

Market Focus

New Zealand

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THE POLICY MIX

NZ Economics Team:

Cameron Bagrie

Chief Economist

Telephone: +64 4 802 2212

E-mail: bagriec@anz.com

Khoon Goh

Senior Markets Economist

Telephone: +64 4 802 2357

E-mail: gohk@anz.com

Philip Borkin

Economist

Telephone: +64 4 802 2199

E-mail: borkinp@anz.com

Steve Edwards

Economist

Telephone: +64 4 802 2217

E-mail: edwards1@anz.com

Kevin Wilson

Rural Economist

Telephone: +64 4 802 2361

E-mail: wilsonk1@anz.com

Page 2: Economic overview

- > Stronger than expected inflation numbers have the market pushing for an early policy normalisation start date. While tempting to pull forward our RBNZ OCR expectations, we see little reason for sitting on the crowded Q2 2010 fence. And Q1 just seems too early at this stage. Apart from our obvious caution towards economic prospects and the NZD, the interaction between fiscal and monetary policy – with the former needing to consolidate – should give more scope for continued support from the latter.

Page 5: Economic comment – forecast farm results 2009/10

- > There has been a reversal in the outlook between sheep and dairy farms in favour of dairy. While the forecast business result for both is less than satisfactory, a lot can happen between now and May/June 2010 to shape the final outcome. The revised Fonterra dairy forecast reduces large deficits to smaller deficits. The strengthening of the exchange rate is changing small surpluses on sheep and beef farms back to small to medium deficits. Unlike prior years, farm prices are not going up thereby supporting the provision of working capital. The estimates rely on a reduction in farm working expenses on dairy farms and on these expenditure items remaining tightly constrained on sheep and beef farms. Farmer confidence and expenditure by farmers within the economy will remain constrained. The number of farm land sales will remain at a low level.

Page 8: Interest rate strategy

- > Strong Q3 NZ CPI and growing talk of a 50bp hike from the RBA has led to further selloff in rates. Despite the 2-year yield implicitly pricing in 50bp hikes from January, market sentiment and positioning suggests it is still not an attractive receive level yet. Any corrective rally will struggle to gain traction for a while.

Page 9: Currency strategy

- > The failure of the NZD to capitalise on a string of strong domestic data and a selloff in NZ rates suggest much of the positive news has already been priced into the currency. Hence, from a risk reward perspective, a downside move on any disappointment will be larger than any potential upside.

Page 10: Data and event calendar

Page 12: Data watch

Page 13: Key forecasts

ECONOMIC OVERVIEW

Stronger than expected inflation numbers have the market pushing for an early policy normalisation start date. While tempting to pull forward our RBNZ OCR expectations, we see little reason for sitting on the crowded Q2 2010 fence. And Q1 just seems too early at this stage. Apart from our obvious caution towards economic prospects and the NZD, the interaction between fiscal and monetary policy – with the former needing to consolidate – should give more scope for continued support from the latter.

What's ahead?

- > **September International Travel and Migration** (Wednesday 1045 NZDT). Another solid monthly net migration inflow is expected, but with the number of residency and work permit approvals falling, the number of arrivals may start to ease. We will watch the departures figures for signs of a turnaround.

What's the view?

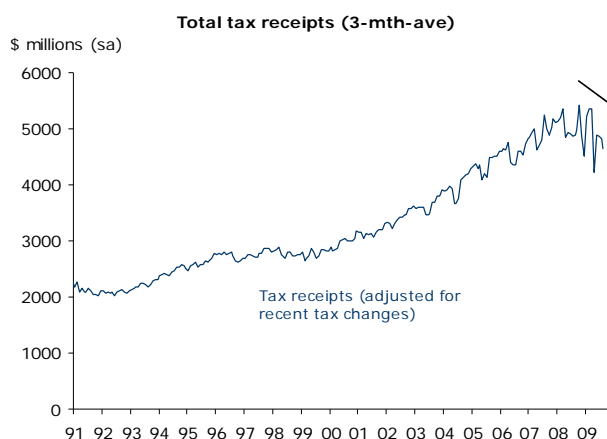
The stronger CPI inflation figures last week have the market now pushing for an even earlier removal of monetary policy support.

The headline number, with the CPI rising 1.3 percent in the quarter, was influenced by some one-offs. However, the stark reality is there looks to be aspects of margin rebuilding and ongoing price increases from non-contestable areas (such as government charges and rates), giving a sticky element to inflation. By our calculations, non-contestable pockets experienced price rises of 2.1 percent in the quarter, making a 0.4 percentage point contribution to the quarterly increase in the CPI. The stronger CPI was in spite of some very contained pockets of inflation which are linked to demand, such as housing, and labour intensive sectors, such as professional services.

While tempting to pull forward our Q3 expectations for the RBNZ, we see little reason for sitting on the crowded Q2 2010 fence. Hiking in Q1 just seems too early. The stronger inflation numbers and also the momentum the economy looks to be regaining (which housing, PMI and retail sales numbers last week all attest to) need to be acknowledged. The stickiness in non-tradable ex-housing inflation (at 3.7 percent on a year ago) will undoubtedly raise a few hackles in central bank circles. However, we also continue to see a considerable amount of uncertainty and are wary of impulsively reacting to these data. There is a strong base effect (deep hole) that the recovery is coming from. The unemployment rate is still rising, and there is intense cashflow pressure on the rural sector (despite the increase in the dairy payout forecast) and other RBNZ sectors such as

retailing, which need a good Christmas sales period. We remain steadfast in our view the economy is de-leveraging, and we struggle to see economic indicators surprising too far on the upside for an extended period in such an environment. With each passing day the currency continues to rise (and all economists, including ourselves, will no doubt be reassessing their projections) and shows little sign of turning unless USD sentiment improves. That is hard to envisage unless we see another bout of risk aversion (we are picking Q2 2010), and the Fed starts the long journey of raising rates (once again mid 2010). In the meantime the trend is your friend. The USD is down, and provided it remains an orderly decline, the G7 will not step in. So up the NZD goes. Will the RBNZ be hiking if the NZD/USD is 0.75-0.80 cents which is probably where it is headed? We doubt it.

When economists look at policy levers within the economy, monetary policy is often quoted and fiscal policy forgotten about. This is only natural as the former is independently charged with controlling inflation and the latter is subject to the court of public opinion which gives it diminished flexibility. In addition, there are also longer time lags in getting fiscal policy moving. However, what is increasingly clear to us is that both have a role to play, and their interaction needs to be closely watched over the coming years.

