

## DE-LEVERAGING

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### Page 2: Key economic forecasts

### Page 3: New Zealand economic outlook

- > The economy is showing signs of stabilisation after heading backwards over the first half of 2008. In terms of our core economic view, we continue to be drawn towards an elongated period of subdued activity as households de-leverage and imbalances within the economy are purged. We have pencilled in flat growth in 2008, a very modest rebound in 2009, and trend activity in 2010 as cyclical forces become more pronounced and structural headwinds subside. While we remain circumspect with regard to prospects at present, the curbing of imbalances and excesses will eventually underpin a more robust medium-term outlook.

### Page 8: Global outlook

- > Weakness in the global economy has broadened beyond the US and commodity prices have fallen, albeit off highs. A huge degree of uncertainty persists, and this ambiguity has asymmetric risks. In terms of the flow-on to NZ, the dairy and tourism industries are key to watch.

### Page 9: Fiscal policy

- > Regardless of who wins this year's election, fiscal policy will continue to act in a counter-cyclical manner, helping to provide a floor to growth. But weak growth also means we will be looking at underlying fiscal deficits for the first time in over a decade, although this should prove to be of a temporary cyclical nature.

### Page 10: Inflation

- > Inflation is set to stay high for a while yet. However, the medium-term outlook is more favourable given weak prospects for the economy. In the absence of a significant fall in commodity prices (a risk at present), inflation pressure will only be dampened via squeezed margins as weak demand dominates considerable cost-push pressures. This is a key judgement that underpins our more favourable medium-term outlook.

### Page 11: Exchange rate

- > We continue to see a long overdue currency correction as an inevitable part of the rebalancing process the economy is embarking upon. The speed of this adjustment will be determined by perception towards the global economy (commodity prices) and de-leveraging process that is occurring across asset markets. We expect the NZD/USD to continue to track lower, although the pace of the decline will be stymied somewhat by continued structural USD headwinds.

### Page 14: Interest rates

- > With the easing cycle starting, the focus is now on how far rates will fall. While weak growth and asset price deflation is pointing towards an aggressive easing cycle, wariness towards lingering inflation mean we look set for a more staggered and cautious approach. The key to a substantial easing cycle looks to hinge on how the global scene unfolds.

### Page 16: Economic forecasts

### Page 17: New Zealand key economic indicators

## KEY ECONOMIC FORECASTS

Calendar years	2006	2007	2008(f)	2009(f)	2010(f)	2011(f)	2012(f)
<b>NZ Economy (annual average % change)</b>							
Real GDP	1.6	3.1	0.3	1.0	2.5	3.6	3.0
Employment	2.1	1.8	0.0	0.0	0.7	1.5	1.5
Unemployment Rate (Dec qtr)	3.8	3.4	4.5	5.3	5.8	5.8	5.6
Terms of Trade	-2.9	6.4	6.6	-2.7	-2.5	0.8	0.5
<b>Global Growth (annual average % change)</b>							
US	2.8	2.0	1.7	1.0	3.0	3.8	3.6
Australia	2.7	4.2	2.5	2.4	3.3	3.1	2.8
Japan	2.4	2.0	0.8	0.8	2.0	1.8	1.6
China	10.7	11.7	9.9	9.2	9.8	10.0	10.0
Trading Partner Growth	3.7	4.0	2.7	2.4	3.6	3.7	3.5
<b>NZ Inflation (annual % change)</b>							
CPI Inflation	2.6	3.2	4.4	3.4	2.7	2.5	2.4
Non-tradable Inflation	3.8	3.5	4.2	2.9	2.8	3.2	3.3
<b>NZ Financial Markets (December quarter averages)</b>							
TWI	68.0	71.6	61.1	60.9	61.3	64.1	63.1
NZD/USD	0.69	0.77	0.65	0.61	0.60	0.66	0.65
NZD/AUD	0.88	0.88	0.77	0.80	0.79	0.80	0.79
Official Cash Rate	7.3	8.3	7.3	6.0	6.0	6.5	6.5
90-day bank bill rate	7.7	8.9	7.6	6.2	6.2	6.7	6.7
10-year bond rate	5.8	6.4	6.0	5.7	6.0	6.3	6.2
<b>Fiscal and External Balance</b>							
Current Account Balance (\$m)	-14,000	-13,800	-13,800	-11,600	-12,500	-12,600	-12,700
as % of GDP	-8.6	-7.9	-7.5	-6.1	-6.3	-6.1	-5.8
Govt. Operating Balance (\$m)*	9,500	8,000	2,500	1,500	1,200	1,000	1,000
as % of GDP	6.1	4.7	1.4	0.8	0.6	0.5	0.5

Forecasts and text finalised 4 September 2008.

\* June years

### Key forecast assumptions:

- > Dubai oil prices are expected to gradually decline below US\$100 per barrel.
- > We expect the current financial market volatility to persist in the near-term but to not deteriorate further.
- > Net migration remains subdued for another 18 months, before increasing to around 10,000 over 2009.
- > Current cyclical potential growth is around 2 to 2½ percent, but longer-term potential is still around 3 percent.
- > The neutral real interest rate is just under 4 percent.
- > Inflation expectations start to drift lower from current elevated levels.

## NZ ECONOMIC OUTLOOK

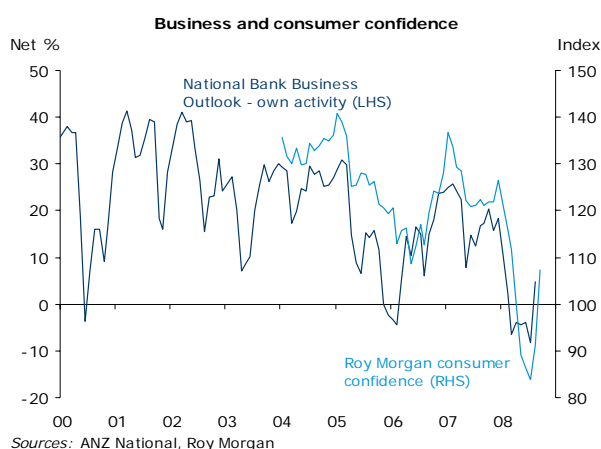
The economy is showing signs of stabilisation after heading backwards over the first half of 2008. In terms of our core economic view, we continue to be drawn towards an elongated period of subdued activity as households deleverage and imbalances within the economy are purged. We have pencilled in flat growth in 2008, a very modest rebound in 2009, and trend activity in 2010 as cyclical forces become more pronounced and structural headwinds subside. While we remain circumspect with regard to prospects at present, the curbing of imbalances and excesses will eventually underpin a more robust medium-term outlook.

### The NZ economy is delicately placed

**Growth is non-existent.** Economic activity contracted by 0.3 percent over the first three months of 2008, taking year-on-year growth to 1.9 percent. Indicators for the June quarter look no better, and in fact suggest activity could possibly be weaker than in the March quarter. September looks equally likely to be a negative read. But that is yesterday's story, and our focus is on the future.

#### We are starting to see signs of stabilisation.

Don't get us wrong. There is a deluge of "bad" data still to come, including a negative read on June quarter GDP, further weakness in the construction sector judging by 20-year lows in building consent issuance, and ongoing housing market weakness impacting on retailing. What started as a correction in the housing market has now broadened to other sectors. The economy is far from out of the woods. Yet more forward-looking gauges have now either started to stabilise or are showing signs of a pick-up. The National Bank *Business Outlook* survey reported a welcome rebound in August. The level remains low, and expectations of lower interest rates looks to be responsible, so we are not getting too carried away. But after an *annus horribilis* over the first half of 2008, any signs of stabilisation and recovery are welcome.



**Positive support factors are still present.** A lower currency is supporting NZ's key commodity export prices. Personal tax cuts are being rolled out from October this year. Infrastructure spending will carry

on regardless, with those orange cones set to continue dominating the roading landscape. Petrol prices have fallen, providing welcome relief to households. The currency has begun to adjust, and of course the RBNZ has started to lower interest rates.

**Then there is the reality check.** We find it hard to be excited about petrol prices, which remain at \$2/litre. Food prices are up 7.6 percent on a year ago and are continuing to erode household disposable incomes. Monetary policy is still tightening, with the cheapest fixed lending rate on offer (around 9 percent) currently well above the average mortgage rate rolling off. Some NZ\$52.4 billion of fixed mortgages are due to roll off contracts within the next 12 months, and will face increases of up to 100bps. Corporates are also seeing a material repricing in terms of their cost of credit, as the ongoing impact of the global credit crisis flows through. Then of course we have the weakening global growth picture, still elevated inflationary pressure, high household indebtedness, falling asset prices and an unsustainable current account position to contend with. The latter, in particular, is a significant structural headwind running against those espousing the strong rebound thesis.

#### We envisage a lot of "noise" in the data over the coming months.

Economies do not simply slip into despair at ever accelerating rates, especially when you have the population growing at just under 1 percent, which provides a natural source of demand in itself. Hence there is a base effect to be wary of. We expect to see a fair bit of volatility in some of the future data and would not be surprised if one of the June or September quarter GDP prints was a "shocker" as some technical aspects (drought, electricity generation, manufacturing etc) play havoc, but then see a strong rebound in Q4. Stripping out the noise, conditions remain challenging. The unemployment rate is yet to materially nudge higher. We expect indicators to be patchy and fickle over the coming months.

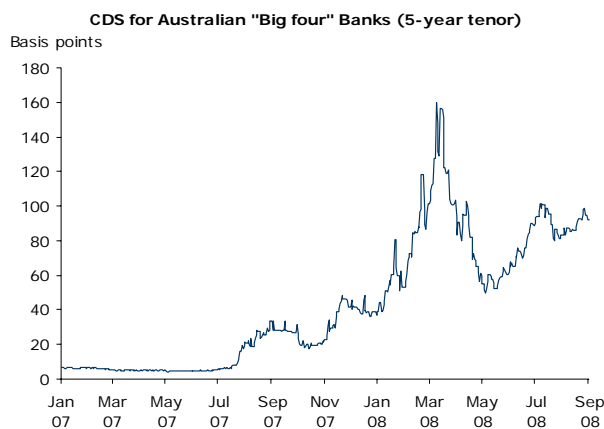
### A sense of reality dominates our economic assessment

**The path we were on was unsustainable.** The economy was growing above trend, leading to inflationary pressures. Households were spending beyond their means and bidding house prices well above fundamentals, resulting in high debt levels and a ballooning current account deficit. Alas, corrections inevitably emerge.

**To fully understand current circumstances, we need to appreciate the strong financial accelerator that had been at work over the preceding seven years.** This financial accelerator manifested globally via strong international growth, high risk appetites; and critically, narrow credit spreads. Narrow credit spreads meant NZ had access to cheap money making NZ a strong beneficiary of the financial accelerator. But we also saw the impact more directly in areas such as the growth in finance companies (debenture funding and associated lending which drove strong ripple effects across the property

market, notably land values), credit availability, private equity deals and expectations towards asset prices (especially housing). At the heart of this financial accelerator were remarkably strong appetites for risk and expectations that the benign and risk-free environment over the preceding few years would continue. It was a global phenomenon.

