

NEW ZEALAND ECONOMICS MARKET FOCUS

12 September 2011

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PLAYING DEFENSIVELY

ECONOMIC OVERVIEW

The focus turns to domestic developments this week with the main event being Thursday's RBNZ *Monetary Policy Statement*. We also get a raft of domestic data, some rescheduled from last week, which will give us a better steer on how Q2 GDP fared. While construction activity slumped, we see sufficient strength in other sectors to support a solid Q2 GDP print. While lagged, such "momentum", and the Rugby World Cup, which kicked off last Friday, are providing important crutches of support amidst a fragile global scene.

RBNZ MONETARY POLICY STATEMENT PREVIEW

Were it not for the deteriorating global outlook and financial market volatility, the RBNZ would be removing the 50bp insurance cut taken out in March this Thursday. We still believe the current level of the OCR is on borrowed time, given the improving momentum in the New Zealand economy and clear inflation pressures. But the RBNZ will want greater clarity around the global situation before deciding to hike rates. As such, we see the RBNZ maintaining a clear tightening bias, but the removal of the insurance cut will very much be dependent on global financial risks receding, even if this means taking a chance on inflation.

MONTHLY INFLATION GAUGE

Our monthly inflation gauge recorded a 0.4 percent decline over August, the largest monthly decline since we started compiling this series in 2008. Part of the fall can be attributed to seasonal factors. There were also a couple of influential one-off price declines. While our inflation gauge is pointing to a subdued non-tradable CPI print for Q3, this masks mounting underlying inflation pressure – particularly for construction-related costs. We will also be paying close attention to services-related prices in our inflation gauge for any evidence of spillover from elevated inflation expectations.

INTEREST RATE STRATEGY

We expect the focus to shift away from global events and towards the domestic outlook in the lead-up to Thursday's RBNZ *Monetary Policy Statement*. Although pre-conditions for an OCR hike (global financial stability) can't be satisfied, and the Governor is likely to be somewhat cautious following his visit to Jackson Hole, we expect the tone of the MPS to mirror the better tone of the domestic data pulse. By contrast, US markets are likely to tread water ahead of next week's announcement of details of Obama's stimulus plan and FOMC meeting.

CURRENCY STRATEGY

The focus for currency markets turned from the SNB's unilateral action to weaken the CHF early last week, towards increasing speculation about Greek default and euro exit, sending EUR sharply lower and dragging the NZD down. A lack of co-ordinated action from the G7 leaves EUR very vulnerable this week. RBNZ will be on hold this week but global events will continue to dominate. While NZD has further downside, we expect key support at 0.80 to hold for now.

ECONOMIC OVERVIEW

SUMMARY

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THIS WEEK'S EVENTS

REINZ Housing Market Report – August (circa Tuesday, September 13, 10:00am). We had been expecting continued recovery with a 2 percent increase in sales volumes, but a fall in seasonally adjusted Barfoot & Thompson Auckland sales suggests some downside risk. Prices are expected to remain broadly unchanged, with days to sell stable.

SNZ Food Price Index – August (Tuesday, September 13, 10:45am). The month of August typically sees a large seasonal fall in food prices. We expect to see only a 0.2 percent decline in the month, with fruit and vegetable prices not falling as much as usual because of the freezing southerly snap in August. After sharp increases in the past 2 months, any fall would be welcome.

SNZ Manufacturing Survey – 2011Q2 (Tuesday, September 13, 10:45am – *rescheduled from September 8*). We expect a 3 percent increase in primary manufacturing volumes, with ex-primary volumes down 1 percent.

ANZ Job Ads – August (Tuesday, September 13, 1:00pm).

RBNZ September Monetary Policy Statement (Thursday, September 15, 9:00am). We expect the RBNZ to leave the OCR unchanged at 2.5 percent. See page 5 for our preview.

BNZ Business NZ Manufacturing PMI – August (Thursday, September 15, 10:00am). Given the decline in manufacturing PMI readings around the globe, NZ's is also expected to follow the trend down but maintain a read above the 50 level.

ANZ Roy Morgan Consumer Confidence – September (Friday, September 16, 1:00pm).

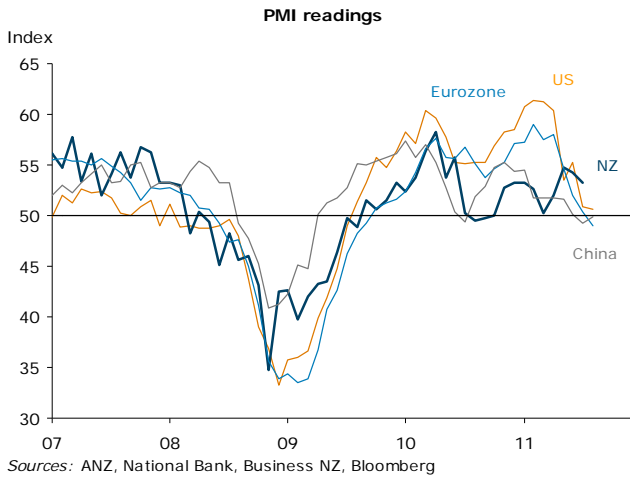
WHAT'S THE VIEW

Risks to the global outlook continue to intensify. Recent central bank decisions around the world have focused on the global situation in their deliberations. The uncertainty is leading to caution, with central banks either delaying previously flagged rate increases (Riksbank), going from a tightening bias to neutral (RBA, BoC and ECB), or signalling a preparedness to ease policy (Norges Bank). **We expect the RBNZ to put a lot of focus on the downside risks to global growth** in their September *Monetary Policy Statement* this Thursday. Indeed, if it were not for the deteriorating global situation, the RBNZ would be preparing to hike rates (see our preview on page 5).

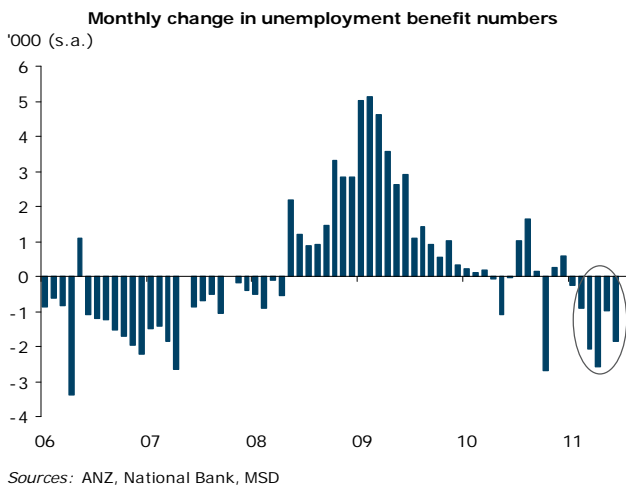
Some policymakers have been forced to provide more support to their economies in light of the deteriorating outlook. US President Obama unveiled a US\$447bn American Jobs Act package last week. But for some, policy action involves stemming the tide of capital inflows that is sending their currencies too high. The Swiss National Bank's decision to unilaterally draw a line in the sand and hold EURCHF above 1.20 shows the extremes some are forced to go to. The policy has the potential to cost a small fortune, but the SNB seem fairly determined, and the market so far is taking them at their word. In essence, it means that the Swiss franc is no longer a destination for safe haven flows, and the world's cash has to go looking for alternative places to hide. The Norwegian krone is already an ungrateful beneficiary, rising 2 percent in a matter of hours following the SNB action. New Zealand may also find itself having money thrown at it. This has the potential to support the NZD, making the RBNZ's life a little bit more difficult. But Australia is arguably an even more appealing safe-haven destination, so the NZDAUD cross rate should stay favourable for NZ exporters.

