

NEW ZEALAND ECONOMICS MARKET FOCUS

27 June 2011

INSIDE

Economic Overview	2
NZ Inflation Expectations	4
Interest Rate Strategy	9
Currency Strategy	10
Data Event Calendar	11
Data Watch	13
Key Forecasts	14

NZ ECONOMICS TEAM

Cameron Bagrie
Chief Economist
Telephone: +64 4 802 2212
E-mail: Cameron.Bagrie@anz.com

Khoon Goh
Head of Market Economics and
Strategy
Telephone: +64 4 802 2357
E-mail: Khoon.Goh@anz.com

David Croy
Senior Interest Rate Strategist
Telephone: +64 4 576 1022
E-mail: David.Croy@anz.com

Sharon Zöllner
Senior Economist
Telephone: +64 4 576 1062
E-mail: Sharon.Zollner@anz.com

Mark Smith
Economist
Telephone: +64 4 802 2199
E-mail: Mark.Smith2@anz.com

Steve Edwards
Economist
Telephone: +64 9 357 4065
E-mail: Steve.Edwards@anz.com

Con Williams
Rural Economist
Telephone: +64 4 802 2361
E-mail: Con.Williams@anz.com

THE COST OF CERTAINTY

ECONOMIC OVERVIEW

Last week's additional fiscal package for some Christchurch households should help dispel some of the uncertainties resulting from continuing aftershocks. While challenges remain and the non-residential rebuild remains a way off, greater clarity ups the ante for residential-related work starting promptly. This week's National Bank Business Outlook will be examined to see if Christchurch-centric events have impacted on what looks to be an improving domestic outlook. There is a growing dichotomy between a relatively upbeat local outlook and mounting concerns over a global slowdown. While you can never divorce the two, and overseas central banks seem content to wait on the sidelines, the RBNZ may not have that luxury for long.

A LOOK AT NZ INFLATION EXPECTATIONS

All New Zealand inflation expectations measures looked at have something to offer when assessing medium-term inflation trends. Wages, the output gap, the exchange rate and interest rates all influence expectations. But in terms of prices, petrol is very important for all but the most forward-looking surveys. There is also some evidence that food prices matter above and beyond their impact on CPI inflation. Once food and petrol prices are included, headline CPI doesn't always add much explanatory power. Food and energy are at the heart of current inflation pressure, and our findings suggest inflation expectations may not drop back as quickly as the Reserve Bank probably wishes.

INTEREST RATE STRATEGY

Although the domestic news flow has generally been positive, markets have discounted the odds of a rate hike by year-end. This has largely been in response to global uncertainties, particularly in relation to Greece and the US. We expect heightened uncertainty to remain in place for some time yet, keeping a lid on local interest rates. But if domestic data continues to print on the strong side, the debate about the importance of domestic versus global influences is set to intensify.

CURRENCY STRATEGY

With nothing definitive settled for Greece yet and negotiations over the US debt ceiling reaching a short-term impasse, the focus this week will likely be "risk off" for currency markets. The NZD will continue to be driven by offshore factors but should hold up well against other currencies (except the USD). Commodity prices continue to look soft, adding further to the risk off theme.

ECONOMIC OVERVIEW

SUMMARY

Last week's additional fiscal package for some Christchurch households should help dispel some of the uncertainties resulting from continuing aftershocks. While challenges remain and the non-residential rebuild remains a way off, greater clarity ups the ante for residential-related work starting promptly. This week's National Bank Business Outlook will be examined to see if Christchurch-centric events have impacted on what looks to be an improving domestic outlook. There is a growing dichotomy between a relatively upbeat local outlook and mounting concerns over a global slowdown. While you can never divorce the two, and overseas central banks seem content to wait on the sidelines, the RBNZ may not have that luxury for long.

THIS WEEK'S EVENTS

SNZ Building Consents – May (Thursday, June 30, 10:45am). We expect a 5 percent increase in residential consent numbers. Non-residential consents of about \$270m are envisaged.

National Bank Business Outlook – June (Thursday, June 30, 1:00pm).

RBNZ Credit Aggregates – May (Thursday, June 30, 3:00pm). Low rates of annual credit growth are expected for households and businesses. A small fall is expected for agricultural credit.

WHAT'S THE VIEW?

Fiscal policy continues to provide a lot of economic support to Canterbury. Assuming most Red Zone residents take up the Government's offer (at 2007 GV's, the peak in the market!) there is about \$1.2 billion additional cash that is set to hit the region¹, although the net cost to the Government over time is estimated to be \$485m to \$635m. **While challenges remain and the non-residential rebuild remains a way off, more money and greater clarity ups the ante for residential-related work to start promptly.**

Rather than go into extensive detail we'll make some broad observations.

- The pre 13 June shake starting position for Christchurch was one of growing resilience and it needed to stay that way. Last week we noted that there were more jobs advertised in Christchurch than Wellington and Auckland combined in May. Such resilience may have been seriously undermined given the psychological and emotional aspects to recent shakes. While we won't know until we see consumer and business confidence for July, shoring up

sentiment still needs to be a part of policymakers' reaction function and a reason for acting decisively to give certainty (or hope!).

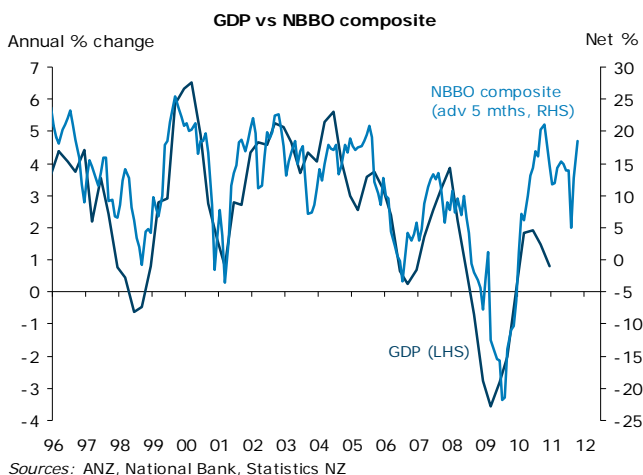
- While we expect to see some take the cash and run – either to another region or offshore – we suspect most will be recycled locally.
- Land supply – at an affordable price – will be critical going forward. A quick check of the Trade Me website shows 1,558 Canterbury sections available. There is talk of thousands more coming onto the market. We hope they do. The counter is construction inflation.
- Even without pending land supply, it's hard to see the existing dwelling market not performing reasonably well. Many displaced homeowners will not want the hassle of waiting. Cash in the hand and some pretty attractive interest rates (bank specials) looks like an encouraging cocktail. And on top of that you can throw in the Christchurch labour market with more anecdotes of skill shortages leading to salary adjustments (the seismic premium).
- The announced package for the Red Zone was bold and very helpful for those people. We presume more will be pending (has Pandora's box been opened?). Challenges from here will include managing expectations while keeping a tight rein on expenditure, and managing the various risk-related moral hazard issues, versus the clear need to give some clarity and certainty to the situation. In such a messy situation, it is impossible to keep everyone happy. There will be winners and losers, and those in the Orange Zone still face considerable uncertainty. We approve of the Government using its balance sheet to fast-track insurance settlements. In our view the decision was not just about Christchurch, though acting decisively was critical to stymie the obvious risk of confidence in the region plunging. But more than that, not acting also risked creating negative externalities, such as pressure on infrastructure in other key regions if emigration from Christchurch to other parts of the country (i.e. Auckland) took off!
- We continue to ponder the various internal pressures the whole rebuild effort will place on the economy. Last week's current account deficit figures (4.3 percent of GDP) looked okay, compared with 8 percent deficits of late. Yet the "improvement" has largely come from collapsing business and residential investment. The former is picking up, and we're in no doubt the latter will too, as the construction sector goes from famine to feast. If the current account deficit is to avoid heading back towards 7-8 percent of GDP, consumer spending will have to be the sacrificial lamb.

¹ Assuming 80 percent take up the offer and the average house price in the regions in 2007 was \$300,000.

