

LABOURING ON

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Page 5: Economic comment – National Bank *Business Outlook* update

- > Despite a small rebound in the April National Bank *Business Outlook* survey, current confidence levels are pointing to Q1 weakness extending into Q2. Based on both the own activity indicator and our composite measure, GDP growth could be negative over the year.

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- > Households continue to face further tightening over coming months via higher mortgage rates. Given that a higher proportion of mortgages are now fixed, the effective mortgage rate will be sticky on the way down when the RBNZ eventually starts the easing cycle.

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ECONOMIC OVERVIEW

Domestic data continues to paint a subdued near-term economic picture. The economy is flat at best. Labour market data this week will show classic late cycle wage support but we expect employment growth to unwind following 2007 strength. Evidence is mounting that US weakness is spreading and this will further weigh on the economy's prospects over 2008 and 2009.

What's ahead?

- > **NZ March quarter Labour Cost Index (LCI) and Quarterly Employment Survey (QES)** (Monday 1045 NZST). Wage inflation to remain elevated, showing a degree of persistence from a tight labour market and previously strong economy. We expect the private sector LCI to increase by 0.8 percent, taking annual growth to 3.6 percent.
- > **ANZ April Commodity Price Index** (Monday 1500 NZST).
- > **RBNZ Financial Stability Report** (Wednesday 0900 NZST).
- > **NZ March quarter Household Labour Force Survey (HLFS)** (Thursday 1045 NZST). Employment growth is expected to contract by 0.2 percent in Q1 following the 1.1 percent increase in the December quarter. This, coupled with a fall in the participation rate to 68.5 percent, is expected to result in a small increase in the unemployment rate to 3.5 percent.

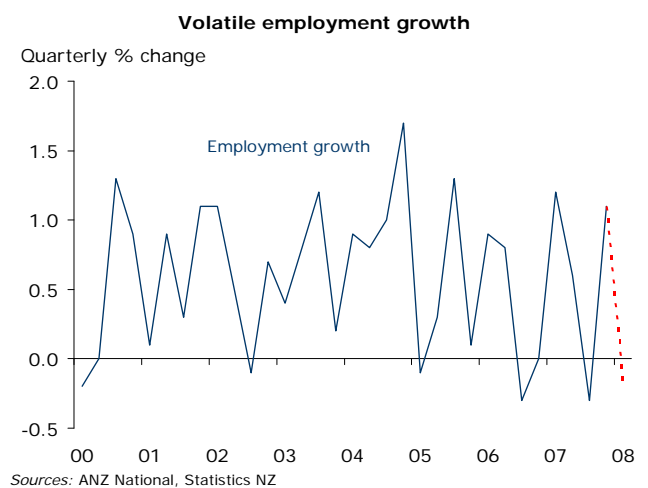
What's the view?

It was business as usual on the domestic data front last week as partial data continues to paint a flat-to-negative picture for the near-term economic outlook. As we have said in previous weeks, growth over the first half of the year looks to be flat at best. Data released last week did little to change this view.

Businesses continue to find it tough going. Although there was, on the whole, a slight improvement in business sentiment in April according to the National Bank *Business Outlook*, the absolute levels of the indicators in the survey tell us that the economic environment is challenging. A net 55 percent of businesses expect conditions to deteriorate over the coming 12 months, up slightly from a net 58 percent expecting a worsening environment in March. The more important own activity measure – which has a good correlation with GDP growth – remains in negative territory. A net 4 percent of firms expect a deterioration in their own activity over the coming year, again slightly better than last month's reading of minus 6 percent. However, firms' own activity is seldom negative so the fact that there have been two consecutive negative readings is telling us something (see page 5 for a more detailed breakdown of the survey components).

Probably the most telling indicator within the survey was firms' profit expectations. A net 30 percent of firms expect their profits to fall over the coming year, a record low for this survey. With the demand environment softening, but cost pressures intensifying though high fuel prices and the like, firms are naturally trying to pull the price lever to recover margins. Pricing intentions within the survey remain elevated, with a net 31 percent of businesses intending to increase their selling prices in the next three months. Will this strategy succeed? It will be a difficult one to push through. The more likely scenario will be for firms to assess their costs structures as stresses on bottom lines mount. We feel it will only be a matter of time before the focus turns squarely to staffing levels. In some ways this already looks to be occurring with employment intentions in negative territory for three consecutive months.

This therefore is a good time to bring in the discussion on the important events of this coming week, namely the labour market data for the March quarter. There are now clear signs the economy has turned, but the labour market typically lags developments in the real economy. The wage and employment reports due on Monday and Thursday respectively are collectively expected to show a degree of persistence from the previously strong economy. Private sector LCI wage growth is expected to post another record high. Although employment is expected to contract by 0.2 percent in the quarter, this is more a consequence of the volatile and autoregressive nature of the HLFS, following the strong 1.1 percent growth in the December quarter, rather than an underlying trend. The unemployment rate is expected to increase slightly, but remain at a historically low level of 3.5 percent.



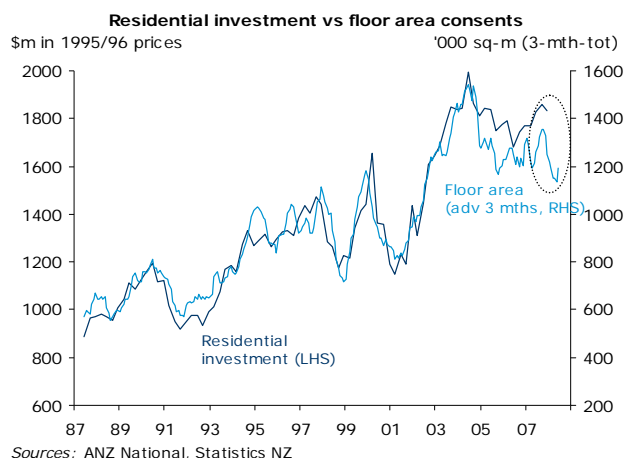
On the whole, the data will reinforce that the labour market remains a key source of inflationary risk for the Reserve Bank. We believe that, having won the battle over housing, the labour market is the Bank's next inflation battleground and prospects for lower interest rates remain contingent on it turning.

However, there may be early signs that the slowing economy is beginning to have an impact. Certainly falling employment intentions are telling us this. We

will be particularly eyeing sectors linked to the housing market and related pockets. Given the weakness in the housing market and signs that it is broadening, particularly into retail, employment developments in these sectors will be critical. Over the past five years the construction, retail, finance and business services sectors have collectively contributed 171,000 of the 254,000 jobs added within the economy (67 percent). We expect to see early signs of a softening in the labour market, starting with those sectors most closely linked to housing. But given the incredibly volatile nature of the data, it is likely that it will not be until the June quarter data (due in early August) where we will be able to more confidently assess the underlying trends.

