

NEW ZEALAND ECONOMICS MARKET FOCUS

14 November 2011

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TRUCKING ALONG

ECONOMIC OVERVIEW

We're still seeing modest momentum across the economy but are increasingly alert to 1) global challenges, and 2) more signs of flakiness in the local dataflow. The latter is not poor (with today's retail figures a timely positive boost), but more mixed signals are keeping us alert to the possibility that the economy may have hit an inflection point. We expect fragmentation in the dataflow to continue, with this week's National Bank Regional Trends providing an indication of how much of a potential lift the Rugby World Cup provided to Q3 activity. The next Fonterra auction will show how a key pillar of support is faring, while offsetting cost side influences will be evident in the broader Q3 price data.

THE ANZ TRUCKOMETER

The ANZ Truckometer is a new economic indicator derived using traffic volumes data. It has a 6 month lead to GDP growth and is best thought of as an indicator of economic base momentum. It has been volatile of late but consistent with ongoing sluggish trend growth. However, a sharp fall in October is a potential red flag. The Truckometer will be released on a monthly basis.

INTEREST RATE STRATEGY

The "risk" pendulum has swung wildly, and is back at optimism this morning. We suspect the current correction will persist for a few days. However, with Italian bonds still above 6 percent, and talk that Germany is seeking to include exit clauses for the Euro area, we suspect the optimism will fade once the short covering rally fades. New Zealand bond yields are the most attractive of the non-basket case developed markets, and we prefer to play it from the long side, with a bias for flatteners.

CURRENCY STRATEGY

The FX markets seem remarkably stable considering the risk of contagion that erupted in Europe last week. In particular, EUR seemed resilient trading within a relatively small 2-3 percent range. A modicum of political stability with the appointment of technocrats to lead Greece and Italy has provided a positive boost to sentiment, but this may not last. US data continues to show a slow return to growth but not enough to spur USD support. Given the light local dataflow this week, expect NZD and AUD to be driven by offshore events again. Any moves higher will be capped to the topside of recent ranges.

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FORTHCOMING EVENTS

GlobalDairyTrade auction (Wednesday, 16 November, early am). We expect a 2 percent fall in USD dairy prices to an average of around US \$3,450/tonne.

National Bank Regional Trends – Q3 (Wednesday, 16 November, 1:00pm).

SNZ Capital Goods Price Index – Q3 (Thursday, 17 November, 10:45am). A 0.5 percent increase is expected, underpinned by higher construction costs.

SNZ Producer Prices – Q3 (Thursday, 17 November 10:45am). Higher electricity prices to contribute to a 1.2 percent increase in input prices and a 0.8 percent increase in output prices.

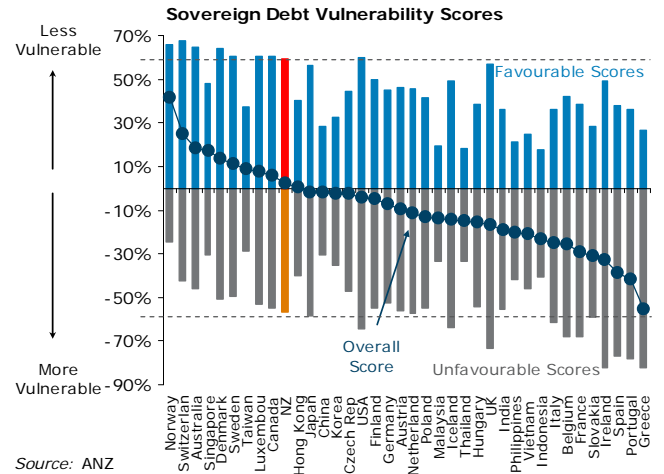
WHAT'S THE VIEW

Three points are notable from last week.

First, the situation in Europe remains worrying.

We've taken some encouragement from the appointment of Papademos and Monti at the helm of Greece and Italy respectively, as both have an aura of independence (if we can use such a term in the realms of politics) given their so-called technocrat backgrounds. Yet when we eye our Sovereign Debt analysis (refer chart below), financial conditions for the likes of Italy (refer last week), and simple sustainability measures, you get the feeling they are poisoned chalice jobs, aimed at loss minimisation as opposed to anything even close to a solution. Bellwethers of a true solution include European fiscal union, true group leadership and sufficient nominal GDP growth to avert the debt trap. We're seeing none of these and hence remain somewhat sceptical over how quickly "tail-risks" can subside. Last week Italian 10-year Government bond yields pushed past 7 percent, a euro-era high, their highest since 1997. But it's the growing dichotomy between Germany and

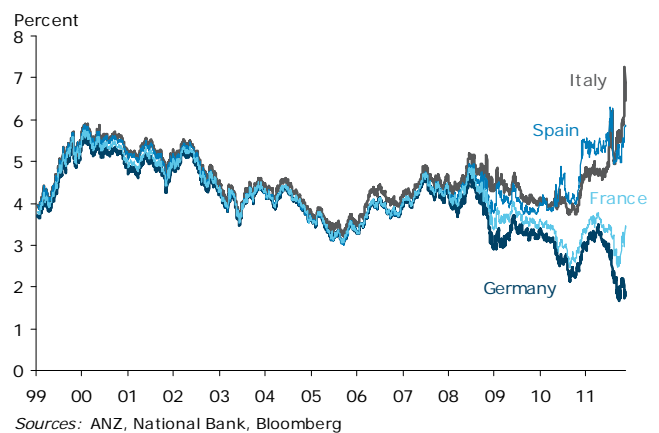
everyone else (including France) that is telling of intra-Europe tensions.



Second, given global ructions, the RBNZ Financial Stability Report highlighted that downside risks to economic and financial stability have increased, which is no surprise.

The RBNZ did concede that households and firms have been containing debt, but there are pockets of high leverage which remain vulnerable, particularly with offshore debt funding remaining an issue. While the RBNZ deem the local banks to be better placed in weathering current market turbulence than back in 2008, we note that there is reduced latitude to adjust policy settings. **The kitchen sink has now shrunk to a ladle.** We are now in an effective fiscal straightjacket and the OCR is at 2.5 percent versus 8.25 percent at the start of 2008.

10-year Government bond yields



Third, a dichotomy is shaping up between the relatively resilient lagging activity data (which cover the RWC period) and weaker forward looking indicators. Manufacturing sentiment plunged to its lowest level since May 2009, reflecting a combination of local and global influences.

ECONOMIC OVERVIEW

Electronic Card Transactions (ECT) showed a sizeable October increase, led by fuel and apparel, part of which was undoubtedly due to the Rugby World Cup (RWC). Today's Q3 retail trade data showed evidence of a sizeable RWC boost to the retail sector, with a 2.4 percent increase for core retail sales volumes (ex-fuel and vehicle related), the strongest quarterly increase since late 2006. It much more sizeable than the modest increase in the ECT data, and showed that the cash spending boost from the tournament was sizeable. Our pick for Q3 GDP (+0.8 percent q/q) remains on track, and with the tournament concluding last month, we expect a solid Q4 GDP result. Other consumer-centric data was guarded. The housing market failed to rebound in October, with sales around 30 percent below historical averages as a portion of the dwelling stock. Regional differences remained evident, with the Auckland market continuing to outperform. Consumer confidence was marginally lower in November. Last week's Government Financial Statements also showed tax revenue forecasts undershooting the Pre-election Economic and Fiscal Update (PREFU) forecasts by \$300m. No cause for immediate alarm, but something to which we will remain attuned.

