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THE FIRST CUT IS THE DEEPEST

Page 2: Economic overview

- > With the RBNZ starting the easing cycle, attention is now on how far. While the big picture is pointing towards an aggressive cycle over time, we continue to look for a series of stabilisation cuts, pause, then resumption. We also continue to watch commodity prices closely. Data this week is expected to reinforce a weak economic picture.

Page 4: Economic comment – the debate to participate

- > The participation rate typically moves in line with employment, resulting in less volatility in the unemployment rate. However, an area we are receiving considerable anecdotes about is a supply side response of labour to the rising cost of living. Statistically, it appears to have some validity. If it does come to fruition, it could be one factor propelling the unemployment rate higher and faster.

Page 5: Economic comment – going for gold: predicting New Zealand's chances at the Beijing Olympics

- > Using an economic model for predicting Olympic medal tallies, we come up with our predictions for the Beijing Games. Our model is picking that the New Zealand Olympic team will do slightly better at the Beijing Games compared to Athens with six medals including three gold. China, as host, will threaten the US's dominance. While our model predicts that China's total medal haul will not surpass the US, the host nation will amass more gold medals, thereby taking the number one ranking.

Page 7: Economic comment – global watch

- > US data was generally stronger than expected last week, particularly the data released nearer the end of the week. However, it was the opposite case across the Atlantic, with European weak across the board. The European economy appears to have slowed quite sharply, and there is increased speculation it could now slip into recession.

Page 8: Interest rate strategy

- > The RBNZ easing cycle has started. Swap yields will continue to remain heavy as receivers continue to have the upper hand. Some profit taking may see yields pop higher but such moves will be temporary.

Page 9: Currency strategy

- > With interest rates falling and set to fall further, the kiwi should remain on the back foot. While the rates market now has a lot priced in, it is hard to go against the spirit of a declining yield differential, and pending negative carry vis-à-vis the AUD. Attention will now turn to the speed, and in that regard the global environment, the EUR/USD (or USD sentiment) and commodity prices will have a huge say.

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ECONOMIC OVERVIEW

With the RBNZ starting the easing cycle, attention is now on how far. While the big picture is pointing towards an aggressive cycle over time, we continue to look for a series of stabilisation cuts, pause, then resumption. We also continue to watch commodity prices closely. Data this week is expected to reinforce a weak economic picture.

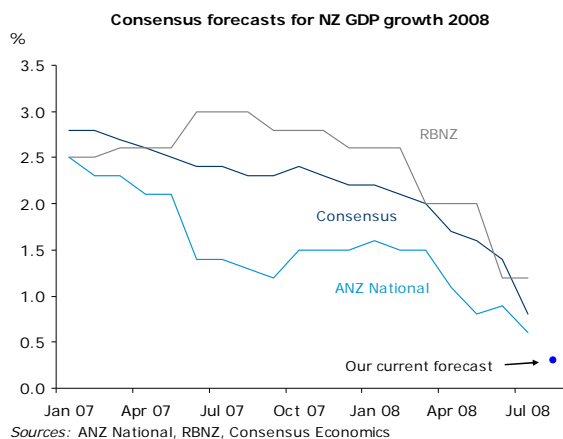
What's ahead?

- > **June Overseas Merchandise Trade** (Monday 1045 NZST). We expect a monthly trade deficit of \$350 million as the high oil prices continue to add to the import bill.
- > **June Building Consents** (Tuesday 1045 NZST). After considerable volatility, we expect a fall of around 5 percent.
- > **Credit Growth** (Wednesday 1500 NZST). Housing lending growth will remain soft.
- > **NBNZ Business Outlook** (Thursday 1500 NZST).

What's the view?

It would have been a difficult decision, but the RBNZ's move to cut the Official Cash Rate by 25 basis points last week was the prudent choice in our view. Yes, inflation pressures are high and the RBNZ (and ourselves) now expect inflation to peak around 5 percent in the September quarter, but growth pressures have simply deteriorated to such an extent that they needed to act. In our eyes it shows a willingness to use the full flexibility of the Policy Targets Agreement and monetary policy framework itself.

The RBNZ are now obviously of the view that the growth picture is far weaker than the subdued portrait they painted in June. *"Economic activity is likely to remain weak over the remainder of 2008"*, which goes against the grain of the rebound they had pencilled in. Certainly, the retail data received for June last week (credit card and Electronic Transactions) show that the household wallet remains firmly shut and we expect a considerable contraction in real retail sales data due in a couple of week's time.



We have put through some minor tinkering to our growth forecasts over the past couple of weeks and now expect both the June and September quarters to post negative growth and calendar year growth to slow to just 0.3 percent. You can hide a lot in annual averages, and the annual picture will undoubtedly be negative. We are also deeply suspicious of a fair bit of volatility in some of the upcoming data and would not be surprised if one of the Q2 or Q3 GDP prints was a "shocker". Technical aspects such as curtailed manufacturing production in response to energy cutbacks, high amounts of thermal electricity generation and ongoing drought effects will play havoc with the figures. "Bounce" from these will likely artificially inflate Q4 so we need to be careful focusing on quarterly figures. Stripping out the noise we suspect we're not yet at the trough. Facing offshore headwinds and a mammoth de-leveraging process across households, any recovery will be subdued.

So where to now for monetary policy? With the hurdle being jumped last week, and dovish tones delivered, it's difficult to envisage rates not moving down over the next few meetings, and that's certainly a view the market has taken by pricing in 145 basis points of cuts over the coming year. We doubt there will be anything on the local data front that will stand in the way of the Bank cutting at each of its meetings for the rest of the year, taking the OCR to 7.25 percent by December. The trend in the local dataflow is likely to remain very weak, with risks still skewed to the downside.

Cycles always tend to go further than what we expect, either up or down, and looking at the macro picture, we find it hard to be bullish on the economy, hence we are bullish rates. The big picture is rates falling 200 to 300 bps. This is a reality everyone needs to keep in the back of their heads.

However, the picture is not clear-cut. We'd consider ourselves at the dovish side of the hawk-dove divide, but even we have some continued concerns on the inflation front, despite the economic picture. Relative prices (labour – capital, commodity prices, wages in some instances) are changing so rapidly that it is hard to disentangle the cycle versus the trend. Hence, central banks still need to maintain a degree of vigilance.

Neutralising or normalising monetary policy seems to be the latest buzz-word, and justification for a pretty substantial easing. The rationale is simple. When central banks cut, the first target is normally "neutral". But where is neutral? Six percent is often quoted as this represents a neutral real rate of four percent, plus the middle of the 1 to 3 percent inflation band. However, the picture is far from clear.

The correct deflator should be inflation expectations, and two year ahead estimates are around 3 percent. So it is conceivable to argue that the first target may well be 7 than 6.