Moving back to the data released last week we received further confirmation that the housing market will act as a significant drag on the economy over 2008. Residential building consents issued for March tumbled 9.1 percent (in seasonally adjusted terms) or 13.6 percent when apartments are excluded. Lending to households also slowed, with growth of just 0.5 percent in March – the softest monthly growth in 6½ years.

A sharp fall in house sales, coupled with the recent weakening trend in net migration is weighing heavily on the residential construction sector. Based on the floor area of consents issued, residential investment looks set to contract over 2008. In fact, we expect building consent issuance to continue to fall over coming months given the current level of house sales. Although the construction sector will be partly buoyed by a still elevated level of commercial consent issuance, we also note that growth within this sector has dried up. The construction sector as a whole looks likely to be one that underperforms this year, just as it outperformed most other sectors over the recent years.



The other piece of data last week, which also has important implications for GDP growth over the first half of this year, was overseas merchandise trade data. The economy recorded a surprise trade deficit of \$50 million in March, only the second time in ten years where a March month has recorded a trade deficit. Weaker than expected exports, coupled with large importation of oil (both price and volume related)

contributed to the surprise deficit. Data for the March quarter was also released and it highlighted that the net external sector is likely to be a drag on Q1 GDP growth. We estimate that primary export volumes (which account for 45 percent of total exports) fell 6 percent in the March quarter, partially due to dry weather conditions. Primary exports in the June quarter are likely to fall again as the weather impact continues to flow through.

Moving to offshore news, it was a volatile week. There was plenty of data released around the globe, but the centrepiece of events was the Federal Reserve interest rate announcement. There was speculation the Fed would signal an end to their easing cycle. What transpired was that the Fed did tone down their recent dovish language, removing phrases such as *"downside risks to growth remain"*, but they also left the door fully open to further interest rate cuts. Effectively the Fed was noncommittal on the policy outlook and has given itself full flexibility to respond as developments unfold. This, of course, is the prudent step to take given the extent of uncertainty still present. The Fed does not want to back itself into a corner. Markets were initially disappointed with this stance with many (particularly in currency markets) looking for more hawkish rhetoric given elevated headline inflation and rising inflation expectations. However, market pricing for rate cuts has been pared back. Based on current futures prices there is only a 16 percent chance of another 25bps cut priced in for their next (June) meeting. In fact, there is even a small chance priced in at their September meeting that the Fed will lift interest rates.

This leaves us pondering a number of key issues for the global economy:

- > **Has the US real economy found a base?** US economic data remains consistent with the economy entering recession. However, recent data has not deteriorated as some would have expected. Q1 GDP data last week was soft, but still better than expectations, and unchanged from the December quarter. The ISM manufacturing report for April showed the same level of activity as in March. The unemployment rate actually improved to 5.0 percent (from 5.1 percent previously) and the economy shed far less jobs than the market was expecting. Of course, the risks to US growth are still to the downside. The US housing market remains particularly weak and is yet to find a nadir. An inventory build up in Q1 is likely to unwind in Q2 and see GDP push lower. Then there are credit conditions which remain challenging. Nevertheless, the run of recent data is at least providing support to those who believe the Fed is done.
- > **How will the rest of the world fare?** While last week was consistent with US data generally surprising on the upside, data released around the rest of the world, but particularly in Europe, UK and Japan, came in weaker than expected (refer page 8). In the UK, the housing market is the weakest it has been since the early 1990s. House

prices have recorded their sixth straight monthly decline. In Europe, business confidence is at its lowest levels since August 2005. Spanish and Germany retail sales are down 8.7 and 6.3 percent respectively on a year ago. Italian manufacturing activity is contracting and French consumer confidence is at its lowest levels since 1987. In Japan, household spending, housing starts, and industrial production all contracted far more than expected. We are in no doubt that global growth will slow this year as US economic malaise broadens from its shores. However, the key question remains whether growth in emerging market economies will be enough to continue to hold up, particularly in the face of spiralling food price inflation.

> **Does this mean the USD has turned a corner?**

Of course it is far too early to say. But we have consistently said that if growth in Europe slows, then a by-product of this will be a stronger USD. Currency markets were disappointed by the Fed not delivering a more hawkish statement, but the initial currency weakness immediately after the statement did not push on. The greenback has risen to a two month high against the yen and a five-week high against the euro. Although US data remains soft, it is not deteriorating at the rate that many had expected and is being seen as USD positive because so much of the bad news economic story had already been priced in.

There are no definitive answers to any of the above questions and it remains a case of watching and waiting. In the meantime, the international calendar is quieter this week. The big event is the RBA's interest rate announcement. Although they are expected to leave interest rates unchanged at 7.25 percent, many are expecting a stern statement given the incredibly strong Q1 inflation data released a fortnight ago. The Bank is likely to show a degree of patience to see how their previous tightenings are slowing the economy. There is evidence suggesting activity has slowed in recent partial data. However, this patience is likely to wear very thin if activity does not continue to moderate. The BoE and ECB are also

due to make interest rate announcements and both banks are also expected to leave interest rates unchanged.

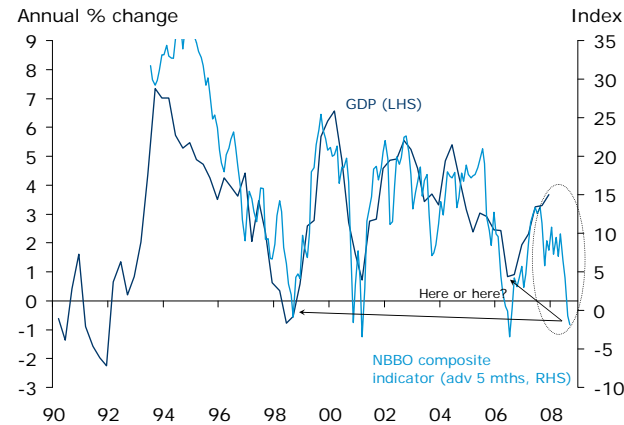
Recent data...

- > **NZ Overseas Merchandise Trade (March).** As surprise trade deficit of \$50 million was recorded in March, taking the annual deficit to \$4,529 million.
- > **NZ Credit Growth (March).** Total household claims grew by 0.5 percent.
- > **NZ Building Consents Issued (March).** Total residential building consents fell 9.1 percent. Excluding apartments, consent issuance fell 13.6 percent.
- > **NBNZ Business Outlook survey (April).** Headline confidence and most activity measures improved slightly, although the levels remain consistent with an outright stalling in economic activity. Pricing intentions remains elevated.