The labour market is also showing signs of weakening. Official unemployment benefit numbers for October showed the first rise in eight months and our own job ads figures are showing signs of rolling over. We haven't yet seen the consistency across labour market gauges to be convinced a turning point has been reached. Our unemployment direction index, which collates current and lagged monthly labour market indicators to predict annual changes in the unemployment rate, is still pointing to a small improvement in the near term. But another weak month for job ads in November would go a long way to settling the debate.

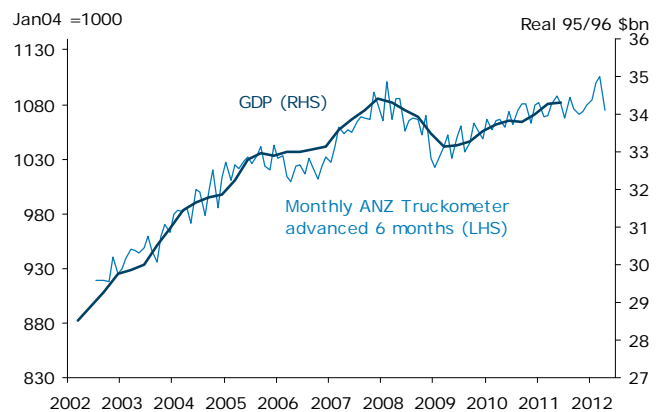
This combination is keeping us alert to the possibility that the economy may be hitting an inflection point. Certainly we're seeing semblances of that now. But with only a modest pace of growth to begin with and relatively mild swings in dataflow, one would be drawing a long bow to say such a point has been reached. Tensions across data are always going to manifest when you integrate the business cycle with structural challenges and seismic events. Amongst such cautious overtures we need to remind readers that relative to what we are seeing in other pockets of the global economy, New Zealand is holding up well. This may seem a hollow observation but such counter-factuals are important nonetheless.

We continue to take comfort from how the macro framework is responding to such mixed

signals. Fixed mortgage rates have fallen. The currency – notably the NZDAUD – is responding to local specifics (and some waning in New Zealand's momentum over Australia of late) far more so than the NZDUSD which is still risk sentiment driven. We're heading into an election and both the main political parties are selling the virtues of austerity and responsible government. This takes money out of the economy but also gives businesses certainty to plan ahead.

A key issue we have been grappling with is the degree of underlying momentum within the economy. There is an old adage – use a wide range of models but trust none of them! We have been steadily building up our analytical toolkit. Today we introduce the **ANZ Truckometer, a new economic indicator derived using traffic volumes data from around the country.** It is a real-time and timely real-world proxy for economic activity, as vehicle and cargo movements reside at the heart of the economy. The Truckometer shows a **six month lead on activity.** It points towards ongoing volatility around a sluggish trend over coming months, but notably the final month (October) dropped quite sharply. A summary of the ANZ Truckometer is on page 5.

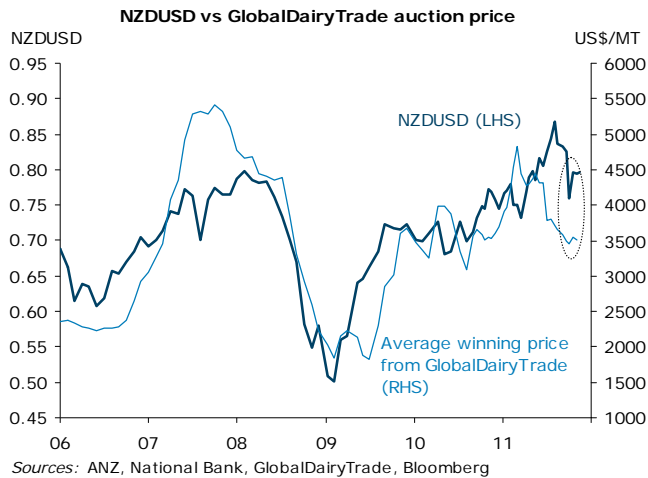
Monthly ANZ Truckometer and GDP levels



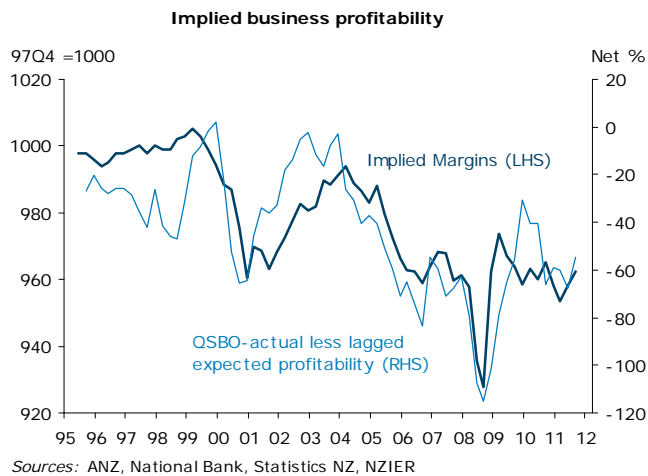
Sources: ANZ, NZ Transport Agency, Statistics NZ

The local data calendar for the rest of the week is light, but will shed more light on one of the key pillars of economic support. We are expecting a small fall in dairy prices in this week's GlobalDairyTrade auction, with the stronger USD and reasonably high volumes on offer weighing on USD prices. The key takeout will be prices remaining at historically high levels, with the lower NZD proving an offset for producer returns.

ECONOMIC OVERVIEW



The National Bank Regional Trends provide some regional flavour. We will be keeping a close eye on what is happening in Canterbury. Our internal anecdotes show that while insurance issues remain a major obstacle, demolition activity remains flat-out and firms are looking at ways of circumventing insurance issues.



Producer and capital good prices are envisaged to reflect differences in sector cost pressures, rather than demand-side influences. The high NZD is expected to contribute to further falls in imported capital equipment, with rising raw material and labour costs expected to drive an increase in construction costs.

A higher rate of producer price inflation is expected, given widespread cost pressures, with increases in wholesale electricity prices a key influence in Q3. Implied producer margins are well below what they were during the halcyon period for investment or employment. This could scupper the durability of the upswing.

RECENT LOCAL DATA

SNZ Electronic Card Transactions – October. Retail-related ECT rose 1.5 percent s.a. (8.0 percent y/y). Core ECT spending rose 0.9 percent s.a. (6.9 percent y/y).

RBNZ Financial Stability Report. The New Zealand banking system is better placed to weather the current market turbulence than at the outbreak of the financial crisis in 2008. However, risks to New Zealand's economy and financial system have increased in recent months.

BNZ Business NZ Manufacturing PMI – October. The headline PMI fell to 46.5 s.a. from 50.5 in the previous month. All five diffusion indices declined below 50.

ANZ Roy Morgan Consumer Confidence – November. Headline consumer confidence fell 3 points to 109. Current conditions eased 4 points (to 100.6), with future conditions down 3 points (to 114.6).

Government Financial Statements – 3 months to September. The operating balance before gains and losses was in deficit of \$2,480m, with net public debt at \$45,247m (22.6 percent of GDP).

SNZ Food Price Index – October. Food prices fell 1.3 percent (+1.1 percent y/y).

