

RISK AVERSION VS RISK REDUCTION

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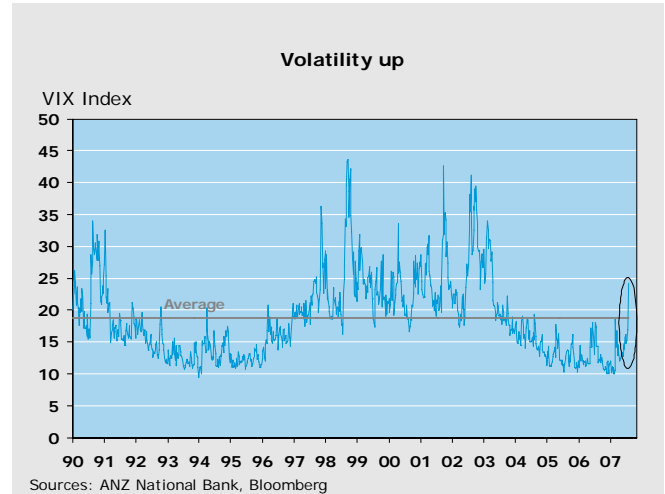
- Credit concerns and rising risk aversion have seen an exiting of carry trades which has pushed the NZD sharply lower. Positioning and the degree of leveraging across funds will be key to the future direction, and the bias is down. A cautious approach is warranted.

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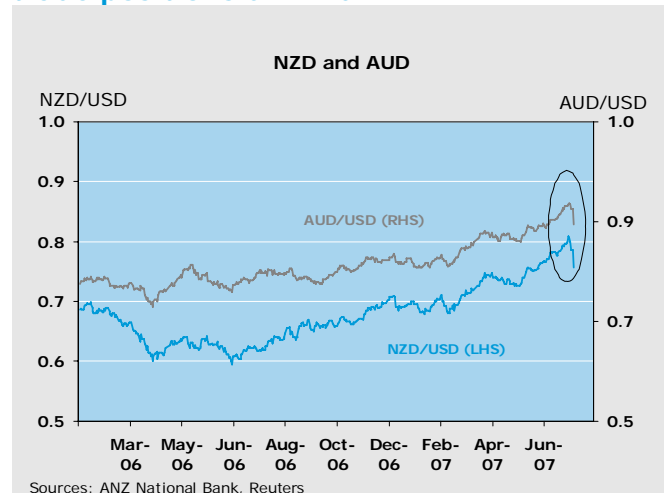
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Risk aversion measures have increased.



NZ and Australian dollars tumble as carry trade positions unwind.



ECONOMIC OVERVIEW

The Reserve Bank is now in a holding pattern. In the absence of an economic shock we ascribe a 25 percent probability to a rate hike and a negligible probability to a rate cut at the September MPS. We expect offshore developments to dominate this week, with all eyes on US equities.

What's ahead...

- NZ June Building Consents (Monday 1045 NZST). Builders would have rushed to get consents in prior to the council fee increases in July. This impact was felt in May and will also be seen this month.
- NZ June Credit Growth (Monday 1500 NZST). Monthly increases around 1 percent have been the norm over the past 24 months; we expect this to continue.
- NBNZ July *Business Outlook* (Tuesday 1500 NZST).

What's the view

Last week was HUGE! The Reserve Bank hiked but shifted to a neutral stance. The NZ dollar got whacked, with the change of stance setting the scene, but accentuated by risk aversion.

There are some obvious questions surrounding the change to a neutral stance by the Reserve Bank, which subsequently eased financial conditions. An interesting outcome for a central bank seeking to slow the economy! It is difficult to go past this shift at least being partly directed at the currency, and also mindful of the political pressure and sensitivity regarding the upcoming inquiry into monetary policy. The Reserve Bank has operational independence, and that's where it stops. Of course such considerations should be put to one side when setting monetary policy. But the reality is that they are still influential. NZ is not alone in that regard. Just look at the sensitivity market-watchers place on the election in Australia, although last week's strong CPI figure has seen the market largely put such considerations aside for now.

Yet stepping back, common sense seems to have prevailed. Financial conditions are tight, and are consistent with growth moderating to around 1½ percent (refer page 4 for the latest update of our *Financial Conditions Index*). The currency is still high. Central banks invariably end up having to take a leap of faith at some stage in the cycle. The science to monetary policy takes a step back and the judgment takes over. To religiously follow the science would see policy over-tightened every time.