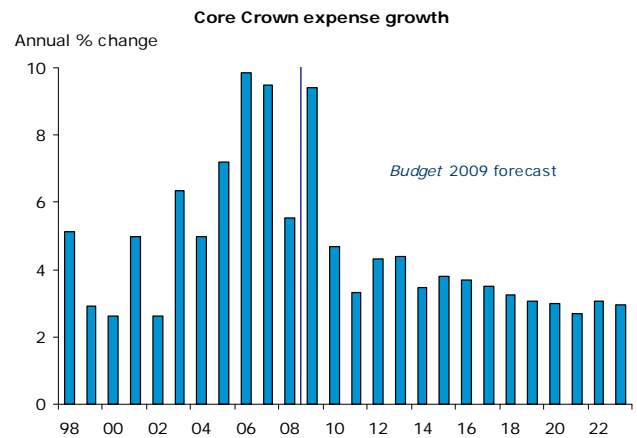


In terms of fiscal policy, a few points need to be noted.

- > **Last week's Crown Financial Statements flagged some worrying trends.** Across nearly every gauge (OBEGAL, tax revenue, expenses and net debt) the Government's accounts had deteriorated more than forecast in the *May Budget*. To be fair, there were again some one-offs that complicated this picture slightly (provisions for the retail deposit scheme, KiwiRail writedown, tax receivable impairments etc). But even looking through this noise, there is no stepping away from the fact the fiscal position is weaker than expected.

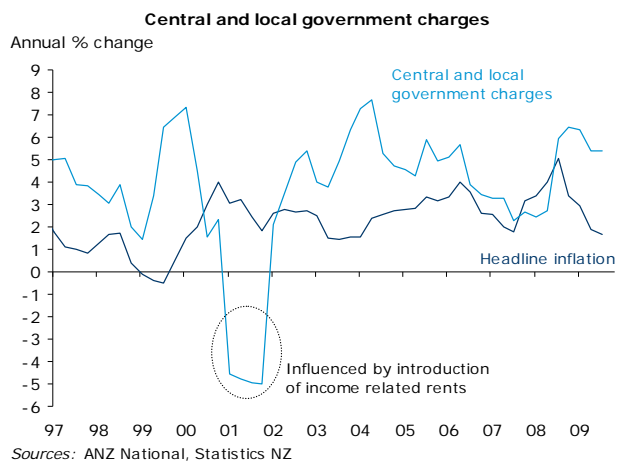
Looking at timely gauges such as tax receipts for July and August (and adjusting for tax changes), it is clear the tax take remains under pressure.

- > **NZ's fiscal position still looks better than a host of other countries**, particularly on the debt front (with government net debt still below 10 percent of GDP). **But it is the rate of change that is important.** Net debt was only 5.7 percent of GDP last year, and the deterioration in the underlying operating balance was equivalent to 5.3 percent of GDP. Of course, other nations do not have net external liability positions of close to 100 percent of GDP.
- > **Policymakers have made it clear they will not let the deterioration continue.** At the release of the Government's accounts, the Minister of Finance Bill English stated *"We cannot afford for these trends to continue indefinitely ... This underlines the need for us to get our books in order as soon as possible - because budget surpluses give us choices. Deficits do not."*
- > **The relative prospective paths for fiscal policy is a major difference with Australia**, and a huge justification for why the yield differential between NZ and Australia can widen (and also why the NZD/AUD should correct further).
- > **Consolidation will take time, but steps are already being taken.** At the May *Budget*, the average rate of core crown expense growth was projected at 3½ percent per year out to 2023. This is a horrendously tight assumption to hit given demands that permeate from the likes of health and education, let alone other core government services. This compares with average growth of 6 percent per year over the previous decade. Spending allocations for the 2010 Budget are tight. Anecdotally you can see this manifesting already via pay negotiations, departmental spending freezes and huge pressure to find savings or reprioritise existing spending.



- > **The process of fiscal consolidation will involve:** (a) a better emphasis on productivity, (b) reduced services in some instances, and (c) changes to some tax rates (not the majors but small things like ACC levies will continue to be tinkered with). Politically some of the changes will be difficult to make. But the reality is that the alternative – doing nothing – is more unpalatable.
- > **The process of fiscal consolidation effectively involves a transfer from the household sector to the government, and this is being overlooked.** In the first legs of the crisis, the flows were in the other direction as the government's strong balance sheet was (correctly) used to lean against the cycle. Things are now set to operate in reverse as both sectors are forced to de-leverage. You can see it in other areas as well. Local authorities are facing cashflow pressure and the path of least resistance is to raise council rates, which continue to rise well in excess of both inflation and incomes. There is tremendous pressure in the health system, so health insurance premiums are set to rise sharply. All these are small individually, but they add up. They also come at a time when households need to rebuild savings (or at least not have a savings rate that is negative), and face a different labour market environment. One could colloquially refer to the pressure on the government and households as having champagne taste but beer income: something has to give.
- > **Projections suggest the fiscal stance will turn contractionary in 2011** (which is about where monetary policy will be targeting right now) and it will remain the same for a decade. Measures of the fiscal impulse are subject to a huge degree of uncertainty but there is no doubt the pending trend.
- > **From a policy mix perspective (monetary and fiscal policy), is it preferable at this juncture for fiscal policy to do the early**

work – and in an array of areas. Monetary policy, through tweaking the OCR, is a blunt tool and any move to raise rates will no doubt only further inflame the NZD and frustrate the economy's rebalancing process. Fiscal policy faces challenges as well. It is subject to the court of public opinion and changes are often slow burn in nature. However, any option is going to have shortcomings. In the current environment, and given the degree of sensitivity over the currency, using fiscal policy as more of a fine tuning instrument will deliver superior (or less inferior) economic outcomes.

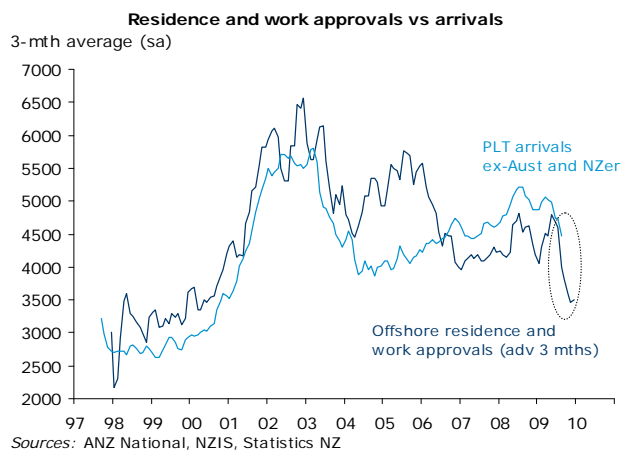


We hope the process of fiscal consolidation does not get assisted via the price card.

