

Market Focus

New Zealand

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LOOKING FOR SUBSTANCE

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

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Page 4: Economic comment – NZ financial conditions revamp and update

- > We have upgraded our NZ Financial Conditions Index to incorporate retail as opposed to wholesale interest rates. The historical fit remains tight. Our revamped FCI still points to a recovery, but of a more muted magnitude relative to our old measure. Such divergences highlight the uncertainty surrounding any recovery, particularly given structural changes within the economy, an example of which being new RBNZ liquidity rules.

Page 5: Economic comment – section / apartment listing update

- > Listings of sections and apartments continue to grow relative to the total number of listings on the market. Typical hotspots including Queenstown continue to feature, with sections and apartments representing more than 50 percent of total listings. Sections and the price of land remains an area where we believe a substantial proportion of the housing market correction will pan out.

Page 7: Interest rate strategy

- > Increased risk aversion offshore and an expected soft CPI print domestically should see the bias remain firmly on the receive side in the local rates market. Increased bid tone for bonds as the various maturities find their way back into the market should see bonds outperform swaps yet again.

Page 8: Currency strategy

- > Weak equity sentiment, deteriorating risk appetites and lower commodity prices has the commodity bloc on the back foot. The NZD has been surprisingly resilient but risks playing catch-up. With the US earnings season heading into full swing, and expectations being lowered daily, this week is all about more downside risk for the NZD.

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ECONOMIC OVERVIEW

We continue to take some heart from gradual improvements across credit markets. However, the real side of the adjustment is still progressing and markets are looking for substance when it comes to speculation of recovery. After a massive surge (off the capitulation in February) equities and commodities have turned lower, flagging a more elongated adjustment or less "V" shaped recovery, in line with our core view. Inflation figures this week are expected to show rapidly abated headline and domestic inflation pressure.

What's ahead?

- > **June quarter CPI** (Thursday 1045 NZST). The headline CPI is expected to rise by 0.3 percent, taking annual inflation to 1.6 percent. Non-tradable and tradable inflation are also both expected to rise by 0.3 percent in the quarter.

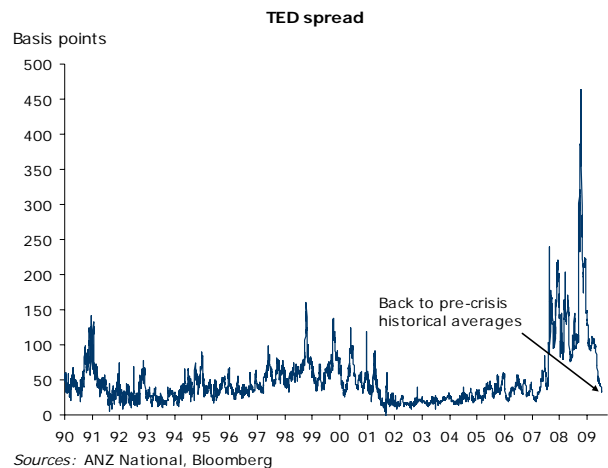
What's the view?

To sum up last week, it was really a case of "on expectations", at least in terms of the dataflow. Once again, there have been no new developments to alter our core economic views. The NZIER's *Quarterly Survey of Business Opinion* (QSBO) for the June quarter and the REINZ house sales numbers for June both showed further signs that the economy is gradually finding a base (or at least contracting at a slower rate) and is closer to regaining forward momentum. For the former, it broadly mirrored the trends present in the National Bank *Business Outlook*. Bottom line, the economic bungy-cord is kicking in, but there remains some caution over the recovery path.

Internationally we continue to be encouraged by continued gains across credit markets (although it does depend on where you look, with improving trends not occurring across the board last week). The TED spread – or the difference between what US banks and the government can borrow at in the near-term – is back to pre-crisis average levels. US corporate bond spreads are back to levels consistent with previous recessions (albeit rising slightly last week). But it is equally clear when looking at various real economic indicators – both cyclical (hard and soft data) and structural aspects (i.e. morphing the global economy off the US consumer) – that challenges remain.

Equity markets and commodity prices have turned lower, as have freight rates, further signs that all is not well. To be fair, we discounted a lot of the recent rebound we saw in equities and commodities, so we are hardly going to jump on a negative bandwagon now that they are back in decline. All have shown a tendency to be oversold

and overbought. It is the nature of markets. Suffice to say however, that in an economic environment where the economy (domestic and international) has just about stopped slipping down the side of the bathtub – but has yet to crawl along the bottom as households de-leverage – we see financial markets (equities, commodities, interest rates etc) plugging out ranges. We suspect the risk profile remains down, and will be closely watching the feedback effect from the macro-economy into the financial sector, and particularly the impact of rising unemployment. Various leading indicators have also shown a huge correlation with equities over the past two years, and is another area we are closely eyeing. But with talk now permeating of exit strategies across central banks, the transition from stabilising credit markets to ensuring the inflation genie does not get let out of the bottle has given markets something further to think about. Transition too early and any recovery could be kneecapped. Make the move too late, and inflation becomes problematic. Reeling in inflation is not growth friendly. All this spells of continued volatility, and a period of grumpiness for some time as excesses from the previous cycle are corrected.



Turning to this week, it is all about inflation (both domestically and offshore), with the June quarter CPI due for release on Thursday and also CPI releases in the UK, Euro-zone and the US. In terms of NZ's data, it will undoubtedly show that inflation pressures are easing. The weak domestic economy, the opening up of significant spare capacity and further loosening in the labour market are now clearly manifesting in reduced pricing pressure. This obviously follows the considerably reduced commodity induced inflation coming from offshore. We expect the headline CPI to increase by a modest 0.3 percent in the June quarter, taking annual inflation to 1.6 percent. This will be the lowest rate of annual inflation since March 2004.

