

JUDGEMENT DAY

CONTENTS

Page 2: Economic overview

- A no-change decision is widely expected for the RBNZ and we expect the *Statement* to highlight the uncertainty surrounding the outlook. Once again, we expect global developments to have the major say in the NZD and rates market over the week.

Page 3: Economic comment – financial conditions update

- The slump in the NZ dollar led to an easing in financial conditions over August. However, when we incorporate the US 2-year swap spread to proxy tightness in the credit market, our *Financial Conditions Index* was largely unchanged.

Page 4: Interest rate strategy

- RBNZ liquidity injection should see 90-day yields lower, putting pressure on the 2-year swap yield.

Page 5: September Monetary Policy Statement Preview

- We expect the Reserve Bank to leave the OCR unchanged but continue to express concern over inflation pressures. The key area to watch will be how the Reserve Bank communicates the heightened uncertainty surrounding the outlook.

Page 7: Interest rate comment – NZ 10-year bond fair value model

- From a “fundamental” perspective, NZ 10-year bonds are expensive. But based on the NZ-US bond spread, which provides a more accurate fair value estimate compared to the bond model, current bond yields are close to fair value.

Page 9: Currency strategy

- The NZD will remain hostage to overseas developments as volatility looks set to continue and the USD struggles. RBNZ’s *Monetary Policy Statement* the key local event this week.

Page 10: Currency comment – effective exchange rates update

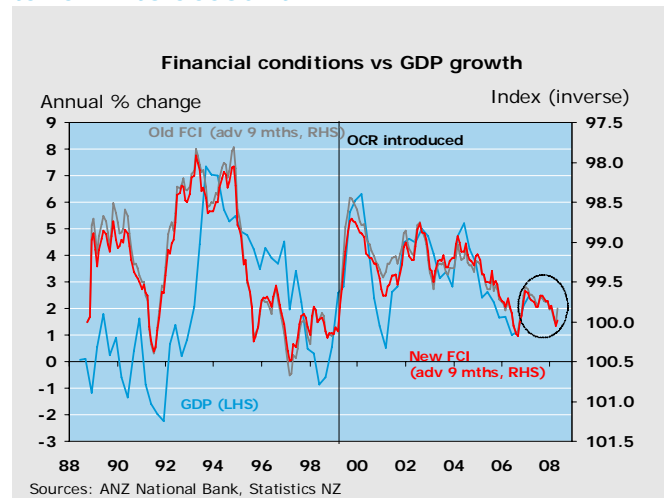
- The lower NZD has provided relief to all of the sectors that we monitor, although conditions still remain restrictive for the meat, forestry, horticulture, crude and services sectors.

Page 12: Data timetable

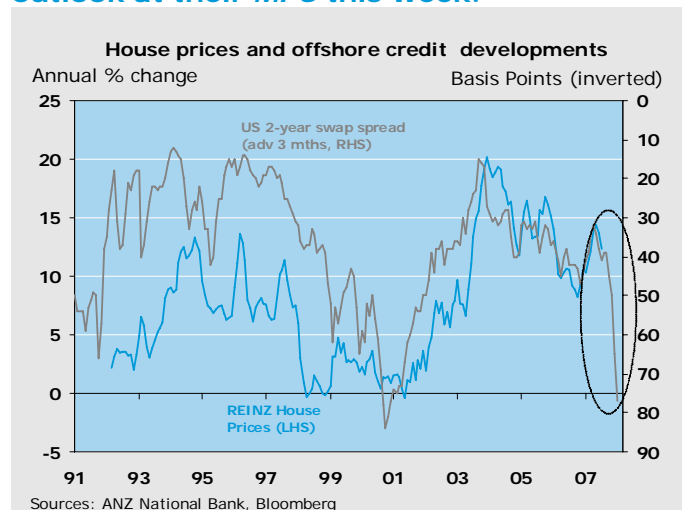
Page 14: Data watch

Page 15: Key forecasts

Financial conditions remained tight over August when credit developments are taken into account.



We expect the RBNZ to acknowledge the heightened uncertainty of the economic outlook at their MPS this week.



ECONOMIC OVERVIEW

A no-change decision is widely expected for the RBNZ and we expect the *Statement* to highlight the uncertainty surrounding the outlook. Once again, we expect global developments to have the major say in the NZD and rates market over the week.

What's ahead...

- NZ June qtr PPI (Monday 1045 NZST). Lower input prices courtesy of a stronger NZD, which firms will take advantage of to rebuild margins.
- NZ August REINZ Housing report (Tuesday). Further signs of softening are expected in August with interest rate increases this year now fully manifesting.
- NZ June qtr OTIs (Tuesday 1045 NZST). Strong increases in dairy prices are expected to result in a large increase in the terms of trade.
- RBNZ September *Monetary Policy Statement* (Thursday 0900 NZST). The RBNZ is in a conditional neutral mode, signalling that they believe they have done enough to contain inflation. The Bank will likely highlight increased uncertainty about the outlook.
- NZ July Retail Sales (Thursday 1045 NZST). Another soft month expected, pointing to ongoing moderation in consumer spending.
- NZ June qtr Economic Survey of Manufacturing (Friday 1045 NZST). Based on the PMI, we are expecting modest growth in production.

What's the view

We find ourselves very much in the minority camp with our Official Cash Rate call for easings in March next year. Most of the other market economists are looking at rate cuts late in 2008, a view we held up until two weeks ago. Amongst other things, last week's surge in commodity prices pose a challenge to our modified view. They rose by 1.4 percent in world terms over August and a whopping 10 percent in NZ dollar terms. We are also well aware that there is a high probability of a good old fashion election year spend-up next year. Inflation pressure remains extensive.

Yet, we believe that the impact from the changed global environment is being underestimated, along with the risks to a debt-laden nation such as NZ. In light of this, it no longer feels appropriate to run with what was implicitly an OCR on hold forever story. The turn in the global credit cycle and the re-pricing of risk currently underway marks a fundamental shift in the global economy, and comes on the heels of a rapid tightening in domestic financial conditions. We may be a long way away from the US subprime market, but that does not mean we will be immune. The NZ economy – particularly the domestic economy – has become conditioned to debt and rising asset prices, which has seen household debt and servicing levels rise to record levels, while house prices get ever stretched. As credit is re-priced internationally, NZ

is likely to end up paying, and that comes at a time when the housing market is already slowing. Throw in dislocation across non-bank financial institutions, the likely disappearance of mezzanine-related finance (a key influence on the development property market), a lack of overseas appetite for NZ commercial paper and overseas funding volatility, and the result is a huge tightening in credit conditions. NZ is hugely reliant on foreign capital. In our eyes this makes it clear cut. The credit cycle and re-pricing of risk will have a materially bigger (negative) impact than the dairy boom.

Our updated *Financial Conditions Index* (see page 3) is a reminder that, though rising commodity prices and a fall in the currency have resulted in an easing in financial conditions, overall business conditions remain tight when credit developments are taken into account. Liquidity pressures remain in global markets, forcing the Fed and ECB to inject more liquidity into their banking systems to ease the pressure. The cash squeeze in the local market continues to keep the 90-day rate high at 8.85 percent despite monetary policy on hold. There is a real cost for corporate NZ from this.