NATIONAL BANK *BUSINESS OUTLOOK* UPDATE

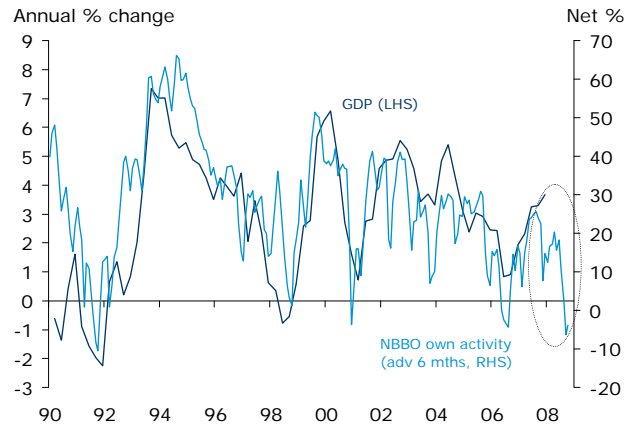
Despite a small rebound in the April National Bank *Business Outlook* survey, current confidence levels are pointing to Q1 weakness extending into Q2. Based on both the own activity indicator and our composite measure¹, GDP growth could be negative over the year. Looking across sectors, construction looks set to contract significantly over the year, while manufacturing also looks set to act as a drag on growth. The agriculture indicator points to flat activity, though recent rain may yet provide some support down the track. While the composite indicators for the retail and services sectors are still pointing to positive growth, they are slowing sharply. All up, our composite growth indicators are pointing towards a broad based slowdown in growth for the year ahead.

GDP vs NBBO composite indicator



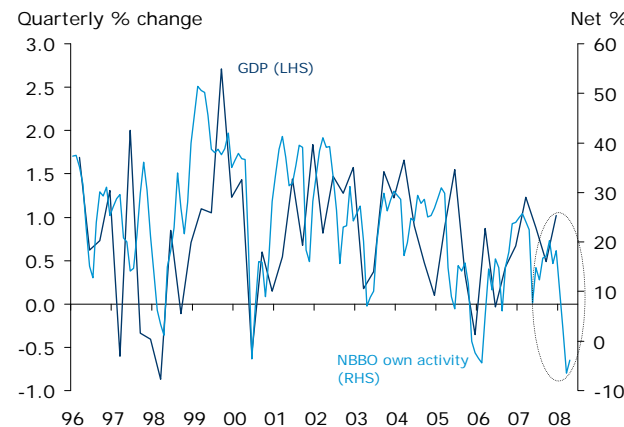
Sources: ANZ National, Statistics NZ

GDP vs NBBO own activity



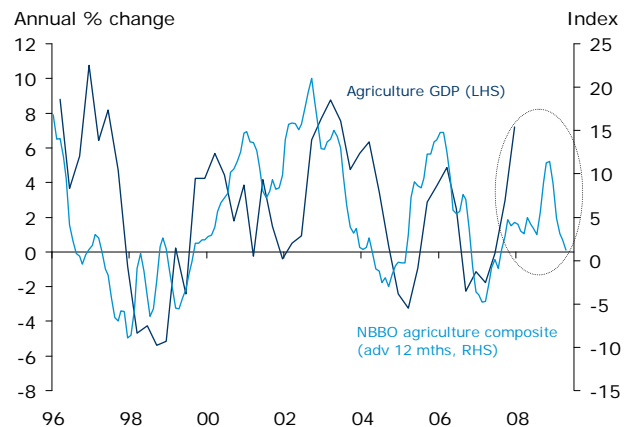
Sources: ANZ National, Statistics NZ

GDP vs NBBO own activity - negative in Q1



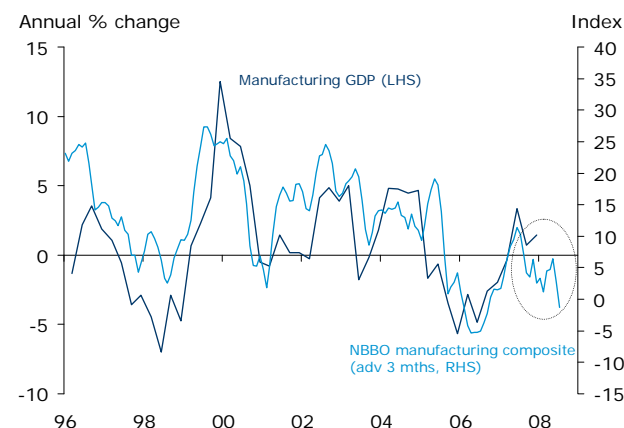
Sources: ANZ National, Statistics NZ

Agriculture GDP vs NBBO composite (12% of GDP)



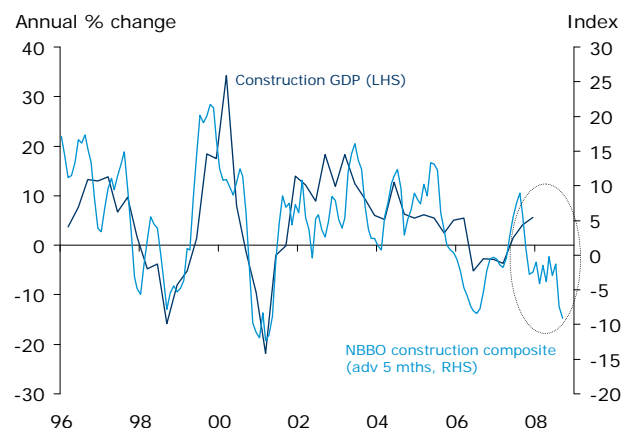
Sources: ANZ National, Statistics NZ

Manufacturing GDP vs NBBO composite (9% of GDP)



Sources: ANZ National, Statistics NZ

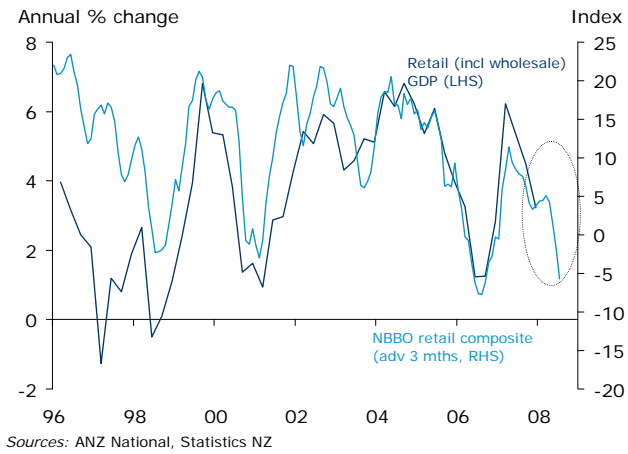
Construction GDP vs NBBO composite (5% of GDP)