Government related charges from the CPI rose 2.8 percent in Q3. This is partly seasonal given the timing of local body rates, but the trend over the past decade is clear. Government related inflation has averaged 3.8 percent over the past decade, compared with 2.5 for the CPI itself. This not only adds to inflation in a direct sense, but also has a deflationary impact as money is siphoned out of households' and businesses' pockets. Inflation in non-contestable areas makes life extremely difficult for the RBNZ. They are not one-offs that can be looked through. Policy is tighter and the currency higher than would otherwise be the case.

Turning to this week, external migration statistics for September is the main focal point on the domestic calendar. **We are expecting another reasonable increase in net migration in the month.** Once again, this will be due to fewer New Zealanders departing. However, we suspect the net inflow will not be as large as has been the case over recent months. One influence is likely to be a decrease in the number of non-NZ and Australian arrivals. NZ Immigration Service data has been forewarning of this as the number of residency and work permit approvals have been declining. One interesting dynamic we will also be looking for (although suspect it is more likely to be an early 2010 story) is a pick-up in the number of New Zealanders moving to Australia. The

Australian economy is clearly outperforming most developed country counterparts. Those who delayed their migration plans at the onset of the financial crisis may begin to reassess their position.



Internationally, there are a number of central bank officials speaking this week. Monetary policy is at a very interesting juncture as officials now begin to toy with the idea of withdrawing (or thinking about withdrawing) monetary policy support. Speeches this week, as well as the minutes from recent RBA and BoE meetings, will be combed through to try and assess the timing and pace of any withdrawal. In terms of data, UK advanced Q3 GDP, Chinese Q3 GDP, the German IFO and housing data is the US are the major releases.

Recent local data...

- > **Retail Trade Survey (August):** Headline sales rose 1.1 percent following a 0.5 percent fall in July. Core sales rose by a slightly stronger 1.2 percent.
- > **REINZ House Sales (September):** In seasonally adjusted terms, house sales rose 2.7 percent and median days to sell remained unchanged at 34 days. The median house price rose to \$350,000 and is up 6.1 percent on a year ago.
- > **Financial Statements of Government for the year to June 2009:** The underlying operating balance (OBEGAL) was a deficit of \$3.9 billion (or 2.2 percent of GDP) and nearly \$1 billion larger than forecast.
- > **Consumers Price Index (September quarter):** The CPI rose 1.3 percent in the quarter, taking annual inflation to 1.7 percent.
- > **Food Price Index (September):** Prices fell 0.7 percent, taking annual growth to 3.3 percent.
- > **BNZ Capital-Business NZ Manufacturing PMI (September):** The index rose 2.9 points to 51.7 – a level indicating expansion.

FORECAST FARM RESULTS 2009/10

There has been a reversal in the outlook between sheep and dairy farms in favour of dairy. While the forecast business result for both is less than satisfactory, a lot can happen between now and May/June 2010 to shape the final outcome.

The revised Fonterra dairy forecast reduces large deficits to smaller deficits.

The strengthening of the exchange rate is changing small surpluses on sheep and beef farms back to small to medium deficits. Unlike prior years, farm prices are not going up thereby supporting the provision of working capital.

The estimates rely on a reduction in farm working expenses on dairy farms and on these expenditure items remaining tightly constrained on sheep and beef farms.

Farmer confidence and expenditure by farmers within the economy will remain constrained.

The number of farm land sales will remain at a low level.

Background

We provide a guide to the history of farm business returns and a possible outcome at the farm level for 2009/10 based on the current economic forecasts.

Three dairy and three sheep and beef farms each owned by a single farming family are modelled. Actual data is used up to 2008. An estimate is provided for the farming year end 2009 and forecasts for farm year end 2010.

There is some statistical noise in the historic data but the focus should be on the trends as the detail can always be challenged. The Waikato dairy model is considered to be largely representative of about 50 percent of the cows in New Zealand. Canterbury and Southland account for another six percent each. The sheep models account for about two thirds of New Zealand sheep.

Business return

The trend in BR indicates how sustainable (or otherwise) the farm business is on its own.

The business return (BR) equals gross farm profit less total costs, including farm working expenses, depreciation, interest plus drawings, life insurance and tax. It does not include off-farm earnings or capital introduced. It is not adjusted for changes in livestock, development that may be in farm working expenses or debt servicing that may be associated

with an off-farm investment (cannot isolate in any event). It includes the effects of adverse weather and market returns. The BR is the result for the year. The trend in BR indicates how sustainable (or otherwise) the farm business is on its own.

The BR is expressed as a percentage of gross profit to give an idea of the magnitude of the result relative to the scale of the enterprise i.e. how good or how serious the BR is.

Product price forecasts

There has been a reversal in the outlook between sheep and dairy farms in favour of dairy.

The first forecast is based on our expectations in May 2009 where the outlook for dairy was very gloomy. The second is based on the assumption that both international prices and the NZD exchange rates stay at current elevated levels. That provides a weaker outlook for sheep and beef while dairy has improved on the back of a stronger Fonterra forecast.

Fonterra revised their 'available for payout' forecast from \$4.55/ kilogram milk solids (kg ms) in May 2009 to \$5.10 in September 2009.

Indicative benchmark international prices for NZ lamb and beef are steady but the current impact of the NZD is highly likely to take \$20/head off the standard 17.5kg mid season lamb price of \$90 obtained in 2008/09, down to \$70 for 2009/10. The mid season schedule for bull beef is likely to fall from \$3.40/kg hook weight to around \$2.90/kg. Crossbred wool has also collapsed \$0.50/kg clean from the last season average.

Current exchange rates are 10 to 30 percent above the average levels that applied for the dominant mid season sales in 2008/09 (November to June). While 'fundamentals' suggest a lower NZD exchange rate, markets think otherwise and this dichotomy looks set to continue for some time.

The weather

The season is off to a good start with August and September weather very benign. Lamb survival rate has been high and milk production was rapidly gaining momentum over the previous season. Soil moisture is good all over NZ.