We continue to monitor the global situation closely. **Thus far, we have not detected any negative impact on New Zealand.** It is early days of course, and the dataflow we are receiving now generally predates the August turmoil. But we have been comforted by the resilience of recent business and consumer confidence readings. We will be keeping a close eye on how they fare over the next few months. A key test will be how New Zealand's manufacturing PMI fared, given that global readings have been falling in recent months, with some heading into contractionary territory. If demand for New Zealand products has been affected by the slowing in global growth, this will be reflected in the PMI reading.

ECONOMIC OVERVIEW

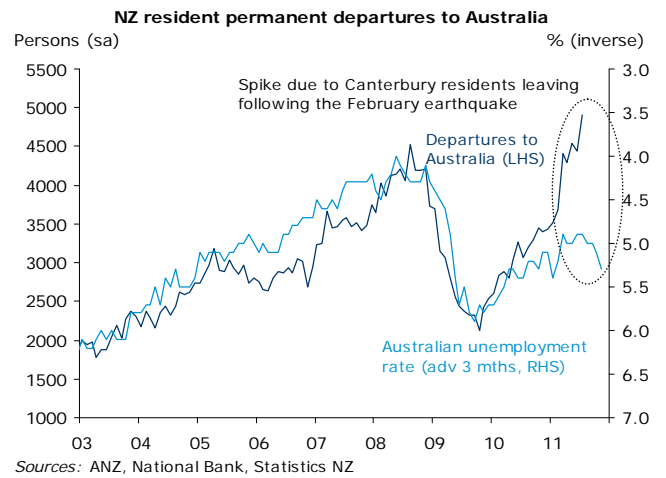


There are signs that **the New Zealand labour market continues to improve**. The number of people receiving the unemployment benefit fell by 1,800 persons in August, the sixth consecutive monthly decline. Fewer people on the dole queue is a sure sign that the job market is picking up, which will lead to further declines in the unemployment rate. Tomorrow's ANZ Job Ads will provide another important gauge of the state of the labour market. The improving jobs picture is a key reason explaining why consumer confidence is holding up in New Zealand so far. We will get another read on this when the ANZ Roy Morgan Consumer Confidence data for September is released on Friday.

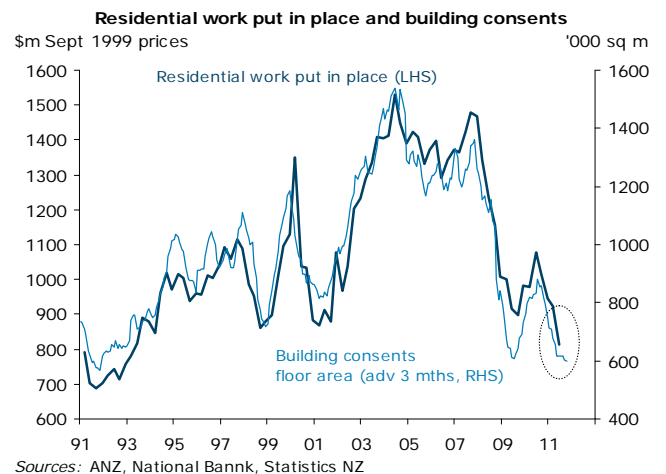


It is interesting that **the New Zealand labour market is strengthening at a time when Australia's appears to be going the other way**. Our unemployment rate, at 6.5 percent, is higher than theirs (5.3 percent), but is set to decline whereas the Australian unemployment rate has risen and could move higher still. If there is a positive for New Zealand from a rising Australian unemployment rate, it is that we could start to see fewer people

permanently crossing the ditch in search of better opportunities. This net exodus to Australia had climbed to 42,600 persons in the 12 months to July, with the net outflow close to 30,000 persons since the start of the year. The number of permanent departures to Australia is highly correlated to the Australian unemployment rate, with the recent spike higher due to Canterbury residents leaving following the February earthquake. We can expect departures to start to ease off in the coming months, resulting in a turnaround in our net migration outflows. This will help to ease NZ skill shortages at the margin.



Building work put in place data for Q2 was grim, with volumes falling 6.6 percent on top of a similar sized fall in Q1. We estimate this will shave 0.3 percentage points off GDP. The silver lining is that the worst looks to be over. Although the construction sector is in the doldrums, the light at the end of the tunnel is blinding. The earthquake rebuild may be mired in bureaucracy and insurance woes, but one way or another New Zealand needs to eventually fix or replace a lot of broken buildings. The only way is up for construction activity from here.

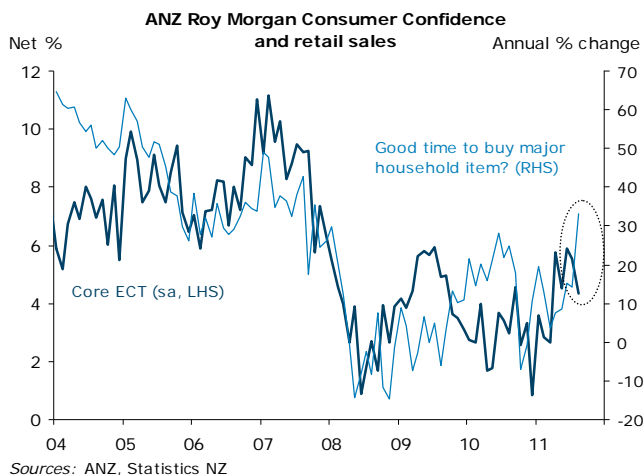


ECONOMIC OVERVIEW

Weakness in construction activity will cap the upside for Q2 GDP. But other indicators have come in strong, leaving us still comfortable with our view that Q2 GDP will come in above trend.

Wholesale trade and manufacturing data for Q2 out this week (rescheduled from last week) will allow us to finalise our GDP estimate, **which for the moment is at 0.7 percent.**

The electronic cards transactions data for August was disappointing, registering a fair-sized fall when we had been expecting a small rise. At this stage we are not reading too much into it, given the week-long southerly blast may have kept potential shoppers bundled up at home by the heater. Retail spending in June and July was firm, with the 2.8 percent increase in core retail sales in the 3 months to August indicating reasonably solid momentum. Spending intentions from the ANZ Roy Morgan Consumer Confidence survey suggest that retail sales should be picking up. But if the weakness is sustained into September, we may have to reassess our view of a relatively robust (albeit cautious) consumer.



RECENT LOCAL DATA

SNZ Work Put in Place – 2011Q2. The volume of total building work put in place fell 6.6 percent in Q2, following a similar-sized fall in the previous quarter. Residential volumes slumped 11.6 percent to their lowest level since early 1993.

