

RECYCLING

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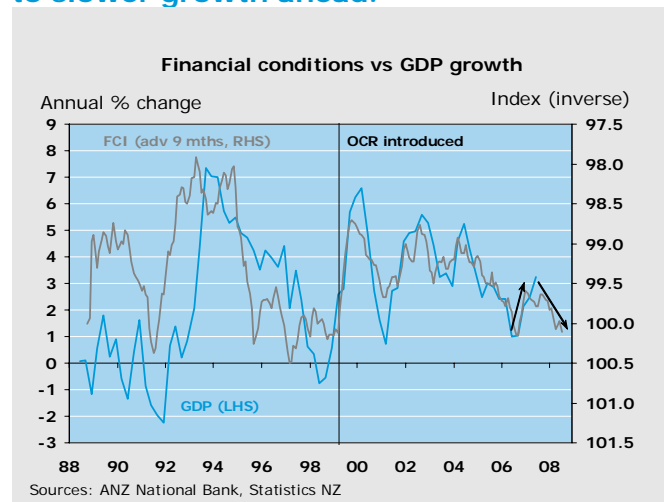
- The NZD remains in a tussle between yield support and risk aversion. USD weakness and a strong AUD have forced us to once again update our NZD forecasts. The overall spirit is a relatively flat path over the coming six months with a slight easing bias until we are firm in how such contrasting forces will pan out. We remain comfortable maintaining our long-held weak NZD/AUD view.

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Financial conditions still tight and pointing to slower growth ahead.



Labour market data this week to reinforce the cost-push pressures evident within the economy.



ECONOMIC OVERVIEW

Domestic data continues to give mixed messages. Looking at the broad picture, the economy remains solid. The Reserve Bank looks set to gain additional policy traction via higher fixed lending rates, aiding their anti-inflation cause. This week local labour market data, the spectre of tax cuts and a probable hike from the RBA should keep the bias for NZ interest rates pointed upwards.

What's ahead...

- NZ Q3 LCI and QES (Monday 1045 NZDT). Wage growth to remain elevated given reported difficulties in finding staff.
- ANZ October Commodity Price Index (Tuesday 1500 NZDT).
- NZ Q3 HLFS (Thursday 1045 NZDT). Robust employment growth should ensure the unemployment rate remains at a record low.

What's the view

The domestic dataflow last week provided further signs that the slowdown in the housing market is continuing to extend. Building consents fell 8.3 percent and credit growth eased to its slowest level since late 2002. To be fair, consents excluding apartments fell a more muted 2.5 percent and continue to show a degree of resilience, although the other aspect of building consent figures was a notable easing in non-residential work. Non-residential consent issuance (value) had shown remarkable strength over the preceding four years (averaging 13 percent annual growth) so there might be a base effect at work. Of course we don't like to read too much into one month's data, but this could also be an early indication of re-rated credit risk perhaps impacting. Looking forward, there is typically a 3-4 month lag between a decline in house and lower building consent issuance. Present weakness in house sales is anticipated to result in further falls in consent issuance over the months ahead, which will lead to declines in residential construction activity by early next year.

Last week's credit data was also relatively muted, particularly in the housing sector, with growth easing to 0.8 percent in the month, and annualised housing credit growth now down to around 9 percent. However, business sector and rural lending remain strong, highlighting the narrowly based slowdown the Reserve Bank is seeing. Of equal interest was data on non-bank financial institutions (NBFIs), which unsurprisingly experienced liquidity pressures over the September quarter. There was a net outflow of funds to the tune of \$276 million, and this is larger than the \$140m outflow in the September 2006 quarter following the collapses of National Finance 2000, Provincial and Western Bay. NBFIs lending growth has also slowed. The slowdown is expected to be a noticeable constraint on economic prospects as this

lending is typically manifested in more speculative pockets of building and spending activity.

Looking across the economy as a whole, business sentiment remains surprisingly buoyant, with the National Bank Business Confidence Survey showing a further improvement. Despite financial conditions tightening over October (see page 4), businesses appear to be settling into a comfortable base. Not so comforting for the Reserve Bank are the pricing intentions and inflation expectations, both of which took disconcerting steps up. The Reserve Bank would have been disappointed with the confidence readings, and were probably expecting more of a dent after delivering 100bps of tightening over the first half of this year. The Bank is also likely to be concerned with import growth, which remains relatively robust and monthly trend measures continue to increase. Export growth on the other hand looks decidedly soft and suggests the net external sector will once again detract from growth in the September quarter.

However, one development that the Reserve Bank is likely to be comfortable with is the rise in the NZ swaps curve last week. The entire curve is up by between 6-18bps as market participants are starting to ascribe a higher probability that the Reserve Bank may hike again. Fixed rates are moving up. The real skill in monetary policy is manipulating the yield curve as opposed to the OCR itself although it can also turn into a game of the chicken and the egg. Maintaining traction in some instances is dependent on sometimes delivering with the primary monetary policy instrument. A further hike is not a view we currently share, largely because of underlying wariness towards global events and the credit cycle. We suspect the Reserve Bank will be quietly chuffed that they are getting more policy traction (about 30 percent of all fixed mortgages - \$36.2 billion - are due for refinancing in less than 12 months). They will also be mindful of the impact this may be having on the export sector via the higher currency. Collectively, we suspect the higher interest rates will cement expectations that the housing slowdown is going to be sustained and we will be wary of the hype that the market is firming into spring and Christmas, which tends to be a seasonal influence anyway.

With data this week expected to reinforce capacity constraints, late cycle economic support, and inflationary pressure, we expect the curve to continue working in the Reserve Bank's favour until Christmas. The higher curve will allow the Bank to maintain their wait-and-see stance.

Of note over the weekend was also confirmation at the Labour Party's annual conference that tax cuts are on the cards. Given the structural surplus nuances we can only presume that the actual projections are far higher, and this is in turn expected to provide greater flexibility and scope to loosen the fiscal reins. This will allow injections that will be considerably larger than has been already factored into the fiscal projections. The

Government may try to sell this as being fiscally neutral (more tax in owing to a stronger economy, tax cuts out is technically neutral in a pure cash flow sense). However, this does not help the Reserve Bank as noted in our *Market Focus* last week. The recycling of the constant upside surprises to tax revenue through spending and tax initiatives, and other areas of inflationary pressure (regulation, Government employment) are making life difficult for the Reserve Bank.