The cold snap in early October will be significant for farmers caught with lambing at that time but the duration of the weather event was relatively short. It is, however, a long way to the end of the season, both from a weather and markets point of view.

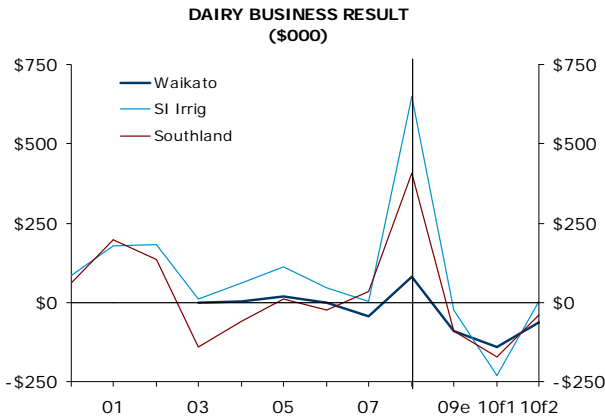
Dairy

The forecast BR for dairy has improved but is barely satisfactory.

The dairy models are based on a Waikato, an irrigated farm in Canterbury and a farm in Southland producing around 120,000, 380,000 and 220,000 kg ms respectively. Their debt levels are moderate.

All farms are estimated to have made a negative BR in 2008/09 and to make another loss in 2009/10.

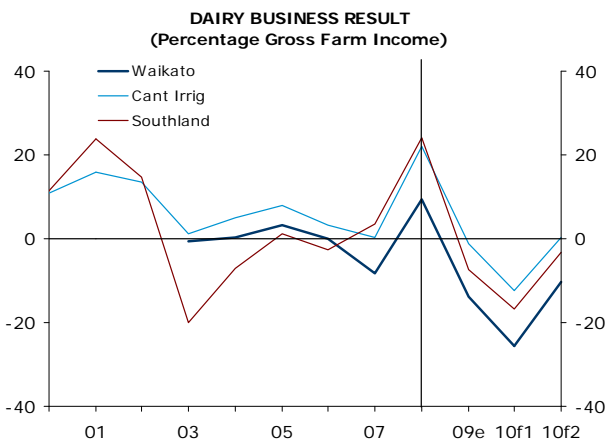
That all three farms had a 'good' year in 2007/08 goes without having to say so but the Waikato and Southland units had been struggling to make a break even BR in the four years prior.



Sources: Pers Com, ANZNational

The magnitude of the loss in 2008/09 was moderate for the Waikato farm (13 percent of gross income) and the revised Fonterra forecast leaves the business with a second deficit of similar magnitude. The gain in 2007/08 does not offset forecast negative BR in 2008/09 and 2009/10.

The other two dairy businesses are forecast with small deficit BRs in 2008/09 and 2009/10.



Sources: Pers Com, ANZNational

Sheep and beef

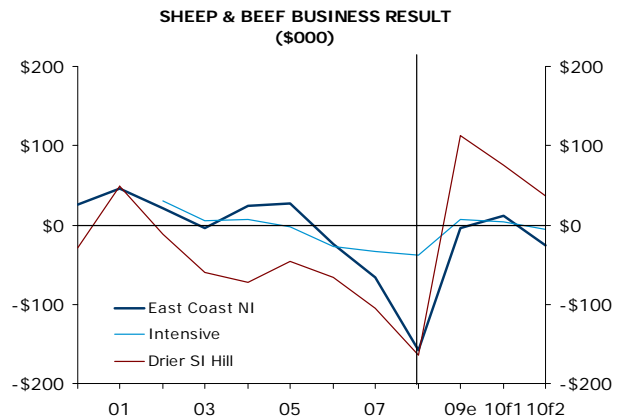
The forecast BR for sheep and beef farms has deteriorated putting the BR on many farms back in the red.

The three sheep and beef models are based on an East Coast North Island medium hill property (5,400 stock units), a drier, more extensive South Island hill country farm (12,500 stock units) and a smaller more intensive Southland unit (3,400 stock units).

Many North Canterbury down-land properties are of similar size and experienced similar weather conditions to the East Coast model. The Southland model is also broadly representative of more intensive farms in Hawke's Bay and Manawatu.

Debt is high on the East Coast model after consecutive droughts but moderate on the other two farms. This is a little surprising on the drier hill country farm given the poor performance since 2002 but reflects low indebtedness at the starting point of the analysis.

The models are forecast to have broken even in 2008/09 with the benefits of scale and controlled expenditure cutting in on the South Island Hill property. The first forecast for 2009/10 had a bare breakeven for the smaller farms but reverts to a small loss on the second forecast.

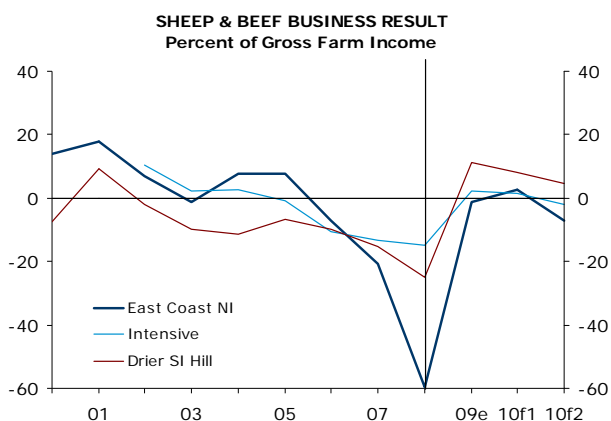


Sources: Pers Com, ANZNational

A favourable season helped the North Island farm in 2003/04 but it subsequently has been beaten up by a combination of consecutive droughts and low prices. The South Island farms have struggled to break even or had negative returns between 2003 and 2007 on flat or declining prices for lamb.

The magnitude of consecutive negative BR returns in 2007 and 2008 on the East Coast and SI Hill farms is large.