Moreover, the door to a further hike is not shut. The shift in bias was contingent on New Zealanders moderating their borrowing behaviour further.

For now the story looks to be the Reserve Bank remaining in a holding pattern. In the absence of

an economic shock we ascribe a 25 percent probability to a rate hike, largely on the back of surging commodity prices, and a negligible probability to a rate cut.

Looking at the domestic calendar over the week ahead, there is little to dictate. The main focal point will be the National Bank *Business Outlook*, which will gauge business sentiment in the midst of the surging currency and the June interest rate hike, but also strong commodity prices.

We expect offshore developments to dominate this week, with most attention on US equities, risk appetites and the currency. The NZ dollar eased on the Reserve Bank's change in stance, but has been subsequently belted on rising risk aversion, and weakness in equities. It's been a subtle reminder to many that the NZ dollar is a small illiquid currency that can move a long way in a short space of time.

Subprime woes in the US continue to feature in many economic news headlines, with emerging fear that contagion could develop and spread. Credit-default swap spreads have blown out, the S&P VIX index has surged to its highest level since 2003, swap spreads have widened, and equities have come under pressure.

Are we on the cusp of some sort of major event, which is a key source of vulnerability to the New Zealand economy? As noted on page 3, we suspect not. At present we'd call it risk reduction as opposed to full-blown risk aversion. People tend to forget that global equities have risen over 12 percent since the start of the year. Investors in riskier assets should not always expect to get their money back, and the correction we are seeing is a healthy reminder of that! Fed officials continue to state that although there are definitely risks, they expect things to remain largely contained. Moreover, commodity prices – the typical transmission mechanism to the New Zealand economy from global unease – have not budged.

So for now we'll keep our thumbs, fingers and toes crossed. But markets do tend to take on a mind of their own, and we suspect we have not seen the last of weakness in the New Zealand dollar. Movements lower have certainly been a welcome reprieve for exporters, although stepping back and looking at the big picture, it's still exceptionally high at 0.76 cents. After being forced to ditch our bearish kiwi stance and call for a more aggressive turn in 2007 in the eyes of a flying kiwi, it will be a case of Murphy's Law if we end up re-instating it.

Recent data...

- **RBNZ OCR Review.** The Bank lifted the OCR to 8.25 percent, the fourth hike this year.
- **NZ Overseas Merchandise Trade (Jun).** The monthly trade balance recorded a deficit of \$524 million. The annual deficit increased from \$5,898 million to \$6,230 million.

RISK AVERSION VERSUS RISK REDUCTION

At this stage, we are viewing last week's events as a healthy bout of risk normalisation, as opposed to being indicative of a pending credit event. However, we are closely watching commodity prices, swap and credit spreads for signs of any spillover.

Markets continue to recoil. The US equity market suffered its worst weekly fall since 2003. US 10 year yields have rallied close to 50 basis points in three weeks. Concerns over the subprime market are showing signs of cascading into other areas. The S&P VIX index increased sharply and an array of credit measures deteriorated, albeit off remarkably low levels. The first leg has been a short-term wash-out of leveraged trading positions, including currency carry trades, interest rates, commodities (gold) and equities; and a rise in volatility. From that point on, psychology, inertia and outright fear had a major say.

Risk gauge	Average 1990-2007	Two weeks ago	current
S&P VIX Index	18.89	15.15	24.17
JP Morgan emerging market spreads*	325.55	175.66	227.91
US 5-year swap spread	49 bps	57 bps	68 bps
US 10-year swap spread	56 bps	65 bps	74 bps
CMBS spreads to swaps index [^]	140.3	134.6	138.9
S&P US credit investment grade index [^]	419.4	328.6	372.7
S&P US credit speculative grade index [^]	30.7	36	46

* average only since January 2000. ^ average since January 2003.

The first bout of subprime nervousness started five months ago, which partly contributed to the global market correction in February. However, market concern subsequently subsided as the tenor of US data showed strength in the non-housing areas of the economy and the initial subprime fears dissipated. The major difference between February and now is that we are seeing changes in lending criteria, re-pricing in the prime market and a widening of credit and swap spreads. In addition, the uncertainty over subprime issues is now extending across a range of financial institutions. We also note that international oil prices continue to slowly grind up and are now close to an all time high.