In this altered environment, we find it difficult to run with a core view that interest rates will stay at current levels for another year. Our updated view merely reflects where we believe the risk profile resides. Six months (until March 2008) is still a long time away in monetary policy circles and cycles! Only four weeks ago the Fed was expected to be on hold forever! Moreover, our core view is merely for some of the late cycle tightening undertaken in 2007 to be unwound in early 2008. The OCR will still remain restrictive for most of next year, just not as restrictive.

For the Reserve Bank, this week is a judgement day (as opposed to science day) when it delivers its *Monetary Policy Statement* (see page 5 for our preview). In the local dataflow this week, we will get the final pieces of the GDP jigsaw with the terms of trade and manufacturing survey for Q2. July retail sales and August housing data are also due, which we expect to be soft. The offshore data calendar is very busy, but the main focus will be on speeches by various Fed governors and ECB board members on their take on recent events and the outlook for the economy and policy.

Recent data...

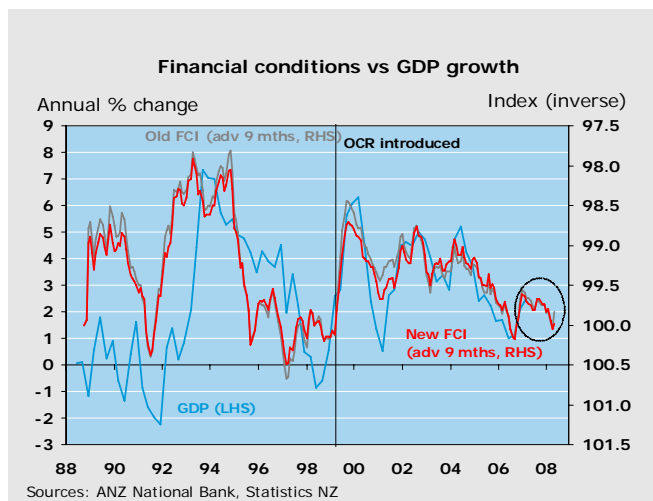
- **NZ Wholesale Trade Survey (Jun qtr)** recorded total sales growth of 2.4 percent.
- **ANZ Commodity Price Index (Aug)**. World prices rose 1.4 percent, while in NZ dollar terms the index rose by 10 percent.
- **NZ Building Work Put in Place (Jun qtr)** recorded a 0.5 percent fall in real activity.
- **NZ Capital Goods Price Index (Jun qtr)** rose 0.4 percent.

FINANCIAL CONDITIONS UPDATE

The slump in the NZ dollar led to an easing in financial conditions over August. However, when we incorporate the US 2-year swap spread to proxy tightness in the credit market, our *Financial Conditions Index* was largely unchanged.

Regular readers will be familiar with our *Financial Conditions Index (FCI)*¹, which we monitor and provide periodic updates in this publication. Unlike the conventional *Monetary Conditions Index*, our *FCI* includes a wider array of variables to recognise the different channels through which monetary policy influences the economy. Our *FCI* provides a timely gauge of economic activity 6 to 9 months into the future, and more importantly it has been successful in predicting key turning points in the growth cycle.

In our research piece in last week's *Market Focus*, we noted that the availability of credit and risk appetites have become more significant as a driver of the housing market since 1999. The current volatility in global financial markets marks a turn in the credit cycle, which will have an impact on the NZ economy. To explicitly capture this credit channel, we have replaced the 10-year bond yield in our *FCI* with the US 2-year swap spread (we use the US swap spread because a lack of liquidity in the NZ market makes the NZ equivalent too volatile). The swap spread is a proxy for both the cost and supply of credit.



The inclusion of the US 2-year swap spread greatly improves the fit between our *FCI* and year-on-year GDP growth. The correlation coefficient since June 1999 (after the OCR was introduced and when we noticed the significant role that credit was playing) increased from -0.80 to -0.88. There are no significant differences between the old and new

¹ Our index is calibrated so that there is a 4:1 ratio between the internal (e.g. interest rates) and external (e.g. currency) variables.

Index over history. However, they tell a very different story about financial conditions over August.

Indicators	Comment	Impact on activity
Currency, adjusted for commodity prices and input costs	Higher commodity price boosted by a near 7% fall in currency as measured by TWI.	↑
Interest rates	Higher 90-day rate offset by lower swap yield.	↔
US 2-year swap spread	Widened due to global credit concerns.	↓
Equity market index as a proxy for corporate wealth	Equity prices fell on the back of global financial market turmoil.	↓
House prices as a proxy for household wealth	Annual house price inflation easing, with recent monthly data showing slight declines.	↔
Private sector credit growth	Credit growth still buoyant but showing signs of easing.	↑/↔
Liquidity	Liquidity remains ample but at risk given the turn in the credit cycle.	↔
Overall conditions	Unchanged over August but still tight. Higher short-term rates and tighter credit market offset currency fall.	↓

The continued rise in world commodity prices (up 1.4 percent) coupled with a 6.9 percent fall in the currency on a TWI basis resulted in a substantial easing in financial conditions over August. But the re-pricing of risk around the world and rising risk aversion has acted to tighten financial conditions quite markedly. The global liquidity squeeze filtered through into NZ, resulting in the 90-day bank bill rate rising despite the Reserve Bank clearly being on hold. More significantly, a widening in the US 2-year swap spread alludes to harder and costlier access to funds.

Overall, despite currency and commodity price movements over August, financial conditions remain tight and point to year-on-year GDP growth of 1½ percent in mid-2008. Lending growth has started to show signs of easing and recent house price data have recorded outright declines – all indications that financial conditions are expected to remain tight for some time.

Our revamped *FCI* highlights the importance that developments in credit markets can have. The currency looks set to be the main avenue by which further global volatility will transmit through into New Zealand, helping to buffer any adverse impact. However, the credit channel could prove to have an even larger impact should financial markets go through another bout of de-leveraging, particularly for an economy heavily reliant on foreign funding.

INTEREST RATE STRATEGY

RBNZ liquidity injection should see 90-day yields lower, putting pressure on the 2-year swap yield.

Market themes...

- Dysfunction in cash market continues, holding the 2-year swap yield and the rest of the curve higher.
- Liquidity remains a major issue, exacerbating moves particularly in bonds.
- Global moves continuing to dictate.

Outlook...

The focus of the local rates market should shift towards domestic developments this week, although the surprise fall in US non-farm payrolls over the weekend point to further global financial market volatility, which could end up having a larger influence on the local market.

The local dataflow is rather heavy this week, but the market moving ones will be the August REINZ housing market report and the July retail sales outturn. Both are expected to show further evidence of moderation in domestic demand, giving the market confidence that further rate hikes can be ruled out for this cycle. Though the RBNZ is expected to leave rates unchanged this week, their *Monetary Policy Statement* will be closely read for signs of any change in the Bank's tone. The Bank is unlikely to provide any endorsement to a near-term easing, but will likely give itself flexibility to respond to upcoming data and developments. In this regard, the market will continue to test an early easing theme.

The dysfunction in the cash market remains an issue for the swaps curve. The 90-day rate rose to 8.85 percent and given the negative carry, has been holding the 2-year swap yield higher. This in turn is keeping the 2s10s curve at the bottom of its range at -80bps, preventing it from steepening. But the RBNZ injected \$1 billion into the system on Friday, and we expect further moves by the RBNZ to eventually see the 90-day rate ease from recent highs. This will put pressure on the 2-year swap yield, and we expect the entire yield curve to trade lower this week. We favour swap spreads to narrow on this move given the moves in the bonds last week.