Of course, there are other factors. People have a lot more debt so central banks shouldn't have to have rates so high, although we could similarly argue that if

this is correct they shouldn't need to cut them too far the other way!

Then there is the distinction between wholesale rates versus the borrowing rate, and arguably it is the borrowing rate that matters. We all know that higher credit costs are offsetting lower wholesale rates so this argues for the neutral rate being lower, on the assumption credit conditions are going to remain volatile for some time. An important consideration is also the expectations of house prices. The reason why higher rates were needed to tame the housing market and slow the economy is that people believed house prices were going to rise 10+ percent pa. Hence, at that point in time, the "neutral rate" needed to be higher to counter that. Now that the housing market has well and truly turned, with most people expecting house prices to fall, you don't need as high a interest rate to elicit the same response as when you were trying to slow a rampant housing market. Of course, in the end it is what the RBNZ thinks that matters.

There is also the currency to contend with, as acknowledged by the RBNZ. If it moves down too fast, cuts are likely to be off the agenda. While we agree that the currency will hold a lot of sway, we see commodity prices (as the biggest source of imported inflation at present) as being the key factor to watch. If commodity prices fall then the RBNZ can obviously accommodate a lot more weakness on the currency front. It is the net effect after all that is the most important. We admit that a lower NZD will also risk higher prices for other non-commodity type imported goods. But given the current juncture of very weak demand, we struggle to see firms being able to pass these imported costs on. Hence, we'll be closely monitoring our *Financial Conditions Index*, which is a conventional Monetary Conditions Index, but with a few bells and whistles including commodity prices, and asset prices. We will present an update of the index in next week's *Market Focus*.

Net on net, we're happy to run with our prior view of 100 basis points of stabilisation cuts, then a pause, and a second easing cycle in H2 2009. If the commodity picture turns into a wider trend we'll be inclined to a more steady and regular easing profile.

It's the currency outlook that's giving us greater palpitations. Our official house view is that the AUD/USD pushes through parity (1.04). It is obviously hard to get the NZD/USD declining a lot (which feels more correct given the state of the economy and reality that the RBNZ is cutting the OCR), unless we are prepared to put the NZD/AUD with a high 6 in front of it. We're calling it to 0.72 already (the bottom end of consensus), but with the Australian economy slowing rapidly as well, are reticent to take it below that. Our take on the global scene at present is that the USD is finding a base, not just because the US data has surprised on the strong side, but because the European economic picture is deteriorating rapidly.

European data last week showed the services and manufacturing sectors are well-and-truly in contraction

mode, with PMI surveys printing below the key 50 level. The widely watched German IFO survey has fallen to its lowest levels since September 11 and Italian and French business confidence has also fallen. EUR/USD, NZD/USD and AUD/USD correlations are high, and commodity prices still look vulnerable to further retracement.

So for now, let's just say our currency forecasts are under review. While not in our core numbers, the spirit of our view is that the NZD/USD will print a high 6 before the end of the year. From that point we suspect we'll get a temporary bounce, particularly if the RBNZ signals a pause ahead. We're still looking for 72 cents for the NZD/AUD.

Looking forward to this week, most of our attention is going to be on the global picture, and particularly how commodity prices are behaving. As noted last week, it seems to us that the global growth story now has sufficient critical mass that the commodity story is being questioned. Consumer and business confidence gauges out of Europe as well as labour market data from Germany will be closely followed. For the US, the first reading on June quarter GDP is due along with the key non-farm payrolls and ISM reports. The market is expecting the former to show a further rise in the unemployment rate.

Locally, as mentioned above, the flavour of the domestic data is likely to remain one of weakness. This week, building consents issued for June are likely to post a fall given the softness in the housing market. Volatility aside, the trend in consent issuance will reinforce the view that the construction sector is at the forefront of the current domestic slowdown. We are expecting a fall of around 5 percent and will also be looking for further evidence that construction costs are easing after a proxy we watch (the value of dwelling consents issued per floor area) has showed some signs of softening over recent months, with the three-month average falling to just 1 percent on an annual basis in May. Non-residential consent issuance has surprised us with its robustness to date and should be due to start correcting as well. Credit growth for June should also reaffirm the weak housing market, with both the demand side and the supply side (tighter lending criteria) having an impact. The RBNZ Business Outlook survey for July will give us the first look at how the September quarter is faring.

Recent local data...

External Migration (June): A net inflow of 490 people was recorded, taking the annual total to 4,732.

Electronic Card Transactions (June): Total retail ECT sales fell 0.4 percent, while core sales fell 1.2 percent.

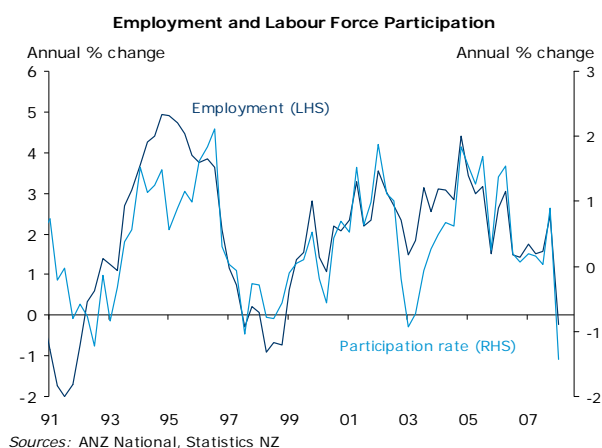
Roy Morgan Consumer Confidence (late July): Consumer sentiment improved slightly to 85.7, from 82 in early July.

Credit Card Spending (June): Total billings on credit cards in NZ fell 0.7 percent following a 0.7 percent fall in May.

THE DEBATE TO PARTICIPATE

The participation rate typically moves in line with employment, resulting in less volatility in the unemployment rate. However, an area we are receiving considerable anecdotes about is a supply side response of labour to the rising cost of living. Statistically, it appears to have some validity. If it does come to fruition, it could be one factor propelling the unemployment rate higher and faster.

The labour force participation rate typically swings with the employment cycle. It moves up when jobs are aplenty, and down when times are tough. As such it tends to dampen swings in the unemployment rate via the encouraged or discouraged worker effect.