However, when we step back and look at broad global economic conditions:

- Liquidity remains ample courtesy of still low global interest rates.
- We continue to see robust growth across the G3, China, Middle East and emerging markets.

- While swap spreads have widened, they remain well below levels seen in previous periods of dislocation. For instance, the US 5-year and 10-year swap spreads both widened by 50bps during stresses seen in 1998.
- Fundamentals across emerging markets, including fiscal positions and inflation, are far stronger relative to history and previous periods of dislocation.
- The "prime" residential markets around the globe remain in good order. Strong economic fundamentals are underpinning household credit more broadly. Low unemployment, stable and low interest rates, and continued access to credit have been a feature of economies that have successfully weathered the end of housing booms in recent years.
- Central banks, notably the Fed, continue to express faith in any spillover being contained.
- Events at present are largely contained to the US, which we believe will be far more ruthless in their approach (relative to the Japanese experience of the early 1990's) in purging excess supply and applying governance.

The obvious risk at present is whether we see evidence of contagion. This does not seem to be the case at present, and we are characterising current events as a healthy bout of risk normalisation. Specifically, there does not appear to have been large scale selling down of positions in 'healthy' markets to cover losses in expensive assets.

While we do not yet believe that recent price action will have a lasting negative impact on the global economy, we believe it is firmly signalling an end to the low volatility environment we have been living in for the past three years. This transition to a more normal (though not high) period of volatility where markets can and do move around in different directions. Increased volatility may cause a modest widening of credit spreads and greater headwinds for equity markets, but it does not in itself signal a substantial shift in underlying macroeconomic conditions. At the margin, it does represent a modest tightening of financial conditions, but not sufficient to alter the policy or economic outlook.

For New Zealand, we see such developments as providing a timely reminder of the economy's vulnerability to an offshore event given the stage in the economic cycle, and risks surrounding the carry trade. We suspect "long" market positioning will have a significant say over the coming weeks, and all eyes will be on equities for cues with regard to risk appetites. Yet with no signs yet of global events stemming into soft commodity prices, any weakness in the NZD is likely to be short-lived, with any sustained run dependent on investors seeing firm evidence of a cooling economy.

FINANCIAL CONDITIONS UPDATE

Financial conditions tightened over July. However, recent financial market volatility courtesy of offshore moves, if sustained, will see a slight easing in August. But our *Financial Conditions Index* is still pointing towards growth of around 1¼ to 1½ percent by early 2008.

Regular readers of *Market Focus* will be aware of our *Financial Conditions Index*¹, which we monitor and provide periodic updates in this publication. Unlike the conventional *Monetary Conditions Index*, our *Financial Conditions Index* includes a wide array of variables to recognise the different channels through which monetary policy influences the economy.

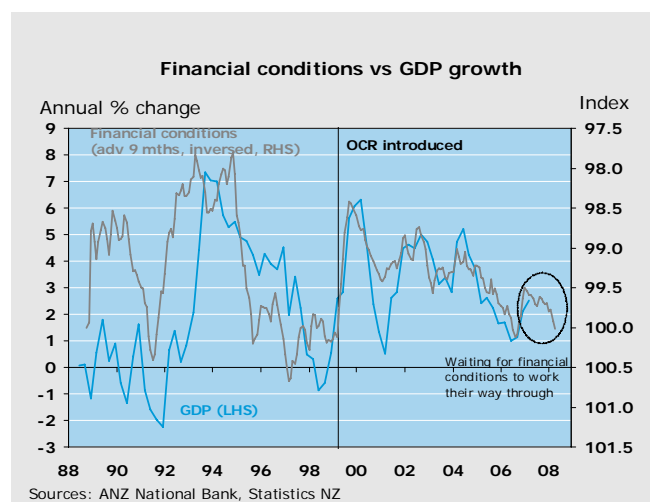
Our *Financial Conditions Index* is a good leading indicator of growth, with a correlation of -0.81 since June 1999 (after the OCR was introduced). More importantly, it has been successful in predicting key turning points in the growth cycle.

