

MOTHER NATURE

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- > Soil moisture is now sufficient to kick start pasture growth but Mother Nature will need to be in a benign mood for the next six months. The outlook for pastoral products is improving. The meat industry has only a short time to grasp the nettle (or should that be briar?).

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- > We expect the RBNZ to leave the OCR unchanged at 8.25 percent and deliver a slightly softer tone relative to March given real economic developments. However, we also expect the usual inflationary nuances to be repeated. In such an environment the hurdle to lower rates will remain high.

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- > US data was mixed last week. The Philly Fed remains at levels consistent with recession and the housing market is in the doldrums. However, industrial production and retail spending rebounded. Evidence is mounting that US weakness is broadening into the UK, with housing data particularly soft. In Asia, Chinese data remains exceptionally strong and this is a key reason why the PBoC is attempting to cool the economy.

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- > The NZD continues to under-perform despite improving risk appetites and commodity prices. In our minds this cements that the market is more attuned to the turn in NZ's economic cycle, and also more traditional drivers such as the current account deficit. With the domestic picture deteriorating, the NZD will remain vulnerable to a break lower. Stepping back, the NZD is the inevitable release valve the altered credit cycle needs to be expressed through.

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ECONOMIC OVERVIEW

No smoking gun in the CPI last week, but little comfort either. The *OCR Review* dominates the landscape this week. Other domestic data is second tier, which leaves us eyeing global developments.

What's ahead?

- > **NZ Credit Card spending** (Monday 1500 NZST). An early Easter this year is likely to drag this reading lower.
- > **NZ March Electronic Card Transactions** (Wednesday 1045 NZST). Similar themes to the credit card data should be present.
- > **RBNZ OCR Review** (Thursday 0900 NZST). No change in the OCR expected. A similar stance to the March *MPS*, albeit with a slightly softer tone (refer page 6 for our full preview).

What's the view?

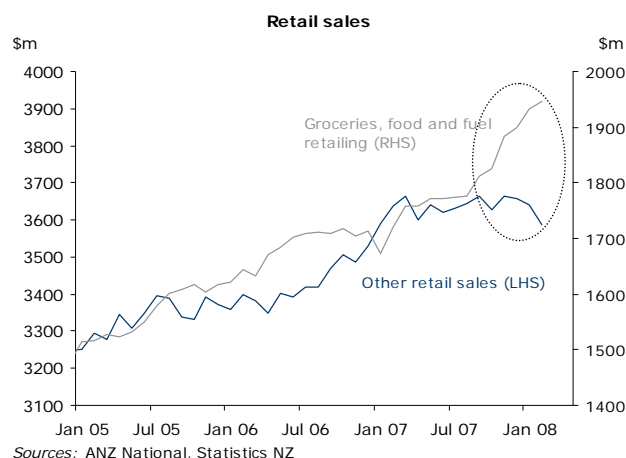
After jumping on the weakening domestic economy bandwagon over the past few months, which has seen the NZD under pressure (at least on a TWI basis) and 2-year swap rates rally some 55 basis points since the start of the year, local markets approached last week with a great deal of trepidation. Standing in front of them was the CPI release for the March 2008 quarter. The fear was that any upside inflation surprises would further limit the RBNZ's ability to respond to the mounting evidence that economic activity has come to a grinding halt and see potential interest rate cuts (what the market is looking for) would be pushed further out.

What transpired was that the inflation data came in broadly in line with the RBNZ's March *MPS* projections (and in fact slightly below market expectations). Markets had a collective sigh of relief. They were relieved, not because inflation pressures have eased (in fact they still remain strong), but because at least pressures did not appear to intensify.

The CPI rose by 0.7 percent in the March quarter, taking annual inflation to 3.4 percent. Once again it was food and petrol prices that were the big contributors to the quarterly CPI increase (collectively adding 0.5 percentage points). That a structural shift higher in commodity prices is manifesting in elevated headline inflation rates is a common global theme.

Ironically, it is also food and petrol price increases that are playing a major role in slowing the economy. Price increases for core staples are siphoning households' discretionary income away from other areas. We note that petrol prices rose a further 3 cents last week to 1.859/litre. Ouch! The effect of this was clearly evident in the retail sales data for February. Total monthly sales fell by 0.7 percent, largely a result of a sharp fall in motor vehicle retailing. Stripping this out (and other motor vehicle components), retail sales grew by a still soft 0.2 percent in the month. Supermarket and grocery store retailing made the largest contribution to the increase, but with food

prices rising 0.8 percent over February we suspect it was mostly price-related. A clear gap now appears to be opening up between spending on fuel and food and other retailing. Looking at individual trends, only food (we have to eat), petrol and tourism-linked sectors, are positive. The remainder are flat to negative. This is particularly the case for some key (interest rate sensitive) durables sectors such as appliance retailing. It looks to be a theme that will continue to develop over coming months as households' wallets continue to be squeezed. The retailing environment remains a challenging one and is consistent with housing market weakness diffusing into the broader economy. Local manufacturing suppliers to retailing will be next to watch, as fewer sales means less inventories.



One interesting dynamic that showed up in the CPI data is that the weakening sales are forcing firms to react. Heavy price discounting occurred in the non-food and petrol-related retailing sectors over the March quarter. The aggressive discounting was across the board and even though we suspected it was occurring, the magnitude still came as somewhat of a surprise. For example, clothing and footwear prices fell 1.0, household appliances fell 1.3 percent, and audio visual and computing equipment prices fell 3.6 percent. A high NZD will be one factor. But we see it as a clear signal that retailers have to be aggressive with their pricing to get the stock out the door in an environment where households' discretionary income is diminishing. Inventory levels remain elevated and as such we can expect further retail discounting over coming months. Of course, this does not bode well for profitability. Therefore, we will be closely watching the employment indicators out of the retail sector to see how firms approach the pressure on their bottom lines.