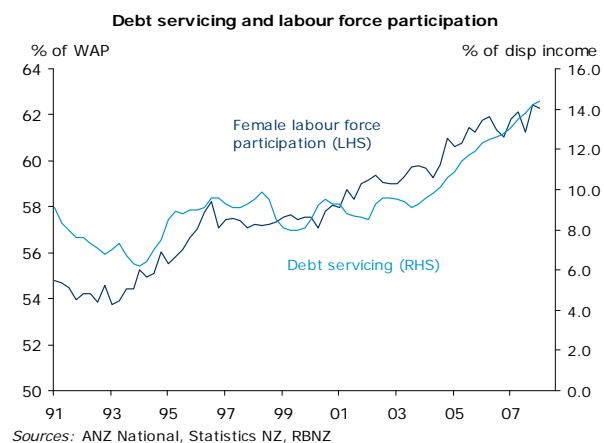
Conventional participation rate equations are calibrated or estimated such that a 1 percent fall in the employment rate (or the proportion of working age population that is employed) results in a 0.5 percent fall in the participation rate. That is, if employment prospects diminish, people are more likely to leave the labour force. This is known as the “discouraged worker effect”. It implies that a fall in employment is also met by falling participation, resulting in a more muted change in the unemployment rate. Given the turn in the labour market we are beginning to see, it suggests the participation rate is also likely to fall (as it has already started to in the March 2008 quarter).

One of the interesting aspects about our jobs is the strong anecdotes you often receive while travelling. Some of these you don't give a second thought, although others, if delivered repeatedly leave us musing. When it comes to the labour market, we've been receiving a steady flow of anecdotes of late suggesting an interesting dynamic may be at work in regard to the participation rate. Notably, it seems the supply of labour coming from some quarters, reputedly second income earners (or second income earners looking for a second job) has jumped.

Now it's easy to justify why this could be happening. After all, we are seeing a lot of pressure on household budgets. The price of necessities has skyrocketed and debt servicing levels have marched ever higher and look unlikely to ease in the near term. This leaves us biased to the view that some people just may not have

a choice when it comes to participating in the labour force as they look for subsequent income to ease budget pressures.

Of course it's difficult to disentangle the causality. Rising participation could be driving confidence (or making it easier) to take on more debt and debt servicing as opposed to the other way around. Nevertheless, a comprehensive study by the RBA using longitudinal survey data (similar to the current SOFIE survey currently being run by Statistics NZ) found that it was mainly the level of indebtedness that had an impact on an individual's decision to participate and not the other way around.¹



In terms of New Zealand, we've attempted to adapt our participation rate equations to capture this effect. We find that a 1 percent increase in debt servicing results in around a 0.17 percent increase in the aggregate participation rate. We're a bit cautious about the estimates as there are a lot of dynamics to control for. However, if we use this result, and our forecasts of employment growth shown on page 13, plus the assumption that debt servicing (as a share of disposable income) remains at current levels of 14.4 percent (a very conservative assumption), it suggests the participation rate will hover around current levels. It also suggests the unemployment rate could easily hit 6 percent. Of course a constant participation rate would be a very peculiar development given its historical relationship with actual jobs growth.

We also need to be mindful of structural aspects. Participation rates typically “tail” as the population ages and Statistics NZ project that by 2051, 25 percent of NZ's population will be over 65 years old. However, this should be more of a factor for the next cycle. There is some debate whether Working for Families has encouraged or discouraged participation. Tax changes would be expected to have a positive effect, although this is difficult to detect in NZ.

For now, we're closely keeping our ears to the ground in terms of anecdotes towards labour force participation. The anecdotes are strong that the unemployment rate is moving up sharply, and it's not just from the demand side.

¹ Belkar, R., L Cockerill, & R. Edwards (2007), “Labour Force Participation and Household Debt” *RBA Research Discussion Paper*, June.

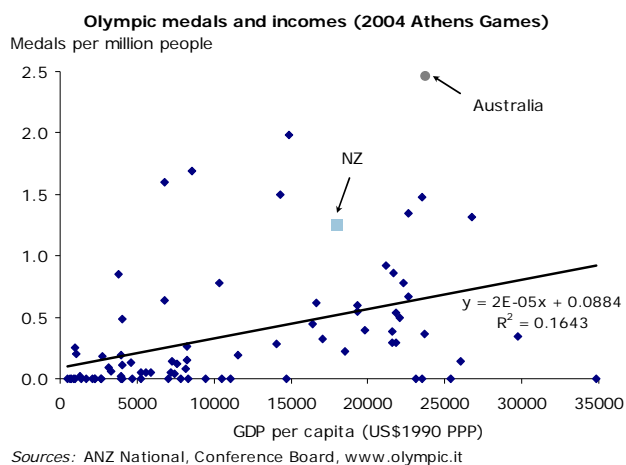
GOING FOR GOLD: PREDICTING NEW ZEALAND'S CHANCES AT THE BEIJING OLYMPICS²

Using an economic model for predicting Olympic medal tallies, we come up with our predictions for the Beijing Games. Our model is picking that the New Zealand Olympic team will do slightly better at the Beijing Games compared to Athens with six medals including three gold. China, as host, will threaten the US's dominance. While our model predicts that China's total medal haul will not surpass the US, the host nation will amass more gold medals, thereby taking the number one ranking.

Sick of all the doom and gloom? If it's been difficult to read, it hasn't been particularly pleasant to write (although it is our job to tell it like it is). But it is sometimes refreshing to break from tradition and look at non-macro issues.

With the Olympics kicking off in less than two weeks, we thought we would take a much needed distraction and look at New Zealand's medal prospects at the Beijing Games based on economic variables. There is quite a bit of literature on explaining medals won at Olympic Games based on economic variables.³

However, as the graph below shows, the relationship between medals won and income levels (on a per capita basis) is not strong. If it were, then Luxembourg would consistently be a top performer (in fact, they haven't won a medal since 1952!). New Zealand typically does well on medals won per capita, relative to its income level. Australia is a standout performer in this regard.



Nonetheless, income levels are still generally regarded as one of the key determinants of medal counts. The

² This analysis is intended to be a light-hearted look at our chances of winning medals in Beijing. Current rankings and recent performances of our athletes have not been taken into account.

³ For example, see Johnson, D and Ayfer Ali (2004), "A tale of two seasons: Participation and medal counts at the Summer and Winter Olympic Games." *Social Science Quarterly* 85(4) pp 974-993

richer you are, the more you are able to afford world class equipment and training facilities, attract sponsorship money, employ the best coaches, become a full-time athlete rather than hold down your day job etc. Population size is also another important factor. The more people you have, the bigger the chances that one of your citizens is a world beater in something. Home ground advantage is often touted as giving athletes or teams that extra edge, and the same can be said if playing in nearby countries where familiarity with conditions and weather is strong (or making it relatively easier to travel to and get acclimatised to local conditions).