ANZ Job Ads – October. Job ads fell 2.5 percent s.a. in October. Internet job ads fell 1.6 percent, with newspaper advertisements down 6.4 percent s.a. Our composite indicator fell 4.1 percent s.a.

REINZ housing market report – October. House sales fell a seasonally adjusted 2.5 percent (+28.3 percent y/y). The median days to sell was unchanged on 39 days s.a., with the house price index down 0.5 percent s.a. (+3.4 percent y/y).

SNZ Retail Trade Survey – Q3. Retail values rose a seasonally adjusted 2.1 percent, with core values up 2.7 percent s.a. Retail volumes rose 2.2 percent s.a. and core volumes rose 2.4 percent s.a.

ANZ TRUCKOMETER

SUMMARY

The ANZ Truckometer is a new economic indicator derived using traffic volumes data. It has a 6 month lead to GDP growth and is best thought of as an indicator of economic base momentum. It has been volatile of late but consistent with ongoing sluggish trend growth. However, a sharp fall in October is a potential red flag. The Truckometer will be released on a monthly basis.¹

ABOUT THE TRUCKOMETER

The ANZ Truckometer is a new economic indicator derived using traffic volumes data from around the country. It is a real-time and real-world proxy for economic activity, as vehicle and cargo movements reside at the heart of an economy – particularly the New Zealand economy, where a very high proportion of freight is moved by road. Given that traffic data is available within a matter of days, it represents a timely barometer of momentum in the economy.

With soft leading indicators (i.e. confidence surveys) suffering from the vexing question of whether confidence will actually translate into actual decisions, timely hard economic indicators such as traffic movements are a critical gauge to watch, for picking turning points in the economy as they happen. **The ANZ Truckometer shows a strong leading relationship to GDP, giving a six month lead on activity.** This lead is surprisingly long. Some traffic series have their strongest correlation with GDP at a three month lead, and some by up to nine. But the vast majority lead GDP by a remarkably consistent 5-7 months, and so six months, or two quarters, was the lead modelled within the overall index.

Because the monthly data is volatile, **we tend to focus on the 3-month moving average in the index.** Such an approach reduces volatility in the data at the cost of delaying turning points. But since the Truckometer has such a long lead on GDP growth, the small delay is of secondary importance.

The fit of the Truckometer against GDP growth over coming periods will be adversely impacted by two key one-off (in economic parlance, “exogenous”) events: the Christchurch earthquakes and the Rugby World Cup. Traffic movements will not fully capture the Christchurch rebuilding activity, certainly not at its usual lead, at least (and in fact, there are no Christchurch roads in the aggregate Truckometer). And while the visitors

for the Rugby World Cup will be captured to some extent in the traffic data, it will also not provide the index’s usual six month lead to measured activity. We can therefore expect reported GDP growth to generally outperform the Truckometer. These kinds of issues mean the ANZ Truckometer is best interpreted as an indicator of base momentum in the economy rather than a predictor of GDP outturns.

CONSTRUCTION OF THE TRUCKOMETER

The traffic data underlying the ANZ Truckometer is sourced from the New Zealand Transport Agency (NZTA). Our analysis uses monthly average daily traffic volumes (MADT) (seasonally adjusted by ANZ). The MADT data as used by ANZ does not always correspond to the NZTA’s published figures due to differing treatment of missing data.²

For most of the 96 telemetry sites around the country, a split is available into heavy (>2.5t) and light traffic, giving a total of almost 300 potential series (heavy, light, all). But many series were ruled out because of too many missing values, excessive volatility, or structural breaks such as level shifts. Of the remainder, **14 series were chosen that provided the best information about economic activity.** These are a mix of heavy (4), light (6), and all (4) traffic flows at **9 different sites around the country** (7 North Island, 2 South Island). Including many more sites (typically with very small weights) gave a much closer historical relationship, but this approach greatly increases the risk of “over-fitting”, whereby coincidental historical spikes flatter the correlation of the final index and GDP over history, overstating the likely accuracy of the implied forecasts. Including fewer roads also meant it was feasible to go through the data with a fine-tooth comb and make informed judgements about any adjustments for physical disruptions to traffic. For recent years, we looked at the NZTA’s database of highway disruptions. For earlier years, disruptions were inferred from examination of the data right down to an hourly frequency.

The (non-negative) weights on the series underlying the index are a mix of optimisation and somewhat arbitrary bounds. No one road was permitted a weight of over 0.25, for robustness. Narrower bounds were placed on some roads that were deemed to be less reliable (e.g. because of

¹ The ANZ Truckometer was developed by Sharon Zöllner. For queries, see contact details on page 1.

² The NZTA MADT data is the simple average of the daily totals as long as at least 15 days are measured in the month. ANZ examined the daily data and interpolated missing days where possible, taking account of the very strong weekly pattern evident for many roads. We also made some corrections for missing hourly data.

ANZ TRUCKOMETER

ongoing road-works). The weights are allowed to vary by up to 1 percentage point each quarter, and within this constraint, plus the discretionary bounds, they are set to maximise the correlation between the quarterly change in the quarter-average of the index and the quarterly percent change in real GDP six months later (both seasonally adjusted) over a rolling 5 year period.

These rolling weights are intended to “future-proof” the index, as our investigations reveal that the importance of various roads, not surprisingly, changes somewhat over time as the economy evolves. Allowing the weights to change slowly does not have a great deal of impact on the index. **The index also performed remarkably well in robustness tests** such as using only half the sample to determine the weights.

Missing observations were interpolated (1.8 percent of observations) and the data is seasonally adjusted. Around 2.8 percent of total observations were adjusted for known or inferred physical disruptions to traffic flows.

The impact of Easter was removed from all series. Public holidays can have a very large impact on traffic flows, which for light traffic can be counter to economic activity (i.e. people driving on holiday). This is usually adequately dealt with by seasonal adjustment. However, Easter moves between March and April, causing extreme volatility in the seasonally adjusted quarterly data for some roads in those minority years when Easter falls in March. Given we have daily data, removing the Easter impact could be done quite precisely.

We will keep readers updated by releasing the ANZ Truckometer on a monthly basis, soon after the end of the month. This provides a new source of unique, timely, hard data about the New Zealand economy. It remains experimental and subject to revision.

RESULTS

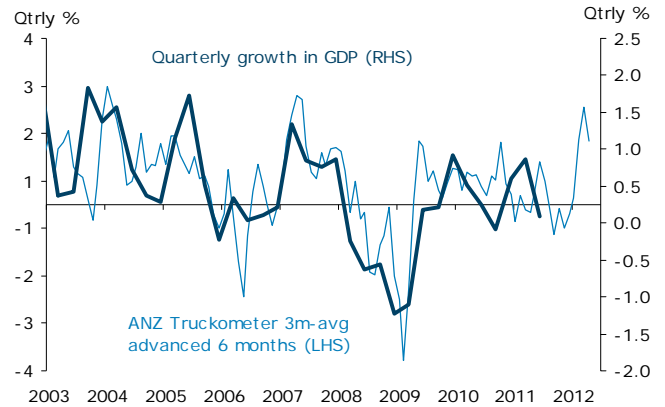
The ANZ Truckometer has been telling a mixed picture of late.

The Truckometer dipped between March and May this year, **implying economic momentum would wane in the second half of the year**, with basically flat growth. This suggests the boost from the Rugby World Cup was very nicely timed, to prevent some fairly glum GDP outturns.