But looking through discounting, on the whole the CPI release reinforced that an undercurrent of inflationary pressures still exists. Non-tradable inflation rose by 1.1 percent over the quarter, taking the annual increase to 3.5 percent, and other core measures of inflation hovered around the 3-3½ percent level in annual terms. Trimmed mean and weighted median measures were up 0.8 percent in the quarter. With pricing intentions elevated according to forward looking surveys, the RBNZ will remain on alert to further pipeline inflation pressure.

Looking forward, the unemployment rate – as a critical driver of medium-term inflation - remains key to watch. On our travels around the country we are getting very mixed reads. In some pockets we continue to receive stories of staffing shortage and appetites to hire. Yet there is also a growing chorus citing increased attention on costs, and this is extending into the staffing arena. Moreover it seems businesses have been surprised by the extent of the slowdown. Such mixed signals – although increasingly moving in the latter direction – are consistent with an inflection or turning point being reached for labour demand.

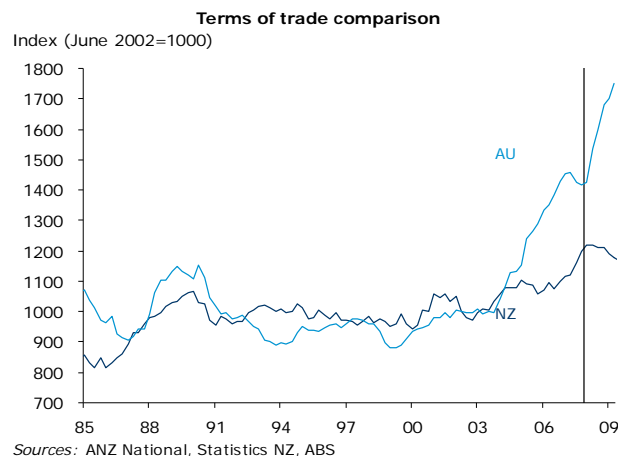
For now, this week will be all about the RBNZ as we await their *OCR Review* on Thursday. Interest rates will almost certainly be left unchanged. It will be the tone of the accompanying statement that will be of most significance. We expect the content of Dr Bollard's recent speeches in Sydney and Marlborough to be used as a base for the statement. Overall we expect the stance to be broadly similar to the March *MPS*, albeit with a slightly softer tone. The Bank is likely to acknowledge that economic activity has slowed markedly, but also reinforce the continued concern over inflationary pressures (for our full preview refer page 6).

In offshore developments last week, the themes are very similar to the week prior. The dataflow out of the US remains weak and equity markets continue to be the directional barometer that currencies, bonds, credit and the like are following. Although capital raising initiatives by some large investment banks are providing a boost to financial sector sentiment and renewing calls (or hopes) that the worst of the credit dislocation is over, the real effects are increasingly being felt. The weak data continues to weigh heavily on the USD, which appeared to shrug off G7 comments and possible coordinated FX intervention last week and fell to new record lows. This boosted commodities and saw oil prices hit another record high of US\$117/bbl (although a weaker than expected inventories report and supply concerns also contributed). There was also further evidence that US weakness is spreading. The UK in particular, is looking soft. UK house prices fell 1.6 percent in February and a report showed a net 78.5 percent of surveyors reported house price falls in March.

We tend to look for "strings" and consistency in economic data, and two messages are apparent at present. First, real economic momentum is slowing across the OECD and in the case of the US, sharply. Second, surveyed measures of inflation expectations are all either high, or trending up. While markets may have shown another dead-cat bounce as credit sentiment improves, the next leg may be driven by disappointing earnings given the growth-inflation mix.

Closer to home, the RBA minutes repeated the relatively balanced tone expressed in the statement accompanying the interest rate decision on 1 April. The RBA seem increasingly comfortable that they have done enough work to restrain domestic demand growth and even expressed the likelihood of a further

downward revision to their inflation forecasts. However, the RBA does not want to overplay this card and is conscious that the Australian economy still faces a number of "cross-currents". In particular, while *"the slowing global economy and tighter financial conditions ... were likely to reduce expansionary forces"*, there is also likely to be a large boost to real incomes. This will flow from further increases in the terms of trade influenced by higher contract prices for bulk commodities such as coking coal, thermal coal and iron ore. In fact, the Australian terms of trade boost far outweighs anything New Zealand is experiencing from the dairy boom. We'll maintain a very bearish view of the NZD/AUD given such divergences.



Apart from the RBNZ's announcement, the other local dataflow this week is all second-tier in nature. Credit card spending and Electronic Transactions Data for March (released on Monday and Wednesday respectively) should be weak, particularly given the early Easter this year.

On the international calendar, the big release is the March quarter Australian CPI release. As always, the core measures of inflation will be particularly important. We expect a 1.2 percent increase in the quarter. In the US, further house sales data is expected along with durable goods spending for March. In the UK, the minutes from the BoE's latest meeting are released, as well as an advanced read on Q1 GDP.

Recent data...

- > **NZ Retail Sales (February).** Total monthly sales fell 0.7 percent in the month. Excluding motor vehicle-related industries, "core" sales rose 0.2 percent.
- > **NZ CPI (March quarter).** The CPI increased by 0.7 percent taking annual inflation to 3.4 percent. Non-tradable inflation rose 1.1 percent in the quarter, while tradable inflation rose 0.2 percent.

RURAL UPDATE

Soil moisture is now sufficient to kick start pasture growth but Mother Nature will need to be in a benign mood for the next six months.

The outlook for pastoral products is improving.

The meat industry has only a short time to grasp the nettle (or should that be briar?).

Widespread rain with minimal run-off has fallen over most of the country over the past fortnight. The exception (Friday morning) was North and Central Otago.

Soil moisture is now adequate to kick start pasture growth. The rate of recovery to satisfactory feed covers (kilos of dry matter/hectare) is driven by a combination of the following.

- > How long the plant was subject to drought conditions.
- > How hard it was grazed during this period.
- > How many plants per square meter are left alive.
- > The level of plant nutrients available to the plants.
- > How long the pasture can be left before grazing.
- > What grass species are in the pasture.
- > How many growing days before winter (sunshine hours, soil temperature and more rainfall).