Taking all the above factors into account, the model specification we have come up with to determine Olympic medal success is as follow:

$$MEDALS_{it} = \alpha + \beta_1 GDP_PC_{it} + \beta_2 GDP_PC_{it}^2 + \beta_3 POPN_{it} + \beta_4 POPN_{it}^2 + \beta_5 HOST_{it} + \beta_6 NEIGH_{it} + \beta_7 POL_{it} + \beta_8 DRUG_{it} + \beta_9 PAST_{it} + \varepsilon$$

where $MEDALS_{it}$ is medals won by country i at time t (in this case the relevant Olympic year), GDP_PC is per capita GDP, $POPN$ is population, $HOST$ is a dummy variable taking on the value 1 if the country is playing host, $NEIGH$ is a dummy variable for countries in close proximity to the host, the $PAST$ is the medal count at the previous Games (a lagged dependent variable).

We have included two other variables into our specification. POL is a dummy variable for countries with a communist regime. Previous studies have found that such countries (particularly the former Soviet Bloc) won a disproportionately greater number of medals, possibly due to the amount of resources dedicated to sporting excellence.

The $DRUG$ variable is a unique innovation in our model. We have sought to test whether countries caught doping have an edge over others. We assign a dummy for countries that have had athletes tested positive for banned substances. For countries that have had athletes caught in at least two Games, the dummy variable is assigned to all years starting from the first Games they were caught. The first offence could be excused as an isolated incident. But getting caught twice or more increases the odds of more potential widespread abuse.

The GDP per capita and population data come from *The Conference Board and Groningen Growth and Development Centre Total Economy Database*⁴. Information on past Olympic medal tallies and host venues were obtained from www.olympics.it. Data on drug cheats came from Wikipedia (note that we are unable to verify the accuracy of this).

Due to data limitations, our analysis covers around 80 countries and each Olympic Games starting from the 1952 Helsinki Games up to the 2004 Athens Games. Not all countries took part in each Games (due to boycotts or other reasons), and the data has been

⁴ <http://www.conference-board.org/economics>

adjusted accordingly. Countries that have never won a medal at all since 1952 are not included in the sample.

Table 1 below shows the regression result of our model. We used two specifications, one to model total medals won, and the other only for gold medals. The models performed surprisingly well given the simplistic nature of the explanatory variables (though it is roughly in line with past studies), and the coefficients are of the expected sign.

The model supports the conclusion that the richer and more populated you are, the better your chances of winning medals. Being host or neighbours of hosting nations also helps increase the potential medal haul. The *POL* variable is significant. And though the *DRUG* variable has a positive sign, which means it has a positive effect on medals won, that variable was not found to be significant.

Table 1 – Results of regression analysis

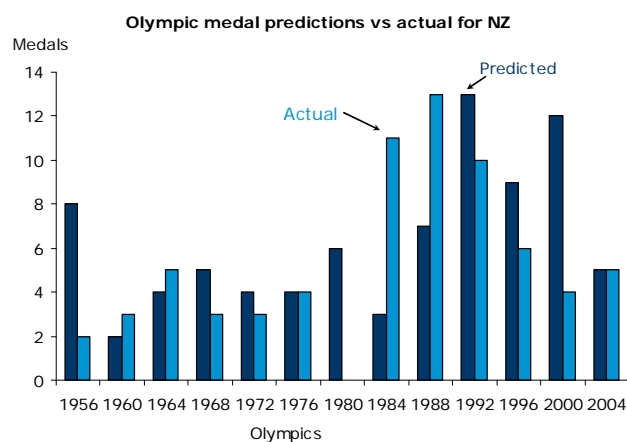
	All medals		Gold medals only	
	Coefficient	t-stat	Coefficient	t-stat
Constant	-2.523	-3.631**	-1.092	-3.525**
GDP_PC	0.460	3.265**	0.182	2.920**
GDP_PC ²	-0.012	-2.079*	-0.005	-1.808
POP_N	0.036	5.325**	0.015	4.813**
POP_N ²	0.000	-4.551**	0.000	-3.905**
HOST	23.555	10.154**	12.723	12.366**
NEIGH	4.517	3.232**	1.156	1.860
POL	10.379	6.825**	5.068	7.520**
DRUGS	0.702	0.743	0.508	1.214
PAST	0.802	44.837**	0.746	37.35**
Adj-R ²	0.84		0.80	
Sample	863		863	

Note: Significance denoted as ** for 1 percent and * for 5 percent.

So what can the models tell us about our chances in the Beijing Games? We present our predictions on New Zealand's medal prospects, alongside those for the top twenty Olympic nations, in Table 2. Our model is picking that the New Zealand Olympic team will do slightly better in Beijing compared to Athens four years ago, coming home with six medals including three gold.

Note that these numbers should be seen as benchmarks from which New Zealand's performance can be judged⁵. A comparison of past predictions from our model versus actual results shows considerable variability at times. The 1984 Los Angeles and 1988 Seoul Games were two standout events for New Zealand not only in terms of the number of medals won, but also in terms of outperforming the model predictions. The 2000 Sydney Games saw New Zealand come in well below predictions, particularly given that it was held in neighbouring Australia.⁶ But

the last medal count at the 2004 Athens Games was exactly in line with our model prediction. Here's hoping that our model is under-predicting New Zealand's actual outcome in Beijing. But whatever happens, it'll always be a case of go kiwi from us.



Since our models predict that playing host provides an advantage and that communist countries tend to outperform, China looks set to do well this year. Our model predicts that China will threaten the US's dominance at the Games, and while the total medal haul will not surpass the US, the host nation will amass more gold medals, thereby taking the number one ranking.

Table 2 – Beijing medal predictions

	Beijing Predictions		Athens 2004	
	Gold Medals	All Medals	Gold Medals	All Medals
China	41	81	32	63
USA	30	91	35	102
Russia	23	83	27	92
Japan	15	40	16	37
Germany	13	45	14	49
Australia	14	41	17	49
Cuba	11	31	9	27
France	10	30	11	33
Italy	9	30	10	32
South Korea	9	32	9	30
Great Britain	8	28	9	30
Ukraine	7	20	9	23
Hungary	7	15	8	17
Romania	6	16	8	19
Greece	6	16	6	16
Brazil	6	14	5	10
The Netherlands	4	20	4	22
Spain	4	19	3	19
Sweden	4	8	4	7
Norway	4	6	5	6
New Zealand	3	6	3	5

⁵ New Zealand has not set an official medal target for Beijing.

⁶ Note that while New Zealand officially boycotted the 1980 Moscow Games, it was still represented by four athletes.