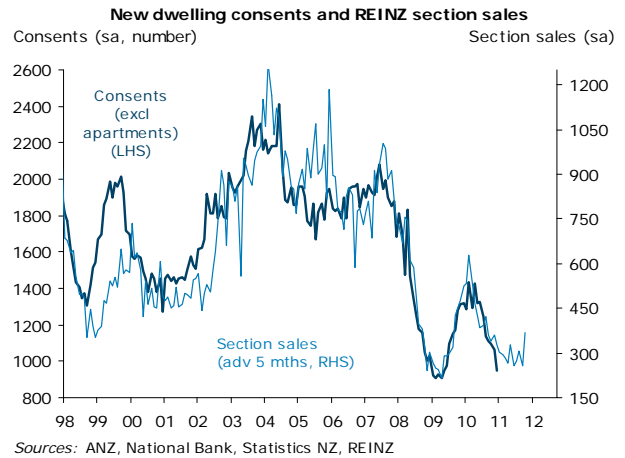
ECONOMIC OVERVIEW

Suffice to say that last week's developments (and we include the data-flow) has done little to alter our view that the RBNZ will start to remove some of the March policy support late this year. We have been updating our Q1 pick for GDP, which stands at a quarterly increase of 0.4 percent, testament to the data-flow coming in stronger. Regular readers will recall our inflection point view of the economy early in the year which was dashed post the February quake. Now, nearly five months on, it seems incredible to believe the economy recorded that sort of growth given the massive capital destruction. The fact it did is testament to the momentum outside of Christchurch, with 2011 starting on a much firmer note. That said, there is a distinct possibility Statistics NZ will make adjustments to the GDP figures to account for seismic events and we expect an announcement on this prior to July 7.

This week's local data calendar has a trifecta of data releases on Thursday. **The key release will be the June National Bank Business Outlook.** This month's results will be too early to detect a post-shake fallout or reaction to last week's announcements. The key focus will be on a) what firms are actually planning on the investment, pricing and hiring front and b) how New Zealand's economic pulse is beating at a time offshore equivalent indicators have turned down sharply.



Building Consents for May are expected to recover from low levels. We are expecting an increase in residential consent issuance of 5 percent, with section sales (a key residential lead indicator) suggesting some uplift to come. The outlook for residential construction remains very positive, given the likelihood of usual cyclical dynamics reasserting themselves and the further impetus provided by earthquake reconstruction. To put this into context, if all of the 5,100 dwellings in the Red Zone are rebuilt, this would be equivalent to about one-third of the number of new dwellings built in NZ last year!



Credit aggregates for May are expected to confirm the ongoing deleveraging dynamic. We expect low rates of growth for household and business credit, with agricultural debt tailing off. As long as income growth manages to remain firm, businesses, farmers and households can spend more and also retire debt.

Today's merchandise trade data was a reminder that it was not one-way traffic for export values, with the topping out in NZD commodity export prices (down 4.7 percent since March) partly a consequence of NZD/USD strength. Nevertheless, we expect export values to climb higher over the next few months, given the boost to primary sector production provided by the mild winter conditions so far. Despite improving business confidence, seasonally adjusted capital good imports eased to \$609m s.a (\$396m s.a. excluding aircraft), which was the weakest month since April 2000! We hope this is temporary as we dearly need to see more capacity enhancing investment taking place that will help keep limit the amount of work that the RBNZ would have to do.

RECENT LOCAL DATA

SNZ Merchandise Trade – May. A monthly surplus of \$605m was recorded, taking the annual surplus to \$1,067m.

SNZ International Travel and Migration – May. May saw a seasonally adjusted net permanent and long-term migration outflow of 350 persons (annual PLT inflow of 4,625 persons). Visitor arrival numbers fell a seasonally adjusted 0.3 percent (-0.4 percent y/y).

SNZ Balance of Payments – 2011Q1. The March quarter registered a deficit of \$97m, with the annual deficit widening to \$8.3b (4.3 percent of December 2010 year GDP). The international investment position fell \$10.3b to 76.7 percent of 2010 GDP.

RBNZ Credit Card Billings – May. Credit card billings rose by a seasonally adjusted 0.6 percent (5.1 percent y/y).

A LOOK AT NZ INFLATION EXPECTATIONS

SUMMARY

All New Zealand inflation expectations measures looked at have something to offer when assessing medium-term inflation trends. Wages, the output gap, the exchange rate and interest rates all influence expectations. But in terms of prices, petrol is very important for all but the most forward-looking surveys. There is also some evidence that food prices matter above and beyond their impact on CPI inflation. Once food and petrol prices are included, headline CPI doesn't always add much explanatory power. Food and energy are at the heart of current inflation pressure, and our findings suggest inflation expectations may not drop back as quickly as the Reserve Bank probably wishes.

CRUNCH TIME

Anchored inflation expectations are a key pillar for monetary policy frameworks. In fact, "inflation targeting" has been characterised as "inflation expectations targeting," so important is the link. Yet in reality we have limited information about how inflation expectations evolve. We do know that:

- Central banks have noticed that they're rising. In the June *MPS* the RBNZ listed as one of their three key assumptions that "recent increases in surveyed inflation expectations will be short lived." Inflation expectations were mentioned 12 times versus an average of 7 times over the preceding four *MPS*s;
- Input costs are putting pressure on headline inflation. The default assumption is that such surges will prove transitory, on the basis that inflation expectations are well anchored;
- True inflation expectations are unobservable;
- Since the onset of inflation targeting we haven't really had a real test case of tensions between good old cost-push and demand-pull inflation; and
- Inflation targeting credibility, like any other form of trust, is hard-won and easily squandered.

So the big question at present is, will inflation expectations stay anchored through the spike in inflation, or have central banks already lost the game?

Firstly, we assess what surveys matter or are relevant for future inflation, and second, we try to derive some statistical insights into what determines inflation expectations. Of course, some inputs are equally as unobservable or difficult to assess as inflation expectations themselves! Nonetheless it is interesting to compare what drives different measures. This is particularly relevant given the volatility in the price of food and fuel in recent years.

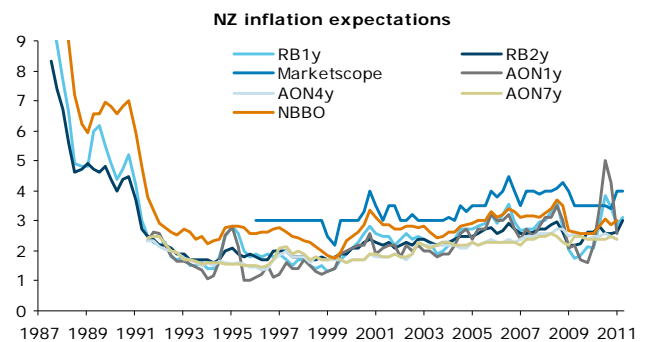
MEASURES OF INFLATION EXPECTATIONS

Inflation expectations are enormously important in principle; in practice they are difficult to measure. We want the expectations for inflation that everyday economic agents build into their daily economic decision-making, even if they are only vaguely aware of it. Asking households what they expect tends to yield unrealistically high numbers. Asking businesses or analysts what they expect yields more "sensible" numbers, but omits the opinions of a large chunk of the economy. The difference between yields on inflation-indexed bonds and regular bonds gives another measure that has the advantage of people putting their money where their mouth is, but again, this captures the opinions of only a relatively small number of (unusually well-informed) people.

We look at a range of surveyed expectations of consumers, businesses and analysts:

- **Marketscope**, an ACNielsen quarterly survey of, *inter alia*, consumer inflation expectations 1 year ahead, conducted by telephone to 1000 random households.
- **AON Economist Survey**, a quarterly survey of a small number of economists from private companies and financial institutions. Respondents are asked about their expectations of inflation 1, 4 and 7 years ahead.
- **RBNZ Survey of Expectations**, a quarterly survey of up to 200 business leaders of their expectations both 1 and 2 years ahead.
- **National Bank Business Outlook Survey**, a monthly survey of around 500 businesses. Respondents are asked about their expectations of inflation 1 year ahead.