Mother Nature will have to be kind over the next six months. The normal winter tight rope walk, with stock demand on one end of the long pole and feed supply on the other, is further off the ground than usual.

Many farm businesses will have hard decisions to make about one or more of stock policies, finances and personal aspirations. They must have a plan, have milestones, discuss it with advisors, monitor the plan and then act decisively. Easy to write about from Wellington, much harder for those in the paddock to do. But best outcomes depend on it.

Outlook

The tone of the markets for most New Zealand farm products is assessed as firm.

Indicative international benchmark sheep meat and beef prices appear to be on an upward trend.

Part of it is a usual seasonal pattern but it is occurring at a higher level than the past. Part must be due to the cost/price jaws clamping tight on Northern Hemisphere meat producers. Meat protein businesses reliant on grain inputs must now be well out of any forward pricing contracts for feed. They will now be buying at substantially higher prices (50 to 70 percent plus) on similar income prices to last year. Red ink must be on profit and loss statements (sorry, Statements of Financial Performance!).

But the increases in meat prices are likely to be incremental rather than a substantial jump. Supply is still adequate and meat consumers have a choice

between meats which they can be quick to exercise if price relativities change too far.

Demand for venison is good and reflected in the price.

Dairy commodity prices are slowly easing but remain at elevated levels.

The strong wool indicator price has slowly trended up and was \$3.44/kg clean at the last sale, up \$0.47/kg on the comparable sale in 2007.

Opening pip fruit prices in Europe are fully firm on last year at a lower EUR/NZD exchange rate and a good crop of kiwi fruit are just about to hit the market.

Meat Industry Restructuring

It is a very big challenge to restructure the meat industry. The concept is simple but the practicalities complex.

The driver is the low farm gate returns for sheep meat in particular but returns from beef have not been that strong either. Long-term structural changes in land use are occurring at an increasing rate after three years of low dollar earnings from sheep and beef and the widening chasm between cash flows for dairy and meat production. Associated with this are changes in the classes and numbers of livestock. The end result is meat companies with excess processing capacity in sheep, potential shortfalls in capacity for beef and in both the wrong place.

**New Zealand Livestock Numbers
(000 head)**

Location/class	2003 (Stats NZ)	2007 (Meat & Wool est)	2010 (ANZNB forecast)
<i>North Island</i>			
Sheep	18,530	19,550	18,000
Beef Cattle	3,420	3,260	3,300
Dairy Cattle	3,800	3,715	3,850
Deer	605	500	500
<i>South Island</i>			
Sheep	21,155	20,550	18,500
Beef Cattle	1,225	1,180	1,200
Dairy Cattle	1,310	1,455	1,700
Deer	1,085	850	850

The causes of low returns are attributed to (a) competition in the international market place between New Zealand companies destroying value of the final product and (b) inefficiencies with on shore procurement.

Conceptually, there is a relatively easy quick fix on the sale side by forming a jointly owned marketing company. Practically there are potential issues with quota market and how many of the industry participants join in. There are four major companies and at least another 12 smaller companies processing livestock, and over 200 export licences. Would the marketing company include all meats?

(sheep meat, beef and venison). Where do by-products fit? How will the returns be divided up so that the correct market signals reach suppliers?

Fixing the off-shore issues is only part of the story. Processing 'on demand' from suppliers with a very pronounced seasonal supply curve is not cost efficient for the processors. Conversely, supplying livestock outside the grass growth curve has wide implications for farmers. Far reaching changes in livestock policies, company and farmer attitudes are required if a more orderly and cost efficient livestock supply curve is to be put in place.

Next is the hard decisions about what processing capacity should be kept and where. Closing facilities has a high capital cost and a high people cost. Skilled process workers are a valuable resource. The impact on smaller towns where some of the processing facilities are located would be major. Inevitably, there would also be redundancies within administration and sales teams. Loss of institutional knowledge has been expensive to merged/take over companies in the past.

The two remaining big issues are what capital structure should any merged companies take and what capital is required to get there?

Would a marketing company require a lot of capital? We think not. Only a relatively small part of the business is high value meat cuts, where branding might be important. The majority is a commodity meat market and by-products where branding and associated support costs are arguably only required at a low level, if at all. We suspect it is unlikely that private companies (ANZCO and AFFCO) would want to be part of a marketing co-operative with Alliance and PPCS, and would prefer an investor owned company.

On shore is a similar argument. Again, it is unlikely that the private companies would fit into a co-operative. The book value of the shareholders funds in AFFCO and ANZCO is approximately \$480m. Quite a sum for the pastoral industry to find to retain co-operative ownership! Even one of them is a big bite. Sure a valuation may reduce (increase!) the sum involved but the dollar bite is still likely to be big.

But why does a restructured meat industry need to be a co-operative? Can the expertise of the shareholders in AFFCO and ANZCO be harnessed within a private company with farmer shareholders? Either way, there are significant challenges in capital structure and finance.

Will anything happen? Farmer momentum for change appears higher in the South Island than the North, where they generally have a better sheep/cattle mix and greater choice of processors.

The two co-operatives have different product mixes, processing capacity issues and different debt levels.

ANZCO is reportedly weighted more to beef processing. AFFCO have a mix of sheep, beef and venison. Its major shareholder (Talleys') has built up a diversified food business. Will they want to now drop part of that business?

There is a lot of history to be left behind. Very strong leadership and governance is required. Pushing two entities together is a big job, pushing three or more at once is gigantic. The time frame to act and deliver a positive result that satisfies producers is short. The alternative is for an even faster structural change in NZ agriculture which will only exacerbate the profitability of the meat industry, both at the production and processing levels. The management of supply and processing capacity would remain as significant issues.

Grasping the nettle is never easy but restructuring the meat industry is more akin to dealing with a big briar bush. Making sure it does not sprout again from the stump is just another challenge!

Footnote:

It now appears that mega merger is floundering. Differences of opinion on the extent of the merger required and about process have stymied the proposal. That leaves farmers facing a piecemeal, on above rationalisation of procurement, processing and competitive international marketing.