Other important developments last week were a further interest rate cut from the Federal Reserve and surging world oil prices. The Fed cut rates by 25bps to 4.50 percent as housing and credit woes continue to weigh on the US economy. Despite the cut, the Fed now sees the upside risks to inflation broadly balanced by the downside risks to growth. Perhaps it's a signal that the Fed is willing to sacrifice a bit of growth to ensure inflation remains well contained. Higher oil prices last week emphasise the upside risks to inflation that all central bankers are dealing with.

The higher oil prices have led to local pump price increases and we are now getting closer to the level where petrol prices peaked at \$1.769/ltr in August last year. The continued rise has the potential to depress consumer spending and overall economic activity just as the rise in the domestic pump prices did in the middle of last year. However, it will also add to headline inflation pressure at a time core inflation pressures are elevated. The Reserve Bank will look through the first round impacts of higher petrol prices on inflation but guard against second round impacts.

Moving to the data/events this week, the calendar is dominated by local labour market data and interest rate announcements by the RBA, ECB and BoE. The RBA is expected to lift rates by 25 basis points given solid growth indicators and high core inflation results. Evidence is growing by the day that an RBNZ-style tightening is needed over the Tasman to reign in persistent inflation pressures. This hike, along with NZ labour market data that is expected to reinforce the cost-push pressure and late cycle support for the economy, are expected to maintain the current upward bias for NZ interest rates.

Recent data...

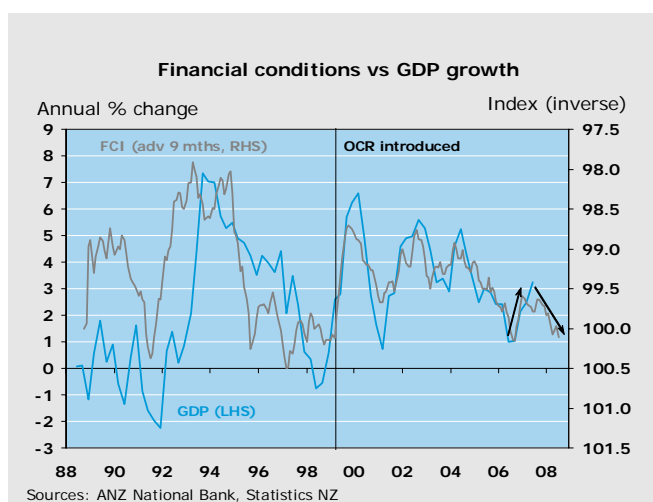
- **NZ Overseas Merchandise Trade (Sep).** The monthly trade deficit was \$544 million, taking the annual balance to \$6,256 million.
- **NZ Building Consents (Sep).** Residential consents fell 8.3 percent. Ex-apartment consents fell a more modest 2.5 percent.
- **RBNZ Credit Growth (Sep).** Total household claims grew 0.8 percent in the month.
- **NBNZ Business Outlook (Oct).** Headline business confidence increased. All measures of resource and pricing pressures rose.

FINANCIAL CONDITIONS UPDATE

Financial conditions tightened over October, courtesy of a run-up in the currency and higher swap yields. Our *Financial Conditions Index* continues to point to a slowdown in growth towards 1½ percent by mid-2008.

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

Economic activity rebounded strongly over the first half of this year, growing at an annualised rate of 4 percent. This rebound was largely predicted by our *FCI*, though the strength of the rebound was more than anticipated. However, it was well within the normal error bounds.



Most of the tightening in financial conditions in October was due to a strengthening in the NZD and higher domestic interest rates. The NZD has rebounded strongly and is up 4.1 percent in the month on a TWI basis. Though the 90-day rate has fallen as the domestic cash squeeze eased, the rise in the 2-year swap yield on the back of inflation concerns has more than provided an offset. This activity unwound the slight easing in financial conditions seen over August and September, when the NZD fell sharply and the 2-year swap yields declined on the back of global financial market turbulence.

Movements in the other indicators that make up our *FCI* largely offset one another. The easing in global credit concerns has seen the US 2-year swap spread narrow and domestic equities rise. But house prices continue to move sideways and credit growth, while still robust, is starting to slow.

Indicators	Comment	Impact on activity
Currency, adjusted for commodity prices and input costs	Dominated by TWI rising 4.1%.	↓
Interest rates	Higher 2-year swap rate offset fall in 90-day rate.	↓
US 2-year swap spread	Easing global credit concerns led to a narrowing in swap spreads.	↑
Equity market index as a proxy for corporate wealth and liquidity	Equity prices recovered on the back of the rebound in global equities.	↑
House prices as a proxy for household wealth	House prices largely moving sideways over recent months.	↔/↓
Private sector credit growth	Credit growth still robust but showing signs of easing.	↔/↓
Liquidity	Liquidity still abundant but starting to show early signs of slowing.	↑
Overall conditions	Tightened due to higher currency and interest rates.	↓

Looking forward, our *FCI* continues to point towards a slowdown in economic activity over the second half of this year and into early next year. Financial conditions remain tight despite high commodity prices, and point to year-on-year GDP growth of 1½ percent by mid-2008.

The currency and domestic interest rates are expected to hold up in the near term as the NZ market becomes more closely correlated with Australia (and the RBA is expected to engage in a new tightening cycle).

Of course at this juncture, uncertainty will remain over whether this slowdown will in fact translate into easing inflationary pressure. Certainly the experience of 2006 (1.0 percent growth) shows that inflationary pressure can continue to intensify in a soft-landing type environment. It leaves us a little uneasy over what sort of growth outcome, or level of financial conditions will be required to tame the inflationary beast.

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

INTEREST RATE STRATEGY

Labour market data this week to keep the local market biased towards higher rates. Central bank announcements offshore to provide some direction.

Market themes...

