

NEW ZEALAND ECONOMICS MARKET FOCUS

7 June 2011

INSIDE

| | |
|--------------------------------|----|
| Economic Overview | 2 |
| June MPS Preview | 6 |
| Interest Rate Strategy | 9 |
| Currency Strategy | 10 |
| Effective Exchange Rate Update | 11 |
| Data Event Calendar | 12 |
| Data Watch | 14 |
| Key Forecasts | 15 |

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CENTRAL BANKS CENTRE STAGE

ECONOMIC OVERVIEW

The aggregate tenor of leading gauges in New Zealand continues to hold out the allure (though not necessarily the reality) of a strong upturn. Significantly, such signs are going against the grain of the general trend in leading global gauges, most notably out of the US. In such a situation, monetary conditions have firmed, with the NZD/USD hitting a post-float high last week of 0.8264 US cents. This runs the risk of choking off the recovery before it really gets underway, making the RBNZ's job difficult. This week's retail, construction and housing data should illustrate the theme of sector divergences and shed further light on the possibility of a negative Q1 GDP print.

JUNE MPS PREVIEW

With a no-change decision widely expected, once again the key focus will be on the tone of the assessment. We expect a more upbeat assessment (probably better described as less downbeat) relative to April and March, although cautious undertones are expected to remain. The shape of the yield curve, a massive proportion of mortgages on floating and tight fiscal policy buys the RBNZ more time to wait for concrete evidence of recovery. We continue to believe this evidence will soon appear and are less sanguine on the inflation outlook. However, for now, the path of least regret, particular given the RBNZ's experience in mid 2010, is one of patience.

INTEREST RATE STRATEGY

Another string of better than expected data releases caught the market off guard again last week, and has led to a re-pricing of monetary policy expectations. We expect the RBNZ to be less dovish this week, but still see market pricing as relaxed relative to our view and expect the slow grind higher at the short end to continue. US interest rates have moved lower in the past week on the back of weaker data, and may go lower yet. But NZ bonds have lagged, despite still very strong demand at the weekly tenders.

CURRENCY STRATEGY

Currency markets are torn between the continuing Greek debt crisis and a string of weak economic data in the US. At present, the latter is winning out, leading to a weaker USD. Expect this to continue as talk of QE3 grows louder. A weaker USD means NZD will be supported, though we expect the RBNZ to try to jawbone the currency down this Thursday. Any reaction will likely be brief, with support on dips expected to be strong. Further post-float highs beckon if USD weakness extends. While we do not expect the RBA to hike today, the market looks to be underpricing a hike in subsequent months and the clear risk this week is that a more upbeat RBA sends the AUD higher, taking the NZD along with it.

EFFECTIVE EXCHANGE RATE UPDATE

May saw mixed conditions by sector, with some falls and rises. Disparities in trading conditions remain, with trading conditions more enhancing than average for four groups but more restrictive than average for three groups. The strengthening NZD looks set to place parts of the export sector not benefiting from high commodity prices under further pressure.

ECONOMIC OVERVIEW

SUMMARY

The aggregate tenor of leading gauges in New Zealand continues to hold out the allure (though not necessarily the reality) of a strong upturn. Significantly, such signs are going against the grain of the general trend in leading global gauges, most notably out of the US, which adds support to there being more local substance. In such a situation, monetary conditions have firmed, with the NZD/USD hitting a post-float high last week of 0.8264 US cents. However, the firming currency and increasing interest rate expectations run the risk of choking off the recovery before it really gets underway. This makes the RBNZ's job all the more difficult. This week's retail, construction and housing data should illustrate the theme of sector divergences and shed further light on the possibility of a negative Q1 GDP print.

NEXT WEEK'S EVENTS

SNZ Building Work Put in Place - 2011Q1

(Wednesday, June 8, 10:45am). We expect a 4 percent decline in residential volumes. A 2 percent fall in non-residential building volumes is expected.

June Monetary Policy Statement (Thursday, June 9, 9:00am). The RBNZ are expected to hold the OCR at 2.5 percent. See our preview on page 6.

REINZ Housing Market Report - May (Friday, June 10, 10:00am). We expect a 2 percent increase in sales volumes, with prices to be broadly unchanged.

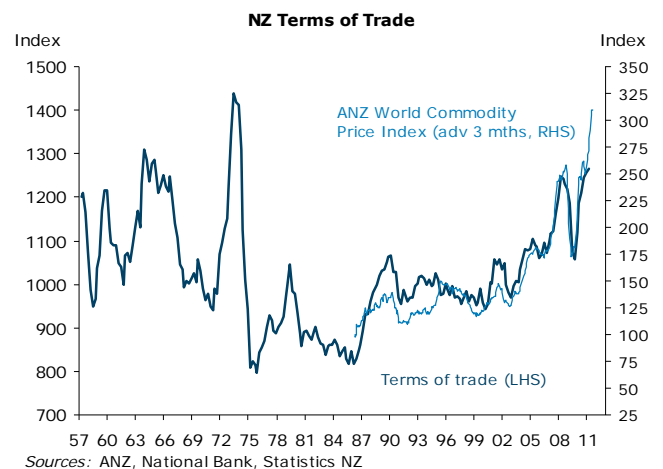
Electronic Card Transactions – May (Friday, June 10, 10:45am). We expect May retail spending levels to be unchanged from April.

WHAT'S THE VIEW?

Local developments continue to hold out the allure of a strong upswing.

- The terms of trade hit their highest point since 1974. Underpinning our increasing purchasing power has been broad-based strength in commodity prices.
- The *globalDairyTrade* auction reaffirmed the positive news story for the dairy sector, with USD prices up 4.5 percent from the previous event. While USD whole milk powder prices eased back, it was not by much.
- The improvement in business confidence from its immediate post-quake nadir continued. The May National Bank Business Outlook was littered with signs of improvement, albeit from a low base.
- We're seeing a continued recovery in business

lending which is now 3 percent up from late 2010 lows. Overseas Trade volume data showed a climb in capital good imports and transportation imports, held onto their late 2010 gains, a further positive for the supply side capacity of the economy. Capital import figures held up pretty well in April. Unlike the mid 2010 jump in business confidence (when hope of a strong upswing turned out to be a false dawn), this one is being accompanied by stronger business sector borrowing and capital imports.



Of course we would be amiss not to recognise weak spots. The April RBNZ credit aggregates confirmed the deleveraging dynamic sweeping the country, with agricultural credit levels down on February peaks as farmers put high commodity prices to work on improving balance sheets. Whether that will continue into the 2011/12 season given the prospective multi-year income boost remains to be seen. Household credit growth remained anaemic (positive but slow relative to income), with consumers repaying debt. The April Barfoot & Thompson housing market data was not inspiring price-wise. April residential building consents were weak, although more signs of life were apparent for ex-apartment issuance. Weakness was also evident in non-residential consent issuance, which suggests construction sector activity has contracted over the first half of this year. And in the weekend Christchurch recorded another seismic jolt, with the magnitude 5.5 aftershock one of the six largest quakes since last September. With the EQC classifying the aftershock as a new event for insurance purposes, claims are likely to increase.

We continue to wait for improving sentiment to translate into improving activity, which, if our on-the-road anecdotes are correct should start to manifest in more consistent hard data from July. Of course we fully expect a degree of

ECONOMIC OVERVIEW

patchiness to remain and the real message here is simply expectations of more positive critical mass, as distinct to overwhelming critical mass. The latter simply can't happen when you have an economy still "transitioning" from a borrow and spend model to an earn and spend paradigm, a process that will take time.

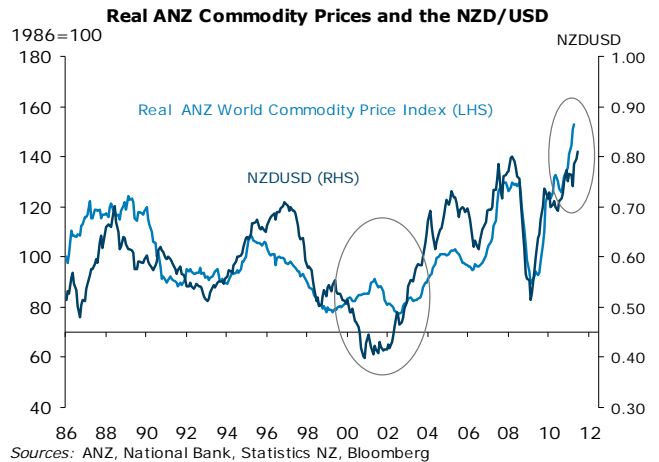
At this juncture, two observations are also noteworthy.

First, the general tenor of NZ's leading gauges have been completely at odds with the global scene, most notably relative to the US, where various business confidence measures have been slipping sharply of late and speculation is mounting of QEIII (unfounded in our view). Since the onset of the global financial crisis, business sentiment lead indicators have all been reasonably well correlated across countries and also with the general trend in equities (which we refer to as the blind leading the blind). Either:

- New Zealand businesses are missing something global peers aren't;
- There are local specific issues in both nations that are dominating temporarily (i.e. cuts in US defence spending, the impact of the Japanese earthquake and tsunami is greater in the US, etc); or
- There is more local substance.