However, August 2011 saw a surge in the seasonally adjusted Truckometer, and this higher level was sustained into September. These strong

months are **positive for GDP growth in the March quarter of 2012.**

ANZ Truckometer (3-month avg) and GDP growth

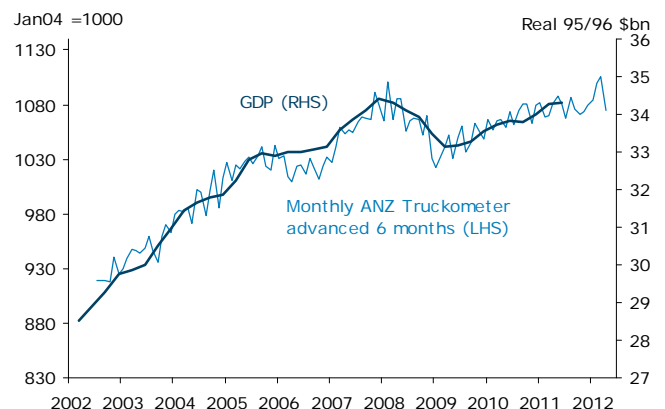


Sources: ANZ, NZ Transport Agency, Statistics NZ

We should perhaps look through some of this sharp lift. The Rugby World Cup will boost Q4 GDP, meaning correspondingly weaker quarterly growth in Q1. And second, given international developments, investment and employment, in particular, may respond more cautiously than they normally would to the signals coming from the general pick-up in base economic activity. But nonetheless, even smoothing out the quarterly noise the Truckometer was pointing firmly up.

However, traffic across virtually all sites in the Truckometer dropped markedly in October. This saw the Truckometer fall 2.9 percent, back to its levels of 4-6 months ago (see the unsmoothed levels chart below). If traffic volumes do not bounce back in November, the indicator will soon be pointing to a renewed stall in the economy.

Monthly ANZ Truckometer and GDP levels



Sources: ANZ, NZ Transport Agency, Statistics NZ

The Rugby World Cup adds a layer of complication in interpreting the Truckometer. One could argue that the recent strength was an

ANZ TRUCKOMETER

unseasonal lift in tourist traffic – positive for Q3 but not for 2012 Q1 – i.e. the signal could be misleadingly strong at the Truckometer's usual lead. However, the main lift came in August, before the RWC began. And in October, the business end of the tournament, traffic dropped sharply. Was this, then, alternatively, the locals putting life on hold to watch the rugby, meaning that the weakness implied in six months from October is overstated? We have certainly heard anecdotes of freight contracts being delayed, and it is true that heavy traffic fell more sharply than light traffic in October. But this is not unusual; heavy traffic is generally more volatile. Maybe we should just take the data at face value! The recent volatility is not unusual. **We'll have to wait for the November data to get a clearer picture** regarding whether the October fall was a red flag or a red herring.

In sum, it is too soon to read a great deal into the fall in October. It is best for now to look through the volatility, and conclude that the Truckometer is picking a continuation of the economy's recent trajectory of weak positive growth, albeit with some lumps and bumps.

If we take the signals coming out of the ANZ Truckometer at face value, **we can expect data outturns that are not directly related to Rugby World Cup spending to be fairly mediocre over coming months.**

The ANZ Truckometer over the next few months should give a guide as to whether the economy is going to roll over in the face of the global ructions, or keep right on trucking.

ANZ TRUCKOMETER			
	Index (Jan 04= 1000)	3-month average	Qtrly % chg, 3m avg
Oct-10	1081	1073	-0.2
Nov-10	1087	1080	0.3
Dec-10	1081	1083	0.9
Jan-11	1067	1078	0.5
Feb-11	1087	1078	-0.1
Mar-11	1075	1076	-0.6
Apr-11	1071	1078	-0.1
May-11	1073	1073	-0.5
Jun-11	1080	1074	-0.2
Jul-11	1084	1079	0.1
Aug-11	1099	1088	1.4
Sep-11	1106	1096	2.0
Oct-11	1075	1093	1.3

INTEREST RATE STRATEGY

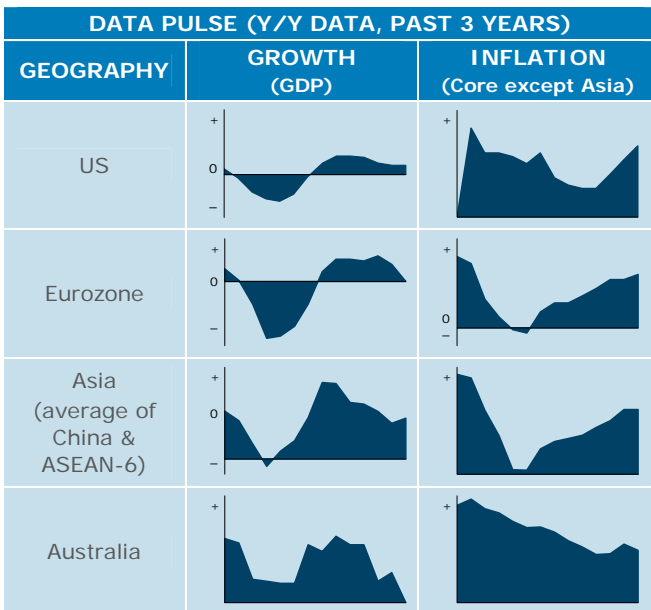
SUMMARY

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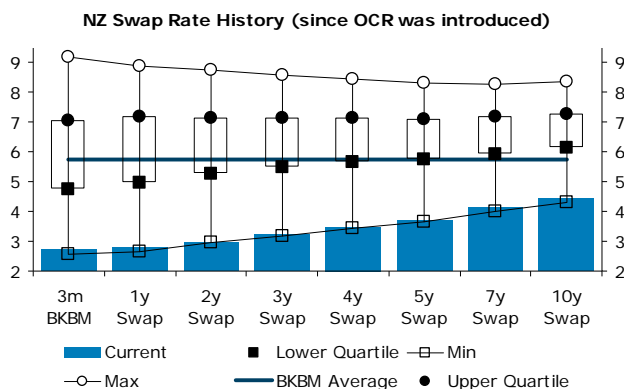
THEMES

- Global wobbles are being felt here, with commodity prices and house prices lower. But it is still too soon to seriously contemplate OCR cuts.
- Expect bonds to be well bid as the NZGS 11/11 matures, helping flatten the yield curve.

GLOBAL DATA PULSE



NZ SWAP RATES VS HISTORIC RANGES



Sources: ANZ, National Bank, Bloomberg

PREFERRED STRATEGIES – INVESTORS

Our preference remains to play the market from the long side, but we prefer to tactically lighten up based on the view that bearish momentum has stalled, and we are likely to see a brief “risk on” move. But we would regard any meaningful sell-off as an opportunity to re-institute longs. We still like flatteners, and better still, they benefit from positive roll+carry.

KEY VIEWS – FOR INVESTORS		
GAUGE	DIRECTION	COMMENT
Duration	Long	Bearish global scene dominates the outlook. Europe looks ugly.
Curve	Flatter	Short end lower, long end can go lower on global concerns. NZ has lagged US flattening.
NZ-US 10y bond spread	Neutral/Positive	NZGS have superb roll+carry, but US is THE safe haven.
Swap spreads	More positive	CPI data holds the key. Hard to see market satisfied.