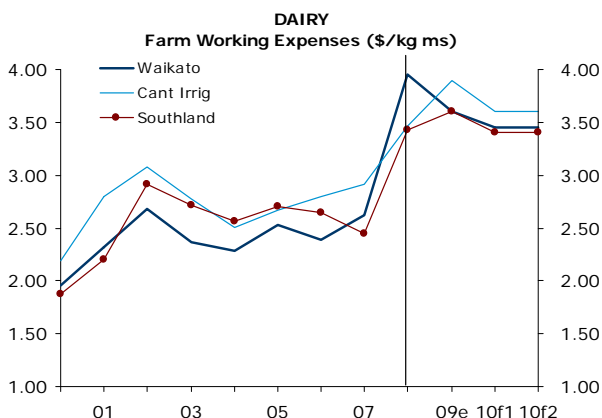


Sources: Pers Com, ANZNational

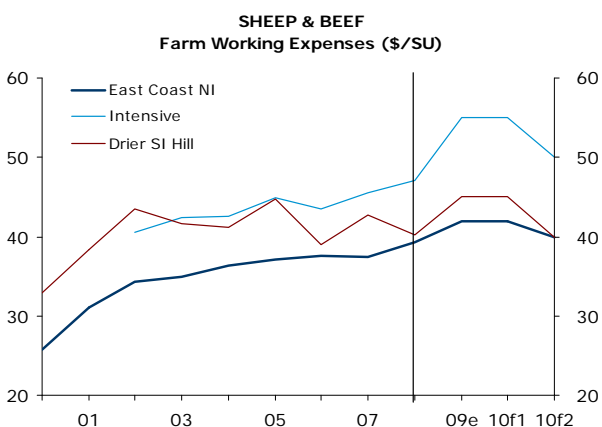
Comments

It would take a \$0.60/kg increase in payout or a decrease of \$0.60/kg ms in costs (e.g. farm working expenses from \$3.45 to \$2.85) or some combination of the two to get the Waikato BR to break even. The second requirement above is highly unlikely. History shows that costs do not fall back to previous levels after a sharp increase fuelled by additional spend plus cost increases.

Super phosphate is still around \$200/tonne (100 percent) above pre boom prices.



Sources: Pers Com, ANZNational



Sources: Pers Com, ANZNational

The intensive Southland farm is estimated to have been able to increase farm working expenses (F.W.E.) and maintain the farm. The increase in F.W.E. on the other two model farms is considered to hardly keep up with inflation. There is strong anecdotal evidence that fertiliser applications have been less than maintenance for the past two or three years on many farms.

The forecast BR for sheep and beef farms may be optimistic given the combination of negative revenue indicators.

Implications

Farmer confidence will remain muted albeit dairy farmers will have taken another breath.

Expenditure by farmers within the economy will remain constrained. Reducing debt will be a key priority.

The number of farm land sales will remain at a low level. Values are not expected to crash but are not expected to increase either. Buyers will remain very selective. The availability of debt capital will be more important than its cost (not that cost will be a trivial consideration) for purchasers and be a significant influence on the level of land values.

Summary

There are a mix of positive (soil moisture) and negative (markets) signs facing NZ agriculture at this time. That is normal for the industry. While the forecast BRs for 2009/10 are less than satisfactory, a lot can happen between now and May/June 2010 to shape the final outcome. But heartland NZ looks set to remain firmly in consolidation mode for the foreseeable future.

INTEREST RATE STRATEGY

Strong Q3 NZ CPI and growing talk of a 50bp hike from the RBA has led to further selloff in rates. Despite the 2-year yield implicitly pricing in 50bp hikes from January, market sentiment and positioning suggests it is still not an attractive receive level yet. Any corrective rally will struggle to gain traction for a while.

Market themes...

- > Surprisingly strong Q3 CPI ups the odds of an earlier rate hike.
- > Talk of a 50bp move by the RBA in November only intensified the selloff in the NZ market.
- > Market now focused on RBNZ October review, looking for a change in stance.

Review and outlook

A run of positive data in both NZ and Australia saw rates moving higher last week. The surprisingly strong Q3 NZ CPI print caught the market off-guard and saw it buckle with short end received positions being stopped out and the curve flattening significantly. With the CPI data following on from strong retail sales and housing market data earlier in the week, the ability for the RBNZ to hold off raising rates until late 2010 is being questioned by the market. Strong data in Australia has also seen higher rates, and some commentators are calling a 50bp move by the RBA on Melbourne Cup day. As a result, the Australian market has moved towards fully pricing 50bps in November. This has the market questioning where NZ swap rates should be and how wide the divergence with Australia could get.

With the front end selloff we saw massive curve flattening. The 2s10s moved from 153.5bps to 107.5bps. We also saw the 5-year swap yield break higher through a technical level which it had been testing recently (and had even looked as if it would begin to trend lower). Following the selloff we saw one local bank increase their fixed mortgage rates across the curve, steepening the mortgage curve even further. This is continuing to restrict the amount of payside mortgage flow hitting the market. But with historic received 2-year positions and 1y/1y positions under water, the recent move has been caused largely by stopping out.

While the market pricing is at extremes with the 2-year around breakeven if the RBNZ were to hike in 50bp increments at every meeting from January 2010 until the OCR reaches 5.00 percent, this is still not attracting receiving interest for the meantime given market sentiment. The dataflow is improving and will

continue to do so in the near-term, the extent of the next RBA hike is unknown and recent receivers have been stopped out. It will be difficult for a corrective rally to gain any traction for a while. We have also seen interest to put in place speculative outright short NZ swap positions and increasing corporate pay side interest as well.

Borrowing strategies we favour at present

With the risk of an earlier start to the tightening cycle than we had envisaged increasing, borrowers should start to consider using options to hedge. Caps allow borrowers to take advantage of current low floating rates while protecting against higher rates, for a premium.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ / OCR	↔/↑	Risk of earlier rate hike than our September view has increased.
NZ data	↔/↑	Data pointing to further momentum, with stickier inflation.
Fed Funds / front end	↔	Fed still committed to low rates for an extended period.
RBA	↑	Talk of a 50bp move in November heats up.
US 10 year	↔/↑	Still dependent on equity moves, with 3.5% a key topside resistance level.
NZ swap curve	↔	More flattening pressure as market brings forward RBNZ expectation.
Flow	↔/↑	Lack of mortgage paying, but still big risk of further stop-losses of long or 1y1y positions.
Technicals	↔/↑	5-year swap yield broken through key technical level.

Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 29-Oct-09	0	0
Thu 10-Dec-09	+5	+11
Thu 28-Jan-10	+13	+21
Thu 11-Mar-10	+48	+56
Thu 29-Apr-10	+67	+92
Thu 10-Jun-10	+97	+128
Thu 29-Jul-10	+121	+168

Trading themes we favour at present

Markets are pushing for an earlier and more aggressive tightening cycle from the RBNZ, and our preferred trades have not performed in such an environment. With the risk of a further selloff high, we are looking to take a step back.