**The global credit cycle has now turned, risk is being repriced, and this is having pronounced implications.** For one, it is highlighting NZ's Achilles heel, namely a huge reliance on offshore capital to fund a savings shortfall. There is still ample cash available offshore, but with a turn in the global credit cycle (instigated by US subprime woes) the cost has risen materially. Credit spreads in the NZ banking sector (as the intermediary between domestic borrowers and offshore lenders) are now triple digit compared with a remarkably low 10-20bps previously. This represents a significant tightening in financial conditions that will filter through to borrowers, and will mitigate the impact of falls in the Official Cash Rate.



**Higher international funding costs have resulted in increased competition in the domestic deposit arena.** This is great news for savers, but of course it also reduces the incentive to put physical cash to work in other asset classes such as housing. As the debenture funding market has become more difficult for non-bank financials, it constrains their ability to grow and lend. While a lot of attention is focused on the direct wealth loss (or potential loss) of recent moratoriums and failures, it is the ripple effects across the property market that will be most telling. This is simply because the multiplier effect from that sector (given where the lending was being directed) is higher than for the economy as a whole.

**The real risk is investor confidence in itself.** Economics and business cycles are as much about human behaviour (the feel-good factor and risk appetites) as they are about the laws of supply and demand. During the good times, asset prices move up, spending rises, profits increase, employment rises, risk appetites improve as an aura of enthusiasm dominates, buyers emerge, asset prices move up again, spending rise, profits increase, employment, risk appetites, asset prices...and the upward spiral is in motion. Of course we can also see the reverse. Asset prices fall, spending shrinks, profits fall, the

unemployment rate moves up, risk appetites wane, buyers are absent, asset prices fall some more, spending eases, profits drop further...and the spiral continues. The risk with the latter spiral is that it feeds on itself and becomes self-fulfilling, as investors and financiers swing from being incredibly risk seeking to risk averse, leading to a process of wholesale de-leveraging. While there are good reasons for this, it is the extent of the swings that do the economy more harm than good. Chicken Little style commentary does little to help. Thankfully, we've seen signs of improving confidence of late, and NZ's macro framework via lower rates and a currency have started to respond. These are the first critical steps in seeing the spiral broken and conditions stabilising.

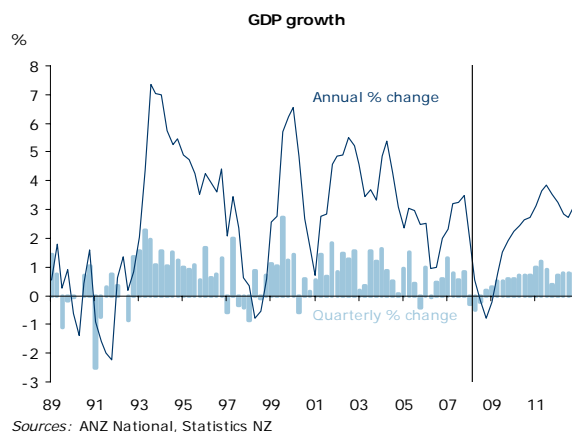
### Abstracting from some noise, this cyclical downturn will be drawn out and protracted

**We need to acknowledge the global reality.** From a pure macro perspective, the repricing (or correct pricing) of risk occurring around the globe is a healthy dynamic. Conditions over the preceding years rewarded borrowers at the expense of investors. The "new" environment is all about the reverse. Yet once again, as a nation very reliant on offshore capital to fund our savings shortfall, we would be remiss to downplay what is going on around the globe. Looking at the global backdrop, there are two necessary conditions before credit related unease settles. The first is that US subprime and credit related losses are fully disclosed. The second is that the US housing market needs to stabilise. Both are beyond NZ's control, and while underway, the general feeling is that these processes will take another year at least.

**Domestically, imbalances will take time to purge.** Non-tradable inflation remains stubbornly elevated. Inflation expectations are at the top of the RBNZ's target band, something the Bank has warned before that can be difficult and costly to reverse. Remember, the RBNZ can only cut rates if they believe growth is slow enough to dampen inflation, and we fully expect the Bank to pause in early 2009 to reassess conditions as they balance off growth versus inflation. The current account deficit remains large despite a terms of trade boom, and narrowing the deficit is looking like a slow grind. The imbalances in the economy have taken several years to build up, and it is perhaps wishful thinking to expect those imbalances to be purged over just a few quarters. We'd be more optimistic on such imbalances if we were seeing stronger productivity growth; we are not. Improving productivity is the next leg of the cycle NZ must embark.

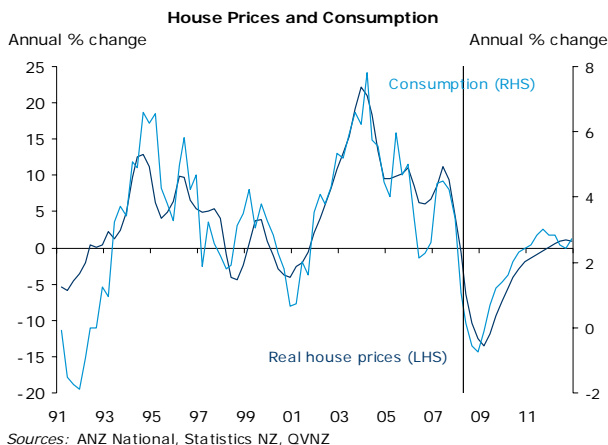
**This is a household consolidation story.** Households enter this slowdown being the most exposed. Debt to income stands at over 160 percent, while debt servicing to income is over 14 percent. Housing represents around three quarters of total household assets and dominates the balance sheet, House prices are falling. We have pencilled in a 10-20 percent house price correction, which while large,

needs to be put in the context of the 90 percent surge over the prior six years. However, in this cycle we see a far greater proportion of the adjustment to actually come through land values (as it was a key beneficiary of the financial accelerator and exceptional appetites for risk). While the unemployment rate is low (in a relative sense) and income growth still solid, the former is rising as businesses face pressure from weak demand and rising costs. It all points to a sustained period of de-leveraging and consolidation ahead. This is actually a healthy development. But households typically only have one lever to pull when they enter consolidation phases and that is to reduce spending. We have already seen real retail spending contract for two consecutive quarters this year. We are also seeing it through credit growth, with 3-month annualised growth easing to sub 4 percent and below income growth. But it will take more soft spending growth before balance sheets can be strengthened. Unlike corporate sector equivalents (who have multiple levers to pull to restore balance sheet health), households have few choices, and hence the consolidation process will be far more protracted.



Sources: ANZ National, Statistics NZ

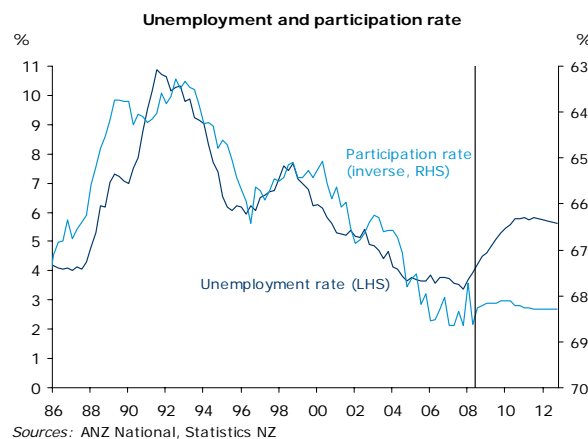
**The labour market is the next leg of vulnerability for households.** Anecdotes and employment intentions show that businesses are increasingly looking at costs given pressure on profits, and the major cost for most firms is labour. The unemployment rate has already risen to a 27-month high and is expected to increase towards 5½ percent by the end of 2009. This is still low, but up considerably from the 3.4 percent trough. One specific risk we see is that unlike previous cycles where the participation rate (the proportion of the working age population in the labour force) typically falls in line with employment (the discouraged worker effect), the current environment of pressures on household budgets will see many **forced** to enter, or remain in the labour market for longer than they normally would. This could see the unemployment rate rise faster and higher.



Sources: ANZ National, Statistics NZ, QVNZ

**Economic activity will remain subdued into 2009** as the spending side of the economy, notably residential investment and consumption, remain weak. We are forecasting flat private consumption growth in calendar year 2008 and just 0.8 percent growth for 2009. Residential investment is expected to continue to contract, with falls of 11.5 percent in 2008 and 9.1 percent in 2009. Announced tax cuts provide some boost to spending, but will not be enough to fully offset cost of living pressures. Further falls in house prices will continue to weigh on homeowners.

**The corporate sector will also not be immune,** particularly those closely aligned to housing or domestic sectors of the economy. Those sectors at the forefront of the recent period of economic strength, namely construction, retail, and business services, will also be at the forefront on the other side. Although corporate balance sheets on the whole remain solid, margins are being squeezed by significant cost pressures and consequently profitability expectations have fallen sharply. Investment intentions have turned, and are expected to see business investment slow accordingly.



Sources: ANZ National, Statistics NZ

**Exports will eventually lead the economic recovery, but not just yet.** The period of subdued growth the economy is embarking on is a healthy dynamic. Slowing domestic growth paves the way for exports to come to the forefront as the NZ dollar falls. Indeed, the decline in the currency, especially against the Australian dollar, has already led to improved competitiveness for manufacturers. Further expected declines in the NZ dollar will see export receipts pick-up initially, gradually leading to a rebound in volume growth down the track. We'll see a fillip to agriculture production and exports over the coming season as the impact of the drought washes through from the prior season. However, it will not be until late 2009 to early 2010 before we really see the export sector drive

growth, given the usual lags between changes in the currency and export response. For sure, there will be other pockets of strength including infrastructure, and beyond dairy a number of exporters are also seeing high commodity prices (such as the seafood industry). But net-on-net, we just don't see sufficient critical mass from those sectors over the coming year to offset a significant household consolidation story. Consumption and residential investment account for two thirds of GDP.

### The global scene remains a key risk

**Weak growth has moved beyond the US.** Apart from the immediate impact of an altered global environment for risk and credit, which has already been discussed, we are now also seeing traditional signs of a broad slowdown in the major economies. Growth across Europe looks to have gone backwards, and the UK housing market is looking particularly vulnerable. There is growing talk of recession in Japan. While there still remains a fair bit of uncertainty over how emerging market economies will be affected, we are circumspect with how developing nations will remain immune.

**For NZ, there are two key areas to watch in this regard:**

- > **Commodity prices, which are traditionally influenced by the global growth cycle.** Since early-July, we have seen a notable fall in the CRB commodities futures index. While a host of reasons are cited, the truth in our eyes is that the global economy has simply hit an inflection point where demand barometers are being reassessed. Indeed, barometers such as freight rates, Asian equity markets and the AUD are all giving a "turning point" signal. In terms of NZ, dairy prices are key to watch. Skim-milk powder prices are 36 percent off their late-2007 peak and whole-milk powder some 29 percent off. Both still remain exceptionally high, so we need to be cautious in the interpretation. However, we have dairy prices on our radar for three reasons. First, a lot of the good news story has already been capitalised into the farm values. Second, we continue to be staggered by the extent of rising farm expenses (up 9.2 percent from a year ago). Too much attention is being focused on revenue as opposed to the other driver of the bottom line, namely costs. Finally, high dairy prices were a key factor "extracting" at least one if not two additional hike(s) from the RBNZ in 2007. Looking at other commodity prices, we are far more encouraged over the outlook for traditional meat products, despite the global backdrop.
- > **Tourism inflows.** Tourism is a luxury good with an income elasticity of around two. Hence, small changes in global growth can have a big impact. It is also very pro-cyclical in relation to the global growth cycle and influenced by the wealth effect. Falling wealth is currently a big drag and likely to be for some time given declining equity markets and house prices in most developed nations.