PREFERRED STRATEGIES – BORROWERS

Interest rates are low – offering opportunities to add hedges for those needing to have a proportion of debt hedged. But with uncertainty high and the OCR on hold for now, we prefer to be well exposed to floating – the cheapest point on the curve.

KEY VIEWS – FOR BORROWERS		
GAUGE	DIRECTION	COMMENT
Hedge ratio	Mostly floating	Floating still the lowest rate, OCR on hold for a while.
Value	Extreme	Swap rates basically all at record lows.
Uncertainty	High	Takes the gloss off low rates.

GLOBAL SCENE

Even though the dataflow is stabilising in the US, Europe continues to completely dominate the global focus and has been the main driver of overall risk appetite. All eyes are on the Italian bond market, which has recovered strongly over the past two trading days, with ECB intervention initially driving yields lower, and Berlusconi’s promise to step down cementing the price action. A technocrat government in Italy (headed by Mario Monti) will certainly help – and Italy arguably now has the best chance it has had in a while to push through key reforms. Austerity may be welcomed by the bond market, but it remains to be seen how the Italian public will feel – and we note that Italian 10yr government bond yields remain above 6 percent. They are not out of the woods yet.

Europe’s problems run deep. Political will is vital and will go a long way – but time is the key ingredient.



INTEREST RATE STRATEGY

While markets are looking for a quick fix, the reality is there isn't one. As such, we remain deeply sceptical of any "risk on" moves and continue to focus on the big picture – which has just been made more precarious by news that the German CDU party is pushing for Eurozone exit clauses.

DOMESTIC

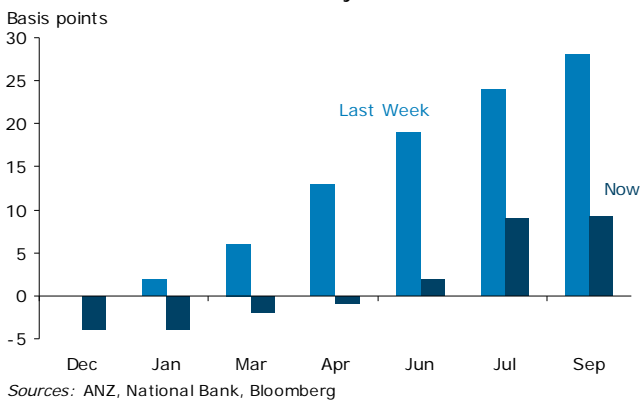
The domestic data pulse remains upbeat (or at least less downbeat) relative to global peers, but is starting to moderate, with commodity prices, job ads, and house prices all falling last week. Evidence that Europe's wobbles are having an impact here is mounting. Of particular concern is the possibility that falling risk appetite leads to a tightening in key funding markets. Any increase in bank funding costs will only further delay OCR increases, which recall we have long characterised as "fluid".

MONETARY POLICY AND MARKET PRICING

The market is now pricing in (low) odds of a cut in December. This is not surprising, but it is unrealistic at this stage to expect cuts.

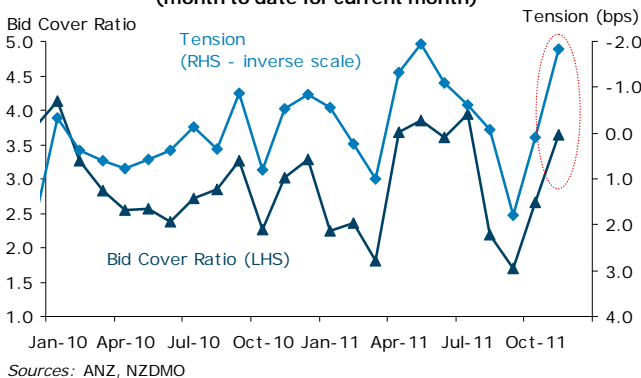
Although the RBNZ's decision to delay the scheduled January 2012 increase in the Core Funding Ratio from 70 to 75 percent is technical, it was done because of global concerns, and highlights the RBNZ's mind-set.

What's Priced In - Today vs. Last Week



BONDS

NZGS Tender Statistics (month to date for current month)



NZGS bonds continue to be exceptionally well bid at the weekly tenders. Although last week's tender was reasonably small, at just \$150m in total, all bonds offered were long bonds. More importantly, key gauges of demand – bid cover (4.0 times) and price tension (3.5bps below market) were all exceptional. As the chart above shows, both measures are back towards previous highs. New Zealand has its challenges, but the market continues to view it favourably.

The lengthening of the duration of the NZGS index is likely to lead to increased spot demand for bonds on the close on Tuesday. These may be low enough yields to be comfortable being short, but it would be a brave investor to be "lifestyle" short into Europe's problems and the November 26th deadline for a US budget deal.

SWAPS AND SWAP SPREADS

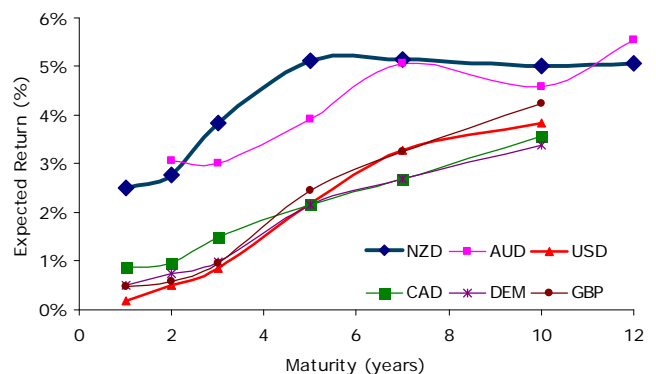
Swap yields have rallied hard over the past few sessions, taking the bellwether 2yr to a record low of 2.94 percent on Thursday. NZGS demand has been strong, but swaps have outpaced bonds, widening spreads.

Looking ahead, we're fairly neutral on swap vs bond. Swaps will continue moving lower if the global scene continues to deteriorate. But this is also likely to lead to safe haven buying of bonds – so long as New Zealand remains on the list of "can" rather than "can't" countries for global investors.

RELATIVE VALUE

The NZGS market offers the best roll-adjusted expected returns of the developed non-basket case markets, particularly in the belly of the curve, as the bottom chart shows. The New Zealand market has been cheap for some time, but the "hump" in the belly of the curve has widened.

1 month Annualised Roll Adjusted Expected Return



CURRENCY STRATEGY

SUMMARY

The FX markets seem remarkably stable considering the risk of contagion that erupted in Europe last week. In particular, EUR seemed resilient trading within a relatively small 2-3 percent range. A modicum of political stability with the appointment of technocrats to lead Greece and Italy has provided a positive boost to sentiment, but this may not last. US data continues to show a slow return to growth but not enough to spur USD support. Given the light local dataflow this week, expect NZD and AUD to be driven by offshore events again. Any moves higher will be capped to the topside of recent ranges.

MARKET THEMES

- European political stability (of sorts) will provide the same for the EUR. But the region's Q3 GDP data out this week will be a test.
- NZD and AUD will take direction from offshore.
- US inflation and housing data to provide insight but not direction to USD.