GlobalDairyTrade auction. The weighted GDT-TWI Price Index from the early September auction fell 1.4 percent from the previous event. The average winning price was US\$3,580/MT.

SNZ Electronic Card Transactions – August. The value of retail-related electronic card transactions fell 0.7 percent in August. Excluding fuel and motor vehicle related sales, core transactions were down 1.0 percent in the month.

RBNZ MONETARY POLICY STATEMENT PREVIEW

SUMMARY

Were it not for the deteriorating global outlook and financial market volatility, the RBNZ would be removing the 50bp insurance cut taken out in March this Thursday. We still believe the current level of the OCR is on borrowed time, given the improving momentum in the New Zealand economy and clear inflation pressures. But the RBNZ will want greater clarity around the global situation before deciding to hike rates. As such, we see the RBNZ maintaining a clear tightening bias, but the removal of the insurance cut will very much be dependent on global financial risks receding, even if this means taking a chance on inflation.

HOLDING OFF FOR NOW

At the July OCR Review, the RBNZ made it clear that it was getting ready to remove the March 2011 insurance cut. Based purely on domestic economic considerations, there is a compelling case for removing that insurance cut this Thursday. After all, the economy looks to be accelerating after a solid Q1 performance, the labour market continues to improve, and the Rugby World Cup and earthquake reconstruction activity are yet to really kick in. Growth over H2 this year looks set to be very strong, at a time when core inflation is close to 2½ percent and inflation expectations are elevated, at close to 3 percent. With resource slack potentially set to be used up fairly quickly, inflation pressures could start to emerge sooner rather than later. Hence, **a 2.5 percent OCR is not consistent with getting inflation back to the mid-point of the target band, given the domestic economic outlook.**

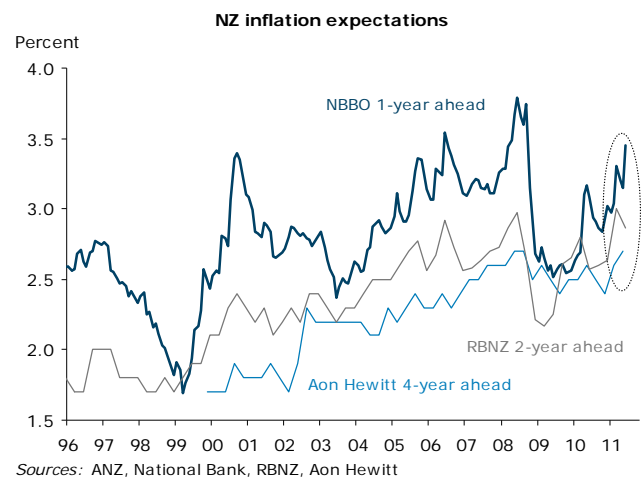
However, the RBNZ gave themselves an out-clause at the July Review, conditioning the removal of the insurance cut on global financial risks receding. The global outlook since the July Review has undoubtedly deteriorated. Equity markets have sold off aggressively, S&P has cut the US credit rating from AAA to AA+, the sovereign debt crisis in Europe has taken a step for the worse, and global economic momentum is easing.

Recent central bank decisions around the world highlight the changed global outlook. The US Federal Reserve has eased conditions further by committing to low policy interest rates until mid-2013 and is looking at providing further policy accommodation. The ECB has moved away from their prior tightening bias towards a neutral stance, the Bank of Canada's latest statement was dovish, the Riksbank has postponed their rate hikes and the RBA has turned neutral after contemplating a hike in early August. Norway's Norges Bank has gone a step further, hinting

that they could cut rates to combat a strengthening currency and head off undesirably low inflation and growth. **With the global outlook clouded in uncertainty, we see the RBNZ taking a leaf from other central banks' books and standing pat this Thursday.**

BUT NOT ALL THE RISKS ARE TO THE DOWNSIDE

While the decision to stay on hold looks straightforward on the face of it, there are risks around keeping the OCR too low for too long. Chief among them is the elevated level of inflation expectations. While the RBNZ's preferred 2-year ahead measure eased marginally from 3 percent to 2.9 percent, it is too high for comfort. Also worrying is the increase in the National Bank Business Outlook 1-year ahead inflation expectations from 3.2 to 3.5 percent, and the nudge up in the Aon Hewitt 4-year ahead inflation expectations from 2.6 to 2.7 percent. The risk of elevated inflation expectations seeping into wage and price-setting behaviour is non-trivial, particularly in an environment where the labour market is improving.

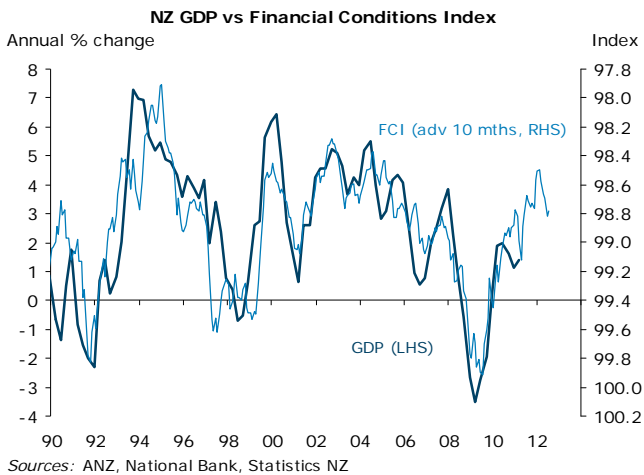


While there is no denying that the recent domestic dataflow has been stronger, what is less clear is the impact that the weakened global outlook will have on future activity. In terms of global growth, *Consensus* forecasts are being revised lower, with forecast growth for New Zealand's major trading partners for 2012 likely to be around half a percentage point lower than the RBNZ's June *Monetary Policy Statement* forecast. This will still leave growth at around 4 percent, which is close to trend. But we note that the RBNZ has in previous episodes of global volatility chosen weaker global growth forecasts compared to the *Consensus* (their usual benchmark). We suspect they will do so again.

To date, the global volatility has had a minimal impact on New Zealand, apart from the credit default swap (CDS) spreads for the large Australian

RBNZ MONETARY POLICY STATEMENT PREVIEW

banks (a proxy for funding costs) widening sharply. Business and consumer confidence have so far held up remarkably well during the financial market turmoil, as have the prices for New Zealand's major export commodities. While our financial conditions index has tightened in the past few months, it remains at very accommodative levels, flagging 3 percent year-on-year growth by mid-next year.



While New Zealand will not be totally immune to global developments, we are better placed than most to weather the storm. For a start, the economy had strengthening momentum over the first half of the year, which gives it impetus to roll through the challenges to some extent. In addition, the Rugby World Cup will provide a large stimulus to the economy over the second half of this year, helping to cushion any impact from offshore. Indeed, not many economies around the world are set to benefit from a one-off stimulus package which will add 1 percentage point to GDP growth over the second half of the year. Let's hope the party doesn't come with an inflation hangover. Earthquake reconstruction work will also help underpin domestic spending. But with the NZD remaining stubbornly high the RBNZ is unlikely to get the mix of growth that they want. While the policy statement will comment on the high NZD, there is little that the RBNZ can do about it.