When you are worth less, you travel less. Finally, tourism is a logical by-product and beneficiary of globalisation, and oil prices (whether that be via freight rates or jet fuel costs for airfares) is a major spanner in that process at present. It's not widely recognised but the tourism sector earned more in foreign exchange than the dairy sector in the year to March 2007.

**From a "U" to a "W"?** Our core prognosis is built around a "U" (or saucer-shaped) cycle as opposed to the "V" (or sharp in, bounce out) scenario, which was what manifested in 1997/98. Improved export performance, in particular from the dairy and tourism sectors (as bellwethers), are critical components of the rebalancing process that the economy is embarking upon over 2009. Any spanners coming from global growth and/or credit dislocation and we may well be staring down the barrel of a "W". The currency and monetary policy would of course respond, but both typically kick-in too late.

### Light at the end of the tunnel

**We see a number of positives out of the adjustment process.** While there is a lot of attention towards the dreaded "R" word, in our minds it stands for rebalancing. Relative price signals (deposit rates and lending rates, a lower currency – with more to come, capital investment being favoured over labour) are now fostering a steady rebalancing of growth away from the spending side of the economy towards the earnings sector. Such a rotation will bring some much needed balance and spine to growth. As the going gets tough, businesses are increasingly re-examining their business model, cost structures, and looking at consolidation. It's all about driving the key elixir of wealth creation and higher living standards, which is better productivity growth.

**The financial stabilisers have already begun to work.** The seeds of the next upswing are being sown. The RBNZ has cut interest rates for the first time in five years and have signalled they are prepared to do more. The currency has fallen and financial conditions have eased. Facing significant structural headwinds, they will of course take time to work. But clearly, the macro framework is responding.

**Bottom line is that we need to appreciate where we have come from.** While corrections of the type the economy is now embarking on are never painless, we need to be cognisant of how well the economy has performed over the preceding decade. NZ has experienced its longest economic expansion since the 1960s. House prices have effectively doubled in five years. The unemployment rate was at record low levels, restricting the ability of firms to expand. Some of the recent growth has been "borrowed" in the sense that it has resulted in high household indebtedness and a large current account deficit, and therefore necessitates the adjustment the economy is currently embarking on. The piper will be paid. For those that were patient late in the cycle and have strong balance sheets and business models, good things – even out of downturns – will still emerge.

## NEW ZEALAND NATIONAL ACCOUNTS FORECAST

Calendar years	2006	2007	2008(f)	2009(f)	2010(f)	2011(f)	2012(f)
<b>Total Consumption</b>	<b>3.1</b>	<b>4.1</b>	<b>0.9</b>	<b>1.5</b>	<b>2.4</b>	<b>2.9</b>	<b>2.7</b>
Private Consumption	2.6	4.1	0.0	0.8	2.1	2.8	2.6
Public Consumption	5.0	3.9	4.1	3.7	3.3	3.1	3.0
<b>Total Investment</b>	<b>-1.1</b>	<b>4.3</b>	<b>-1.4</b>	<b>-1.9</b>	<b>3.5</b>	<b>6.3</b>	<b>3.8</b>
Residential investment	-3.3	4.4	-11.5	-9.1	-0.9	2.0	3.3
Other investment	-0.5	4.3	1.2	-0.3	4.4	7.1	3.8
<b>Stockbuilding<sup>1</sup></b>	<b>-0.9</b>	<b>0.5</b>	<b>0.2</b>	<b>-0.3</b>	<b>0.1</b>	<b>0.0</b>	<b>0.0</b>
<b>Gross National Expenditure</b>	<b>1.2</b>	<b>4.7</b>	<b>0.8</b>	<b>0.6</b>	<b>2.7</b>	<b>3.7</b>	<b>3.0</b>
<b>Total Exports</b>	<b>1.8</b>	<b>3.3</b>	<b>0.9</b>	<b>6.5</b>	<b>5.7</b>	<b>6.5</b>	<b>6.0</b>
Goods	3.2	4.8	1.6	6.9	5.2	4.4	4.7
Services	-1.8	-0.5	-2.0	3.7	7.6	14.0	9.8
<b>Total Imports</b>	<b>-2.7</b>	<b>8.6</b>	<b>4.5</b>	<b>3.8</b>	<b>6.3</b>	<b>6.6</b>	<b>5.5</b>
Goods	-2.0	8.9	5.0	4.7	7.4	6.9	6.0
Services	-5.0	7.7	1.7	-0.2	2.2	5.2	3.7
<b>Expenditure on GDP</b>	<b>2.4</b>	<b>3.1</b>	<b>-0.5</b>	<b>0.9</b>	<b>2.4</b>	<b>3.5</b>	<b>3.0</b>
<b>GDP (production based)</b>	<b>1.6</b>	<b>3.1</b>	<b>0.3</b>	<b>1.0</b>	<b>2.5</b>	<b>3.6</b>	<b>3.0</b>

<sup>1</sup> Percentage point contribution to growth

## GLOBAL BACKDROP

Weakness in the global economy has broadened beyond the US and commodity prices have fallen, albeit off highs. A huge degree of uncertainty persists, and this ambiguity has asymmetric risks. In terms of the flow-on to NZ, the dairy and tourism industries are key to watch.

### Recoupling

**The global economy is slowing.** The decoupling versus recoupling debate was always a little redundant in our view. The world embarked on a massive period of globalisation, which brought wealth benefits, opened trade linkages, and improved the free-flow of capital and labour. It therefore seems odd to argue that we live in a decoupled world. For sure there has been some delay in the time it has taken US weakness to broaden. Emerging market economies remained robust, but it is now clear that the rest of the developed world is not immune. The UK is stagnant. European growth contracted in the June quarter as did Japan. This is also coming at a time when the US economy remains fragile as consumers de-leverage and the unemployment rate rises.

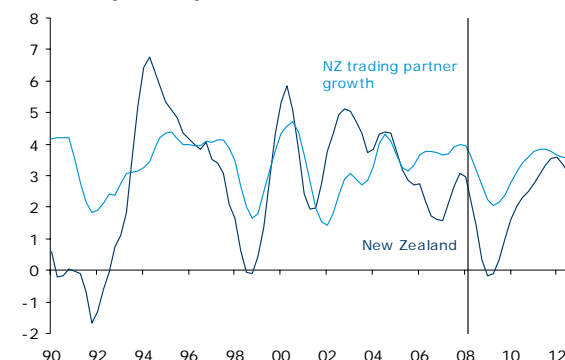
**Credit conditions are yet to stabilise and represent a huge risk.** Further writedowns from financial institutions continue to be announced, and although capital is also being raised, sentiment remains fickle. To date over US\$500 billion of writedowns have been declared, although if the IMF's estimates are to be believed, we are only half way through the adjustment process. Credit and swap spreads remain at levels well wider than pre-subprime crisis levels, and the cost of funding is impacting on nations with large current account deficits such as NZ and Australia. Although policymakers have been busy trying to stabilise the financial system through liquidity injections and safety-net packages, short-term money market rates remain elevated. De-leveraging across the financial system looks set to weigh on global growth prospects for some time yet.

**But inflation also remains high.** These are the most challenging economic times for central banks in more than three decades. Policymakers around the globe are grappling with the dynamics of weak growth at the same time as inflation rates are high. Most of the upward pressure on inflation has been a commodity price story. Core inflation rates on the whole have been well contained, although an upward bias is starting to emerge in some countries, hence the tough talk from some central banks.

**So will emerging markets be the global growth saviour?** Asia is being impacted, though debate surrounds the degree. Undoubtedly, the region is better placed than during past economic slowdowns to weather the storm. Fundamentals are stronger, economies are more flexible and policymaking has generally improved. Nevertheless, with a concerted slowdown emerging across the OECD, there is already evidence that the Asian region is starting to slow as a number of their central banks also raise policy rates in response to inflationary pressures. Chinese PMI data shows the manufacturing sector contracting over the past two months and industrial production growth in India has slowed to a 5½-year low. Chinese officials have signalled they will act to provide a floor to growth. However, there remain many headwinds for China alone to carry, particularly when the G7 is struggling.

**Commodity prices are now key to watch.** The past two months has seen a major turn in sentiment towards commodities, which in our view reflects that the global slowdown has simply past an inflection point. Oil prices have fallen 25 percent. The weakness is widespread with industrials and some softs also well off their peaks. Even "tests" for the oil market such as the Georgian war and Hurricane Gustav have failed to elicit the response we would have perhaps expected. In our minds, such forces give credence to a sustained turn being reached, and global barometers such as the AUD have responded, falling 10 cents in a month. Currency markets pre-empted commodity movements in 1997 and have done so once again.

NZ and trading partner growth forecasts  
Annual average % change



Sources: ANZ National, Bloomberg, Statistics NZ

**NZ's trading partner growth will slow.** We have pencilled in growth easing from 4.0 percent in 2007 to around 2¾ and 2½ percent over 2008 and 2009 before recovering thereafter. The risk profile still looks to have a clear downward bias.

## GLOBAL ECONOMIC GROWTH FORECAST

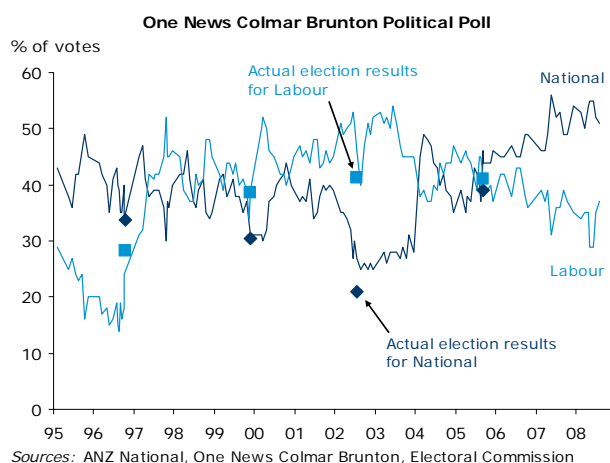
Calendar years	2006	2007	2008 (f)	2009 (f)	2010 (f)	2011 (f)	2012 (f)
United States	2.8	2.0	1.7	1.0	3.0	3.8	3.6
Australia	2.7	4.2	2.5	2.4	3.3	3.1	2.8
Japan	2.4	2.0	0.8	0.8	2.0	1.8	1.6
Euro Zone	3.0	2.6	1.3	0.9	2.1	2.3	2.0
China	10.7	11.7	9.9	9.2	9.8	10.0	10.0
<b>Trading Partner Growth</b>	<b>3.7</b>	<b>4.0</b>	<b>2.7</b>	<b>2.4</b>	<b>3.6</b>	<b>3.7</b>	<b>3.5</b>

## FISCAL POLICY

Regardless of who wins this year's election, fiscal policy will continue to act in a counter-cyclical manner, helping to provide a floor to growth. But weak growth also means we will be looking at underlying fiscal deficits for the first time in over a decade, although this should prove to be of a temporary cyclical nature.