CURRENCY STRATEGY

The failure of the NZD to capitalise on a string of strong domestic data and a selloff in NZ rates suggest much of the positive news has already been priced into the currency. Hence, from a risk reward perspective, a downside move on any disappointment will be larger than any potential upside.

Market themes...

- > More analysts and commentators in Australia now calling 5bps from the RBA, sending AUD higher.
- > Surprisingly strong NZ CPI number has the market questioning whether the RBNZ still has the head room.
- > US equity earnings season mainly good, but question is how much of this has already been priced in?

Review and outlook...

The NZ and Australian central bank landscape has changed rapidly, flowing through into the NZD and AUD. What a difference two weeks makes. It was only 15 days ago that talk of an October RBA rate hike was surfacing. Now that the RBA has actually delivered a 25bp hike, we have multiple calls for a 50bp hike on Melbourne Cup day in November (interesting to note that a year ago on Melbourne Cup day the RBA cut by 75bps instead of the expected 50bps). More importantly we have the market now pricing in aggressive hikes from the RBNZ much sooner than what they flagged in September.

The equity earnings season in the US continues to largely surprise on the upside.

This has manifested itself in the market by participants being comfortably long risk and looking forward to a return to trend growth. We still question this given the employment situation and the recent pullback in US consumer confidence reads.

The question is how much of the 'positive' news has already been priced into the NZD. It should be noted that the NZD has opened only 40 points higher this morning compared to where it opened last week. And in between, there was a string of positive dataflow including retail sales, housing market data and the surprisingly strong Q3 CPI print. This suggests the NZD has been priced for perfection. And as shown by the Bank of America earnings result over the weekend, any data that disappoints can now produce a bigger move to the downside than up.

Needless to say risk reward still suggests to us the NZD has a lot of positives priced in that may not eventuate. Hence our preference is to

be short NZD calling last week's high at 0.7496 the top and looking for a retest of 0.7150 support. Note at current levels this is the biggest positive deviation from the 200 day moving average since the float!

It is also worthwhile noting that while the Asian central banks are still underweight this region, particularly Australia, the DMO is issuing fewer bonds as they are ahead of their targets for the year. With 74.5 percent of bonds in foreign hands, the offshore market simply cannot buy what doesn't exist. This again is dampening demand for the NZD. We see the 0.8100/0.8130 level in the NZDAUD as a sell, with major support at 0.8050. Should that break, it could potentially open up a move towards the next major support level at 0.7750.

NZD vs AUD: monthly directional gauges

Gauge	Direction	Comment
Fair value	↔	Within the range.
Yield	↓	Yield favours Australia.
Commodities	↔	Both softs and hards performing well.
Partial indicators	↔/↓	Both economies improving, but Aussie much faster.
Technicals	↓	Break lower possible this week.
Sentiment	↔/↓	Rate hike talk giving positive sentiment.
Other	↔/↓	Asian central banks underweight Australian asset.
On balance	↔/↓	NZD struggling to keep up with AUD.

NZD vs USD: monthly directional gauges

Gauge	Direction	Comment
Fair value – long-term	↔/↓	Above long term average.
Fair value – short-term	↔/↓	Above cyclical fair value estimates.
Yield	↔	Are we lower for longer?
Commodities	↔	Still lagging but gaining momentum.
Risk aversion	↔	Improved, but earnings season key.
Partial indicators	↔/↓	Inventories being rebuilt, but what about demand?
Technicals	↔/↓	Technical top at 0.75 level.
AUD	↑	First to hike in G20.
Sentiment	↔	Positive NZ data last week failed to send NZD higher.
Other	↔/↓	All commodity currencies doing better than NZ.
On balance	↔/↓	Risk-reward suggests a correction.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
19-Oct	UK	Rightmove House Prices (Oct) - mom	-	0.6%	12:01
	JN	BoJ Monetary Policy Meeting Minutes	-	-	12:50
		Tertiary Industry Index (Aug) - mom	0.1%	0.6%	12:50
	US	Fed's Bernanke, Yellen Give Remarks at S.F. Fed Conference	-	-	14:00
	AU	RBA Assistant Governor Lowe Speaks in Sydney	-	-	15:00
	EC	Construction Output (Aug) - mom	-	-2.0%	22:00
20-Oct	US	Bernanke Speaks on Asia and Financial Crisis in California	-	-	04:00
		NAHB Housing Market Index (Oct)	20	19	06:00
	AU	RBA's Board October Minutes	-	-	13:30
	JN	BoJ Deputy Governor Nishimura to Speak in Kobe City	-	-	14:30
		Leading Index CI (Aug F)	-	83.3	18:00
		Coincident Index CI (Aug F)	-	91.4	18:00
		Machine Tool Orders (Sep F) - yoy	-	-61.9%	19:00
	GE	Producer Prices (Sep) - mom	-0.1%	0.5%	19:00
	UK	Public Finances (PSNCR) (Sep)	19.0B	10.4B	21:30
		Public Sector Net Borrowing (Sep)	15.5B	16.1B	21:30
		M4 Money Supply (Sep P) - mom	0.5%	0.1%	21:30
21-Oct	US	Producer Price Index (Sep) - mom	0.0%	1.7%	01:30
		PPI Ex Food & Energy (Sep) - mom	0.1%	0.2%	01:30
		Housing Starts (Sep)	610K	598K	01:30
		Building Permits (Sep)	590K	579K	01:30
		Fed's Warsh Moderates Sessions at S.F. Fed Conference	-	-	04:00
		Fed's Plosser to Speak at Stanford on Monetary Policy	-	-	13:00
	UK	BoE Governor King to Make Speech	-	-	08:15
		BoE Minutes	-	-	21:30
	NZ	Visitor Arrivals (Sep) - mom	-	-0.8%	10:45
		Credit Card Spending (Sep) - yoy	-	0.1%	15:00
	AU	Westpac Leading Index (Aug) - mom	-	1.1%	13:00
		New Motor Vehicle Sales (Sep) - mom	-	0.3%	13:30
22-Oct	US	Fed's Lacker to Speak at Economics Workshop at Richmond Fed	-	-	05:00
		Fed's Tarullo Speaks to Exchequer Club in Washington	-	-	06:00
		Fed's Beige Book	-	-	07:00
		Fed's Rosengren Speaks at Chatham, Massachusetts	-	-	09:30
	JN	Adjusted Merchandise Trade Balance (Sep)	¥375.0B	¥235.4B	12:50
		Merchandise Trade Exports (Sep) - yoy	-29.7%	-36.0%	12:50
		Merchandise Trade Imports (Sep) - yoy	-38.0%	-41.3%	12:50
		All Industry Activity Index (Aug) - mom	0.4%	0.5%	17:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
22-Oct cont.	EC	ECB Current Account s.a. (Aug)	-	6.6B	21:00
		Euro-Zone Govt Debt/GDP Ratio (Aug)	-	69.3%	22:00
	UK	Retail Sales (Sep) - mom	0.5%	0.0%	21:30
		BoE Releases Trends in Lending Report	-	-	21:30
23-Oct	US	Initial Jobless Claims (w/e Oct-18)	517K	514K	01:30
		Continuing Claims (w/e Oct-11)	5990K	5992K	01:30
		Leading Indicators (Sep)	0.9%	0.6%	03:00
		House Price Index (Aug) - mom	0.3%	0.3%	03:00
		Fed's Rosengren Speaks in Massachusetts on Financial Stability	-	-	03:30
		Fed's Lockhart to Speak on Early Childhood Education in Miami	-	-	05:00
		Fed's Dudley Moderates Policy Panel at Boston Fed Event	-	-	06:30
		Fed's Evans Speaks on Panel in Ann Arbor, Michigan	-	-	09:00
	AU	Import price index (3Q) - qoq	-2.8%	-6.4%	13:30
		Export price index (3Q) - qoq	-4.7%	-20.6%	13:30
	GE	PMI Manufacturing (Oct A)	50.1	49.6	20:30
		PMI Services (Oct A)	52.5	52.1	20:30
		IFO - Business Climate (Oct)	92.0	91.3	21:00
		IFO - Current Assessment (Oct)	88.0	87.0	21:00
		IFO - Expectations (Oct)	96.2	95.7	21:00
		ECB Council Member Weber Speaks in Frankfurt	-	-	22:15
	EC	PMI Manufacturing (Oct A)	50.0	49.3	21:00
		PMI Services (Oct A)	51.3	50.9	21:00
		Industrial New Orders (Aug) - mom	1.2%	2.6%	22:00
	UK	GDP (3Q A) - qoq	0.2%	-0.6%	21:30
24-Oct	US	Fed's Bernanke Speaks on Regulation at Boston Fed Conference	-	-	01:30
		Existing Home Sales (Sep)		5.10M	03:00
		Fed's Kohn Speaks on Panel at Boston Fed Conference	-	-	04:30