REVIEW AND OUTLOOK

Following a week of turmoil for Italy, a week of potential political stability beckons with new Prime Ministers in Greece and Italy. The Italian bond market welcomed the exit of PM Silvio Berlusconi, retracing all of the sell-off seen in the preceding week and sending 10 year yields down from a post GFC high of 7.49 percent to 6.45 percent in two days. However a new bout of political turmoil is possible as the Spanish go to the polls on Sunday. This should give the markets some insight into the mood of the people towards the austerity measures being forced upon the Club Med economies. On the German political front, Merkel's CDU conference is expected to adopt a motion to create exit clauses from the EUR which in itself should serve to undermine the credibility of the EUR, although the currency continues to look immune to any onslaught of bad news.

The EFSF apparently had some difficulty selling its EUR3 billion tranche of 10 year bonds, with rumours that the fund itself purchased the last EUR300 million emphatically denied by the fund. Suffice to say that the appetite for any European bonds is steadily falling given the lack of commitment to deal with the problems as perceived by potential investors (think China et al). *And still the EUR is stable!?*

US data will focus on inflation and housing this week but is unlikely to lead to any real focus on the USD. With the US economy demonstrating at least some sense of growth compared to the dire

economic prospects for Europe over the medium term, we are still wary of the possibility that the USD could come back into vogue during the next 6 months. While the exact trigger will be impossible to pinpoint we would be unsurprised to see a move in favour of USD.

Local developments will again take a back seat this week. The positive sentiment to start the week could see NZD test the topside of recent ranges, but a break to the topside is unlikely. Expect range trading between the familiar 0.7750 and 0.8000 levels. We expect NZDAUD to edge higher from here, given our view that this cross is undervalued at current levels.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value	↔/↑	Undervalued on a near-term cyclical basis.
Yield	↑	NZD yield curve is positive and AUD inverted.
Commodities	↔	Softs peaking.
Partial indicators	↔	Data showing signs of slowing in NZ.
Technicals	↔↑	Support at 0.7630.
Sentiment	↑	See NZD undervalued vs AUD.
Other	↔	Global sentiment big driver.
On balance	↔/↑	Sentiment sees lazy buyers coming forward.

NZD VS USD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value – long-term	↓	Above structural fair value of 0.67.
Fair value – short-term	↔	Closer to short term FV.
Yield	↑	Official rates to stay low but investable yields support.
Commodities	↔	Softs peaking.
Risk aversion	↔↑	Positive US data and short covering leads to risk on.
Partial indicators	↔	NZ data now mixed. US data improving.
Technicals	↔	Rangebound 0.7750 - 0.8000.
AUD	↔	Seems rangebound.
Sentiment	↑↔↓	EU debt crisis sentiment driving currencies in all directions.
Other	↔	Nothing apparent.
On balance	↔↓	EU situation causing nervous and skittish moves.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
14-Nov	NZ	Performance Services Index - OCT	- -	50.6(a)	10:30
	NZ	Retail Sales Ex Inflation(QoQ) - 3Q	0.6%	2.2%(a)	10:45
	JN	GDP Deflator YoY - 3Q P	-2.2%	-2.2%	12:50
	JN	Nominal GDP (QoQ) - 3Q P	1.4%	-1.5%	12:50
	JN	GDP Annualized - 3Q P	5.9%	-2.1%	12:50
	JN	Gross Domestic Product (QoQ) - 3Q P	1.5%	-0.5%	12:50
	EC	Eurozone Ind. Prod. wda (YoY) - SEP	3.5%	6.0%	23:00
	EC	Eurozone Ind. Prod. sa (MoM) - SEP	-2.3%	1.4%	23:00
15-Nov	AU	RBA Board Minutes - NOV	- -	- -	13:30
	AU	New Motor Vehicle Sales MoM - OCT	- -	-1.5%	13:30
	AU	New Motor Vehicle Sales YoY - OCT	- -	1.3%	13:30
	NZ	Non Resident Bond Holdings - OCT	- -	62.9%	15:00
	GE	GDP nsa (YoY) - 3Q P	2.4%	- -	20:00
	GE	GDP s.a. (QOQ) - 3Q P	0.5%	0.1%	20:00
	GE	GDP wda (YoY) - 3Q P	2.5%	- -	20:00
	UK	CPI (MoM) - OCT	0.2%	0.6%	22:30
	UK	CPI (YoY) - OCT	5.1%	5.2%	22:30
	UK	Core CPI YOY - OCT	3.2%	3.3%	22:30
	UK	Retail Price Index - OCT	238.3	237.9	22:30
	UK	RPI (MoM) - OCT	0.1%	0.8%	22:30
	UK	RPI (YoY) - OCT	5.5%	5.6%	22:30
	UK	RPI Ex Mort Int. Payments (YoY) - OCT	5.7%	5.7%	22:30
	EC	Eurozone GDP s.a. (QoQ) - 3Q A	0.2%	0.2%	23:00
	EC	Eurozone GDP s.a. (YoY) - 3Q A	1.4%	1.6%	23:00
	GE	ZEW Survey (Current Situation) - NOV	32.0	38.4	23:00
	EC	ZEW Survey (Econ. Sentiment) - NOV	-55.3	-51.2	23:00
	GE	ZEW Survey (Econ. Sentiment) - NOV	-52.5	-48.3	23:00
	EC	Eurozone Trade Balance sa - SEP	-€1.5B	-€1.0B	23:00
	EC	Eurozone Trade Balance - SEP	€2.0B	-€3.4B	23:00
16-Nov	US	Producer Price Index (MoM) - OCT	-0.1%	0.8%	02:30
	US	PPI Ex Food & Energy (MoM) - OCT	0.1%	0.2%	02:30
	US	Producer Price Index (YoY) - OCT	6.3%	6.9%	02:30
	US	PPI Ex Food & Energy (YoY) - OCT	2.9%	2.5%	02:30
	US	Advance Retail Sales - OCT	0.3%	1.1%	02:30
	US	Retail Sales Less Autos - OCT	0.2%	0.6%	02:30
	US	Retail Sales Ex Auto & Gas - OCT	0.2%	0.5%	02:30
	US	Empire Manufacturing - NOV	-2.2	-8.48	02:30
	US	Business Inventories - SEP	0.1%	0.5%	04:00
	AU	Westpac Leading Index (MoM) - SEP	- -	0.8%	12:30
	JN	Housing Loans YoY - 3Q	- -	2.4%	12:50
	NZ	NBNZ Regional Trends – 3Q	- -	1.0%	13:00
	AU	DEWR Internet Skilled Vacancies MoM - OCT	- -	-1.3%	13:00
	AU	Wage Cost Index QoQ - 3Q	0.9%	0.9%	13:30
	AU	Wage Cost Index YoY - 3Q	3.8%	3.8%	13:30
	UK	Claimant Count Rate - OCT	5.1%	5.0%	22:30
	UK	Jobless Claims Change - OCT	21.0K	17.5K	22:30
	UK	Average Weekly Earnings 3M/YoY - SEP	2.5%	2.8%	22:30
	UK	Weekly Earnings ex Bonus 3M/YoY - SEP	1.6%	1.8%	22:30