- Market starting to price in higher odds of another rate hike next year, prompted by inflation concerns.
- Fed cut rates but moved into neutral stance.
- Fresh credit concerns send global markets rallying late last week.

Outlook...

The local dataflow was mixed last week. Weak building consents data and slowing household borrowing failed to elicit much movement from the market. There was a strong payside bias in the swaps market, which combined with flow movements, saw the entire swaps curve trade much higher. Resilient business confidence data had the market starting to contemplate the odds of another rate hike next year. OIS pricing is currently ascribing close to a 50 percent chance of a further hike from the Reserve Bank.

This week's labour market data is likely to show strong wage growth and ongoing tightness in the labour market, which will keep the market biased towards higher rates. The 2-year swap yield traded as high as 8.7 percent last week before pulling back, but will likely struggle to break through that level this week. The labour market data will set the tone for the swaps market heading into the Reserve Bank's December MPS. A strong print will see a new higher trading range form. Softer than expected outturns will likely see the 2-year yield drift back to its recent 8.50 to 8.60 percent range. But as has been the case in recent weeks, the front end of the curve will remain well anchored, limiting moves in the long end in response to any global rally.

Despite the US Federal Reserve cutting interest rates by 25bp and moving to a neutral stance, the market continues to price in further cuts amid fresh credit concerns. The Fed might be worried about inflation risks, but the market is not taking notice as yet. Expectations of further Fed easings will see further widening in the NZ-US 10-year bond spread.

The RBA, ECB and BoE announce their interest rate decisions this week. Of the three, only the RBA is widely tipped to increase interest rates. With the market fully priced for a rate hike, the accompanying statement will be closely eyed for clues of whether the RBA will make a follow-up move in December.

Gauges for NZ interest rates yields

Gauge	Direction	Comment
RBNZ	↔	RBNZ in wait-and-see mode but still worried about inflation.
NZ data	↔/↑	Strong wage inflation data this week to keep yields higher.
Fed Funds/front end	↔	Fed cut by 25bp but signals a shift to neutral mode.
RBA	↔/↑	Stronger than expected retail sales final nail in the coffin for a rate hike this week.
US 10 year	↔/↓	Renewed credit concerns sending safe haven flows back into bonds.
NZ swap spreads	↔/↓	EFP spreads favoured to contract – bond led.
Flow	↔/↓	Data dependent pullbacks will be limited given payside interest.
Technicals	↔	New technical levels are being tested.

Borrowing strategies we favour at present

NZ yields pushed higher once again last week in response to payside pressure and a continuation of strong data from across the Tasman. This week's employment data will be closely watched with the labour market expected to remain tight. Those who have long-term fixed hedges in place may want to consider shortening their duration. Interest rate caps could be an effective option for those who don't have cover and are reluctant to fix at current levels.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 6-Dec-07	9	0
Thu 24-Jan-08	18	6
Thu 6-Mar-08	28	14
Thu 24-Apr-08	28	46
Thu 5-Jun-08	28	46
Thu 24-Jul-08	20	46
Thu 11-Sep-08	4	46

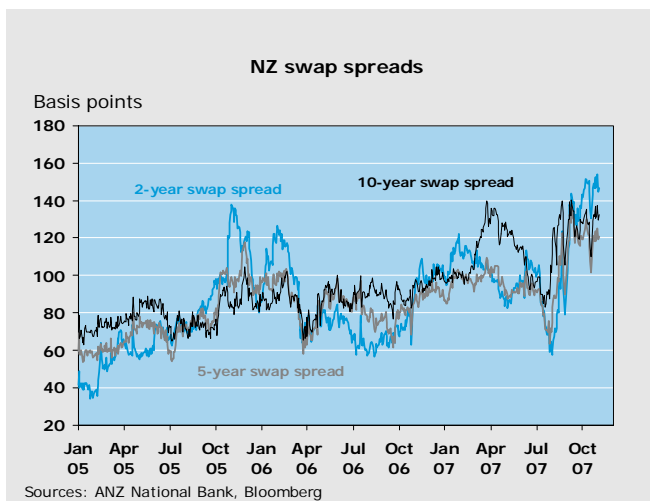
Trading themes we favour at present

Payside bias expected to once again dominate this week. HLFs data this week to dictate near-term direction.

NZ SWAP SPREADS

Swap spreads in NZ are primarily flow driven. Our modelling shows the importance of mortgage paying, issuance and offshore demand for NZGBs in influencing swap spreads. We expect swap spreads to narrow from current elevated levels primarily driven by flows initially.

Swap spreads (which are the difference between swap yields and the comparable government bond yield) in NZ have been widening over the past two months, driven in part by the global financial market turbulence that has seen global credit spreads widen. More recent moves wider in NZ swap spreads have been due to the global rally in bond yields on the back of concerns over US economic growth and increasing expectations of easings from the US Federal Reserve². While NZ bond yields partly followed global moves, NZ swap yields actually rose due to ongoing inflation concerns and an expectation that monetary policy in NZ is on hold for some time. Swap yields in NZ are at elevated levels by historical standards.



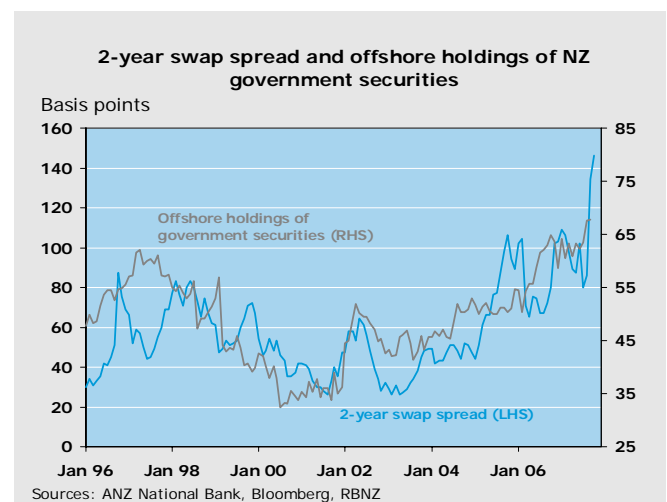
Swap spreads can be thought of as comprising a convenience yield from holding government bonds, a credit risk element, and swap-market specific factors. When modelling swap spreads, the usual variables used include: the outright yield; the slope of the yield curve; high quality corporate bond spreads (as a proxy for default premium); implied volatility; the Government's fiscal position and proxies for the business cycle (such as GDP growth or the unemployment rate). Previous attempts at modelling NZ swap spreads using the conventional variables described above have provided mixed results. While some of the variables do show some statistical significance in determining swap spreads, the parameter estimates tend to be unstable.