### Winds of change

**Polls will be polls, so we'll just concentrate on the big picture.** The opposition is ahead in current polling, and globally, "change" (the US, UK local authority elections, Australian elections last year) does seem to be the buzzword. Of course, a lot can happen in politics between now and the general election, which has to be held no later than 15 November and recent polling does point to a narrowing between the two major parties. We need to remember that MMP can throw up an interesting mix. However, beyond more tax cuts and increased infrastructure spending, funded by debt, we see little differences between the major parties to influence the spirit of our economic assessment. It all looks broadly similar under a red or blue hue, particularly if MMP keeps all and sundry pitching for the middle ground. Importantly, NZ's current macroeconomic framework, which has served it well, looks set to remain in place.



**The fiscal accounts will slip into the red.** This year's *Budget* foreshadowed the underlying surplus

## FISCAL FORECAST

June years	2006	2007	2008(f)	2009(f)	2010(f)	2011(f)	2012(f)
Operating Balance (\$m)	9,500	8,000	2,500	1,500	1,200	1,000	1,000
- as % of GDP	6.1	4.7	1.4	0.8	0.6	0.5	0.5
OBEGAL (\$m)	7,091	5,860	5,000	500	-300	-700	-900
- as % of GDP	4.5	3.5	2.8	0.3	-0.2	-0.3	-0.4
Net Crown debt (\$m)	7,700	4,400	2,000	4,500	7,500	10,500	13,500
- as % of GDP	4.9	2.6	1.1	2.4	3.9	5.2	6.4
Core Crown residual cash (\$m)	2,985	2,877	900	-4,000	-4,100	-4,350	-4,650
Bond Tender Programme (\$m)	2,400	2,300	2,400	3,600	4,000	4,200	4,500

shrinking to 0.1 percent of GDP by 2012, compared to the 2.6 percent average underlying surpluses achieved over the past decade. Cash deficits of around \$3.4b from fiscal year 2009 onwards were also forecast as the combination of spending increases, infrastructure, tax cuts and funding for the Cullen Fund weighed. In our minds the cash measure is the more important gauge to watch. With the economy even weaker, it seems safe to assume that the accounts will be firmly in the red (when it comes to the OBEGAL or Operating Balance Excluding Gains and Losses), and the cash deficit will also be higher. We'll be eying this as a cyclical deterioration for now, and expect the structural position to remain healthy. Internationally, the structural versus cyclical element to the fiscal position are hard to disentangle with the former tending to be overstated at the top. Hence it's a case of 'watch this space'. Irrespective, it's clear that any incoming government's hands will be fiscally constrained on what promises they can deliver.

**Deficit aside, the government's balance sheet will remain solid.** Higher debt levels will still leave public debt at very low levels as a percentage of GDP, and the envy of many other countries. As such, we think it is unlikely that the country's credit rating will be affected, although maintaining the current rating requires the current account deficit to continue narrowing. **A much higher forecast cash deficit means we can expect the bond tender programme to be increased from the current \$3.4b to something closer to \$4.5b.**

**Counter-cyclical fiscal policy is still set to provide support, but only so far as the fiscal headroom allows.** By all indications, fiscal policy in the next few years will continue to be expansionary and help provide a floor to growth. Tax cuts will go a small way to ease cost of living pressures on households, and infrastructure spending will help to boost the nation's capital stock – which in turn should help lift longer term growth potential. But there is a limit to how much more expansionary fiscal policy can get given the current economic and fiscal realities. Temporarily running small fiscal deficits is understandable when the economy is going through a cyclical trough, but the danger is that if left unchecked, this can quickly turn to one of a more permanent nature.

## INFLATION

Inflation is set to stay high for a while yet. However, the medium-term outlook is more favourable given weak prospects for the economy. In the absence of a significant fall in commodity prices (a risk at present), inflation pressure will only be dampened via squeezed margins as weak demand dominates considerable cost-push pressures. This is a key judgement that underpins our more favourable medium-term outlook.

### A medium-term focus

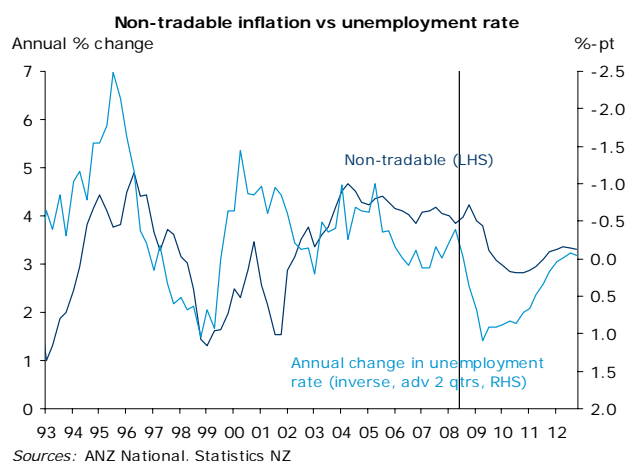
**Headline inflation has not yet peaked.** After hitting 4 percent in the June quarter following solid contributions from food and petrol prices, annual inflation is expected to approach 5 percent in the September quarter. Despite commodity prices being off their peaks recently, their meteoric rise over recent years is now clearly manifesting in high headline inflation rates around the globe. Many other central banks are having to contend with inflation rates well above their respective target bands. Increases in rents, local authority rates and energy prices are also contributing locally.

**Pipeline pressures, a lower currency and inflation expectations remain risks.** Significant pressure on profitability is naturally seeing many firms try to pull the price lever. Pricing intentions from the National Bank *Business Outlook* survey remain elevated. Along with this, inflation expectations have continued to drift higher, with the RBNZ's 2-year measure rising to 3.0 percent. While likely to be in part a result of high headline rates and "visible" price increases such as petrol, the fact that inflation has averaged 2.7 percent for the decade to date compared with 2.1 percent over the 1990s, suggests that it cannot just be blamed on the former. These factors pose upside risks to the inflation outlook. In the RBNZ's own words, "reversing an increase in inflation expectations can be difficult and costly".

**But the medium-term inflation outlook is now more favourable, and we have faith in the whole policy framework.** While pipeline inflation pressures are high, we suspect that pricing intentions will diverge from reality in an environment of very soft demand. In fact, this is a critical judgement underpinning our forecasts. A sharp sustained slowing in economic growth along with a turn in the labour market suggests that domestic inflation pressures will moderate over 2009. There is already some evidence of this, with discounting occurring across the retail sector and annual non-tradable inflation easing. However, other 'core' measures remain elevated so it is not yet clear cut. Nonetheless, it is encouraging to see services inflation remain well behaved, up only 2.8 percent on a year ago. Now that the housing market has turned, we expect construction prices and other housing-related inflation to slow towards the end of this year. To be fair, pipeline pressure from elevated commodity prices (such as steel) suggest construction

costs could remain more sticky – meaning they will not turn as aggressively as in the past.

**Inflation is expected to fall to within the RBNZ's target band in 2010.** Recent falls in domestic petrol prices will obviously help the headline rate 12 months out, and mitigate some of the risks a persistently high headline rate has on inflation expectations. Yet it is the core measures we are more interested in. Previous economic slowdowns over 1991/92 and 1997/98 suggest that it may be another 12 months before non-tradable inflation turns in a sustained manner. However, those two periods also show us that inflation can turn quite sharply. Nevertheless, given capacity constraints, elevated inflation expectations and a degree of cost-push pipeline in some areas (such as construction costs), we expect inflation to show persistence and moderate in a more gradual manner over 2009, which is a little bit at odds with previous cycles.



## CPI FORECAST

Quarter	Qtr % chg	Ann % chg
Dec-07	1.2	3.2
Mar-08	0.7	3.4
Jun-08	1.6	4.0
Sep-08 (f)	1.2	4.8
Dec-08 (f)	0.8	4.4
Mar-09 (f)	0.9	4.7
Jun-09 (f)	0.9	4.0
Sep-09 (f)	0.7	3.4
Dec-09 (f)	0.8	3.4
Mar-10 (f)	0.7	3.2
Jun-10 (f)	0.6	2.9
Sep-10 (f)	0.6	2.8
Dec-10 (f)	0.7	2.7
Mar-11 (f)	0.5	2.5
Jun-11 (f)	0.8	2.6
Sep-11 (f)	0.6	2.6
Dec-11 (f)	0.6	2.5
Mar-12 (f)	0.6	2.6
Jun-12 (f)	0.6	2.4
Sep-12 (f)	0.6	2.4
Dec-12 (f)	0.6	2.4

## EXCHANGE RATE

We continue to see a long overdue currency correction as an inevitable part of the rebalancing process the economy is embarking upon. The speed of this adjustment will be determined by perception towards the global economy (commodity prices) and de-leveraging process that is occurring across asset markets. We expect the NZD/USD to continue to track lower, although the pace of the decline will be stymied somewhat by continued structural USD headwinds.

### Pygmy trading

**No currency looks attractive.** The kiwi is looking vulnerable given the growth picture, high current account deficit and prospects for lower interest rates, despite a still positive yield differential. The AUD has been hit by global growth concerns and a surprise change of tack by the RBA, whom cut rates. Perception towards the EUR has waned as growth in the Euro-zone slips. The GBP has been thumped. The USD, unloved in the first six months of the year, has suddenly become the default play and stands tallest. Of course, with the EUR getting to 1.60, the AUD nearing parity and the NZD around 0.80, the USD looked amazingly cheap. Hence, a fair bit of what we are seeing at present is a classic case of the rubber band snapping back from extended levels.

**Markets are oscillating on what matters.** Risk, equity markets, Asia growth prospects, commodity prices, current account deficits, sovereign wealth fund flows, growth and yield, are influential one month and forgotten the next. The latest thing to spook the market is carry trade unwind with global risk appetites looking fragile as the process of de-leveraging extends. The market is desperate to jump on any trends, and at times the currency market has been acting schizophrenic. The bottom line is that NZ's massive yield differential is no longer the huge driving force it once was as the global economy transitions to an environment that is far more risk and capital preservation conscious. We also need to bear in mind that it is the shape of the yield curve (and particularly indicators such as the spread between the 1<sup>st</sup> and 4<sup>th</sup> bank bill contract as a directional gauge for policy) that is equally if not more important than the yield spread itself. With the RBNZ cutting – even in a slow and steady fashion, it's hard to paint a bullish kiwi picture, particularly with commodity prices now easing.

