	-	1.4%	22:30
		Net Consumer Credit (Sep)	1.1B	1.2B	22:30
		Net Lending Sec. on Dwellings (Sep)	-	0.1B	22:30
		Mortgage Approvals (Sep)	32K	32K	22:30
	US	Former Fed's Volcker to Speak on Economy in Miami Beach	-	-	01:00
		S&P/CS Composite-20 (Aug) - yoy	-16.5%	-16.4%	02:00
		Consumer Confidence (Oct)	53	59.8	03:00
		Richmond Fed Manufact. Index (Oct)	-21	-18	03:00
		Treasury's Paulson Speaks At SIFMA Annual Meeting	-	-	03:00
	EU	ECB's Bini Smaghi Speaks in Brussels	-	-	06:00
	JN	Industrial Production (Sep P) - mom	-	-3.5%	12:50
	AU	DEWR Skilled Vacancies (Oct) - mom	-	-3.5%	13:00
	GE	Consumer Price Index (Oct P) - mom	-0.2%	-0.1%	-
		Consumer Price Index (Oct P) - yoy	2.4%	2.9%	-
		CPI - EU Harmonised (Oct P) - mom	-0.2%	-0.1%	-
		CPI - EU Harmonised (Oct P) - yoy	2.6%	3.0%	-
30 Oct	<b>NZ</b>	<b>Building Permits (Sep) - mom</b>	-	<b>-7.9%</b>	<b>10:45</b>
		<b>NBNZ Business Confidence (Oct)</b>	-	<b>1.6</b>	<b>15:00</b>
		<b>Money Supply M3 (Sep) - yoy</b>	-	<b>7.2%</b>	<b>15:00</b>
	US	Durable Goods Orders (Sep)	-0.7%	-4.5%	01:30
		Durables Ex Transportation (Sep)	-1.5%	-3.0%	01:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
30 Oct cont.	US	FOMC Rate Decision	1.25%	1.50%	07:15
	AU	Deputy RBA Governor Battellino Gives Speech in Sydney	-	-	11:30
	AU	Conference Board Leading Index (Aug)	-	0.0%	12:00
	GE	Retail Sales (Sep) - mom	-1.0%	3.1%	11/05
		ILO Unemployment Rate (Sep)	7.2%	7.2%	19:00
		Unemployment Rate (Oct)	7.6%	7.6%	21:55
	EU	Business Climate Indicator (Oct)	-0.9	-0.79	23:00
		Euro-Zone Consumer Confidence (Oct)	-21	-19	23:00
		Euro-Zone Economic Confidence (Oct)	86	87.7	23:00
		Euro-Zone Indust. Confidence (Oct)	-14	-12	23:00
		Euro-Zone Services Confidence (Oct)	-2	0	23:00
31 Oct	US	GDP (3Q A) - annualised	-0.5%	2.8%	01:30
		Personal Consumption (3Q A)	-0.9%	1.2%	01:30
		GDP Price Index (3Q A)	4.0%	1.1%	01:30
		Core PCE (3Q A) - qoq	2.2%	2.2%	01:30
		Initial Jobless Claims (w/e Oct 26)	-	478K	01:30
		Continuing Claims (w/e Oct 19)	-	3720K	01:30
		Fed's Yellen Speaks in Berkeley, California	-	-	08:15
	EU	ECB's Wellink Speaks at Dutch Central Bank event in Amsterdam	-	-	03:00
		Euro-Zone CPI Estimate (Oct) - yoy	3.30%	3.60%	23:00
		Euro-Zone Unemployment Rate (Sep)	7.50%	7.50%	23:00
	AU	Private Sector Credit (Sep) - mom	-	0.5%	13:30
		Assistant RBA Governor Debelle Gives Speech in Melbourne	-	-	13:30
	UK	GfK Consumer Confidence Survey (Oct)	-	-32	13:01
	JN	Jobless Rate (Sep)	-	4.2%	12:30
		Job-To-Applclicant Ratio (Sep)	-	0.86	12:30
		Household Spending (Sep) - yoy	-	-4.0%	12:30
		Tokyo CPI (Oct) - yoy	-	1.4%	12:30
		Natl CPI (Sep) - yoy	-	2.1%	12:30
		BOJ Target Rate	0.50%	0.50%	/2008
		Housing Starts (Sep) - yoy	-	53.60%	18:00
		Construction Orders (Sep) - yoy	-	-0.3%	18:00
		BOJ to Release Semi-Annual Economic Outlook Report	-	-	19:00
1 Nov	US	Personal Income (Sep)	0.1%	0.5%	01:30
		PCE Deflator (Sep) - yoy	-	4.5%	01:30
		Personal Spending (Sep)	-0.2%	0.0%	01:30
		PCE Core (Sep) - mom	0.1%	0.2%	01:30
		Employment Cost Index (3Q)	0.7%	0.7%	01:30

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:** Labour market data for Q3 is the key release over the coming weeks. With labour costs being highlighted by the RBNZ as a source of domestically generated inflation pressure, the wage inflation read will be important. We expect evidence of a weakening labour market to be confirmed in the HLFS employment report, giving the RBNZ some confidence that wage inflation will start to ease off and not add further upward pressure on inflation.