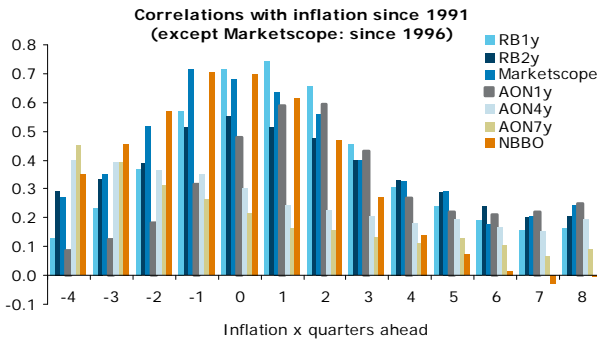
The New Zealand inflation-indexed bond market is unfortunately not liquid enough to derive reliable inflation expectations from.



A LOOK AT NZ INFLATION EXPECTATIONS

QUESTION 1: WHICH SURVEYS MATTER?

Inflation expectations should, in principle, lead inflation. But they tend to be more closely correlated with past inflation. The RBNZ and AON 1-year ahead surveys are most reliably forward-looking. The other measures are generally more correlated with contemporaneous or past inflation.



However, since CPI inflation itself tends to be persistent, these findings do not necessarily mean that expectations are not at least partly forward looking (and by implication, informative).

We run regression analysis, examining the contribution inflation expectations make to explaining inflation. We use current inflation and lagged inflation expectations to explain CPI inflation 1 to 8 quarters ahead. The table below summarises our findings. If the coefficients were incorrectly signed or statistically insignificant they are omitted. Contributions of at least 10 percent to the equation's explanatory power are marked in bold.

New Zealand: increase in R ² from including inflation expectations in a regression of CPI inflation on its own lags							
Q ahead	RB1y	RB2y	AON1y	AON4y	AON7y	Mscope	NBBO
1	0.05	0.03	0.10	0.06	--	0.10	0.04
2	0.12	0.09	0.13	0.10	0.04	0.05	0.13
3	0.12	0.10	0.11	0.05	--	0.06	--
4	0.14	0.14	0.16	--	--	--	0.08
5	0.16	0.15	--	--	--	--	0.10
6	0.12	0.16	--	--	--	--	0.10
7	0.12	0.16	--	--	--	--	0.07
8	0.12	0.14	--	--	--	--	0.07

The RBNZ survey is the most useful over these horizons. The AON 1-year-ahead survey also adds information up to a year ahead. This consumer survey is useful only in the very near term. The NBBO also adds explanatory power at various horizons.

Note that the sample periods differed depending on when the expectations surveys began. This flattered the results for the RB Survey and NBBO, as these series were analysed back as far as 1989, thereby including some of the volatile disinflation period. When the sample period was shortened to omit this period (from 1992), the RB

series added significant value at 3 and 4 quarters ahead (even more than here, in fact) but not otherwise. The NBBO series still added value 1 to 3 quarters ahead.

A tougher test is whether inflation expectations add value in forecasting CPI inflation when other drivers of inflation are included. We add into the equation the real 90 day interest rate (deflated by the CPI), the annual percent change in the trade weighted exchange rate, and a simple measure of the output gap (percentage deviations from an HP1600 trend).

New Zealand: increase in R ² from including inflation expectations in a regression of CPI inflation on a range of variables							
Q ahead	RB1y	RB2y	AON1y	AON4y	AON7y	Mscope	NBBO
1	0.03	0.02	0.02	0.04	0.03	--	0.03
2	0.05	0.05	0.04	0.07	0.08	0.02	0.08
3	0.08	0.06	0.07	0.09	0.14	0.10	0.08
4	0.23	0.23	0.14	0.17	0.14	0.20	0.19
5	0.26	0.25	0.16	0.14	0.14	0.18	0.30
6	0.27	0.25	--	0.09	--	--	0.34
7	0.21	0.22	--	0.04	--	--	0.25
8	0.12	0.26	--	--	--	--	0.24

The inflation expectations data actually perform better in a more comprehensive regression. All series add some value 4 quarters ahead. **The RBNZ and NBBO Survey measures are again the most obviously helpful** (but similarly to before, if the sample period is shortened, the RB series add significant value only at 3, 4 and 5 quarters ahead, and the NBBO series at 1 to 6 quarters ahead – though increasing the explanatory power much less dramatically than for the full sample). **Based on these results, none of the series should be ignored.**

Perhaps the most interesting finding of these results is that they show that inflation expectations matter more, particularly at longer horizons, when inflation itself is less stable. Using estimates of the impact of inflation expectations during a period of stable inflation is therefore likely to understate their importance should inflation break into a higher range. The table below shows the results for the RB 2-year series and the NBBO series starting either in 1989 or 1992 (for the case including just inflation expectations. The pattern is similar when the other variables are also included).

New Zealand: increase in R ² from including inflation expectations in a regression of CPI inflation on its own lag: different sample periods				
	RB2y		NBBO	
Start date	1989	1992	1989	1992
1	0.03	0.04	0.04	0.08
2	0.09	0.06	0.13	0.20
3	0.10	0.13	--	0.12
4	0.14	0.20	0.08	0.07
5	0.15	0.01	0.10	0.07
6	0.16	0.01	0.10	0.07
7	0.16	0.01	0.07	0.07
8	0.14	--	0.07	--

A LOOK AT NZ INFLATION EXPECTATIONS

QUESTION 2: DRIVERS OF EXPECTATIONS

We regressed the expectations measures initially on their own lag, past CPI inflation (1 to 4 lags), the annual change in the TWI exchange rate (0 to 4 lags), annual LCI wage growth (0 to 4 lags), 90-day interest rates (1 to 4 lags),² and the output gap, defined as before (1 to 4 lags). Data are quarterly, in annual change terms (except the output gap). Standard errors are adjusted for any moving average process in the residuals.

We then examined the possibility that highly visible and/or commonly transacted prices could have an outsized impact on surveyed inflation expectations. We include petrol and/or food in the regressions (then using a CPI excluding these components). Other candidates, including narrower components of food, electricity, cigarettes, housing components, health, postage, newspapers, personal items, and others were examined but offered little beyond their impact on the CPI. We also tried an (ad hoc) index made up of various "frequently purchased" goods, but this did not outperform headline CPI. Splitting CPI into tradable and non-tradable inflation, or goods versus services, was also not useful.

The sample period was generally 2001Q2 to 2011Q1. Equations are given at the end of this article.

RB SURVEY 1 YEAR AHEAD

This series is robustly influenced by its own lag (+), the past exchange rate (-), the lagged output gap (+), and the lagged 90 day rate (-). In some specifications, but not all, past wage growth and CPI inflation were significant, but the coefficient signs were not robust. Petrol prices were not always significant but generally had the right sign (+).

RB SURVEY 2 YEAR AHEAD

These expectations were consistently influenced across specifications by past wages (+), 90 day rates (-), CPI inflation (+), the output gap (+) and petrol (+). Coefficients on the exchange rate and food prices were less robust, but usually had the right sign. Coefficients on lagged wages were often positive and statistically significant, but not, as it happens, in the preferred equation. (Once petrol was included, either wages and the output gap tended to have the wrong sign).

² The contemporaneous 90-day rate is observable, but excluded. There is dual causality: higher inflation expectations possibly prompt rate rises, while rate hikes should lower inflation expectations. The coefficient on rates is thus ambiguous. It is the latter effect we are interested in, which is likely to be slower (an intuition backed up by the fact that the coefficient on the contemporary 90-day rate was always positive, and that on the lags negative). Omitting the contemporaneous impact may go some way to isolating the causality we are interested in.

AON SURVEY 1 YEAR AHEAD

We note the circularity in that the survey captures the expectations of economists, but that these expectations can be used to forecast inflation! Across a broad range of specifications these expectations were reliably influenced by past values of the output gap (+), exchange rate (-), wages (+), 90 day interest rates (-) and petrol price (+) movements. The coefficients on CPI and food prices were not robust across specifications.

AON SURVEY 4 YEARS AHEAD

AON 4-year-ahead expectations are less variable, making it harder to statistically isolate its drivers. The most reliable regressors were past wages (+) and food prices (+). The coefficients on the exchange rate and output gap were not robust across specifications, and petrol was insignificant. Past 90-day rates were seldom significant, suggesting the impact of recent monetary policy decisions is expected to have washed out 4 years ahead.

