

NEW ZEALAND ECONOMICS ANZ MARKET FOCUS

1 November 2010

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ALL ABOARD THE QE2

ECONOMIC OVERVIEW

Last week's OCR Review struck an even softer tone than the subdued September MPS assessment. While the remainder of 2010 is looking soft, in line with the RBNZ's assessment, we continue to take a more upbeat view towards 2011. Our suspicion is that the mild improvement in business confidence last week may mark a turning point, though this will take time to filter into hard data. Internationally, attention will centre on what the Fed flags for further quantitative easing (QE), and our Australian counterparts expect the RBA to hike on Tuesday.

CYCLICALLY ADJUSTED FISCAL BALANCES

We estimate that 80 percent of the deterioration in the fiscal position between a peak in 2006 and 2011 is owing to structural factors (read: the discretionary policy changes) with the remaining 20 percent owing to a cyclical deterioration in the economy (read: downturn). The size and magnitude of the cyclically adjusted deterioration in the government's cash position highlights the medium-term challenges the Government faces in returning the fiscal position to a sustainable footing.

STILL HAPPILY FLOATING BUT FOR HOW MUCH LONGER?

Borrowers continue to favour floating and short-dated borrowing over the longer durations – a dynamic that is still apparent despite the mortgage curve flattening of late. With more than 70 percent of mortgage debt at maturities for one year or less the RBNZ currently have considerable monetary policy traction. This can quickly change if borrowers opt en masse for the greater certainty of a longer-term rate.

2010Q3 LABOUR MARKET PREVIEW

We are expecting signs of ongoing recovery in the labour market amidst a backdrop of considerable quarterly volatility. Wage inflation is expected to remain contained and of no concern to the RBNZ.

INTEREST RATE STRATEGY

NZ interest rates rose fairly dramatically over the past week. Indeed, although the RBNZ left the OCR on hold as widely expected, it was higher US bond yields that did the damage, with markets pondering the size of the upcoming QE package. The focus this week is also offshore, the RBA rate decision and the US FOMC meeting both must-see events. We expect a rate hike from the RBA, and QE2 from the Fed.

CURRENCY STRATEGY

While everyone's attention has been focused elsewhere, the NZD quietly slipped under the radar last week and finished the week with a flourish. The weaker CPI in Australia has added doubt to another rate rise in Australia, triggering a short covering rally in the NZD/AUD cross. With central bank decisions in focus, with QE2 the big defining moment and lots of economic data to be released this week, expect more volatility than usual.

ECONOMIC OVERVIEW

SUMMARY

Last week's OCR Review struck an even softer tone than the subdued September MPS assessment. While the remainder of 2010 is looking soft, in line with the RBNZ's assessment, we continue to take a more upbeat view towards 2011. Our suspicion is that the mild improvement in business confidence last week may mark a turning point, though this will take time to filter into hard data. This week's data is expected to reinforce the boost to the economy from commodity prices. Labour market data is expected to highlight gradual improvement. Internationally, attention will centre on what the Fed flags for further quantitative easing (QE), and our Australian counterparts expect the RBA to hike on Tuesday.

THIS WEEK'S EVENTS

- **ANZ Commodity Price Index – October 2010** (Monday, November 1, 3:00pm).
- **SNZ Labour Cost Index – Q3 2010** (Tuesday, November 2, 10:45am). Private sector hourly salary and wage rates are expected to increase by 0.4 percent in Q3 (+1.4 percent y/y).
- **SNZ Quarterly Employment Survey – Q3 2010** (Tuesday, November 2, 10:45am). QES filled jobs are expected to increase by 0.5 percent in Q3. An increase in hours worked per employee is expected to boost weekly earnings by more than 1 percent in the quarter.
- **globalDairyTrade online auction** (Wednesday, November 3, 6:00am). We envisage whole milk powder prices in the early November event will remain around the US \$3,500 per tonne level.
- **SNZ Household Labour Force Survey – Q3 2010** (Thursday, November 4, 10:45am). We expect a 0.5 percent rise in employment and the unemployment rate to tick down to 6.6 percent.

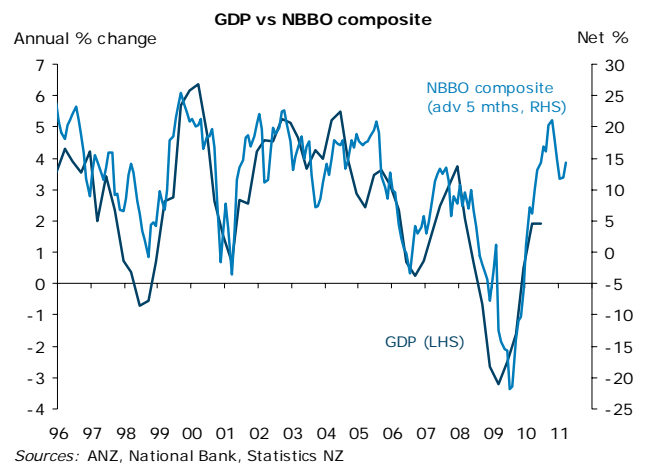
WHAT'S THE VIEW?

At the margin last week's October OCR statement struck a slightly softer tone than the September MPS. Domestically, recent data has turned out weaker than the relatively downbeat September MPS projections. Much of this is attributable to subdued household sector data, with the RBNZ also alluding to declining business sentiment as being influential in slowing the (already muted) recovery in business investment. The RBNZ also highlighted their ongoing concern over prospects for the major developed economies, although the Statement did acknowledge that strong growth in Australia and emerging Asia is providing an offset.

The RBNZ maintained their tightening bias but the "at some stage" time frame suggests they are in no particular hurry, with growth now expected to only gradually absorb spare capacity over the next few years.

While we concur with the RBNZ's assessment for 2010, we still have a more optimistic view of economic activity over 2011 than the RBNZ or the market consensus. Don't get us wrong – we are not expecting the economy to rip away next year. As shown by the weak credit figures, deleveraging remains pervasive and is likely to remain around for some time yet. Residential building consent numbers out last week were poor. The economy continues to face huge structural headwinds, with some household and rural balance sheets under pressure. The Government faces a huge job curing a structural (cyclically adjusted) deficit, which implies more money will be going out of our pockets than we receive back in government services over a number of years. But, in addition to the forthcoming boost from earthquake-related reconstruction, we are starting to see signs of encouragement from other sources:

- US indicators such as the Chicago PMI and other regional PMI gauges are starting to look more upbeat in the forward orders and inventory components – so much so that people are now starting to rethink the potential size of QE2!
- Domestically, business confidence has started to pick up and our suspicion is that the improvement in the National Bank Business Outlook survey last week may well mark a turning point, though this will take time to filter through into the hard data.

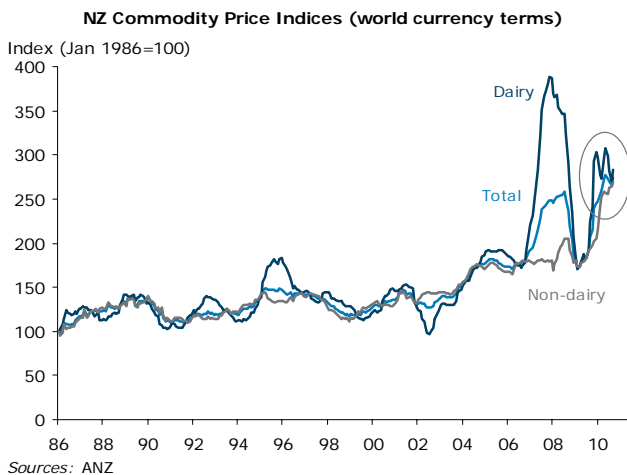


- Import figures are starting to show a clear pickup in capital good imports (up a seasonally adjusted 16 percent in the September quarter), a welcome

ECONOMIC OVERVIEW

dynamic. This augurs well for business investment.