GLOBAL WATCH

We present a table of global data outturns over the past week given the significance of the international backdrop at present. US data was generally stronger than expected last week, particularly the data released nearer the end of the week. However, it was the opposite case across the Atlantic, with European weak across the board. The European economy appears to have slowed quite sharply, and there is increased speculation it could now slip into recession.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	Leading Indicators (Jun)	-0.1%	-0.1%	0.1%	In-line
	Richmond Fed Manufacturing Index (Jul)	-9	-16	-17.1	Weaker
	House Price Index (May) – mom	-0.8%	-0.3%	-0.8%	Stronger
	Initial Jobless Claims (w/e Jul 20)	380k	406k	372k	Weaker
	Existing Home Sales (Jun) – mom	-1.0%	-2.6%	2.0%	Weaker
	Durable Goods Orders (Jun)	-0.3%	0.8%	0.1%	Stronger
	University of Michigan Confidence (Jul F)	56.4	61.2	56.6	Stronger
	New Home Sales (Jun) - mom	-1.8%	-0.6%	-1.7%	Stronger
Europe	Industrial New Orders (May) – mom	-1.3%	-3.5%	-2.0%	Weaker
	PMI Manufacturing (Jul A)	48.6	47.5	49.2	Weaker
	PMI Services (Jul A)	48.8	48.3	49.1	Weaker
	PMI Composite (Jul A)	49.0	47.8	49.3	Weaker
	M3 Money Supply (Jun) - yoy	10.3%	9.5%	10.0%	Weaker
UK	Retail Sales (Jun) – mom	-2.6%	-3.9%	3.6%	Weaker
	GDP (2Q A) – qoq	0.2%	0.2%	0.3%	In-line
	Index of Services (May) – 3mth/3mth	0.4%	0.4%	0.3%	In-line
Asia Ex-Japan					
<i>South Korea</i>	GDP (2Q P) – qoq	0.8%	0.8%	0.8%	In-line
<i>Singapore</i>	CPI (Jun) – yoy	8.0%	7.5%	7.5%	Weaker
	Industrial Production (Jun) - mom	4.0%	4.5%	-6.2%	Stronger
<i>Taiwan</i>	Unemployment Rate (Jun)	3.90%	3.88%	3.89%	In-line
	Export Orders (Jun) – yoy	12.75%	9.27%	14.46%	Weaker
	Industrial Production (Jun)	5.70%	5.12%	5.59%	Weaker
<i>Philippines</i>	Total Imports (May) – yoy	-	11.3%	11.8%	-
<i>Thailand</i>	Customs Exports (Jun) – yoy	-	27.4%	21.4%	-
	Customs Imports (Jun) – yoy	-	30.7%	15.7%	-
<i>Vietnam</i>	CPI (Jul) – yoy	-	27.0%	26.8%	-
	Exports (Jul) – yoy	-	37.7%	31.8%	-
	Imports (Jul) – yoy	-	56.8%	60.3%	-
Japan	All Industry Activity Index (May) – mom	0.4%	0.4%	0.4%	In-line
	National CPI (Jun) – yoy	1.9%	2.0%	1.3%	Stronger
	National CPI Ex-Fresh Food (Jun) – yoy	1.9%	1.9%	1.5%	In-line
	National CPI Ex Food & Energy (Jun) – yoy	0.0%	0.1%	-0.1%	Stronger
	Corporate Service Price (Jun) - yoy	0.7%	1.2%	0.7%	Stronger
Australia	CPI (2Q) – qoq	1.3%	1.5%	1.3%	Stronger
	RBA Weighted Median (2Q) – qoq	1.1%	1.0%	1.3%	Weaker
	RBA Trimmed Mean (2Q) – qoq	1.1%	1.2%	1.2%	Stronger

INTEREST RATE STRATEGY

The RBNZ easing cycle has started. Swap yields will continue to remain heavy as receivers continue to have the upper hand. Some profit taking may see yields pop higher but such moves will be temporary.

Market themes...

- > RBNZ surprises the market with a rate cut.
- > No smoking gun from AU CPI and credit concerns means RBA on hold for now.
- > US data slightly better, causing a selloff in bonds.

Review and outlook...

The market went into last week's OCR decision close to 50:50, so whichever way it went would have seen a market reaction. In what was likely to have been a very close decision, the RBNZ chose to cut the OCR by 25bps, which caused rates and bank bills to rally. The RBNZ has more or less given the green light to further OCR cuts, and the market has moved pricing accordingly – 25bp rate cuts have been fully priced in for each OCR decision up until March next year, with a good chance of another move after that.

Though further easings is conditional on the inflation outlook improving and the NZD not falling excessively, these are not arduous conditions to satisfy. The domestic dataflow has been printing consistently weak, and this week should continue that trend. The next major piece of data is next week's Q2 labour market read, which is expected to show the unemployment rate rising even if employment growth is expected to rebound following Q1's large fall.

With the RBNZ now in easing mode and the dataflow unlikely to stand in the way of further rate cuts, the NZ rates market will remain well received. The 2-year swap yield has fallen below 7.40 percent and while some profit taking early this week could see yields move higher, this is likely to prove temporary. With the market mindful of a weak labour market print around the corner, the market will be reluctant to push yields too much higher. A continued weak housing market also means there will be an absence of mortgage paying in the near term.

In offshore events, AU Q2 CPI data, while higher than expected, did not contain any smoking gun that will cause the RBA to shift from its recent stance. The RBA remains comfortable with current cash rate settings, especially with the Australian retail banks lifting their mortgage rates, causing a further tightening in financial conditions. With the RBNZ now cutting, the market sees the next RBA move as down. However, while we may well have seen the peak in the RBA cash rate, easings are still some time away.

The Freddie and Fannie saga seems like a long time ago now. The US economic data has been printing better than expectations, and the earnings reporting season so far has contained more upside surprises than downside. While it is too early to call a trough in the economic cycle, markets have started to think of

Fed rate hikes by the end of the year, causing bond yields to sell off. US Q2 GDP, ISM and non-farm payrolls data this week will either cement this view or lead to another bout of safe haven flows back into bonds.

Gauges for NZ interest rates yields		
Gauge	Direction	Comment
RBNZ	↓	Easing cycle has now commenced. Further rate cuts expected.
NZ data	↔/↓	Data this week will not derail prospects for rate cuts.
Fed Funds/front end	↔	Economic data not as bad as feared. Market starting to contemplate end of year hikes again.
RBA	↔	CPI no smoking gun. RBA on hold for now.
US 10 year	↔/↑	Safe haven flows unwinding. Better US data sending yields higher.
NZ swap curve	↔	Curve is expected to consolidate around current levels – steepeners favoured.
Flow	↔	Consolidation ahead. Unwind of received positions limiting the move lower.
Technicals	↔/↓	Technically the market is still positioned for a move lower in rates.