Date	Data/Event	Economic Signal	Comment
Wed 29 Oct (10.45)	Overseas Merchandise Trade (Sep)	Deficit	Another large monthly deficit is expected. However, the annual deficit should narrow on lower oil prices and falling consumption goods imports. But a substantial improvement is still some way off.
Thu 30 Oct (10.45)	Building Consents (Sep)	Weak	A bounce is likely following another large fall last month, but the trend is still down. Falling house prices will continue to weigh on the residential construction sector.
Thu 30 Oct (15.00)	NBNZ <i>Business Outlook</i> (Oct)	-	-
Thu 30 Oct (15.00)	Credit Growth (Sep)	Soft	We expect another subdued 0.3 or 0.4 percent increase in household credit growth. Business lending growth should continue to slow, as will agriculture lending but the latter is coming off a very high base.
Mon 3 Nov (10.45)	Labour Cost Index and Quarterly Employment Survey (Q3)	Wage inflation peaking	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)	Unemployment on the up	After the surprise surge in employment growth last quarter, we expect a reversal. Volatility aside, the overall report is expected to point to a weakening labour market, with the unemployment rate continuing to move higher.
circa 11 Nov	REINZ House Sales (Oct)	Will a base be found?	Housing market activity remains weak, and recent declines in mortgage rates may start to entice more prospective buyers into the market. Even if house sales do pick up, we expect house prices to remain under downward pressure.
Thu 13 Nov (10.45)	Retail Trade Survey (Sep)	Volume contraction again	ECT and credit card data suggest modest growth in monthly nominal retail spending, led by a rebound in car sales. For the quarter though, we are expecting a third consecutive contraction in volume terms.
Mon 17 Nov (10.45)	Food Price Index (Oct)	High	Recent declines in world commodity prices, including for dairy, mean lower prices are on their way. But not just yet. A more modest monthly rise in food prices expected in October.
Tue 19 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.
Fri 21 Nov (10.45)	External Migration (Oct)	Arrivals softening	Net migration inflows have been positive, but subdued. Of interest is visitor arrivals, which have been falling in recent months. Given the deteriorating global outlook, further declines look on the cards.
Tue 25 Nov (15.00)	RBNZ Survey of Expectations (Q4)	Still high but easing	Lower petrol prices should see inflation expectations fall from the last read of 3.0 percent. Still high, but at least in the right direction.
<b>On Balance</b>		<b>Key issue now is the flow-on from the global scene.</b>	<b>Further signs of weakening growth over Q3, but hopeful of some early "evidence" of easing inflation pressure.</b>

## 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	<b>-0.5</b>	<b>0.5</b>	<b>0.2</b>	<b>-0.1</b>	<b>0.2</b>	<b>0.6</b>	<b>0.7</b>
GDP (% yoy)	3.7	2.2	1.1	<b>-0.1</b>	<b>-0.5</b>	<b>0.0</b>	<b>0.1</b>	<b>0.8</b>	<b>0.9</b>	<b>1.4</b>
CPI (% qoq)	1.2	0.7	1.6	1.5	<b>0.2</b>	<b>0.4</b>	<b>0.8</b>	<b>0.7</b>	<b>0.8</b>	<b>0.7</b>
CPI (% yoy)	3.2	3.4	4.0	5.1	<b>4.1</b>	<b>3.7</b>	<b>2.9</b>	<b>2.1</b>	<b>2.8</b>	<b>3.1</b>
Employment (% qoq)	0.9	-1.3	1.3	<b>-0.6</b>	<b>-0.3</b>	<b>-0.2</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>	<b>0.2</b>
Employment (% yoy)	2.5	-0.2	0.7	<b>0.2</b>	<b>-0.9</b>	<b>0.2</b>	<b>-1.0</b>	<b>-0.3</b>	<b>0.0</b>	<b>0.4</b>
Unemployment Rate (% sa)	3.4	3.7	3.9	<b>4.2</b>	<b>4.7</b>	<b>5.0</b>	<b>5.2</b>	<b>5.5</b>	<b>5.7</b>	<b>5.8</b>
Current Account (% GDP)	-8.2	-8.0	-8.4	<b>-8.7</b>	<b>-9.2</b>	<b>-9.2</b>	<b>-8.4</b>	<b>-7.8</b>	<b>-7.4</b>	<b>-7.3</b>
Terms of Trade (% qoq)	2.9	4.2	-0.5	<b>-1.0</b>	<b>-2.0</b>	<b>-1.5</b>	<b>-1.1</b>	<b>-1.1</b>	<b>-0.9</b>	<b>-0.7</b>
Terms of Trade (% yoy)	8.8	11.6	10.6	<b>5.6</b>	<b>0.5</b>	<b>-5.0</b>	<b>-5.6</b>	<b>-5.6</b>	<b>-4.5</b>	<b>-3.7</b>