One reason for the limited success in modelling NZ swap spreads using the usual array of variables is the importance of flows. Given the relatively illiquid

² The global rally partly reversed last week following the Fed's 25bp cut and move to a neutral stance.

nature of the NZ market, particularly for government bonds, near-term movements in swap spreads can be dictated by flows hitting the market as opposed to the more fundamental drivers. Hence, in our new swap spread modelling approach, we have explicitly incorporated flows data which we know have an influence on the swap spread either via the swap yield or bond yield. Specifically, we looked at:

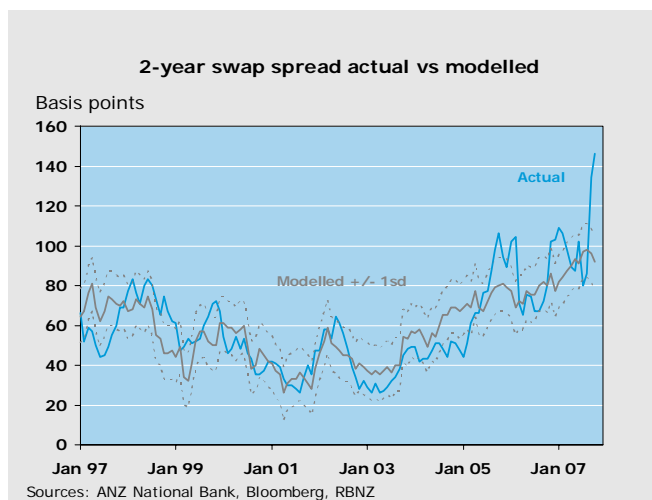
- **The change in household credit growth.** As banks dominate the mortgage market in NZ, a rise in demand for household credit will result in increased mortgage paying in the swaps market, driving swap yields higher and therefore the swap spread wider.
- **Net Uridashi/Eurokiwi issuance.** Increased issuance tends to lead to increased receiving in swaps with no corresponding impact on bonds, which will push swap yields lower and hence lead to a narrowing in swap spreads.
- **Offshore holdings of NZ Government securities.** Greater demand for NZ bonds tends to push their yields lower, particularly if the amount is sizeable, leading to a widening in swap spreads.



We restricted our modelling to the 2-year swap spread, as the 2-year is the most liquid part of the NZ curve and the longer end tends to be dominated by offshore movements. Our final model found all three flow variables above to be significant in explaining the NZ 2-year swap spreads. However, the net Uridashi/Eurokiwi issuance variable had a positive sign, counter to our expectations that increased issuance would lead to a narrowing in the spread. A possible explanation could be that the "announcemnet effect" of a new issuance leads to only a temporary narrowing in the spread as participants receive initially, but the longer-term effect is positive for spreads, which is what our modeling based on monthly data suggests. Apart from the flow variables, the other variables included in our swap spread model include the NZ 2-year swap yield and the AU 2-year swap spread as a proxy for the default premium, since all the major

banks in NZ are Australian owned. The slope of the yield curve was not found to be significant and was dropped from the model.

The chart below shows the modelled results versus actual for the NZ 2-year swap spread based on our model. Our model does a reasonably decent job in approximating the actual swap spread, considering the volatility of the series. Deviations outside of the +/-1 standard deviation tend to correct eventually, though it is clear that there are a lot of short-term factors that are driving the swap spreads which are not accounted for in our model. We have tried incorporating the VIX index, US 2-year swap spreads and global corporate bond spreads as proxies for credit risk but they were not found to be significant or had the wrong sign.



Our model did not predict and could not explain the sharp rise in the swap spread over the past two months on the back of increased global financial volatility. In fact, the current spread is +4 standard deviations above our model's estimate.

The upshot

When we look at the fundamental and flow drivers, we expect the NZ 2-year swap spread to narrow from current elevated levels. We expect flows to be the primary driver, noting that:

- The NZ housing cycle has turned, with house sales down 32 percent from a year ago. In line with this, mortgage growth has slowed over recent months and we expect this trend to continue. This will translate into less mortgage paying leading to narrower swap spreads.
- Current NZ interest rate levels are still attractive for Uridashi issuers. However, the rate of issuance has slowed and with reasonably large maturities averaging NZ\$1.5bn over the coming six months, net issuance is expected to remain subdued.
- Offsetting the mortgage paying and net issuance to some extent is ongoing demand for NZGBs, which is expected to remain strong

particularly with ongoing Asian central bank diversification and the growing prominence of sovereign wealth funds. The size of some of these flows will push NZ bond yields lower, leading to a widening in swap spreads.

In addition, once there are clear signs that the slowdown in domestic demand is starting to ease inflation pressure, swap spreads will start to narrow as the market will see scope for the Reserve Bank to ease monetary policy. The narrowing will be led by lower swap yields. However, this is not likely to occur until late next year.

CURRENCY STRATEGY

With labour market data and the RBA interest rate decision this week, yield should regain the upper hand after taking a back seat to risk aversion at the end of last week.

Market themes...

- Yield versus risk aversion. The battle continues.
- RBA to hike, labour markets to remain tight.

Outlook...

With the Fed's interest rate announcement front and centre, last week was always going to be another week of balancing the yield/carry story against risk appetites. Local currency markets had a relatively quiet start to the week, with most participants generally looking towards the FOMC announcement on Thursday morning to provide direction. The Fed cut their target rate 25 basis points to 4.5 percent, and surprised the market by signalling a shift to a neutral stance. US equities powered ahead after the Fed statement despite the negative implications for equities, and risk appetites came back to the fore. This saw the NZD, which had fallen sharply immediately following the announcement, reverse its losses and power towards resistance at 0.7750.