### Rebalancing

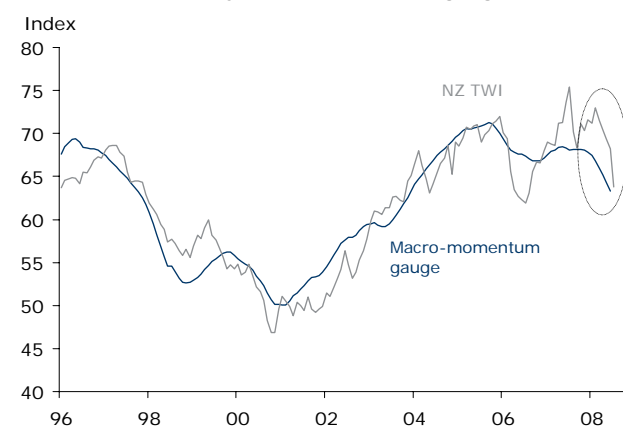
**At times like this you need to go back to first principles.** Fair value for the NZD/USD resides at 65 cents in our view (weak productivity growth has capped upside pressure on fair value from a higher terms of trade), the AUD is likewise extended (fair value in the low 80s), and the same for the EUR/USD and GDP/USD. Hence, a stronger USD looks like it has further to run and these estimates are the medium-term anchors our forecasts are built around. However,

we are also mindful that current credit dislocation could yet halt the USD's new-found attraction. In the altered credit environment, economies running current account deficits are the most vulnerable – and the US is still running a huge one. While smaller than NZ's, relative to the size of the economy, size does matter. Given weakness in the consumer and housing sector, the US needs a weak currency to give its export sector a boost. We have already seen this in progress into recent trade data, and this is a positive dynamic to the current credit dislocation for it will help address current global imbalances.

### A weaker currency is an inevitable part of the rebalancing process for the NZ economy.

Typically we hear stories about high commodity prices and the like sustaining the NZD higher. While there is an element of truth in this, there is also some wilful blindness. For one, weak productivity growth means fair value for the NZD has only altered modestly. Second, the economy still needs to embark on a current account adjustment process. Remember, the nation continues to run a large current account deficit despite having the biggest terms of trade (commodity price) boost in 30 years. Historically, current account adjustments around the globe have involved decent contractions in the domestic economy, falling asset prices, and a currency realignment process. We expect NZ's adjustment to be no different. The fact we have witnessed an economy heading backwards in H1 2008 (eye the trend in our macro momentum gauge below), yet seen no material improvement in the external position, indicates that the economic the adjustment seen to date is by no means enough, and growth and economic performance are never to far apart.

Currency macro-momentum gauge



Sources: ANZ National, Bloomberg

### The trend is your friend

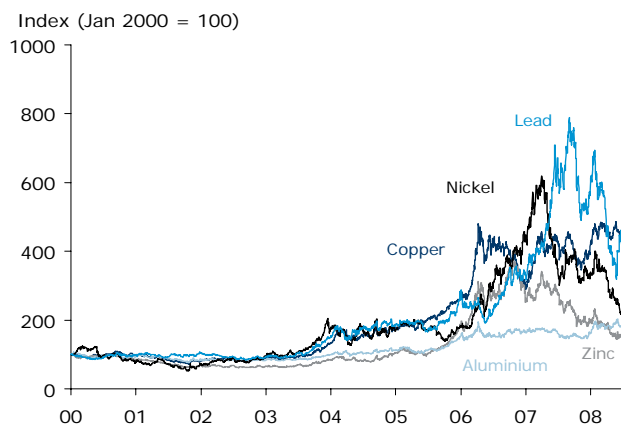
#### We continue to envisage a lower NZD as rebalancing progressively takes hold.

Strategically, we have the NZD falling in a gradual manner against the USD, reaching 0.61 by the end of 2009. A key reason we envisage a gradual adjustment is that we have to also acknowledge the structural headwinds facing the USD. Strictly speaking this means while we expect the EUR/USD (whom NZD/USD correlations are strong) to move lower (towards fair

value), the pace is likely to be gradual. Those looking to diversify out of USD assets are likely to welcome the opportunity of a stronger dollar, so we see some natural sellers on the other side of USD strength. After the moves we've seen over the preceding month, we wouldn't be surprised to see a corrective fillip to the EUR/USD on positioning, and our expectations the RBNZ will end up pausing in their monetary policy easing cycle make us even more inclined to that view. The RBNZ desires a lower currency, but can ill afford to let it fall too far given tradable inflation pressure. Likewise, the interest rate market in Australia looks to be pencilling in an incredibly aggressive easing cycle (75 basis points on top of one cut already delivered) over the next 12 months, and is vulnerable to a pull-back, hence a bounce in the AUD. Indeed, the latter has never fallen 10 cents in a month before, so appears "due" for a corrective move higher.

**We've built in a mild bounce in Q1 2009 before a downward trend resumes.** Timing remains hard to assess but we are mindful of the reality that currencies do not extend in a linear type fashion. Such a bounce is of course critically dependent on the global environment stabilising, and in fact it looks to be the flipside that is the more material risk at present). Massive currency movements, widening credit spreads, and falling commodity prices, reputed central bank intervention in Asia defending currencies are ominous signals something more is going on. But we are not forecasting a calamity, so we must adhere to the traditional adage towards the kiwi that moves down the elevator are followed by grinds up the stairs. But the bounce needs to be read on the context and spirit of a general downward trend.

**Industrial commodity prices**

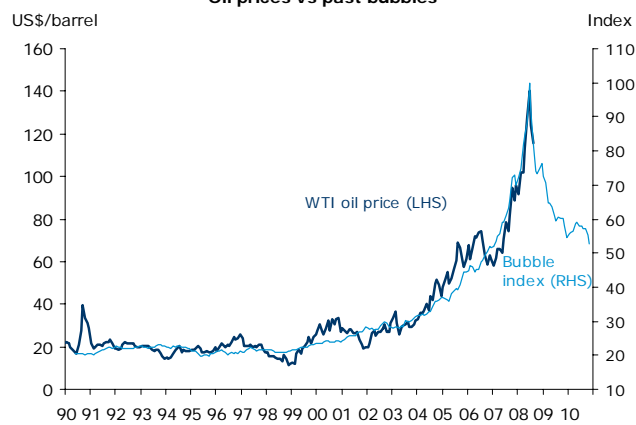


**Commodity prices remain key to watch and if they keep falling, the trend in the kiwi will nonetheless remain down.** We remain more biased towards a recoupled as opposed to a decoupled world. Indeed, we have seen sentiment swing towards the former as commodity prices start to drop and other global barometers such as freight rates also ease (albeit off high levels). We expect more of the same given the global growth picture. Casting our minds back to 1997/98, the currency market was relatively more informed and liquid in terms of predicting what was going on. Hence, while recent moves in the

currency look distinctly oversold, we need to respect the action.

As a tongue in cheek analysis, we have created a Bubble Index, based on past experiences (US equities in 1987, tech bubble of 2000, Japanese equities in the late 1980s, gold and silver in 1980, USD in 1985). The index takes an equal weighting of all the past bubbles included in our sample. Overlaying our Bubble Index with recent oil price movements shows a startling correlation of 0.97. The spirit of what our Bubble Index is suggesting for oil prices (heading towards US\$80/bbl by end of 2009) is something we have a lot of sympathy for. It shows a substantial correction in a cyclical sense, but still remaining at an elevated level (the structural adjustment). We could tell a similar story about dairy prices. Bottom line though is that commodity prices could fall a lot further, and still be historically high. A lot of uncertainty exists when it comes to disentangling structural and cyclical forces. But such analysis highlights that recent unwind in commodity prices could have a lot further to run, although this is also dependent on the USD being able to maintain and extend gains.

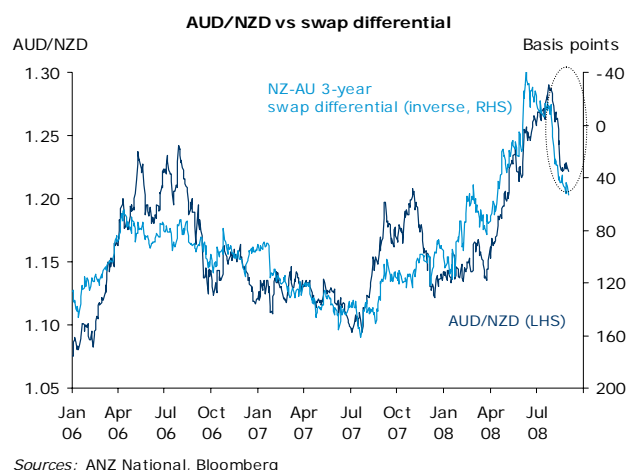
**Oil prices vs past bubbles**



**Looking at the other crosses,** we expect to see relative stability against all excluding the JPY. This really reflects the reality that a lot of what is driving sentiment at present – and what we expect to dominate – is perception towards the USD, global growth gyrations, risk appetites and de-leveraging. Effectively, we expect the USD to remain the tallest pygmy, which will leave others jostling. Remember, though, a lot of this is merely the USD correctly from a massively undervalued position against a lot of the majors. Strictly speaking, more of the NZD's adjustment should be born against the EUR (i.e. weaker than the track below) and JPY given the relative current account positions of each, including the US. But until we see sentiment towards the global economy settle down, and a sense of normality return, the NZD will continue to be driven by wider global forces.

**Our NZD/AUD view is higher than previously forecast,** reflecting a more bearish prognosis towards the AUD. This primarily reflects perception towards the global growth cycle, commodity prices, and de-leveraging that is occurring across an array of asset

classes including assessment of country risk. Strictly speaking, we suspect there are sufficient divergences between the two economies that could yet see another run lower and we've built in such a dynamic over the coming six months. However, the risk in the current global environment is that the NZD and AUD are both lobbed in together in terms of perception. Hence, the spirit of our assessment over the coming years is relatively flat and uninspiring trajectory. It feels odd, but we'll run with that for now until we see how the global scene unfolds.