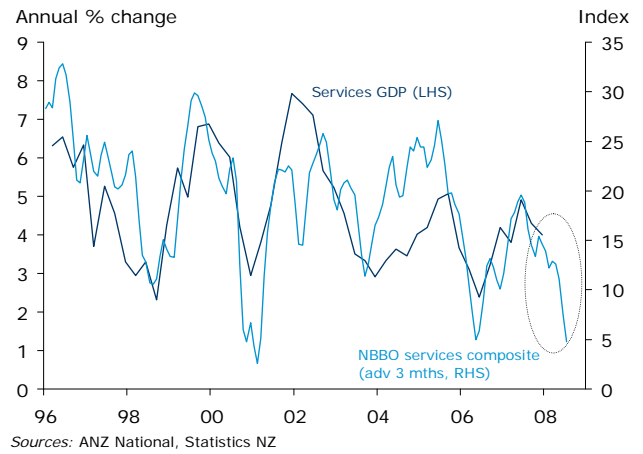
Sources: ANZ National, Statistics NZ

¹ Our composite measure uses the forward looking activity indicators from the National Bank Business Confidence Survey (own activity, investment intentions, employment intentions and profit expectations), combining them into a single index. The sectoral composite indicators use the same methodology as the economy-wide indicator.

Retail GDP vs NBBO composite (8% of GDP)



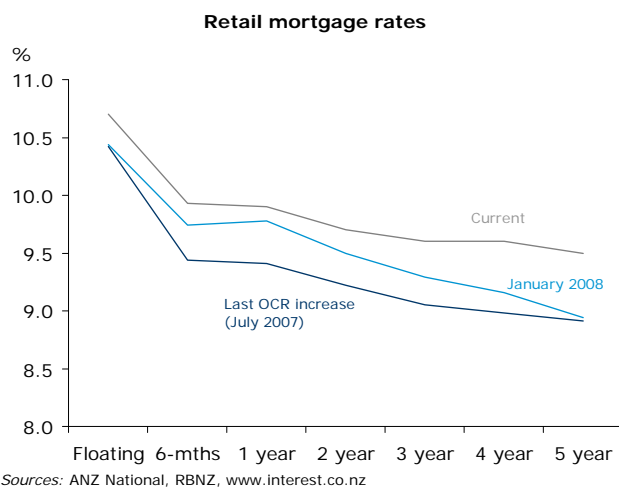
Services GDP vs NBBO composite (43% of GDP)



MORTGAGE PIPELINE UPDATE

Households continue to face further tightening over coming months via higher mortgage rates. Given that a higher proportion of mortgages are now fixed, the effective mortgage rate will be sticky on the way down when the RBNZ eventually starts the easing cycle.

Retail mortgage rates have been rising over recent months, even though the RBNZ has been on hold. Since the last OCR increase, mortgage rates have risen by between 30 and 60bps across the curve. This largely reflects the higher wholesale cost of funding from offshore, as a result of the turn in the global credit cycle. This means that the RBNZ has been getting a de facto tightening despite keeping the OCR at 8.25 percent since July 2007.



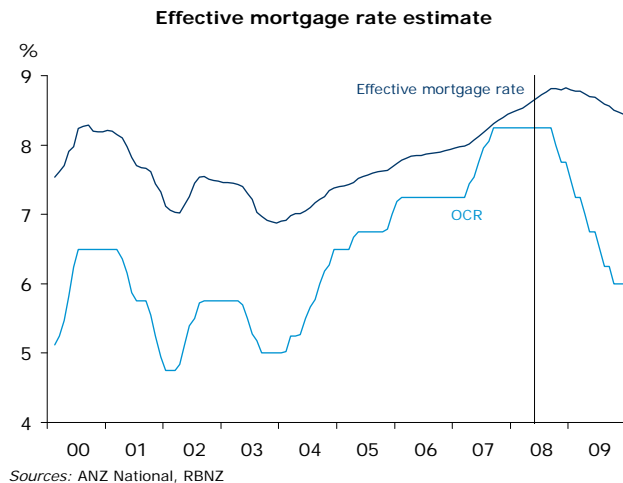
As a result of the ongoing mortgage rolloff at significantly higher interest rates, the effective mortgage rate faced by households is set to increase further. Based on RBNZ data, there is some \$45.3b worth of mortgages due for refinancing over the next 12 months. At the moment, these mortgages are on a weighted average interest rate of 8.16 percent, but will be facing current rates of between 9.5 and 10.7 percent.

We estimate that over the coming three months, some \$10b will be rolling off at an average existing rate of 8.0 percent. Given that most people are opting for the 2-year rate at present (9.7 percent), those having to refinance over the next three months are facing a 170bp increase. On a \$300,000 mortgage, this translates to an extra \$75 a week. For a \$400,000 mortgage, households will need to find an extra \$100 a week to service the mortgage. Add on top of that the higher cost of petrol and food, and the strain on household budgets is clear.

It is well known that the large increase in the proportion of fixed mortgages over the last few years has frustrated the RBNZ's efforts to slow the economy by muting the OCR impact on households. This longer transmission channel can be seen by the increases in the effective mortgage rate compared to the OCR since the start of the tightening cycle. Since early 2004, the

OCR has been increased by 325bps, yet the effective mortgage rate has only risen by 168bps.

We estimate that there is another 25bp increase in the effective mortgage rate to come, which will take it from the current 8.58 percent to 8.82 percent by the end of this year. And even then, this is based on our view that the OCR will be reduced from September this year.



The longer monetary policy transmission channel is set to work in the other direction when the easing cycle eventually begins. We estimate that the effective mortgage rate will be sticky on the way down for the following reasons:

- > At present, only the 13 percent of mortgages that are on floating rates will immediately benefit from any reduction in the OCR, compared to the last easing cycle in 2003 where 36 percent of mortgages were on floating.
- > There is a large gap between current mortgage rates and the rates of those coming up for refinancing over the next 12-18 months. This means that mortgage rates need to fall quite substantially for these people to refinance at lower rates, thereby causing the overall effective mortgage rate to fall.
- > The turn in the credit cycle means there is continued upward pressure on wholesale funding costs. Fixed rate mortgages are unlikely to fall by the same magnitude as any fall in the OCR.

The upshot is that households will not stand to benefit from a lower OCR in the same manner as in previous easing cycles. Interest rate relief will be slower to filter through, even if the RBNZ were to ease aggressively. Based on our forecast of a September easing cycle taking the OCR to 6.0 percent by late 2009 (or broadly neutral), we estimate that the effective mortgage rate will only fall by 40bps over that period. This suggests that monetary policy will have to move far below perceived notions of neutral. It also suggests that after struggling to gain policy traction when tightening policy, there is a real risk the potency of monetary policy will be even more diluted on the other side.