We err towards the latter two.

Second, financial market variables are facing a chicken-and-egg battle with the economy. The interest rate market has started to re-price expectations towards the first hike from the RBNZ. In the past two weeks, the odds of a 25 basis point hike have risen from less than 60 percent to 80 percent currently. This has gone against the background of falling US Treasury yields, normally a bellwether for the NZ rates market. Last week the NZD/USD reached a post-float high, with the NZD TWI also skirting three-year highs. While global forces have been prevalent, along with a lack of liquidity, the movement in the NZD/AUD from sub 0.74 to around 0.76 tells us there have been some relative NZ specifics in the mix. However, at present the *de facto* tightening in financial conditions does not appear significant in so far as recovery prospects are concerned. While the buffering role of the NZD to commodity price movements is well known, its impact will be blunt. Our analysis of effective exchange rates on page 11 shows parts of the export sector are holding up quite well, whereas others are still finding the going tough.



And here is the catch. A sustained recovery is somewhat conditional on financial markets not overly factoring in an upswing, which would push up the NZD and interest rates, thereby choking the recovery off. This makes the RBNZ's job all the more difficult. While we suspect the RBNZ is perceiving the same improving undercurrents we are behind the scenes, there seems little point declaring their hand at this juncture. **The RBNZ face a tricky balancing act trying to maintain their inflation targeting credibility (we suspect their inflation trajectory in this week's MPS will be very interesting!) yet prevent the currency going higher.** We expect they will emphasise the patchiness of the economic recovery as a key reason for keeping the OCR on hold. While the obvious risk is of falling behind the curve, the huge proportion of floating rate mortgages affords the RBNZ the luxury of taking a punt. It is still six months before the December Monetary Policy Statement, which is when we expect the first unwind of the March MPS insurance cut. In central bank and New Zealand data terms, this is a very long time!

Turning to the more general data outturns, this week's building work put in place figures will shed more light on the make-up of Q1 GDP. We already know sector performances have been mixed, with robust retail but negative Q1 net trade contribution. **The Work Put in Place figures should confirm construction sector activity went backwards in Q1.** Low consent issuance suggests the potential for weakness in construction sector activity to carry over into the second half of 2011, but we expect increased work on demolition and non-consented work on alterations and additions to partly offset this. Statistics New Zealand have noted that as demolition work is not included in the consent figures, the relationship between consents and activity is likely to change. As such, we would expect that actual levels of construction activity will remain higher than that

ECONOMIC OVERVIEW

implied by consents for a while to come. A major part of the positive story for 2012 is the earthquake reconstruction boost. This looks set to transform the construction sector from a laggard to a star performer, contributing 1.5 percent of GDP over at least the next five years.

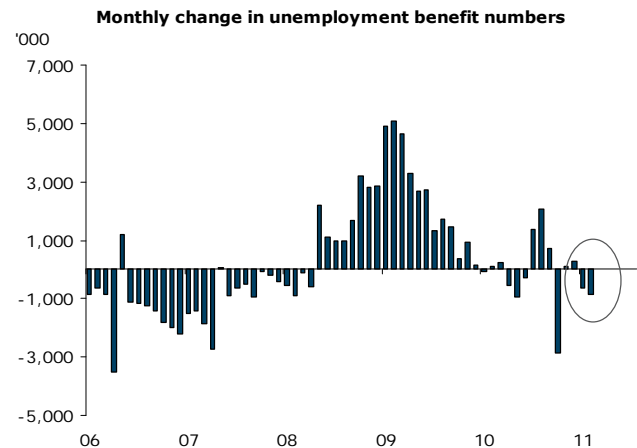
The May REINZ housing market report is expected to present a dichotomised picture. The number of mortgage approvals has continued to track below last year's levels, and while we are expecting a May pick-up in house sales, it is to levels that still remain well below historical averages relative to the size of the housing market. Deleveraging and emigration are proving to be effective counterweights to low mortgage interest rates and solid income growth. We expect the housing market to strengthen over the latter part of this year as the economic recovery picks up and looming housing shortages become more evident.



This week's retail numbers are expected to show the retail sector taking a breather after a heady last few months. We expect no change in May retail Electronic Card Transaction (ECT), spending, but this will still deliver 6 percent annual ex-GST spending growth.

We hope to receive May unemployment benefit numbers this week. This is not something that is on most people's radar but we are paying close attention to such figures; for they are timely, have stabilised of late and official household labour force unemployment rate figures have been a lottery recently. On top of this, the Government is in the process of winding down the jobs support package for Christchurch businesses. **Anecdotes are that the expected jump in benefit numbers is not materialising.** Whether this is merely timing or more evidence of real resilience remains to be seen. Unemployment benefit numbers for May are likely to

be too early to answer this question, but **timely labour market indicators such as benefit numbers and job ads are going to become very influential over the coming months.**



This week is heavy with central bank decisions, with the RBA first up today. While the RBA are expected to leave the cash rate unchanged, our Australian colleagues believe the market is underpricing the risks of the RBA moving earlier. They expect an August hike, but view a July move as a 50/50 proposition. Indeed, market complacency could be in for a shake up by today's RBA statement. The ECB and BOE are expected to remain on hold, but the market is still expecting inflation concerns to prompt an ECB hike over the next few months.

RECENT LOCAL DATA

Merchandise Trade – April. April recorded a monthly surplus of \$1,113m, the highest monthly surplus ever recorded. The annual trade surplus rose to \$1,187m.

National Bank Business Outlook – May. Headline business confidence rose 24 points to +38.3, with own activity firming 10 points (to +39.7). Investment and employment intentions rose (to +14.8 and +12.6 respectively), with pricing intentions and inflation expectations also firming (to +34.2 and 3.3 percent respectively).

RBNZ Credit Aggregates – April. Household credit was 1.2 percent higher than 12 months earlier, whereas annual business credit growth was 1.0 percent. Agricultural credit levels were 0.1 percent lower than 12 months earlier.

SNZ Overseas Trade Indexes – 2011Q1. The terms of trade rose 0.9 percent, driven by a 6.3 percent increase in export prices. Export volumes fell 0.3 percent q/q, with import volumes up 5.1 percent q/q.

ECONOMIC OVERVIEW

ANZ Commodity Price Index – May. Commodity prices rose 0.3 percent (+19.5 percent y/y), with the NZD index easing 0.8 percent in May (+7.5 percent y/y).

globalDairyTrade online auction. Dairy prices increased by 4.5 percent to an average of US \$4,306 per tonne. Whole milk powder prices eased by 3 percent this event to US \$3,780/tonne.

SNZ Building Consents – April. The number of residential consents fell a seasonally adjusted 1.7 percent (-32.5 percent y/y), but rose 3.7 percent on an ex-apartment basis (-30.1 percent y/y). Non-residential consent values fell 21 percent s.a. to \$244m.

Government Financial Statements for the 10 months ended April 2011. Due to lower than forecast expenditure, the operating deficit excluding gains and losses was smaller than forecast in the May Budget at \$10,920m (versus \$11,326 expected). Net debt, at 21.3 percent of GDP was narrowly under the Budget forecast.

JUNE 2011 MPS PREVIEW

SUMMARY

With a no-change decision widely expected, once again the key focus will be on the tone of the assessment. We expect a more upbeat assessment (probably better described as less downbeat) relative to April and March, although cautious undertones are expected to remain. The shape of the yield curve, a massive proportion of mortgages on floating and tight fiscal policy buys the RBNZ more time to wait for concrete evidence of recovery. We continue to believe this evidence will appear sooner as opposed to later. Hence, we are less sanguine on the inflation outlook than the RBNZ (in fact we can't get it towards 2 percent!), and see upside risks around market pricing from late 2011/early 2012. However, for now, the path of least regret, particular given the RBNZ's experience in mid 2010, is one of patience.

ONE POLICY FOR A MULTI-SPEED AND MULTI-SHOCK ECONOMY

The dataflow on the New Zealand economy has generally strengthened (or at least been less poor relative to expectations) since the Reserve Bank last assessed its policy settings in April. Clearly, the economy remains patchy, with some sectors performing strongly and others struggling. Export performance is getting more critical mass behind it, courtesy of commodity prices, despite an inflated NZD/USD. Conversely, consumers are still cautious. Housing is lifting, but off deep lows. This combination is exactly what the doctor ordered, in terms of the required rebalancing of the New Zealand economy away from spending towards earning, as we pay for the binge of a few years ago.

With such disparate performance across the economy at present, the Reserve Bank is in the awkward but familiar situation of having to set one policy rate for a multi-speed and multi-shock (a multi-decade high terms of trade, seismic events and ongoing deleveraging) economy. Prospects for restrictive fiscal policy and use of the prudential policy lever mean the OCR instrument is no longer such an isolated tool, but it remains the primary one and a blunt one at that.