Wage inflation is persistent, so it is intuitive that it makes the cut. Petrol and exchange rate-induced inflation is temporary, so it is sensible that these have a limited impact on 4-year-ahead expectations. That food prices make the cut suggests that economists expect food price inflation to either be inherently persistent, or to have second-round effects on other prices.

AON SURVEY 7 YEARS AHEAD

This series is the least variable of the three AON series (which makes sense, given the longer-term horizon). The coefficient on its own lag was high, and generally the explanatory power of any other variables was weaker and less robust than for the shorter horizon surveys. Past wage inflation (+) and past 90-day rates (-) were usually significant. Food prices usually made the cut (+), but petrol prices did not have a discernible impact. The exchange rate often entered with an incorrect (+) sign but had a very small coefficient.

MARKETSCOPE SURVEY 1 YEAR AHEAD

The coefficients were generally quite robust. This measure of consumer expectations was influenced by past inflation (+), the past output gap (+), past wages (+), the past 90 day rate (+), past petrol prices (+), and food prices (+). The coefficient on the past exchange rate was usually correctly signed but is not in our preferred equation. The output gap likewise did not appear, but where it did it had a coefficient around 0.1-0.2.

NBBO SURVEY 1 YEAR AHEAD

This series was influenced robustly by the past output gap (+), CPI inflation (+), petrol (+), and food prices (+). The coefficient on the past 90 day rate was less robust. Wages were usually significant (+) but weren't when both petrol and food were included.

A LOOK AT NZ INFLATION EXPECTATIONS

WHAT DRIVES EXPECTATIONS: SUMMARY

The specifications vary, which is hardly surprising as surveyed measures of inflation expectations move quite differently. But there are some general themes.

- Past **wages matter**, especially for consumers.
- **Petrol prices generally have a large impact at short horizons**, but less at long horizons. They have a greater impact on consumer expectations than expectations of businesses or economists.
- **Food prices have a large impact on consumers' inflation expectations**, but there is evidence of an impact on economists' expectations too.
- **An output gap measure influences inflation expectations at shorter horizons.**
- **Monetary policy (as measured in movements in 90-day interest rates) has the largest impact on economists' inflation expectations**, but affects consumers' and businesses' expectations too.
- **The exchange rate matters most for expectations at shorter horizons.**
- Interestingly, once these other variables are included, **past CPI inflation quite often did not have a reliable additional impact**. But notably, the RB 2-year ahead survey is an exception, and this is a series upon which the Reserve Bank focuses.

	RB1Y	RB2Y	AON1Y	AON4Y	AON7Y	MKT1Y	NBBO
Coefficient on own lag	0.46	0.50	0.56	0.72	0.52	0.34	--
Output gap	**	**	**	--	--	**	**
APC TWI	**	*	**	--	--	*	--
APC LCI wages	--	**	**	**	**	**	*
90 day rates	**	**	**	--	**	**	*
CPI (definition varies)	--	**	--	--	--	**	**
Food	--	*	--	**	*	**	**
Petrol	*	**	**	--	--	**	**

** Strong evidence * Some evidence -- No evidence

So what can we conclude?

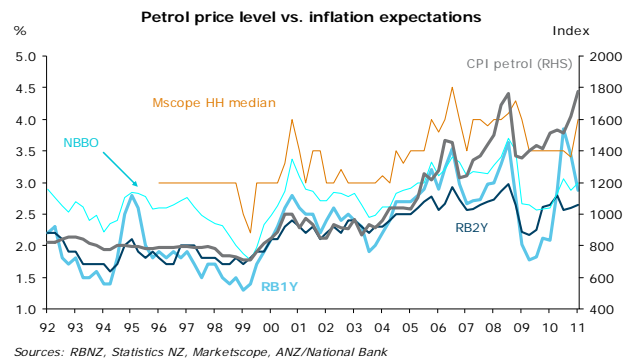
- Given the various inflation expectation measures have different drivers, but all had something to offer for inflation targeting, all are worth considering when examining the future path of inflation expectations.
- Looking at price drivers in particular, some prices matter more than others, notably petrol. Indeed, the influence of petrol prices was more robust and significant than the impact of past CPI inflation, once other drivers were included.
- The RB might take comfort from the fact that there is not strong evidence that food prices impact the inflation expectations measures upon which they focus. But there's enough of a general heads-up in the results to suggest food prices might well start to

matter a great deal if they continue to head north.

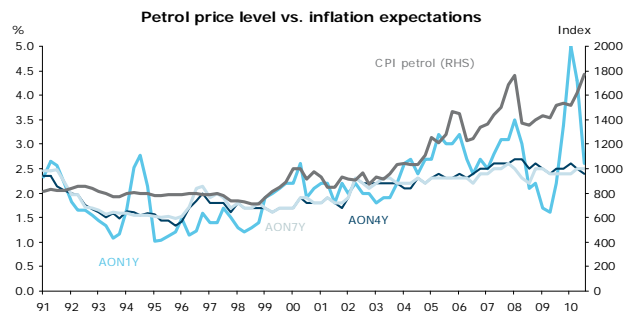
MODELLING MISTAKES

What if people get confused and think a high level of petrol prices implies a high rate of change in prices generally, i.e. high inflation? Of course, with a temporary shock, it wouldn't matter much. But in the case of a *permanent* shock to petrol prices, such confusion could see inflation expectations impacted long after petrol prices have stopped rising.

Eyeballing inflation expectations and the petrol price level suggests similar trends. However, inflation expectations have not risen as much as petrol prices in the past two years – the weak economy at play.

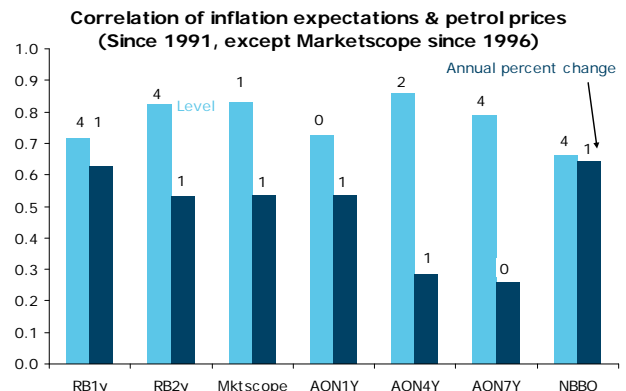


Sources: RBNZ, Statistics NZ, Marketscope, ANZ/National Bank



Sources: AON, Statistics NZ, ANZ/National Bank

The chart below shows the maximum correlation of the inflation expectations series with the level and the annual percent change in petrol prices. The numbers refer to the lag (0-4 quarters) at which the correlation was highest.



A LOOK AT NZ INFLATION EXPECTATIONS

All the surveys have higher correlations with the petrol price level than with its rate of change. Curiously, those surveys asking for expectations further ahead show a higher correlation with the level of petrol prices. It makes sense that the impact of the change in petrol prices should be expected to wash out by this point, and this correlation is indeed lower. But the correlation with the level is very high for these series. Perhaps this reflects that when oil prices are high, a great deal of it is rationalised, rightly or wrongly, by structural factors that are expected to persist.

Eyeballing charts and correlations is of course too simplistic when there are many variables that impact on inflation expectations. Econometric analysis would seem to be called for, but for technical reasons, regressing a rate of change of prices, which is bounded (except perhaps in Zimbabwe), on a price level, which could wander off anywhere, is simply not done in polite circles. Although our estimates might be valid within a fairly narrow range of petrol prices, and over a relatively brief time period, they couldn't reliably be used to predict the impact going forward.

So we'll settle for just raising the possibility that **a permanent petrol price shock might cause a larger and more persistent increase in inflation expectations than conventional analysis would suggest**. And most analysts believe oil is on a structural upward trend (although most analysts have been known to be wrong on occasion).

SUMMARY AND IMPLICATIONS

With the RBNZ on "expectations watch" our results suggest one should pay particular attention to wages, signs of pick-up in the economy, and petrol prices. But food prices and headline CPI matter too.