### NEW ZEALAND DOLLAR FORECAST (end of quarter)

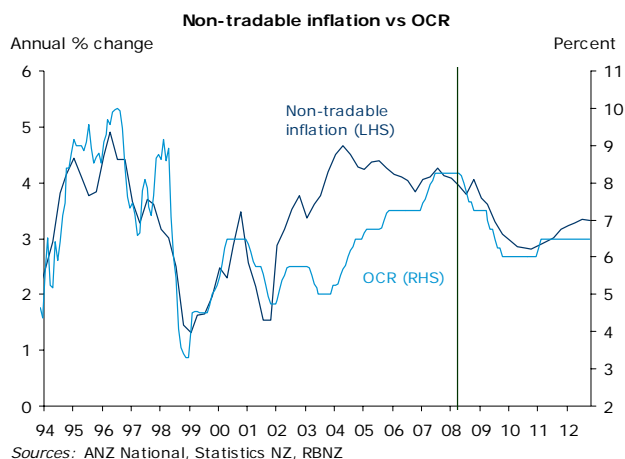
Quarter	NZD/USD	NZD/AUD	NZD/JPY	NZD/GBP	NZD/EUR	NZ TWI
<b>Dec-05</b>	<b>0.70</b>	<b>0.94</b>	<b>82.7</b>	<b>0.40</b>	<b>0.59</b>	<b>72.0</b>
<b>Dec-06</b>	<b>0.69</b>	<b>0.88</b>	<b>81.0</b>	<b>0.35</b>	<b>0.52</b>	<b>68.0</b>
<b>Dec-07</b>	<b>0.77</b>	<b>0.88</b>	<b>86.3</b>	<b>0.38</b>	<b>0.53</b>	<b>71.6</b>
Mar-08	0.80	0.87	81.0	0.40	0.52	71.5
Jun-08	0.76	0.80	81.4	0.39	0.49	68.2
Sep-08 (f)	0.67	0.80	72.0	0.38	0.47	63.9
<b>Dec-08 (f)</b>	<b>0.65</b>	<b>0.77</b>	<b>70.2</b>	<b>0.37</b>	<b>0.45</b>	<b>61.1</b>
Mar-09 (f)	0.68	0.82	74.8	0.38	0.49	65.0
Jun-09 (f)	0.65	0.81	71.5	0.37	0.48	63.1
Sep-09 (f)	0.63	0.81	70.6	0.36	0.47	61.9
<b>Dec-09 (f)</b>	<b>0.61</b>	<b>0.80</b>	<b>69.5</b>	<b>0.35</b>	<b>0.47</b>	<b>60.9</b>
Mar-10 (f)	0.59	0.80	67.9	0.34	0.46	59.6
Jun-10 (f)	0.58	0.81	68.4	0.34	0.47	59.6
Sep-10 (f)	0.58	0.78	66.7	0.34	0.48	59.4
<b>Dec-10 (f)</b>	<b>0.60</b>	<b>0.79</b>	<b>68.4</b>	<b>0.35</b>	<b>0.50</b>	<b>61.3</b>
Mar-11 (f)	0.62	0.78	69.4	0.36	0.51	62.2
Jun-11 (f)	0.64	0.80	70.4	0.36	0.51	63.5
Sep-11 (f)	0.66	0.80	71.3	0.38	0.52	64.6
<b>Dec-11 (f)</b>	<b>0.66</b>	<b>0.80</b>	<b>70.0</b>	<b>0.37</b>	<b>0.51</b>	<b>64.1</b>
Mar-12 (f)	0.66	0.80	70.0	0.37	0.51	64.1
Jun-12 (f)	0.65	0.79	68.9	0.37	0.50	63.1
Sep-12 (f)	0.65	0.79	68.9	0.37	0.50	63.1
<b>Dec-12 (f)</b>	<b>0.65</b>	<b>0.79</b>	<b>68.9</b>	<b>0.37</b>	<b>0.50</b>	<b>63.1</b>

## INTEREST RATES

With the easing cycle starting, the focus is now on how far rates will fall. While weak growth and asset price deflation is pointing towards an aggressive easing cycle, wariness towards lingering inflation mean we look set for a more staggered and cautious approach. The key to a substantial easing cycle looks to hinge on how the global scene unfolds.

### The big picture

**Rates are moving lower.** Despite facing a headline inflation rate that is approaching 5 percent, the RBNZ has shown they are willing to focus on future inflation rather than the current headline, and use the full flexibility of the Policy Targets Agreement. In our minds, it's the complete reciprocal of 2007, when the RBNZ was hiking interest rates despite a falling headline inflation rate. Their focus is correctly on medium-term inflation pressure. A weak prognosis for growth and a turn in the labour market (with the unemployment rate rising from 3.4 percent at the end of last year to 3.9 percent by mid-this year and is expected to track up further) has given the RBNZ comfort that the medium-term inflation outlook is improving. Moreover, there is the material tightening in financial conditions via wider credit spreads and global conditions that are also impacting on borrowing rates, which threatened to tighten policy further. We also know that monetary policy now operates with longer lags given the prevalence of fixed rate lending, with the average mortgage rate rolling off for the rest of this year (at 8.1 percent) still massively below the cheapest fixed mortgage rate in the market, even after the easing cycle has started. At the same time, a generic repricing of risk is impacting on corporate borrowing rates.



### Attention now swings to how far, and how fast.

It is certainly difficult to envisage rates not moving down over the next few meetings. We don't believe – despite signs of stabilising confidence – that there is anything in the economic data that will cause the RBNZ to back away from their easing stance over the coming months. Indeed, it's not on peoples' radar at present but if the financial accelerator turns into the decelerator equivalent, it will become an issue of

financial stability, and the RBNZ will need to act more aggressively. At this stage this remains a risk as opposed to the central track and of course with the currency falling of late, there is also a counter case for more caution. Looking at the big macro picture, it is easy to see rates falling as much as 300bps before this easing cycle is through. The stone cold reality is that monetary policy cycles also always tend to go further than what we expect, either up or down. Typically, the first stop or target is the perceived neutral interest rate, but historically we tend to push beyond that.

**The RBNZ will be weighing up a number of considerations as it assesses how far and how fast rates can fall.** These will include the domestic growth picture, inflation expectations, wage bargaining behaviour, the labour market and firm price setting behaviour. Our core macro prognosis (weak growth, loosening labour market) suggests none will be a barrier to lower rates. However, we are also mindful of other considerations.

- > **The neutral interest rate.** The first port of call for policy is usually to take rates towards neutral. But this begs the question where neutral is. Six percent is often quoted as this represents a neutral real rate of 4 percent, plus the middle of the 1 to 3 percent inflation target band. However, if we use inflation expectations, currently at 3 percent, as opposed to the mid-point of the target band, the neutral rate rises closer to 7 percent. Of course, there are other factors that influence the neutral rate, such as the higher levels of indebtedness and the increased credit spread between retail and wholesale rates to name two. Arguably, the real neutral rate is no longer 4 percent given where potential growth resides. Provided the RBNZ is successful in getting inflation expectations towards the middle of the target band, then the neutral rate should ultimately reside nearer 6 percent. However, in the current environment, around 7 percent may well be the RBNZ's perceived first stop, and ultimately it is their view that counts.
- > **Pro-cyclical pockets of inflation,** such as housing related inflation. Typically we see outright deflation from certain areas such as construction costs when the demand story bites. Historically, such a dynamic has been a key swing factor getting non-tradable inflation down. We still believe this dynamic will pan out, although with more stickiness than previously. The additional stickiness reflects the impact of higher input costs such as steel and the like, which continue to flow through, along with structural changes in housing related policy (i.e. requiring double glazing on new construction etc).
- > **Commodity prices and the currency.** If the latter falls without the former, the RBNZ will have an even greater inflation problem. Sure, it's of the tradable dimension, but we need to be mindful that the headline inflation rate is already projected to hit close to 5 percent, and stay outside the band for another four quarters. If commodity

prices continue to correct, then the RBNZ can obviously accommodate a weaker currency. Indeed, historically the currency (as a more liquid market) has in fact led commodity prices, so a weaker currency in itself is not necessarily a reason for the RBNZ to panic. It's often telling us something. The other aspect to commodity prices is the level versus the change. With a turning point seemingly reached for commodities, central banks can take comfort. However, we are also mindful of the overall level, which remain high across an array of commodities. Certainly when we look at global measures of business sector costs such as producer prices, all remain high. These portend of still considerable pipeline inflation, although our key judgement is that in an environment of weak growth, this will simply be absorbed into margins.

**On balance, we've pencilled in a staggered easing cycle as the RBNZ weighs up these factors.** This involves rate cuts for the rest of this year, taking the OCR to 7.25 percent (close to the current "neutral level"), then a pause to reassess the economic and inflation outlook. As inflation and inflation expectations continue to ease, the RBNZ will then commence a second easing cycle from mid-2009, taking the OCR towards 6 percent by year's end. We see the RBNZ easing by less than consensus in the next 9 months, but by more over the next 2 years. However, if we see the global picture continue to deteriorate, commodity prices fall further, and/or financial stability concerns emerge, it will be a case of

more aggressive moves lower, and sooner as opposed to later.

**Our longer-end forecasts sees the 10-year bond yield head lower initially on a narrowing spread versus the US.** With short rates in NZ going down and the US remaining unchanged in the near term, the narrowing yield differential will lead to a narrowing in the NZ-US bond spread. But as the US economic recovery eventually takes hold and US bond yields start to rise, NZ yields will similarly move higher towards 6¼ percent by 2011.

**Looking around the globe,** central banks continue to face a tough balancing act as they weigh up credit and growth concerns, against a near-term spike in inflation courtesy of oil and food prices. The text-book hasn't been penned in terms of how to respond, and in a sense central banks are flying blind. Certainly, the nuances coming out of the ECB remain hawkish, although growth concerns remain. And a number of US Federal Reserve officials continue to talk tough on inflation, although concerns towards the financial system remain. Members of the Bank of England are divided. Abstracting from the RBA and RBNZ – both of which have higher starting positions for their cash rates – we expect central banks to adopt a reasonably cautious stance as they weigh up contrasting forces. We envisage the Federal Reserve remaining on hold for the foreseeable future (while the market is anticipating a hike by March 2009) and ECB to remain in wait and see mode.

## INTEREST RATE FORECAST (end of quarter)

Quarter	OCR	90-day	2-year swap	5-year swap	10-year bond	US 10-year bond	AU 10-year bond
Dec-05	7.2	7.7	7.3	6.9	5.8	4.5	5.3
Dec-06	7.3	7.7	7.5	7.1	5.8	4.6	5.7
Dec-07	8.3	8.9	8.7	8.2	6.4	4.1	6.2
Mar-08	8.3	8.9	8.3	7.9	6.4	3.5	6.1
Jun-08	8.3	8.8	8.0	7.6	6.4	3.9	6.4
Sep-08 (f)	7.8	8.0	7.2	6.9	5.9	3.7	5.7
<b>Dec-08 (f)</b>	<b>7.3</b>	<b>7.6</b>	<b>7.2</b>	<b>7.1</b>	<b>6.0</b>	<b>3.9</b>	<b>5.9</b>
Mar-09 (f)	7.3	7.6	7.2	7.1	6.0	3.9	5.8
Jun-09 (f)	7.0	7.1	7.1	6.9	5.8	3.9	5.8
Sep-09 (f)	6.5	6.5	6.7	6.7	5.7	4.0	5.8
<b>Dec-09 (f)</b>	<b>6.0</b>	<b>6.2</b>	<b>6.5</b>	<b>6.6</b>	<b>5.7</b>	<b>4.3</b>	<b>6.0</b>
Mar-10 (f)	6.0	6.2	6.5	6.6	5.8	4.5	6.0
Jun-10 (f)	6.0	6.2	6.6	6.7	6.0	4.8	6.2
Sep-10 (f)	6.0	6.2	6.6	6.7	5.9	4.9	6.3
<b>Dec-10 (f)</b>	<b>6.0</b>	<b>6.2</b>	<b>6.6</b>	<b>6.7</b>	<b>6.0</b>	<b>5.0</b>	<b>6.4</b>
Mar-11 (f)	6.3	6.6	6.8	6.8	5.9	4.8	6.1
Jun-11 (f)	6.5	6.7	6.9	6.9	6.2	5.0	6.3
Sep-11 (f)	6.5	6.7	6.9	6.9	6.2	5.0	6.3
<b>Dec-11 (f)</b>	<b>6.5</b>	<b>6.7</b>	<b>6.9</b>	<b>7.0</b>	<b>6.3</b>	<b>5.0</b>	<b>6.3</b>
Mar-12 (f)	6.5	6.7	6.9	7.0	6.2	5.0	6.3
Jun-12 (f)	6.5	6.7	6.9	7.0	6.2	5.0	6.3
Sep-12 (f)	6.5	6.7	6.9	7.0	6.2	5.0	6.3
<b>Dec-12 (f)</b>	<b>6.5</b>	<b>6.7</b>	<b>6.9</b>	<b>7.0</b>	<b>6.2</b>	<b>5.0</b>	<b>6.3</b>