DAMNED IF YOU DO

A number of factors explain the RBNZ's intention to step lightly in starting off the hiking cycle:

- **Wait until a clearer picture emerges.** The RBNZ were fooled by a "head-fake" from rising confidence in mid-2010 that quickly dissipated

when rates were raised 50bp. These hikes were subsequently reversed after the February earthquake. The only problem with this strategy is that turning points only become unambiguously clear well after the event.

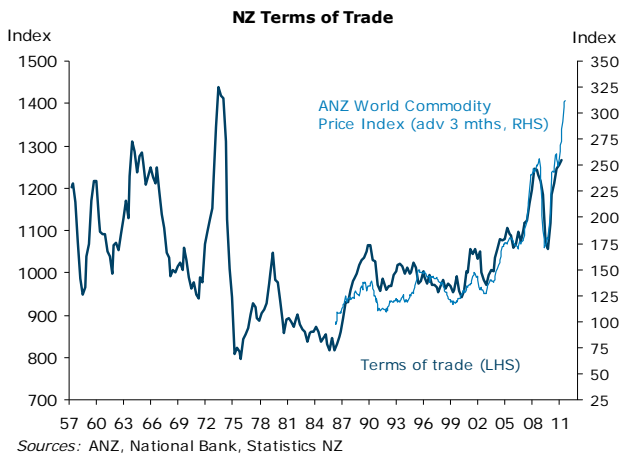
- **Tighter fiscal policy will reduce demand in the economy,** though most measures will take considerable time to implement.
- **Global concerns.** There is a high degree of uncertainty over the global outlook, with downside risks evident in Europe (a sovereign debt crisis that has strong potential to become a banking crisis), the US (sovereign debt concerns and another slump in the beleaguered housing market), and China (as some scary bubbles face a policy tightening). Lower global growth would mean lower commodity prices and fewer tourists.
- **Earthquake impacts.** It is still very early days to assess the impact of the February earthquake on the New Zealand economy. There are encouraging signs of businesses "getting on with it", but there is still massive disruption, and the sustainability of the rebound in confidence is yet to be proven. A 23 percent chance of a further magnitude 6+ quake in the Canterbury region in the next year is another wildcard.
- **Strong NZD.** Last week the NZD reached a post-float high against the USD, with the broad-based NZD strengthening due to New Zealand's story stacking up pretty well against countries with bigger problems, even given our highly indebted status. This is good for consumers but bad for exporters, particularly those not enjoying the high commodity prices that are largely responsible for pushing the currency up to these heady heights. On balance, the strong NZD buys the RBNZ some time, as it does reduce economic activity within the economy. But it brakes different sectors that low interest rates stimulate, so the two are not interchangeable.
- **Ongoing deleveraging.** Paying the piper will dampen economic growth for years yet. Consumers will not respond to lower interest rates like they would have were debt levels lower. Consumer credit is still falling year-on-year and monetary policy has little work to do here. Happily, New Zealand's income-earning potential is excellent at the moment, which makes the adjustment a whole lot quicker and less painful.

JUNE 2011 MPS PREVIEW

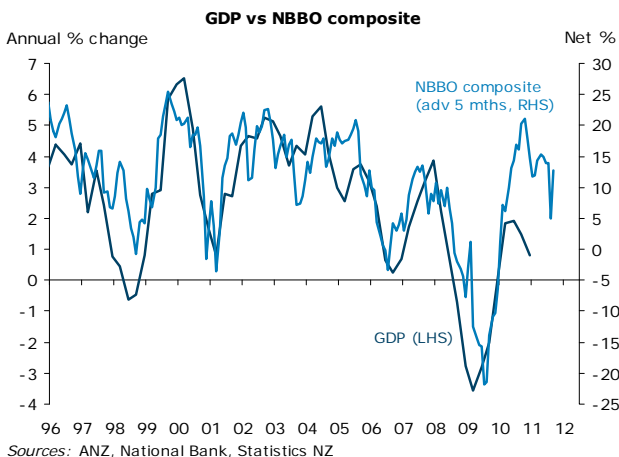
DAMNED IF YOU DON'T

But it's not one-way traffic by any means. There are good reasons to be wary of over-stimulating the economy by keeping the OCR too low, for too long.

- **The terms of trade are at a record high.** How much longer will farmers continue to diligently save the entire windfall? Anecdotes suggest the champagne corks are about to start popping. The RBNZ has some prudential policy tightening in the shadows but is it enough?

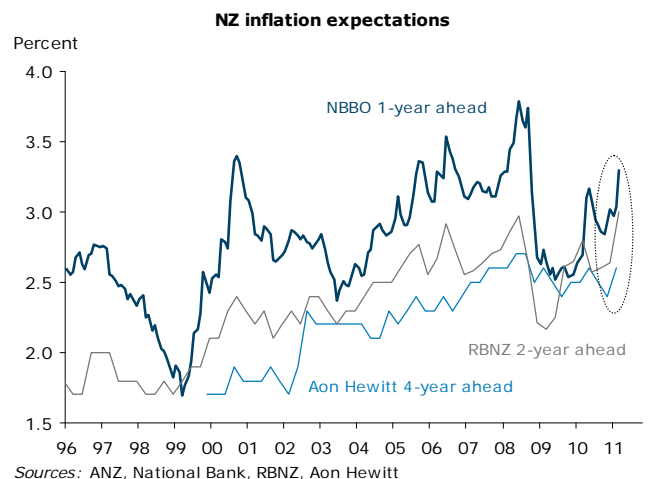


- **Rebound in business confidence.** Yes, this did prove a false dawn in mid-2010. But it's more often right than wrong. Ignore the rebound at your peril.



- **Looming resource shortages.** The economy is in no shape to absorb higher demand, with levels of capacity utilisation holding up despite pretty anaemic growth. The rebuild of Christchurch is about to go head-to-head with housing shortages in Auckland. And where building costs go, house prices follow.

- **Financial conditions are extremely supportive.** Mortgage rates are at levels that traditionally see house prices take off. The RBNZ is assuming that high debt levels will close off this channel. Probably. But Auckland may prove to be dancing to its own tune.
- **New Zealand is "one carriage on the Australia-China train,"** to quote Bill English. Even if the China bubble pops, structural growth in the Asian middle class is a long-term story that will support global protein and fat prices for the foreseeable future. Worsening water shortages and extreme weather events point the same way.
- **Rising inflation expectations.** The RBNZ is choosing to look through a large number of one-offs that have seen headline inflation rise from 1.5 percent in September last year to 4.5 percent in the March quarter, and a near-certainty it's heading over 5 percent in the next read. Trouble is, when a lot of one-offs pile up on each other, they no longer look quite so innocuous. Petrol prices are now falling back, and inflation expectations will follow – a tad. But a simple eyeballing of the chart below suggests inflation expectations have been on an upward trend since the late 1990s. At some point, this has to be acknowledged as an issue in regards to the credibility of the framework.



IN SUM: MAINTAINING CONTINUITY BUT MINDFUL OF THE INFLATION RISKS

Many central banks are grappling with the same dilemma – inflation risks are rising while household demand is weak. There is no "right" policy, in that there are unavoidable trade-offs between stabilising inflation, and stabilising the economy. The RBNZ will try to choose a



JUNE 2011 MPS PREVIEW

“reasonable” path between the two. **The Reserve Bank won’t want to scare the horses – either skittish show-jumping confidence or the galloping exchange rate.** So we are expecting their growth and inflation forecasts to be very similar to those presented in March. Suffice to say we think they have enough new information to be more upbeat relative to their assessment in March, but we’d characterise any subtle changes in tone as expressing a less downbeat view.

We’ve typically been at the dovish end of the inflation spectrum and even we are struggling to get inflation anywhere near the mid-point of the policy band. Deleveraging is still an inflation suppressant, as is the higher NZD. But rising commodity prices, diminished supply-side capacity, a huge array of one-offs and rising inflation expectations are not. This does not mean either the RBNZ or we are right or wrong. **But there seems to be more asymmetric (upside) risks around the inflation outlook** and a lot needs to go right for inflation (or more likely more go wrong for the economy) to see 2 percent inflation anytime soon.

For now we expect fairly similar profiles for inflation and 90-day rates to those presented in March. Petrol prices shot up subsequently but have since retraced considerably, and the Government has delayed the fuel tax hike. The shape of the yield curve, a massive proportion of floating mortgage and tight fiscal policy buys the RBNZ more time to wait for concrete evidence of recovery.

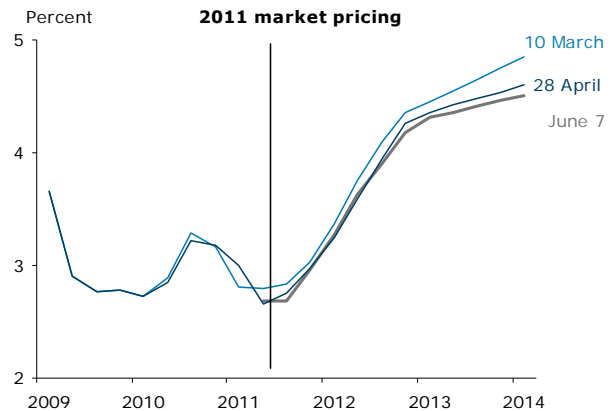
FINANCIAL MARKET IMPLICATIONS

We suspect the RBNZ will try to deliver a statement that generates minimal market reaction, namely by not communicating an overtly different tone from last time. This means rates will more likely than not still be expected to remain at current levels for “some time”. What this means in reality is anyone’s guess, but we can surmise anything from six months and beyond.