The weak economic backdrop is expected to be reflected in soft domestic or non-tradable inflation. We expect non-tradable CPI to rise by just 0.3 percent – the smallest quarterly increase since June

2001. In fact, this is very similar to what our *Monthly Inflation Gauge* (which has performed very well to date in picking non-tradable inflation out-turns) is also suggesting. For the second consecutive month, our gauge reported a flat reading in June (the May reading actually recorded a very small decline based on the second decimal point). Price increases for the items we surveyed were completely offset by price declines.

	Monthly Inflation Gauge (m/m%)	Implied Inflation Gauge (q/q%)	Actual non tradable CPI (q/q%)
Mar-08	0.4		1.1
Apr-08	0.3		
May-08	0.3		
Jun-08	0.4	1.0	0.9
Jul-08	1.0		
Aug-08	0.2		
Sep-08	0.2	1.4	1.3
Oct-08	0.2		
Nov-08	0.2		
Dec-08	0.2	0.7	0.8
Jan-09	0.4		
Feb-09	0.3		
Mar-09	0.1	0.8	0.7
Apr-09	0.2		
May-09	0.0		
Jun-09	0.0	0.2	

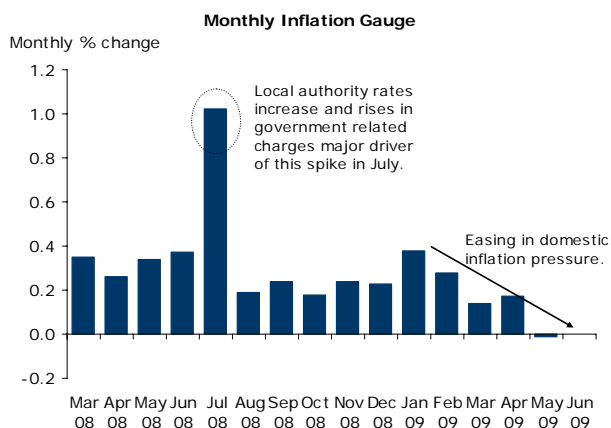
Leading the charge lower were alcohol prices. However, this is likely to be temporary, and July looks set for a hefty rise courtesy of increases to the excise tax on alcohol, which rose 2.8 percent from 1 July. There are also reports of wholesale prices increasing from early July, though how much of this ends up being passed on to end consumers remains to be seen. Other notable price declines in our inflation gauge occurred in the transport group, with domestic airfares falling due to a new entrant in the market offering low cost fares. This led to the incumbent lowering their prices in response. Note that we make no quality adjustments to the prices we collect, and hence do not take into account any changes to the quality of service.

Price increases continue to be recorded in the services sector, with hairdressers, property maintenance services and professional services all putting prices higher in June. However, the size of the price increases was not generally large.

Our modelled measure of rents and purchase of housing (formerly known as construction costs) was flat in the month. The former has effectively been flat-lining for some time, and we expect this to be reflected in further easings in the official CPI rent data over the coming quarters.

The bottom line is that domestic inflation pressures are reducing. Abstracting from some monthly volatility and seasonal increases (particularly in July with local authority rate rises coming through), we expect our gauge to continue to mirror this in the near-term. The beauty of having a gauge such as this one (and what NZ lacks compared to its peers

offshore) is the ability to be able to provide timelier information for when inflation trends are starting to turn one way or another.



Internationally this week, as mentioned above, there are also CPI releases in a number of other countries. Unsurprisingly given the economic backdrop, they are also expected to be reasonably subdued. Other releases include the NAB Business Confidence survey for June, which provides a reasonable leading read on the Australian economy, and another important leading gauge – the US Philadelphia Fed survey. The latter showed a considerable surge last month and saw many begin to believe the US recession is nearing an end. The obvious question will be whether this is sustained. Finally, the FOMC minutes from their latest meeting will be perused very closely to determine how close the Fed was to increasing (or potentially decreasing) the size of their QE programme.

Probably what will also be the major focus is the continuation of the US Q2 earnings reporting season. While a couple of big financials (Goldman Sachs and JP Morgan) are due to make announcements this week, the attention is likely to have shifted from financials and towards more “real” sectors to assess not only their performance, but also what their guidance is for the future.

Recent local data...

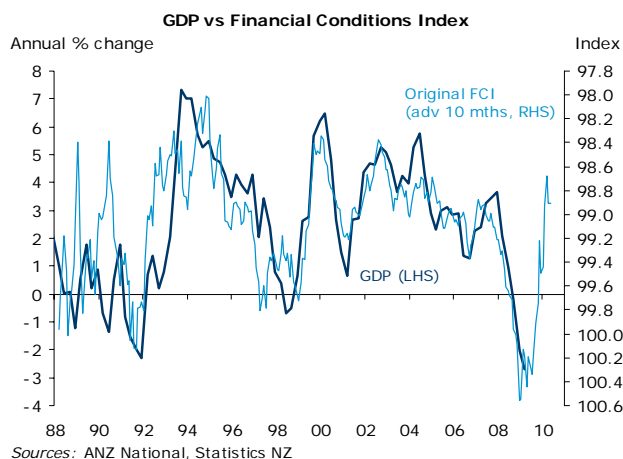
- > **NZIER Quarterly Survey of Business Opinion (June quarter):** Headline business confidence and domestic trading activity expectations both rose in the quarter. However, sentiment towards profit, employment and investment remains weak.
- > **Electronic Card Transactions (June):** Total retail card spending fell 1.0 percent in the month, while core spending fell 1.2 percent.
- > **REINZ House Sales (June):** In seasonally adjusted terms, the number of house sales rose 9.3 percent in the month, and the median days to sell fell 1 day to 40 days. House prices are now flat on a year ago.