If we input some conservative scenarios for their determinants, the results suggest some stickiness in the evolution of the various surveys over coming quarters. This may present a challenge to the RBNZ assumption that actual and expected inflation will ease towards the midpoint of the inflation target. We're not inflation hawks, but **we can see some potential nasty tradeoffs looming at some point**.

APPENDIX: REGRESSIONS (SIGNIFIANCE LEVEL IN BRACKETS)

$$RB1Y = 1.99 + 0.46RB1Y(-1) + 0.18ygap(-1) - 0.03twi(-1) + 0.03twi(-2) - 0.02twi(-4) + 0.22r90d(-1) - 0.31r90d(-2) + 0.010petrol(-1)(-3)$$

(0.00) (0.00) (0.00) (0.01) (0.03) (0.00) (0.02) (0.00) (0.01)

$R^2 = 0.83$ DW = 2.09 Sample 2001Q2 - 2011Q1

$$RB2Y = 1.23 + 0.50RB2Y(-1) + 0.05ygap(-1) - 0.007twi(-3) + 0.008petrol$$

(0.00) (0.00) (0.04) (0.00) (0.00)

$R^2 = 0.80$ DW = 1.91 Sample 2001Q2 - 2010Q4

$$AOMY = 2.93 + 0.56AOMY(-1) + 0.43ygap(-1) - 0.04twi(-1) + 0.03twi(-2) - 0.04twi(-4) + 0.87wage(-1)$$

(0.00) (0.00) (0.03) (0.00) (0.00) (0.00) (0.02)

$$- 0.80wage(-2) - 0.51r90d(-2) + 0.44r90d(-3) - 0.23r90d(-4) + 0.016petrol(-2) - 0.009petrol(-4)$$

(0.04) (0.00) (0.01) (0.05) (0.00) (0.11)

$R^2 = 0.93$ DW = 2.244 Sample 2001Q2 - 2010Q4

$$AON4Y = 0.35 + 0.72AON4Y(-1) + 0.02food - 0.03food(-1) + 0.02food(-4) + 0.33wage(-1) - 0.53wage(-2) + 0.30wage(-3)$$

(0.00) (0.00) (0.02) (0.00) (0.02) (0.00) (0.02) (0.04)

$R^2 = 0.93$ DW = 2.058 Sample 2001Q2 - 2011Q1

$$AON7Y = 0.73 + 0.52AON7Y(-1) + 0.01twi + 0.01twi(-4) + 0.17wage(-4) - 0.03r90d(-1) + 0.04food - 0.03food(-1)$$

(0.00) (0.00) (0.00) (0.01) (0.00) (0.00) (0.00) (0.00)

$R^2 = 0.92$ DW = 1.818 Sample 1994Q4 - 2011Q1

$$mkt1Y = 0.96 + 0.34mkt1Y(-1) + 0.02twi(-2) + 0.36wage(-4) - 0.08r90d(-3) + 0.24cpixfp(-1) + 0.07food + 0.01petrol(-1) + 0.01petrol(-4)$$

(0.01) (0.00) (0.00) (0.00) (0.00) (0.00) (0.00) (0.00) (0.00)

$R^2 = 0.84$ DW = 1.845 Sample 2001Q2 - 2011Q1

$$nbbo1Y = 2.41 + 0.72r90d(-1) - 0.28r90d(-2) + 0.15ygap(-1) + 0.05cpixfp(-1) + 0.03food + 0.065food(-4) + 0.01petrol(-1) + 0.01petrol(-3)$$

(0.00) (0.00) (0.00) (0.00) (0.045) (0.00) (0.00) (0.00) (0.00)

$R^2 = 0.84$ DW = 1.845 Sample 2001Q2 - 2011Q1

INTEREST RATE STRATEGY

SUMMARY

Although the domestic news flow has generally been positive, markets have discounted the odds of a rate hike by year-end. This has largely been in response to global uncertainties, particularly in relation to Greece and the US. We expect heightened uncertainty to remain in place for some time yet, keeping a lid on local interest rates. But if domestic data continues to print on the strong side, the debate about the importance of domestic versus global influences is set to intensify.

MARKET THEMES

- Global and domestic factors are pulling markets in opposite directions, with the positive domestic outlook offset by a deteriorating global picture.
- Some were disappointed that Fed chair Bernanke did not announce QE3. But he did concede that he had options if conditions warranted more action. The Fed certainly appears to have an easing bias.

REVIEW AND OUTLOOK

Had it not been for an intensification of global risks, domestic interest rates would almost certainly be higher. Indeed, short-end rates have been affected by lower Australian rates, with the market pricing in cuts, while the long end has been held down by US Treasury yields, which have moved to new lows for the year.

We doubt global influences will disappear anytime soon, and as such there is good reason to be cautious. What is alarming is that the contagion from the Greek debt crisis is spreading, and not just through the periphery. Indeed, Spanish and Italian government bond yields are also rising, increasing the level of nervousness.

The US is a completely different story. Whereas Europe is struggling with a debt problem, **the US appears to be experiencing a slowdown that may not be as temporary as initially assumed.** Even Fed chair Ben Bernanke has acknowledged that he doesn't know how much of the US slowdown is due to temporary factors, and how much is permanent. But perhaps the most important concession he gave after last week's FOMC meeting was that "we'd be prepared to take additional action" if conditions warrant it. US data later this week on housing and manufacturing will add to the picture.

How this impacts locally is difficult to tell. **We don't think the market is ready to go making changes to its assumptions on the RBNZ policy outlook yet,** but the uncertainty is likely to remain for some time, and it is having a downward impact on local interest rates. We need a catalyst here, with next month's inflation figures, Q2 employment (early August) and Q2 inflation

expectations (late August) key. Until then, **we expect recent ranges to hold, and for "carry" to be a significant influence on investment.** NZ's high nominal interest rates also add to the allure of bonds, which remain in good demand at the weekly tenders.

PREFERRED BORROWING STRATEGIES

The fact that short-end interest rates are well below where they ought to be if the market was to "subscribe" to the RBNZ's 90 day bill projection suggests value, as does the fact that global issues are holding rates down. The overall term structure of interest rates is certainly very low given the domestic economic outlook. Had it not been for global events, we would have a preference for fixing at these levels. However, global uncertainty is extreme at the moment, and as it looks like it will be some time before the air clears, we favour holding off for now. If we do nothing, we may in future look back on interest rates prevailing today and consider them an opportunity missed. However, equally, we need to acknowledge substantial risks in Europe and the US, which are not likely to disappear quickly. Although we don't think the market is ready yet to debate the possibility that these risks will delay the RBNZ's plans to normalise policy, they could in time.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔/↑	Christchurch deal will allow people to get on with it.
NZ data	↑	Recent data has generally beat market expectations.
Fed Funds / front end	↔/↓	Bernanke's tone circumspect at FOMC press conference.
RBA	↔/↑	Market pricing in cuts!
US 10 year	↔/↓	Yields look set to continue moving lower.
NZ swap curve	↔/↓	Set to flatten, especially if US bonds remain bid.
Flow	↔	Range-trading.
Technicals	↔	It's all about momentum.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 28-Jul-11	0	0
Thu 15-Sep-11	0	0
Thu 27-Oct-11	+2	+5
Thu 8-Dec-11	+12	+16
Thu 26-Jan-12	+21	+26
Thu 8-Mar-12	+38	+38
Thu 26-Apr-12	+52	+50

TRADING THEMES WE FAVOUR AT PRESENT

The 2yr remains range-bound, and although there is some appeal in paying on rallies, we prefer not to until we get more clarity on the global picture. Flatteners make sense given our divergent local and global views, as do outright longs in NZGS 5/21s and 4/23 given the widening in the NZ/US spread and our bullish view on US Treasuries.

CURRENCY STRATEGY

SUMMARY

With nothing definitive settled for Greece yet and negotiations over the US debt ceiling reaching a short-term impasse, the focus this week will likely be risk off for currency markets. The NZD will continue to be driven by offshore factors but should hold up well against other currencies (except the USD). Commodity prices continue to look soft, adding further to the "risk off" theme.