We expect the general flavour to come across as less downbeat, part of a step-change process we expect to continue over the coming few months, of modest prepping for the inevitable long journey of normalising policy. **Just as April’s assessment was sombre, but less downbeat relative to March, we expect June to be more rosy relative to April, but not sufficiently so to turbo-charge the NZD further.** Market pricing, which is now erring towards a late 2011 tightening

as opposed to early 2012, looks to be pre-empting this.

Our forecasts are not too far away from current market pricing. Given all that has happened, it is a mug’s game to pinpoint differences at this stage.



Sources: ANZ, National Bank, RBNZ, Bloomberg

OUR EXPECTATION OF RBNZ PROJECTIONS (MAR 2011 MPS IN BRACKETS)

| | 90-DAY | TWI (YEAR AVG) | CPI (ANN % CHG) | GDP (ANN AVE % CHG) |
|---------|-----------|----------------|-----------------|---------------------|
| Q1 2011 | 2.9 (3.0) | 67.2 (67.5) | 4.5 (4.4) | 1.0 (0.9) |
| Q2 | 2.7 (2.9) | | | |
| Q3 | 2.9 (2.9) | | | |
| Q4 | 3.0 (3.0) | | | |
| Q1 2012 | 3.5 (3.4) | 66.9 (67.1) | 2.2 (2.1) | 2.8 (2.7) |
| Q2 | 3.8 (3.7) | | | |
| Q3 | 4.1 (4.1) | | | |
| Q4 | 4.3 (4.3) | | | |
| Q1 2013 | 4.5 (4.5) | 65.0 (65.2) | 2.6 (2.4) | 4.6 (4.7) |



INTEREST RATE STRATEGY

SUMMARY

Another string of better than expected data releases caught the market off guard again last week, and has led to a re-pricing of monetary policy expectations. We expect the RBNZ to be less dovish this week, but still see market pricing as relaxed relative to our view and expect the slow grind higher at the short end to continue. US interest rates have moved lower in the past week on the back of weaker data, and may go lower yet. But NZ bonds have lagged, despite still very strong demand at the weekly tenders.

MARKET THEMES

- The run of better NZ data continued last week, which was not lost on the NZ rates market.
- RBNZ faces a tricky balancing act. The market is coming to our view of a December move though the RBNZ is not likely to endorse it fully yet.
- US non-farm payrolls data weaker than expected, sending US 10-year bond yields below 3 percent.

REVIEW AND OUTLOOK

Last week's domestic data releases surprised on the upside, extending a run of positives (or less negatives) dating back to HLFS data in early May. Not surprisingly, **monetary policy expectations have firmed, with market pricing coming round to our view of a December rate hike**. The high NZD and the timing of the election (not to mention the RWC) do pose challenges for the RBNZ, but we prefer to look through them when considering where the risks lie for interest rates.

Looking more closely at expectations – **what stands out is how timid market pricing is beyond the first hike**, which is now expected to be in December. While we can understand why the RBNZ is willing to be “behind the curve”, the rise in inflation expectations, low level of real rates and surge in business confidence all suggest that there will be catch-up when rate hikes begin. **Back to back hikes in December, January and March are now on the cards**. As that gets priced in, short end rates will move much higher, flattening the curve. As such, we expect the slow grind higher in swap yields to continue. A firmer stance for the RBA this week is expected to add to this.

US rates continue to plumb new lows for the year, spurred on by weak data, the latest of which is the disappointing non-farm payrolls last week. This sent US 10-year bond yields below 3 percent, the lowest since December last year. **We have been surprised by the recent widening in bond spreads** (to the US in particular), particularly in the

face of strong demand for NZGS at the weekly tenders. As such, **we expect NZGS to outperform from here**. This is likely to be more extreme if US rates suddenly start to rise, but could also occur if the US starts to price in a more prolonged slowdown. Indeed, such an outcome would only add to the relative credit and carry appeal of NZGS, particularly if it is accompanied by ongoing NZD strength.

PREFERRED BORROWING STRATEGIES

Given the steep slope of the curve and the low outright level of floating rates, we would not ordinarily be in a hurry to fix. But we are inching ever closer to the day when the RBNZ will start raising rates, and we are now at the point where we believe what the market is pricing in is sufficiently different from our forecast to prompt action. 4-5 year swaps are the most “mis-priced” relative to the long term 3mth BKBM average (when adjusted for duration), and thus are a natural starting point. But with 6 months to go till the first hike (i.e. December), we are starting to see value in shorter (1-2 year) hedges.

GAUGES FOR NZ INTEREST RATES

| GAUGE | DIRECTION | COMMENT |
|-----------------------|-----------|--|
| RBNZ / OCR | ↑ | NZD muddies the waters, but OCR needs to rise. |
| NZ data | ↑ | Confidence and commodity prices both very strong. |
| Fed Funds / front end | ↔/↓ | Momentum of data continues to slow. |
| RBA | ↔/↑ | Rate hike still on the cards. July 50/50. |
| US 10 year | ↔/↓ | Break of 3% significant. Expected to remain well bid. |
| NZ swap curve | ↔/↓ | Flattening likely to continue, short end needs to go up. |
| Flow | ↔ | Roll and carry the only thing holding payers back. |
| Technicals | ↔ | Swap spreads hovering at crucial zero level. |

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

| OCR DATES | LAST WEEK | THIS WEEK |
|---------------|-----------|-----------|
| Thu 9-Jun-11 | 0 | 0 |
| Thu 28-Jul-11 | +1 | +1 |
| Thu 15-Sep-11 | +2 | +1 |
| Thu 27-Oct-11 | +8 | +4 |
| Thu 8-Dec-11 | +18 | +20 |
| Thu 26-Jan-12 | +29 | +29 |
| Thu 8-Mar-12 | +48 | +45 |

TRADING THEMES WE FAVOUR AT PRESENT

With US bond yields biased lower and the short end biased higher, we favour curve flatteners, particularly the 1yr-4yr, which enjoys positive roll+carry. NZ/US spread narrowers are good defensive trades to add to flattener, and we continue to favour NZGS 4/15 asset swaps.

CURRENCY STRATEGY

SUMMARY

Currency markets are torn between the continuing Greek debt crisis and a string of weak economic data in the US. At present, the latter is winning out, leading to a weaker USD. Expect this to continue as talk of QE3 grows louder. A weaker USD means NZD will be supported, though we expect the RBNZ to try to jawbone the currency down this Thursday. Any reaction will likely be brief, with support on dips expected to be strong. Further post-float highs beckon if USD weakness extends. While we do not expect the RBA to hike today, the market looks to be underpricing a hike in subsequent months and the clear risk this week is that a more upbeat RBA sending the AUD higher, taking the NZD along with it.

MARKET THEMES

- Greek saga continues with second bailout not a done deal yet.
- But currency markets focusing more on weak US data, sending USD lower. We view the weakness in US data as temporary but the currency trend is not worth fighting, yet.
- This week heavy with central bank announcements. None expected to hike, but RBA and ECB to signal hike is imminent.

REVIEW AND OUTLOOK

The RBNZ decision this Thursday is the main domestic event this week. There is no doubt that the NZ economy is on a better footing, but the high NZD is again a complicating factor for the RBNZ. We struggle to see them wanting to deliver a statement that sends the NZD to yet another record high. In fact, **we suspect that the Governor will take the opportunity to try and to jawbone the currency lower.** Any effect will likely be limited, however, with the NZD to find good buying support on any dips. Technically speaking, momentum in NZD is stalling and the next major support is at 0.8010, with resistance at 0.8200.

Today's RBA decision should see the cash rate remain unchanged, though the RBA has been known to surprise the market from time to time. The key issues are a) the tone - it's hard to see the RBA not talking firmly with inflation riding the top of their target; and b) the employment report. The latter has been a significant near-term driver of the AUD over the last couple of years, as economists have consistently underestimated the data. However, 4 of the last 5 releases have been significantly below economists' estimates. A firmer RBA and statistical jobs recoil (a normal outturn for monthly surveys) suggest upside AUD probing.

NZD remains susceptible to bouts of risk aversion from the ongoing Greek debt crisis.

Currency markets are in a tug of war between European sovereign debt concerns and weak US economic data. The latter is winning out at present, hence the EUR performing well despite the Greek crisis.