We'll be paying close attention to commodity price data this week, which is expected to highlight the promise of a better 2011. There is typically about a 6 to 12 month lag between changes in commodity prices and when it starts to filter through into the general economy. Given the weak state of balance sheets, this lag may well be longer during the current cycle. But NZD commodity prices have risen 27 percent in the past year and a key feature of late has been a broadening in commodity price strength beyond dairy products, which will ensure the gains are being more evenly shared amongst commodity exporters. **Today's release of the ANZ Commodity Price Index for October is expected to highlight export commodity prices remaining at historically high levels.**



Early Wednesday sees the *globalDairyTrade* online auction. We expect the early November trading event to deliver a whole milk powder price of around US \$3,500 per tonne. Prices have hovered around this mark since the early September event, although the NZD has strengthened by 5 percent against the USD since then. At the margin, the weak USD may be a factor contributing to higher USD prices for the auction, but we will have to wait and see.

This week's labour market data is expected to highlight ongoing (mild) improvement amongst considerable quarterly noise. Our labour market preview is on page 8. The RBNZ will closely watch wage inflation readings from the labour cost index (LCI), and are likely to be reassured if wage inflation from this measure is at (or slightly below) the market consensus of a 0.4 percent increase. Recall the past three quarterly unemployment rate readings have been 7.1, 6.0 and 6.8 percent respectively – making

interpretation of the state of the labour market difficult. The RBNZ noted in the September MPS they were mindful of the high degree of volatility in the HLFS and will also take into account a broad range of indicators to assess the state of the labour market. We'll be doing the same.

Central bank action takes particular importance this week. Our Australian counterparts expect the RBA to hike tomorrow – an out of consensus call, with the market only pricing in 6 bps. In the US, sentiment has swung rapidly of late towards the launch of QE2, in part fuelled by Fed Governor speeches and rhetoric.

The market looks to be playing chicken in terms of the size of the QE2 package. Something too small risks undermining confidence and the recent rebound in global equity sentiment, while the recent improvement in key leading gauges suggests a more cautious response size wise. Some also question whether QE2 will actually work. Initially, we expect the Fed will commit to several months of asset purchases of between US \$100-150bn per month, although there is some talk it may start off with a bit of a kicker and above US \$200bn/month. We expect the prime target to be Treasury bonds of 5+ year duration. Thereafter the roll out of QE2 will be dependant on how the key economic parameters of inflation and unemployment evolve relative to the Fed's policy objectives (of price stability and full employment). We suspect this sort of outcome will keep the market on edge. That is, QE2 should technically be USD negative but it's already factored in, and the same when it comes to bonds, which have now backed up slightly. Both look key in terms of the broad direction for NZ equivalents.

The other thing to keep an eye on this week is the second instalment from the 2025 Taskforce, whom are "tasked" with setting out an agenda for closing the income gap with Australia. With the Australian economy growing at around 3.25 percent and NZ 2 percent over the past year, the income gap continues to widen, and in Australia's favour. Before we close the gap we need to stabilise it in the first place and Australia is a moving target! Realistically, closing the gap is simply not feasible unless some truly heroic step change initiatives come to the fore. We've certainly got the aspiration in terms of the target, but uncertainty surrounds whether the inspiration exists to identify and implement the necessary changes. So we'll be eying both the recommendations from the report as well as the political reaction.

ECONOMIC OVERVIEW

RECENT LOCAL DATA

- **Business confidence – October.** Headline business confidence jumped 10 points to +23.7, with own activity up 3.8 points to +30.5. Profit, investment and employment expectations all lifted (to +9.5, +3.6 and +7.6 respectively). Export expectations dipped 10.2 points to +20.4.
- **RBNZ OCR Review – October.** The RBNZ held the OCR at 3 percent. While the RBNZ deemed it appropriate to leave the OCR unchanged, further removal of monetary policy support is likely to be required “at some stage”.
- **RBNZ Credit Aggregates – September.** Private Sector Credit ex-repo increased by 0.2 percent (0.3 percent y/y).
- **SNZ Merchandise Trade – September.** The monthly trade deficit rose to \$532m, although the annual trade surplus increased to \$921m. Export values fell 3.9 percent in seasonally adjusted terms (+14.8 percent y/y), whereas imports rose 3.0 percent (+8.8 percent y/y).
- **SNZ Building Consents – September.** The number of residential consents rose 0.6 percent (s.a.) but fell 2.6 percent excluding apartments. The value of non-residential consents rose 14 percent to \$326m.

CYCLICALLY ADJUSTED FISCAL BALANCES

SUMMARY

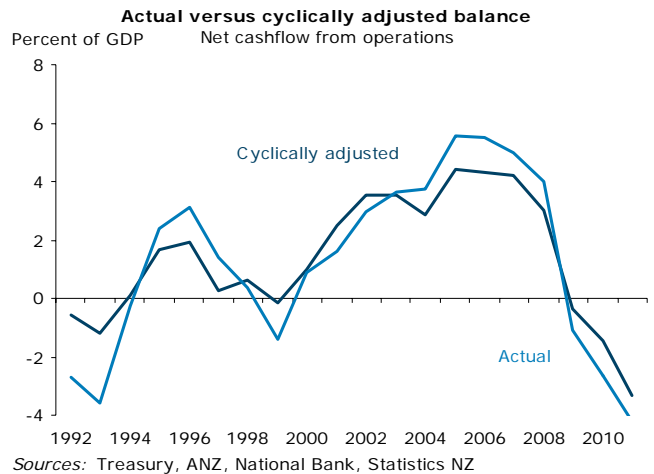
We estimate that 80 percent of the deterioration in the fiscal position between a peak in 2006 and 2011 is owing to structural factors (read: the discretionary policy changes) with the remaining 20 percent owing to a cyclical deterioration in the economy (read: downturn). Cyclical dynamics, or the so-called automatic stabilisers, will reverse over time and do not warrant attention. However, the size and magnitude of the cyclically adjusted deterioration in the government's cash position highlights the medium-term challenges the Government faces in returning the fiscal position to a sustainable position. Restrictive fiscal policy settings – if they can be delivered upon – will alleviate pressure on the RBNZ to hike aggressively.