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 largely surprised on the stronger side last week, particularly GDP, ISM and non-farm payrolls. However, the opposite was the case in the UK, Europe and Japan where their data generally came in below market expectations.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	S&P/CS Composite-20 (Feb) – yoy	-12.0%	-12.7%	-10.7%	Weaker
	Consumer Confidence (Apr)	61.0	62.3	65.9	Stronger
	Annualised GDP (1Q A)	0.5%	0.6%	0.6%	Stronger
	FOMC Interest Rate Announcement	2.00%	2.00%	2.25%	In-line
	Personal Income (Mar)	0.4%	0.3%	0.5%	Weaker
	Personal Spending (Mar)	0.2%	0.4%	0.1%	Stronger
	PCE Core (Mar) – mom	0.1%	0.2%	0.1%	Stronger
	ISM Manufacturing (Apr)	48.0	48.6	48.6	Stronger
	Change in Non-Farm Payrolls	-75k	-20k	-81k	Stronger
	Unemployment Rate	5.2%	5.0%	5.1%	Stronger
	Europe	Unemployment Rate (Mar)	7.1%	7.1%	7.1%
CPI Estimate (Apr) – yoy		3.4%	3.3%	3.6%	Weaker
Business Climate Indicator (Apr)		0.69	0.44	0.79	Weaker
Economic Confidence (Apr)		98.9	97.1	99.6	Weaker
UK	Net Consumer Credit (Mar)	1.1B	1.2B	2.3B	Stronger
	Mortgage Approvals (Mar)	66K	64K	72K	Weaker
	GfK Consumer Confidence (Apr)	-20	-24	-19	Weaker
	Nationwide House Prices (Apr) – mom	-0.5%	-1.1%	-0.7%	Weaker
	PMI Manufacturing (Apr)	50.8	51.0	51.3	Stronger
	PMI Construction (Apr)	47.0	46.1	47.2	Weaker
Asia Ex-Japan					
<i>Singapore</i>	Unemployment Rate (1Q P)	1.6%	2.0%	1.7%	Weaker
<i>South Korea</i>	Industrial Production (Mar) – mom	0.0%	0.8%	-0.2%	Stronger
	Ex Trade – Export (Apr P) – yoy	21.6%	27.0%	18.6%	Stronger
	Ex Trade – Import (Apr P) – yoy	26.0%	28.6%	25.8%	Stronger
	Consumer Price Index (Apr) – yoy	3.9%	4.1%	3.6%	Stronger
<i>Malaysia</i>	Overnight Rate	3.50%	3.50%	3.50%	In-line
<i>India</i>	Exports (Mar) – yoy	-	26.6%	35.3%	-
	Imports (Mar) - yoy	-	35.2%	30.5%	-
<i>Thailand</i>	Manufacturing Production (Mar) – yoy	13.0%	10.1%	14.9%	Weaker
	Consumer Price Index (Apr) - yoy	5.2%	6.2%	5.3%	Stronger
Japan	Retail Trade (Mar) – mom	0.7%	0.5%	-0.9%	Weaker
	Jobless Rate (Mar)	3.9%	3.8%	3.9%	Stronger
	Household Spending (Mar) – yoy	0.5%	-1.6%	0.0%	Weaker
	Industrial Production (Mar P) – mom	-0.8%	-3.1%	1.6%	Weaker
	BoJ Interest Rate Announcement	0.50%	0.50%	0.50%	In-line
	Housing Starts (Mar) – yoy	-6.7%	-15.6%	-5.0%	Weaker
Australia	Private Sector Credit (Mar) – mom	0.8%	0.8%	0.6%	In-line
	Building Approvals (Mar) - mom	-1.0%	-5.7%	-0.8%	Weaker
	Retail Sales (Mar)	0.3%	0.5%	-0.1%	Stronger

INTEREST RATE STRATEGY

Domestic data continues to print on the soft side, causing rates to rally further. Bias firmly on the receive side, though 2-year yield unlikely to stay below 8 percent unless this week's labour market data shows broad based weakness.

Market themes...

- > Local data pointing to soft first half growth.
- > Increasing offshore interest to receive swaps.
- > Fed cuts but future moves uncertain.

Review and outlook...

In last week's commentary, we noted that we expected the near-term dataflow to turn more bearish, and given the RBNZ's softer tone, the market will be more willing to rally on weaker data. This turned out precisely to be the case, as the market jumped on the weak trade and building consents data, sending the 2-year swap yield below 8 percent at one stage. However, the moves have been exaggerated by a market that is dysfunctional and very thin. The trade data is pointing towards soft Q1 GDP with exports to be a big drag. The sharp fall in March building consents suggest residential investment will contract for the most part of this year. And although the National Bank *Business Outlook* survey showed a small rebound, it is still consistent with flat growth over the first half of this year. All up, it was a green light for receivers to enter the market, with payers largely staying out.

We think the market has now moved to a new lower range, with the 2-year swap yield likely to stay within a 7.95 to 8.15 percent band. The focus for this week is on the labour market data, though the Barfoot and possibly REINZ housing market data will also be of interest. While the housing data will show further weakness, the RBNZ's main focus now is on the labour market. But given its lagging nature, we suspect Q1 wage growth will remain strong, though we expect employment growth to contract slightly, though this comes after a strong Q4. We are unlikely to see another big rally in rates this week, unless the labour market data shows broad based weakness. We suspect it is still too soon for that.

The market is now pricing in 100bps of cuts by April next year. While our formal call is a September start to the easing cycle, the risk remains that it could be delayed, but we continue see an aggressive easing cycle once it begins. For this reason, we continue to prefer received positions in the 3 to 5 year part of the curve, as opposed to the 2-year given the carry cost and the risk that the easing cycle is delayed.

The big event offshore last week was the FOMC decision. A 25bp cut was delivered, but the statement was unclear as to the future policy path. While further easings is possible, the market has largely take the view that the easing cycle in the US is at an end. This may be premature, but the Fed looks to be in datawatch mode now.

This week, we have interest rate decisions from the RBA, BoE and ECB. All three are expected to hold, though the RBA's statement in particular will be closely perused, as will their upcoming Statement on Monetary Policy, for any signs of the RBA's discomfort over the latest inflation numbers.

Gauges for NZ interest rates yields		
Gauge	Direction	Comment
RBNZ	↔	In wait-and-see mode but a hint of softening bias now.
NZ data	↔/↓	This week's labour market data the next key read.
Fed Funds/front end	↔	Fed cut by 25bp but could this be the end of the easing cycle?
RBA	↔/↑	Data printing soft but inflation risks to the upside.
US 10 year	↔/↑	Equity market rally and focus on inflation sees selloff in bonds.
NZ swap curve	↔/↑	Steepening of curve given outright levels of front end.
Flow	↔/↑	Domestic payside stronger heading into Thursday's labour data.
Technical	↔	NZ markets have decoupled from AU and US. Labour data the next key read to establish next technical move.