Should the US economic data continue to disappoint, expect the calls for QE3 to grow louder. Though the US Federal Reserve will not be entertaining this notion, the US Treasury market is already partly pricing this in, with 10-year bond yields below 3 percent. Further USD weakness seems likely in the near term until we get a turnaround in the US economic dataflow. Until then, a weaker USD can only mean a stronger NZD.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

| GAUGE | DIRECTION | COMMENT |
|--------------------|-----------|---|
| Fair value | ↑ | Close to our fair value estimates. |
| Yield | ↔/↓ | RBA set to move in the next few months. RBNZ on hold. |
| Commodities | ↔ | Weak commodities leave NZD and AUD vulnerable. |
| Partial indicators | ↓ | RBNZ and RBA in opposing directions again. |
| Technicals | ↑ | Support at 0.7580. |
| Sentiment | ↔ | Risk off. |
| Other | ↑ | Terms of trade support. |
| On balance | ↔ | Rangebound 0.7580 - 0.7700. |

NZD VS USD: MONTHLY DIRECTIONAL GAUGES

| GAUGE | DIRECTION | COMMENT |
|-------------------------|-----------|--|
| Fair value – long-term | ↓ | Above structural fair value of 0.67. |
| Fair value – short-term | ↔/↓ | Still above our cyclical fair value estimates. |
| Yield | ↓ | Yield differentials suggest NZD should be lower. |
| Commodities | ↔ | Weak commodities leave NZD and AUD vulnerable. |
| Risk aversion | ↔ | Equities softer. |
| Partial indicators | ↑ | NZ data better, US data worsening. |
| Technicals | ↓ | Bearish divergence. |
| AUD | ↔/↓ | AUD in correction mode. |
| Sentiment | ↔ | Awaiting RBNZ. |
| Other | ↑ | Strong demand for NZ bonds. |
| On balance | ↔ | Pending RBNZ keeping NZD rangebound. |

EFFECTIVE EXCHANGE RATE UPDATE

SUMMARY

Our effective exchange rate (EER) measures take into account the world prices of our exports (e.g. commodity prices in the case of commodity exporters), adjusted for currency movements based on their main destinations. May saw mixed conditions by sector, with some falls and rises. Disparities in trading conditions remain, with trading conditions more enhancing than average for four groups but more restrictive than average for three groups. The strengthening NZD looks set to place parts of the export sector not benefiting from high commodity prices under further pressure. For individual exporters, however, competitiveness will depend on who you sell to as well as what you are selling.

MIXED CONDITIONS BY SECTOR

Conditions improved for three sectors but became more restrictive for four. The mixed performance was largely the result of differing commodity price movements, with nine commodities seeing price rises in May, but six seeing price falls. There were also differing fortunes for NZD bilaterals with the NZD/USD increasing by 1.3 percent against the USD, broadly unchanged against the AUD, and easing against the yen and euro.

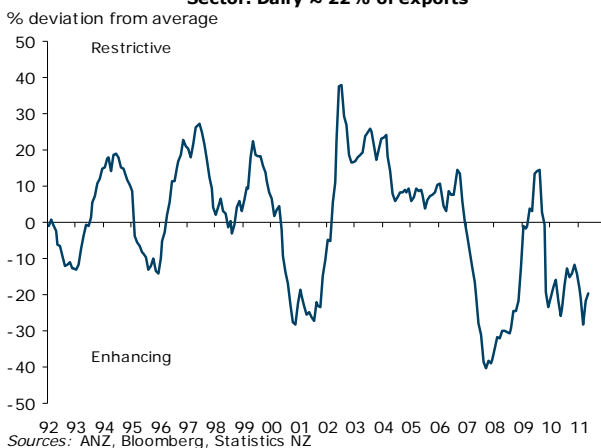
The largest gain in competitiveness was for the horticulture sector, on account of the 27 percent increase in kiwifruit prices for the new season. Climbing forestry prices also contributed to more favourable conditions, while currency movements for seafood exporters were offsetting. However, lower commodity prices for beef and dairy and a stronger NZD/USD contributed to less enhancing (but still good) conditions in those sectors. Lower oil prices saw less enhancing conditions for crude.

Sizeable disparities in trading conditions are evident in the various export groups.

Conditions remain stimulatory for four groups: meat, skins and wool, dairy, crude and seafood. Despite oil prices easing in May, conditions for crude remain more enhancing than historical averages. Manufacturers are still benefitting from the low NZD/AUD, but are likely to find the strengthening NZD/USD more of a headwind. While parts of the export sector are doing very well, there are still pockets of weakness, particularly for those sectors not benefiting from the upswing in export commodity prices. Despite this month's increase in apple prices, conditions remain challenging for horticulture. Due to the high NZD against the USD, GBP and euro, conditions remain very difficult for services exporters (e.g. tourism, education), with seismic events adding to the challenges facing the sector.

Our analysis is illustrative only as it does not take into account currency hedging, particularly for sectors such as dairy. And even within sector groups, trading conditions are likely to be quite variable. The low NZD/AUD, for example, is likely to benefit manufacturers selling to the Australian market, and trans-Tasman tourism. Conversely, a NZD/USD above the 75 cent level (it hit a post float high of 82.64 cents last week) makes the going tough for firms selling into USD-denominated markets, especially those with little pricing power, or those not benefiting from historically high export commodity prices. **The picture is also complicated by the fact that some exporters have imported inputs, providing a natural buffer against exchange rate moves.** This is difficult to measure and is not taken into account in this analysis.

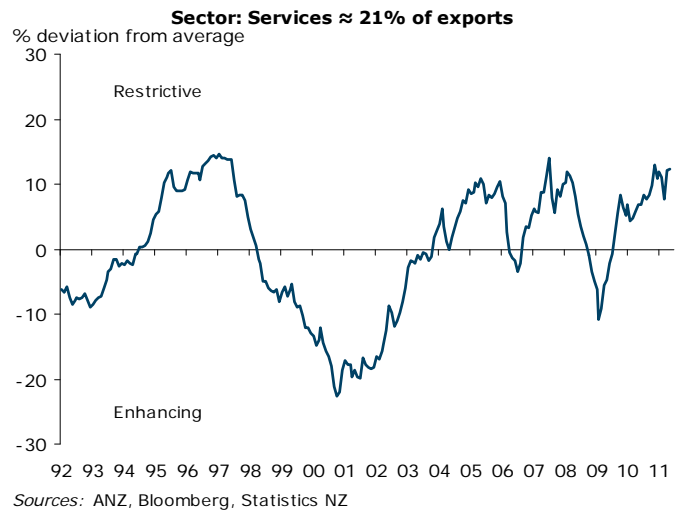
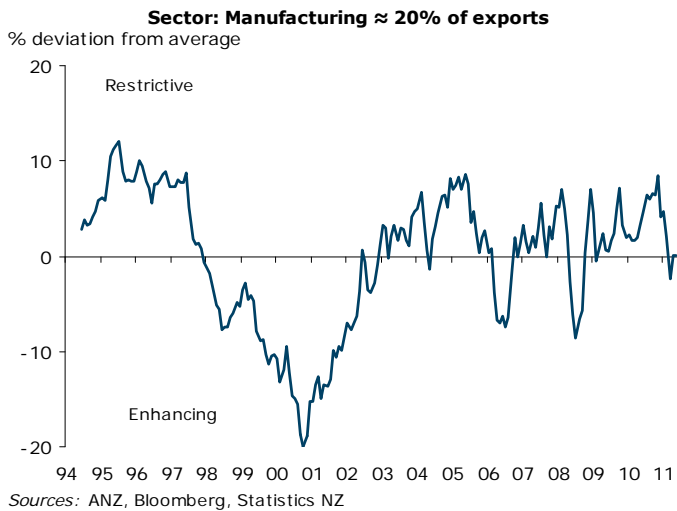
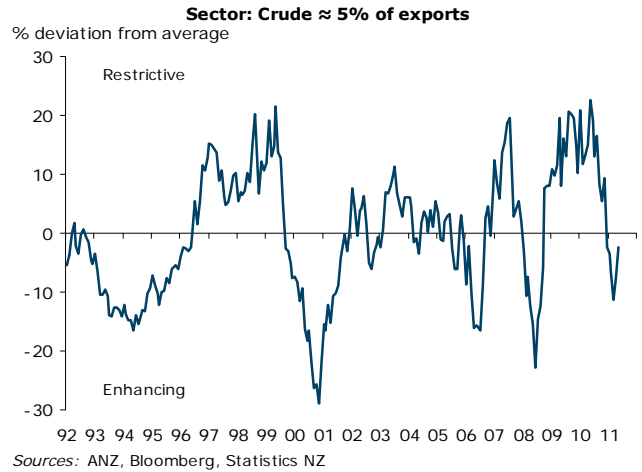
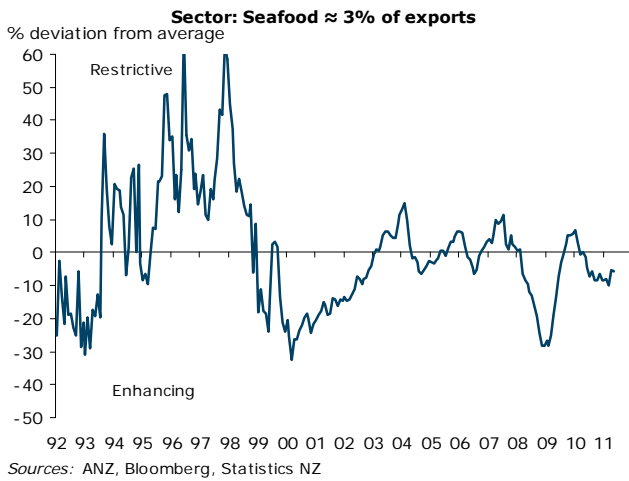
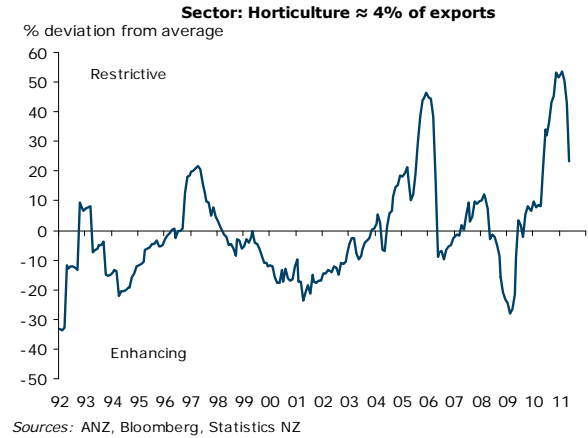
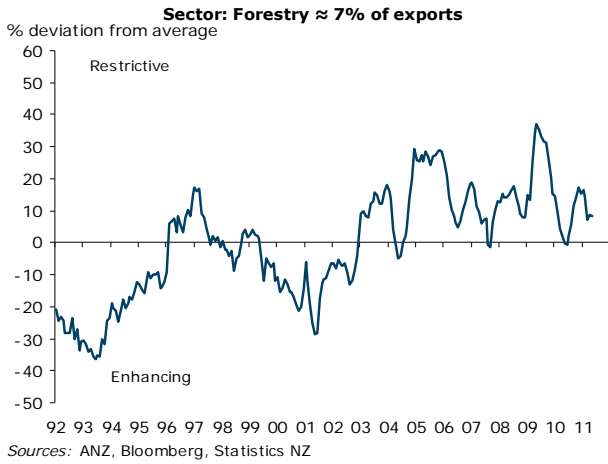
Sector: Dairy \approx 22% of exports