Ultimately, the RBNZ will have to weigh up what will **almost certainly** be rising inflation pressure from a strengthening domestic economy, against **possible** downside inflation pressure from a sharp global slowdown. **Leaving the OCR low for too long risks putting the RBNZ behind the curve, and having to play catch-up by hiking more aggressively later on.** With the yield curve steep and a record proportion of mortgages on floating rates, the RBNZ will be willing to run this risk.

Though the RBNZ will stay on hold, they will make it clear that the removal of the insurance cut is still on the cards. This will obviously be conditional on the global situation. But the inflation picture will increasingly also feature as well.

Turning to the RBNZ's economic projections, we expect their near-term GDP growth forecasts to be revised higher, but for growth next year to be lowered due to weaker trading partner growth and the impact of a higher currency. The TWI assumption will be higher across the whole projection period, which will help to contain inflation. We are expecting a 90-day interest rate profile similar to June's. As in June, the key assumptions surrounding the RBNZ's projections will be that construction cost inflation will not accelerate as high as the mid-2000s peak, household deleveraging will hold back consumption growth to some extent, and that inflation expectations will start to ease back towards the mid point of the inflation target. In addition, an additional key assumption is that global financial market uncertainty will subside and global growth will not deteriorate too markedly.

FINANCIAL MARKET IMPLICATIONS

Market expectations are unanimous in expecting an unchanged decision for this Thursday. But **the market is still under-pricing the RBNZ in our view, with only 40bps of hikes priced in by June next year.** In the absence of a global meltdown, the RBNZ will look to remove the insurance cuts in one go. The policy normalisation path will be gradual and of a stop-start nature, but a 2.5 percent OCR is not consistent with the inflation picture at present.

OUR EXPECTATIONS OF RBNZ SEPTEMBER 2011 MPS PROJECTIONS (JUNE 2011 MPS IN BRACKETS)

	90-DAY	TWI (QTR AVERAGE)	CPI (ANN % CHG)	GDP (ANN % CHG)
Q1 2011	3.0	67.1	4.5	1.4 (0.4)
Q2	2.7 (2.6)	69.1 (68.8)	5.3 (5.0)	1.9 (0.7)
Q3	2.9 (2.7)	72.2 (68.5)	5.0 (4.8)	3.0 (1.8)
Q4	3.2 (3.0)	72.0 (68.6)	3.2 (2.5)	3.6 (2.9)
Q1 2012	3.5 (3.4)	72.0 (68.5)	2.8 (2.0)	4.5 (4.4)
Q2	3.7 (3.8)	71.8 (68.4)	2.5 (2.2)	4.8 (5.1)
Q3	4.2 (4.3)	71.4 (68.1)	2.2 (1.8)	4.8 (5.1)
Q4	4.5 (4.6)	71.0 (67.8)	2.1 (1.9)	4.5 (4.7)
Q1 2013	4.8 (4.7)	70.6 (67.5)	2.2 (2.2)	3.5 (3.6)
Q2	4.8 (4.8)	70.2 (67.2)	2.4 (2.3)	3.2 (3.3)
Q3	4.9 (4.8)	69.8 (66.9)	2.5 (2.4)	2.8 (2.9)
Q4	4.9 (4.9)	69.3 (66.5)	2.5 (2.5)	2.6 (2.6)
Q1 2014	4.9 (4.9)	68.7 (66.0)	2.4 (2.3)	2.5 (2.2)

MONTHLY INFLATION GAUGE

SUMMARY

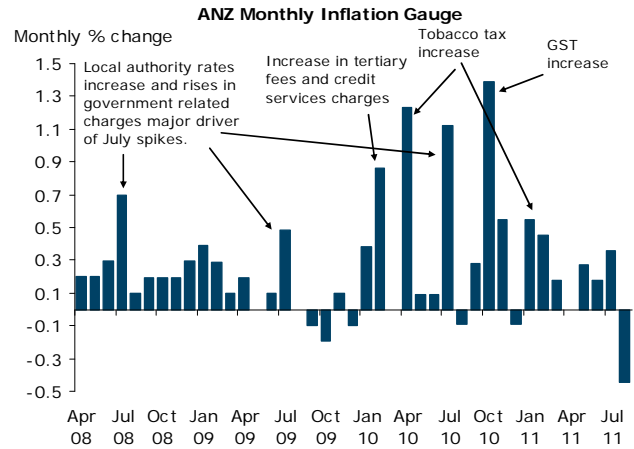
Our monthly inflation gauge recorded a 0.4 percent decline over August, the largest monthly decline since we started compiling this series in 2008. Part of the fall can be attributed to seasonal factors. There were also a couple of influential one-off price declines. While our inflation gauge is pointing to a subdued non-tradable CPI print for Q3, this masks mounting underlying inflation pressure – particularly for construction-related costs. We will also be paying close attention to services-related prices in our inflation gauge for any evidence of spillover from elevated inflation expectations.

TRANSITORY?

Our Monthly Inflation Gauge is intended to provide a timely indication of broad trends in CPI non-tradable inflation. While designed to be as comparable as possible to the official quarterly non-tradable CPI as measured by Statistics NZ, differences in methodology and coverage mean the gauge will not exactly mirror the official series. Nonetheless, its performance to date shows that it is a useful indicator of domestic inflationary trends.

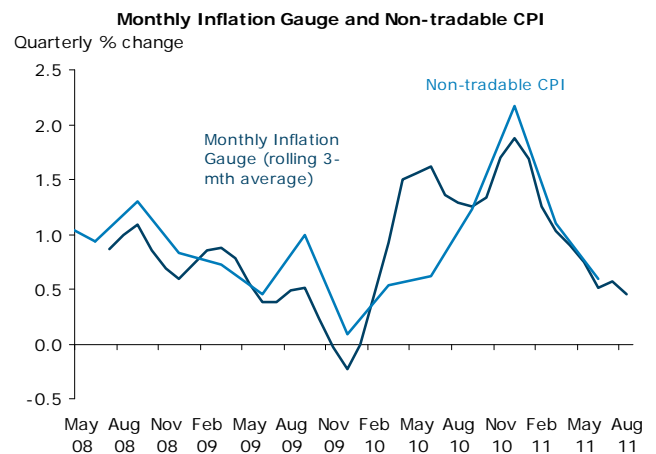
The gauge recorded a 0.4 percent fall in August, completely unwinding the 0.4 percent rise in the previous month. This is the biggest monthly decline in our gauge since we started compiling the series in early 2008. Part of the fall is seasonal: our gauge has tended to be soft during August months. However, there were a couple of one-offs in the month which pulled the gauge down. Electricity prices fell 4 percent, largely due to one major nationwide provider lowering its prices. This alone shaved 0.3 percentage points off our gauge. The gauge also recorded a large decline in vehicle insurance, which subtracted 0.1 percentage points. Such declines in electricity and insurance prices are unusual, and unlikely to be repeated. Therefore, we suspect that the August decline in our gauge is temporary rather than a sign of easing inflation pressure.