MARKET THEMES

- The Government's latest Christchurch package a positive move.
- Headlines will continue to drive EUR developments. Spreads on Italian and Spanish bonds widen.
- US debt ceiling negotiations will cause jitters but they will get a result.
- IEA action softens oil prices further (down 14 percent in the last 2 weeks) impacting other commodities.

REVIEW AND OUTLOOK

The NZDUSD may be under a little pressure as a "risk off" week looms. Conversely, the NZD tends to perform well against the other currencies when the USD is in vogue. The big news for NZ last week was the Government's package for Christchurch homeowners in the badly affected Red Zone. This was viewed as a larger-than-expected shot in the arm for the Canterbury economy and caused swap yields to rise. However, this had little real impact on the NZD as offshore developments continue to dominate.

The NZD continues to outperform the AUD as the relative interest rate story shifts towards being in NZ's favour. Expect the differing rate cycles to continue to provide support for the NZDAUD cross. The extremely low levels of the NZDAUD have been very favourable for NZ, not only in terms of export competitiveness for NZ exporters to Australia, but also in Australian companies relocating production to NZ. However, we believe we have seen the lows in NZDAUD and dips should be bought.

While Greek headlines will continue to dominate, Chinese Premier Wen has said "China is a long term investor in Europe's sovereign debt market". He also said they will buy a "certain amount" of Hungarian government bonds. This news has given the EUR a lift in early trading but we suspect this will be overshadowed during the week by more Greek headlines. Comments from the BOE's Mervyn King that the European crisis is a crisis of solvency rather than one of liquidity, together with

comments from George Soros that a Euro-Member exit mechanism is probably inevitable, perhaps indicate that we are entering a new phase of "realism". There can be no good outcomes from here and we may see a very different EUR in 12 months time.

The US debt ceiling deal (or lack of one to date) will cause some small jitters but these deals are ALWAYS reached. Behind all the chest beating in Congress, the prospect of the US government juggernaut shutting down due to a lack of cash is just too scary to contemplate. This story will get some airtime but should have little impact on the USD.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value	↑	Close to our fair value estimates.
Yield	↔/↑	Yield convergence favouring AUD less.
Commodities	↔	Weak commodities leave NZD and AUD vulnerable.
Partial indicators	↔/↑	NZ consumer confidence on the up.
Technicals	↑	Support at 0.7650.
Sentiment	↔	Risk off.
Other	↑	Christchurch package a positive for NZD.
On balance	↔↑	Trending higher 0.7650 - 0.7780.

NZD VS USD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value – long-term	↓	Above structural fair value of 0.67.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↑	NZ bonds have more fun.
Commodities	↓	Commodities have turned down.
Risk aversion	↔↓	Equities softer.
Partial indicators	↑	NZ data better, US data worsening.
Technicals	↓	Bearish divergence.
AUD	↔/↓	AUD in correction mode.
Sentiment	↔	Post-float highs encourage sellers.
Other	↔	External factors to drive NZD this week.
On balance	↔↓	Risk off, soft tone this week.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
27-Jun	UK	Hometrack Housing Survey (MoM) - JUN	-	-0.10%	11:01
	UK	Hometrack Housing Survey (YoY) - JUN	-	-3.70%	11:01
	CH	Industrial Profits YTD YoY - MAY	-	29.70%	14:00
	CH	Leading Index - MAY	-	102.11	UNCONFIRMED
	UK	Nat'wide House prices sa (MoM) - JUN	0.00%	0.30%	UNCONFIRMED
	UK	Nat'wide House prices nsa(YoY) - JUN	-1.30%	-1.20%	UNCONFIRMED
28-Jun	US	Personal Income - MAY	0.40%	0.40%	00:30
	US	Personal Spending - MAY	0.10%	0.40%	00:30
	US	PCE Deflator (YoY) - MAY	2.50%	2.20%	00:30
	US	PCE Core (MoM) - MAY	0.20%	0.20%	00:30
	US	PCE Core (YoY) - MAY	1.10%	1.00%	00:30
	US	Dallas Fed Manf. Activity - JUN	-3.2	-7.4	02:30
	JN	Retail Trade YoY - MAY	-2.20%	-4.80%	11:50
	JN	Retail Trade MoM SA - MAY	1.00%	4.10%	11:50
	GE	GfK Consumer Confidence Survey - JUL	5.3	5.5	18:00
	GE	Import Price Index (MoM) - MAY	-0.30%	0.30%	18:00
	GE	Import Price Index (YoY) - MAY	8.60%	9.40%	18:00
	UK	GDP (QoQ) - 1Q F	0.50%	0.50%	20:30
	UK	GDP (YoY) - 1Q F	1.80%	1.80%	20:30
	UK	Current Account (BP) - 1Q	-4.7B	-10.5B	20:30
	UK	Total Business Investment(QoQ) - 1Q F	-7.10%	-7.10%	20:30
	UK	Total Business Investment(YoY) - 1Q F	-3.20%	-3.20%	20:30
	GE	Consumer Price Index (MoM) - JUN P	0.10%	0.00%	UNCONFIRMED
	GE	Consumer Price Index (YoY) - JUN P	2.30%	2.30%	UNCONFIRMED
	GE	CPI - EU Harmonised (MoM) - JUN P	0.10%	-0.20%	UNCONFIRMED
	GE	CPI - EU Harmonised (YoY) - JUN P	2.50%	2.40%	UNCONFIRMED
29-Jun	US	S&P/CS 20 City MoM% SA - APR	-0.20%	-0.23%	01:00
	US	S&P/CS Composite-20 YoY - APR	-4.00%	-3.61%	01:00
	US	Consumer Confidence - JUN	61	60.8	02:00
	US	Richmond Fed Manufact. Index - JUN	-3	-6	02:00
	JN	Industrial Production (MoM) - MAY P	5.50%	1.60%	11:50
	JN	Industrial Production YOY% - MAY P	-6.30%	-13.60%	11:50
	AU	DEWR Skilled Vacancies MoM - JUN	-	-0.40%	13:00
	UK	Index of Services (3mth/3mth) - APR	1.30%	0.90%	20:30
	UK	Index of Services (MoM) - APR	-	0.60%	20:30
	UK	Net Consumer Credit - MAY	0.4B	0.5B	20:30
	UK	Net Lending Sec. on Dwellings - MAY	0.7B	0.7B	20:30
	UK	Mortgage Approvals - MAY	46.3K	45.2K	20:30
	UK	M4 Money Supply (MoM) - MAY	-	0.10%	20:30
	UK	M4 Money Supply (YoY) - MAY	-	-0.90%	20:30
	EC	Business Climate Indicator - JUN	0.9	0.99	21:00
	EC	Euro-Zone Consumer Confidence - JUN F	-10	-10	21:00
	EC	Euro-Zone Economic Confidence - JUN	105	105.5	21:00
	EC	Euro-Zone Indust. Confidence - JUN	3.5	3.9	21:00
	EC	Euro-zone Services Confidence - JUN	9	9.2	21:00
30-Jun	US	Pending Home Sales MoM - MAY	2.50%	-11.60%	02:00
	US	Pending Home Sales YoY - MAY	-	-26.80%	02:00
	NZ	Building Permits MoM - MAY	3.20%	-1.60%	10:45