Sector: Meat, Skins and Wool \approx 14% of exports



EFFECTIVE EXCHANGE RATE UPDATE



DATA EVENT CALENDAR

| DATE | COUNTRY | DATA/EVENT | MKT. | LAST | NZ TIME |
|-------|---------|--|----------|-----------|---------|
| 7-Jun | AU | AiG Perf of Construction Index - MAY | - - | 37.9 | 11:30 |
| | AU | RBA CASH TARGET - Jun | 4.75% | 4.75% | 16:30 |
| | JN | Coincident Index CI - APR P | 103.7 | 103.5 | 17:00 |
| | JN | Leading Index CI - APR P | 96.5 | 100.1 | 17:00 |
| | EC | Euro-Zone Retail Sales (MoM) - APR | 0.30% | -1.00% | 21:00 |
| | GE | Factory Orders MoM (sa) - APR | 2.00% | -4.00% | 22:00 |
| 8-Jun | US | IBD/TIPP Economic Optimism - JUN | 42.0 | 42.8 | 02:00 |
| | US | JOLTs Job Openings - APR | - - | 3124 | 02:00 |
| | US | Consumer Credit - APR | \$5.000B | \$6.016B | 07:00 |
| | NZ | Value of All Buildings SA - 1Q | - - | 1.1 | 10:45 |
| | JN | Japan Money Stock M2 YoY - MAY | 2.70% | 2.70% | 11:50 |
| | JN | Japan Money Stock M3 YoY - MAY | 2.00% | 2.10% | 11:50 |
| | JN | Bank Lending Ex-Trusts YoY - MAY | - - | -1.00% | 11:50 |
| | JN | Bank Lending incl Trusts (YoY) - MAY | - - | -0.90% | 11:50 |
| | JN | Current Account Total - APR | ¥200.0B | ¥1679.1 B | 11:50 |
| | JN | Adjusted Current Account Total - APR | ¥266.0B | ¥752.7B | 11:50 |
| | JN | Current Account Balance YOY% - APR | -83.50% | -34.30% | 11:50 |
| | JN | Trade Balance - BOP Basis - APR | -¥379.0B | ¥240.3B | 11:50 |
| | NZ | QV House Prices YoY% - MAY | - - | -1.90% | 12:00 |
| | AU | Home Loans MoM - APR | 2.30% | -1.50% | 13:30 |
| | AU | Investment Lending - APR | - - | 2.10% | 13:30 |
| | AU | Owner-Occupied Home Loan Value MoM - APR | - - | -1.10% | 13:30 |
| | JN | Bankruptcies (YoY) - MAY | - - | -6.80% | 16:30 |
| | JN | Eco Watchers Survey: Current - MAY | 33.0 | 28.3 | 17:00 |
| | JN | Eco Watchers Survey: Outlook - MAY | - - | 38.4 | 17:00 |
| | GE | Exports SA (MoM) - APR | -3.00% | 7.30% | 18:00 |
| | GE | Imports SA (MoM) - APR | -0.30% | 3.10% | 18:00 |
| | GE | Current Account (EURO) - APR | 11.0B | 19.5B | 18:00 |
| | GE | Trade Balance - APR | 14.9B | 18.9B | 18:00 |
| | EC | Euro-Zone GDP s.a. (QoQ) - 1Q P | 0.80% | 0.80% | 21:00 |
| | EC | Euro-Zone GDP s.a. (YoY) - 1Q P | 2.50% | 2.50% | 21:00 |
| | EC | Euro-Zone Household Cons (QoQ) - 1Q P | 0.30% | 0.40% | 21:00 |
| | EC | Euro-Zone Gross Fix Cap (QoQ) - 1Q P | 1.80% | -0.50% | 21:00 |
| | EC | Euro-Zone Govt Expend (QoQ) - 1Q P | 0.10% | 0.10% | 21:00 |
| | GE | Industrial Prod. YoY (nsa wda) - APR | 10.00% | 11.20% | 22:00 |
| | GE | Industrial Production MoM (sa) - APR | 0.20% | 0.70% | 22:00 |
| 9-Jun | US | Fed's Beige Book | - - | - - | 06:00 |
| | NZ | RBNZ Official Cash Rate - Jun | 2.50% | 2.50% | 09:00 |
| | JN | GDP Deflator YoY - 1Q F | -1.90% | -1.90% | 11:50 |
| | JN | Nominal GDP (QoQ) - 1Q F | -1.30% | -1.30% | 11:50 |
| | JN | GDP Annualized - 1Q F | -3.10% | -3.70% | 11:50 |
| | JN | Gross Domestic Product (QoQ) - 1Q F | -0.80% | -0.90% | 11:50 |
| | AU | Employment Change - MAY | 25.0K | -22.1K | 13:30 |
| | AU | Unemployment Rate - MAY | 4.90% | 4.90% | 13:30 |
| | AU | Full Time Employment Change - MAY | - - | -49.1K | 13:30 |
| | AU | Part Time Employment Change - MAY | - - | 26.9K | 13:30 |
| | AU | Participation Rate - MAY | 65.70% | 65.60% | 13:30 |
| | JN | Consumer Confidence - MAY | 34.5 | 33.1 | 17:00 |