Borrowing strategies we favour at present

The RBNZ has embarked on an easing cycle. We see the first stop of the OCR as 7.25 percent by the end of this year. We suggest borrowers continue to shorten duration or borrow in the 1-year space. Given that the 2-year has moved quite far, borrowers who want certainty can consider borrowing in the 2-year space.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 11-Sep-08	-26	-25
Thu 23-Oct-08	-51	-50
Thu 4-Dec-08	-74	-73
Thu 22-Jan-09	-88	-93
Thu 5-Mar-09	-100	-108
Thu 23-Apr-09	-108	-123
Thu 4-Jun-09	-115	-138

Trading themes we favour at present

Remain received the belly of the curve (3-5 year). The June 09's bank bill position suggested last week has done well (+26 pts). Continue holding as a play on the RBNZ having to ease more.

CURRENCY STRATEGY

With interest rates falling and set to fall further, the kiwi should remain on the back foot. While the rates market now has a lot priced in, it is hard to go against the spirit of a declining yield differential, and pending negative carry vis-à-vis the AUD. Attention will now turn to the speed, and in that regard the global environment, the EUR/USD (or USD sentiment) and commodity prices will have a huge say.

Market themes...

- > RBNZ moves to stabilise and looks prepared to do more easing.
- > The global economy appears to have reached an inflection point, and Europe in particular is looking very weak.
- > The USD may be finding a base, despite our suspicion there is another leg of weakness to come.
- > Commodity prices remain under pressure and key to watch.

Review and outlook...

With the RBNZ cutting interest rates for the first time in 5 years (and arguably coming as a surprise to the market), the NZD is on the back foot. It is testing year-to-date lows against the USD, has fallen below 0.78 against the AUD and is below 0.48 against the EUR.

Given the weak domestic economic backdrop, and now the strong likelihood that NZ's large yield advantage will slowly be reduced over the remainder of this year – given the relatively dovish tones by the RBNZ accompanying their rate cut – we remain very comfortable holding a bearish view of the NZD. Strictly speaking the yield curve has rapidly moved to have a lot priced in (145 basis points of cuts over the coming year) but it's hard to go against the spirit of lower rates, despite some uncertainty over the speed of decline.

How quickly the currency falls will depend heavily on the global environment, the EUR/USD (or USD sentiment) and commodity prices. Last week was another forgettable week for commodity markets, with oil down another 6 percent, nickel 10 percent and softs such as rice and corn not immune. Lead and wheat of course rebounded so it is not strictly one way traffic.

Looking at the big picture, we find it hard to be bullish on global prospects. With weakness clearly extending rapidly into Europe, global fragilities are being exposed almost daily. The USD still looks like it is finding a base in this environment, and Yankee doodle data has been far dandier than Europe's. The market continues to price for future interest rate hikes and recent Fed rhetoric (admittedly from renowned hawkish officials) suggest they could be delivered. The US 10-year Treasury note is back above 4 percent.

This week it is likely to be the global backdrop that holds sway over near-term directional moves. Important data to watch will be the initial Q2 GDP print out of the US as well as the key ISM and non-farm payrolls reports. In Europe, there is business and consumer sentiment surveys released, as well as German labour market data. Locally, the data is all second-tier in nature, although the National Bank *Business Outlook* will be important for the first reading on Q3 economic performance.

Technically, the NZD is on major support against most crosses with NZD/USD hovering above 0.7380 and the NZD/EUR above 0.4716. The 1.3000 level in AUD/NZD equates to the 0.7690 level in NZD/AUD terms and has option barrier interest. NZD/JPY at 78.50 is critical. This week we expect these levels to hold, but sell rallies approaching 0.7500 NZD/USD.

NZD vs AUD: monthly directional gauges

Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↓	RBA on hold for a long time and RBNZ cuts.
Commodities	↔	Same picture for both.
Partial indicators	↔/↓	Were better across the Tasman but Oz now slowing abruptly.
Technicals	↓	The key 0.7850 level has been broken.
Sentiment	↓	Terms of trade says it all.
Other	↔	AUD/USD uncertain.
On balance	↓	We still like the trend.

NZD vs USD: monthly directional gauges

Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔	Yield and commodity story factored.
Yield	↓	RBNZ now easing
Commodities	↔	The big one to watch.
Risk aversion	↔	Credit again an issue but is it a bigger issue for US?
Partial indicators	↓	NZ real data simply weaker than US.
Technicals	↔/↓	Solid base at 0.7380.
AUD	↔	AUD now struggling to push on
Sentiment	↔	Changes daily.
Other	↔	Still need a break lower for EUR/USD.
On balance	↔/↓	RBNZ has cut so trend becomes clearer

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
28-Jul	NZ	Trade Balance (Jun)	-350.0M	-195.8M	10:45
		Imports (Jun)	3.70B	3.92B	10:45
		Exports (Jun)	3.35B	3.73B	10:45
	AU	Reserve Bank Asst Governor DeBelle Speaks in Sydney	-	-	11:45
		Conference Board Leading Index (May)	-	0.3%	12:00
		NAB Business Confidence (2Q)	-	-4	13:30
	GE	GfK Consumer Confidence Survey (Aug)	3.5	3.9	18:10
29-Jul	US	Fed's Mishkin Speaks on Communication in Washington	-	-	04:30
	NZ	Building Permits (Jun) - mom	-	-42.3%	10:45
	JN	Jobless Rate (Jun)	4.0%	4.0%	11:30
		Household Spending (Jun) - yoy	-2.8%	-3.2%	11:30
		Retail Trade (Jun) - mom	-0.6%	-0.2%	11:50
	UK	Net Consumer Credit (Jun)	1.0B	1.4B	20:30
		Net Lending Sec. on Dwellings (Jun)	3.7B	4.1B	20:30
		Mortgage Approvals (Jun)	37K	42K	20:30
30-Jul	US	S&P/CS Composite-20 (May) - yoy	-16.0%	-15.3%	01:00
		Consumer Confidence (Jul)	50.0	50.4	02:00
	JN	Industrial Production (Jun P) - mom	-1.6%	2.8%	11:50
		Vehicle Production (Jun) - yoy	-	6.8%	16:00
		Small Business Confidence (Jul)	-	40.7	17:00
	AU	Building Approvals (Jun) - mom	1.0%	-6.5%	13:30
	NZ	Money Supply M3 (Jun) - yoy	-	4.9%	15:00
	GE	Bloomberg Retail PMI (Jul)	-	44.9	20:00
	EC	Bloomberg Retail PMI (Jul)	-	44	20:00
		Business Climate Indicator (Jul)	-0.02	0.14	21:00
		Consumer Confidence (Jul)	-18	-17	21:00
		Economic Confidence (Jul)	93.0	94.9	21:00
		Industrial Confidence (Jul)	-7	-5	21:00
		Services Confidence (Jul)	8	9	21:00
31-Jul	US	ADP Employment Change (Jul)	-60K	-79K	00:15
	UK	GfK Consumer Confidence Survey (Jul)	-37	-34	11:01
	AU	Private Sector Credit (Jun) - mom	0.6%	0.6%	13:30
		Trade Balance (Jun)	-100M	-965M	13:30
		Retail Sales (Jun) - mom	0.0%	0.7%	13:30
		Retail Sales Ex Inflation (2Q) - qoq	-0.1%	-0.1%	13:30
	JN	Labour Cash Earnings (Jun) - yoy	0.6%	0.2%	13:30
		Housing Starts (Jun) - yoy	17.8%	-6.5%	17:00