Offshore focus this week will be on speeches by various Fed and ECB officials. The US and European data calendar is also busy, which means more volatility can be expected as the credit fallout starts to appear in the dataflow.

Gauges for NZ interest rates yields		
Gauge	Direction	Comment
RBNZ	↔	RBNZ is done hiking but lack of inflation headroom make near-term easings unlikely. Balance of risks starting to shift towards lower rates.
NZ data	↔/↓	August housing market data and July retail sales this week to show further slowdown.
Fed Funds/front end	↔/↓	Weak non-farm payrolls ups the ante on a Fed Funds cut next week. 25 or 50bps?
RBA	↔/↑	Australian data still printing strong pointing to another rate hike, but global developments a sticking point.
US 10 year	↓	Concerns over US economic growth putting downward pressure on longer term yields.
NZ swap spreads	↔/↓	We continue to favour swap spreads to narrow – US moves on Friday should help.
Flow	↔	Offshore markets remain the key for NZ direction heading into Thursday's MPS.
Technicals	↔/↓	Recent US moves has once again clouded the technical picture.

Borrowing strategies we favour at present

Borrowers with existing debt maturing in 2008/09 will find rates becoming attractive to forward fix swaps out of their maturity dates and should be aware the steeper the yield curve gets, the more benefit in these trades. Borrowers with existing long dated cover at good rates may want to look at taking some profit from these trades.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 13-Sep-07	0	-6
Thu 25-Oct-07	-12	-14
Thu 6-Dec-07	-32	-20
Thu 24-Jan-08	-48	-40
Thu 6-Mar-08	-92	-84
Thu 24-Apr-08	-104	-128
Thu 5-Jun-08	-104	-172

Trading themes we favour at present

The swaps curve will trade lower this week, with the 2-year swap yield under pressure as RBNZ injects liquidity into system to bring the 90-day rate down.

SEPTEMBER MONETARY POLICY STATEMENT PREVIEW

We expect the Reserve Bank to leave the OCR unchanged but continue to express concern over inflation pressures. The key area to watch will be how the Reserve Bank communicates the heightened uncertainty surrounding the outlook.

We expect the Reserve Bank to leave the OCR unchanged at 8.25 percent at this week's *Monetary Policy Statement*. In the July *OCR Review*, the Reserve Bank noted that provided household borrowing moderates and pressure on resources continues to ease, the four OCR increases delivered this year will be sufficient to contain inflation. The domestic dataflow since then will have given the Reserve Bank some confidence that no further tightening is required:

- The housing market has turned, with house sales well down in recent months and the number of days to sell rising. The median house price has declined in the past two months. According to Barfoot and Thompson, "we have to look back to 2000 to find a quieter August".
- Consumer spending appears to have taken a step down, with retail sales falling in June and indicators pointing to a soft July.
- The monthly rate of increase in household borrowing slowed to 0.9 percent in July, after averaging 1.1 percent over the first half of this year.
- There is still further pipeline tightening to come via the effective mortgage rate. The current retail fixed mortgage rate curve is between 8.9 and 9.5 percent, giving households nowhere to duck for cover.

Yet there are still pockets of strength, and inflation unease.

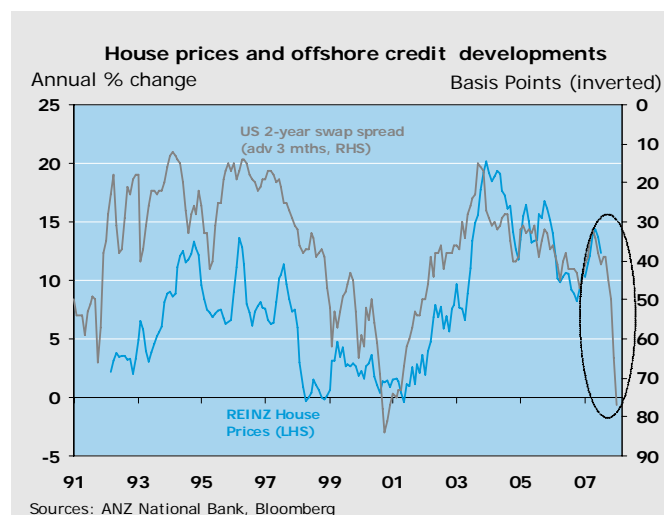
- The labour market remains extremely tight, and is a key source of cost-push inflation pressure.
- The forecast record dairy payout of \$6.40/kg ms will sustain activity in the rural aligned regions.
- Inflation expectations, though stable at 2.6 percent (2-year ahead), remains too elevated for the Reserve Bank's liking.
- The NZ dollar has weakened, thereby loosening monetary conditions, and adding to tradable inflation pressure at a time non-tradable inflation is uncomfortably high.

Inflation will rightly remain the key focal point. We fully expect this to be borne out in the

text and the 90-day trajectory in the mechanistic forecasts, which will explicitly be signalling rates remaining high for some time.

However, the current economic environment contains a greater degree of uncertainty. The US housing market continues to weaken, risk is being repriced, and central banks are injecting liquidity furiously for fears of a full-blown credit crunch. New Zealand has not been immune, with the global liquidity squeeze flowing through into the local cash market and causing the 90-day rate to spike up to 8.85 percent. Wider credit and swap spreads have delivered tighter financial conditions. Non-bank financial institutions are under stress (although the Reserve Bank could – and should – play the Bernanke line that it is not the central bank's job to bail investors out of bad investment decisions).

At the same time, international soft and food based commodity prices continue to rise, portending of additional inflation, dairy prices are soaring, and our terms of trade are up. Excluding the US, the global economy remains strong, although the decoupling theme is expected to be tested.



Given the higher than usual level of uncertainty facing the Reserve Bank, the nuances we expect from the September *Statement* are:

- **Acknowledgement of the moderation in domestic demand.**
- **Highlight that inflation pressures are strong and remain a significant concern.**
- **Remain uncommitted to further policy moves**, but giving themselves full flexibility to respond to developments as required.
- **Given the volatile global environment, we expect a reduced role in the actual Reserve Bank projections itself, including the 90-day profile.** We expect the Reserve Bank's growth forecasts to be revised lower (from a rather optimistic view of 3 percent over the coming year) and near-term inflation to be

revised higher. But it is difficult to put too much weight on hard forecast numbers when developments are unfolding quickly. Instead, the Reserve Bank's discussion of its policy judgements and how the Bank sees global events transmitting through to New Zealand will be the main focus. In this regard, **what type of scenarios the Reserve Bank presents will perhaps contain the most useful guide for the market to assess the Bank's likely policy bias.**

- **The Reserve Bank to follow the lines being expressed by other central banks.** For example ECB President Trichet stated last week: *"the financial market volatility and reappraisal of risk of recent weeks have led to an increase in uncertainty. Given this high level*

of uncertainty, it is appropriate to gather additional information and to examine new data before drawing further conclusions for monetary policy in the context of our medium-term-oriented monetary policy strategy aimed at delivering price stability."

Financial market implications

At the time of writing the market was pricing in 2pts of easings, with a 20 percent chance of a rate cut by the end of this year. While the core message will remain inflation wary, we struggle to see the curve pushing higher given the high degree of uncertainty likely to be flagged and the current international environment.