But those post-Fed gains were short-lived, as risk aversion reared its ugly head. Brokerage downgrades of the two largest US banks, and a US\$1.9b write-down by one bank due to credit-related losses, were enough to send investors bailing out of US equities and into the relative safety of bonds. With risk appetites running for the hills, carry-trade currencies (NZD, AUD) suffered, and the NZD dropped to 0.7580. US non-farm payrolls data helped to stem the fall in the NZD and it starts this week above the initial support zone at 0.7595-0.7605.

Last week's results are a timely reminder that credit market woes are far from over, and will not be resolved by the Fed cutting interest rates. With still further mortgage resets to come and more foreclosures and delinquencies expected, more credit-related losses by financial institutions that are exposed to them can be expected. The impact that these have on risk appetites will clearly be a major source of direction for the NZD - yield support for the kiwi remains, but risk aversion lurks around many corners, and the volatility looks set to continue.

In the absence of further credit rumblings from offshore, this week should see the NZD begin the week tentatively, wanting to move higher in sympathy with the AUD. Data and events on both sides of the Tasman are expected to reinforce the Antipodean yield advantage. The data calendar is

dominated by labour market data (both here and in Australia), which are expected to confirm that both labour markets remain tight, and a key source of inflation pressure. The Reserve Bank of Australia is widely expected to raise their cash target rate to 6.75 percent on Wednesday morning. The market will be closely examining the accompanying statement for clues about the RBA's future intentions.

Technically, both the NZD and AUD have probed key support levels and remained on the edge with rising risk aversion. The NZD/AUD remains below the 0.8333 level but until Australian interest rates are actually increased the road down to 0.8210 will be a hard one. Risks remain if the RBA fail to raise rates for a kick back above 0.8333.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↔	Growth differentials favouring AUD. But 0.83 feels about right.
Yield	↔/↓	RBA likely to hike this week.
Commodities	↔/↓	Still supportive of both, but precious metals strong.
Partial indicators	↓	Better across the Tasman.
Technicals	↔	Support at 0.8210
Sentiment	↓	AUD data is better.
Other	↔	AUD elections just a distraction?
On balance	↔/↓	0.8333 pivotal

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔	US data is weak as well.
Yield	↑	1 year forwards above 300 points is impossible to fight.
Commodities	↑	Higher commodity prices are still a major factor.
Risk aversion	↔/↓	Credit concerns reignite.
Partial indicators	↔	NZ domestic economy is soft, but US is softer.
Technicals	↑	Test of 0.7800 again possible this week.
AUD	↑	AUD doing well.
Sentiment	↔	Neutral in NZ, bearish in US.
Other	↑/↔	USD heavy.
On balance	↑/↔	Yield v risk aversion. Yield to win this round on points?

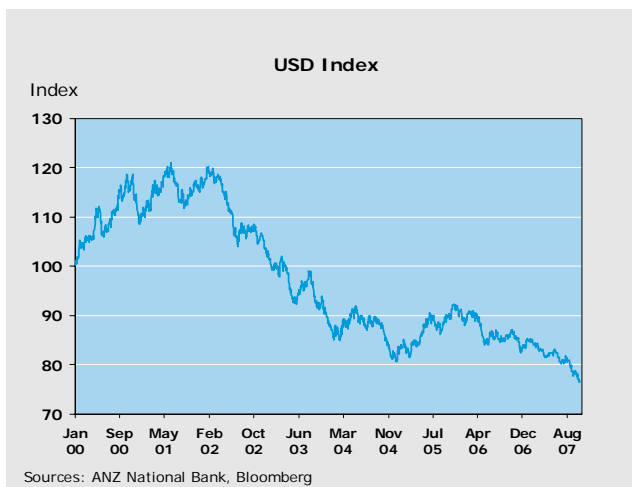
CURRENCY UPDATE

The NZD remains in a tussle between yield support and risk aversion. USD weakness and a strong AUD have forced us to once again update our NZD forecasts. The overall spirit is a relatively flat path over the coming six months with a slight easing bias until we are firm in how such contrasting forces will pan out. We remain comfortable maintaining our long-held weak NZD/AUD view.

We are back chasing currency pygmies and the USD is looking shortest. Housing market woes, evidence of a slowing economy, lingering concerns over credit market losses and an aggressive easing in monetary policy from the US Federal Reserve (cutting interest rates 75 basis points in two months) have contributed to significant weakness for the greenback. Even a broadly neutral statement from the Fed and a lack of committal to future interest rate cuts has failed to stem the tide. USD weakness is pushing the NZD higher by default (along with other major currencies).

If the Fed is concerned about the weak USD they are not showing it. There also looks to be a lack of political support for a stronger USD. Although both US Treasury Secretary Paulson and Vice President Cheney have stuck to the "strong dollar" policy in recent days, this stance lacks potency with the Fed in easing mode. And there is no sign that the US would support any argument for intervention.

Beyond short-term cyclical moves in rate differentials, diversification out of the USD from sovereign wealth funds remains a major structural threat to the USD. The longer the USD remains under pressure, the greater the risk that diversification of reserves will be forced to accelerate. It looks as though a USD weakness theme is here to stay.

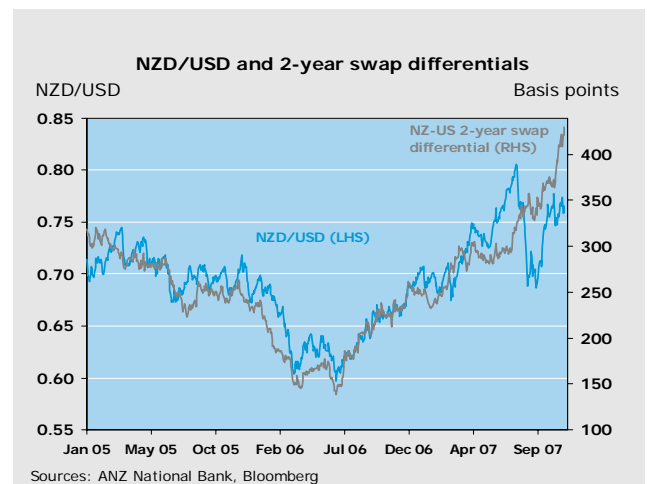


For exporters, this seems like tough-love, although we only need to hark back to 2001 to recall the theme in reverse and a strong USD pushing the NZD down. Indeed if there is a surprise to be had it may well be that the USD turns against the

"bearish" trend, just as the structurally higher USD in 2001 proved to be a mirage. But for now we'll run with the pack and the call for the USD to remain heavy.