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
30-Jun	UK	GfK Consumer Confidence Survey - JUN	-24	-21	11:01
	AU	Job vacancies - MAY	- -	-1.70%	12:30
	AU	RPData-Rismark House Px Raw - MAY	- -	-0.10%	12:30
	AU	RPData-Rismark House Px S.A - MAY	- -	-0.30%	12:30
	NZ	NBNZ Activity Outlook - JUN	- -	39.7	13:00
	NZ	NBNZ Business Confidence - JUN	- -	38.3	13:00
	AU	Private Sector Credit MoM% - MAY	0.40%	0.00%	13:30
	AU	Private Sector Credit YoY% - MAY	3.20%	3.30%	13:30
	NZ	Money Supply M3 YoY - MAY	- -	5.70%	15:00
	GE	Retail Sales (MoM) - MAY	0.50%	0.60%	18:00
	GE	Retail Sales (YoY) - MAY	0.20%	3.60%	18:00
	GE	Unemployment Change (000's) - JUN	-17K	-8K	19:55
	GE	Unemployment Rate (s.a) - JUN	7.00%	7.00%	19:55
	EC	Euro-Zone M3 s.a. 3 mth ave. - MAY	2.10%	2.10%	20:00
	EC	Euro-Zone M3 s.a. (YoY) - MAY	2.10%	2.00%	20:00
	EC	Euro-Zone CPI Estimate (YoY) - JUN	2.80%	2.70%	21:00
1-Jul	US	Initial Jobless Claims - JUN-25	421K	429K	00:30
	US	Continuing Claims - JUN-18	3690K	3697K	00:30
	US	Chicago Purchasing Manager - JUN	54	56.6	01:45
	US	NAPM-Milwaukee - JUN	59	62	02:00
	AU	AiG Performance of Mfg Index - JUN	- -	47.7	11:30
	JN	Overall Hhold Spending (YoY) - MAY	-1.70%	-3.00%	11:30
	JN	Jobless Rate - MAY	4.80%	4.70%	11:30
	JN	Natl CPI YoY - MAY	0.20%	0.30%	11:30
	JN	Natl CPI Ex-Fresh Food YoY - MAY	0.50%	0.60%	11:30
	JN	Natl CPI Ex Food, Energy YoY - MAY	0.00%	-0.10%	11:30
	JN	Tankan Lge Manufacturers Index - 2Q	-7	6	11:50
	JN	Tankan Non-Manufacturing - 2Q	-4	3	11:50
	JN	Tankan Lge Mfg Outlook - 2Q	2	2	11:50
	JN	Tankan Non-Mfg Outlook - 2Q	0	-1	11:50
	JN	Tankan Large All Indust Capex - 2Q	2.30%	-0.40%	11:50
	CH	PMI Manufacturing - JUN	51.5	52	13:00
	AU	HIA New Home Sales (MoM) - MAY	- -	0.20%	13:00
	CH	HSBC Manufacturing PMI - JUN	- -	51.6	14:30
	AU	RBA Commodity Price Index Au - JUN	- -	107.3	18:30
	AU	RBA Commodity Index SDR YoY% - JUN	- -	29.40%	18:30
	GE	PMI Manufacturing - JUN F	54.9	54.9	19:55
	EC	PMI Manufacturing - JUN F	52	52	20:00
	UK	PMI Manufacturing - JUN	52.3	52.1	20:30
	EC	Euro-Zone Unemployment Rate - MAY	9.90%	9.90%	21:00
2-Jul	US	U. of Michigan Confidence - JUN F	72	71.8	01:55
	US	Construction Spending MoM - MAY	0.10%	0.40%	02:00
	US	ISM Manufacturing - JUN	51.8	53.5	02:00
	US	ISM Prices Paid - JUN	70.5	76.5	02:00
	US	Total Vehicle Sales - JUN	12.05M	11.76M	09:00
	US	Domestic Vehicle Sales - JUN	9.40M	9.22M	09:00
	CH	China Non-manufacturing PMI - JUN	- -	61.9	13:00

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

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

Note: All surveys are preliminary and subject to change.



LOCAL DATA WATCH

Key focus over the next few weeks: Last week's announcement on the future of Christchurch has allayed some uncertainty and is a clear positive for the economic outlook. Further small net migration outflows are to be expected but we do not expect a mass exodus. The Q1 balance of payments was better than expected, and next week's Q1 GDP release is expected to confirm the economy moving forward despite the February earthquake. This week's business confidence will be closely scrutinised for signs of resilience. Data over the coming months is expected to show continued improvement, but with continued volatility from seismic events.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Thur 30 Jun (10:45am)	Building Consents – May	Lifting	We expect a 5 percent increase in residential consent numbers.
Thur 30 June (1:00pm)	National Bank Business Outlook	- -	- -
Thur 30 June (3:00pm)	RBNZ Credit Aggregates – May	Low	Low annual rates of credit growth expected, with business credit climbing and agricultural credit easing. Housing credit up 0.2 percent m/m.
Mon 4 July (1:00pm)	ANZ Commodity Price Index – June	- -	- -
Wed 6 July (6:00am)	<i>globalDairyTrade</i> auction	Consolidation	We expect whole milk powder prices to consolidate around the US \$3,800 per tonne level.
Thur 7 July (10:45am)	Gross Domestic Product – 2011Q1	Building	We expect a 0.4 percent rise in activity. Sector performance will be mixed, with solid retail and manufacturing offset by weaker construction activity. Services sector activity will be mixed.
Mon 11 July (10:45am)	Electronic Card Transactions - June	Flat	A 4 percent fall in fuel prices will contribute to unchanged retail ECT spending. A small increase is expected for core spending.
Wed 13 July (10:45am)	Food Price Index – June	Heading higher	Seasonal increases and storm-affected increases in tomato prices will underpin a 0.7 percent monthly increase.
Thur July (10:00am)	REINZ Housing Market data – June	Inching up	Prices flat, with increasing property listings expected to translate into a 1 to 2 percent increase in sales volumes.
Thur 14 July (10:30am)	Manufacturing PMI – June	Expansion	We expect the headline measure in the low 50's but are conscious of weakness in overseas gauges.
Mon 18 July (10:45am)	Consumers Price Index – 2011Q2	5 percent+	A 0.8 percent increase is expected, taking annual CPI inflation to 5.1 percent. Annual inflation ex one-offs should hit 2.6 percent.
Thur 21 July (10:45am)	International Travel and Migration - June	Down	We expect a net outflow of 200 persons. Ash clouds and not much snow will contribute to a 2 percent fall in visitor numbers.
Thur 21 July (1:00pm)	ANZ/Roy Morgan Consumer Confidence	- -	- -
Thur 21 July (1:00pm)	RBNZ Credit Statistics – June	Up	A monthly increase of approximately 0.5 percent is envisaged. Spending on overseas cards should fall.
Tue 26 July (10:45am)	Overseas Merchandise Trade - June	Another surplus	We expect a monthly surplus of \$500m, with the annual surplus to widen towards \$1800m.
Thur 28 July (9:00am)	RBNZ OCR Review	On hold	We expect the OCR to be maintained at 2.5 percent. We expect the first RBNZ hike to be at the December <i>MPS</i> .
Fri 29 July (10:45am)	Building Consents – June	Climbing	We expect a 3 percent increase in residential consent numbers.
Fri 29 July (3:00pm)	RBNZ Credit Aggregates -June	Flat	Low annual rates of credit growth expected, with business credit climbing and agricultural credit easing.
On Balance		On the up	Soft leading gauges and less uncertainty over the future of Christchurch point towards a better Q2 and beyond.

KEY FORECASTS AND RATES

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
GDP (% qoq)	0.2	0.4	0.7	1.5	1.8	0.7	0.9	0.9	0.8	0.7
GDP (% yoy)	0.8	0.6	1.1	2.8	4.5	4.8	5.0	4.4	3.3	3.3
CPI (% qoq)	2.3	0.8	0.8	0.8	0.7	0.6	0.8	0.7	0.6	0.8
CPI (% yoy)	4.0	4.5	5.1	4.8	3.1	2.9	2.9	2.7	2.6	2.9
Employment (% qoq)	-0.4	1.4	-0.2	0.4	0.5	0.5	0.4	0.5	0.4	0.4
Employment (% yoy)	1.3	1.8	1.8	1.2	2.1	1.2	1.8	1.9	1.8	1.7
Unemployment Rate (% sa)	6.7	6.6	6.6	6.3	6.3	6.2	6.2	6.0	6.0	6.0
Current Account (% GDP)	-4.1	-4.3	-4.8	-4.8	-4.3	-4.3	-4.4	-4.7	-4.9	-5.0
Terms of Trade (% qoq)	0.8	0.9	3.0	3.0	1.0	-0.8	-0.9	-0.8	-0.8	-0.8
Terms of Trade (% yoy)	12.3	6.8	7.9	7.9	8.0	6.2	2.2	-1.6	-3.2	-3.3