A STRUCTURAL DETERIORATION

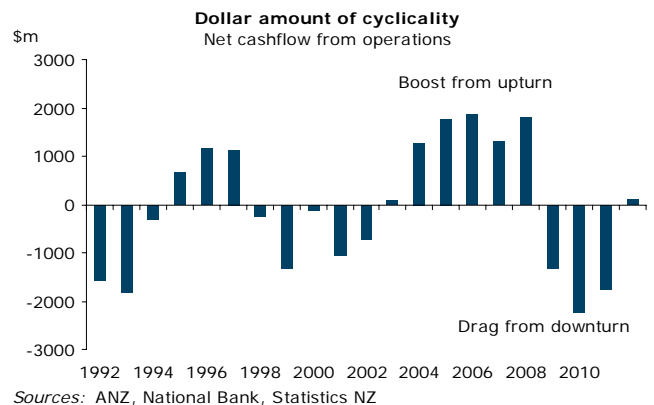
When analysing government accounts, the headline numbers tend to receive most attention. However, **because the fiscal position is influenced by both the discretionary fiscal stance (i.e. spending and tax decisions) as well as movements in the underlying economy, the underlying picture can be difficult to see in headline figures.** For instance, a cyclical deterioration in the fiscal position into deficit need not require a policy response: rather the automatic stabilisers should be left to do the work.

The cyclically adjusted balance is a simple measure that aims to remove such automatic stabilisers from the fiscal position, and as such provide an indication of the true underlying fiscal position. In practice, such cyclical adjustment is prone to a huge amount of uncertainty, with key assumptions required in regard to the output gap (or where the economy sits in the business cycle), the sensitivity of tax revenue to the economic cycle and the trend rate of unemployment. These challenges should not deter us from such calculations, but it is important to bear in mind that derivations will be prone to a degree of sensitivity in terms of the underlying assumptions.

According to our cyclically adjusted estimates of the government position (focusing on net cash flows from operations), whilst a cash flow deficit of around 4.2 percent of GDP is projected for 2011, the cyclically adjusted deficit is around 3.3 percent of GDP. Or put another way, almost 1 percent of the deficit is accounted for by cyclical and economic factors. The remainder (3.3 percent of GDP) reflects a broader or underlying structural deficit. It is the latter component that requires attention.



An alternative means of interpretation is to look at the degree of cyclicity in the fiscal position over time as per the following chart. Looking at the broad swings in the chart shows that the fiscal position can swing from \$+2/-2 billion. Such swings make the process of fiscal management more difficult, with upswings and a strong fiscal position normally accompanied by demands for more spending and downturns more restraint. A prudent response requires that any cyclicity is removed from the equation – despite challenges regarding the derivation of such measures.



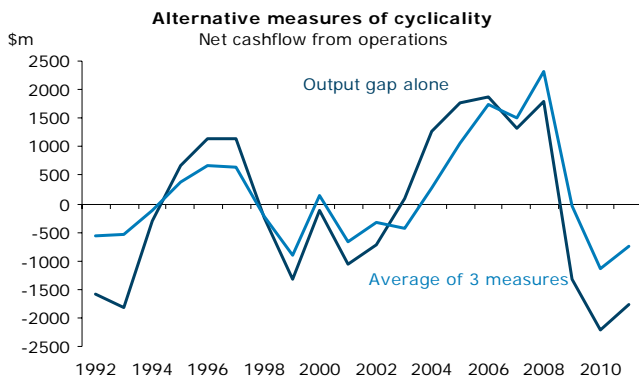
Despite cyclical factors heavily influencing the deterioration in the fiscal position from 2006 to 2011, it is clear that the majority of the deterioration has been structural in nature. By our calculations, 80 percent of the deterioration has been structural and owing to discretionary spending decisions, and 20 percent of it is accounted for by cyclical influences. That is not to say that the structural deterioration has been inherently bad: some of this has been active fiscal management by using the Government's balance sheet (by both the red and blue hues) to support the economy through the downturn and global challenges. But between 2006 and 2011 the underlying cash deficit is

CYCLICALLY ADJUSTED FISCAL BALANCES

projected to have changed by \$17 billion. Economic factors account for \$3.6 billion. We haven't seen any economic support package even close to \$13.4 billion, so other "discretionary" policy decisions have played a sizeable role as well.

The size of the cyclically adjusted deficit is testament to the challenges policymakers face going forward. Of course NZ's fiscal position looks far superior to a number of peers globally when looking at both the cyclically adjusted balance and stock of debt. But equally, sustained structural deficits condemn the next generation to paying such debt accumulation back.

We have also derived estimates of the cyclically adjusted balance that integrate notions of economic balance with where the economy sits in the business cycle¹. The rationale for this approach is that it is not only growth that matters, but rather the mix of growth. Over 2006 to 2007, there was growth alright, but the mix was worrying in terms of the spending-centric nature of it and a ballooning current account deficit.



Sources: Treasury, ANZ, National Bank, Statistics NZ

Our calculations suggest that a lower proportion of the deterioration in the fiscal position is cyclical, which by default also means more of the deficit is structural. Our modified measure suggests only \$500 million of cyclicality exists within the fiscal accounts, compared with our prior \$2 billion estimate. If this is truly the case then an even greater proportion of the improvement or turnaround in the fiscal position will need to come from restraint as opposed to letting cyclical dynamics run their course.

¹We construct our cyclically adjusted estimates using three measures: an assessment of the business cycle based on the deviation in core inflation from the mid-point of the RBNZ inflation target (scaled), a conventional filtering technique to derive the output gap, and a macro-balance measure based on the actual current account deficit compared to a deficit that would stabilise net foreign liabilities relative to GDP.

THE UPSHOT

NZ is facing a multi-year period of spending restraint according to our cyclically adjusted estimates. This in itself is nothing new. In fact, looking at history (see the first chart in this article) shows that sustained improvements in the structural cash position were achieved from 1993 to 1996 and 1999 to 2003. Hence, we need not scare the horses. But equally, we need to appreciate that NZ is entering a period whereby restraint is a prerequisite to a sound fiscal position. Merely leaving it to economic forces will not suffice as the economy accounts for only 20 percent of the issue – and even less if we take account of the mix of growth or notions of balance. **A failure to address the issue simply means shifting the burden elsewhere, and more likely than not that would be onto our kids.**

The size of cyclically adjusted balance estimates has material implications for monetary policy. Restrictive fiscal policy settings – if they can be delivered – will **alleviate pressure on the RBNZ to hike aggressively.** During previous upswings, monetary policy has by-and-large stood alone. We now see the interaction of monetary policy, prudential policy (i.e. the core funding ratio et al) and fiscal policy as all playing material roles over the coming five years and beyond.

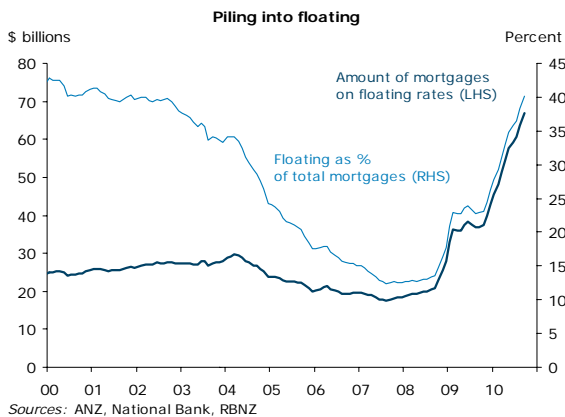
STILL HAPPILY FLOATING BUT FOR HOW MUCH LONGER?

SUMMARY

Borrowers continue to favour floating and short-dated borrowing over the longer durations – a dynamic that is still apparent in the data-flow despite the mortgage curve flattening of late. The effective mortgage rate is now rising – but only marginally offset by borrowers who fixed more than two years ago rolling off higher fixed mortgage interest rates. With more than 70 percent of mortgage debt at maturities for one year or less the RBNZ currently have considerable monetary policy traction. This can quickly change if borrowers opt en masse for the greater certainty of a longer-term rate.