Our forecasts of RBNZ Projections for September MPS (June MPS Projections)

Half year average	H2 2007	H1 2008	H2 2008	H1 2009	H2 2009
90 day	8½ (8.3)	8¼ (8.3)	8¼ (8.2)	7¾ (7.9)	7½ (7.5)
TWI	69 (72.0)	66¼ (71.6)	64¾ (70.7)	63¾ (69.5)	62½ (67.7)
March years	2007	2008	2009	2010	
CPI (ann % chg)	2.5 (2.5)	2¾ (2.2)	2¾ (2.8)	2½ (2.6)	
GDP (ann ave % chg)	1.7 (1.7)	2¾ (3.1)	2¼ (2.8)	2.0 (2.0)	

NZ 10-YEAR BOND FAIR VALUE MODEL

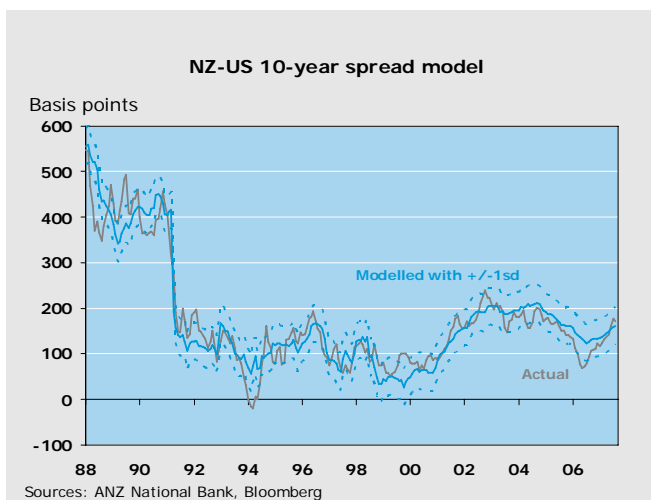
From a “fundamental” perspective, NZ 10-year bonds are expensive. But based on the NZ-US bond spread, which provides a more accurate fair value estimate compared to the bond model, current bond yields are close to fair value.

We use two modelling approaches to estimate fair value for NZ 10-year bonds. The first approach is to model the NZ-US 10-year bond spread as a function of the short-term interest rate differential between the two countries. In this case, we use the 90-day rate differential. We also include dummy variables to account for the structural shift in the spread since the early 1990s.

The second approach is to model the fair value using nominal GDP (in the long-run, the nominal bond yield should capture long term expectations of inflation and real growth), the US 10-year bond yield and the NZ 90-day rate as inputs. We also include a dummy variable to capture the structural decline in NZ long-term yields since 1993, reflecting a reduction in risk premium associated with successfully taming inflation and getting the government’s fiscal accounts in good order.

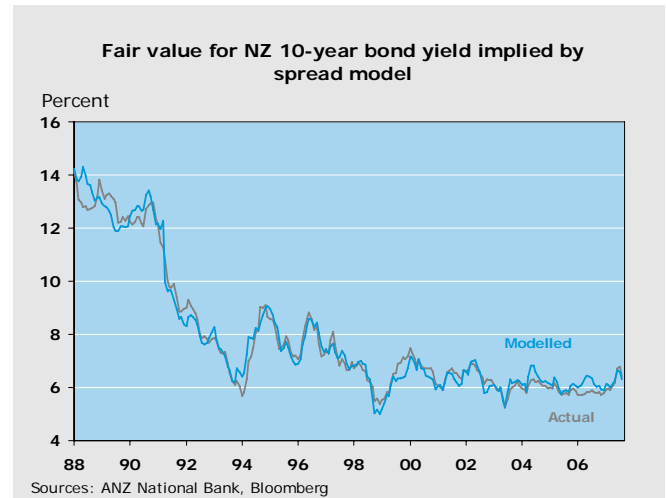
NZ-US 10-year spread model

The spread model suggests 6.1 percent. The figure below illustrates the fair value estimate for the NZ-US 10-year spread versus the actual. The spread model appears to track the actual spread reasonably well, with only brief periods when the actuals deviated substantially (in excess of +/- 1 standard deviation) from the modelled result. We can also use the modelled spreads to come up with the fair value for the NZ 10-year yields.



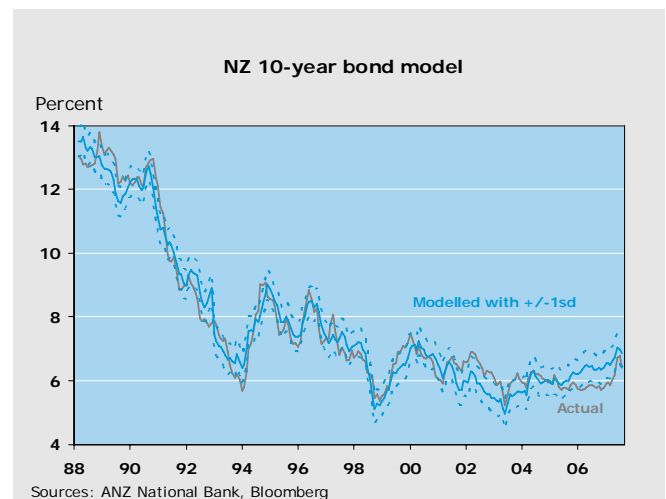
According to the spread model, the fair value spread is around +160bps to US 10-year yields, which translates to a NZ 10-year fair value yield of 6 percent. Hence, yields at current levels appear to be close to fair value relative to the US. With the

Fed widely tipped to ease the Fed funds rate in the near term, the NZ-US 90-day differential is expected to come under widening pressure in the coming months, pointing to a wider 10-year spread.

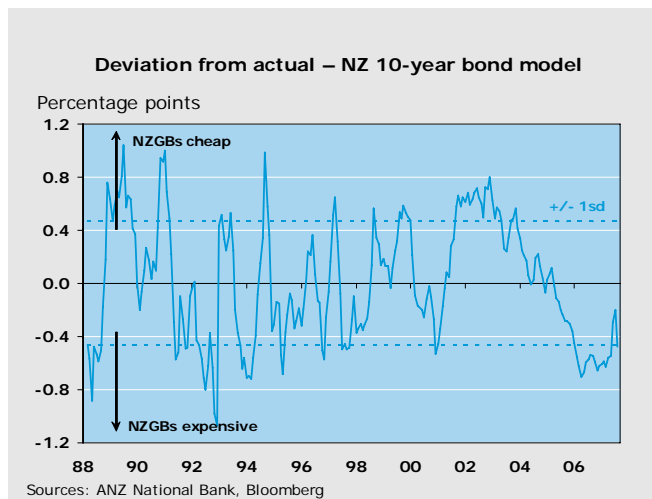


NZ 10-year bond model

The model suggests that current fair value for NZ 10-year yield is closer to 6.7 percent. The figure below shows the fair value modelled results versus actual for the NZ 10-year yields. We tried including the proportion of NZ Government Bonds held by offshore investors as an additional explanatory variable to proxy for demand for bonds. However, this variable did not prove to be significant and was dropped from the specification.



The fair value model does a reasonable approximation of the actual bond yields, but there are some significant periods where the actuals deviate substantially (+/- 1 standard deviation) from the fair value estimate. The model suggests that current fair value for NZ 10-year yield is closer to 6.7 percent, suggesting that bonds are on the expensive side at present. This is counter to the results we obtained from the spread model. The obvious question is which of the two models produces a superior outcome.



rate differential will put pressure on the bond spread to widen.