Borrowing strategies we favour at present

We continue to favour paying in the 2-year or less part of the curve. Those with longer term durations on existing portfolios should shorten them. The market is increasingly pricing in more rate cuts, hence our preference to keep borrowing short, no longer than two years.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 5-Jun-08	-14	-12
Thu 24-Jul-08	-42	-52
Thu 11-Sep-08	-86	-92
Thu 23-Oct-08	-142	-164
Thu 4-Dec-08	-218	-244
Thu 22-Jan-09	-218	-244
Thu 5-Mar-09	-362	-392

Trading themes we favour at present

We suggest taking profit on the fourth bank bill contract, but remain with our core strategy of receiving the belly of the curve (3-5 year). We continue to favour paying the 2-year to benefit from the positive carry and also as a hedge against rates staying higher for longer.

CURRENCY STRATEGY

The kiwi is weak but showing a degree of stubbornness. The path of least regret still looks lower. Although labour market data this week will be important, the RBA's rate announcement is shaping as key.

Market themes...

- > USD strengthening on stronger data, Fed view and slowing Europe.
- > Improving risk aversion providing support to kiwi.
- > But NZD still looks vulnerable to a move lower given domestic economic environment.

Review and outlook...

The NZD is stuck in a range against the USD but movements remain choppy. After falling at the start of the week to below 0.7730, the kiwi recovered to end the week hovering close to the level where it began (0.7800). Despite a stronger USD, narrower yield differentials, and domestic data that continues to paint a gloomy picture for the near-term economic outlook, the kiwi is showing a degree of stubbornness. Improving risk appetites are providing support and countering a shaky domestic picture.

There looks to be a lack of a dominant theme in currency markets at present and this leaves us pondering how the week will unfold. It looks as though volatility will remain the order of the day. Nevertheless, (and as we state on page 3) there are a number of major issues we are focusing on at present.

- > Has the USD turned the corner? With so much bad news previously priced in to the greenback, a run of stronger than expected data is being seen as USD positive. There is also increased speculation the Fed are done. Will this theme be sustained? It remains very early days and is likely to be largely data-dependant.
- > US weakness is spreading. The euro, in particular, has suffered of late as recent data shows the economy slowing. Although the ECB this week are expected to leave interest rates unchanged and signal that inflation remains the number one priority, some will be looking for them to soften their hawkish rhetoric. A lower EUR is one factor that should also weigh on the kiwi going forward.
- > The outlook for commodity prices. A stronger USD is placing a number of commodities under pressure given the large speculative component. However, stronger than expected US data suggests any recession could be milder than initially feared. Commodity price developments remain key for the AUD and NZD's performance.

On balance, and especially given the domestic environment, we continue to feel that the path of least regret for the kiwi is to track lower, although attempts at the topside of recent ranges cannot be ruled out. Local labour market data this week is likely to show a degree of persistence. But given its historical nature,

we are not envisaging too much of a reaction. The market could be quick to jump at a fall in jobs growth. Beyond that, the big event is the RBA interest rate decision on Tuesday. No change in rates is expected, but given the strength in recent inflation data, we are expecting the tone to be strengthened. Although there remains potential for this cross to further consolidate recent moves, it still appears poised for lower levels.

Technically the NZD is consolidating with continued sideways action expected. The recent high at 0.7845 is the obvious resistance level. A daily close below 0.7700 is required for the 0.7430 downside target to be reached. A consolidation for the NZD/AUD to as high as 0.8500 is possible, but the 0.8480-0.8520 window is the ideal place to sell now for new lows.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↓	Yield spreads narrowing.
Commodities	↔	First weekly decline.
Partial indicators	↔/↓	Better across the Tasman.
Technicals	↔	Big support at 0.83. Bigger resistance at 0.8500.
Sentiment	↓	RBA key.
Other	↔	Offshore profit-taking at 0.8300.
On balance	↓	Moving lower, but you can afford to wait to sell rallies.

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	↓	Yield differentials narrowing as RBNZ repriced, and Fed finished?
Commodities	↔/↓	Still a key one to watch.
Risk aversion	↑	Positive sentiment returns.
Partial indicators	↔	Both economies weak.
Technicals	↔	Major support at 0.7700.
AUD	↔/↑	Will the RBA need to hike?
Sentiment	↔	Market extremely bearish. Overly so?
Other	↔/↑	Genuine interest from Fed to fix banking gridlock.
On balance	↔/↓	Domestic factors negative but risk seeking reoccurring.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
5 May	NZ	Tax Receipts (Mar)	-	-	10:00
		Labour Cost Index (Private Sector) (1Q) – qoq	0.8%	1.1%	10:45
		Average Hourly Earnings (1Q) – qoq	0.9%	0.9%	10:45
		ANZ Commodity Price Index (Apr)	-	2.0%	15:00
	AU	AiG Performance of Service Index (Apr)	-	53.8	11:30
		TD Securities Inflation (Apr) – mom	-	0.4%	12:30
		House Price Index (1Q) – qoq	0.0%	3.2%	13:30
		ANZ Job Advertisements (Apr) – mom	-	-0.7%	13:30
	EU	Sentix Investor Confidence (May)	3.9	4.1	20:30
6 May	US	ISM Non-Manufacturing Index (Apr)	49.1	49.6	02:00
	AU	Trade Balance (Mar)	-2,900m	-3,289m	13:30
		Exports (Mar) – mom	-	-4.1%	13:30
		Imports (Mar) – mom	-	-0.2%	13:30
		RBA Interest Rate Announcement	7.25%	7.25%	16:30
	EU	ECB's Ordóñez Speaks at ADB Meeting in Madrid	-	-	18:45
		PMI Services (Apr F)	51.8	51.8	20:00
		PMI Composite (Apr F)	51.9	51.9	20:00
		PPI (Mar) – mom	0.7%	0.6%	21:00
	GE	PMI Services (Apr F)	54.6	54.6	20:00
	UK	PMI Services (Apr)	51.7	51.1	20:30
7 May	NZ	RBNZ Financial Stability Report	-	-	-
	UK	Nationwide Consumer Confidence (Apr)	74	77	11:01
		Industrial Production (Mar) – mom	0.1%	0.3%	20:30
		Manufacturing Production (Mar) – mom	0.0%	0.4%	20:30
		AiG Performance of Construction Index (Apr)	-	48.4	11:30
	US	Fed's Hoenig Speaks in Denver on Market Risk and Policy	-	-	13:30
	AU	Foreign Reserves (Apr)	-	A\$36.3B	18:30
	EU	ECB's Smaghi, Stark Hold Speeches in Frankfurt	-	-	19:00
		Retail Sales (Mar) – mom	0.2%	-0.5%	21:00
	GE	Factory Orders (Mar) – mom	0.3%	-0.5%	22:00
8 May	US	Non-Farm Productivity (1Q P)	1.5%	1.9%	00:30
		Unit Labour Costs (1Q P)	2.6%	2.6%	00:30
		Fed's Kroszner speaks in Cincinnati on Foreclosures	-	-	00:45
		Pending Home Sales (Mar) – mom	-1.0%	-1.9%	02:00
		Consumer Credit (Mar)	\$6.0B	\$5.2B	07:00
	NZ	Unemployment Rate (1Q)	3.5%	3.4%	10:45
		Employment Change (1Q) – qoq	0.1%	1.1%	10:45