A-FLOATING WE WILL GO

The dollar value of mortgages on floating rates continues to reach new highs. As at September, there was \$67 billion of mortgage debt on floating, compared to \$37 billion a year ago. As a proportion of all mortgages, the share is currently 40.1 percent, not far off from the 42.7 percent high of early 2000, and significantly above the 12.4 percent low reached in August 2007.



The increased popularity of floating rates is simply a function of the upward-sloping mortgage interest rate curve. Although the once popular 2-year fixed rate, at 6.7 percent, is around 100 basis points below its historical average and only 30 basis points above the floating rate, this has not been enough to entice borrowers away from floating. With the RBNZ in no hurry to lift rates, and Governor Bollard a few weeks back validating market expectations (no OCR increases before March 2011), borrowers appear comfortable staying floating and benefiting from low rates for a little longer.

There is a large wave of fixed mortgages coming up for refinancing in the next few months - we estimate at over \$15 billion between November 2010 and January 2011. There is a strong likelihood that a large proportion of these will opt to

go into floating, taking the proportion of total mortgages on floating to new highs (at least since June 1998 when the data was first available).

	OUTSTANDING MORTGAGE (\$M)*	WEIGHTED AVERAGE RATE (%)*		RATE NOW (%)^	POST OCR AVG. (%)
Floating	66,993	6.3	Floating	6.4	8.1
<1-yr	53,660	6.7	6-mth	6.3	7.3
1<2-yr	32,966	7.1	1-year	6.5	7.4
2<3-yr	6,800	8.0	2-year	6.7	7.7
3<4-yr	5,198	6.8	3-year	7.1	7.9
4<5-yr	423	8.1	4-year	7.5	8.0
5-yr +	151	7.1	5-year	7.7	8.1

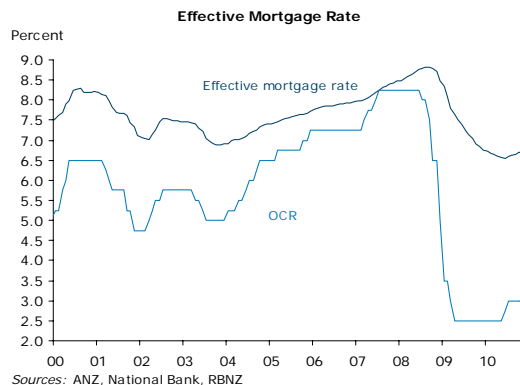
* As at September 2010

^ Average headline mortgage rates of the major banks.

Sources: ANZ, National Bank, RBNZ, www.interest.co.nz

Not everyone coming up for refinancing will enjoy interest savings though. Those who fixed for 6 months 6 months ago are coming off rates of 5.9 percent, and those who fixed for a year 12 months ago are coming off rates of 6.1 percent. The floating rate is currently averaging around 6.4 percent. However, those who fixed for 2 years 24 months ago are coming off rates of 7.5 percent, a significant saving for them, even if they opt to fix for 2 years again (current rate of 6.7 percent).

We have seen an increase in the overall effective mortgage rate (EMR) from the trough of 6.54 percent in June to 6.65 percent in September, and we expect the EMR to increase only slightly until March next year, which is when we expect the RBNZ to next lift the OCR. At that juncture a 25 basis point increase would add 10 basis points to the EMR immediately. Compare this to the last tightening cycle in 2007, when the proportion on floating rates was at its lowest at 12.4 percent, a 25 basis point increase in the OCR then only translated through into an immediate 3 basis point increase in the EMR!



Of course the million dollar question is, will borrowers continue to favour short-dated borrowing? If not, the RBNZ will probably need to consider moving more pre-emptively to avoid falling behind the curve.



2010Q3 LABOUR MARKET PREVIEW

SUMMARY

We are expecting signs of ongoing recovery in the labour market amidst a backdrop of considerable quarterly volatility. A 0.5 percent increase in HLFS employment is expected, and while we forecast the unemployment rate to ease to 6.6 percent, recent volatility suggests anything could happen. Wage inflation is expected to remain contained and of no concern to the RBNZ.

September 2010 quarter expectations		
	Our Forecast	Market
LCI salary and wage ordinary time (private sector)	+0.4% q/q +1.4% y/y	+0.4% q/q +1.4% y/y
QES salary and wage ordinary time (private sector)	+1.0% q/q +0.7% y/y	+0.7% q/q +0.6% y/y
HLFS unemployment rate (s.a.)	6.6%	6.7%
HLFS participation rate (s.a.)	68.0%	68.0%
HLFS employment growth	+0.5% q/q +1.3% y/y	+0.5% q/q +1.2% y/y

We expect HLFS employment to increase by 0.5 percent, following a 0.3 percent fall in June.

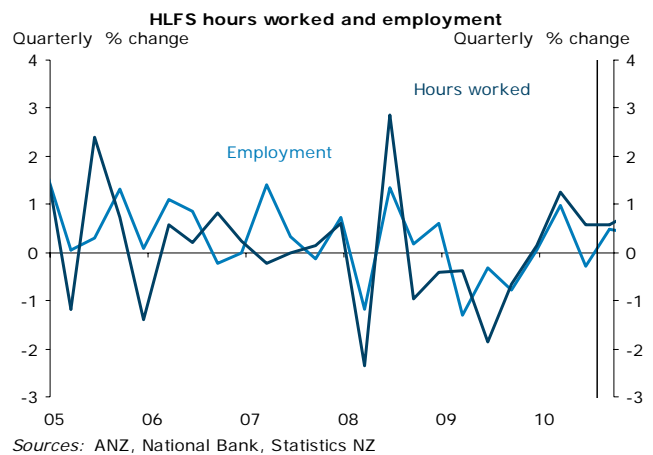
HLFS hours worked are expected to increase by 0.6 percent, taking the hours worked per employee closer to historical norms from their mid-2009 trough. The labour market typically lags the economic cycle and there is still likely to be an element of catch-up. Although we are now on the recovery path, employment and hours worked are anticipated to remain nearly 2 percent below their pre-recession peak.

While the general spirit is of an improving labour market, indicators have been providing mixed signals of late. The number of new job ads from the SEEK website peaked in July and has been heading down over the last few months. Official benefit numbers were broadly unchanged in the September quarter. Survey measures suggest that firms are still intending to take on more staff and skill shortages are becoming more acute. But rather than highlighting strengthening employment, these may be partly a consequence of continued high outflows of migrants, particularly to Australia.

An increase in employment and some statistical noise is expected to drive a fall in the unemployment rate to 6.6 percent from 6.8 percent. Recall that the Q1 HLFS showed an outsized fall in the unemployment rate from 7.1 to 6 percent, with some payback evident in the spike up in the Q2 unemployment rate to 6.8 percent. Last week's published data suggest there could be a moderate 9,000 increase in the seasonally adjusted working age population for Q3, following the bumper

21,000 increase in Q2. We are expecting labour force participation to hold at around 68 percent of the labour force, with improving employment prospects likely to encourage potential job seekers to remain in the labour market.

Quarterly HLFS outturns have been volatile recently and there is a large margin of error around our Q3 picks. If the seesaw pattern is more influential than we assume there are upside risks around our pick for employment growth but downside risks to our unemployment rate pick.