NZ FINANCIAL CONDITIONS REVAMP AND UPDATE

We have upgraded our NZ Financial Conditions Index to incorporate retail as opposed to wholesale interest rates. The historical fit remains tight. Our revamped FCI still points to a recovery, but of a more muted magnitude relative to our old measure. Such divergences highlight the uncertainty surrounding any recovery, particularly given structural changes within the economy, an example of which being new RBNZ liquidity rules.

Our Financial Conditions Index (FCI) has proven to be a very timely leading gauge of economic growth, and has been successful in picking the turning points in the economic cycle. We include a wide array of variables to capture the different channels through which monetary policy influences the economy. Included in our FCI are the currency (adjusted for terms of trade movements), interest rates, asset prices, liquidity and proxies for the cost and supply of credit.

While our FCI has been accurate in predicting the sharp slowdown in growth that has occurred to date, we continually seek to improve it. In NZ we are seeing deposit rates as opposed to wholesale rates dictating retail borrowing rates. The credit channel of monetary policy is more prominent.

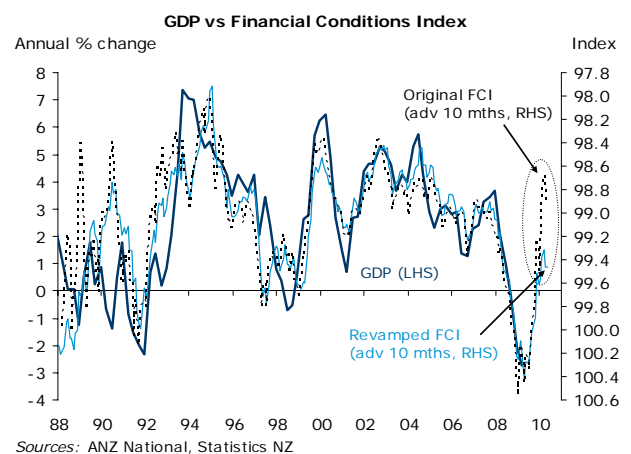


The last revamp of our FCI earlier this year saw the inclusion of a proxy to capture the supply of credit, using the US Federal Reserve's Senior Loan Officer Opinion Survey on Bank Lending Practices. We had to use the Fed survey due to a lack of a comparable series in NZ. However, this is being rectified, with both the National Bank *Business Outlook* and the NZIER *Quarterly Survey of Business Opinion* now collecting information on the access to credit in NZ. But it will be some time before there is a sufficiently long times series which we can incorporate into our FCI. The "old" FCI was picking a turning point in GDP growth, with a rebound back into positive territory by early next year and

towards around 4 percent annual growth. This is encouraging, but after a very sharp decline in 2008/09.

In our latest revamp we have replaced the wholesale interest rates (90-day and 2-year swap yield) with the floating and 2-year fixed lending rates. All other inputs remain unchanged. This is somewhat cosmetic at one level, given that it has resulted in no material change over history. The rationale for using the lending rates is simple. Retail lending rates are what matters and these rates have disconnected from the wholesale curve. While we use retail housing borrowing rates, the spirit of the gap with the wholesale curve also applies to business rates. Looking forward, we do not see the competition for deposits – a key driver of retail rates – abating any time soon. In fact, with the RBNZ's new prudential liquidity policy for banks announced at the end of June (and covered in our *Market Focus* last week), the competition for deposits is likely to intensify as domestic financial institutions seek to raise more retail funding.

The new revamped FCI is still pointing to a turnaround in growth and back into positive territory by early next year. However, the recovery is potentially a lot more subdued with annual growth in the 1 to 2 percent region, half of what the old FCI was suggesting.



The upshot

Our latest revamped FCI still suggests that the worst is behind us, with a turning point in growth now before us. Hence, the turning point message is unchanged. However, our updated FCI casts doubt on the magnitude and pace of recovery. While we can debate the relative merits of such changes, one thing is obvious – there is considerable structural change going on within the economy. We are in no doubt "old school" indicators and relationships (coefficients and weights within such FCI's) will not apply going forward. In this environment, greater uncertainty will surround the outlook, and central banks are likely to remain very cautious and circumspect.

SECTION / APARTMENT LISTING UPDATE

Listings of sections and apartments continue to grow relative to the total number of listings on the market. Typical hotspots including Queenstown continue to feature, with sections and apartments representing more than 50 percent of total listings. Sections and the price of land remains an area where we believe a substantial proportion of the housing market correction will pan out.

The section and apartment sectors of the property market – traditionally more speculative areas – are often touted as being the pockets that are the most vulnerable in the property cycle. Higher interest rates or changes in the credit cycle often mean that these pockets can experience large price swings, relative to other types of property, as demand wanes. They tend to outperform at the top, but also turn more aggressively as the cycle turns.

Following on from the stories and anecdotes we regularly hear about the limited numbers of properties on the market (and what we discussed in last week's *Market Focus*), there is often no real comments about the composition. Moreover, a lot of people are missing a key point about this housing cycle: it is a land price adjustment as opposed to a normal house price correction.

The following table and analysis, which was last updated in January, shows the number of sections and apartments for sale, relative to the total number of properties on the market. It is based on data from the Trade Me website (which provided easy access to this type of data). Although it is somewhat of a crude indicator and suffers from drawbacks (i.e. the same property can be listed multiple times and some people use the vehicle more than others), we feel it is still reasonably effective nonetheless. The simple reality is that nothing is perfect (and even NZ's hard data is notoriously volatile) so you have to make do with what is available. The key when looking at partial data is to rely on broad themes as opposed to relying explicitly on the detail.

The table ranks the various regions from highest to lowest and also shows their movement compared with January and other dates in the past when we have looked at the relationship.