Indicators	Comment	Impact on activity
Currency, adjusted for commodity prices and input costs	Commodity price gains more than offset by higher currency and input costs.	↓
Interest rates	Higher wholesale interest rates across the curve.	↓
Equity market index as a proxy for corporate wealth and liquidity	Equity prices rose on the back of M&A activity.	↑
House prices as a proxy for household wealth	House prices still rising but growth rate is easing.	↔/↑
Private sector credit growth	Credit growth still buoyant.	↑
Liquidity	Liquidity remains ample.	↑
Overall conditions	Continues to tightened in July.	↓

The sharp tightening in financial conditions that began earlier this year intensified over July. Looking at the variables that make up our *Financial Conditions Index*, most of the tightening was due to higher interest rates and a currency at post-float highs. Certainly, higher commodity prices have dampened the impact of the currency. But even accounting for the surge in dairy prices, the currency is acting as a drag on the overall export sector. It is worth remembering that 80 percent of our export volumes are not insulated by higher dairy prices.

Offsetting the currency and interest rates somewhat were reasonable gains in the equity market over July and a still reasonably high (though easing) demand for credit. Liquidity still remains abundant. House prices are starting to moderate, and their impact on financial conditions is expected to be only slightly positive.

At current levels, our *Financial Conditions Index* is pointing towards year-on-year GDP growth of 1¼ to 1½ percent by early 2008. This suggests that while Q2 GDP growth is likely to still be solid, the second half of this year is set for a slowdown. In particular, Q3 growth looks particularly vulnerable. We note that the last time financial conditions were this tight was in Q4 2005 – the last time there was a contraction (albeit a small one) in quarterly GDP growth.



The conditions to drive the slowdown in growth that the Reserve Bank is looking for appear to already be in place. Certainly, the four successive interest rate hikes delivered so far this year play a big part in that. The unanswered question at this stage is whether this pending slowdown is sufficient to dampen inflation pressures.

Heightened global volatility and risk aversion late last week has seen quite large shifts down in the NZD and local yields within a short space of time. While it is too early at this stage to assess whether recent price action will prove enduring or whether this represents a temporary correction (much like late February this year), if sustained, this will lead to a slight easing in financial conditions over August. However, should global developments also lead to a reduction in global liquidity, the overall effect could actually lead to more tightening in financial conditions.

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.

INTEREST RATE STRATEGY

With the tightening cycle over, the bias is to trade the ranges. Credit concerns in the US to dominate local rates market, putting pressure on spreads to widen.

Market themes...

- Reserve Bank hikes but shifts into neutral.
- Bias is to trade the ranges now that the tightening cycle is over.
- Credit concerns in the US to dominate. This is looking far bigger than the February global market correction.

Outlook...

The Reserve Bank raised the OCR as expected, but the tone of the statement caught the market by surprise. The Reserve Bank has moved into neutral gear, believing that they have done enough to contain inflation. This saw the swaps curve rally as the market reduced the odds of another hike and started pricing in odds of a rate cut by mid-next year.

While we believe the tightening cycle is finally over, the risk profile is still pointed up. Certainly, the near term dataflow will still print on the strong side, particularly next week's Q2 wages and employment reports. But given the Reserve Bank's stance, we suspect the market will place more weight on weaker data – particularly those relating to housing and domestic demand. However, we doubt the market will do a repeat of last year, where easings were priced in too early.

Ultimately, the Reserve Bank needs to see concrete signs that domestic inflation is easing before they can contemplate cutting the OCR. Since this is still some time away, the OCR is set to stay high for some time. This means the bias is to trade the ranges. The 2 year IRS is set to remain within a 8.25 to 8.55 percent range. Despite global developments, the 2 year IRS will struggle to go below 8.35 percent with balance sheet flows dominating.

Credit concerns in the US have seen flight-to-safety flows into US bonds, sending 10 year yields to two month lows (see page 3). The widening in US credit and swap spreads mean there is pressure on the local spread to widen. Events in the US look set to dominate direction in the local market for the rest of the week. In other global developments, a strong Q2 CPI print in Australia has seen the market price in a rate hike for August. The house view is that while the next move by the RBA is up, they still have time to wait until early next year. The BoE and ECB will be announcing their interest rate decision this week. Both are expected to leave their rates unchanged.