Continued on following page

DATA EVENT CALENDAR

| DATE | COUNTRY | DATA/EVENT | MKT. | LAST | NZ TIME |
|-----------|---------|--------------------------------------|-----------|----------|---------|
| 9-Jun | GE | Labor Costs Workday Adj (YoY) - 1Q | - - | 1.10% | 18:00 |
| | GE | Labor Costs Seas. Adj. (QoQ) - 1Q | - - | 0.70% | 18:00 |
| | JN | Machine Tool Orders (YoY) - MAY P | - - | 32.30% | 18:00 |
| | UK | Visible Trade Balance GBP/Mn - APR | -£7549 | -£7660 | 20:30 |
| | UK | Trade Balance Non EU GBP/Mn - APR | -£4350 | -£4479 | 20:30 |
| | UK | Total Trade Balance (GBP/Mn) - APR | -£2950 | -£3005 | 20:30 |
| | UK | BOE Asset Purchase Target - JUN | 200B | 200B | 23:00 |
| | UK | BOE ANNOUNCES RATES - Jun | 0.50% | 0.50% | 23:00 |
| | EC | ECB Announces Interest Rates - Jun | 1.25% | 1.25% | 23:45 |
| 10-Jun | US | Initial Jobless Claims - w/e 4-Jun | 419K | 422K | 00:30 |
| | US | Continuing Claims - w/e 28 May | 3700K | 3711K | 00:30 |
| | US | Trade Balance - APR | -\$48.8B | -\$48.2B | 00:30 |
| | US | Wholesale Inventories - APR | 1.00% | 1.10% | 02:00 |
| | NZ | NZ Card Spending - Retail MoM - MAY | - - | 1.50% | 10:45 |
| | NZ | NZ Card Spending - Total MoM - MAY | - - | 1.70% | 10:45 |
| | JN | Tertiary Industry Index (MoM) - APR | 2.70% | -6.00% | 11:50 |
| | JN | Domestic CGPI (MoM) - MAY | 0.20% | 0.90% | 11:50 |
| | JN | Domestic CGPI (YoY) - MAY | 2.50% | 2.50% | 11:50 |
| | CH | Trade Balance (USD) - MAY | \$19.30B | \$11.42B | 14:00 |
| | CH | Exports YoY% - MAY | 20.50% | 29.90% | 14:00 |
| | CH | Imports YoY% - MAY | 22.00% | 21.80% | 14:00 |
| | GE | Consumer Price Index (MoM) - MAY F | 0.00% | 0.00% | 18:00 |
| | GE | Consumer Price Index (YoY) - MAY F | 2.30% | 2.30% | 18:00 |
| | GE | CPI - EU Harmonised (MoM) - MAY F | -0.20% | -0.20% | 18:00 |
| | GE | CPI - EU Harmonised (YoY) - MAY F | 2.40% | 2.40% | 18:00 |
| | GE | Wholesale Price Index (MoM) - MAY | - - | 0.20% | 18:00 |
| | GE | Wholesale price Index (YoY) - MAY | - - | 9.20% | 18:00 |
| | UK | Industrial Production (MoM) - APR | 0.00% | 0.30% | 20:30 |
| | UK | Industrial Production (YoY) - APR | 1.30% | 0.70% | 20:30 |
| | UK | Manufacturing Production (MoM) - APR | -0.10% | 0.20% | 20:30 |
| | UK | Manufacturing Production (YoY) - APR | 3.40% | 2.70% | 20:30 |
| | UK | PPI Input NSA (MoM) - MAY | -1.00% | 2.60% | 20:30 |
| | UK | PPI Output n.s.a. (MoM) - MAY | 0.30% | 0.80% | 20:30 |
| | UK | PPI Output Core NSA (MoM) - MAY | 0.30% | 0.60% | 20:30 |
| 10-15 Jun | CH | Actual FDI (YoY) - MAY | - - | 15.20% | 5 Jun |
| 10-12 Jun | NZ | REINZ Housing Price Index MoM% - MAY | - - | 1.10% | 2 Jun |
| | NZ | REINZ House Sales YoY% - MAY | - - | -4.20% | 2 Jun |
| 11-Jun | US | Import Price Index (MoM) - MAY | -0.70% | 2.20% | 00:30 |
| | US | Import Price Index (YoY) - MAY | 11.20% | 11.10% | 00:30 |
| | US | Monthly Budget Statement - MAY | -\$140.0B | \$135.9B | 06:00 |
| 11-15 Jun | CH | New Yuan Loans - MAY | 622.5B | 739.6B | 5 Jun |
| | CH | Money Supply - M0 (YoY) - MAY | - - | 14.70% | 5 Jun |
| | CH | Money Supply - M1 (YoY) - MAY | 13.70% | 12.90% | 5 Jun |
| | CH | Money Supply - M2 (YoY) - MAY | 15.50% | 15.30% | 5 Jun |

Key: AU: Australia, EC: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States, CH: China.

Sources: Dow Jones, Reuters, Bloomberg, ANZ, National Bank. All \$ values in local currency.

Note: All surveys are preliminary and subject to change.

LOCAL DATA WATCH

Key focus over the next few weeks: Last week's export-centric and business confidence data confirmed the positive story for NZ. Inc. The NZD/USD also reached a post-float high with the NZD TWI touching its highest point this year. This week's June MPS will provide an assessment of the degree of patience the RBNZ is willing to show before raising the OCR. Housing and retail data is not expected to challenge the cautious RBNZ assessment, with construction sector activity likely to contract in Q1. Data over the coming months will remain noisy and will highlight sector differences.

| DATE | DATA/EVENT | ECONOMIC SIGNAL | COMMENT |
|------------------------|--|-----------------------|--|
| Wed 8 June (10:45am) | SNZ Value of Building Work Put in Place – Q1 | Down in the dumps | We expect a 4 percent decline in residential volumes. A 2 percent fall in non-residential building volumes is expected. |
| Thur 9 June (9:00am) | RBNZ June MPS | Patience | The RBNZ will be in no hurry to move the OCR higher. A more detailed set of projections is expected to convey a similar theme to the March MPS, with core inflation under control. |
| Fri 10 June (10:45am) | REINZ housing market data – May | Creeping up | We expect a 2 percent increase in sales volumes, but with strong regional divergences. The upward trend in prices should run out of puff. |
| Fri 10 June (10:45am) | Electronic Card Transactions – May | Holding | Past readings have shown the resilience of retail spending, but we expect unchanged readings for May. |
| Wed 15 June (10:45am) | Retail Trade Survey - Q1 | Up | Retail volumes are expected to rise 1.5 percent, with core volumes up 1.0 percent. |
| Thur 16 June (10:45am) | Wholesale Trade – Q1 | Sideways | We expect a 0.2 percent increase in wholesale trade volumes. |
| Thur 16 June (10:45am) | Economic Survey of Manufacturing – Q1 | Down | Ex-primary manufacturing volumes are expected to fall 2 percent. Primary manufacturing volumes should track sideways. |
| Thur 16 June (1:00pm) | ANZ-Roy Morgan Consumer Confidence | - - | - - |
| Tue 21 June (10:45am) | International Travel and Migration – May | Up | We expect a net PLT inflow of 100 persons in May. Visitor arrival numbers should stabilise, with wide country divergences. |
| Wed 22 June (10:45am) | Current Account Balance – Q1 | As good as it gets | A \$6bn reinsurance flow will produce a \$5.4bn surplus, with the first annual surplus (0.4 percent of GDP) since the early 1970s. |
| Wed 22 June (3:00pm) | Credit Card Statistics - May | Easing | We expect a modest 0.2 percent increase. |
| Mon 27 Jun (10:45am) | Overseas Merchandise Trade – May | Commodity price boost | A monthly surplus of around \$800m is forecast, with the annual surplus widening towards \$700m. |
| Thur 30 Jun (10:45am) | Building Consents – May | Lifting | We expect a 5 percent increase in residential consent numbers. |
| Thur 30 June (1:00pm) | National Bank Business Outlook | - - | - - |
| Mon 4 July (1:00pm) | ANZ Commodity Price Index - June | - - | - - |
| Wed 6 July (6:00am) | <i>globalDairyTrade</i> auction | Consolidation | We expect whole milk powder prices to consolidate around the US \$3,800 per tonne level. |
| Thur 7 July (10:45am) | Gross Domestic Product – 2011Q1 | Down | We expect a 0.4 percent fall in activity. Weakness will be concentrated in some pockets, including net trade, construction, and services. |
| On Balance | | Mixed | A real economy and pricing side dichotomy may start to emerge. Strong primary sector activity. |

KEY FORECASTS AND RATES

| | Dec-10 | Mar-11 | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 | Mar-13 |
|--------------------------|--------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|
| GDP (% qoq) | 0.2 | -0.4 | 0.1 | 1.4 | 1.8 | 0.7 | 0.9 | 0.9 | 0.8 | 0.7 |
| GDP (% yoy) | 0.8 | -0.3 | -0.3 | 1.3 | 2.9 | 4.1 | 4.9 | 4.4 | 3.3 | 3.3 |
| CPI (% qoq) | 2.3 | 0.8 | 1.0 | 0.8 | 0.7 | 0.6 | 0.8 | 0.7 | 0.6 | 0.8 |
| CPI (% yoy) | 4.0 | 4.5 | 5.3 | 5.0 | 3.3 | 3.1 | 2.9 | 2.7 | 2.6 | 2.9 |
| Employment (% qoq) | -0.4 | 1.4 | -0.2 | 0.4 | 0.5 | 0.5 | 0.4 | 0.5 | 0.4 | 0.4 |
| Employment (% yoy) | 1.3 | 1.8 | 1.8 | 1.2 | 2.1 | 1.2 | 1.8 | 1.9 | 1.8 | 1.7 |
| Unemployment Rate (% sa) | 6.7 | 6.6 | 6.6 | 6.3 | 6.3 | 6.2 | 6.2 | 6.0 | 6.0 | 6.0 |
| Current Account (% GDP) | -2.3 | 0.3 | 0.2 | -1.8 | -1.6 | -4.7 | -5.0 | -5.3 | -5.6 | -5.8 |
| Terms of Trade (% qoq) | 0.8 | 0.9 | 3.0 | 2.0 | 1.0 | -0.8 | -0.8 | -0.8 | -0.8 | -0.8 |
| Terms of Trade (% yoy) | 12.3 | 6.8 | 7.9 | 6.8 | 7.0 | 5.2 | 1.4 | -1.4 | -3.2 | -3.2 |