So what does it show?

- > The number of sections and apartments listed relative to total listings across the whole country sits at 35 percent. This is up from 31 percent in both October 2008 and January 2009. Looking at the change between January and July, every region except one (Rodney) has seen an increase. The average increase across

the entire country was 3.7 percent, while the median increase was slightly less at 3.2 percent. Interestingly, 12 regions now have sections and apartments making up more than 40 percent of their total listings.

- > In general, the relative rankings of the regions are broadly similar to how they have been in the past. That is, those regions that had a high (low) proportion of sections and apartments for sale in the past typically have a high (low) proportion now, with obviously some structural issues dominating for some regions (i.e. Auckland City naturally has a shortage of land and so sees more apartment listings). Queenstown Lakes once again tops the rankings, as it has done every time we have done this analysis since June 2008.
- > However, where the biggest change has occurred is in the top ten ranked regions. Nelson has been steadily rising to now sit second on the table after being the 22nd ranked region in June 2008, although it is interesting to note that the Tasman region has been doing the opposite. The biggest movers look to be Upper Hutt, where the proportion of sections and apartments has jumped from 15.9 percent in June 2008 to now be 48.1 percent, and to a lesser extent Selwyn. At the other end of the scale, Taupo, Thames/Coromandel and Waitaki have all experienced a reasonably marked fall down the rankings.
- > While there remains a holiday or retirement destination theme (although arguably not nearly as strong as previous updates, with Taupo, Tasman and Thames/Coromandel falling), it is interesting to note the movement up the rankings in some of the larger cities (Wellington City, Manukau City and to a lesser extent North Shore City). There is also the question of whether some of the other tourist destinations (Northland and Queenstown) are due to play catch up to the likes of the ones that appear to have already adjusted lower?

The upshot

The supply of sections and apartments relative to the total stock of houses for sale continues to increase. While this partly reflects a decline in the number of core housing listings, the bottom line is a rising ratio still tells us that sections and apartments are proving "stickier" and more difficult to shift.

Sections and the price of land remains an area where we believe a substantial proportion of the housing market correction will pan out.

Number of sections and apartments for sale, relative to total properties for sale

	% of total				% chg Jul-Jan	Ranking			
	Jul-09	Jan-09	Oct-08	Jun-08		Jul-09	Jan-09	Oct-08	Jun-08
Queenstown Lakes	54.1	51.8	53.8	52.1	2.3	1	1	1	1
Nelson City	48.9	41.8	42.6	26.2	7.1	2	6	6	22
Upper Hutt	48.1	34.8	31.3	15.9	13.3	3	13	20	32
Northland - Far North	47.9	45.4	46.2	42.7	2.5	4	2	2	3
Auckland City	46.9	41.9	44.1	43.8	5.0	5	5	3	2
West Coast	46.5	43.2	42.9	36.6	3.2	6	3	4	5
Wellington City	44.5	38.1	38.1	28.0	6.5	7	10	11	18
Selwyn	43.6	40.5	36.2	26.3	3.1	8	7	13	21
Kaikoura	43.2	43.2	38.5	32.0	0.0	9	4	10	15
Central Otago ex Qtwn	43.1	31.7	42.7	36.1	11.5	10	19	5	7
Northland - Whangarei	41.2	39.7	40.6	33.1	1.5	11	9	8	12
Thames/Coromandel	40.2	39.9	41.2	39.4	0.3	12	8	7	4
Hurunui, Hanmer	39.1	36.8	28.5	32.5	2.2	13	11	26	13
Manukau City	37.4	31.3	18.1	14.0	6.2	14	20	34	36
Gisborne	36.6	27.6	24.8	27.2	9.0	15	28	29	19
Western BoP	36.1	31.9	29.1	28.4	4.2	16	18	22	17
Franklin	35.9	34.3	32.1	16.7	1.6	17	14	18	31
Rodney	34.6	36.0	35.2	32.4	-1.4	18	12	14	14
Taupo	34.0	33.2	36.8	35.2	0.7	19	15	12	8
North Shore City	33.4	29.7	28.9	23.7	3.7	20	23	23	26
Hauraki	33.3	32.5	31.5	28.9	0.8	21	16	19	16
Waitakere	33.2	32.1	32.3	22.5	1.1	22	17	16	27
Kapiti Coast	32.9	28.3	23.4	20.7	4.5	23	26	30	29
Hamilton City	32.3	27.8	22.0	21.5	4.5	24	27	32	28
Tasman	32.3	30.5	39.2	36.5	1.8	25	21	9	6
Papakura	32.3	29.4	32.1	33.2	2.9	26	24	17	11
Tauranga City	31.3	29.3	30.6	25.4	2.0	27	25	21	23
Southland	30.8	23.9	21.7	24.1	6.9	28	31	33	24
Whakatane	30.4	30.1	28.6	26.8	0.3	29	22	25	20
Waitaki	30.1	26.8	28.8	33.8	3.3	30	29	24	9
Taranaki	28.9	25.4	25.0	23.8	3.5	31	30	28	25
Dunedin City	27.6	19.6	22.1	15.0	8.0	32	33	31	34
Waimakariri	24.4	23.5	26.5	20.3	0.9	33	32	27	30
Manawatu/Wanganui	22.7	19.1	18.0	15.2	3.7	34	34	35	33
Hawke's Bay	21.1	17.8	16.9	14.9	3.3	35	35	36	35
Christchurch City	20.4	16.4	16.1	10.8	4.0	36	36	37	37
Marlborough	19.2	16.4	34.4	33.5	2.9	37	37	15	10
Timaru	17.6	15.6	8.6	9.4	2.0	38	38	40	38
Lower Hutt	17.6	11.5	11.3	7.8	6.1	39	40	39	40
Rotorua	14.9	13.2	12.6	9.4	1.7	40	39	38	38

INTEREST RATE STRATEGY

Increased risk aversion offshore and an expected soft CPI print domestically should see the bias remain firmly on the receive side in the local rates market. Increased bid tone for bonds as the various maturities find their way back into the market should see bonds outperform swaps yet again.