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
8 May cont.	UK	NIESR GDP Estimate (Apr)	-	0.5%	11:01
		BoE Interest Rate Announcement	5.00%	5.00%	23:00
	AU	Employment Change (Apr)	10.0k	14.8K	13:30
		Unemployment Rate (Apr)	4.1%	4.1%	13:30
		Participation Rate (Apr)	65.2%	65.2%	13:30
	GE	Trade Balance (Mar)	16.9B	16.9B	18:00
		Industrial Production (Mar) – mom	-0.5%	0.4%	22:00
	EU	ECB Interest Rate Announcement	4.00%	4.00%	23:45
9 May	US	Wholesale Inventories (Mar)	0.5%	1.1%	02:00
		Former Fed Chairman Greenspan Speaks in New York	-	-	04:30
		ISCS Chain Store Sales (Apr) – yoy	-	-0.5%	05:30
	JN	Official Reserve Assets (Apr)	-	\$1015.6B	11:50
		Leading Economic Index (Mar P)	20.0%	54.5%	17:00
		Coincident Index (Mar P)	33.3%	70.0%	17:00
	AU	RBA Quarterly Monetary Policy Statement	-	-	13:30
10 May	US	Trade Balance (Mar)	-\$61.4B	-\$62.3B	00:30

Key: AU: Australia, EU: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States.
Sources: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. (Note: all surveys are preliminary and subject to change).

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: The labour market data this week is critical for the Reserve Bank to assess the medium-term inflation outlook. We suspect the data will reinforce that the labour market remains tight, although we are looking for early signs that housing weakness is beginning to filter. Looking further out, the Government's *Budget* on 22 May is the next key event.

Date	Data/Event	Economic Signal	Comment
Mon 5 May (10.45)	QES and LCI (Mar qtr)	Still elevated	Wage growth should stay elevated (and near record highs) as a consequence of the lagged impact of a tight labour market.
Mon 5 May (15.00)	ANZ Commodity Price Index (Apr)	-	-
Thu 5 May (10.45)	Household Labour Force Survey (Mar qtr)	Early signs of softness?	Given recent employment intentions have eased we expect employment growth to be relatively soft over the quarter. This should see the unemployment rate tick-up from its record low.
circa 12 May	REINZ Housing Report (Apr)	Weak	March saw house sales collapse, but the median house price surge due to compositional aspects. Sales could possibly bounce back slightly in April, although we expect the prices to unwind.
Thu 15 May (10.45)	Retail Sales (Mar)	Exclude price, going backwards	We expect another soft month for retail, particularly due to the early Easter this year. Excluding price increases for food and petrol, the retail sector is heading backwards.
Fri 16 May (10.45)	Producer Price Index (Mar qtr)	Margins under pressure	A large surge in wholesale electricity prices is expected to drive both input and output prices higher. A small recovery in margins is expected, although they remain under pressure.
Tue 20 May (10.45)	External Migration (Apr)	Is a base forming?	The 3-month annualized inflow is expected to remain around 3,000. However, the risks do appear skewed to the downside.
Wed 21 May (10.45)	Electronic Card Transactions (Apr)	Bounce	An early Easter this year likely contributed to the softness in March. We expect a small bounce in sales in April, although the underlying weakness will remain.
Wed 21 May (15.00)	Regional Trends (Jun qtr)	-	-
Wed 21 May (15.00)	Credit Card Spending (Apr)	Bounce	An early Easter this year likely contributed to the softness in March. We expect a small bounce in sales in April, although the underlying weakness will remain.
Thu 22 May (14.00)	Budget Economic and Fiscal Update	Tax cuts, how much and when?	Personal tax cuts have been well signaled and details will be the major focus of this Budget. Given it is an election year we will also be looking for other spending initiatives. Nevertheless, the fiscal accounts are likely to remain strong.
Mon 26 May (10.45)	Overseas Merchandise Trade (Apr)	Small deficit	Another small monthly trade deficit is expected, with record high oil prices increasing the value of imports.
Tue 27 May (15.00)	RBNZ Expectations Survey (Jun qtr)	Elevated	Given petrol and food price increases, along with the Government's emissions trading scheme, inflation expectations will remain elevated. We expect the key 2-year ahead measure to remain around current levels of 2.7 percent.
Thu 29 May (15.00)	National Bank <i>Business Outlook</i> (May)	-	-
Thu 29 May	Credit Growth (Apr)	Soft	This should remain soft in line with weakness in the housing market.
Fri 30 May (10.45)	Building Consents Issued (Apr)	Weak	Given the extent of softness in monthly house sales volumes, along with muted net migration inflows, we expect building consent issuance to continue to track lower.
On Balance		An economy heading backwards, but still with inflation	Growth indicators are now expected to come in consistently weak, but inflation still problematic.

SUMMARY OF KEY ECONOMIC FORECASTS

	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
GDP (% qoq)	1.2	0.9	0.5	1.0	0.1	-0.3	0.1	0.2	0.3	0.5
GDP (% yoy)	2.3	3.2	3.3	3.7	2.5	1.3	0.9	0.1	0.3	1.1
CPI (% qoq)	0.5	1.0	0.5	1.2	0.7	1.0	0.9	0.8	0.4	0.7
CPI (% yoy)	2.5	2.0	1.8	3.2	3.4	3.3	3.7	3.4	3.1	2.8
Employment (% qoq)	1.2	0.6	-0.3	1.1	-0.2	-0.2	0.0	0.0	0.1	0.1
Employment (% yoy)	1.7	1.6	1.6	2.5	1.2	0.4	0.7	-0.4	-0.1	0.2
Unemployment Rate (% sa)	3.7	3.6	3.5	3.4	3.5	3.8	3.9	4.1	4.1	4.3
Current Account (% GDP)	-8.2	-8.1	-8.4	-7.9	-7.5	-6.9	-6.5	-6.5	-6.5	-6.5
Terms of Trade (% qoq)	1.5	0.4	3.7	2.9	2.0	0.0	-1.0	0.0	-1.5	-1.2
Terms of Trade (% yoy)	4.5	2.3	8.4	8.8	9.3	8.8	4.0	1.0	-2.5	-3.6