Another factor providing support to the NZD in the near-term is AUD strength. The Australian economy continues to perform strongly, and the market is now fully set for an RBA interest rate hike this week with the possibility of more to come next year or potentially before year-end. Australia looks to be set for a RBNZ-style tightening cycle given persistent inflationary pressures.

But, USD weakness and AUD strength aside, the NZD remains caught in a tussle between yield demand and risk aversion. The 2-year US-NZ swap differential has increased to around 430 basis points – a record high. Not only have the Fed been cutting rates, but local markets have begun testing the possibility the RBNZ may need to tighten again. The NZD looks to be lagging based on the yield differential. Perhaps this is testament to the underlying nervousness across markets, also demonstrated by volatility late last week.



For now we are running with a relatively flat path for the NZD/USD over the coming months, with a higher for longer theme until we see how contrasting forces pan out.

Regular readers will be well aware of our long-held bearish view towards the NZD/AUD. Our 80 cent call by early 2008 at the start of the year looked decidedly outrageous relative to the consensus. Yet it is a view we remain comfortable calling and prospects now look for a move south of that.

	NZD/USD	NZD/AUD	AUD/NZD
Dec 07	0.77	0.83	1.20
Mar 08	0.76	0.81	1.24
Jun 08	0.75	0.78	1.28
Sep 08	0.72	0.77	1.31
Dec 08	0.69	0.76	1.32
Mar 09	0.67	0.76	1.32
Jun 09	0.65	0.76	1.31
Sep 09	0.63	0.77	1.31
Dec 09	0.62	0.77	1.29

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
5 Nov	NZ	Labour Cost Index All Sectors (3Q) – qoq	0.8%	0.8%	10:45
		Labour Cost Index Private Sector (3Q) – qoq	0.8%	0.7%	10:45
	AU	TIG Performance of Service Index (Oct)	-	56.4	11:30
		TD Securities Inflation (Oct) – mom	-	0.2%	12:30
		ANZ Job Advertisements (Oct) – mom	-	-0.4%	13:30
	JN	BoJ Governor Fukui to speak at Financial Conference	-	-	19:00
	UK	Official Reserves (Changes) (Oct)	-	\$1,069m	22:30
		PMI Services (Oct)	56.0	56.7	22:30
		Industrial Production (Sep) – mom	0.2%	0.1%	22:30
		Manufacturing Production (Sep) – mom	0.1%	0.4%	22:30
6 Nov	US	Fed's Mishkin speaks at Risk Conference in New York	-	-	03:00
		ISM Non-Manufacturing (Oct)	54.0	54.8	04:00
		Fed's Kroszner speaks on Subprime Mortgages in Virginia	-	-	06:00
	NZ	ANZ Commodity Price Index (Oct)	-	0.4%	15:00
	JN	Leading Economic Index (Sep P)	0.0%	27.3%	18:00
	GE	PMI Services (Oct)	54.9	53.1	21:55
	EU	PMI Services (Oct F)	55.6	55.6	22:00
		PMI Composite (Oct F)	54.5	54.5	22:00
		PPI (Sep) – mom	0.3%	0.1%	23:00
		Retail Sales (Sep) – mom	0.6%	0.1%	23:00
7 Nov	GE	Factory Orders (Sep) – mom	-0.3%	1.2%	00:00
	NZ	RBNZ publishes Financial Stability Report	-	-	-
	US	Fed's Bernanke speaks at Microfinance Conference in San Antonio	-	-	06:30
	AU	RBA Cash Target Rate Announcement	6.75%	6.50%	11:30
		Home Loans (Sep)	0.1%	1.6%	13:30
		House Price Index (3Q) – qoq	3.0%	3.2%	13:30
		Foreign Reserves (Oct)	-	A\$52.7B	18:30
	JN	Official Reserve Assets (Oct)	-	\$945.6B	12:50
	UK	Nationwide Consumer Confidence (Oct)	97	99	13:01
8 Nov	GE	Industrial Production (Sep) – mom	-0.5%	1.7%	00:00
	US	Non-Farm Productivity (3Q P)	3.1%	2.6%	02:30
		Unit Labour Costs (3Q P)	1.1%	1.4%	02:30
		Fed's Lacker speaks to Credit-Portfolio Managers in New York	-	-	02:45
		Wholesale Inventories (Sep)	0.2%	0.1%	04:00
		Fed's Warsh speaks to Economists in New York	-	-	06:00
		Fed's Lockhart speaks on US Economic Outlook in Alabama	-	-	07:10
		Consumer Credit (Sep)	\$9.0B	\$12.2B	09:00