Gauges for NZ interest rates yields

Gauge	Direction	Comment
RBNZ	↔	RBNZ shifts to neutral bias, believing they have done enough to contain inflation.
NZ data	↔/↑	Wages and employment data to still print on strong side next week.
Fed Funds/front end	↔	Q2 GDP stronger than expected, but housing market adjustment still ongoing. Credit developments to dominate.
RBA	↔/↑	Next move by RBA is up following strong Q2 CPI data. August a close call.
US 10 year	↔/↓	Subprime woes, credit worries and repricing of risk sent US bond yields to two month lows.
NZ swap spreads	↔/↑	Swap spreads to widen due to credit concerns in the US.
Flow	↔	Real money investors pushing long end yields lower and causing curve to invert.
Technicals	↔/↓	US 10-year yields in a 4.5-5.0 percent range. NZ 2-year IRS in a 8.25-8.55 percent range.

Borrowing strategies we favour at present

A strong move towards risk aversion in global financial markets has seen the New Zealand yields move lower over the past week, despite a rise in the OCR to 8.25 percent. This move allows clients with fixed rates maturing in 2008/09 to forward fix interest rates at attractive levels as the yield curve has steepened and inverted further. This dip in yields also presents clients who have floating debt to add cover at attractive levels as the saving between floating and the 2 - 5 year fixed rates has increased.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 13-Sep-07	24	15
Thu 25-Oct-07	40	15
Thu 6-Dec-07	40	15
Thu 24-Jan-08	40	15
Thu 6-Mar-08	36	-1
Thu 24-Apr-08	36	-1
Thu 5-Jun-08	36	-37

Trading themes we favour at present

We favour curve inversion trades. EFPs are expected to push wider in the short-term, hence we suggest paying EFPs at current levels.

CURRENCY STRATEGY

Credit concerns and rising risk aversion have seen an exiting of carry trades which has pushed the NZD sharply lower. Positioning and the degree of leveraging across funds will be key to the future direction, and the bias is down. A cautious approach is warranted.

Market themes...

- Reassessment of risk has seen a large liquidation of NZD positions.
- Interest differentials taking a back seat, but should provide support when the dust settles.

Outlook...

It was a big week for currency markets. The NZD started the week posting a new post-float high in advance of the RBNZ's interest rate decision. While the RBNZ's shift to "neutral" weighed on the kiwi, key to watch will be to what extent the market starts to price in easings, with the bias for the market to jump on weak data, particularly relating to the interest rate sensitive housing market, in a similar fashion to that seen in the US.

The fall in the NZD over the latter part of the week was triggered by offshore developments. Subprime concerns in the US caused a reassessment of risk appetites, raised questions about tighter access to credit, and saw a shift towards less-risky investment classes. This has seen the S&P VIX index climb to its highest level since 2003, US equity markets fall sharply, and yields on US 2 and 10-year notes touch two-month lows. It also resulted in a large unwinding of carry trade positions, which at one stage saw the NZD fall over a cent against the USD in the space of a few hours. There has also been a sharp drop in the NZD/JPY.

Offshore developments remain key to the future path for the NZD. The extent of positioning and degree of leveraging across funds will have a material impact on the extent of "correction" that occurs. Given the uncertainty surrounding this, it would be prudent to take a cautious outlook. We note that the widening of credit and swap spreads makes the fall in the kiwi a lot more consistent with other asset classes than was the case in late February/early March when the kiwi fell but spreads were unaffected.

Looking ahead, the key question is how entrenched will the current risk-reduction theme become. Further weakness in equities will continue to see investors pull money out of riskier assets and this includes currencies. In such an environment, the NZD will remain under pressure as yield advantage takes a back seat. Nevertheless, with the USD still looking shaky, given the credit concerns and equity market sell-off, the fall in the kiwi is unlikely to be a result of a sustained improvement in the USD.

When financial markets take stock of the adjustment that has occurred, yield differentials are likely to see demand for the NZD return, although not to the levels we have seen. Interest rate differentials are likely to see the NZD/AUD struggle, with the RBNZ signalling that further rate hikes are unlikely, while there is a growing expectation that the RBA will hike rates next week.

Technically, the next major support level for the NZD is the 38.2 percent Fibonacci level at 0.7575, although there are other minor supports close to current levels. The NZD/AUD is seeing support at 0.8928, but if this is broken, will test 0.8875.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↔/↓	Yield gap wider in front-end, narrower in back-end.
Commodities	↔	Still supportive of both.
Partial indicators	↓	Aussie ahead of us in the terms of trade cycle.
Technicals	↔	Still range bound at middle of this year's range.
Sentiment	↓	Risk aversion.
Other	↔	Yield still attractive for both Uridashi and eurokiwi. But maturity profile steepening.
On balance	↓	Risk aversion bearish AUD but NZD tends to struggle on liquidity.