	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
Retail ECT (% mom)	2.2	0.8	1.0	-0.8	2.4	-0.1	1.4	1.5	-0.8	..
Retail ECT (% yoy)	5.0	4.8	6.3	4.4	5.7	6.2	6.6	10.0	6.8	..
Credit Card Billings (% mom)	1.1	0.6	0.1	-1.8	3.7	-0.4	-1.3	1.8	0.6	..
Credit Card Billings (% yoy)	4.3	4.6	3.8	2.0	5.6	5.3	1.7	6.1	5.1	..
Car registrations (% mom)	2.6	-3.9	12.8	-8.3	0.9	-1.7	-0.3	-5.6	3.2	..
Car registrations (% yoy)	19.2	9.4	23.5	6.4	6.8	2.8	-1.0	-10.5	-3.7	..
Building consents (% mom)	0.9	-2.0	8.0	-18.4	9.1	-9.9	2.0	-1.7
Building consents (% yoy)	-9.4	-17.4	-9.1	-26.5	-14.8	-29.0	-26.3	-32.5
REINZ House Price Index (% yoy)	-1.3	-3.5	-1.9	-1.6	-2.6	-0.7	-1.8	-0.4	-0.7	..
Household Lending Growth (% mom)	0.2	0.1	0.0	0.0	0.1	0.1	-0.1	0.2
Household Lending Growth (% yoy)	2.3	2.0	1.8	1.6	1.6	1.5	1.2	1.2
ANZ Roy Morgan Consumer Confidence	116.4	113.6	114.5	112.2	117.1	108.1	101.4	101.4	103.3	112.5
NBNZ Business Confidence	13.5	23.7	33.2	29.5	..	34.5	-8.7	14.2	38.3	..
NBNZ Own Activity Outlook	26.7	30.5	35.3	34.5	..	36.6	14.7	29.5	39.7	..
Trade Balance (\$m)	-455	-220	-177	-218	9	184	586	1148	605	..
Trade Balance (\$m ann)	978	1259	1363	1172	909	765	744	1232	1067	..
ANZ World Commodity Price Index (% mom)	2.6	3.0	2.1	1.6	4.3	2.7	4.7	1.6	0.3	..
ANZ World Commodity Price Index (% yoy)	25.1	23.1	13.1	12.1	16.3	20.3	23.5	19.8	19.5	..
Net migration (sa)	1000	400	600	720	440	450	-520	-120	-350	..
Net migration (annual)	13914	12610	11519	10451	8689	8249	6554	5508	4625	..

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

KEY MARKET FORECASTS AND RATES

	ACTUAL			Forecast (end month)						
FX RATES	Apr-11	May-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZD/USD	0.810	0.824	0.808	0.80	0.81	0.79	0.77	0.75	0.73	0.73
NZD/AUD	0.738	0.772	0.771	0.74	0.75	0.75	0.75	0.74	0.74	0.74
NZD/EUR	0.547	0.572	0.570	0.58	0.60	0.59	0.57	0.55	0.53	0.54
NZD/JPY	65.75	67.16	64.98	68.0	70.5	70.3	70.1	69.8	69.4	70.1
NZD/GBP	0.485	0.501	0.506	0.50	0.52	0.51	0.49	0.47	0.46	0.46
NZ\$ TWI	68.6	70.9	70.2	70.4	71.8	70.9	69.4	67.8	66.4	66.8
INTEREST RATES	Apr-11	May-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZ OCR	2.50	2.50	2.50	2.50	2.75	3.25	3.50	3.75	4.00	4.25
NZ 90 day bill	2.68	2.69	2.65	2.70	3.10	3.70	3.80	4.20	4.30	4.80
NZ 10-yr bond	5.44	5.11	4.96	5.60	5.80	6.00	6.10	6.20	6.10	6.20
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.75	1.50	2.00	2.00	2.50
US 3-mth	0.27	0.25	0.25	0.35	0.35	0.85	1.60	2.10	2.10	2.60
AU Cash Rate	4.75	4.75	4.75	5.00	5.25	5.25	5.50	5.75	5.75	5.75
AU 3-mth	4.92	5.02	5.02	5.30	5.50	5.60	5.80	6.00	6.00	6.00

	24 May	20 Jun	21 Jun	22 Jun	23 Jun	24 Jun
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.65	2.64	2.64	2.64	2.64	2.65
NZGB 04/13	3.19	3.16	3.14	3.18	3.18	3.19
NZGB 04/15	4.06	3.94	3.91	3.95	3.95	3.95
NZGB 03/19	4.95	4.80	4.76	4.81	4.79	4.78
NZGB 05/21	5.16	5.01	4.97	5.01	5.00	4.99
2 year swap	3.33	3.31	3.30	3.33	3.37	3.37
5 year swap	4.42	4.29	4.27	4.30	4.35	4.35
RBNZ TWI	69.4	69.9	69.9	70.2	70.8	70.5
NZD/USD	0.7952	0.8075	0.8089	0.8123	0.8172	0.8129
NZD/AUD	0.7542	0.7644	0.7672	0.7676	0.7747	0.7713
NZD/JPY	65.06	64.76	64.82	65.20	65.74	65.45
NZD/GBP	0.4936	0.5004	0.4990	0.5009	0.5093	0.5075
NZD/EUR	0.5657	0.5671	0.5646	0.5654	0.5711	0.5699
AUD/USD	1.0543	1.0564	1.0544	1.0582	1.0548	1.0540
EUR/USD	1.4057	1.4240	1.4327	1.4368	1.4310	1.4264
USD/JPY	81.82	80.20	80.13	80.26	80.44	80.51
GBP/USD	1.6111	1.6136	1.6211	1.6218	1.6047	1.6018
Oil (US\$/bbl)	97.06	93.02	93.23	94.96	94.96	90.89
Gold (US\$/oz)	1517.50	1535.55	1542.05	1549.10	1547.05	1500.05
Electricity (Haywards)	1.32	2.87	3.37	3.06	4.33	5.23
Baltic Dry Freight Index	1398	1418	1409	1406	1414	1424
Milk futures (USD)	160	162	162	162	162	162

IMPORTANT NOTICE

NEW ZEALAND DISCLOSURE INFORMATION

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

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

Qualifications, experience and professional standing Experience

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

Relevant professional body

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

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

Professional indemnity insurance

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

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

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

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

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

Criminal convictions

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

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

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

Fees

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

Other interests and relationships

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

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

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

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

- Providing cash;



IMPORTANT NOTICE

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

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

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

NEW ZEALAND DISCLAIMER

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

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

This document is provided for informational purposes only and does not constitute an offer to sell or solicitation to buy any security or other financial instrument. No part of this document can be reproduced, altered, transmitted to, copied to or

distributed to any other person without the prior express permission of the Bank.

This document is a necessarily brief and general summary of the subjects covered and does not constitute advice. You should obtain professional advice before acting on the basis of any opinions or information contained in it. The information contained in this document is given in good faith, has been derived from sources perceived by it to be reliable and accurate and the Bank shall not be obliged to update any such information after the date of this document. Neither the Bank nor any other person involved in the preparation of this document accepts any liability for any opinions or information (including the accuracy or completeness thereof) contained in it, or for any consequences flowing from its use.

UNITED STATES DISCLAIMER

This document is being distributed in the United States by ANZ Securities, Inc. (Member of FINRA [www.finra.org] and registered with the SEC) ("ANZ S") (an affiliated company of Australia and New Zealand Banking Group Limited ("ANZBG") and the Bank), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZ S upon request. Any US person(s) receiving this document and wishing to effect transactions in any fixed income securities referred to herein should contact ANZ S 277 Park Avenue, 31st Floor, New York, NY 10172 USA, Tel: 1-212-801-9160, Fax: 1-212-801-9163, not its affiliates.

This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy.

In addition, from time to time ANZBG, the Bank, ANZ S, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZBG, the Bank, ANZ S or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request.

The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable. The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will be directly or indirectly related to specific recommendations or views expressed in this document. ANZBG, the Bank, ANZ S, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation.

This document has been prepared by ANZ National Bank Limited. ANZ (part of ANZ National Bank Limited), Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-496 8639 <http://www.anz.co.nz> e-mail nzeconomics@anz.com