Market themes...

- > OSBO shows NZ economy still in recession, though pace of contraction is moderating.
- > Disappointing offshore data casts further doubts over the global recovery story.
- > Safe haven flows benefiting swaps and bonds.
- > More receiving interest expected as risk aversion rises, at the expense of risk assets.

Review and outlook

The domestic dataflow last week reinforced the message that the RBNZ will not be in play for some time. The QSBO painted a picture of an economy still in recession and needing loose and stimulative policy settings. While the housing market continues to recover, housing turnover has merely reached a level that is consistent with the troughs in past housing market downturns. And ECT data shows that consumers are still leaving their credit/debit/EFTPOS cards at home when they leave the house.

We saw another rally in the NZ rates market last week, though the moves massively underperformed those in Australia and the US, where yields fell as much as 23 and 30bps respectively, compared to just 6bps in NZ. NZ bonds again outshone swaps, despite a bond tender that was not as well bid as expected. We expect the bid tone to remain in the NZ bond market as the various maturities this month (July 2009 bonds, uridashi and eurokiwi) see money flow back into the 2011's and 2013's. We could also see some funds extend duration of their portfolios to take advantage of the steep yield curve and a low for longer environment for rates, providing support for the long end.

Receivers should continue to have the upper hand this week on ongoing global risk aversion. Inflation prints around the globe (including NZ's on Thursday) are expected to show subdued inflation trends and keep talk of end of year rate hikes at bay. Safe haven flows will dominate as investors continue to flee risk assets, and it looks increasingly like bonds are the sole safe haven destination at present, given that gold has been shunned of late. All these point to further moves down in yields for NZ swaps and bonds, though we suspect the NZ market will again under perform offshore counterparts. The low for longer message

will continue to gain traction in this environment, and see the OIS and bank bill futures push out the rate hikes currently priced in further into next year.

Borrowing strategies we favour at present

Floating rates remain the cheapest part of the curve, and rate hikes still look to be at least 12 months away. As such, our favoured strategy is still to go floating, or simply roll a series of short fixes, rather than to fix for a longer period. Consideration can also be given to the use of options as a way to hedge further out. In our *Borrowers Strategy* publication last week, we presented an example of Interest Rate Caps which provides protection against rate rises but allows full participation in lower floating rates, for a premium.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ / OCR	↔	On hold with easing bias. Further cuts unlikely but hikes still a long way off.
NZ data	↔	Housing market may continue to recover, but the dole queue keeps growing and this week's CPI to show muted inflation.
Fed Funds / front end	↔	Turnaround in US consumer confidence to keep talk of hikes at bay.
RBA	↔	More upbeat statement but still happy to retain the easing bias.
US 10 year	↔/↓	Benefiting from safe haven flows.
NZ swap curve	↔/↓	We still like the flattening move.
Flow	↔/↓	Bond maturities should see bid tone as money finds its way back into the market.
Technicals	↔	NZ swaps still range trading.

Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 30-Jul-09	-6	-5
Thu 10-Sep-09	-6	-7
Thu 29-Oct-09	-5	-6
Thu 10-Dec-09	-3	-5
Thu 21-Jan-10	+7	+4
Thu 11-Mar-10	+20	+12
Thu 29 Apr-10	+34	+29

Trading themes we favour at present

Nothing has changed to alter our preferred trading strategy. Recent offshore concerns over the global recovery story leave us comfortable with long outright in the March and June bank bill futures. And we still favour 2s10s flatteners.

CURRENCY STRATEGY

Weak equity sentiment, deteriorating risk appetites and lower commodity prices has the commodity bloc on the back foot. The NZD has been surprisingly resilient but risks playing catch-up. With the US earnings season heading into full swing, and expectations being lowered daily, this week is all about more downside risk for the NZD.

Market themes...

- > Risk aversion rising – earnings season underway.
- > Commodities remain under pressure.
- > JPY storms higher.
- > Bond maturity profile – waiting and watching.

Review and outlook...

Risk aversion came to the fore last week. Concerns are centred on the US earnings season, with the effects of the global economic slowdown expected to show through in company results. Over the week the S&P 500 closed down 1.7 percent, US 10 year yields traded down 20bps to 3.3 percent, the VIX index at one point reached 33 and the EURJPY lost nearly 4 percent. The Japanese economy is poor but the JPY is up 6 percent in four weeks. Commodities had a torrid week with a number of factors working against them. The recent elevation in concerns over global growth has seen oil hit aggressively; down nearly 20 percent in two weeks. The CRB index, a broader measure of commodity prices, was down 4.9 percent last week alone.

The NZD was initially caught in the crossfire breaking key support at around 0.6240 and briefly pushing below 0.6200 before staging a recovery to finish the week largely unchanged. But across the commodity bloc, the NZD has been lagging on this move, and the weeks ahead may well be all about catch-up.

The currency options market has seen a marked increase in puts (downside protection) being bought in the NZD and AUD by offshore counterparties – potentially portending of things to come. All was quiet on the uridashi front last week, with no new issue announced. As previously highlighted this month is a large redemption month so we continue to watch this space closely.