## ECONOMIC FORECASTS

	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
<b>Real Gross Domestic Product</b>												
Total GDP, QPC	1.3	0.8	0.5	0.8	-0.3	<b>-0.5</b>	<b>-0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.5</b>	<b>0.5</b>	<b>0.6</b>
Total GDP, APC	2.3	3.2	3.3	3.5	1.9	<b>0.6</b>	<b>-0.2</b>	<b>-0.8</b>	<b>-0.2</b>	<b>0.8</b>	<b>1.5</b>	<b>1.9</b>
Total GDP, AAPC	1.6	2.1	2.7	3.1	3.0	<b>2.3</b>	<b>1.4</b>	<b>0.3</b>	<b>-0.2</b>	<b>-0.1</b>	<b>0.3</b>	<b>1.0</b>
<b>Real GDP Components</b>												
Private Consumption, QPC	1.9	0.4	0.5	0.5	-0.4	<b>-0.5</b>	<b>-0.2</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.3</b>	<b>0.5</b>
Private Consumption, AAPC	2.9	3.5	3.9	4.1	3.3	<b>2.2</b>	<b>1.0</b>	<b>0.0</b>	<b>-0.3</b>	<b>-0.2</b>	<b>0.3</b>	<b>0.8</b>
Public Consumption, QPC	0.7	0.9	1.8	0.2	1.1	<b>1.1</b>	<b>1.0</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>0.9</b>	<b>0.8</b>
Public Consumption, AAPC	4.7	4.3	4.1	3.9	3.9	<b>4.2</b>	<b>4.0</b>	<b>4.1</b>	<b>4.0</b>	<b>3.9</b>	<b>3.9</b>	<b>3.7</b>
Residential Investment, QPC	0.7	3.0	1.7	-2.3	-5.4	<b>-5.0</b>	<b>-4.0</b>	<b>-3.0</b>	<b>-2.0</b>	<b>-1.5</b>	<b>-1.0</b>	<b>-0.5</b>
Residential Investment, AAPC	-2.7	1.7	3.5	4.4	3.9	<b>-1.1</b>	<b>-6.7</b>	<b>-11.5</b>	<b>-14.0</b>	<b>-14.0</b>	<b>-12.0</b>	<b>-9.1</b>
Other Investment, QPC	3.2	-1.3	0.1	5.1	-1.2	<b>-0.5</b>	<b>-0.9</b>	<b>-0.9</b>	<b>0.2</b>	<b>0.3</b>	<b>0.6</b>	<b>0.6</b>
Other Investment, AAPC	-1.3	0.5	1.9	4.3	4.3	<b>4.0</b>	<b>3.9</b>	<b>1.2</b>	<b>0.0</b>	<b>-1.1</b>	<b>-1.6</b>	<b>-0.3</b>
Gross National Expenditure, QPC	1.1	1.9	0.2	0.5	0.2	<b>-0.5</b>	<b>-0.9</b>	<b>-0.9</b>	<b>0.2</b>	<b>0.3</b>	<b>0.6</b>	<b>0.6</b>
Gross National Expenditure, AAPC	1.1	3.0	4.6	4.7	4.6	<b>3.2</b>	<b>1.8</b>	<b>0.8</b>	<b>0.0</b>	<b>0.0</b>	<b>0.1</b>	<b>0.6</b>
Exports, QPC	3.1	-1.2	0.0	4.5	-1.8	<b>-2.0</b>	<b>1.2</b>	<b>2.8</b>	<b>1.9</b>	<b>1.6</b>	<b>1.4</b>	<b>1.4</b>
Exports, AAPC	3.1	3.4	2.1	3.3	2.2	<b>1.8</b>	<b>2.4</b>	<b>0.9</b>	<b>1.5</b>	<b>3.3</b>	<b>4.9</b>	<b>6.5</b>
Imports, QPC	4.2	2.6	0.8	3.8	1.2	<b>-1.2</b>	<b>0.3</b>	<b>0.8</b>	<b>1.3</b>	<b>1.2</b>	<b>1.5</b>	<b>1.5</b>
Imports, AAPC	-1.6	1.8	5.4	8.6	9.6	<b>8.5</b>	<b>7.2</b>	<b>4.5</b>	<b>2.6</b>	<b>2.4</b>	<b>2.6</b>	<b>3.7</b>
<b>Prices</b>												
Headline CPI, QPC	0.5	1.0	0.5	1.2	0.7	1.6	<b>1.2</b>	<b>0.8</b>	<b>0.9</b>	<b>0.9</b>	<b>0.7</b>	<b>0.8</b>
Headline CPI, APC	2.5	2.0	1.8	3.2	3.4	4.0	<b>4.8</b>	<b>4.4</b>	<b>4.7</b>	<b>4.0</b>	<b>3.4</b>	<b>3.4</b>
Non-tradable CPI, QPC	1.2	1.1	0.6	0.7	1.1	0.9	<b>1.2</b>	<b>0.8</b>	<b>0.8</b>	<b>0.6</b>	<b>0.7</b>	<b>0.7</b>
Non-tradable CPI, APC	4.1	4.1	3.7	3.5	3.5	3.4	<b>4.0</b>	<b>4.2</b>	<b>3.8</b>	<b>3.5</b>	<b>3.0</b>	<b>2.9</b>
Tradable CPI, QPC	-0.4	0.9	0.5	1.8	0.2	2.3	<b>1.1</b>	<b>0.8</b>	<b>1.0</b>	<b>1.2</b>	<b>0.8</b>	<b>1.0</b>
Tradable CPI, APC	0.9	-0.5	-0.3	2.8	3.4	4.8	<b>5.4</b>	<b>4.3</b>	<b>5.2</b>	<b>4.1</b>	<b>3.9</b>	<b>4.1</b>
<b>External Accounts</b>												
Annual Balance on Goods, % of GDP	-1.7	-1.7	-1.8	-1.3	-1.0	<b>-0.5</b>	<b>-0.3</b>	<b>-0.3</b>	<b>-0.3</b>	<b>-0.1</b>	<b>0.0</b>	<b>-0.2</b>
Annual Balance on Services, % of GDP	0.3	0.3	0.3	0.2	0.2	<b>0.1</b>	<b>0.1</b>	<b>0.0</b>	<b>0.1</b>	<b>0.1</b>	<b>0.2</b>	<b>0.4</b>
Annual Balance on Invisibles, % of GDP	-6.8	-6.7	-6.8	-6.8	-6.9	<b>-7.3</b>	<b>-7.3</b>	<b>-7.3</b>	<b>-7.1</b>	<b>-6.6</b>	<b>-6.5</b>	<b>-6.3</b>
Annual Current Account Balance, % of GDP	-8.1	-8.1	-8.3	-7.9	-7.7	<b>-7.7</b>	<b>-7.6</b>	<b>-7.5</b>	<b>-7.3</b>	<b>-6.6</b>	<b>-6.3</b>	<b>-6.1</b>
Net International Invt Position, % of GDP	-86.5	-88.2	-87.9	-86.5	-86.2	<b>-86.4</b>	<b>-86.4</b>	<b>-86.7</b>	<b>-86.9</b>	<b>-87.0</b>	<b>-87.0</b>	<b>-87.0</b>
<b>Terms of Trade (SNA basis)</b>												
Export Prices, QPC	-0.4	-1.4	2.6	7.9	3.3	<b>3.4</b>	<b>3.4</b>	<b>1.8</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.5</b>	<b>-0.9</b>
Export Prices, APC	2.3	-3.1	-1.6	8.7	12.7	<b>18.2</b>	<b>19.2</b>	<b>12.5</b>	<b>8.3</b>	<b>4.2</b>	<b>0.2</b>	<b>-2.4</b>
Import Prices, QPC	-2.2	-2.5	-1.3	4.6	0.3	<b>4.0</b>	<b>5.5</b>	<b>2.9</b>	<b>0.1</b>	<b>-0.4</b>	<b>-0.5</b>	<b>-0.7</b>
Import Prices, APC	0.7	-8.1	-9.1	-1.6	1.0	<b>7.7</b>	<b>15.2</b>	<b>13.3</b>	<b>13.0</b>	<b>8.2</b>	<b>2.0</b>	<b>-1.5</b>
Terms of Trade, QPC	1.9	1.1	3.9	3.2	3.0	<b>-0.6</b>	<b>-2.0</b>	<b>-1.0</b>	<b>-0.7</b>	<b>-0.1</b>	<b>0.0</b>	<b>-0.2</b>
Terms of Trade, APC	1.6	5.5	8.2	10.5	11.6	<b>9.8</b>	<b>3.5</b>	<b>-0.7</b>	<b>-4.2</b>	<b>-3.7</b>	<b>-1.8</b>	<b>-1.0</b>
<b>Labour Market</b>												
Employment, QPC	1.4	0.3	-0.1	0.9	-1.3	1.3	<b>-0.6</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.1</b>	<b>0.1</b>	<b>0.1</b>
Employment, APC	1.8	1.5	1.5	2.5	-0.2	0.7	<b>0.2</b>	<b>-0.7</b>	<b>0.6</b>	<b>-0.6</b>	<b>0.0</b>	<b>0.2</b>
Labour Force, QPC	1.4	0.2	-0.2	0.7	-1.0	1.5	<b>-0.3</b>	<b>0.2</b>	<b>0.1</b>	<b>0.3</b>	<b>0.4</b>	<b>0.3</b>
Labour Force, APC	1.6	1.5	1.3	2.1	-0.3	1.1	<b>0.9</b>	<b>0.4</b>	<b>1.5</b>	<b>0.3</b>	<b>1.0</b>	<b>1.1</b>
Unemployment Rate, sa	3.7	3.6	3.5	3.4	3.7	3.9	<b>4.2</b>	<b>4.5</b>	<b>4.6</b>	<b>4.9</b>	<b>5.1</b>	<b>5.3</b>
Participation Rate, sa	68.7	68.7	68.3	68.6	67.7	68.6	<b>68.3</b>	<b>68.2</b>	<b>68.2</b>	<b>68.2</b>	<b>68.2</b>	<b>68.1</b>
Private Sector Wages (apc)	5.5	4.2	3.7	4.0	4.4	5.4	<b>5.3</b>	<b>5.3</b>	<b>5.2</b>	<b>4.2</b>	<b>4.0</b>	<b>4.1</b>
Public Sector Wages (apc)	1.9	4.6	4.9	5.0	5.4	4.8	<b>4.7</b>	<b>4.2</b>	<b>3.0</b>	<b>4.1</b>	<b>4.1</b>	<b>4.1</b>