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
31-Jul cont.	JN	Construction Orders (Jun) - yoy	-	-25.2%	17:00
	NZ	NBNZ Business Confidence (Jul)	-	-38.7	15:00
	GE	ILO Unemployment Rate (Jun)	7.4%	7.40%	18:00
		Unemployment Change (000's) (Jul)	-20K	-38K	19:55
		Unemployment Rate (s.a) (Jul)	7.8%	7.8%	19:55
	EU	CPI Estimate (Jul) - yoy	4.1%	4.0%	21:00
		Unemployment Rate (Jun)	7.2%	7.2%	21:00
1-Aug	US	GDP (Annualized) (2Q A)	2.3%	1.0%	00:30
		Personal Consumption (2Q A)	1.5%	1.1%	00:30
		GDP Price Index (2Q A)	2.3%	2.7%	00:30
		Core PCE (2Q A) – qoq	1.9%	2.3%	00:30
		Employment Cost Index (2Q)	0.7%	0.7%	00:30
		Initial Jobless Claims (w/e Jul 27)	395K	406K	00:30
		Continuing Claims (w/e Jul 20)	3,150K	3,107K	00:30
		Chicago Purchasing Manager (Jul)	49.0	49.6	01:45
		NAPM-Milwaukee (Jul)	43.5	39	02:00
	AU	AIG Performance of Mfg Index (Jul)	-	47	11:30
		TD Securities Inflation (Jul) - mom	-	0.5%	12:30
		RBA Commodity Index SDR (Jul) - yoy	-	38.2%	18:30
	JN	Vehicle Sales (Jul) - yoy	-	-3.6%	17:00
	GE	PMI Manufacturing (Jul F)	50.9	50.9	19:55
	EC	PMI Manufacturing (Jul F)	47.5	47.5	20:00
	UK	PMI Manufacturing (Jul)	45.5	45.8	20:30
2-Aug	US	Change in Non-Farm Payrolls (Jul)	-75K	-62k	00:30
		Unemployment Rate (Jul)	5.6%	5.5%	00:30
		Change in Manufacturing Payrolls (Jul)	-40K	-33K	00:30
		Average Hourly Earnings (Jul) - mom	0.3%	0.3%	00:30
		ISM Manufacturing (Jul)	49.2	50.2	02:00
		ISM Prices Paid (Jul)	88.0	91.5	02:00
		Construction Spending (Jul) - mom	-0.3%	-0.4%	02:00

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: Given the RBNZ's interest rate cut last week, we see little on the data horizon to stop them from easing interest rates over the remainder of this year. The dataflow is likely to confirm the economy is slowing rapidly, with the labour market data the next big focus.

Date	Data/Event	Economic Signal	Comment
Mon 28 Jul (10.45)	Overseas Merchandise Trade (Jun)	Another deficit	Another monthly trade deficit is expected as the high oil prices continue to add to the import bill.
Tue 29 Jul (10.45)	Building Consents (Jun)	Weak	An early Easter and some large apartment approvals have increased volatility in consent issuance of late. However, we expect it to settle back down into its weakening trend.
Wed 30 Jul (15.00)	Credit Growth (Jun)	Weak	Housing lending will remain soft.
Thu 31 Jul (15.00)	NBNZ <i>Business Outlook</i> (Jul)	-	-
Mon 4 Aug (10.45)	QES & LCI (Jun qtr)	Still solid	Given the lagging nature of wage data, this is likely to show still strong wage growth, although the employment indicators within the QES may be soft.
Tue 5 Aug (15.00)	ANZ Commodity Price Index (Jul)	-	-
Thu 7 Aug (10.45)	Household Labour Force Survey (Jun qtr)	Bounce but underlying softness	Given the sharp fall last quarter, employment growth will rebound in Q2, albeit modestly. It is very volatile from quarter to quarter and unstable. However, this masks the underlying picture, which is one of a turn in labour demand. The unemployment rate is the more stable indicator of the trend. We expect a rise to 3.8 percent, but would not be surprised to see it higher going by the anecdotes we are hearing.
circa 11 Aug	REINZ House Sales (July)	Still weak	House sale volumes are expected to remain weak until vendors begin to adjust their price expectations.
Wed 13 Aug (10.45)	Producer Price Index (Q2)	Solid increase	Further increases in oil and wholesale electricity prices are expected to see both input and output prices rise strongly in the quarter.
Fri 15 Aug (10.45)	Retail Sales (Jun)	Price increases eating into discretionary income	The ECT and credit card data point to a fall in June retail sales. We expect retail sales volumes for Q2 to show a large contraction.
Wed 21 Aug (10.45)	External Migration (Jul)	Finding a base	The monthly net inflow appears to have found a base and we expect the 12-month total to remain around the current 5,000 level. Visitor arrivals are probably more important to watch as a gauge of global demand.
Wed 21 Aug (10.45)	Electronic Card Transactions (Jul)	Weak	Volatility aside, retail spending is likely to remain weak as cost of living pressures weigh on household budgets.
Wed 21 Aug (10.45)	Credit Card Spending (Jul)	Weak	Similar themes to the ECT data.
Wed 21 Aug (15.00)	NBNZ Regional Trends (Q2)	-	-
On Balance		An economy heading backwards, but with inflation	Growth indicators are poor. But inflation needs to be watched.

SUMMARY OF KEY ECONOMIC FORECASTS

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
GDP (% qoq)	0.8	0.5	0.8	-0.3	-0.5	-0.2	0.2	0.3	0.5	0.5
GDP (% yoy)	3.2	3.3	3.5	1.9	0.6	-0.2	-0.8	-0.2	0.8	1.5
CPI (% qoq)	1.0	0.5	1.2	0.7	1.6	1.4	0.9	0.5	0.7	0.7
CPI (% yoy)	2.0	1.8	3.2	3.4	4.0	5.0	4.7	4.5	3.6	2.9
Employment (% qoq)	0.5	-0.3	0.9	-1.3	0.2	-0.4	0.0	0.1	0.1	0.2
Employment (% yoy)	1.5	1.6	2.5	-0.2	-0.6	-0.7	-1.5	-0.1	-0.2	0.4
Unemployment Rate (% sa)	3.6	3.5	3.4	3.6	3.8	4.2	4.4	4.5	4.7	5.0
Current Account (% GDP)	-8.1	-8.3	-7.9	-7.8	-7.6	-7.4	-7.2	-6.8	-6.4	-6.1
Terms of Trade (% qoq)	0.4	3.7	2.7	4.1	-0.1	-1.0	0.0	-1.5	-1.2	-1.0
Terms of Trade (% yoy)	2.3	8.4	8.5	11.3	10.7	5.8	3.0	-2.5	-3.6	-3.7