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	↓	Some sectors booming, but most struggling.
Yield	↑	Yield differential widening on credit concerns.
Commodities	↔	Higher commodity prices remain supportive.
Risk aversion	↓	Subprime contagion hurting NZD.
Partial indicators	↓	Kiwi overvalued either way you look at it.
Technicals	↓	Don't try to catch a falling knife.
AUD	↑	Fundamentals solid across the Tasman.
Sentiment	↓	They love to sell us.
Other	↑	Position squaring support at 0.7575, 0.7475.
On balance	↔/↓	Moved a long way quickly, but it is a small exit door.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
30 Jul	NZ	Building Permits (Jun) – mom	-	5.5%	10:45
		Private sector credit (Jun) – yoy	-	14.3%	15:00
	JN	Industrial Production (Jun P) – mom	1.0%	-0.3%	11:50
		Vehicle Production (Jun) – yoy	-	6.3%	16:00
	AU	NAB Business Confidence (2Q)	-	10	13:30
	GE	Bloomberg Retail PMI (Jul)	-	49.2	20:00
	EU	Bloomberg Retail PMI (Jul)	-	48.2	20:00
	UK	M4 Money Supply (Jun F) – mom	-	0.8%	20:30
		M4 Sterling Lending (Jun F)	-	5.1B	20:30
		Net Consumer Credit (Jun)	0.8B	0.8B	20:30
		Mortgage Approvals (Jun)	110k	114k	20:30
31 Jul	JN	Jobless Rate (Jun)	3.8%	3.8%	11:30
		Overall Household Spending (Jun) – yoy	0.7%	0.4%	11:30
		Labour Cash Earnings (Jun) – yoy	0.1%	-0.2%	13:30
		Overtime Earnings (Jun) – yoy	-	1.4%	13:30
		Housing Starts (Jun) – yoy	-3.5%	-10.7%	17:00
		Construction Orders (Jun) – yoy	1.6%	48.3%	17:00
		Small Business Confidence (Jul)	-	48.4	17:00
	AU	Building Approvals (Jun) – mom	-	-5.6%	13:30
		Private Sector Credit (Jun) – mom	-	1.2%	13:30
		NAB Business Conditions (2Q)	-	22	13:30
	NZ	NBNZ Business Confidence (Jul)	-	-37.2	15:00
	GE	ILO Unemployment Rate (Jun)	6.3%	6.4%	18:00
		Unemployment Rate (Jul)	9.0%	9.1%	19:55
	EU	Euro-Zone Consumer Confidence (Jul)	-2	-2	21:00
		Euro-Zone Industrial Confidence (Jul)	5	6	21:00
		Business Climate Indicator (Jul)	1.46	1.54	21:00
		Unemployment Rate (Jun)	7.0%	7.0%	21:00
		Euro-Zone Economic Confidence (Jul)	111.2	111.7	21:00
		Euro-Zone Services Confidence (Jul)	21	21	21:00
	UK	GfK Consumer Confidence Survey (Jul)	-4	-3	21:30
1 Aug	US	Personal Income (Jun)	0.5%	0.4%	00:30
		Personal Spending (Jun)	0.1%	0.5%	00:30
		PCE Deflator (Jun) – yoy	2.3%	2.3%	00:30
		PCE Core (Jun) – mom	0.2%	0.1%	00:30
		PCE Core (Jun) – yoy	1.9%	1.9%	00:30
		Employment Cost Index (2Q)	0.9%	0.8%	00:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
1 Aug cont	US	Chicago Purchasing Manager (Jul)	58.4	60.2	01:45
		Consumer Confidence (Jul)	105.0	103.9	02:00
		Construction Spending (Jun) – mom	0.2%	0.9%	02:00
	UK	Nationwide Consumer Confidence (Jul)	93	95	11:01
	AU	AiG Performance of Manufacturing Index (Jul)	-	53.1	11:30
		Retail Sales (Jun)	1.0%	-0.1%	13:30
		Retail Sales Ex Inflation (2Q) – qoq	0.3%	2.0%	13:30
		Trade Balance (Jun)	-1,150m	-807m	13:30
		Exports (Jun)	-	18,727m	13:30
		Imports (Jun)	-	19,534m	13:30
		RBA Commodity Index SDR (Jul) – yoy	-	6.3%	18:30
	GE	PMI Manufacturing (Jul)	56.8	57.3	19:55
	EU	PMI Manufacturing (Jul)	54.8	54.8	20:00
	UK	PMI Manufacturing (Jul)	54.0	54.3	20:30
2 Aug	US	ADP Employment Change (Jul)	100k	150k	00:15
		Pending Home Sales (Jun) – mom	-0.5%	-3.5%	02:00
		ISM Manufacturing (Jul)	55.5	56.0	02:00
		ISM Prices Paid (Jul)	66.5	68.0	02:00
	JN	Monetary Base (Jul) – yoy	-3.0%	-4.1%	11:50
	UK	PMI Construction (Jul)	59.0	60.1	20:30
		BoE Announces Interest Rates	5.75%	5.75%	23:00
	EU	Euro-Zone PPI (Jun) – mom	0.3%	0.3%	21:00
		ECB Announces Interest Rates	4.0%	4.0%	23:45
3 Aug	US	Factory Orders (Jun)	1.0%	-0.5%	02:00
	AU	AiG Performance of Service Industry (Jul)	-	54.9	11:30
		TD Securities Inflation (Jul) – mom	-	0.2%	12:30
	GE	PMI Services (Jul)	58.5	58.9	19:55
	EU	PMI Services (Jul F)	58.1	58.1	20:00
		PMI Composite (Jul F)	57.3	57.3	20:00
		Retail Sales (Jun) – mom	0.8%	-0.5%	21:00
	UK	Official Reserve Changes (Jul)	-	-\$90m	20:30
		PMI Services (Jul)	57.5	57.7	20:30
4 Aug	US	Change in Non-Farm Payrolls (Jul)	130k	132k	00:30
		Unemployment Rate (Jul)	4.5%	4.5%	00:30
		Change in Manufacturing Payrolls (Jul)	-14k	-18k	00:30
		Average Hourly Earnings (Jul) – mom	0.3%	0.3%	00:30
		Average Weekly Hours (Jul)	33.9	33.9	00:30
		ISM Non-Manufacturing (Jul)	59.0	60.7	02:00