Key: AU: Australia, EC: 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: Upcoming data is expected to continue its generally improving trend, but we still question whether the “mix” to growth is right to achieve a sustainable recovery. The RBNZ’s *OCR Review* is now the major focus and we expect the previous soft easing bias to be dropped. Labour market data is expected to show further deterioration, but not at the pace experienced in the June quarter.

Date	Data/Event	Economic Signal	Comment
Wed 21 Oct (10.45)	International Travel and Migration (Sep)	Starting to slow?	While another solid monthly net migration inflow is expected, with the number of residency and work permit approvals falling, the number of arrivals may start to ease. We will be keeping a close watch on departures, especially to Australia, for signs of a turnaround.
Wed 28 Oct (15.00)	NBNZ <i>Business Outlook</i> (Oct)	-	-
Thu 29 Oct (09.00)	RBNZ <i>OCR Review</i>	Reiteration of low for extended period view.	While the economy is now out of recession and recent dataflow has shown improvement, the level of uncertainty is expected to see the RBNZ maintain their view of rates on hold for some time, though the easing bias will be dropped.
Thu 29 Oct (10.45)	Overseas Merchandise Trade (Sep)	Trade deficit expected	Import demand should remain subdued. However, with inventories now at low levels, any further export demand will need to be met out of production and biological constraints will provide a natural handbrake. A monthly deficit is expected.
Thu 29 Oct (15.00)	Credit Growth (Sep)	De-leveraging continues	Housing lending is expected to continue to rise, albeit very modestly. However, business and agricultural credit growth should remain subdued.
Fri 30 Oct (10.45)	Building Consent Issuance (Sep)	On the mend	Residential consent issuance is expected to continue to rebound in line with increased turnover in the housing market. However, non-residential consent issuance is likely to continue to deteriorate.
Tue 3 Nov (10.45)	LCI and QES (Sep qtr)	Softening	Wage growth is expected to continue to moderate as labour market conditions remain weak.
Tue 3 Nov (15.00)	ANZ Commodity Price Index (Oct)	-	-
Thu 5 Nov (10.45)	Household Labour Force Survey (Sep qtr)	Still deteriorating	The unemployment rate is expected to rise again, although not by the significant magnitude recorded in Q2. We have pencilled in an increase to 6.3 percent.
Thu 12 Nov (10.45)	Retail Trade Survey (Sep)	Stabilising	Another modest rise in spending is expected in the month. Volume growth in the quarter should be positive, but modest.
On Balance		Up	Right direction, wrong mix.

SUMMARY OF KEY ECONOMIC FORECASTS

	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10
GDP (% qoq)	-0.5	-1.0	-0.8	0.1	0.5	0.8	0.6	0.6	0.6	0.5
GDP (% yoy)	-0.4	-2.2	-2.6	-2.1	-1.2	0.6	2.0	2.5	2.6	2.3
CPI (% qoq)	1.5	-0.5	0.3	0.6	1.3	0.4	0.3	0.7	0.7	0.8
CPI (% yoy)	5.1	3.4	3.0	1.9	1.7	2.5	2.5	2.7	2.1	2.5
Employment (% qoq)	0.1	0.8	-1.4	-0.5	-0.5	-0.2	-0.2	0.0	0.3	0.4
Employment (% yoy)	1.0	1.0	0.8	-0.9	-1.6	-2.5	-1.3	-0.9	-0.1	0.5
Unemployment Rate (% sa)	4.3	4.7	5.0	6.0	6.3	6.6	6.9	7.1	7.0	7.0
Current Account (% GDP)	-8.6	-8.9	-8.1	-5.9	-4.2	-3.5	-3.7	-4.7	-5.5	-5.6
Terms of Trade (% qoq)	-1.0	-1.0	-2.7	-8.9	1.0	1.0	0.5	0.0	0.2	0.1
Terms of Trade (% yoy)	5.8	1.8	-5.0	-13.1	-11.4	-9.6	-6.7	2.5	1.7	0.7