KEY ECONOMIC INDICATORS

	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08
Retail Sales (% mom)	1.1	-0.5	1.8	0.1	0.2	-0.6	-1.1	1.2	-1.2	..
Retail Sales (% yoy)	4.1	5.8	7.2	5.4	6.3	7.7	-1.0	4.1	1.0	..
Credit Card Billings (% mom)	2.2	-0.4	1.1	0.5	-	0.9	-3.4	3.9	-1.2	-0.7
Credit Card Billings (% yoy)	9.3	7.7	9.5	7.6	8.6	8.0	3.3	8.2	5.9	3.3
Car Registrations (% mom)	-6.6	5.7	-3.5	-2.6	5.2	-4.3	-13.3	11.7	-14.7	3.3
Car Registrations (% yoy)	0.1	4.7	2.3	1.4	1.7	1.9	-13.2	-1.0	-20.6	-15.9
Building Consents (% mom)	-11.0	-4.2	0.4	-4.3	3.6	-5.7	-14.3	83.0	-45.0	..
Building Consents (% yoy)	-15.7	-16.0	-4.6	-6.6	-5.3	-17.6	-27.3	30.8	-27.1	..
REINZ House Price (% yoy)	12.3	8.0	6.7	4.5	4.0	0.7	1.6	-1.1	-1.4	..
Household Lending Growth (% mom)	0.8	0.8	0.8	0.7	0.7	0.8	0.4	0.4	0.5	..
Household Lending Growth (% yoy)	13.2	13.0	12.8	12.3	11.9	11.6	10.8	9.9	9.3	..
Roy Morgan Consumer Confidence	121.3	122.0	121.9	126.6	121.2	116.0	111.7	99.9	89.2	86.5
NBNZ Business Confidence	-26.5	-12.9	-19.6	-24.9	..	-43.9	-57.9	-54.8	-49.7	-38.7
NBNZ Own Activity Outlook	17.2	20.3	15.7	18.2	..	2.4	-6.4	-3.8	-4.4	-4.0
Trade Balance (\$m)	-572	-774	-628	39	-311	243	-44	-296	-196	..
Trade Balance (\$m annual)	-6282	-5883	-5691	-5307	-4793	-4422	-4527	-4609	-4813	..
ANZ World Commodity Price Index (% mom)	0.4	1.8	0.8	0.0	-1.4	1.1	2.0	-0.3	0.9	0.0
ANZ World Commodity Price Index (% yoy)	35.7	37.8	35.9	30.9	27.4	26.9	26.9	20.7	18.7	11.6
Net Migration (sa)	630	230	440	20	100	250	530	480	960	490
Net Migration (annual)	8309	7517	6588	5491	4799	4643	4678	4666	4931	4732

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)						
	May-08	Jun-08	28-Jul-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
NZD/USD	0.778	0.762	0.743	0.770	0.750	0.720	0.680	0.640	0.630	0.620
NZD/AUD	0.819	0.801	0.777	0.762	0.721	0.720	0.723	0.719	0.724	0.738
NZD/EUR	0.500	0.489	0.473	0.494	0.484	0.468	0.453	0.441	0.450	0.456
NZD/JPY	81.1	81.4	80.1	80.1	78.0	75.6	73.4	70.4	69.3	69.4
NZD/GBP	0.395	0.387	0.373	0.393	0.389	0.379	0.364	0.346	0.346	0.344
NZ\$ TWI	69.4	68.2	66.3	67.8	65.9	64.0	61.9	59.6	59.6	59.7
NZ interest rates	May-08	Jun-08	28-Jul-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
OCR	8.25	8.25	8.00	7.75	7.25	7.25	7.00	6.50	6.00	6.00
90 day bill	8.72	8.76	8.29	8.00	7.60	7.60	7.10	6.50	6.20	6.20
10 year bond	6.43	6.44	6.14	6.50	6.20	6.00	6.10	6.10	6.10	6.20
International	May-08	Jun-08	28-Jul-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
US Fed funds	2.00	2.00	2.00	2.00	1.75	1.75	1.75	2.25	2.75	3.25
US 3-mth	2.68	2.78	2.79	2.50	2.00	1.75	2.00	2.50	3.00	3.50
AU cash	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.00	6.75
AU 3-mth	7.79	7.84	7.71	7.90	7.90	7.90	7.60	7.30	7.20	6.70

KEY RATES

	25 Jun	21 Jul	22 Jul	23 Jul	24 Jul	25 Jul
Official Cash Rate	8.25	8.25	8.25	8.25	8.00	8.00
90 day bank bill	8.71	8.45	8.45	8.43	8.30	8.29
NZGB 07/09	7.06	6.95	7.02	6.95	6.87	6.84
NZGB 11/11	6.48	6.21	6.26	6.24	6.17	6.14
NZGB 04/13	6.39	6.16	6.24	6.22	6.16	6.13
NZGB 12/17	6.42	6.10	6.18	6.18	6.13	6.10
2 year swap	7.88	7.65	7.64	7.58	7.40	7.38
5 year swap	7.53	7.36	7.35	7.29	7.19	7.18
RBNZ TWI	67.8	67.4	67.3	67.1	66.3	66.2
NZD/USD	0.7574	0.7615	0.7610	0.7558	0.7433	0.7431
NZD/AUD	0.7917	0.7805	0.7796	0.7801	0.7752	0.7754
NZD/JPY	81.66	81.33	80.99	81.10	80.16	79.36
NZD/GBP	0.3844	0.3816	0.3801	0.3791	0.3720	0.3740
NZD/EUR	0.4864	0.4798	0.4778	0.4787	0.4735	0.4733
AUD/USD	0.9567	0.9756	0.9762	0.9689	0.9589	0.9584
EUR/USD	1.5572	1.5871	1.5926	1.5790	1.5698	1.5701
USD/JPY	107.81	106.80	106.43	107.31	107.85	106.79
GBP/USD	1.9705	1.9953	2.0021	1.9938	1.9982	1.9867
Oil	136.49	128.94	131.43	127.25	123.73	124.62
Gold	888.40	959.95	967.75	944.95	923.30	932.35
Electricity (Haywards)	31.37	4.92	8.29	11.70	13.60	15.60
Milk futures (US\$/contract)	142	143	143	143	143	143
Baltic Dry Freight Index	9244	8961	8904	8856	8771	8637

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.

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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