OCR REVIEW PREVIEW

(due 9.00am 24 April)

We expect the RBNZ to leave the OCR unchanged at 8.25 percent and deliver a slightly softer tone relative to March given real economic developments. However, we also expect the usual inflationary nuances to be repeated. In such an environment the hurdle to lower rates will remain high.

Since the March *Statement*, the weight of new information has been on the real side of the economy. The dataflow is pointing towards a far more marked deterioration in the growth outlook compared to that underpinning the RBNZ's March projections.

- > **Consumer and business confidence readings have collapsed**, and are at levels consistent with the economy stalling or even sliding backwards over the first half of this year.
- > **Investment and hiring intentions are down**, indicating that businesses are shelving investment plans and going on a hiring freeze.
- > **Housing remains weak with no signs of bottoming out yet.** The number of house sales are down 53 percent from a year ago, and inventory levels are now in excess of 12 months. Further downward pressure on house prices will intensify.
- > **Nominal retail spending on non-food and fuel items are flat to down.** Retail volumes look likely to contract over Q1, and the squeeze on household budgets suggests consumer spending in Q2 will not be faring much better.
- > **The global economy is weaker.** The US is in recession. Non-Japan Asia remains strong, and while Australia has received a further leg up in commodity prices, partial indicators of momentum have led the RBA to note that underlying inflation *"would fall by a little more than earlier thought over the next two to three years."*

But it is not necessarily all one way traffic:

- > **Commodity prices remain high** and will remain a source of support for the economy. Fonterra has revised their payout for the current season from \$6.90/kg ms to \$7.30, which will help offset some of the impact from the drought (which recent rain may also have broken).
- > **Tax cuts are (finally) on their way.** The Minister of Finance Dr Cullen has indicated that the upcoming May *Budget* will contain a programme of tax cuts over the next three years, most likely starting from 1 October this year. While the potential timing is new information, the expected tax cuts is not. Fiscal policy has repeatedly been acknowledged as an inflation risk.

Moreover, developments on the inflation front will still leave the RBNZ wary:

- > **Q1 CPI may have come in as the RBNZ expected, but non-tradable inflation remains high.** Rent increases are now an additional source of upside inflation risk.
- > **Oil prices continue to hit record highs**, with the international price \$22/bbl above the RBNZ's March projections. Petrol prices look set to rise further, and add to inflation. Our Q2 CPI estimate is currently at 1.0 percent for the quarter, leaving the annual rate above the target band.
- > **Q4 2007 GDP was stronger than expected and capacity utilisation is at record highs**, (although we suspect the latter was heavily drought induced).
- > **Pricing intentions continue to rise.** Our reading is that firms are looking at pulling the price lever in response to falling profitability. We doubt this will be achievable in a weak demand environment. However, it will have the RBNZ on alert to continued cost-push inflation risks.

Monetary conditions have loosened over the past six weeks, as expected given economic developments. The TWI is 2.0 percent lower and the 2-year swap yield is some 22bps lower since the March *MPS*. **However financial conditions have tightened.** Retail mortgage rates have risen, and borrower margins continue to be repriced at wider levels given a higher international cost of credit. The RBNZ seems (we hope) more alert to the impact and risks emanating from a tightening environment for credit, which was recently acknowledged by the Governor in recent communication.

Net-on-net, we suspect the RBNZ will attempt to deliver an assessment that keeps market pricing where it broadly sits at present. Such an assessment would be slightly softer in tone than that delivered in March, and in line with the April 9th speech delivered by the Governor. (As an aside, we were puzzled why the market sold off that day, overlooking the key reference that growth was slowing markedly). At the time of writing the market was pricing in 90 basis points of rate cuts over the coming 12 months. While well in advance of the spirit of the RBNZ's March projections, it is clearly in line with where the risk profile resides. Less restrictive monetary policy (via the yield curve) is appropriate given the tightening seen via the credit environment.

While delivering a slightly softer tone, the RBNZ will also remain on inflation watch. They are inflation targeters after all! Looking forward, we remain far more attuned to the downside risks to the economy emanating from the credit channel of monetary policy, and we remain comfortable looking for lower rates in 2008. The key to unlocking the easing cycle remains the labour market – the halfway house between the real and pricing sides of the economy. Q1 labour market data in two week's time will be closely perused.