Looking to the week ahead, we doubt domestic news in relation to the CPI and retail sales will bring a NZ specific story to the fore. For the bird, the key issue remains the global scene and earnings announcements will be key. The decline in equities over the past weeks needs to be put in perspective – they had risen 40 percent since February. But clearly the market looks to be searching for

substance and is lacking conviction on the recovery front. In this sort of environment the NZD is prone to playing catch-up. Domestically, the big elephants in the room are the unemployment rate and dairy payout but it may well be August (the Q2 HLFS) before they give a domestic push to the kiwi's moves.

Last week's high of 0.6396 will be the major level of resistance for the week. However sellers will initially target 0.6330. Horizontal support at 0.6230 should be tested early in the week with a break of this targeting the key 0.6180 level.

NZD vs AUD: monthly directional gauges

Gauge	Direction	Comment
Fair value	↔	Within the range.
Yield	↓	Yield advantage Australia.
Commodities	↔	Concerns rising over Australia's export basket on the back of weaker Asia demand. Dairy still weak.
Partial indicators	↔/↓	Data this week to confirm the NZ economy lags.
Technicals	↔/↓	0.8080 to 0.8100 important resistance.
Sentiment	↔/↑	AUD bearing the brunt of risk aversion.
Other	↔	Positioning working against the AUD.
On balance	↓	Negatives here but not the focus.

NZD vs USD: monthly directional gauges

Gauge	Direction	Comment
Fair value – long-term	↔/↓	Above long term average.
Fair value – short-term	↔	Slightly above cyclical fair value estimates.
Yield	↔/↓	NZ yields lower, NZD yet to follow.
Commodities	↔/↓	CRB under pressure.
Risk aversion	↓	Rising...
Partial indicators	↔	Stating to disappoint.
Technicals	↔/↓	Downside levels vulnerable.
AUD	↔/↓	On the back foot.
Sentiment	↔	NZD cyclical play versus USD structural story.
Other	↔	Turning point for the USD?
On balance	↓	Downside pressure growing.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
13-Jul	NZ	Retail Sales (May) - mom	0.2%	0.5%	10:45
		Retail Sales Ex-Auto (May) - mom	0.5%	-0.1%	10:45
	JN	Industrial Production (May F) - mom	-	5.9%	16:30
		Capacity Utilization (May F) - mom	-	10.2%	16:30
		Consumer Confidence (Jun)	-	36.3	17:00
	EC	ECB's Trichet Speaks at IFO Seminar in Munich	-	-	22:30
14-Jul	US	Monthly Budget Statement (Jun)	-\$97.0B	\$33.5B	06:00
	UK	RICS House Price Balance (Jun)	-4.0%	-44.1%	11:01
		DCLG UK House Prices (May) - yoy	-12.6%	-13.0%	20:30
		CPI (Jun) - mom	0.3%	0.6%	20:30
		CPI (Jun) - yoy	1.8%	2.2%	20:30
		Core CPI (Jun) - yoy	1.6%	1.6%	20:30
		RPI (Jun) - mom	0.3%	0.6%	20:30
	AU	NAB Business Conditions (Jun)	-	-14	13:30
		NAB Business Confidence (Jun)	-	-2	13:30
	NZ	Non-Resident Bond Holdings (Jun)	-	73.3%	15:00
	GE	ZEW Survey (Econ. Sentiment) (Jul)	47.8	44.8	21:00
		ZEW Survey (Current Situation) (Jul)	-88.0	-89.7	21:00
	EC	ZEW Survey (Econ. Sentiment) (Jul)	44.0	42.7	21:00
		Industrial Production (May) - mom	1.5%	-1.9%	21:00
15-Jul	US	Producer Price Index (Jun) - mom	0.9%	0.2%	00:30
		PPI Ex Food & Energy (Jun) - mom	0.1%	-0.1%	00:30
		Advance Retail Sales (Jun) - mom	0.4%	0.5%	00:30
		Retail Sales Less Autos (Jun) - mom	0.5%	0.5%	00:30
		Business Inventories (May)	49.3	-1.1%	02:00
	AU	Westpac Leading Index (May) - mom	-	0.7%	13:00
	JN	BoJ Target Rate	0.10%	0.1%	-
		Machine Tool Orders (Jun F) - yoy	-	-73.1%	18:00
	UK	Claimant Count Rate (Jun)	5.0%	4.8%	20:30
		Jobless Claims Change (Jun)	41.3K	39.3K	20:30
		Average Earnings inc bonus (May) - 3m/yoy	2.1%	0.8%	20:30
		ILO Unemployment Rate (3mths) (May)	7.4%	7.2%	20:30
	EC	CPI (Jun) - mom	0.2%	0.1%	21:00
		CPI (Jun) - yoy	-1.0%	0.0%	21:00
		CPI - Core (Jun) - yoy	1.5%	1.5%	21:00
16-Jul	US	Consumer Price Index (Jun) - mom	0.6%	0.1%	00:30
		CPI Ex Food & Energy (Jun) - mom	0.1%	0.1%	00:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
16-Jul cont.	US	Consumer Price Index (Jun) - yoy	-1.5%	-1.3%	00:30
		CPI Ex Food & Energy (Jun) - yoy	1.7%	1.8%	00:30
		Empire Manufacturing (Jul)	-5.00	-9.41	00:30
		Industrial Production (Jun)	-0.6%	-1.1%	01:15
		Capacity Utilization (Jun)	67.9%	68.3%	01:15
		Minutes of June 24 FOMC Meeting	-	-	06:00
	NZ	Business NZ PMI (Jun)	-	42.7	10:30
		Food Prices (Jun) - mom	-	0.3%	10:45
		Consumer Prices (2Q) - qoq	0.5%	0.3%	10:45
		Consumer Prices (2Q) - yoy	1.8%	3.0%	10:45
	JN	Tertiary Industry Index (May)	0.3%	2.2%	11:50
	AU	RBA Foreign Exchange Transactions (Jun)	-	1433M	13:30
17-Jul	US	Initial Jobless Claims (w/e Jul-12)	554K	565K	00:30
		Continuing Claims (w/e Jul-5)	6850K	6883K	00:30
		Net Long-term TIC Flows (May)	\$25.0B	\$11.2B	01:00
		Philadelphia Fed (Jul)	-5.0	-2.2	02:00
		NAHB Housing Market Index (Jul)	16	15	05:00
	AU	Import price index (2Q) - qoq	-6.0%	-2.8%	13:30
		Export price index (2Q) - qoq	-16.0%	-4.6%	13:30
	JN	Coincident Index CI (May F)	87.1	86.9	17:00
		Leading Index CI (May F)	76.8	77.0	17:00
	EC	Trade Balance s.a. (May)	0.0B	-0.3B	21:00
		Construction Output (May) - mom	-	0.6%	21:00
18-Jul	US	Housing Starts (Jun)	528K	532K	00:30
		Building Permits (Jun)	524K	518K	00:30