KEY ECONOMIC INDICATORS

	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09	Jul-09	Aug-09	Sep-09
Retail Sales (% mom)	-0.5	-1.2	0.2	0.0	0.4	0.7	0.0	-0.5	1.1	..
Retail Sales (% yoy)	-0.9	-3.7	-6.9	-1.9	-1.7	-2.4	-1.1	-1.4	-1.1	..
Credit Card Billings (% mom)	-2.2	1.6	1.0	-3.0	2.4	-0.3	0.1	0.2	1.6	..
Credit Card Billings (% yoy)	-3.7	-2.4	-2.0	-4.8	-1.6	-2.3	-2.1	-1.9	0.1	..
Car Registrations (% mom)	13.3	-14.4	-14.8	6.8	-0.7	-3.0	6.1	7.2	-3.4	7.0
Car Registrations (% yoy)	-23.7	-36.5	-44.6	-32.9	-41.0	-33.3	-29.6	-16.4	-18.3	-16.8
Building Consents (% mom)	-5.6	-12.7	11.9	-1.8	11.3	2.6	-9.3	4.5	1.7	..
Building Consents (% yoy)	-41.4	-51.2	-39.8	-34.2	-56.5	-23.8	-23.7	-16.9	-8.8	..
REINZ House Price (% yoy)	-4.8	-4.4	-2.2	-4.0	-1.4	-2.2	0.0	0.0	5.1	6.1
Household Lending Growth (% mom)	0.1	0.2	0.1	0.1	0.2	0.4	0.1	0.3	0.3	..
Household Lending Growth (% yoy)	4.2	3.8	3.1	2.7	2.6	2.5	2.4	2.4	2.3	..
Roy Morgan Consumer Confidence	102.9	103.7	98.8	94.7	101.1	104.9	105.3	107.0	113.2	117.3
NBNZ Business Confidence	-35.0	..	-41.2	-39.3	-14.5	1.9	5.5	18.7	34.2	49.1
NBNZ Own Activity Outlook	-21.5	..	-20.1	-21.2	-3.8	3.8	8.3	12.6	26.0	32.2
Trade Balance (\$m)	-341	-102	483	438	322	906	-331	-175	-725	..
Trade Balance (\$m annual)	-5614	-5405	-5165	-4684	-4070	-2994	-3111	-2488	-2365	..
ANZ World Commodity Price Index (% mom)	-7.4	-4.3	-4.6	1.0	2.6	2.8	0.2	1.0	4.4	6.8
ANZ World Commodity Price Index (% yoy)	-24.3	-26.5	-30.7	-31.4	-29.4	-28.1	-27.9	-28.5	-22.7	-13.0
Net Migration (sa)	390	870	1660	1730	2100	2610	1700	2420	1610	..
Net Migration (annual)	3814	4538	6160	7482	9176	11202	12515	14488	15642	..

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)						
	Aug-09	Sep-09	19-Oct-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
NZD/USD	0.675	0.702	0.740	0.710	0.720	0.710	0.690	0.680	0.670	0.650
NZD/AUD	0.809	0.816	0.809	0.798	0.783	0.780	0.775	0.782	0.788	0.793
NZD/EUR	0.474	0.482	0.497	0.480	0.474	0.473	0.466	0.463	0.459	0.455
NZD/JPY	64.1	64.2	67.3	62.5	61.9	62.5	62.1	62.6	63.0	61.8
NZD/GBP	0.408	0.430	0.453	0.425	0.431	0.430	0.421	0.412	0.404	0.389
NZ\$ TWI	62.9	64.3	66.39	63.8	63.6	63.3	62.3	61.9	61.6	60.6
NZ interest rates	Aug-09	Sep-09	19-Oct-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
OCR	2.73	2.74	2.50	2.50	2.50	2.50	3.00	4.00	4.50	5.00
90 day bill	2.76	2.77	2.83	2.80	2.80	2.80	3.60	4.50	5.00	5.50
10 year bond	6.03	5.82	5.73	5.30	5.30	5.50	5.90	6.10	6.30	6.50
International	Aug-09	Sep-09	19-Oct-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.25	1.75
US 3-mth	0.35	0.29	0.28	0.50	0.70	0.80	1.25	1.50	2.00	2.50
AU cash	3.00	3.00	3.25	3.50	4.00	4.00	4.00	4.00	4.00	4.50
AU 3-mth	3.49	3.38	3.87	3.90	4.40	4.30	4.30	4.30	4.50	5.00

KEY RATES

	16 Sep	12 Oct	13 Oct	14 Oct	15 Oct	16 Oct
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.77	2.81	2.81	2.81	2.82	2.82
NZGB 11/11	4.02	4.17	4.16	4.16	4.37	4.37
NZGB 04/13	4.81	4.95	4.94	4.94	5.16	5.15
NZGB 12/17	5.65	5.55	5.54	5.54	5.74	5.73
NZGB 05/21	6.04	5.85	5.84	5.84	6.03	6.00
2 year swap	3.96	4.36	4.36	4.36	4.60	4.64
5 year swap	5.26	5.44	5.45	5.46	5.63	5.62
RBNZ TWI	64.3	65.7	66.5	66.3	66.9	66.8
NZD/USD	0.7061	0.7271	0.7371	0.7390	0.7479	0.7474
NZD/AUD	0.8151	0.8059	0.8127	0.8106	0.8116	0.8080
NZD/JPY	64.30	65.53	66.20	65.93	66.90	67.80
NZD/GBP	0.4287	0.4593	0.4673	0.4638	0.4658	0.4562
NZD/EUR	0.4812	0.4947	0.4990	0.4967	0.5001	0.5001
AUD/USD	0.8663	0.9022	0.9070	0.9117	0.9215	0.9250
EUR/USD	1.4675	1.4698	1.4772	1.4878	1.4955	1.4944
USD/JPY	91.07	90.12	89.81	89.22	89.45	90.71
GBP/USD	1.6470	1.5832	1.5775	1.5932	1.6055	1.6382
Oil	70.81	71.75	73.24	74.10	75.20	77.55
Gold	1009.80	1049.25	1055.35	1067.80	1063.90	1050.65
Electricity (Haywards)	1.36	0.31	0.50	6.63	5.23	0.88
Milk futures (US\$/contract)	98	106	106	106	110	110
Baltic Dry Freight Index	2415	2696	2646	2597	2688	2728

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.
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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.

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

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

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

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

Record Keeping

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

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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.

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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 ecnmcs@anz.com

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