Comparisons

In evaluating the diagnostics of the two models, it appears that the spread model is the more superior one in terms of its better predictive power and lower standard errors. The spread model also generally has fewer instances when the deviation exceeds +/- 1 standard deviation, and when it does this tends to correct fairly quickly. There are instances in the bond model when the actuals deviated substantially from the modelled results for longer periods of time.

In theory, the fair value bond model should provide a better valuation compared to the spread model, as the former includes fundamental economic data in the form of nominal GDP growth (which captures economic activity and inflation). However, in reality NZ's economic data comes with a considerable lag (in the case of GDP data, a lag of three months) and is subject to sometimes fairly large revisions. This means coming up with a current fair value for NZ 10-year bond yields requires forecasts of nominal GDP growth, which itself is subject to forecast error.

Hence, while the fair value bond model has the attraction of having some fundamental anchors in it, the modelled outputs themselves are subject to revisions. For this reason, the bond spread model provides a better method for estimating fair value.

Conclusion

So what can we draw from all this? Our modelling suggests that from a "fundamental" perspective, current NZ 10-year bond yields look on the expensive side at 6.7 percent. However, the NZ-US 10-year spread model provides a more accurate fair value estimate of 6 percent, much closer to current levels, compared to the fair value bond model.

With monetary policy in NZ on hold for the rest of this year, we expect the main driver of the NZ-US 10-year spread to be expectations of US monetary policy. With the Fed widely tipped to cut rates at its next meeting, a widening short-term interest

CURRENCY STRATEGY

The NZD will remain hostage to overseas developments as volatility looks set to continue and the USD struggles. RBNZ's Monetary Policy Statement the key local event this week.

Market themes...

- Offshore developments will continue to dominate, with USD weakness and expected Fed rate cut (next week) likely to provide some support for the NZD.
- Looking for RBNZ *Monetary Policy Statement* for short-term direction.

Outlook...

A quiet start to the week, with US markets on holiday on Monday and a lack of local data saw the NZ dollar trading in relatively tight ranges. But disappointing data out of the US in the second half of the week (sharply lower US pending home sales data and the first negative non-farm payrolls result in 4 years) weighed. With further announced job layoffs reported in recent weeks (e.g. Countrywide plans to shed 10k to 12k jobs) and the housing market adjustment having further to go, the US labour market is suddenly looking vulnerable. This suggests that the US housing market adjustment has more to run yet (and has upped the likelihood of it spilling over into other sectors of the economy – despite Fed Beige Book assertions that there is little evidence of this occurring) and has weighed heavily on sentiment. US Treasury interest rates and equity markets have fallen, and the US dollar index has fallen to its lowest level in 15 years.

As we have come to expect in recent weeks, the NZD underperformed in such an environment. The largest moves in the NZ dollar over the past week occurred against the Australian dollar, with stronger than expected GDP and employment data across the ditch reinforcing the different stages that the two economies are in their respective business cycles. Further news of finance company difficulties provided a reminder of the vulnerabilities facing the NZ economy, and the NZD/AUD dropped to 0.8325.

The broader fortunes of the NZ dollar will continue to be determined by offshore developments, with any indications of credit difficulties or further fallout from the subprime collapse likely to impact on risk appetites and weigh on the NZ dollar. The Fed's rate decision next week will be key – a 50 basis point cut from them will underpin asset prices and bring yield back into play – whereas a 25 basis point cut will likely not be enough for the market, and leave risk appetites edgy. We are favoured to the latter with central banks wary of reacting excessively to moral hazard issues. With the US dollar index likely to struggle below 80, the NZ dollar should be contained in a 0.6750 – 0.7030

range over the week ahead. Domestically, the market is looking for the RBNZ's *Monetary Policy Statement* to provide some short-term direction.

Technically, big weekly moving average support around the 0.6830/50 level is the key to the downside. Expect last week's range to contain until data provides a reason to break. The NZD/AUD is now trending nicely, and we expect this to continue. Looking at the 0.8400/0.8450 window to get positioned for the next leg towards 0.8200.

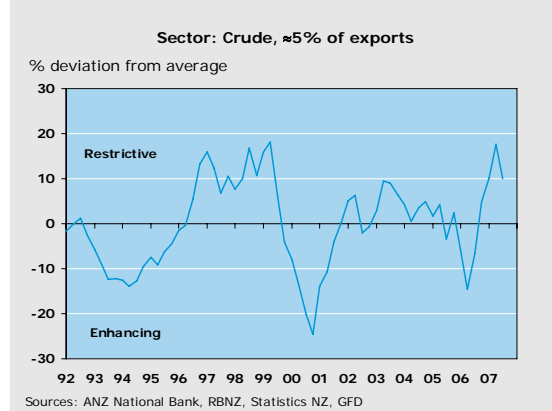
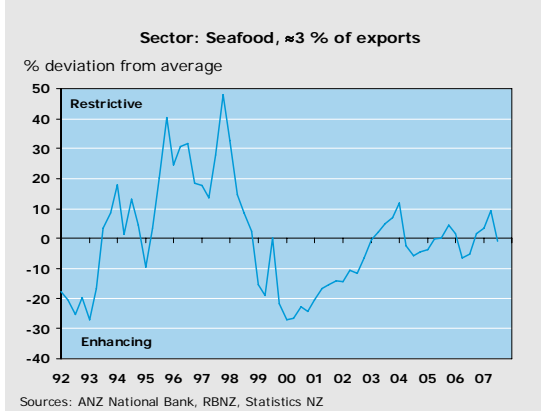
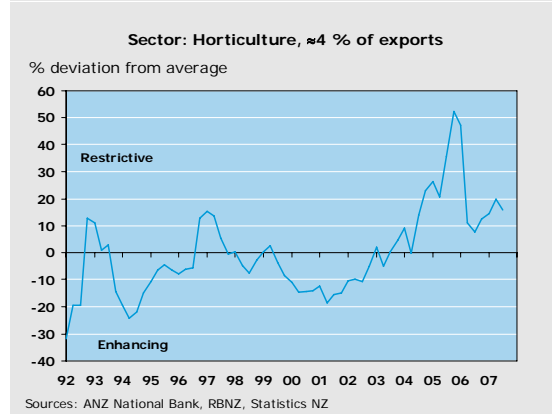
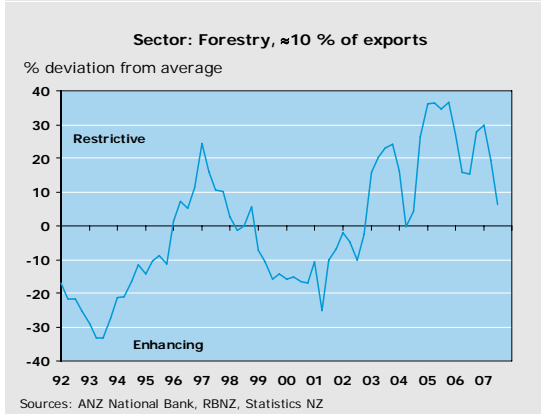
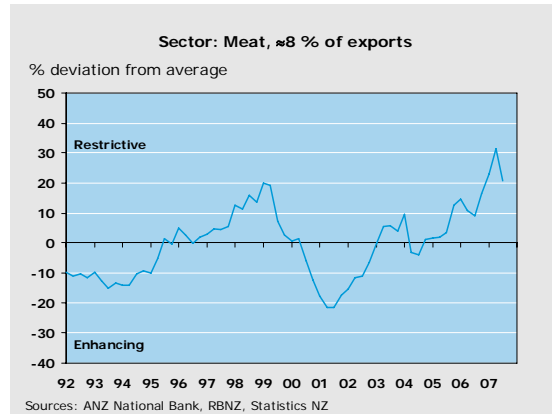
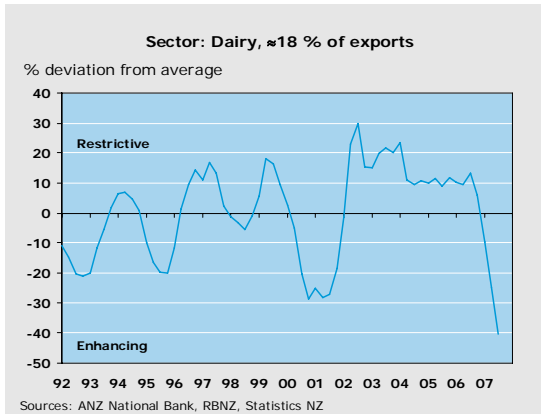
NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD. But below 0.85 we can survive.
Yield	↔/↑	Yields converged last week but still favour NZ.
Commodities	↔	Still supportive of both. And both doing well in weak USD environment.
Partial indicators	↓	Aussie ahead of us in the terms of trade cycle.
Technicals	↓	0.8450 now good resistance.
Sentiment	↓	AUD data is better.
Other	↓	Australian economy is stronger.
On balance	↓	0.8450 top for moves lower. Target 0.80