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)	
8 Nov cont.	NZ	Unemployment Rate (3Q)	3.6%	3.6%	10:45	
		Employment Growth (3Q) – qoq	0.4%	0.7%	10:45	
	JN	Machine Orders (Sep) – mom	-0.9%	-7.7%	12:50	
		Money Supply M2+CD (Oct) – yoy	1.7%	1.7%	12:50	
		Broad Liquidity (Oct) – yoy	4.1%	4.1%	12:50	
		Eco Watchers Survey: Current (Oct)	-	42.9	20:00	
		Eco Watchers Survey: Outlook (Oct)	-	46.0	20:00	
	AU	Employment Change (Oct)	20k	13.0k	13:30	
		Unemployment Rate (Oct)	4.2%	4.2%	13:30	
		Participation Rate (Oct)	65.0%	65.0%	13:30	
9 Nov	UK	BoE announces Interest Rates	5.75%	5.75%	01:00	
		Leading Indicator Index (Sep) – mom	-	-0.2%	04:30	
		Coincident Indicator Index (Sep) – mom	-	0.2%	04:30	
			Total Trade Balance (Sep)	‑£4,100	‑£4,107	22:30
	EU	ECB announces Interest Rates	4.00%	4.00%	01:45	
		ECB's Trichet speaks at ECB Monthly News Conference	-	-	02:30	
	US	Initial Jobless Claims (Nov 4)	325k	327k	02:30	
		Continuing Claims (Oct 28)	2,550k	2,588k	02:30	
		Fed's Bernanke testifies Before Joint Economic Committee	-	-	04:00	
	JN	Industrial Production (Sep F) – mom	-1.4%	-1.4%	17:30	
Capacity Utilisation (Sep F)		-	109.7	17:30		
10 Nov	US	Trade Balance (Sep)	‑\$58.5B	‑\$57.6B	02:30	
		Import Price Index (Oct) – mom	1.1%	1.0%	02:00	
		University of Michigan Confidence (Nov P)	80.0	80.9	04:00	

Key: AU: Australia, EU: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States.

Sources: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. (Note: all surveys are preliminary and subject to change).

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: The Reserve Bank needs to see evidence that weakness in the housing market is spilling over into other parts of the economy and eventually into reduced inflationary pressure. This week, labour market data will reinforce the cost-push pressures and late cycle support for the economy and keep the market biased towards higher interest rates.

Date	Data/Event	Economic Signal	Comment
Mon 5 Nov (10.45)	QES and LCI Surveys (Sep qtr)	Solid	Firms continue to report difficulty in finding both skilled and unskilled labour. This will ensure that wage inflation remains elevated for some time.
Tue 6 Nov (15.00)	ANZ Commodity Price Index (October)	-	-
Thu 8 Nov (10.45)	Household Labour Force Survey (Sep qtr)	Still tight	Given still elevated employment intentions, we expect robust employment growth in the quarter and the unemployment rate to remain near record low levels.
Circa 12 Nov	REINZ Housing Report (Oct)	Soft	Further weakness in housing activity is expected. This is also expected to result in more subdued house price growth, which should see the annual rate of growth begin to reduce.
Wed 14 Nov (10.45)	Capital Goods Price Index (Sep qtr)	Mixed	A lower NZD over the quarter is expected to have lifted plant and machinery equipment prices. Construction costs are still expected to be elevated, although the rate of growth is likely to have slowed in line with the moderation in housing activity.
Wed 14 Nov (10.45)	Producer Price Index (Sep qtr)	Slight improvement in margins	Output prices are expected to increase by slightly more than input prices in the quarter. Higher commodity prices are supporting output prices, while higher oil prices lift input prices.
Thu 15 Nov (10.45)	Retail Trade Survey (Sep)	Month strong, but quarter soft	Strong credit card spending indicates retail sales were solid in September. However, we expect quarterly volume growth will be much more muted.
Tue 20 Nov (10.45)	External Migration (Oct)	Consolidation	Despite an easing trend in annual net migration inflows, recent monthly inflows have ticked up slightly. We expect a period of consolidation around current levels.
Wed 21 Nov (15:00)	Credit Card Spending (October)	Pull-back	Given the large surge in spending in the previous month, we are expecting a reasonable pull-back in October.
Mon 26 Nov (10.45)	Overseas Merchandise Trade (October)	Improving?	Higher commodity prices and further production from Tui will help support export values. Nevertheless, the trade balance is expected to remain in deficit in October. The importation of an oil production vessel will contribute to the import bill.
Tue 27 Nov (15.00)	RBNZ Survey of Expectations	Elevated	Inflation expectations to remain stable but still too elevated for the Reserve Bank's liking.
Thu 29 Nov (10.45)	Building Consents Issued (October)	Soft	Given weakness in housing market activity, we expect a softening trend in residential building consents to continue. Of most interest will be how non-residential issuance is faring.
Thu 30 Nov (15.00)	Credit Growth (October)	Soft	Housing lending growth was soft in September. We expect the same theme to have occurred in October.
On Balance		Sub-trend but respectable	All about inflation from here.

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SUMMARY OF KEY ECONOMIC FORECASTS

	Sep-06	Dec-06	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08
GDP (% qoq)	0.4	0.8	1.2	0.7	0.2	0.3	0.3	0.4	0.4	0.6
GDP (% yoy)	1.0	2.1	2.5	3.2	3.0	2.5	1.5	1.2	1.4	1.7
CPI (% qoq)	0.7	-0.2	0.5	1.0	0.5	0.8	0.5	0.8	0.8	0.8
CPI (% yoy)	3.5	2.6	2.5	2.0	1.8	2.8	2.8	2.5	2.8	2.8
Employment (% qoq)	-0.4	0.1	1.2	0.7	0.6	0.2	0.2	0.0	0.0	0.1
Employment (% yoy)	1.5	1.4	1.7	1.5	2.6	2.6	1.6	1.0	0.4	0.3
Unemployment Rate (% sa)	3.8	3.7	3.7	3.6	3.6	3.7	3.8	4.0	4.1	4.3
Current Account (% GDP)	-8.8	-8.7	-8.3	-8.2	-8.2	-7.9	-7.4	-6.9	-6.8	-6.8
Terms of Trade (% qoq)	-2.2	2.5	1.5	0.6	5.5	2.4	0.2	-0.2	-0.5	-0.3
Terms of Trade (% yoy)	-1.3	3.8	4.5	2.5	10.5	10.5	9.0	8.1	1.9	-0.8