The labour market has displayed considerable flexibility in the recent cycle. Hours worked and labour earnings took most of the brunt of the slowdown. In the upturn, initially we expect the higher demand for labour to be met by an increase in quantities (i.e. employment and hours worked). **As such, wage inflation from the Labour Cost Index is expected to remain moderate, with a 0.4 percent increase forecast for private sector salary and wage rates in Q3.** QES private sector ordinary average earnings are expected to display their usual seasonal pattern with an increase of around 1 percent in the September quarter. Although the CPI inflation trajectory is clearly rising, by and large the balance of bargaining power is still on the side of employers. Firms are less well placed to accommodate higher wage demands, with surveyed measures of expected profitability at low levels.

We'll also be paying close attention to the gross earning figures from the Quarterly Employment Survey. These have picked up of late, courtesy of a combination of higher wages and climbing hours per employee, with total gross earnings in the year to June up 4.6 percent. While the proceeds are likely to be used initially to repair balance sheets, such income generation will not be saved indefinitely.

INTEREST RATE STRATEGY

SUMMARY

NZ interest rates rose fairly dramatically over the past week. Indeed, although the RBNZ left the OCR on hold as widely expected, it was higher US bond yields that did the damage, with markets pondering the size of the upcoming QE package. The focus this week is also offshore, the RBA rate decision and the US FOMC meeting both must-see events. We expect a rate hike from the RBA, and QE2 from the Fed. The latter is expected to support markets and on the face of it should be bond-friendly. But the rubber band looks taut and markets are now looking beyond QE2, and signs of improvement in the data.

MARKET THEMES

- QE remains the major theme, but thankfully we only need to wait till Thursday (NZ time) to hear what the US Federal Reserve has in store.
- The RBNZ seems comfortable with the outlook, with last week's OCR Review a mirror of the MPS.
- The bond market looks increasingly like it's had its day. QE brings with it significant inflation risks, and when added to that above consensus 2011 growth for NZ, rates need to go higher.

REVIEW AND OUTLOOK

Last week's RBNZ OCR Review confirmed that the RBNZ is comfortable with the stance of monetary policy, so it was no surprise that it came and went with little market reaction. But while the tone was fairly circumspect, let's not forget that they still have a tightening bias, albeit a non-urgent one, noting that "further removal of monetary policy support will be required at some stage". As such, we need to be mindful of how relaxed market pricing is, particularly given how strong growth (read: demand) is in key trading partners in Asia, and inflation trends in Asia. But that's a 2011 story, and one we will focus on as it develops into something more substantial.

Of key interest now is the size of the Fed's QE package, with all eyes on Thursday's FOMC statement (0715 NZ time Thursday). All going to plan (read: market expectations), the Fed will launch its second instalment of QE, nicknamed QE2. We expect a programme of between \$1.5 and \$2.0 trillion, to be spread out over a number of quarters. Like the BOE's programme last year, it is more likely to be successful if the scale of bond purchases are up for review at each FOMC meeting. This may cause confusion initially, particularly as markets expect something significant. However, the Fed has been sounding out market opinion which is strongly suggestive of a desire not to disappoint. If that is the case, we can probably expect a small relief rally in

the bond market after the meeting. **The trouble is, as the market digests the package, thoughts will inevitably start to focus on the inflation risks down the track.** So while there is good scope for yields to make new lows for the year, unless you think QE will fail to re-ignite the US economy (we note that the overall tone of US data has started to pick up), it's hard to see yields staying low for too long. Indeed, **the great bond bull market of the last 30 years may be coming to an end.**

PREFERRED BORROWING STRATEGIES

QE2 has the potential to take interest rates a little lower, unwinding some of last week's rise, and perhaps more, particularly if the package is well received by the market. But it also has the scope to disappoint, particularly if it is less aggressive than the market expects, or there are issues around communication. Add to that the risk of a RBA rate hike, and all of a sudden you come to the inescapable conclusion that we're at the mercy of what happens offshore. In that regard, we think it pays to consider where rates would be in the absence of global influences, and position accordingly. To us, that suggests lengthening the term of hedges, acknowledging the opportunity QE has presented us with.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔	No urgency to raise rates.
NZ data	↔/↑	Rise in confidence adds to 2011 rebound story.
Fed Funds / front end	↔	Looking to QE2 this week. Binary risk, fully priced in.
RBA	↔/↓	No inflation smoking gun makes a hike a tough sell.
US 10 year	↔	Relief rally following QE confirmation most likely.
NZ swap curve	↔/↓	Likely to flatten a little more after QE, but then steepen.
Flow	↔/↓	Pay-side flow fading.
Technicals	↔/↓	2yr has broken higher.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 9-Dec-10	+1	+1
Thu 27-Jan-11	+3	+5
Thu 10-Mar-11	+10	+13
Thu 28-Apr-11	+23	+29
Thu 9-Jun-11	+31	+39
Thu 28-Jul-11	+47	+56
Thu 15-Sep-11	Not forecast	+68

TRADING THEMES WE FAVOUR AT PRESENT

We view long end NZGS as an outright safety trade ahead of QE, with plenty of scope to rally if QE is a blockbuster, and the spread likely to contract on any disappointment.

CURRENCY STRATEGY

SUMMARY

While everyone's attention has been focused elsewhere, the NZD quietly slipped under the radar last week and finished the week with a flourish. It seems that a confluence of minor data (including NBNZ business confidence and trade balance) and a rise in NZ swap yields have conspired to provide support to NZD on all fronts. The weaker CPI in Australia has added doubt to another rate rise in Australia, triggering a short covering rally in the NZD/AUD cross. With central bank decisions in focus, with QE2 the big defining moment and lots of economic data to be released this week, expect more volatility than usual.

MARKET THEMES

- Data and positioning lending support to NZD.
- NZD/AUD a major mover as NZ/Australian interest rate differential comes into focus.
- FOMC and QE2 at the forefront this week.
- RBA – rate rise or not?
- USD/JPY creeps closer to all time low at 79.70.

REVIEW AND OUTLOOK

NZD was a star performer last week as positive minor data releases conspired to provide surprising support. NBNZ business confidence, trade data and shifting Trans-Tasman interest rate differentials all lent support to the NZD. Technically 0.7645 is an important level but this is not an exact science so be wary of a false break. However, the big picture looks a little more promising with the potential to trade towards 0.7760 and possibly 0.7830. Major support is at 0.7560. The big caveat is around the FOMC decision on Thursday morning NZ time. NZ labour market data this week is likely to be of only temporary interest as offshore events dominate.

NZD/AUD was a strong performer last week as data swung in NZ's favour and the position overhang had the market caught. Yet again, NZD/AUD below 76 cents proves to be a bridge too far. Despite a benign comment from the RBNZ last week, NZ interest rates could not move lower while a weaker Australian CPI has put a rate rise there this week at risk. Market participants holding NZD/AUD shorts felt the pinch and this cross could now head back towards 80 cents.

The big event this week is the FOMC meeting (announcement 7.15am NZ time Thursday).

This event will define the direction for the major currencies for the rest of the year and it really is a bit

of a lottery. The currency market is convinced there will be QE2 but is uncertain of the size.