According to our gauge, non-tradable CPI for Q3 is shaping up to be soft. But this masks mounting underlying inflation pressure – particularly for construction-related costs, where anecdotes point to strong price increases over coming months. Services-related price rises have been a feature in our gauge, particularly for health and professional services, and this was again the case in August. With the labour market improving and inflation expectations at elevated levels, the risk is that we see further acceleration in services-related prices. This is an area we will be paying particular attention to in our inflation gauge.



Source: ANZ

	Monthly Inflation Gauge (Index)	Monthly Inflation Gauge (m/m%)	Implied Inflation Gauge (q/q%)	Actual non-tradable CPI (q/q%)
Jan-10	1044	0.4		
Feb-10	1053	0.9		
Mar-10	1053	0.0	0.9	0.5
Apr-10	1066	1.2		
May-10	1067	0.1		
Jun-10	1068	0.1	1.6	0.6
Jul-10	1080	1.1		
Aug-10	1079	-0.1		
Sep-10	1082	0.3	1.2	1.2
Oct-10	1097	1.4		
Nov-10	1103	0.5		
Dec-10	1102	-0.1	1.9	2.2
Jan-11	1108	0.5		
Feb-11	1113	0.5		
Mar-11	1115	0.2	1.0	1.1
Apr-11	1115	0.0		
May-11	1118	0.3	0.5	0.6
Jun-11	1120	0.2		
Jul-11	1124	0.4		
Aug-11	1119	-0.4		



Sources: ANZ, National Bank, Statistics NZ



INTEREST RATE STRATEGY

SUMMARY

We expect the focus to shift away from global events and towards the domestic outlook in the lead-up to Thursday's RBNZ *Monetary Policy Statement*. Although pre-conditions for an OCR hike (global financial stability) can't be satisfied, and the Governor is likely to be somewhat cautious following his visit to Jackson Hole, we expect the tone of the *MPS* to mirror the better tone of the domestic data pulse. By contrast, US markets are likely to tread water ahead of next week's announcement of details of Obama's stimulus plan and FOMC meeting.

MARKET THEMES

- The RBNZ *MPS* will take centre stage this week. Global instability remains an issue, and will stave off an OCR hike. But expect the tone of the *MPS* to be cautiously upbeat.
- Europe continues to "muddle" its way through the sovereign debt crisis. This is very de-stabilising for markets – but don't expect things to change.
- US 10yr bond yields have fallen to all-time lows. But even if a stimulus plan is seen by markets as credible, it may not see bond yields rise.

REVIEW AND OUTLOOK

This **Thursday's *MPS* will be a keenly watched affair, and one that could shift market pricing.** Although an OCR hike is unlikely, what really matters is what tone the Bank takes, and whether it chooses to focus on global risks or the domestic outlook. We expect more of an emphasis on the latter, and if we are right, expect the market pricing (with just 39bps of hikes by June priced in) to be challenged. The short end of the curve certainly seems to be giving the global risk view the benefit of the doubt, and **we doubt anything short of an extremely cautious tone (or some global disaster in the meantime) will come anywhere close to justifying tight spreads on the bank bill futures curve.** We are thus mindful of upside risks.

By contrast, the long end will continue to be influenced more by global moves. It has become apparent that **European politicians have opted for the "muddle through" approach, and this is likely to bring with it a few more months (if not years) of malaise and fatigue.** As such, it will hang over the market, and continue to be de-stabilising. **Escalating concerns in Europe are certainly not helping the local market digest news that the High Court has ruled that the EQC may be liable for multiple claims on a property, which could add \$1bn to its liability.**

The tone seems to be changing in the US, and could become much more upbeat if Obama's stimulus package gets passed, and is seen as credible. But this depends crucially on bond yields staying low, and any additional loosening by the Fed will ensure that this is the case. **As such, we need to be careful not to necessarily associate better US prospects with higher interest rates. This is compounded further by slowing momentum in Australia,** with last week's weak jobs data adding more fuel to the RBA rate cut debate.

PREFERRED BORROWING STRATEGIES

Our preference has been to stand on the sidelines for some time now, with global market instability extending the opportunity to take advantage of low floating rates. This has paid off, and in an ideal world, we'd stay on the sidelines, and wait till we have confirmation that we're in the clear and the OCR is heading higher before fixing. Of course, if one waits till then, rates may have already have moved. Although the level of stress and tension in global markets remains high, our preference is to have more hedge cover in place ahead of Thursday's RBNZ *Monetary Policy Statement*. In short, we doubt the RBNZ will condone further downside, but they are likely to reinforce the upside. Some fortitude is of course required, and this isn't a suggestion to "fill your boots", particularly given global uncertainty. But we do feel that short term swaps like the 2 and 3 year offer reasonable value. They're certainly trading well below where they "ought to" if our OCR forecasts eventuate. Our preference is not to add to long dated cover unless the intention is to take profit on this later, and embed profit into shorter hedges – but such a strategy isn't for the faint-hearted!

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔/↑	<i>MPS</i> to be better.
NZ data	↑	Overall data pulse positive.
Fed Funds / front end	↔/↓	More stimulus is likely after next week's FOMC meeting.
RBA	↔/↑	Jobs data could lead to cuts.
US 10 year	↔	Policy to keep rates low.
NZ swap curve	↔/↓	Biased to flatten, tempered by poor long bond demand.
Flow	↔/↑	Still vulnerable to upside.
Technicals	↔	Not in focus.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 15-Sep-11	+6	+2
Thu 27-Oct-11	+12	+8
Thu 8-Dec-11	+20	+15
Thu 26-Jan-12	+30	+26
Thu 8-Mar-12	+37	+33
Thu 26-Apr-12	+43	+33
Thu 14-Jun-12	+47	+39

TRADING THEMES WE FAVOUR AT PRESENT

Expect more curve flattening as the short end starts to focus on the RBNZ *MPS* on Thursday, while the long end gets held down by depressed global yields. We prefer to be short the December RBNZ meeting OIS at current levels, with the market pricing in around 15bps of tightening.

CURRENCY STRATEGY

SUMMARY

The focus for currency markets turned from the SNB's unilateral action to weaken the CHF early last week, towards increasing speculation about Greek default and euro exit, sending EUR sharply lower and dragging the NZD down. A lack of co-ordinated action from the G7 leaves EUR very vulnerable this week. RBNZ will be on hold this week but global events will continue to dominate. While NZD has further downside, we expect key support at 0.80 to hold for now.

MARKET THEMES

- European situation continues to deteriorate.
- RBNZ will be on hold with removal of insurance cut contingent on global situation.
- USD downside limited as markets look for "least worst" currencies, especially with the SNB action taking CHF off the "safe haven" list.
- Australian data mixed but more recent data showing cracks in Aussie economy.

REVIEW AND OUTLOOK

The European situation remains the focus for markets as a Greek tragedy becomes more likely. The resignation of ECB Chief Economist Juergen Stark is the second after Axel Weber that appears to be motivated by irreconcilable differences over current ECB policies. The sense that the European (read "Club Med") debt problem is unsolvable is weighing on financial markets and has finally forced EUR lower. This situation remains the single biggest factor driving currencies at the moment and in this environment, we can expect the NZD to appreciate vs EUR and GBP. In the end, for all the G7's talk of a "strong and coordinated international response", markets want to see firm action, not mere words. The fact that the SNB felt the need to go it alone to put a floor on EURCHF at 1.20 shows the lack of coordination, or at the very least a lack of faith in any coordinated action.