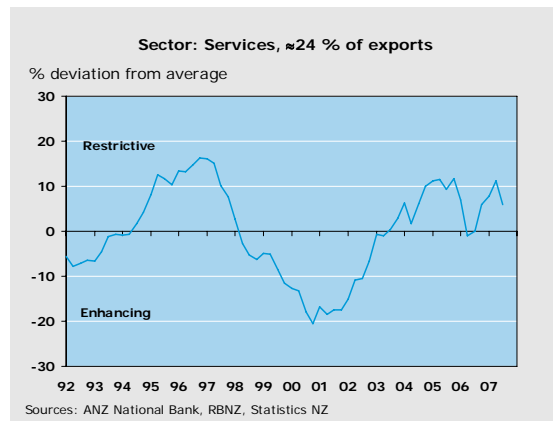
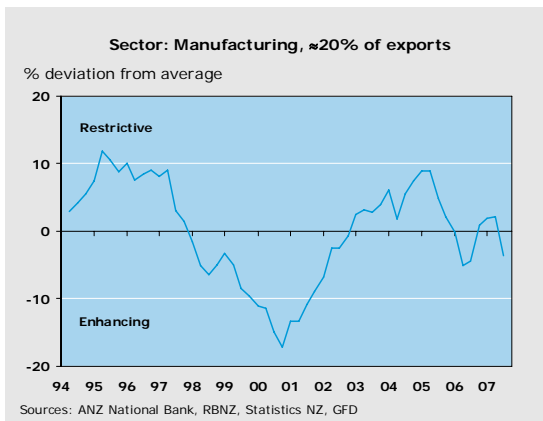
NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔	Employment data shows US real economy is slowing.
Yield	↑	Yield differential widening.
Commodities	↑	Higher commodity prices are still a major factor.
Risk aversion	↓	Talk of round 2 starting.
Partial indicators	↔	Neutral here.
Technicals	↔	Major support 0.6830/6850, resistance at 0.7000/7030.
AUD	↑	Fundamentals solid across the Tasman. AUD doing well.
Sentiment	↓	Market is getting short.
Other	↔	Massive volatility negates carry benefit but calmer waters see renewed interest.
On balance	↔	Wait and see this week - fairly priced to us. If Fed cuts on 18th we look better.

EFFECTIVE EXCHANGE RATES (UPDATE)

Regular readers will know that we track real effective exchange rate measures across various export industries. These measures adjust for the impact of commodity prices and are weighted by the export destination. They highlight that the performance of the NZD has a contrasting impact on different sectors of the New Zealand export community.

World dairy prices keep increasing, and this, in combination with a fall in the NZD has seen a further fall in the commodity adjusted real exchange rate for the dairy sector. The lower NZD has provided relief to all of the sectors that we monitor, although conditions still remain restrictive for the meat, forestry, horticulture, crude and services sectors. Conditions have returned to "neutral" for the seafood sector, and are now mildly enhancing for the manufacturing sector. Recent movements (down) in the NZ dollar, if sustained, will provide further relief in the absence of contrary movements in commodity prices.





DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
10 Sep	NZ	Producer Prices – Inputs (2Q) – qoq	0.8%	-1.6%	10:45
		Producer Prices – Outputs (2Q) – qoq	0.9%	-0.2%	10:45
	JN	GDP (2Q F) – qoq	-0.2%	0.1%	11:50
		GDP Annualised (2Q F)	-0.7%	0.5%	11:50
		GDP Deflator (2Q F) – yoy	-0.3%	-0.3%	11:50
		Money Supply M2+CD (Aug) – yoy	2.1%	2.0%	11:50
		Broad Liquidity (Aug) – yoy	4.2%	4.2%	11:50
		Eco Watchers Survey: Current	-	44.7	17:00
		Eco Watchers Survey: Outlook	-	46.7	17:00
	AU	Home Loans (Jul)	-2.0%	1.1%	13:30
		Investment Lending (Jul)	-	14.8%	13:30
		Foreign Reserves (Aug)	-	80.3B	18:30
	UK	PPI Input (Aug) – mom	-0.3%	-0.5%	20:30
		PPI Output (Aug) – mom	0.2%	0.2%	20:30
		PPI Output – core (Aug) – mom	0.2%	0.2%	20:30
		DCLG House Prices (Jul) – yoy	-	12.1%	20:30
11 Sep	US	Fed's Lockhart Speaks on US Economic Outlook in Atlanta	-	-	00:30
		Fed's Yellen Speaks at Conference in San Francisco	-	-	03:00
		Fed's Fisher Speaks at Forum in Laredo, Texas	-	-	05:00
		Consumer Credit (Jul)	8.0B	13.2B	07:00
		Fed's Mishkin Speaks to Investors in New York	-	-	11:30
	NZ	Terms of Trade Index (2Q) – qoq	4.2%	2.0%	10:45
	JN	Machine Orders (Jul) – mom	5.3%	-10.4%	11:50
	AU	NAB Business Confidence (Aug)	-	12	13:30
		NAB Business Conditions (Aug)	-	20	13:30
	UK	Visible Trade Balance (Jul)	-6,400m	-6,266m	20:30
		Total Trade Balance (Jul)	-	-3,608m	20:30
12 Sep	US	Trade Balance (Jul)	-59.0B	-58.1B	00:30
		IBD/TIPP Economic Optimism (Sep)	-	49.5	02:00
		Fed's Bernanke Delivers Annual Bundesbank Lecture in Berlin	-	-	03:00
	EU	EBC's Trichet Testifies to EU Parliament Panel in Special Session	-	-	02:00
		ECB's Weber, Fed's Bernanke Speak in Berlin	-	-	03:00
		ECB's Liescher Speaks at Book Presentation	-	-	05:00
		Labour Costs (2Q) – yoy	-	2.2%	21:00
		Industrial Production (Jul) – mom	0.2%	-0.1%	21:00
	UK	Leading Indicator Index (Jul) – mom	-	0.2%	02:30
		Coincident Indicator Index (Jul) – mom	-	0.2%	02:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)	
12 Sep cont.	UK	Claimant Count Rate (Aug)	2.6%	2.6%	20:30	
		Jobless Claims Change (Aug)	-8.0k	-8.5k	20:30	
		Average Earnings inc Bonus (Jul) – 3m/yoy	3.4%	3.3%	20:30	
		ILO Unemployment Rate (Jul) – 3mths	5.4%	5.4%	20:30	
	NZ	Food Prices (Aug) – mom	-	1.2%	10:45	
	JN	Domestic CGPI (Aug) – mom	0.1%	0.6%	11:50	
		Adjusted Current Account Total (Jul)	1,900.0B	2,046.7B	11:50	
		Consumer Confidence (Aug)	45.0	44.6	17:00	
	AU	Westpac Consumer Confidence (Sep)	-	-8.1%	12:30	
13 Sep	NZ	RBNZ Interest Rate Announcement	8.25%	8.25%	09:00	
		Retail Sales (Jul) – mom	0.2%	-0.4%	10:45	
		Retail Sales – Ex-Auto (Jul) – mom	0.1%	-0.5%	10:45	
		Consumer Inflation Expectation (Sep)	-	17.8%	12:30	
		Dwelling Starts (2Q)	-0.5%	1.3%	13:30	
	EU	ECB Publishes September Monthly Report	-	-	20:00	
		Employment (2Q) – qoq	-	0.4%	21:00	
14 Sep	US	Initial Jobless Claims (Sep 9)	330k	318k	00:30	
		Continuing Claims (Sep 2)	2570k	2598k	00:30	
		Monthly Budget Statement (Aug)	-81.3B	-64.7B	06:00	
		NZ	Manufacturing Activity (2Q)	-	0.8%	10:45
			Business NZ PMI (Aug)	-	54.6	12:00
		JN	Industrial Production (Jul F) – mom	-0.4%	-0.4%	16:30
			Capacity Utilisation (Jul F)	-	105.8	16:30
	GE	Consumer Price Index (Aug F) – mom	-0.1%	-0.1%	18:00	
	EU	CPI (Aug) – mom	0.1%	-0.2%	21:00	
		CPI – Core (Aug) – yoy	2.0%	1.9%	21:00	
15 Sep	US	Current Account Balance (2Q)	-190.0B	-192.6B	00:30	
		Import Price Index (Aug) – mom	0.2%	1.5%	00:30	
		Advance Retail Sales (Aug)	0.5%	0.3%	00:30	
		Retail Sales Less Autos (Aug)	0.2%	0.4%	00:30	
		Industrial Production (Aug)	0.3%	0.3%	01:15	
		Capacity Utilisation (Aug)	82.0%	81.9%	01:15	
		Business Inventories (Jul)	0.3%	0.4%	02:00	
		U of Michigan Consumer Confidence (Sep P)	83.5	83.4	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: Further signs of softening growth for Q3 will start to emerge in the partial indicators, starting with the REINZ housing market report this week. The RBNZ's September MPS will likely highlight increased uncertainty about the economic outlook.

Date	Data/Event	Economic Signal	Comment
Mon 10 Sep (10.45)	Producers Price Index (Jun qtr)	Margin rebuild	Lower input prices courtesy of NZD strength, which firms will take advantage of to rebuild margins.
Tue 11 Sep (10.45)	Overseas Trade Indices (Jun qtr)	Terms of trade up	Strong increases in commodity prices, particularly dairy, are expected to contribute to a large increase in the terms of trade.
Tue 11 Sep	REINZ Housing Report (Aug)	Softening	Further signs of softening are expected in August with interest rate increases this year now fully manifesting.
Thu 13 Sep (09.00)	Reserve Bank <i>Monetary Policy Statement</i>	On hold	The RBNZ is a conditional neutral mode, signalling that they believe they have done enough to contain inflation. The Bank will likely highlight increased uncertainty about the economic outlook. Given this uncertainty we expect to see some shaving of what were very upbeat growth projections in June.
Thu 13 Sep (10.45)	Retail Trade (Jul)	Soft	Another soft month expected, pointing to ongoing moderation in consumer spending.
Fri 14 Sep (10.45)	Economic Survey of Manufacturing (Jun qtr)	Modest	Based on the PMI, we are expecting modest growth in production volumes.
Thu 20 Sep (10.45)	Balance of Payments (Jun qtr)	Modest improvement	We expect the annual current account deficit to show a modest improvement, but the quarterly seasonally adjusted deficit to worsen.
Fri 21 Sep (10.45)	External Migration (Aug)	Easing	Another modest monthly net gain expected, but the annual net migration total to continue easing.
Fri 21 Sep (15.00)	Credit Card Billings (Aug)	Moderation	A modest rebound expected following July's decline, but the overall direction is for further moderation in consumer spending.
Wed 26 Sep (10.45)	Overseas Merchandise Trade (Aug)	Imbalanced	Trade balance yet to show signs of the surge in dairy prices. But a fall in the NZD over August should help export values.
Wed 26 Sep (02.00)	Westpac McDermott Miller Consumer Confidence (Sep qtr)	Down	Given global market volatility and finance company failures at home, not to mention higher mortgage rates, consumer confidence expected to take a hit.
Thu 27 Sep (10.45)	Building Consents (Aug)	Trending down	With the housing market slowing and net migration easing, the demand for new dwellings will slow – resulting in a downward trend in building consent issuance.
Thu 27 Sep (15:00)	NBNZ <i>Business Outlook</i> (Sep)	-	-
Fri 28 Sep (10.45)	GDP (Jun qtr)	Modest	Soft private consumption and a detraction from net exports is expected to be offset by increases in business investment and inventories. We expect GDP to expand by 0.5 percent for the quarter.
On Balance		Slowing	Dairy versus housing. We are backing the latter.

NZ Economics

Cameron Bagrie Chief Economist +64 4 802 2212	Khoon Goh Interest Rate Strategist +64 4 802 2357
Sean Comber Economist +64 4 802 2286	Steve Edwards Economist +64 4 802 2217
Philip Borkin Economist +64 4 802 2199	Kevin Wilson Rural Economist +64 4 802 2361

SUMMARY OF KEY ECONOMIC FORECASTS

	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
GDP (% qoq)	0.3	0.8	1.0	0.5	-0.2	0.3	0.3	0.4	0.4	0.6
GDP (% yoy)	1.1	2.1	2.5	2.6	2.2	1.6	0.9	0.8	1.4	1.7
CPI (% qoq)	0.7	-0.2	0.5	1.0	0.7	0.7	0.5	0.8	0.7	0.8
CPI (% yoy)	3.5	2.6	2.5	2.0	2.0	2.9	2.9	2.6	2.6	2.7
Employment (% qoq)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Employment (% yoy)	1.5	1.4	1.7	1.5	1.8	1.7	0.6	0.0	0.2	0.4
Unemployment Rate (% sa)	3.8	3.7	3.7	3.6	3.7	3.8	3.9	4.0	4.2	4.3
Current Account (% GDP)	-9.1	-9.0	-8.5	-8.1	-7.8	-7.4	-6.9	-6.5	-6.7	-6.8
Terms of Trade (% qoq)	-2.2	2.5	2.0	4.5	5.5	2.3	0.6	-0.3	-0.4	-0.2
Terms of Trade (% yoy)	-1.3	3.8	5.0	6.8	15.2	14.9	13.3	8.1	2.1	-0.4