Forecast in bold

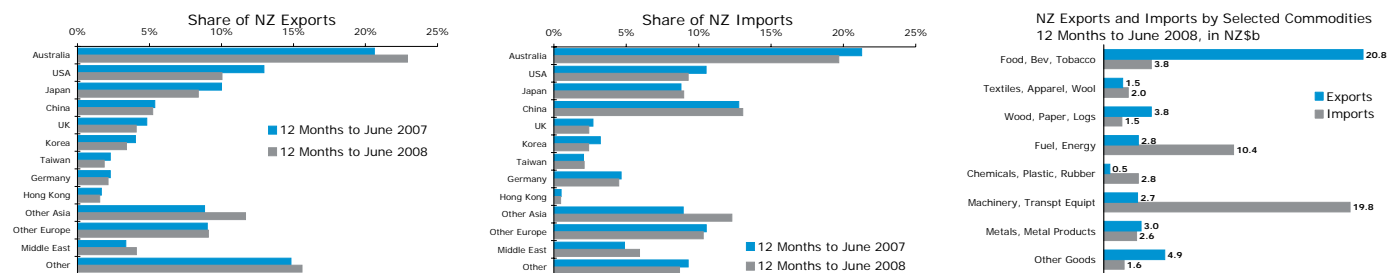
QPC – quarterly percent change

APC – annual percent change

AAPC – annual average percent change

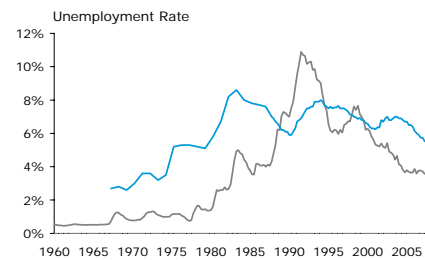
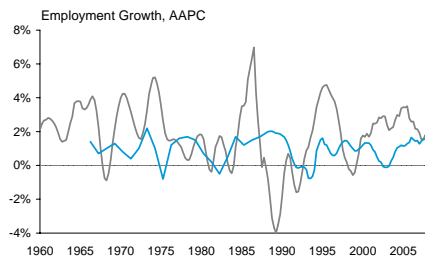
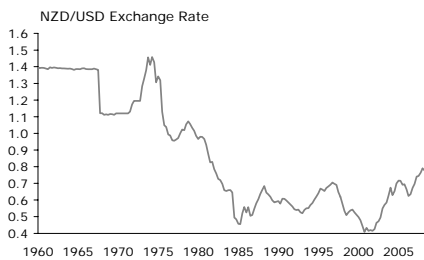
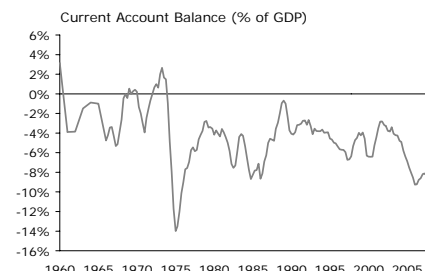
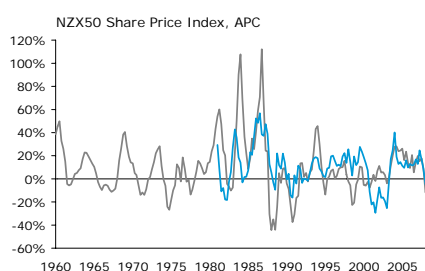
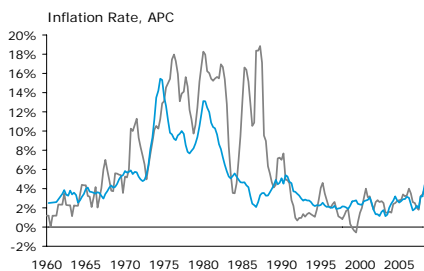
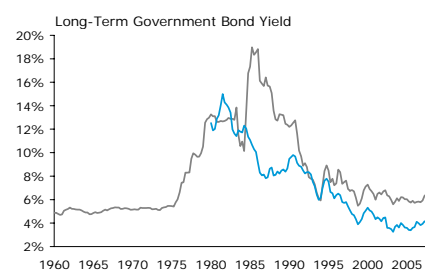
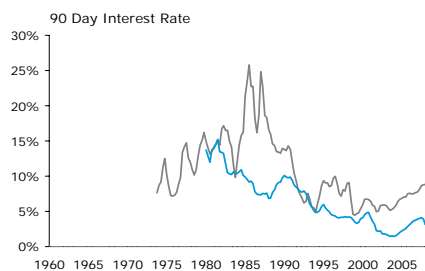
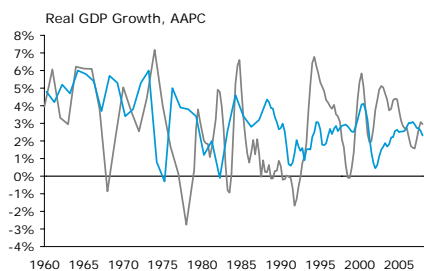
sa – seasonally adjusted

## NEW ZEALAND KEY ECONOMIC INDICATORS



## New Zealand Compared to Main Trading Partners (latest available figures)

	NZ	Aust	USA	Japan	UK	China	Gmany	SKorea	Taiwan	Malaysia	H/kong	S/pore	Indonesia
Population, in millions	4.1	20.5	302.8	127.9	60.5	1320.9	82.6	48.1	22.9	26.1	7.1	4.6	228.9
Area in 1,000 km2	271	7713	9373	378	244	9561	357	92	36	330	1	1	1905
Inhabitants per km2	15.0	2.7	32.3	338.5	247.8	138.2	231.7	521.1	636.1	79.1	7130.0	4600.0	120.1
GDP, in billion NZ\$	178	1274	19407	6088	3842	4898	4641	1368	558	288	301	227	615
Change in real terms (%)	1.9	3.6	1.8	1.0	1.6	10.1	1.7	4.8	6.1	7.1	4.2	1.9	6.4
Nominal GDP per capita in NZ\$	43,726	62,157	64,091	47,597	63,501	3,708	56,165	28,477	24,371	11,016	42,267	49,452	2,689
NZ exports to ..., in million NZ\$ (FOB)	n/a	9173	4017	3359	1633	2091	849	1362	742	855	616	897	959
Share of NZ Exports (%)	n/a	22.9	10.0	8.4	4.1	5.2	2.1	3.4	1.9	2.1	1.5	2.2	2.4
NZ imports to ..., in million NZ\$ (VFD)	n/a	8250	3890	3759	1010	5471	1877	1007	874	1740	194	2161	755
Share of NZ Imports (%)	n/a	19.7	9.3	9.0	2.4	13.0	4.5	2.4	2.1	4.2	0.5	5.2	1.8
Current Account balance as a % of GDP	-7.8	-5.6	-4.8	4.1	-3.6	8.6	6.4	-2.5	5.2	14.4	9.0	19.4	2.8



**DISCLOSURE INFORMATION**

The Bank (in respect of itself and its principal officers) makes the following investment adviser disclosure to you pursuant to section 41A of the Securities Markets Act 1988.

The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

**Qualifications, experience and professional standing****Experience**

The Bank is a registered bank and, through its staff, is experienced in providing investment advice about its own securities and, where applicable, the securities of other issuers. The Bank has been selling securities, and providing investment advice on those securities, to customers as a core part of its business for many years, drawing on the extensive research undertaken by the Bank and its related companies and the skills of specialised staff employed by the Bank. The Bank is represented on many bank, finance and investment related organisations and keeps abreast of relevant issues by running seminars and workshops for relevant staff and having its investment adviser staff attend external seminars where appropriate. The Bank subscribes to relevant industry publications and, where appropriate, its investment advisers will monitor the financial markets.

**Relevant professional body**

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

**Professional indemnity insurance**

The Bank (and its subsidiaries), through its ultimate parent company Australia and New Zealand Banking Group Limited, has professional indemnity insurance which covers its activities including those of investment advisers it employs.

This insurance covers issues (including 'prior acts') arising from staff fraud, electronic crime, documentary fraud and physical loss of property. The scope of the insurance also extends to third party civil claims, including those for negligence. The level of cover is of an amount commensurate with the size and scale of the Bank.

The insurer is ANZcover Insurance Pty Limited.

**Dispute resolution facilities**

The Bank has a process in place for resolving disputes. Should a problem arise, you can contact any branch of the Bank for more information on the Bank's procedures or refer to any of the Bank's websites.

Unresolved complaints may ultimately be referred to the Banking Ombudsman, whose contact address is PO Box 10-573, Wellington.

**Criminal convictions**

In the five years before the relevant investment advice is given none of the Bank (in its capacity as an investment adviser and where applicable an investment broker) or any principal officer of the Bank has been:

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;

- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

**Fees**

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

**Other interests and relationships**

When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

- ANZ Investment Services (New Zealand) Limited (ANZIS), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ANZIS may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- The Bank has a joint venture relationship with ING (NZ) Holdings Limited (ING). ING and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.

**Securities about which investment advice is given**

The Bank provides investment advice on the following types of securities:

- Debt securities including term and call deposits, government stock, local authority stock, State-Owned Enterprise bonds, Kiwi bonds and corporate bonds and notes;
- Equity securities such as listed and unlisted shares;
- New Zealand and overseas unit trusts;
- Share in a limited partnership;
- Superannuation schemes and bonds;
- Group investment funds;
- Life insurance products;
- Derivative products including interest rate and currency forward rate contracts and options; and
- Other forms of security, such as participatory securities.

**PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY**

If you wish to pay investment money to the Bank you can do this in several ways such as by:

- Providing cash;
- Providing a cheque payable to the relevant product or service provider and crossed 'not transferable'; or
- Making an automatic payment or payment through another electronic delivery mechanism operated by the Bank.

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third parties will be deposited in accordance with your instructions, to your nominated account or investment. Such money will be held by the Bank according to usual banking terms and conditions applying to that account or the particular terms and conditions relating to the investment and will not be held by the Bank on trust unless explicitly accepted by the Bank on those terms. Any investment money or property accepted by the Bank on trust will be so held until disbursed in accordance with your instructions. Any investment property lodged with the Bank will be held by the Bank as bailee according to the Bank's standard terms and conditions for holding your property.

**Record Keeping**

The Bank will keep adequate records of the deposit of investment moneys or property and all withdrawals and dealings with such money or property, using the account/investment number allocated to your investment. You may have access to those records upon request.

**Auditing**

The Bank's systems and operations are internally audited on a regular basis. The financial statements of the Bank and its subsidiaries are audited annually by KPMG. However, this does not involve an external audit of the receipt, holding and disbursement of the money and other property.

**Use of Money and Property**

Money or property held by the Bank for a specific purpose communicated to the Bank (e.g. the purchase of an interest in a security) may not be used by the Bank for its own purposes and will be applied for your stated purpose. No member of the Bank's staff may use any money or property deposited with the Bank, for their own purposes or for the benefit of any other person. In the absence of such instructions, money deposited with the Bank may be used by the Bank for its own purposes, provided it repays the money to you upon demand (or where applicable, on maturity), together with interest, where payable.

**DISCLAIMER**

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

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

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