The RBNZ will leave the OCR on hold this week but we expect recognition of the dichotomy between the onshore and offshore economies.

The removal of the OCR insurance cut will still be on the table, but will be contingent on the global situation stabilising. Hence, the global scene will continue to be the primary driver of NZD over the coming weeks. In this environment the NZD and AUD have a degree of safe haven status providing support, though this resilience will be against the crosses. With CHF removed as a safe haven destination by the SNB action, expect some safe haven flows to be attracted back into USD.

Australia's confidence data to be released this week will be a key coincident indicator given the diverse nature of data releases lately. Last week's GDP data seemed at odds with more recent release as well as anecdotes around the Australian consumer. With the export and consumer sectors seemingly on divergent paths, the AUD continues to look fully priced. Last week's dip in NZDAUD to 0.7800 should be seen as a floor in that cross to take advantage of.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↔	Close to our fair value estimates.
Yield	↑	Opposing policy direction favours NZD.
Commodities	↔	Wary of cracks appearing here.
Partial indicators	↔/↑	Data still good in NZ.
Technicals	↔↑	Rangebound 0.7800 - 0.7920.
Sentiment	↔	Balanced.
Other	↔	Global sentiment big driver.
On balance	↑	Yield and undervaluation support NZD.

NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↓	Above structural fair value of 0.67.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↑	September off for now but yield still supports.
Commodities	↔	Starting to be wary of turns in key NZ related commodities.
Risk aversion	↓	EUR woes driving risk off sentiment.
Partial indicators	↑	NZ data better, US data still weak though not as bad as initially feared.
Technicals	↔	Wide range continues 0.8150 – 0.8560.
AUD	↓	AUD undermined by data.
Sentiment	↑↓	Growth vs potential QE3 vs EU debt crisis = confusion.
Other	↑	EUR weakness the key driver for NZD this week.
On balance	↔	Global issues remain the focus.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
12-Sep	AU	Trade Balance - JUL	A\$1.9B	A\$2.1B	13:30
	CH	Actual FDI (YoY) - AUG	-	19.8%	10-15 SEP
	CH	New Yuan Loans - AUG	500.0B	492.6B	11-15 SEP
	CH	Money Supply - M0 (YoY) - AUG	-	14.3%	11-15 SEP
	CH	Money Supply - M1 (YoY) - AUG	12.0%	11.6%	11-15 SEP
	CH	Money Supply - M2 (YoY) - AUG	14.2%	14.7%	11-15 SEP
	NZ	REINZ Housing Price Index MoM% - AUG	-	-0.6%	12-16 SEP
	NZ	REINZ House Sales YoY% - AUG	-	11.7%	12-16 SEP
13-Sep	NZ	Food Prices (MoM) - AUG	-	2.0%	10:45
	NZ	Manufacturing Activity - 2Q	-	2.9%	10:45
	NZ	Manufacturing Activity Volume SA (QoQ) - 2Q	1.0%	1.9%	10:45
	UK	RICS House Price Balance - AUG	-23%	-22%	11:01
	NZ	QV House Prices YoY% - AUG	-	-0.4%	12:00
	NZ	ANZ Job Ads - AUG	-	0.9%	13:00
	AU	NAB Business Confidence - AUG	-	2	13:30
	AU	NAB Business Conditions - AUG	-	-1	13:30
	AU	Australia Manpower Survey - 4Q	-	17%	16:01
	NZ	New Zealand Manpower Survey - 4Q	-	17%	16:01
	CH	China Manpower Survey - 4Q	-	19%	17:01
	UK	DCLG UK House Prices (YoY) - JUL	-1.2%	-2.0%	20:30
	UK	Visible Trade Balance GBP/Mn - JUL	-£8500	-£8873	20:30
	UK	Trade Balance Non EU GBP/Mn - JUL	-£5450	-£5718	20:30
	UK	Total Trade Balance (GBP/Mn) - JUL	-£4200	-£4496	20:30
	UK	CPI (MoM) - AUG	0.6%	0.0%	20:30
	UK	CPI (YoY) - AUG	4.5%	4.4%	20:30
	UK	Core CPI YOY - AUG	3.0%	3.1%	20:30
	UK	Retail Price Index - AUG	235.9	234.7	20:30
	UK	RPI (MoM) - AUG	0.6%	-0.2%	20:30
	UK	RPI (YoY) - AUG	5.1%	5.0%	20:30
	UK	RPI Ex Mort Int. Payments (YoY) - AUG	5.2%	5.0%	20:30
	US	NFIB Small Business Optimism - AUG	88.4	89.9	23:30
14-Sep	US	Import Price Index (MoM) - AUG	-0.8%	0.3%	00:30
	US	Import Price Index (YoY) - AUG	12.5%	14.0%	00:30
	US	IBD/TIPP Economic Optimism - SEP	37.5	35.8	02:00
	US	Monthly Budget Statement - AUG	-\$132.0B	-\$90.5B	06:00
	AU	Westpac Consumer Confidence s.a. (MoM) - SEP	-	-3.5%	12:30
	AU	Westpac Consumer Confidence Index - SEP	-	89.6	12:30
	AU	DEWR Internet Skilled Vacancies MoM - AUG	-	-0.8%	13:00
	AU	Dwelling Starts - 2Q	2.0%	3.1%	13:30
	NZ	Non Resident Bond Holdings - AUG	-	60.10%	15:00
	UK	Jobless Claims Change - AUG	35.0K	37.1K	20:30
	UK	Average Weekly Earnings 3M/YoY - JUL	2.7%	2.6%	20:30
	UK	Weekly Earnings ex Bonus 3M/YoY - JUL	2.1%	2.2%	20:30
	UK	ILO Unemployment Rate (3mths) - JUL	7.9%	7.9%	20:30
	EC	Euro-Zone Ind. Prod. wda (YoY) - JUL	4.6%	2.6%	21:00
	EC	Euro-Zone Ind. Prod. sa (MoM) - JUL	1.5%	-0.8%	21:00
15-Sep	US	Producer Price Index (MoM) - AUG	-0.1%	0.2%	00:30
	US	PPI Ex Food & Energy (MoM) - AUG	0.2%	0.4%	00:30