GLOBAL WATCH

We present a table of global data outturns over the past week given the significance of the international backdrop at present. US data was mixed last week. The Philly Fed remains at levels consistent with recession and the housing market is in the doldrums. However, industrial production and retail spending rebounded. Evidence is mounting that US weakness is broadening into the UK, with housing data particularly soft. In Asia, Chinese data remains exceptionally strong and this is a key reason why the PBoC is attempting to cool the economy.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	Advance Retail Sales (Mar)	0.0%	0.2%	-0.4%	Stronger
	Business Inventories (Feb)	0.6%	0.6%	0.9%	In-line
	PPI (Mar) – mom	0.6%	1.1%	0.3%	Stronger
	Empire Manufacturing (Apr)	-17.0	0.6	-22.2	Stronger
	CPI (Mar) – mom	0.3%	0.3%	0.0%	In-line
	Housing Starts (Mar)	1,010k	947k	1,075k	Weaker
	Building Permits (Mar)	970k	927k	984k	Weaker
	Industrial Production (Mar)	-0.1%	0.3%	-0.7%	Stronger
	Leading Indicators (Mar)	0.1%	0.1%	-0.3%	In-line
	Philadelphia Fed (Apr)	-15.0	-24.9	-17.4	Weaker
Europe	Industrial Production (Feb) – mom	0.2%	0.3%	0.6%	Stronger
	ZEW Economic Sentiment (Apr)	-33.0	-44.8	-35.0	Weaker
	CPI (Mar) – mom	0.9%	1.0%	0.3%	Stronger
UK	PPI Input (Mar) – mom	1.9%	1.8%	1.9%	Weaker
	PPI Output (Mar) – mom	0.5%	0.9%	0.5%	Stronger
	RICS House Price Balance (Mar)	-67.0%	-78.5%	-65.7%	Weaker
	CPI (Mar) – mom	0.6%	0.4%	0.7%	Weaker
	Claimant Count Rate (Mar)	2.5%	2.5%	2.5%	In-line
	Jobless Claims Change (Mar)	-1.8k	-1.2k	-2.8k	(Weaker)
Asia Ex-Japan					
<i>China</i>	Real GDP (1Q) – yoy	10.4%	10.6%	11.2%	Stronger
	Producer Price Index (Mar) – yoy	6.8%	8.0%	6.6%	Stronger
	Consumer Price Index (Mar) – yoy	8.2%	8.3%	8.7%	Stronger
	Retail Sales (Mar) – yoy	19.8%	21.5%	19.1%	Stronger
	Industrial Production (Mar) – yoy	16.5%	17.8%	15.4%	Stronger
	PBoC Reserve Requirement Ratio	-	16.0%	15.5%	-
<i>Singapore</i>	Retail Sales (Feb)	4.2%	-1.3%	8.2%	Weaker
	Non-Oil Domestic Exports (Mar) - yoy	0.4%	-5.9%	6.2%	Weaker
<i>Philippines</i>	Bank Lending (Feb) – yoy	-	4.7%	5.4%	-
<i>South Korea</i>	Unemployment Rate (Mar)	-	3.1%	3.0%	-
<i>Malaysia</i>	Manufacturing Sales	-	21.1%	15.8%	-
Japan	Consumer Confidence (Mar)	37.4	37.0	36.4	Weaker
Australia	Home Loans (Feb)	0.5%	-5.9%	3.1%	Weaker
	Import Price Index (1Q) – qoq	0.5%	2.7%	0.2%	Stronger
	Export Price Index (1Q) - qoq	3.0%	3.5%	-0.6%	Stronger

INTEREST RATE STRATEGY

OCR decision clear-cut, but RBNZ tone to be closely watched. Volumes likely to be light with bias on payside ahead of decision. But receive-side interest to emerge following the announcement.

Market themes...

- > Retail sales weak and CPI slightly lower than expectations.
- > NZ rates massively outperformed offshore.
- > US markets reassessing Fed funds outlook.

Review and outlook...

There were two major developments in the NZ rates market this week. The first was the outcome of the Q1 CPI release on Tuesday. The markets had been fearful of a strong print, with payside pressure coming in the lead-up to the data. This was despite a very weak retail sales release on Monday. In the event, the CPI data came in slightly below expectations, and even though the non-tradable print was strong, the market had a relief rally nonetheless.

The second development was the massive out-performance of the NZ rates market relative to offshore. For the week, the US swaps curve sold off by between 25-47bps and the Aussie curve sold off between 4-7bps. And yet, the NZ curve rallied 2-11bps. The sell off in the US, despite some still weak data releases and the CPI printing as expected, was due to a reassessment of the outlook for the Fed funds rate, as Fed officials are sounding the inflation alarm once again. Another 25bp cut from the Fed is still priced in for the end of this month, but that could well be the end of the easing cycle.

There is also increasing interest from offshore participants and real money to receive NZ swaps, a clear indication that the market is becoming attuned to our view of the prospect of a very aggressive easing cycle once it begins. The RBNZ will likely reiterate this week that the OCR will remain at current levels for some time and express concern about near term inflation pressures, but a softer tone could come through as they acknowledge the marked slowdown underway. We do not anticipate too much reaction in rates to the OCR Review, and we suspect the RBNZ is quite happy to leave the curve where it is.

With the CPI now out of the way, the focus will be back on the deteriorating growth outlook. While we anticipate further weakness in the upcoming housing, retail and building consents dataflow, the next major piece of data to watch is the Q1 labour market release, due on 8 May.

Across the Tasman, the RBA may be content to sit tight, but this week's CPI release could still put them in the hot seat. The BoE minutes are out this week, which could give an indication of whether we can expect further easings. Q1 GDP data in the UK will also be influential in this regard. Durable goods and house sales data from the US are main releases there,

while the German IFO will give an indication of whether growth is starting to ease in the Eurozone area.

Gauges for NZ interest rates yields		
Gauge	Direction	Comment
RBNZ	↔	No change this week but a slightly softer tone may emerge.
NZ data	↔	Light on the data front until Q1 labour market data in early May.
Fed Funds/front end	↔/↓	One more cut and that could be it. Fed speakers sounding inflation alarm.
RBA	↔	On hold but need to see moderation in demand growth continue.
US 10 year	↔/↑	Stronger US equities see flows out of bonds into riskier assets.
NZ swap curve	↔/↑	Curve expected to invert ahead of OCR Review.
Flow	↔/↑	Payside pressure stronger in the front end heading into OCR decision. Support for 2-year yield at 8.10% near term.
Technical	↔	OCR decision to provide the cue for the next technical move.

Borrowing strategies we favour at present

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

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 24-Apr-08	-1	-2
Thu 5-Jun-08	-7	-10
Thu 24-Jul-08	-27	-38
Thu 11-Sep-08	-55	-70
Thu 23-Oct-08	-87	-106
Thu 4-Dec-08	-187	-206
Thu 15-Jan-09	-187	-206

Trading themes we favour at present

Our 1-year protection has worked well. It provided cover over CPI but has only rallied 2pts while 3 and 5-year have rallied 11pts. A similar story for the Sept vs March contracts as well. We continue to favour this strategy heading into the OCR Review.

CURRENCY STRATEGY

The NZD continues to under-perform despite improving risk appetites and commodity prices. In our minds this cements that the market is more attuned to the turn in NZ's economic cycle, and also more traditional drivers such as the current account deficit. With the domestic picture deteriorating, the NZD will remain vulnerable to a break lower. Stepping back, the NZD is the inevitable release valve the altered credit cycle needs to be expressed through.

Market themes...