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
16-Nov	UK	ILO Unemployment Rate (3mths) - SEP	8.2%	8.1%	22:30
	EC	Eurozone CPI - Core (YoY) - OCT	1.6%	1.6%	23:00
	EC	Eurozone CPI (MoM) - OCT	0.3%	0.8%	23:00
	EC	Eurozone CPI (YoY) - OCT	3.0%	3.0%	23:00
	UK	Bank of England Inflation Report - NOV	- -	- -	23:30
	JN	BOJ Target Rate - NOV	0.10%	0.10%	UNSPECIFIED
17-Nov	US	MBA Mortgage Applications - 11-Nov	- -	10.3%	01:00
	US	Consumer Price Index (MoM) - OCT	0.0%	0.3%	02:30
	US	CPI Ex Food & Energy (MoM) - OCT	0.1%	0.1%	02:30
	US	Consumer Price Index (YoY) - OCT	3.7%	3.9%	02:30
	US	CPI Ex Food & Energy (YoY) - OCT	2.1%	2.0%	02:30
	US	Net Long-term TIC Flows - SEP	- -	\$57.9B	03:00
	US	Total Net TIC Flows - SEP	- -	\$89.6B	03:00
	US	Industrial Production - OCT	0.4%	0.2%	03:15
	US	Capacity Utilization - OCT	77.6%	77.4%	03:15
	US	NAHB Housing Market Index - NOV	18	18	04:00
	NZ	Producer Prices- Inputs (QoQ) - 3Q	- -	0.9%	10:45
	NZ	Producer Prices- Outputs (QoQ) - 3Q	- -	1.4%	10:45
	UK	Nationwide Consumer Confidence - OCT	43	45	13:01
	AU	Average Weekly Wages (QoQ) - AUG	1.1%	1.2%	13:30
	AU	Average Weekly Wages (YoY) - AUG	4.8%	4.4%	13:30
	AU	RBA Foreign Exchange Transactions - OCT	- -	641M	13:30
	AU	Foreign Reserves - OCT	- -	A\$44.9B	18:30
	UK	Retail Sales Ex Auto Fuel(MoM) - OCT	-0.3%	0.7%	22:30
	UK	Retail Sales Ex Auto Fuel(YoY) - OCT	-0.2%	0.4%	22:30
	UK	Retail Sales w/Auto Fuel (MoM) - OCT	-0.2%	0.6%	22:30
	UK	Retail Sales w/Auto Fuel (YoY) - OCT	-0.1%	0.6%	22:30
	EC	Construction Output SA MoM - SEP	- -	0.2%	23:00
	EC	Construction Output WDA YoY - SEP	- -	2.5%	23:00
18-Nov	US	Housing Starts - OCT	606K	658K	02:30
	US	Housing Starts MOM% - OCT	-7.90%	- -	02:30
	US	Building Permits - OCT	600K	589K	02:30
	US	Building Permits MOM% - OCT	1.9%	-5.0%	02:30
	US	Initial Jobless Claims - 12-Nov	395K	390K	02:30
	US	Continuing Claims - 5-Nov	3615K	3615K	02:30
	US	Philadelphia Fed. - NOV	9.0	8.7	04:00
	GE	Producer Prices (MoM) - OCT	0.1%	0.3%	20:00
	GE	Producer Prices (YoY) - OCT	5.3%	5.5%	20:00
	US	Mortgage Delinquencies - 3Q	- -	8.44%	UNSPECIFIED
	US	MBA Mortgage Foreclosures - 3Q	- -	4.43%	UNSPECIFIED
19-Nov	US	Leading Indicators - OCT	0.6%	0.2%	04:00

Key: AU: Australia, EC: Eurozone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States, CH: China.

Sources: Dow Jones, Reuters, Bloomberg, ANZ, National Bank. All \$ values in local currency

Note: All surveys are preliminary and subject to change

LOCAL DATA WATCH

Key focus over the next few weeks: Global events remain a key influence, with the situation in Europe swamping local nuances. Risks to the NZ economy and financial system have increased in recent months. Resilient local activity data is contrasting with weaker sentiment, with a post-RWC lull beckoning. The OCR will eventually need to move higher, but this will be conditional on the global scene improving.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 16 Nov (early am)	GlobalDairyTrade auction	Supply response	We expect a 2 percent fall in the average dairy price to US\$3,450/tonne.
Wed 16 Nov (1:00pm)	National Bank Regional Trends – Q3	- -	- -
Thur 17 Nov (10:45am)	Capital Goods Price Index – 2011Q3	Rising	A 0.5 percent increase is expected, underpinned by higher construction costs.
Thur 17 Nov (10:45am)	Producer Price Index – 2011Q3	Cost-push	Higher electricity prices contribute to a 1.2 percent increase in input prices and a 0.8 percent increase in output prices.
Mon 21 Nov (3:00pm)	RBNZ Credit Card Billings – Oct	RWC lift	A 1 percent increase is expected. Overseas-issued card spending should consolidate at high levels.
Tue 22 Nov (10:45am)	International Travel and Migration – Oct	Turning	A net PLT outflow of 300 persons is forecast. Visitor numbers to stabilise, despite the extra 15,000 RWC visitors.
Tue 22 Nov (3:00pm)	RBNZ Survey of Expectations – Q4	Down but not out	The 2-year-ahead survey measure for inflation is expected to ease to around 2.7 percent.
Thur 24 Nov (10:45am)	Overseas Merchandise Trade – October	Down	A monthly trade deficit of \$400m is expected, with the annual trade surplus down to around \$540m.
Mon 28 Nov (1:00pm)	National Bank Business Outlook – Nov	- -	- -
Tue 29 Nov (10:45am)	National Employment Indicator - Sep	Down	Falling job advertising suggests a small fall is in prospect. We expect a 0.3 to 0.4 percent fall.
Wed 30 Nov (10:45am)	SNZ Building Consents – Oct	See-saw	A 5 percent lift in dwelling consents is forecast following the large decline in the previous month.
Wed 30 Nov (3:00pm)	RBNZ Credit Aggregates – Oct	Subdued	Low annual rates of household and business credit growth, with falling agriculture credit expected as dairy cheques are banked.
Thur 1 Dec (1:00pm)	SNZ Overseas Trade Indexes – Q3	Peaking?	We expect a 1.5 percent increase in the terms of trade. Import volumes to rise 1.5 percent, with exports up 0.5 percent.
Thur 1 Dec (1:00pm)	ANZ Commodity Price Index – Nov	- -	- -
Mon 5 Dec (10:45am)	Value of work put in place – Q3	Down	We expect a 5 percent fall in work put in place volumes, with both residential and non-residential posting declines.
Wed 7 Dec (early am)	GlobalDairyTrade auction	Holding	Prices are expected to consolidate at historically high levels.
Thur 8 Dec (09:00am)	RBNZ December MPS	On hold	Global concerns and a benign short-term inflation outlook will keep the RBNZ on the sidelines. The next move for the OCR is up.
Thur 8 Dec (10:45am)	Economic Survey of Manufacturing – Q3	Up	Primary manufacturing volumes are expected to rise 3 percent. Ex-primary volumes are expected to track sideways.
Fri 9 Dec (10:45am)	Electronic Card Transactions - Nov	RWC hangover	A 0.8 percent fall in ECT spending is forecast, with falls for fuel and apparel sales.
On Balance		Local vs global	Domestic gauges for H2 should remain positive but global concerns suggest caution for early 2012.