Also a key event this week is the RBA Cash Rate decision. Following last week's softer Australian Q3 CPI, the market has pared back expectations of a hike. **Our Australian colleagues have an out of consensus call for a 25bp hike.** Market response to this could also be uncertain with the rates announcement being 30 minutes before the Melbourne Cup. No rate rise would put further pressure on an already saturated market positioning in AUD but this may mean nothing following the FOMC on Thursday.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↔/↑	Under fair value now but not that far off.
Yield	↔	Yields stable for now.
Commodities	↔	Soft commodities very strong, lending support to NZD.
Partial indicators	↔	Trans-Tasman data releases slightly more balanced.
Technicals	↑	Comfortable in 0.7600/0.7800 range.
Sentiment	↑	Swung in favour of NZD.
Other	↑	At historically low levels.
On balance	↑	Trending higher 0.7700-0.7900.

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	↑	FOMC happy with weaker USD.
Commodities	↔/↑	Remain supportive overall.
Risk aversion	↔	Equities still relevant.
Partial indicators	↔	NZ data showing slight improvement.
Technicals	↑	Momentum strong. Watching key 0.7645 zone. Next level 0.7760.
AUD	↑	Everyone bullish AUD.
Sentiment	↑	Current move tired.
Other	↔/↑	Will QE2 please or disappoint?
On balance	↔/↑	Remains overall supported with rising base.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
1-Nov	AU	AiG Performance of Mfg Index - OCT	--	47.3	11:30
	AU	TD Securities Inflation MoM% - OCT	--	0.10%	12:30
	AU	TD Securities Inflation YoY% - OCT	--	3.20%	12:30
	UK	Hometrack Housing Survey (MoM) - OCT	--	-0.40%	13:01
	UK	Hometrack Housing Survey (YoY) - OCT	--	1.00%	13:01
	AU	House Price Index QoQ - 3Q	0.00%	3.10%	13:30
	AU	House Price Index YoY - 3Q	13.40%	18.40%	13:30
	CH	PMI Manufacturing – OCT	53.8	53.8	14:00
	NZ	ANZ Commodity Price – OCT	--	--	15:00
	CH	HSBC Manufacturing PMI – OCT	--	52.9	15:30
	JN	Vehicle Sales (YoY) – OCT	--	-4.10%	18:00
	AU	RBA Commodity Index SDR YoY% - OCT	--	52.40%	18:30
	UK	PMI Manufacturing – OCT	53	53.4	22:30
2-Nov	US	Personal Income - SEP	0.20%	0.50%	01:30
	US	Personal Spending - SEP	0.40%	0.40%	01:30
	US	PCE Deflator (YoY) - SEP	1.40%	1.50%	01:30
	US	PCE Core (MoM) - SEP	0.10%	0.10%	--
	US	PCE Core (YoY) - SEP	1.30%	1.40%	--
	US	ISM Manufacturing - OCT	54	54.4	03:00
	US	ISM Prices Paid - OCT	70	70.5	03:00
	NZ	Average Hourly Earnings QoQ - 3Q	--	0.60%	10:45
	JN	Monetary Base (YoY) - OCT	--	5.80%	--
	AU	RBA Interest Rate Decision - NOV	4.50%	4.50%	--
	GE	PMI Manufacturing - OCT F	56.1	56.1	--
	EC	PMI Manufacturing - OCT F	54.1	54.1	--
	UK	PMI Construction - OCT	53	53.8	22:30
3-Nov	AU	AiG Performance of Service Index - OCT	--	45.6	11:30
	AU	Building Approvals (MoM) - SEP	0.00%	-4.70%	13:30
	AU	Building Approvals (YoY) - SEP	-3.70%	4.40%	13:30
	CH	China Non-manufacturing PMI - OCT	--	61.7	14:00
	CH	China HSBC Services PMI - OCT	--	55.2	15:30
	UK	PMI Services - OCT	52.6	52.8	22:30
4-Nov	US	Challenger Job Cuts YoY - OCT	--	-44.10%	00:30
	US	ADP Employment Change - OCT	20K	-39K	01:15
	US	ISM Non-Manf. Composite - OCT	53.5	53.2	03:00
	US	Factory Orders - SEP	1.50%	-0.50%	03:00
	US	FOMC Rate Decision - NOV	0.25%	0.25%	07:15
	NZ	Participation Rate (QoQ) - 3Q	68.00%	68.00%	10:45
	NZ	Employment Change (QoQ) - 3Q	0.50%	-0.30%	10:45
	NZ	Unemployment Rate - 3Q	6.70%	6.80%	10:45
	NZ	Employment Change (YoY) - 3Q	1.20%	-0.10%	10:45
	AU	Trade Balance - SEP	2000M	2346M	13:30
	AU	Retail Sales s.a. (MoM) - SEP	0.50%	--	13:30
	AU	Retail Sales Ex Inflation(QoQ) - 3Q	1.10%	--	14:30
	EC	PMI Composite - OCT F	53.4	53.4	21:00
	EC	PMI Services - OCT F	53.2	53.2	21:00
	GE	PMI Services - OCT F	56.6	56.6	21:55
	EC	Euro-Zone PPI (MoM) - SEP	0.30%	0.10%	23:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
5-Nov	UK	BOE Asset Purchase Target - NOV	200B	200B	01:00
	UK	BOE Interest Rate Decision - NOV	0.50%	0.50%	01:00
	US	Nonfarm Productivity - 3Q P	1.00%	-1.80%	01:30
	US	Unit Labor Costs - 3Q P	0.70%	1.10%	01:30
	US	Initial Jobless Claims - Oct 30	440K	434K	01:30
	US	Continuing Claims - Oct 23	4386K	4356K	01:30
	EC	ECB Interest Rate Decision - NOV	1.00%	1.00%	01:45
	AU	RBA Monetary Policy Statement - NOV			13:30
	UK	PPI Input NSA (YoY) – OCT	7.30%	9.50%	22:30
	UK	PPI Output n.s.a. (YoY) – OCT	4.40%	4.40%	22:30
	UK	PPI Output Core NSA (YoY) - OCT	4.40%	4.60%	22:30
	GE	Factory Orders YoY (nsa) – SEP	19.00%	20.30%	23:00
	GE	Factory Orders MoM (sa) – SEP	0.40%	3.40%	23:00
	EC	Euro-Zone Retail Sales (MoM) - SEP	0.10%	-0.40%	23:00
	EC	Euro-Zone Retail Sales (YoY) - SEP	1.40%	0.60%	23:00
6-Nov	JN	BOJ Interest Rate Decision - NOV	-	0.10%	/2010
	US	Change in Nonfarm Payrolls - OCT	60K	-95K	01:30
	US	Change in Private Payrolls - OCT	80K	64K	01:30
	US	Change in Manufact. Payrolls - OCT	0K	-6K	01:30
	US	Unemployment Rate – OCT	9.60%	9.60%	01:30
	US	Avg Hourly Earning MOM All Emp - OCT	0.10%	0.00%	01:30
	US	Avg Hourly Earning YOY All Emp - OCT	1.60%	1.70%	01:30
	US	Avg Weekly Hours All Employees - OCT	34.2	34.2	01:30
	US	Pending Home Sales MoM - SEP	3.00%	4.30%	03:00
	US	Pending Home Sales YoY - SEP	-	-18.40%	03:00
	US	Consumer Credit - SEP	-\$3.0B	-\$3.3B	08:00
	UK	Halifax House Prices sa (MoM) - OCT	0.60%	-3.60%	6 NOV