- > The NZD remains vulnerable given domestic environment.
- > AUD firms, but does not filter across the antipodean region. NZD/AUD breaks support.
- > Dollar-Yen the major mover over the week.
- > RBNZ the focus, although no major surprise expected. Offshore developments may dominate.

Review and outlook...

The NZD continues to under-perform. In an environment where global risk appetites are gradually improving and equity market sentiment slowly on the mend, the NZD eased last week against the majority of its trading partners (with the JPY the major exception). Stronger commodity prices, with oil hitting new record highs, and a firmer AUD also failed to provide a major boost to sentiment.

The NZD remains vulnerable given the domestic economic backdrop. Interest rate differentials are still wide – but narrowing – particularly against the US, as local markets continue to reprice the RBNZ and some believe the Federal Reserve is close to the bottom of its interest rate cycle. Comments from Philadelphia Federal Reserve President Plosser over the weekend stating that it is a “dangerous misconception” to believe that monetary policy is the solution to all an economy's ills, reinforces this view.

We are becoming increasingly attuned to the more traditional current account as an influence on currencies. Deficits don't matter when the growth picture is strong. They do when the growth picture is deteriorating. There is no doubt the tenor of domestic data is weakening rapidly, and in that environment the NZD will remain vulnerable to moves lower. Stepping back, the NZD is the inevitable release valve the altered credit cycle needs to be expressed through.

Globally, there are a number of themes we are eyeing at present. First, is outright USD sentiment. G7 comments were initially brushed off, but the threat of possible intervention still lingers. Second is the performance of the USD/JPY. It trended higher this past week and is possibly a sign that USD weakness has found a base, particularly with inflation concerns starting to feature again in Fed rhetoric. And thirdly, the AUD is receiving another leg of commodity price

support. The NZD/AUD has broken a key support level and we expect the general trajectory to remain lower.

The major focus locally this week is of course the RBNZ's OCR announcement. No change is expected and the stance is likely to be similar to that presented in the March MPS, albeit with a slightly softer tone. Given this we are not envisaging a major market reaction to the statement as the Bank will want to continue to hold up the yield curve. Internationally, equity markets remain an important barometer. But on the data front, German IFO, UK GDP and most importantly, Australian Q1 CPI will be critical to watch.

Technically, key support levels are currently 0.7855 (minor) and 0.7820 (major). Within the current trading range the 0.7930/50 zone remains a key pivot area providing strong resistance. A bearish divergence has developed and has been a good indicator for weakness in the past, but may take another couple of weeks to manifest.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↓	Yield spreads narrowing
Commodities	↔	Oil new record highs.
Partial indicators	↔/↓	Better across the Tasman.
Technicals	↓	Broken support at 0.8500.
Sentiment	↓	NZD is not a better credit risk than AUD.
Other	↔	All eyes on commodities and equities.
On balance	↓	Moving lower.

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔/↓	Yield and commodity story factored in.
Yield	↓	Yield differentials narrowing as RBNZ repriced.
Commodities	↔	Still a key one to watch.
Risk aversion	↔	Sentiment slowly returning.
Partial indicators	↔	Both economies weak.
Technicals	↔	Major support at 0.7820.
AUD	↔/↑	Commodities boosting.
Sentiment	↔	Risk appetites improving.
Other	↔/↓	Don't forget the current account deficit.
On balance	↓	Domestic factors too big.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
21 Apr	NZ	External Migration (Mar) – 12 mth total	-	4,643	10:45
		Visitor Arrivals (Mar) – mom	-	5.3%	10:45
	AU	Producer Price Index (1Q) – qoq	1.0%	0.6%	13:30
		New Motor Vehicle Sales (Mar) – yoy	-	3.1%	13:30
	EU	ECB's Liebscher Speaks in Vienna	-	-	19:30
22 Apr	EU	ECB's Garganas Speaks in Athens	-	-	18:00
22 Apr	US	Existing Home Sales (Mar)	4.90M	5.03M	02:00
		Existing Home Sales (Mar) – mom	-2.4%	2.9%	02:00
		House Price Index (Feb) – mom	-1.5%	-1.1%	02:00
	JN	Merchandise Trade Balance – Total (Mar)	1,405.0B	966.2B	11:50
	AU	Consumer Prices (1Q) – qoq	1.1%	0.9%	13:30
		Consumer Prices (1Q) – yoy	4.0%	3.0%	13:30
		RBA Trimmed Mean (1Q) - qoq	0.9%	1.0%	13:30
		RBA Trimmed Mean (1Q) - yoy	3.8%	3.4%	13:30
		RBA Weighted Median (1Q) - qoq	0.9%	1.1%	13:30
		RBA Weighted Median (1Q) - yoy	4.0%	3.4%	13:30
	NZ	Credit Card Spending (Mar) – yoy	-	8.1%	15:00
	GE	PMI Services (Apr A)	51.5	51.8	19:30
		PMI Manufacturing (Apr A)	54.8	55.1	19:30
	EU	PMI Manufacturing (Apr A)	51.6	52.0	20:00
		PMI Services (Apr A)	51.4	51.6	20:00
		PMI Composite (Apr A)	51.5	51.8	20:00
		Industrial New Orders (Feb) – mom	-0.4%	2.0%	21:00
	UK	BoE Minutes	-	-	20:30
		BBA Loans for House Purchase (Mar)	-	43,870	20:30
24 Apr	NZ	RBNZ Interest Rate Announcement	8.25%	8.25%	09:00
	JN	Corporate Service Price (Mar) – yoy	0.7%	0.7%	11:50
		All Industry Activity Index (Feb) – mom	-0.5%	0.0%	11:50
	GE	IFO – Business Climate (Apr)	104.3	104.8	20:00
		IFO – Current Assessment (Apr)	111.0	111.5	20:00
		IFO – Expectations (Apr)	98.0	98.4	20:00
	EU	Current Account (Feb)	-	-10.6B	20:00
	UK	Retail Sales (Mar) – mom	-0.3%	1.0%	20:30
25 Apr	EU	ECB's Trichet, Weber, Stark, Hurley, Ordonez in Frankfurt	-	-	00:00
	US	Initial Jobless Claims (w/e Apr 20)	375k	372k	00:30
		Continuing Claims (w/e Apr 13)	2,985k	2,984k	00:30
		Durable Goods Orders (Mar)	0.0%	-1.1%	00:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
25 Apr cont.	US	Durables Ex Transportation (Mar)	0.2%	-2.4%	00:30
		New Home Sales (Mar)	580k	590k	02:00
		New Home Sales (Mar) – mom	-1.6%	-1.8%	02:00
	JN	National CPI (Mar) – yoy	1.2%	1.0%	11:30
		National CPI Ex-Fresh Food (Mar) – yoy	1.2%	1.0%	11:30
		National CPI Ex Food & Energy (Mar) – yoy	0.0%	-0.1%	11:30
	EU	ECB's Weber Speaks near Frankfurt	-	-	19:30
		M3 (Mar) – yoy	10.6%	11.3%	20:00
	UK	GDP (1Q A) – qoq	0.4%	0.6%	20:30
		GDP (1Q A) – yoy	2.6%	2.8%	20:30
26 Apr	US	University of Michigan Confidence (Apr F)	63.3	63.2	02:00