Key: AU: Australia, CA: Canada, EU: European Union, GE: Germany, JP: Japan, NZ: New Zealand, UK: United Kingdom, US: United States.

Source: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. Na= not available. (Note: all surveys are preliminary and subject to change).

NEW ZEALAND DATA WATCH

Key focus over next four weeks: The Reserve Bank last week stated that provided the signs of moderation in household borrowing continue, they do not expect to have to increase interest rates again this cycle. The key for them therefore is further evidence that domestic demand is easing and slowing the demand for debt. The REINZ housing report as well as retail sales data will be important, although the June quarter labour market data will provide a distraction as it should still show a tight labour market and strong wage growth.

Date	Data/Event	Economic Signal	Comment
Mon 30 Jul (10.45)	Building Consents (June)	Up	Builders would have rushed to get consents in prior to the fee increases in July. This impact was felt in May and will also be seen in June.
Mon 30 Jul (15.00)	Credit Growth	Still strong	Monthly increases around 1 percent have been the norm over the past 24 months; we expect this to continue.
Tue 31 Jul (15.00)	National Bank <i>Business Outlook</i> (July)	-	-
Mon 6 Aug (10.45)	QES and LCI Surveys (Jun qtr)	Elevated	Business surveys indicate that firms are increasingly finding it difficult to find both skilled and unskilled staff. This suggests wage pressures will remain elevated for some time.
Tue 7 Aug (15.00)	ANZ Commodity Price Index (July)	-	-
Thu 9 Aug (10.45)	Household Labour Force Survey (Jun qtr)	Still tight overall	Employment is likely to have only grown by a small amount in the quarter after a strong increase in March. The unemployment and participation rates are expected to remain largely unchanged.
circa 13 Aug	REINZ Housing Report (July)	Slowing	There have been signs of easing in the previous two monthly reports. Given that the higher mortgage rates are likely to fully manifest in July, we expect further signs of slowing in this release.
Tue 14 Aug (10.45)	Retail Trade Survey (June)	Still robust	Credit card statistics suggest that consumer spending remains robust. We expect a modest increase for the month.
Wed 15 Aug (10.45)	Producer Price Index (Jun qtr)	Some regaining of margins	The level of the NZD will have resulted in subdued input prices. We expect firms to take the opportunity to claw back some of their lost margins.
Wed 15 Aug (10.45)	Capital Goods Price Index (Jun qtr)	Mixed	The high NZD will have had a downward impact on plant and machinery prices, although construction prices will remain elevated.
Mon 20 Aug (10.45)	External Migration (July)	Easing	Migration inflows have slowed as the number of permanent and long-term departures has increased. This theme is expected to continue.
Fri 24 Aug (10.45)	Overseas Merchandise Trade (July)	Deficit	July historically records a trade deficit. This month will be no exception as the high NZD weighs on export volumes and timing issues delay the impact of higher dairy prices.
On Balance		Slowing	Housing looks to be leading the way but when will the rest follow?