## 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)	0.1	0.3	-0.4	-0.2	0.6	0.0	0.3	-0.1	1.1	..
Credit Card Billings (% yoy)	8.8	7.5	5.8	5.4	6.0	4.0	4.2	2.6	2.6	..
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	790	380	10	..
Net Migration (annual)	4799	4643	4678	4666	4931	4732	5201	4938	4403	..

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	24-Oct-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
NZD/USD	0.710	0.677	0.582	0.620	0.640	0.610	0.580	0.560	0.550	0.550
NZD/AUD	0.803	0.822	0.893	0.849	0.889	0.897	0.906	0.933	0.887	0.859
NZD/EUR	0.474	0.470	0.456	0.456	0.478	0.466	0.453	0.452	0.466	0.458
NZD/JPY	77.7	72.1	55.6	63.2	64.6	63.4	62.6	61.6	61.6	63.3
NZD/GBP	0.375	0.375	0.363	0.352	0.370	0.355	0.341	0.335	0.331	0.333
NZ\$ TWI	65.5	63.9	58.8	60.5	62.9	61.3	59.7	59.1	58.6	58.2
NZ interest rates	Aug-08	Sep-08	24-Oct-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
OCR	8.00	7.68	6.50	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	5.92	5.40	5.10	5.20	5.30	5.30	5.50	5.60
International	Aug-08	Sep-08	24-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	3.54	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	5.89	5.60	5.40	4.80	4.80	4.80	4.70	4.70

## KEY RATES

	24 Sep	20 Oct	21 Oct	22 Oct	23 Oct	24 Oct
Official Cash Rate	7.50	7.50	7.50	7.50	6.50	6.50
90 day bank bill	7.99	7.05	7.03	6.99	7.11	7.06
NZGB 07/09	5.88	5.50	5.50	5.50	5.48	5.50
NZGB 11/11	5.67	5.61	5.60	5.60	5.58	5.58
NZGB 04/13	5.72	5.75	5.74	5.74	5.72	5.72
NZGB 12/17	5.80	5.93	5.92	5.92	5.91	5.89
2 year swap	6.99	6.31	6.34	6.30	6.33	6.35
5 year swap	6.91	6.47	6.49	6.44	6.47	6.48
RBNZ TWI	63.6	60.5	61.2	60.6	59.6	59.4
NZD/USD	0.6798	0.6119	0.6176	0.6026	0.5904	0.5895
NZD/AUD	0.8154	0.8806	0.8849	0.8918	0.8900	0.8897
NZD/JPY	71.83	62.19	62.84	60.42	57.50	57.21
NZD/GBP	0.3667	0.3529	0.3594	0.3656	0.3636	0.3649
NZD/EUR	0.4633	0.4548	0.4633	0.4659	0.4615	0.4577
AUD/USD	0.8337	0.6949	0.6979	0.6757	0.6634	0.6625
EUR/USD	1.4674	1.3455	1.3330	1.2935	1.2793	1.2879
USD/JPY	105.67	101.64	101.75	100.26	97.40	97.08
GBP/USD	1.8540	1.7337	1.7186	1.6484	1.6236	1.6154
Oil	107.85	71.90	74.11	71.29	66.92	66.84
Gold	884.40	799.70	800.60	763.65	725.20	722.93
Electricity (Haywards)	2.38	3.80	14.46	6.07	17.93	n/a
Milk futures (US\$/contract)	121	100	100	100	100	n/a
Baltic Dry Freight Index	4489	1355	1292	1221	1149	n/a

## 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.

#### NEW ZEALAND DISCLAIMER

The Bank does not provide investment advice tailored to an investor's personal circumstances. It is the investor's responsibility to understand the nature of the security subscribed for, and the risks associated with that security. To the maximum extent permitted by law, the Bank excludes liability for, and shall not be responsible for, any loss suffered by the investor resulting from the Bank's investment advice.

Each security (including the principal, interest or other returns of any security) the subject of investment advice given to the investor by the Bank or otherwise, is not guaranteed, secured or underwritten in any way by the Bank or any associated or related party except to the extent expressly agreed in the terms of the relevant security.

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