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
15-Sep	US	PPI Ex Food & Energy (YoY) - AUG	2.6%	2.5%	00:30
	US	Advance Retail Sales - AUG	0.2%	0.5%	00:30
	US	Retail Sales Less Autos - AUG	0.2%	0.5%	00:30
	US	Retail Sales Ex Auto & Gas - AUG	0.3%	0.3%	00:30
	US	Business Inventories - JUL	0.5%	0.3%	02:00
	NZ	RBNZ Official Cash Rate - SEP	2.5%	2.5%	09:00
	NZ	Business NZ PMI - AUG	- -	53.2	10:30
	AU	New Motor Vehicle Sales MoM - AUG	- -	8.6%	13:30
	AU	New Motor Vehicle Sales YoY - AUG	- -	0.9%	13:30
	AU	RBA Foreign Exchange Transaction - AUG	- -	605M	13:30
	EC	ECB Publishes Monthly Report - SEP	- -	- -	20:00
	UK	BoE/GfK Inflation Next 12 Mths - AUG	- -	3.9%	20:30
	UK	Retail Sales Ex Auto Fuel(MoM) - AUG	-0.2%	0.2%	20:30
	UK	Retail Sales Ex Auto Fuel(YoY) - AUG	-0.2%	-0.2%	20:30
	UK	Retail Sales w/Auto Fuel (MoM) - AUG	-0.3%	0.2%	20:30
	UK	Retail Sales w/Auto Fuel (YoY) - AUG	-0.1%	0.0%	20:30
	EC	Euro-Zone CPI - Core (YoY) - AUG	1.2%	1.2%	21:00
	EC	Euro-Zone CPI (MoM) - AUG	0.2%	-0.6%	21:00
	EC	Euro-Zone CPI (YoY) - AUG	2.5%	- -	21:00
	EC	Eurozone Employment (QoQ) - 2Q	- -	0.1%	21:00
	EC	Eurozone Employment (YoY) - 2Q	- -	0.1%	21:00
16-Sep	US	Consumer Price Index (MoM) - AUG	0.2%	0.5%	00:30
	US	CPI Ex Food & Energy (MoM) - AUG	0.2%	0.2%	00:30
	US	Consumer Price Index (YoY) - AUG	3.6%	3.6%	00:30
	US	CPI Ex Food & Energy (YoY) - AUG	1.9%	1.8%	00:30
	US	Current Account Balance - 2Q	-\$122.9B	-\$119.3B	00:30
	US	Empire Manufacturing - SEP	-4.0	-7.7	00:30
	US	Initial Jobless Claims - 10 SEP	411K	414K	00:30
	US	Continuing Claims - 3 SEP	3705K	3717K	00:30
	US	Industrial Production - AUG	0.1%	0.9%	01:15
	US	Capacity Utilization - AUG	77.5%	77.5%	01:15
	US	Philadelphia Fed Index - SEP	-15.0	-30.7	02:00
	NZ	ANZ Consumer Confidence Index - SEP	- -	113.3	13:00
	NZ	ANZ Consumer Confidence MoM - SEP	- -	3.6%	13:00
	EC	Euro-Zone Current Account nsa - JUL	- -	-€3.3B	20:00
	EC	ECB Eurozone Current Account SA - JUL	- -	-€7.4B	20:00
	EC	Euro-Zone Labour Costs (YoY) - 2Q	- -	2.6%	21:00
	EC	Euro-Zone Trade Balance sa - JUL	- -	-€1.6B	21:00
	EC	Euro-Zone Trade Balance - JUL	€2.0B	€0.9B	21:00
	UK	Nationwide Consumer Confidence - AUG	48	49	16-24 SEP
17-Sep	US	Net Long-term TIC Flows - JUL	\$15.0B	\$3.7B	01:00
	US	Total Net TIC Flows - JUL	- -	-\$29.5B	01:00
	US	U. of Michigan Confidence - SEP P	56.6	55.7	01:55

Key: AU: Australia, EC: Euro-zone, 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: The RBNZ September *MPS* takes centre stage this week. Caution over the global outlook will see the RBNZ leave the OCR unchanged, but the Bank will be mindful of accelerating domestic momentum and the impact this has on inflation. Next week's Q2 GDP may be historical, but it will provide an indication of how robust the economy was prior to the recent bout of global ructions. The next key read will be the NZIER QSBO in early October, which will give us an idea of how resilient the economy has been during the period of global volatility. We suspect momentum continued on, signalling that an end of year rate hike is on the cards.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 13 Sep (10:00am)	REINZ Residential Sales - August	Off the floor	A 2 percent recovery in sales volumes is anticipated. Prices are expected to remain broadly unchanged with days to sell stable.
Tue 13 Sep (10:45am)	SNZ Food Price Index - August	Seasonal fall	We expect a 0.2 percent fall in the food price index, driven by lower fruit and vegetable prices.
Tue 13 Sep (10:45am)	SNZ Economic Survey of Manufacturing – Q2	Sector differences	Meat and dairy manufacturing volumes are forecast to rise 3 percent, with the remainder down 1 percent.
Tue 13 Sep (1:00pm)	ANZ Job Ads - August	- -	- -
Thur 15 Sep (9:00am)	RBNZ September <i>MPS</i>	On hold for now	Global considerations will encourage patience. Providing global ructions subside we expect a 50 basis point hike in December.
Thur 15 Sep (10:30)	BNZ Business NZ Manufacturing PMI - August	Global concerns	Given the decline in manufacturing PMI readings around the globe, NZ's is also expected to follow the trend down but maintain a read above the 50 level.
Fri 16 Sep (1:00pm)	ANZ Roy Morgan Consumer Confidence - September	- -	- -
Wed 21 Sep (10:45am)	Balance of Payments – 2011Q2	Stable	A quarterly deficit of \$900m is forecast, with the annual deficit stable at 4.2 percent of GDP.
Wed 21 Sep (10:45am)	International Travel and Migration - Aug	Up	A net PLT migration outflow of 100 persons is expected. Visitor arrivals are expected to rise 2 percent on account of more snow.
Wed 21 Sep (10:45am)	RBNZ Credit Card Billings - Aug	Flat	The decline in Electronic Card Transactions suggests a flat outturn is in store. Billings from overseas credit cards look set to surge over September and October due to the Rugby World Cup.
Thur 22 Sep (10:45am)	Gross Domestic Product – 2011Q2	Resilience	We have pencilled in a 0.7 percent increase though see upside risk to this. Higher primary sector and services production will offset lower goods production.
Fri 30 Sep (10:45am)	Building Consents - August	Holding	A 2 percent increase in residential consents is envisaged. Some pullback is possible for non-residential consent values.
Fri 30 Sep (1:00pm)	National Bank Business Outlook - Sep	- -	- -
Fri 30 Sep (3:00pm)	RBNZ Credit Aggregates - August	Deleveraging	Low annual rates for household and business credit, with agricultural credit falling as farmers repay debt.
Mon 3 Oct (1:00pm)	ANZ Commodity Price Index – September	- -	- -
Tues 4 Oct (10:00am)	NZIER QSBO – 2011Q3	Solid	Domestic confidence to shake off the global gloom, with activity indicators pointing to robust growth and indicators of resource pressures warning of rising inflation pressure.
On Balance		Local vs global	Domestic gauges still resilient, but global concerns suggest some caution further out.