KEY ECONOMIC INDICATORS

	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08
Retail Sales (% mom)	0.2	0.3	1.0	-0.4	1.8	0.1	0.3	-0.7
Retail Sales (% yoy)	5.7	6.3	4.1	5.8	7.2	5.4	6.3	7.7
Credit Card Billings (% mom)	0.1	0.4	2.5	-0.6	1.2	0.5	-	0.5	-2.7	..
Credit Card Billings (% yoy)	7.8	8.5	9.4	7.7	9.4	7.6	8.6	8.0	3.5	..
Car Registrations (% mom)	7.0	1.1	-6.6	5.6	-3.8	-2.9	10.3	-8.8	-12.8	..
Car Registrations (% yoy)	7.0	10.9	0.1	4.7	2.3	1.4	1.7	1.9	-13.2	..
Building Consents (% mom)	-15.4	4.4	-8.9	-5.4	0.9	-4.1	2.7	-6.6	-9.1	..
Building Consents (% yoy)	-4.5	-1.8	-14.9	-16.5	-4.5	-6.2	-5.0	-18.0	-26.4	..
REINZ House Price (% yoy)	10.4	12.9	12.3	8.0	6.7	4.5	4.0	0.7	1.6	..
Household Lending Growth (% mom)	0.8	0.9	0.8	0.9	0.8	0.7	0.7	0.8	0.5	..
Household Lending Growth (% yoy)	13.7	13.6	13.2	13.0	12.8	12.3	11.9	11.6	10.8	..
Roy Morgan Consumer Confidence	121.1	122.4	121.3	122.0	121.9	126.6	121.2	116.0	111.7	99.9
NBNZ Business Confidence	-38.5	-33.8	-26.5	-12.9	-19.6	-24.9	..	-43.9	-57.9	-54.8
NBNZ Own Activity Outlook	12.4	16.7	17.2	20.3	15.7	18.2	..	2.4	-6.4	-3.8
Trade Balance (\$m)	-808	-947	-572	-774	-628	39	-313	249	-50	..
Trade Balance (\$m annual)	-6340	-6336	-6282	-5883	-5691	-5307	-4795	-4418	-4529	..
ANZ World Commodity Price Index (% mom)	4.6	1.4	0.4	1.8	0.8	0.0	-1.4	1.1	2.0	..
ANZ World Commodity Price Index (% yoy)	35.1	36.3	35.7	37.8	35.9	30.9	27.4	26.9	26.9	..
Net Migration (sa)	460	770	640	250	460	30	110	240	490	..
Net Migration (annual)	8966	8730	8309	7517	6588	5491	4799	4643	4678	..

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

SUMMARY OF KEY MARKET FORECASTS

	Actual		Current	Forecast (end month)						
	Mar-08	Apr-08	2-May-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
NZ FX rates										
NZD/USD	0.801	0.791	0.780	0.780	0.740	0.690	0.660	0.640	0.630	0.620
NZD/AUD	0.867	0.851	0.835	0.830	0.804	0.767	0.759	0.762	0.778	0.795
NZD/EUR	0.517	0.502	0.506	0.506	0.490	0.469	0.465	0.464	0.474	0.488
NZD/JPY	81.0	81.1	82.1	79.6	74.0	70.4	69.3	69.1	69.3	70.1
NZD/GBP	0.400	0.399	0.395	0.390	0.379	0.359	0.349	0.344	0.342	0.341
NZ\$ TWI	71.5	70.4	70.1	69.6	66.6	63.0	61.6	60.9	61.2	61.7
NZ interest rates										
OCR	8.67	8.60	8.25	8.25	8.00	7.50	7.00	6.50	6.00	6.00
90 day bill	8.90	8.87	8.83	8.80	8.40	7.90	7.30	6.80	6.40	6.30
10 year bond	6.37	6.48	6.48	6.70	6.70	6.20	5.80	5.40	5.20	5.10
International										
US Fed funds	2.25	1.75	2.00	1.50	1.50	1.50	1.50	1.50	2.00	2.50
US 3-mth	2.69	2.73	2.77	2.00	1.75	1.75	1.75	2.00	2.50	3.00
AU cash	7.25	7.25	7.25	7.25	7.25	7.25	7.25	7.25	6.75	6.00
AU 3-mth	7.86	7.88	7.80	7.70	7.60	7.50	7.40	7.10	6.60	5.80

KEY RATES

	2 Apr	28 Apr	29 Apr	30 Apr	1 May	2 May
Official Cash Rate	8.25	8.25	8.25	8.25	8.25	8.25
90 day bank bill	8.84	8.90	8.91	8.86	8.82	8.83
NZGB 07/09	6.78	7.02	7.03	7.01	6.92	6.92
NZGB 11/11	6.47	6.76	6.76	6.74	6.65	6.65
NZGB 04/13	6.48	6.72	6.72	6.70	6.59	6.59
NZGB 12/17	6.51	6.56	6.56	6.54	6.42	6.42
2 year swap	8.17	8.16	8.09	8.05	8.01	8.05
5 year swap	7.79	7.69	7.62	7.60	7.55	7.58
RBNZ TWI	70.6	70.1	69.8	69.5	69.6	69.8
NZD/USD	0.7883	0.7844	0.7826	0.7766	0.7808	0.7779
NZD/AUD	0.8668	0.8381	0.8354	0.8311	0.8316	0.8338
NZD/JPY	80.23	82.02	81.59	80.77	81.01	81.40
NZD/GBP	0.3984	0.3954	0.3932	0.3946	0.3930	0.3938
NZD/EUR	0.5051	0.5013	0.5000	0.4987	0.4993	0.5031
AUD/USD	0.9094	0.9359	0.9368	0.9344	0.9389	0.9330
EUR/USD	1.5606	1.5648	1.5651	1.5574	1.5639	1.5462
USD/JPY	101.77	104.56	104.26	104.00	103.75	104.64
GBP/USD	1.9786	1.9838	1.9901	1.9681	1.9867	1.9755
Oil	100.92	119.64	118.78	115.67	113.70	112.60
Gold	884.60	892.60	892.10	871.80	876.80	852.45
Electricity (Haywards)	13.28	12.54	13.21	14.35	14.89	15.73
Milk futures (US\$/contract)	130	133	133	133	133	139
Baltic Dry Freight Index	7655	9344	9273	9356	9439	9581

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