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 four weeks: Last week's October OCR Review was even softer in tone than the downbeat September MPS. While the OCR will eventually need to go up, the assessment was non-committal on a timeframe. Credit aggregates showed continued deleveraging, residential consent issuance remained weak and the support provided by high commodity export prices was not enough to deliver another monthly trade surplus, although rising capital good imports were a promising sign. This week's labour market data is expected to highlight gradual improvement. Earthquake-related reconstruction will provide a boost to 2011 but GDP for Q3 2010 will be weighed down by earthquake disruptions. We continue to closely watch the soft gauges for signs of direction, and are encouraged by the improvement shown by the October National Bank Business Outlook survey.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Tue 2 Nov (10:45am)	Labour Cost Index – Q3	Restrained	We expect a 0.4 percent increase in private sector labour costs in Q3 (1.4 percent y/y). The income tax cuts and soggy domestic demand should restrict upward pressure on wages.
Tue 2 Nov (10:45am)	Quarterly Employment Survey – Q3	Improving	We expect a 0.5 percent increase in filled jobs. Private sector average hourly earnings are expected to increase by 1.0 percent in Q3 (0.7 percent y/y).
Wed 3 Nov (6:00am)	<i>globalDairyTrade</i> online auction	Holding	Contract prices for whole milk powder are expected to average around US \$3,500 per tonne.
Thur 4 Nov (10:45am)	Household Labour Force Survey – Q3	Improving	The spirit is of a modest recovery amongst the statistical noise. We expect a 0.5 percent increase in employment with the unemployment rate set to ease to 6.6 percent.
Tue 9 Nov (10:45am)	Electronic Card Transactions - Oct	Small increase	We expect a broadly flat outturn. Lower retail volumes will be offset by higher prices.
Thur 11 Nov (10:45am)	Food Price Index – October	Up	Wet weather and higher export commodity prices will push food prices up.
Fri 12 Nov (10:00am)	REINZ Housing Market Statistics – Oct	Moving higher	Sales are expected to increase as quake-related disruptions lessen. The spirit of household caution remains.
Mon 15 Nov (10:45am)	Retail Trade Survey – Q3	Up	We expect a 1.2 percent increase in total retail sales for the month, with core retail up 1.0 percent. Nominal core retail spending will increase by about 0.7 percent in Q3, with retail volumes broadly unchanged on Q2.
Thur 18 Nov (10:45am)	Producer Price Index – Q3	Moderating	Lower oil and export commodity prices are expected to deliver a moderation in quarterly input and output price inflation to around 0.7 percent for both measures. The September fall in wholesale electricity prices will be a positive for Q4 GDP if sustained.
Thur 18 Nov (10:45am)	Capital Goods Price Index	Drifting up	We expect a small increase of around 0.2 percent. Higher construction costs to be partly offset by lower prices for imported capital equipment.
Mon 22 Nov (10:45am)	International Travel and Migration - Oct	Providing support	We expect a permanent and long-term (PLT) net inflow of around 1000 persons. Visitor arrivals are expected to dip as the ski season nears an end.
On Balance			Data for Q3 looking subdued but we will be looking for an improving tone over Q4.

KEY FORECASTS AND RATES

	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
GDP (% qoq)	0.2	1.0	0.5	0.2	0.4	0.5	1.2	1.4	1.6	0.5
GDP (% yoy)	-1.6	0.5	1.9	1.9	2.1	1.6	2.3	3.5	4.8	4.8
CPI (% qoq)	1.3	-0.2	0.4	0.2	1.1	2.4	0.6	1.0	0.8	0.5
CPI (% yoy)	1.7	2.0	2.0	1.7	1.5	4.1	4.4	5.2	4.9	2.9
Employment (% qoq)	-0.8	0.0	1.0	-0.3	0.5	0.4	0.6	0.7	0.6	0.4
Employment (% yoy)	-1.8	-2.4	-0.1	0.0	1.3	1.6	1.2	2.2	2.3	2.3
Unemployment Rate (% sa)	6.5	7.1	6.0	6.8	6.6	6.4	6.1	5.7	5.5	5.4
Current Account (% GDP)	-3.2	-2.8	-2.4	-3.0	-3.7	-3.0	-3.1	-3.0	-3.1	-3.1
Terms of Trade (% qoq)	-1.6	5.8	6.1	2.0	3.0	0.9	-0.6	-0.6	0.0	-0.9
Terms of Trade (% yoy)	-14.1	-8.2	0.1	12.7	17.9	12.4	5.4	2.6	-0.3	-2.1

	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10	Aug-10	Sep-10	Oct-10
Retail sales (% mom)	0.8	-0.5	0.5	-0.3	0.3	1.0	-0.5	0.0
Retail sales (% yoy)	2.3	2.4	4.4	2.7	1.9	3.4	2.2	2.3
Credit Card Billings (% mom)	1.6	-0.3	0.9	-1.6	1.9	1.0	-1.2	0.6	0.9	..
Credit Card Billings (% yoy)	2.6	1.1	5.2	0.8	3.4	4.4	2.7	2.1	4.1	..
Car registrations (% mom)	-0.6	0.4	5.2	2.9	-3.8	5.6	-6.4	-0.2	2.7	..
Car registrations (% yoy)	15.9	31.4	31.7	40.5	30.5	35.8	16.0	19.0	19.2	..
Building consents (% mom)	-3.1	6.6	0.1	8.4	-10.1	2.0	3.0	-17.9	0.6	..
Building consents (% yoy)	34.9	29.9	32.7	32.6	11.5	26.6	26.1	-3.1	-9.5	..
REINZ House Price (% yoy)	7.7	6.1	7.6	4.7	3.7	3.7	2.6	0.9	0.0	..
Household Lending Growth (% mom)	0.2	0.2	0.0	0.2	0.2	0.2	0.2	0.1	0.2	..
Household Lending Growth (% yoy)	2.9	2.9	2.9	2.8	2.6	2.6	2.5	2.3	2.3	..
ANZ Roy Morgan Consumer Confidence	131.4	123.6	121.8	121.9	126.0	122.0	115.6	116.3	116.4	113.6
NBNZ Business Confidence	..	50.1	42.5	49.5	48.2	40.2	27.9	16.4	13.5	23.7
NBNZ Own Activity Outlook	..	41.9	38.6	43.0	45.3	38.5	32.4	25.7	26.7	30.5
Trade Balance (\$m)	271	328	608	660	770	221	-182	-413	-532	..
Trade Balance (\$m ann)	-176	-330	-160	178	41	593	589	892	921	..
ANZ World Commodity Price Index (% mom)	0.3	3.7	1.8	5.1	1.2	-1.6	-0.8	-1.4	2.9	..
ANZ World Commodity Price Index (% yoy)	36.7	48.6	49.5	53.2	51.8	50.1	47.3	38.6	33.1	..
Net migration (sa)	1850	1000	950	750	340	240	910	880	1070	..
Net migration (annual)	22588	21618	20973	19954	17967	16504	15221	14507	13914	..