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SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	May 07	Jun 07	30 Jul 07	Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09
NZD/USD	0.733	0.756	0.759	0.770	0.730	0.700	0.660	0.640	0.630	0.610
NZD/AUD	0.888	0.898	0.895	0.885	0.830	0.787	0.767	0.771	0.778	0.772
NZD/EUR	0.542	0.563	0.557	0.550	0.525	0.515	0.493	0.485	0.485	0.480
NZD/JPY	88.5	92.6	89.6	95.5	92.0	88.9	83.2	79.4	76.9	73.2
NZD/GBP	0.369	0.380	0.376	0.381	0.367	0.357	0.340	0.333	0.333	0.326
NZ\$ TWI	71.4	73.7	72.9	73.9	70.3	67.8	64.5	63.1	62.5	61.0
NZ interest rates	May 07	Jun 07	30 Jul 07	Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09
OCR	7.85	8.07	8.25	8.25	8.25	8.25	8.25	8.25	7.75	6.75
90 day bill	8.09	8.32	8.54	8.50	8.40	8.40	8.40	8.40	7.70	6.80
10 year bond	6.18	6.73	6.68	6.80	6.90	6.80	6.80	6.90	6.80	6.60
International	May 07	Jun 07	30 Jul 07	Sep 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09
US Fed funds	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.25	5.75
US 3-mth	5.36	5.36	5.36	5.35	5.35	5.35	5.35	5.40	5.50	6.00
AU cash	6.25	6.25	6.25	6.25	6.25	6.50	6.75	6.75	6.75	6.75
AU 3-mth	6.36	6.44	6.56	6.40	6.40	6.70	6.90	6.90	6.90	6.90

KEY RATES

	27 June	23 July	24 July	25 July	26 July	27 July
Official Cash Rate	8.00	8.00	8.00	8.00	8.25	8.25
30 day bank bill	8.21	8.35	8.34	8.38	8.48	8.47
90 day bank bill	8.36	8.48	8.46	8.49	8.54	8.54
NZGB 07/09	7.31	7.80	7.80	7.84	7.80	7.77
NZGB 11/11	7.11	7.42	7.42	7.44	7.40	7.33
NZGB 04/13	7.02	7.25	7.25	7.26	7.23	7.12
NZGB 12/17	6.69	6.84	6.84	6.85	6.82	6.68
1 year swap	8.44	8.60	8.59	8.63	8.61	8.60
2 year swap	8.32	8.49	8.47	8.51	8.44	8.40
5 year swap	8.00	8.12	8.10	8.14	8.07	8.02
RBNZ TWI	74.4	76.2	77.0	76.6	76.3	74.9
NZD/USD	0.7648	0.7995	0.8088	0.8056	0.7992	0.7849
NZD/AUD	0.9070	0.9070	0.9141	0.9090	0.9033	0.8961
NZD/JPY	94.05	96.72	97.48	96.83	96.42	93.43
NZD/GBP	0.3828	0.3885	0.3919	0.3913	0.3896	0.3835
NZD/EUR	0.5692	0.5780	0.5851	0.5833	0.5830	0.5711
AUD/USD	0.8432	0.8815	0.8848	0.8862	0.8848	0.8759
EUR/USD	1.3436	1.3833	1.3823	1.3810	1.3708	1.3744
USD/JPY	122.97	120.98	120.53	120.19	120.65	119.04
GBP/USD	1.9979	2.0579	2.0639	2.0589	2.0511	2.0469
Oil	67.78	75.53	74.65	73.38	77.03	77.03
Gold	641.90	683.40	682.15	681.10	661.40	661.40
Electricity Price Index	8.42	6.91	6.91	6.92	6.76	6.59

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