KEY FORECASTS AND RATES

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
GDP (% qoq)	0.5	0.8	0.7	1.1	1.5	0.7	1.0	0.9	0.8	0.7
GDP (% yoy)	1.1	1.4	1.9	3.1	4.2	4.1	4.4	4.2	3.4	3.4
CPI (% qoq)	2.3	0.8	1.0	0.8	0.7	0.6	0.8	0.7	0.6	0.8
CPI (% yoy)	4.0	4.5	5.3	5.0	3.3	3.1	2.9	2.8	2.7	2.9
Employment (% qoq)	-0.3	1.3	0.0	0.7	0.6	0.7	0.5	0.5	0.4	0.4
Employment (% yoy)	1.3	1.8	2.0	1.7	2.6	2.0	2.5	2.3	2.1	1.8
Unemployment Rate (% sa)	6.7	6.5	6.5	6.2	5.9	5.6	5.5	5.3	5.3	5.3
Current Account (% GDP)	-4.1	-4.2	-4.2	-4.2	-3.7	-4.0	-4.3	-4.6	-4.9	-5.1
Terms of Trade (% qoq)	0.8	0.8	2.3	3.0	1.0	-0.9	-0.8	-0.8	-0.8	-0.8
Terms of Trade (% yoy)	12.3	6.7	7.0	7.1	7.3	5.5	2.3	-1.4	-3.3	-3.1

	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11	Jul-11	Aug-11
Retail ECT (% mom)	1.0	-0.9	2.4	-0.1	1.5	1.4	-0.7	1.1	0.3	-0.7
Retail ECT (% yoy)	6.3	4.4	5.7	6.2	6.6	10.0	6.8	9.0	8.0	8.4
Credit Card Billings (% mom)	0.1	-1.7	3.9	-0.5	-1.2	1.8	0.4	0.5	1.0	..
Credit Card Billings (% yoy)	4.3	2.4	6.2	5.9	2.1	6.6	5.5	4.6	7.3	..
Car registrations (% mom)	12.8	-8.8	1.3	-2.0	0.0	-5.5	3.6	-2.0	-1.0	6.5
Car registrations (% yoy)	23.5	6.4	6.8	2.8	-1.0	-10.5	-3.7	-9.5	-6.0	1.9
Building consents (% mom)	8.8	-18.7	9.0	-9.7	2.6	-1.1	3.1	-1.0	13.0	..
Building consents (% yoy)	-8.8	-26.5	-14.6	-28.9	-26.0	-32.3	-21.9	-25.4	-15.7	..
REINZ House Price Index (% yoy)	-1.9	-1.6	-2.6	-0.7	-1.8	-0.4	-0.7	0.0	0.5	..
Household Lending Growth (% mom)	0.0	0.1	0.1	0.1	-0.1	0.2	0.1	0.1	0.2	..
Household Lending Growth (% yoy)	1.8	1.6	1.5	1.5	1.2	1.2	1.2	1.2	1.2	..
ANZ Roy Morgan Consumer Confidence	114.5	112.2	117.1	108.1	101.4	101.4	103.3	112.5	109.4	113.3
NBNZ Business Confidence	33.2	29.5	..	34.5	-8.7	14.2	38.3	46.5	47.6	34.4
NBNZ Own Activity Outlook	35.3	34.5	..	36.6	14.7	29.5	39.7	38.7	43.7	43.3
Trade Balance (\$m)	-177	-218	9	184	583	1158	554	197	129	..
Trade Balance (\$m ann)	1363	1172	909	765	741	1238	1022	999	1314	..
ANZ World Commodity Price Index (% mom)	2.1	1.6	4.3	2.7	4.7	1.6	0.4	-1.2	-0.2	-1.2
ANZ World Commodity Price Index (% yoy)	13.1	12.1	16.3	20.3	23.5	19.8	19.6	20.6	22.2	22.1
Net migration (sa)	600	700	420	440	-530	-120	-320	-290	-220	..
Net migration (annual)	11519	10451	8689	8249	6554	5508	4625	3867	2867	..

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

KEY MARKET FORECASTS AND RATES

	ACTUAL			Forecast (end month)						
FX RATES	Jul-11	Aug-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZD/USD	0.879	0.896	0.821	0.88	0.91	0.92	0.93	0.93	0.93	0.92
NZD/AUD	0.799	0.808	0.785	0.80	0.81	0.82	0.83	0.82	0.82	0.82
NZD/EUR	0.610	0.620	0.602	0.60	0.61	0.61	0.61	0.60	0.60	0.60
NZD/JPY	67.54	67.13	63.60	66.0	68.3	69.0	67.0	67.0	67.0	68.1
NZD/GBP	0.536	0.541	0.519	0.53	0.55	0.54	0.55	0.53	0.53	0.53
NZ\$ TWI	74.2	75.6	71.8	74.1	75.9	76.3	76.7	75.8	75.8	75.7
INTEREST RATES	Jul-11	Aug-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZ OCR	2.50	2.50	2.50	2.50	3.00	3.25	3.50	3.75	4.00	4.50
NZ 90 day bill	2.95	2.99	2.95	3.00	3.50	3.50	3.90	4.00	4.40	4.90
NZ 10-yr bond	4.93	4.52	4.50	4.60	4.40	4.50	4.60	4.80	4.90	5.00
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	0.26	0.33	0.34	0.35	0.35	0.35	0.35	0.35	0.35	0.35
AU Cash Rate	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75	4.75
AU 3-mth	5.07	4.87	4.89	4.90	4.90	4.90	4.90	4.90	4.90	4.90

	9 Aug	5 Sep	6 Sep	7 Sep	8 Sep	9 Sep
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.82	2.93	2.92	2.92	2.93	2.93
NZGB 04/13	2.86	3.00	2.94	3.02	3.03	3.04
NZGB 04/15	3.46	3.52	3.44	3.52	3.55	3.56
NZGB 03/19	4.26	4.28	4.18	4.26	4.32	4.33
NZGB 05/21	4.45	4.45	4.36	4.44	4.50	4.51
2 year swap	3.19	3.31	3.25	3.31	3.28	3.29
5 year swap	4.12	4.03	3.94	4.01	4.02	4.03
RBNZ TWI	70.7	72.7	71.7	71.5	72.0	72.4
NZD/USD	0.8131	0.8444	0.8292	0.8266	0.8325	0.8350
NZD/AUD	0.8076	0.7971	0.7892	0.7811	0.7860	0.7870
NZD/JPY	62.78	64.83	63.70	63.85	64.42	64.70
NZD/GBP	0.4978	0.5220	0.5155	0.5170	0.5217	0.5227
NZD/EUR	0.5716	0.5962	0.5893	0.5885	0.5921	0.6004
AUD/USD	1.0068	1.0594	1.0507	1.0582	1.0591	1.0610
EUR/USD	1.4224	1.4163	1.4071	1.4047	1.4061	1.3908
USD/JPY	77.21	76.78	76.82	77.25	77.38	77.49
GBP/USD	1.6333	1.6177	1.6085	1.5987	1.5956	1.5974
Oil (US\$/bbl)	79.32	86.45	83.61	86.33	89.29	89.06
Gold (US\$/oz)	1753.20	1876.95	1913.25	1848.60	1831.30	1862.15
Electricity (Haywards)	8.55	8.83	8.81	9.95	7.91	9.73
Baltic Dry Freight Index	1257	1750	1767	1744	1782	1838
Milk futures (USD)	149	..	143	143	144	145

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