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	Aug-10	Sep-10	Today	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
NZD/USD	0.699	0.734	0.766	0.72	0.72	0.73	0.74	0.72	0.71	0.70
NZD/AUD	0.785	0.759	0.778	0.76	0.77	0.75	0.74	0.74	0.74	0.74
NZD/EUR	0.551	0.539	0.548	0.51	0.51	0.52	0.51	0.51	0.51	0.51
NZD/JPY	58.86	61.33	61.49	57.6	56.2	55.1	55.5	56.5	56.8	57.4
NZD/GBP	0.455	0.467	0.477	0.46	0.45	0.46	0.46	0.45	0.44	0.44
NZ\$ TWI	65.5	66.3	67.7	64.1	63.7	64.1	63.8	63.5	63.0	63.0
INTEREST RATES	Aug-10	Sep-10	Today	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12
NZ OCR	3.00	3.00	3.00	3.00	3.25	3.75	4.00	4.25	4.75	5.25
NZ 90 day bill	3.21	3.17	3.16	3.30	3.70	4.20	4.30	4.70	5.20	5.50
NZ 10-yr bond	5.13	5.01	5.11	5.00	5.00	5.30	5.30	5.70	5.80	5.60
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.75
US 3-mth	0.30	0.29	0.29	0.35	0.35	0.35	0.35	0.35	0.35	0.85
AU Cash Rate	4.50	4.50	4.50	4.75	5.25	5.50	5.75	6.00	6.00	6.00
AU 3-mth	4.75	5.01	4.79	5.10	5.60	6.00	6.00	6.20	6.10	6.10

	29 Sep	22 Oct	26 Oct	27 Oct	28 Oct	29 Oct
Official Cash Rate	3.00	3.00	3.00	3.00	3.00	3.00
90 day bank bill	3.18	3.18	3.17	3.18	3.18	3.19
NZGB 11/11	3.45	3.91	3.93	3.94	4.00	4.05
NZGB 04/13	3.81	4.39	4.41	4.42	4.47	4.53
NZGB 12/17	4.76	4.99	5.01	5.03	5.10	5.16
NZGB 05/21	5.03	5.10	5.12	5.14	5.18	5.24
2 year swap	3.68	3.77	3.79	3.77	3.82	3.89
5 year swap	4.26	4.34	4.36	4.36	4.43	4.51
RBNZ TWI	66.6	66.4	66.6	66.7	66.7	66.9
NZD/USD	0.7393	0.7482	0.7522	0.7474	0.7483	0.7539
NZD/AUD	0.7640	0.7630	0.7601	0.7681	0.7673	0.7718
NZD/JPY	61.98	60.74	60.76	61.08	61.05	60.76
NZD/GBP	0.4673	0.4757	0.4783	0.4721	0.4735	0.4729
NZD/EUR	0.5440	0.5370	0.5393	0.5410	0.5414	0.5425
AUD/USD	0.9677	0.9806	0.9896	0.9730	0.9753	0.9768
EUR/USD	1.3589	1.3932	1.3948	1.3815	1.3822	1.3898
USD/JPY	83.83	81.18	80.78	81.72	81.58	80.59
GBP/USD	1.5822	1.5727	1.5728	1.5831	1.5802	1.5941
Oil (US\$/bbl)	76.15	80.03	82.60	82.60	81.90	82.20
Gold (US\$/oz)	1311.90	1327.65	1338.18	1334.70	1328.15	1340.80
Electricity (Haywards)	0.13	0.76	1.82	2.40	3.10	3.75
Milk futures (US\$/contract)	118	117	117	117	117	117
Baltic Dry Freight Index	2468	2748	2778	2784	2707	2678

IMPORTANT NOTICE

NEW ZEALAND DISCLOSURE INFORMATION

The Bank (in respect of itself and its principal officers) makes the following investment adviser disclosure to you pursuant to section 41A of the Securities Markets Act 1988.

The Bank (in respect of itself and its principal officers) makes the following investment broker disclosure to you pursuant to section 41G of the Securities Markets Act 1988.

Qualifications, experience and professional standing Experience

The Bank is a registered bank and, through its staff, is experienced in providing investment advice about its own securities and, where applicable, the securities of other issuers. The Bank has been selling securities, and providing investment advice on those securities, to customers as a core part of its business for many years, drawing on the extensive research undertaken by the Bank and its related companies and the skills of specialised staff employed by the Bank. The Bank is represented on many bank, finance and investment related organisations and keeps abreast of relevant issues by running seminars and workshops for relevant staff and having its investment adviser staff attend external seminars where appropriate. The Bank subscribes to relevant industry publications and, where appropriate, its investment advisers will monitor the financial markets.

Relevant professional body

The Bank is a member of the following professional bodies relevant to the provision of investment advice:

- New Zealand Bankers Association;
- Associate Member of Investment Savings & Insurance Association of NZ;
- Financial Markets Operations Association; and
- Institute of Finance Professionals.

Professional indemnity insurance

The Bank (and its subsidiaries), through its ultimate parent company Australia and New Zealand Banking Group Limited, has professional indemnity insurance which covers its activities including those of investment advisers it employs.

This insurance covers issues (including 'prior acts') arising from staff fraud, electronic crime, documentary fraud and physical loss of property. The scope of the insurance also extends to third party civil claims, including those for negligence. The level of cover is of an amount commensurate with the size and scale of the Bank.

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

The Bank has a process in place for resolving disputes. Should a problem arise, you can contact any branch of the Bank for more information on the Bank's procedures or refer to any of the Bank's websites.

Unresolved complaints may ultimately be referred to the Banking Ombudsman, whose contact address is PO Box 10-573, Wellington.

Criminal convictions

In the five years before the relevant investment advice is given none of the Bank (in its capacity as an investment adviser and where applicable an investment broker) or any principal officer of the Bank has been:

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;

- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

Fees

At the time of providing this disclosure statement it is not practicable to provide accurate disclosure of the fees payable for all securities that may be advised on. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

Other interests and relationships

When a security is sold by the Bank, the Bank may receive a commission, either from the issuer of a security or from an associated person of the Bank. Whether that commission is received and, if received, its value depends on the security sold. At the time of providing this disclosure statement it is not practicable to provide a detailed list of each security that may be advised on, the name of the issuer of that security and the rate of the commission received by the Bank. However, this information will be disclosed to you should you seek advice from one of the Bank's investment advisers on a specific investment.

In addition to the interest that the Bank has in products of which it is the issuer, the Bank, or an associated person of the Bank, has the following interests or relationships that a reasonable person would find reasonably likely to influence the Bank in providing the investment advice on the securities listed below:

- ANZ Investment Services (New Zealand) Limited (ANZIS), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ANZIS may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- UDC Finance Limited (UDC), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. UDC may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- ING (NZ) Holdings Limited (ING), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. ING and its related companies, including ING (NZ) Limited, may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- Direct Broking Limited (DBL), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. DBL may receive remuneration from a third party relating to a security sold by the Investment Adviser.

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

- Providing cash;

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

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

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

NEW ZEALAND DISCLAIMER

The Bank does not provide investment advice tailored to an investor's personal circumstances. It is the investor's responsibility to understand the nature of the security subscribed for, and the risks associated with that security. To the maximum extent permitted by law, the Bank excludes liability for, and shall not be responsible for, any loss suffered by the investor resulting from the Bank's investment advice.

Each security (including the principal, interest or other returns of any security) the subject of investment advice given to the investor by the Bank or otherwise, is not guaranteed, secured or underwritten in any way by the Bank or any associated or related party except to the extent expressly agreed in the terms of the relevant security.

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