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: Leading indicators continue to be the major focus over the coming weeks to help determine how quickly (if at all) the economy is bouncing back. In this regard, the July NBNZ *Business Outlook* at the end of the month will be important. The RBNZ's decision looms large at the end of the month, although we expect the OCR to be left unchanged.

Date	Data/Event	Economic Signal	Comment
Thu 16 Jul (10.45)	CPI (Jun qtr)	Not a focus	We expect headline inflation to rise 0.3 percent in the quarter, taking annual inflation to 1.6 percent. The significant spare capacity now present in the domestic economy should weigh on non-tradable inflation.
Tue 21 Jul (10.45)	International Travel and Migration (Jun)	Solid support	Net migration inflows are expected to remain solid as fewer New Zealanders choose to leave. Visitor arrivals should remain weak.
Tue 28 Jul (10.45)	Overseas Merchandise Trade (Jun)	Positive rebalancing signs	A monthly trade deficit is typically recorded in June months. However, there is the possibility of a trade surplus as the weak domestic economy and inventory adjustment continues to weigh on import demand.
Wed 29 Jul (10.45)	Building Consents Issued (Jun)	Rebounding or record lows	While the level of consent issuance should remain very low, the recent pick-up in house sales activity should see consents begin to recover.
Wed 29 Jul (15.00)	NBNZ <i>Business Outlook</i> (Jul)	-	-
Thu 30 Jul (09.00)	RBNZ <i>OCR Review</i>	On hold	While the RBNZ will remain concerned about market prices and the elevated NZD, we expect them to hold the OCR at 2.50 percent. They will repeat their "low for an extended period" mantra.
Thu 30 Jul (15.00)	Credit Growth (Jun)	Housing improving, but overall credit still weak.	Housing credit growth may start to recover given the improvement in house sales activity. However, business and rural credit growth is likely to remain under pressure.
Tue 4 Jul (10.45)	LCI & QES (Jun qtr)	Softening quickly	While a lagging indicator, wage growth is easing as the economic backdrop and rising unemployment makes it difficult for workers to push for larger wage increases.
Thu 6 Jul (10.45)	HLFS (Jun qtr)	Continuing to turn sharply	Trends in the number of people signing up for the unemployment benefit clearly shows that the unemployment rate is rising sharply. Another large contraction in employment is also expected.
On Balance		Base forming?	With Q1 data out of the way, attention now turns to how Q2 fared and on signs of green shoots. We expect any recovery to be subdued as we move along the bottom of the bath tub.

SUMMARY OF KEY ECONOMIC FORECASTS

	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
GDP (% qoq)	-0.2	-0.5	-1.0	-1.0	-0.7	-0.3	0.1	0.4	0.8	1.2
GDP (% yoy)	1.0	-0.2	-2.1	-2.7	-3.2	-3.0	-1.9	-0.5	1.0	2.5
CPI (% qoq)	1.6	1.5	-0.5	0.3	0.3	0.7	0.5	0.3	0.7	0.7
CPI (% yoy)	4.0	5.1	3.4	3.0	1.6	0.8	1.8	1.8	2.2	2.2
Employment (% qoq)	1.2	0.2	0.6	-1.1	-1.0	-0.9	-0.4	-0.2	0.0	0.2
Employment (% yoy)	0.8	1.1	0.9	0.8	-1.3	-2.4	-3.4	-2.5	-1.5	-0.4
Unemployment Rate (% sa)	4.0	4.3	4.7	5.0	5.6	6.4	7.0	7.5	7.7	7.9
Current Account (% GDP)	-8.4	-8.7	-9.0	-8.5	-6.8	-5.8	-5.0	-4.8	-5.1	-5.1
Terms of Trade (% qoq)	-0.4	-1.0	-1.0	-3.0	-2.0	-2.0	-1.4	-1.1	-0.9	0.4
Terms of Trade (% yoy)	10.7	5.8	1.8	-5.2	-6.8	-7.7	-8.1	-6.3	-5.3	-3.0