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

KEY ECONOMIC INDICATORS

	Nov-06	Dec-06	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07
Retail Sales (% mom)	-0.1	0.8	0.4	2.2	0.9	-1.2	1.0	-0.4
Retail Sales (% yoy)	4.5	3.6	6.9	6.4	7.4	7.4	6.7	4.8
Credit Card Billings (% mom)	-0.7	2.9	-1.1	1.5	1.0	-0.8	0.4	2.0	-0.2	..
Credit Card Billings (% yoy)	7.8	9.9	6.8	8.2	7.4	7.9	5.7	9.2	7.8	..
Car Registrations (% mom)	-1.9	-3.7	13.2	-9.2	0.4	-1.2	5.9	-4.5	7.4	1.9
Car Registrations (% yoy)	-15.3	-17.8	-5.8	-12.5	-11.0	-4.8	-2.5	-1.5	7.0	10.9
Building Consents (% mom)	-11.1	-4.2	4.9	6.6	-1.4	1.1	4.9	14.2	-15.5	..
Building Consents (% yoy)	-1.0	-20.8	-5.6	-8.4	3.0	9.9	2.3	33.4	-3.9	..
REINZ House Price (% yoy)	10.0	11.9	9.0	13.6	13.7	14.4	14.8	12.1	10.2	..
Household Lending Growth (% mom)	1.1	1.0	1.1	1.1	1.2	1.1	1.1	1.1	0.9	..
Household Lending Growth (% yoy)	13.1	12.9	13.0	13.1	13.3	13.6	13.6	13.6	13.6	..
Roy Morgan Consumer Confidence	123.7	128.0	136.8	133.8	129.3	128.6	122.1	121.0	121.1	122.4
NBNZ Business Confidence	-14.0	-7.7	..	-5.9	-12.5	-19.4	-48.3	-37.2	-38.5	-33.8
NBNZ Own Activity Outlook	23.7	24.0	..	25.7	24.1	22.5	7.8	14.8	12.4	16.7
Trade Balance (\$m)	-820	-346	-825	-127	60	-215	9	-511	-791	..
Trade Balance (\$m annual)	-6047	-6082	-6013	-5767	-5776	-6024	-5899	-6217	-6315	..
ANZ World Commodity Price Index (% mom)	2.1	3.8	1.3	1.4	2.0	4.9	2.6	6.3	4.6	1.4
ANZ World Commodity Price Index (% yoy)	5.3	9.4	11.1	13.0	17.1	20.9	21.1	29.8	35.1	36.3
Net Migration (sa)	1840	1020	400	530	630	210	390	570	440	..
Net Migration (annual)	14757	14609	14116	13151	12081	11222	10682	10078	8966	..

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Jul 07	Aug 07	10 Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
NZD/USD	0.786	0.729	0.688	0.680	0.650	0.620	0.620	0.610	0.590	0.580
NZD/AUD	0.907	0.877	0.833	0.829	0.783	0.765	0.775	0.782	0.776	0.773
NZD/EUR	0.573	0.535	0.499	0.496	0.478	0.463	0.470	0.469	0.465	0.468
NZD/JPY	95.6	85.3	77.6	80.2	77.4	74.4	74.4	72.0	69.6	67.3
NZD/GBP	0.386	0.362	0.339	0.342	0.332	0.320	0.323	0.323	0.316	0.315
NZ\$ TWI	75.4	70.2	65.8	65.7	63.0	60.7	61.1	60.6	59.3	58.7
NZ interest rates	Jul 07	Aug 07	10 Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
OCR	8.18	8.35	8.25	8.25	8.00	7.50	7.50	7.50	7.25	6.75
90 day bill	8.44	8.72	8.85	8.80	8.30	7.90	7.70	7.70	7.30	6.80
10 year bond	6.79	6.40	6.04	6.40	6.40	6.50	6.50	6.70	6.70	6.50
International	Jul 07	Aug 07	10 Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
US Fed funds	5.25	5.25	5.25	5.00	5.00	5.00	5.00	5.00	5.50	5.75
US 3-mth	5.36	5.62	5.73	5.00	5.15	5.25	5.25	5.50	5.75	6.10
AU cash	6.25	6.50	6.25	6.50	6.75	6.75	6.75	6.75	6.75	6.75
AU 3-mth	6.62	6.89	6.91	6.70	6.90	6.90	6.90	6.90	6.90	6.90

KEY RATES

	7 Aug	3 Sep	4 Sep	5 Sep	6 Sep	7 Sep
Official Cash Rate	8.25	8.25	8.25	8.25	8.25	8.25
30 day bank bill	8.48	8.52	8.63	8.67	8.81	8.83
90 day bank bill	8.58	8.62	8.72	8.81	8.85	8.85
NZGB 07/09	7.78	7.09	7.09	7.00	6.85	6.85
NZGB 11/11	7.20	6.63	6.64	6.62	6.46	6.46
NZGB 04/13	7.04	6.50	6.51	6.51	6.37	6.38
NZGB 12/17	6.53	6.16	6.17	6.18	6.06	6.08
1 year swap	8.64	8.50	8.54	8.56	8.55	8.57
2 year swap	8.47	8.19	8.24	8.25	8.19	8.20
5 year swap	8.07	7.76	7.81	7.82	7.75	7.75
RBNZ TWI	73.0	67.7	67.7	66.8	66.3	66.4
NZD/USD	0.7637	0.7026	0.7021	0.6929	0.6892	0.6916
NZD/AUD	0.8903	0.8555	0.8520	0.8421	0.8368	0.8355
NZD/JPY	90.64	81.42	81.36	80.24	79.58	79.66
NZD/GBP	0.3757	0.3483	0.3479	0.3442	0.3410	0.3422
NZD/EUR	0.5530	0.5151	0.5158	0.5093	0.5049	0.5059
AUD/USD	0.8578	0.8213	0.8241	0.8228	0.8236	0.8278
EUR/USD	1.3810	1.3639	1.3612	1.3606	1.3650	1.3671
USD/JPY	118.68	115.89	115.88	115.81	115.46	115.18
GBP/USD	2.0327	2.0171	2.0183	2.0129	2.0214	2.0212
Oil	72.03	73.98	75.07	75.07	75.74	76.34
Gold	670.70	672.50	682.40	680.95	683.40	693.65
Electricity Price Index	6.00	5.25	5.37	5.52	5.66	5.76

Disclaimer

This document has been prepared by ANZ National Bank Limited (the "Bank"), is provided for informational purposes only and does not constitute an offer to sell or solicitation to buy any security or other financial instrument. No part of this document can be reproduced, altered, transmitted to, copied to or distributed to any other person without the prior express permission of the Bank.

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

ANZ Bank, Level 7, 1 Victoria Street, Wellington 6011, New Zealand Phone 64-4-802 2000 Fax 64-4-802 2024
<http://www.anz.com/nz> e-mail ecnmcs@anz.com