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

KEY ECONOMIC INDICATORS

	Jan-07	Feb-07	Mar-07	Apr-07	May-07	Jun-07	Jul-07	Aug-07	Sep-07	Oct-07
Retail Sales (% mom)	0.4	2.3	0.9	-1.3	1.0	-0.4	0.1	0.2
Retail Sales (% yoy)	6.9	6.4	7.4	7.4	6.7	4.8	5.7	6.3
Credit Card Billings (% mom)	-0.9	1.5	1.0	-1.0	1.0	1.7	0.0	0.4	3.1	..
Credit Card Billings (% yoy)	6.7	8.2	7.3	7.8	5.9	9.0	7.9	8.5	9.5	..
Car Registrations (% mom)	13.3	-9.5	0.6	-1.3	6.0	-4.6	7.2	1.3	-7.2	..
Car Registrations (% yoy)	-5.8	-12.5	-11.0	-4.8	-2.5	-1.5	7.0	10.9	0.1	..
Building Consents (% mom)	4.1	6.9	-1.0	0.7	5.1	12.6	-15.7	5.2	-8.3	..
Building Consents (% yoy)	-6.1	-8.5	3.3	9.2	3.1	32.8	-4.0	-1.2	-13.5	..
REINZ House Price (% yoy)	9.0	13.6	13.7	14.4	14.8	12.1	10.4	12.9	12.3	..
Household Lending Growth (% mom)	1.1	1.1	1.2	1.1	1.1	1.1	0.9	0.8	0.8	..
Household Lending Growth (% yoy)	13.0	13.1	13.3	13.5	13.5	13.5	13.5	13.4	13.1	..
Roy Morgan Consumer Confidence	136.8	133.8	129.3	128.6	122.1	121.0	121.1	122.4	121.3	122.0
NBNZ Business Confidence	..	-5.9	-12.5	-19.4	-48.3	-37.2	-38.5	-33.8	-26.5	-12.9
NBNZ Own Activity Outlook	..	25.7	24.1	22.5	7.8	14.8	12.4	16.7	17.2	20.3
Trade Balance (\$m)	-825	-127	60	-215	8	-518	-809	-946	-544	..
Trade Balance (\$m annual)	-6013	-5767	-5776	-6024	-5900	-6226	-6342	-6337	-6256	..
ANZ World Commodity Price Index (% mom)	1.3	1.4	2.0	4.9	2.6	6.3	4.6	1.4	0.4	..
ANZ World Commodity Price Index (% yoy)	11.1	13.0	17.1	20.9	21.1	29.8	35.1	36.3	35.7	..
Net Migration (sa)	380	510	660	200	380	590	480	760	720	..
Net Migration (annual)	14116	13151	12081	11222	10682	10078	8966	8730	8309	..

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Sep 07	Oct 07	5 Nov 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
NZD/USD	0.717	0.760	0.765	0.770	0.760	0.740	0.710	0.680	0.660	0.640
NZD/AUD	0.849	0.847	0.830	0.819	0.800	0.771	0.763	0.756	0.759	0.762
NZD/EUR	0.516	0.534	0.527	0.531	0.517	0.507	0.500	0.489	0.489	0.485
NZD/JPY	82.6	88.1	87.8	87.8	85.9	82.9	78.1	73.4	72.6	71.7
NZD/GBP	0.355	0.372	0.366	0.376	0.371	0.362	0.351	0.342	0.340	0.333
NZ\$ TWI	68.3	71.1	70.7	70.9	69.5	67.6	65.6	63.4	62.7	61.8
NZ interest rates	Sep 07	Oct 07	5 Nov 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
OCR	8.32	8.30	8.25	8.25	8.25	8.25	8.00	7.50	7.00	6.75
90 day bill	8.82	8.68	8.64	8.60	8.60	8.60	8.00	7.50	7.00	7.00
10 year bond	6.17	6.38	6.53	6.50	6.50	6.60	6.70	6.70	6.70	6.50
International	Sep 07	Oct 07	5 Nov 07	Dec 07	Mar 08	Jun 08	Sep 08	Dec 08	Mar 09	Jun 09
US Fed funds	4.75	4.75	4.50	4.50	4.50	4.50	4.50	4.50	5.50	5.75
US 3-mth	5.23	4.98	4.87	4.80	4.70	4.65	4.65	4.65	5.75	6.10
AU cash	6.50	6.50	6.50	6.75	7.00	7.25	7.25	7.25	7.25	7.25
AU 3-mth	6.89	6.98	7.02	7.00	7.30	7.50	7.50	7.50	7.50	7.40

KEY RATES

	2 Oct	29 Oct	30 Oct	31 Oct	1 Nov	2 Nov
Official Cash Rate	8.25	8.25	8.25	8.25	8.25	8.25
30 day bank bill	8.61	8.49	8.47	8.47	8.54	8.54
90 day bank bill	8.73	8.62	8.63	8.65	8.65	8.64
NZGB 07/09	6.98	7.07	7.12	7.16	7.25	7.23
NZGB 11/11	6.71	6.86	6.91	6.95	7.04	7.02
NZGB 04/13	6.63	6.76	6.80	6.83	6.92	6.90
NZGB 12/17	6.29	6.37	6.42	6.44	6.53	6.51
1 year swap	8.67	8.76	8.79	8.81	8.83	8.82
2 year swap	8.38	8.55	8.60	8.67	8.70	8.68
5 year swap	7.90	8.06	8.10	8.17	8.25	8.23
RBNZ TWI	71.6	71.0	71.3	71.2	71.3	70.6
NZD/USD	0.7631	0.7639	0.7701	0.7683	0.7718	0.7626
NZD/AUD	0.8594	0.8392	0.8345	0.8361	0.8286	0.8302
NZD/JPY	88.06	87.29	87.93	87.98	89.03	87.58
NZD/GBP	0.3738	0.3723	0.3748	0.3729	0.3713	0.3666
NZD/EUR	0.5366	0.5333	0.5344	0.5334	0.5336	0.5279
AUD/USD	0.8879	0.9103	0.9228	0.9189	0.9315	0.9186
EUR/USD	1.4222	1.4325	1.4410	1.4405	1.4465	1.4446
USD/JPY	115.40	114.27	114.18	114.51	115.36	114.85
GBP/USD	2.0413	2.0517	2.0546	2.0603	2.0789	2.0801
Oil	80.31	92.09	91.73	90.33	94.16	93.53
Gold	743.00	774.85	792.90	781.70	797.40	790.95
Electricity Price (estimate)	4.65	3.26	3.26	3.31	3.42	3.53

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