KEY ECONOMIC INDICATORS

	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09	Feb-09	Mar-09	Apr-09	May-09	Jun-09
Retail Sales (% mom)	0.4	-1.3	0.0	-0.5	-1.2	0.2	-0.2	0.5
Retail Sales (% yoy)	2.2	0.7	-4.1	-0.9	-3.7	-6.9	-1.9	-1.7
Credit Card Billings (% mom)	1.4	-1.8	-0.8	-2.2	1.6	0.8	-2.8	2.4	-0.4	..
Credit Card Billings (% yoy)	2.5	0.9	-0.9	-3.8	-2.4	-1.9	-4.8	-1.6	-2.4	..
Car Registrations (% mom)	10.7	-0.9	-19.9	12.9	-14.1	-15.1	8.3	-2.4	-3.1	5.4
Car Registrations (% yoy)	-15.6	-19.9	-34.4	-23.7	-36.5	-44.6	-32.9	-41.0	-33.3	-29.6
Building Consents (% mom)	8.4	-20.0	3.9	-6.8	-12.8	12.4	-0.9	11.9	3.5	..
Building Consents (% yoy)	-28.2	-43.2	-39.6	-41.5	-51.4	-39.9	-34.3	-56.5	-22.9	..
REINZ House Price (% yoy)	-6.1	-4.3	-4.1	-4.8	-4.4	-2.2	-4.0	-1.4	-2.2	0.0
Household Lending Growth (% mom)	0.2	0.1	-0.1	0.2	0.2	0.2	0.1	0.2	0.4	..
Household Lending Growth (% yoy)	6.6	5.8	4.8	4.2	3.8	3.1	2.8	2.6	2.6	..
Roy Morgan Consumer Confidence	108.6	99.7	99.0	102.9	103.7	98.8	94.7	101.1	104.9	105.3
NBNZ Business Confidence	1.6	-42.3	-43.0	-35.0	..	-41.2	-39.3	-14.5	1.9	5.5
NBNZ Own Activity Outlook	16.7	-11.4	-14.1	-21.5	..	-20.1	-21.2	-3.8	3.8	8.3
Trade Balance (\$m)	-1252	-994	-594	-341	-102	483	439	319	858	..
Trade Balance (\$m annual)	-5048	-5269	-5234	-5614	-5405	-5165	-4683	-4072	-3044	..
ANZ World Commodity Price Index (% mom)	-5.1	-7.6	-7.4	-7.4	-4.3	-4.6	1.0	2.6	2.8	0.2
ANZ World Commodity Price Index (% yoy)	-2.1	-11.1	-18.3	-24.3	-26.5	-30.7	-31.4	-29.4	-28.1	-27.9
Net Migration (sa)	10	80	-240	350	840	1630	1740	2170	2690	..
Net Migration (annual)	4403	4329	3569	3814	4538	6160	7482	9176	11202	..

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)						
	May-09	Jun-09	13-Jul-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
NZD/USD	0.598	0.637	0.629	0.580	0.550	0.540	0.540	0.550	0.560	0.580
NZD/AUD	0.785	0.795	0.806	0.763	0.753	0.735	0.730	0.733	0.737	0.734
NZD/EUR	0.439	0.455	0.451	0.460	0.444	0.443	0.450	0.458	0.467	0.475
NZD/JPY	57.8	61.6	58.1	56.8	52.3	52.4	54.0	56.7	58.8	62.1
NZD/GBP	0.389	0.389	0.388	0.367	0.355	0.355	0.360	0.372	0.378	0.387
NZ\$ TWI	57.9	60.3	59.54	57.4	54.9	54.3	54.8	56.0	57.0	58.4
NZ interest rates	May-09	Jun-09	13-Jul-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
OCR	2.76	2.74	2.50	2.50	2.50	2.50	2.50	2.50	3.00	4.00
90 day bill	2.82	2.78	2.81	2.80	2.80	2.80	2.80	2.80	3.60	4.50
10 year bond	5.74	6.24	5.62	5.80	5.60	5.70	5.70	6.10	6.30	6.40
International	May-09	Jun-09	13-Jul-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.25
US 3-mth	0.66	0.60	0.51	0.70	0.50	0.70	0.80	1.25	1.50	2.00
AU cash	3.00	3.00	3.00	3.00	2.50	2.50	2.50	2.50	2.75	3.25
AU 3-mth	3.19	3.25	3.12	2.90	2.80	2.80	2.80	3.00	3.30	4.40

KEY RATES

	10 Jun	6 Jul	7 Jul	8 Jul	9 Jul	10 Jul
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.72	2.80	2.79	2.80	2.80	2.80
NZGB 07/09	2.63	2.64	2.64	2.62	2.50	2.50
NZGB 11/11	3.73	3.63	3.60	3.59	3.60	3.65
NZGB 04/13	4.77	4.63	4.60	4.57	4.56	4.62
NZGB 12/17	5.95	5.73	5.70	5.64	5.58	5.63
2 year swap	3.64	3.72	3.74	3.69	3.67	3.68
5 year swap	5.14	5.24	5.28	5.23	5.19	5.17
RBNZ TWI	59.6	59.5	60.2	59.7	59.5	59.6
NZD/USD	0.6296	0.6285	0.6358	0.6281	0.6273	0.6295
NZD/AUD	0.7824	0.7899	0.7979	0.7993	0.8027	0.8047
NZD/JPY	61.44	60.08	60.62	59.28	58.41	58.54
NZD/GBP	0.3859	0.3855	0.3905	0.3905	0.3900	0.3857
NZD/EUR	0.4472	0.4495	0.4549	0.4517	0.4511	0.4502
AUD/USD	0.8047	0.7957	0.7968	0.7858	0.7815	0.7823
EUR/USD	1.4078	1.3982	1.3978	1.3906	1.3906	1.3984
USD/JPY	97.59	95.59	95.34	94.38	93.11	92.99
GBP/USD	1.6317	1.6302	1.6281	1.6085	1.6086	1.6323
Oil	70.02	66.68	64.06	60.15	60.15	60.36
Gold	959.80	930.55	924.75	909.00	911.80	915.10
Electricity (Haywards)	4.28	4.65	4.55	5.61	6.67	n/a
Milk futures (US\$/contract)	86	87	86	86	86	86
Baltic Dry Freight Index	3452	3375	3216	3107	3018	2985

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.
- The Bank has a joint venture relationship with ING (NZ) Holdings Limited (ING). ING and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

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

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

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

NEW ZEALAND DISCLAIMER

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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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