KEY FORECASTS AND RATES

	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
GDP (% qoq)	0.9	0.1	0.8	1.2	0.2	0.5	1.0	1.0	0.9	0.7
GDP (% yoy)	1.7	1.5	2.4	3.0	2.3	2.7	2.9	2.7	3.4	3.7
CPI (% qoq)	0.8	1.0	0.4	0.3	0.6	0.7	0.9	0.4	0.6	0.7
CPI (% yoy)	4.5	5.3	4.6	2.5	2.3	2.1	2.5	2.6	2.6	2.6
Employment (% qoq)	1.2	0.0	0.2	0.3	0.2	0.6	0.6	0.2	0.3	0.3
Employment (% yoy)	1.8	2.0	1.1	1.8	0.8	1.4	1.7	1.6	1.7	1.4
Unemployment Rate (% sa)	6.5	6.5	6.6	6.4	6.4	6.1	5.8	5.9	5.9	5.8
Current Account (% GDP)	-3.6	-3.7	-3.9	-3.3	-3.5	-3.6	-4.0	-4.4	-4.5	-4.5
Terms of Trade (% qoq)	0.8	2.3	1.5	2.1	-0.8	-0.8	-0.8	-0.8	-0.7	-0.7
Terms of Trade (% yoy)	6.7	7.0	5.5	6.8	5.1	2.0	-0.3	-3.1	-2.9	-2.9

	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11	Sep-11	Oct-11	Nov-11
Retail ECT (% mom)	-0.2	1.4	1.5	-0.7	1.1	0.3	-0.6	0.7	1.5	..
Retail ECT (% yoy)	6.2	6.6	10.0	6.8	9.0	8.0	8.4	7.5	7.4	..
Credit Card Billings (% mom)	-0.5	-1.0	1.8	0.4	0.5	1.1	-1.4	1.6	..	..
Credit Card Billings (% yoy)	5.8	2.1	6.5	5.5	4.6	7.3	4.7	5.2	..	..
Car registrations (% mom)	-2.0	-0.1	-5.3	3.5	-2.3	-1.9	9.1	-12.3	0.4	..
Car registrations (% yoy)	2.8	-1.0	-10.5	-3.7	-9.5	-6.0	1.9	-12.2	-8.8	..
Building consents (% mom)	-9.7	2.4	-1.1	3.4	-1.2	13.6	16.7	-17.1	..	..
Building consents (% yoy)	-28.8	-26.1	-32.5	-21.8	-25.3	-15.6	18.7	-3.9	..	..
REINZ House Price Index (% yoy)	-0.7	-1.8	-0.4	-0.7	0.0	0.5	0.7	2.7	3.4	..
Household Lending Growth (% mom)	0.1	-0.1	0.2	0.1	0.1	0.2	0.1	0.1	..	..
Household Lending Growth (% yoy)	1.5	1.2	1.3	1.2	1.2	1.2	1.1	1.1	..	..
ANZ Roy Morgan Consumer Confidence	108.1	101.4	101.4	103.3	112.5	109.4	113.3	112.6	112.2	109.0
NBNZ Business Confidence	34.5	-8.7	14.2	38.3	46.5	47.6	34.4	30.3	13.2	..
NBNZ Own Activity Outlook	36.6	14.7	29.5	39.7	38.7	43.7	43.3	35.4	26.1	..
Trade Balance (\$m)	184	583	1158	550	201	102	-697	-751	..	..
Trade Balance (\$m ann)	765	741	1238	1019	999	1287	1020	724	..	..
ANZ World Commodity Price Index (% mom)	2.7	4.7	1.6	0.4	-1.2	-0.2	-1.4	-2.0	-3.5	..
ANZ World Commodity Price Index (% yoy)	20.3	23.5	19.8	19.6	20.6	22.2	22.0	16.5	9.1	..
Net migration (sa)	440	-540	-120	-290	-280	-210	120	-660	..	..
Net migration (annual)	8249	6554	5508	4625	3867	2867	2257	773	..	..

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

KEY MARKET FORECASTS AND RATES

FX RATES	ACTUAL			Forecast (end month)						
	Sep-11	Oct-11	Today	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
NZD/USD	0.761	0.823	0.789	0.77	0.80	0.83	0.86	0.89	0.90	0.90
NZD/AUD	0.788	0.768	0.764	0.79	0.80	0.79	0.78	0.81	0.82	0.82
NZD/EUR	0.569	0.580	0.571	0.57	0.58	0.59	0.61	0.61	0.62	0.62
NZD/JPY	58.67	62.46	60.80	57.8	60.0	59.8	61.9	64.1	63.0	63.0
NZD/GBP	0.489	0.511	0.490	0.50	0.51	0.52	0.53	0.55	0.55	0.55
NZ\$ TWI	68.3	70.6	68.9	68.4	70.3	71.3	72.8	74.8	75.4	75.4
INTEREST RATES	Sep-11	Oct-11	Today	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13
NZ OCR	2.50	2.50	2.50	2.50	2.50	2.75	3.25	3.25	3.50	3.75
NZ 90 day bill	2.86	2.74	2.71	2.70	2.70	3.20	3.50	3.50	3.90	4.00
NZ 10-yr bond	4.42	4.60	4.17	4.30	4.30	4.30	4.30	4.40	4.40	4.60
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
US 3-mth	0.37	0.43	0.46	0.35	0.35	0.35	0.35	0.35	0.35	0.35
AU Cash Rate	4.75	4.75	4.50	4.50	4.25	4.25	4.25	4.25	4.25	4.25
AU 3-mth	4.92	4.75	4.67	4.70	4.60	4.60	4.50	4.50	4.50	4.50

Forecasts finalised as at 28 October 2011

	11 Oct	7 Nov	8 Nov	9 Nov	10 Nov	11 Nov
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.82	2.71	2.71	2.72	2.72	2.72
NZGB 04/13	2.92	2.75	2.75	2.75	2.63	2.59
NZGB 04/15	3.41	3.27	3.27	3.25	3.12	3.08
NZGB 03/19	4.30	4.15	4.15	4.13	3.99	3.95
NZGB 05/21	4.53	4.36	4.36	4.34	4.20	4.18
2 year swap	3.15	3.08	3.07	3.06	2.95	2.94
5 year swap	3.87	3.87	3.85	3.83	3.71	3.70
RBNZ TWI	69.1	69.6	69.6	69.5	68.8	68.6
NZD/USD	0.7821	0.7952	0.7954	0.7966	0.7789	0.7788
NZD/AUD	0.7846	0.7675	0.7678	0.7685	0.7675	0.7665
NZD/JPY	59.96	62.11	62.07	61.80	60.59	60.38
NZD/GBP	0.5006	0.4966	0.4952	0.4948	0.4890	0.4886
NZD/EUR	0.5738	0.5774	0.5776	0.5757	0.5751	0.5715
AUD/USD	0.9968	1.0361	1.0359	1.0365	1.0149	1.0160
EUR/USD	1.3629	1.3771	1.3770	1.3837	1.3544	1.3628
USD/JPY	76.67	78.11	78.04	77.58	77.79	77.53
GBP/USD	1.5622	1.6014	1.6061	1.6100	1.5929	1.5939
Oil (US\$/bbl)	85.14	94.27	95.51	96.75	95.78	97.74
Gold (US\$/oz)	1680.70	1770.15	1791.60	1791.80	1761.80	1767.15
Electricity (Haywards)	13.57	6.38	6.18	7.23	8.23	9.33
Baltic Dry Freight Index	2106	1766	1759	1802	1840	1835
Milk futures (USD)	145	141	141	141	141	142

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