| | Aug-10 | Sep-10 | Oct-10 | Nov-10 | Dec-10 | Jan-11 | Feb-11 | Mar-11 | Apr-11 | May-11 |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Retail ECT (% mom) | -0.6 | 2.3 | 0.8 | 0.9 | -0.8 | 2.4 | 0.0 | 1.6 | 1.5 | .. |
| Retail ECT (% yoy) | 1.7 | 5.0 | 4.8 | 6.3 | 4.4 | 5.7 | 6.2 | 6.6 | 10.0 | .. |
| Credit Card Billings (% mom) | 0.7 | 1.0 | 0.6 | 0.0 | -1.8 | 3.6 | -0.5 | -1.4 | 1.6 | .. |
| Credit Card Billings (% yoy) | 2.3 | 4.2 | 4.7 | 3.8 | 2.0 | 5.6 | 5.3 | 1.6 | 6.0 | .. |
| Car registrations (% mom) | 0.0 | 2.6 | -3.9 | 12.8 | -8.3 | 0.9 | -1.7 | -0.3 | -5.6 | 3.2 |
| Car registrations (% yoy) | 19.0 | 19.2 | 9.4 | 23.5 | 6.4 | 6.8 | 2.8 | -1.0 | -10.5 | -3.7 |
| Building consents (% mom) | -17.7 | 0.9 | -2.0 | 8.0 | -18.4 | 9.1 | -9.9 | 2.0 | -1.7 | .. |
| Building consents (% yoy) | -3.1 | -9.4 | -17.4 | -9.1 | -26.5 | -14.8 | -29.0 | -26.3 | -32.5 | .. |
| REINZ House Price Index (% yoy) | 0.9 | -1.3 | -3.5 | -1.9 | -1.6 | -2.6 | -0.7 | -1.8 | -0.4 | .. |
| Household Lending Growth (% mom) | 0.1 | 0.2 | 0.1 | 0.0 | 0.0 | 0.1 | 0.1 | -0.1 | .. | .. |
| Household Lending Growth (% yoy) | 2.3 | 2.3 | 2.0 | 1.8 | 1.6 | 1.6 | 1.5 | 1.2 | .. | .. |
| ANZ Roy Morgan Consumer Confidence | 116.3 | 116.4 | 113.6 | 114.5 | 112.2 | 117.1 | 108.1 | 101.4 | 101.4 | 103.3 |
| NBNZ Business Confidence | 16.4 | 13.5 | 23.7 | 33.2 | 29.5 | .. | 34.5 | -8.7 | 14.2 | 38.3 |
| NBNZ Own Activity Outlook | 25.7 | 26.7 | 30.5 | 35.3 | 34.5 | .. | 36.6 | 14.7 | 29.5 | 39.7 |
| Trade Balance (\$m) | -430 | -455 | -220 | -177 | -218 | 9 | 182 | 578 | 1113 | .. |
| Trade Balance (\$m ann) | 871 | 978 | 1259 | 1363 | 1172 | 909 | 763 | 734 | 1187 | .. |
| ANZ World Commodity Price Index (% mom) | -1.1 | 2.6 | 3.0 | 2.1 | 1.6 | 4.3 | 2.7 | 4.7 | 1.6 | 0.3 |
| ANZ World Commodity Price Index (% yoy) | 30.8 | 25.1 | 23.1 | 13.1 | 12.1 | 16.3 | 20.3 | 23.5 | 19.8 | 19.5 |
| Net migration (sa) | 860 | 1000 | 390 | 600 | 720 | 440 | 450 | -520 | -90 | .. |
| Net migration (annual) | 14507 | 13914 | 12610 | 11519 | 10451 | 8689 | 8249 | 6554 | 5508 | .. |

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

KEY MARKET FORECASTS AND RATES

| | ACTUAL | | | Forecast (end month) | | | | | | |
|----------------|--------|--------|-------|----------------------|--------|--------|--------|--------|--------|--------|
| FX RATES | Mar-11 | Apr-11 | Today | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 |
| NZD/USD | 0.762 | 0.810 | 0.819 | 0.76 | 0.77 | 0.75 | 0.74 | 0.72 | 0.71 | 0.70 |
| NZD/AUD | 0.737 | 0.738 | 0.764 | 0.72 | 0.71 | 0.72 | 0.73 | 0.72 | 0.72 | 0.73 |
| NZD/EUR | 0.538 | 0.547 | 0.572 | 0.54 | 0.56 | 0.56 | 0.56 | 0.54 | 0.53 | 0.52 |
| NZD/JPY | 63.31 | 65.75 | 66.12 | 64.6 | 66.2 | 66.0 | 66.6 | 66.2 | 66.0 | 66.5 |
| NZD/GBP | 0.475 | 0.485 | 0.497 | 0.47 | 0.48 | 0.47 | 0.47 | 0.46 | 0.45 | 0.45 |
| NZ\$ TWI | 66.7 | 68.6 | 70.6 | 66.6 | 67.8 | 67.1 | 67.0 | 65.7 | 64.9 | 64.4 |
| INTEREST RATES | Mar-11 | Apr-11 | Today | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 |
| NZ OCR | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.75 | 3.25 | 3.50 | 3.75 | 4.00 |
| NZ 90 day bill | 2.63 | 2.68 | 2.68 | 2.70 | 2.70 | 3.10 | 3.70 | 3.80 | 4.20 | 4.30 |
| NZ 10-yr bond | 5.66 | 5.44 | 5.08 | 5.50 | 5.70 | 5.90 | 6.10 | 6.20 | 6.20 | 6.10 |
| US Fed funds | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.75 | 1.50 | 2.00 | 2.00 |
| US 3-mth | 0.30 | 0.27 | 0.25 | 0.35 | 0.35 | 0.35 | 0.85 | 1.60 | 2.10 | 2.10 |
| AU Cash Rate | 4.75 | 4.75 | 4.75 | 4.75 | 5.00 | 5.25 | 5.25 | 5.50 | 5.75 | 5.75 |
| AU 3-mth | 4.93 | 4.92 | 5.03 | 5.30 | 5.30 | 5.50 | 5.60 | 5.80 | 6.00 | 6.00 |

| | 3 May | 30 May | 31 May | 1 Jun | 2 Jun | 3 Jun |
|--------------------------|---------|---------|---------|---------|---------|---------|
| Official Cash Rate | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 | 2.50 |
| 90 day bank bill | 2.65 | 2.67 | 2.67 | 2.67 | 2.66 | 2.66 |
| NZGB 04/13 | 3.32 | 3.23 | 3.27 | 3.32 | 3.32 | 3.24 |
| NZGB 04/15 | 4.31 | 4.08 | 4.11 | 4.15 | 4.15 | 4.07 |
| NZGB 03/19 | 5.28 | 4.90 | 4.92 | 4.95 | 4.95 | 4.90 |
| NZGB 05/21 | 5.44 | 5.10 | 5.11 | 5.14 | 5.14 | 5.10 |
| 2 year swap | 3.36 | 3.39 | 3.43 | 3.46 | 3.41 | 3.37 |
| 5 year swap | 4.53 | 4.44 | 4.44 | 4.45 | 4.42 | 4.41 |
| RBNZ TWI | 68.4 | 70.6 | 71.1 | 70.7 | 70.2 | 70.1 |
| NZD/USD | 0.8037 | 0.8176 | 0.8252 | 0.8221 | 0.8131 | 0.8153 |
| NZD/AUD | 0.7361 | 0.7648 | 0.7702 | 0.7649 | 0.7656 | 0.7637 |
| NZD/JPY | 65.13 | 66.05 | 66.98 | 66.78 | 65.88 | 65.84 |
| NZD/GBP | 0.4835 | 0.4962 | 0.4987 | 0.4990 | 0.4978 | 0.4989 |
| NZD/EUR | 0.5431 | 0.5729 | 0.5738 | 0.5698 | 0.5661 | 0.5629 |
| AUD/USD | 1.0918 | 1.0691 | 1.0714 | 1.0748 | 1.0621 | 1.0675 |
| EUR/USD | 1.4799 | 1.4271 | 1.4382 | 1.4428 | 1.4362 | 1.4483 |
| USD/JPY | 81.04 | 80.79 | 81.17 | 81.23 | 81.02 | 80.75 |
| GBP/USD | 1.6623 | 1.6476 | 1.6546 | 1.6474 | 1.6333 | 1.6343 |
| Oil (US\$/bbl) | 113.03 | 100.58 | 100.35 | 102.70 | 100.30 | 100.41 |
| Gold (US\$/oz) | 1549.05 | 1535.35 | 1537.45 | 1531.20 | 1540.40 | 1530.80 |
| Electricity (Haywards) | 6.97 | 2.34 | 2.82 | 3.16 | 2.78 | 2.05 |
| Baltic Dry Freight Index | 1292 | 1474 | 1480 | 1485 | 1489 | 1489 |
| Milk futures (USD) | 163 | 162 | 162 | 162 | 162 | 162 |

IMPORTANT NOTICE

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.
- OnePath (NZ) Limited, as a wholly owned subsidiary of the Bank, is an associated person of the Bank. OnePath and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- Direct Broking Limited (DBL), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. DBL 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;



IMPORTANT NOTICE

- 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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