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

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: With the March quarter CPI release out of the way, the focus now turns to this week's *OCR Review*. The dataflow post OCR will show further slowing in domestic demand. Q1 labour market data is the next key read on whether signs of slowing activity are starting to impact on labour demand.

Date	Data/Event	Economic Signal	Comment
Mon 21 Apr (10.45)	Net migration (Mar)	Lower	Stable arrivals but rising departures to see net migration continue to head lower.
Wed 23 Apr (10.45)	Electronic card transactions (Mar)	Easter effect	Early Easter this year to drag this reading lower.
Thu 24 Apr (09.00)	RBNZ <i>OCR Review</i>	Similar themes	With Q1 CPI expected to reinforce inflation issues, we expect the line to be reasonably similar to March. However, with some of the downside growth risks materializing, all will be looking for an ever so slightly softer tone.
Tue 29 Apr (10.45)	Overseas Merchandise Trade (Mar)	Small surplus	The ongoing impact of high dairy prices is expected to contribute to a small monthly surplus in March. This is offset slightly by continued high oil prices.
Tue 29 Apr (15.00)	Credit Growth (Mar)	Soft	Last month's data surprised on the upside slightly. However, this could be a consequence of February having five Fridays (which is when lending typically settles on). The underlying trend should remain soft.
Wed 30 Apr (10.45)	Building Consents Issued	Downwards	Both residential and non-residential consent issuance is trending lower. We expect this to continue. We would not be surprised to see a massive decline in residential consents in the March month given the sharp fall in sentiment across the construction sector in the month.
Wed 30 Apr (15.00)	NBNZ <i>Business Outlook</i> (Apr)	-	-
Mon 5 May (10.45)	QES and LCI (Mar qtr)	Still elevated	Wage growth should stay elevated (and near record highs) as a consequence of the lagged impact of a tight labour market.
Mon 5 May (15.00)	ANZ Commodity Price Index (Apr)	-	-
Thu 5 May (10.45)	Household Labour Force Survey (Mar qtr)	Early signs of softness?	Given recent employment intentions have eased we expect employment growth to be relatively soft over the quarter. This should see the unemployment rate tick-up from its record low.
circa 12 May	REINZ Housing Report (Apr)	Weak	March saw house sales collapse, but the median house price surge due to compositional aspects. Sales could possibly bounce back slightly in April, although we expect the prices to unwind.
Thu 15 May (10.45)	Retail Sales (Mar)	Exclude price, going backwards	We expect another soft month for retail, particularly due to the early Easter this year. Excluding price increases for food and petrol, the retail sector is heading backwards.
Fri 16 May (10.45)	Producer Price Index (Mar qtr)	Margins under pressure	A large surge in wholesale electricity prices is expected to drive both input and output prices higher. A small recovery in margins is expected, although they remain under pressure.
On Balance		A growth wall but inflation problems	Growth indicators are now expected to come in consistently weak, but inflation still problematic.

SUMMARY OF KEY ECONOMIC FORECASTS

	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
GDP (% qoq)	1.2	0.9	0.5	1.0	0.1	-0.3	0.1	0.2	0.3	0.5
GDP (% yoy)	2.3	3.2	3.3	3.7	2.5	1.3	0.9	0.1	0.3	1.1
CPI (% qoq)	0.5	1.0	0.5	1.2	0.7	1.0	0.9	0.8	0.4	0.7
CPI (% yoy)	2.5	2.0	1.8	3.2	3.4	3.3	3.7	3.4	3.1	2.8
Employment (% qoq)	1.2	0.6	-0.3	1.1	0.2	0.2	0.2	0.2	0.1	0.1
Employment (% yoy)	1.7	1.6	1.6	2.5	1.5	1.1	1.6	0.7	0.6	0.6
Unemployment Rate (% sa)	3.7	3.6	3.5	3.4	3.5	3.5	3.6	3.8	3.9	4.0
Current Account (% GDP)	-8.2	-8.1	-8.4	-7.9	-7.5	-6.9	-6.5	-6.5	-6.5	-6.5
Terms of Trade (% qoq)	1.5	0.4	3.7	2.9	2.0	0.0	-0.9	0.0	-1.5	-1.2
Terms of Trade (% yoy)	4.5	2.3	8.4	8.8	9.3	8.8	4.0	1.1	-2.4	-3.5

KEY ECONOMIC INDICATORS

	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08
Retail Sales (% mom)	-0.4	0.2	0.3	1.0	-0.4	1.8	0.1	0.3	-0.7	..
Retail Sales (% yoy)	4.8	5.7	6.3	4.1	5.8	7.2	5.4	6.3	7.7	..
Credit Card Billings (% mom)	1.6	0.1	0.8	2.1	-0.5	1.1	0.5	0.1	0.7	..
Credit Card Billings (% yoy)	9.0	7.9	8.5	9.3	7.8	9.5	7.5	8.7	8.1	..
Car Registrations (% mom)	-4.7	7.0	1.1	-6.6	5.6	-3.8	-2.9	10.3	-8.8	-12.8
Car Registrations (% yoy)	-1.5	7.0	10.9	0.1	4.7	2.3	1.4	1.7	1.9	-13.2
Building Consents (% mom)	12.4	-16.1	4.8	-9.3	-5.1	1.3	-4.2	3.2	-6.5	-4.0
Building Consents (% yoy)	32.9	-4.4	-1.9	-15.3	-16.5	-4.1	-6.4	-4.6	-17.9	-20.3
REINZ House Price (% yoy)	12.1	10.4	12.9	12.3	8.0	6.7	4.5	4.0	0.7	1.6
Household Lending Growth (% mom)	1.2	0.8	0.9	0.8	0.9	0.8	0.6	0.7	0.8	0.0
Household Lending Growth (% yoy)	13.5	13.5	13.4	13.0	12.8	12.6	12.2	11.8	11.5	..
Roy Morgan Consumer Confidence	121.0	121.1	122.4	121.3	122.0	121.9	126.6	121.2	116.0	111.7
NBNZ Business Confidence	-37.2	-38.5	-33.8	-26.5	-12.9	-19.6	-24.9	..	-43.9	-57.9
NBNZ Own Activity Outlook	14.8	12.4	16.7	17.2	20.3	15.7	18.2	..	2.4	-6.4
Trade Balance (\$m)	-518	-808	-947	-572	-774	-628	38	-316	258	..
Trade Balance (\$m annual)	-6226	-6340	-6336	-6282	-5883	-5691	-5307	-4798	-4413	..
ANZ World Commodity Price Index (% mom)	6.3	4.6	1.4	0.4	1.8	0.8	0.0	-1.4	1.1	2.0
ANZ World Commodity Price Index (% yoy)	29.8	35.1	36.3	35.7	37.8	35.9	30.9	27.4	26.9	26.9
Net Migration (sa)	610	460	720	650	250	470	20	70	170	..
Net Migration (annual)	10078	8966	8730	8309	7517	6588	5491	4799	4643	..

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

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Feb-08	Mar-08	21-Apr-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
NZD/USD	0.797	0.801	0.790	0.780	0.740	0.690	0.660	0.640	0.630	0.620
NZD/AUD	0.873	0.867	0.847	0.830	0.804	0.767	0.759	0.762	0.778	0.795
NZD/EUR	0.540	0.517	0.500	0.506	0.490	0.469	0.465	0.464	0.474	0.488
NZD/JPY	85.5	81.0	82.0	79.6	74.0	70.4	69.3	69.1	69.3	70.1
NZD/GBP	0.406	0.400	0.395	0.390	0.379	0.359	0.349	0.344	0.342	0.341
NZ\$ TWI	73.0	71.5	70.4	69.6	66.6	63.0	61.6	60.9	61.2	61.7
NZ interest rates	Feb-08	Mar-08	21-Apr-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
OCR	8.40	8.67	8.25	8.25	8.00	7.50	7.00	6.50	6.00	6.00
90 day bill	8.82	8.90	8.90	8.80	8.40	7.70	7.10	6.60	6.20	6.20
10 year bond	6.40	6.36	6.48	7.00	6.70	6.20	5.70	5.40	5.10	5.10
International	Feb-08	Mar-08	21-Apr-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09
US Fed funds	3.00	2.25	2.25	1.50	1.50	1.50	1.50	1.50	2.00	2.50
US 3-mth	3.06	2.69	2.91	2.00	1.75	1.75	1.75	2.00	2.50	3.00
AU cash	7.00	7.25	7.25	7.25	7.25	7.25	7.25	7.25	6.75	6.00
AU 3-mth	7.99	7.86	7.87	7.70	7.60	7.50	7.40	7.10	6.60	5.80

KEY RATES

	18 Mar	14 Apr	15 Apr	16 Apr	17 Apr	18 Apr
Official Cash Rate	8.25	8.25	8.25	8.25	8.25	8.25
90 day bank bill	8.86	8.90	8.91	8.87	8.90	8.90
NZGB 07/09	7.04	6.98	7.00	6.97	6.93	6.94
NZGB 11/11	6.67	6.70	6.74	6.70	6.68	6.69
NZGB 04/13	6.70	6.59	6.64	6.61	6.60	6.60
NZGB 12/17	6.40	6.44	6.40	6.42	6.43	6.43
2 year swap	8.22	8.22	8.15	8.10	8.12	8.14
5 year swap	7.90	7.76	7.66	7.62	7.64	7.65
RBNZ TWI	70.9	70.2	70.3	69.8	70.0	70.1
NZD/USD	0.8028	0.7876	0.7920	0.7846	0.7909	0.7912
NZD/AUD	0.8726	0.8542	0.8523	0.8469	0.8433	0.8446
NZD/JPY	77.87	79.57	80.25	79.79	80.62	81.02
NZD/GBP	0.4007	0.3997	0.4011	0.3998	0.4011	0.3975
NZD/EUR	0.5088	0.5015	0.5005	0.4966	0.4964	0.4977
AUD/USD	0.9200	0.9220	0.9293	0.9264	0.9379	0.9368
EUR/USD	1.5779	1.5704	1.5823	1.5800	1.5933	1.5896
USD/JPY	97.00	101.03	101.33	101.70	101.93	102.40
GBP/USD	2.0033	1.9703	1.9747	1.9625	1.9717	1.9904
Oil	105.74	110.14	113.79	114.93	114.80	114.80
Gold	1000.50	916.10	944.59	938.80	938.20	945.50
Electricity (Haywards)	16.52	13.81	16.44	10.12	10.78	7.68
Milk futures (US\$/contract)	130	136	136	136	136	133
Baltic Dry Freight Index	7893	7961	7957	7967	8038	8203

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