

DOWNGRADES

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Page 2: Economic overview

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Page 4: Economic comment – fiscal penny(less)

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Page 6: Economic comment – the regional gap

- > According to our regional output gap measures, resource pressures are easing rapidly. While some regions are still recording a positive output gap, particularly in the South Island, the message is that pressure is easing across all regions. An implication from this is that weakness across the economy is very broad based.

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- > Key forward looking indicators (US Philadelphia Fed and Euro-zone PMI surveys) have deteriorated further suggesting the global economy is yet to find a base. Asian trade flows remain very weak and global Q4 GDP prints (Japan, Taiwan, Indonesia) have continued the trend of very poor results.

Page 8: Interest rate strategy

- > NZ interest rates have consolidated over the past week, but remain biased downward. Increased issuance and the possibility of a RBA pause may slow progress, but the poor overall macro picture suggests rates will keep falling. For borrowers, this implies that there is no rush to extend hedges, while for investors, it adds to the appeal of steepeners.

Page 9: Currency strategy

- > National Bank *Business Outlook* survey later this week will provide some domestic data for the currency market to chew on. But it will again be offshore events and risk related flows that dominate. More wide ranges and another test of the key 0.50 level for the NZD look on the cards.

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ECONOMIC OVERVIEW

We have shaved our growth expectations for 2009 even further and now see the economy contracting by close to 3 percent (previously 2 percent). A poor global scene is influential, but the sacrificial lamb for a de-leveraging economy is growth.

What's ahead?

- > **March quarter RBNZ Survey of Expectations** (Wednesday 1500 NZDT). We are looking for the key 2-year ahead reading to fall from 2.7 percent to 2.2 percent, in light of declining headline inflation.
- > **January Overseas Merchandise Trade** (Thursday 1045 NZDT). We expect a headline monthly deficit of \$200 million, taking the annual deficit to \$5,501 million.
- > **February NBNZ Business Outlook** (Thursday 1500 NZDT).
- > **January Credit Growth** (Thursday 1500 NZDT). Household credit growth is expected to remain very weak, as households de-leverage and balance sheet repair continues.
- > **January Building Consents** (Friday 1045 NZDT). Residential consent issuance could start to stabilise at these very depressed levels. However, we expect commercial consent issuance to now also trend lower.
- > **January External Migration** (Friday 1045 NZDT). We will be watching permanent departures closely for signs of a turnaround. Visitor arrivals are also expected to continue to head lower in the face of the global economic slowdown.

What's the view?

Once again we have taken a knife to our economic growth forecasts. We have shaved our already downbeat view of the NZ economy even further. We now see the economy contracting by close to 3 percent (previously 2 percent) for calendar 2009. This also sees the unemployment rate rise towards near 8 percent. While tempting to tweak our financial market views as well and call for a lower OCR, we continue to back the currency as the necessary release valve for the economy.

Our revised growth forecast is obviously "out-there" in so far as the mainstream is concerned. But we cannot go past the brutal economic reality that is unfolding. Here's why.

First is the global picture, which continues to deteriorate by the day. It is not just the economic data, which just like consensus forecasts, comes with a notorious lag. Instead, it is the growing innuendo and anecdotes behind the scenes as the

process of global de-leveraging intensifies, with the resulting spillover into spending, profits (losses), jobs and asset prices.

Second, in so far as NZ is concerned, we are on a losing trifecta of a global recession, heavy reliance on offshore capital and the need to de-leverage. We can talk about prospective interest rate cuts, expansionary fiscal policy and a potential influx of returning kiwis all we like. But this is a major global credit event, and NZ needs to get the current account deficit down. The old "rules" no longer apply when you go through a one-in-eighty year credit event. The sacrificial lamb for a de-leveraging economy is growth. There is simply no painless way out of it.

Third, the current downturn has now moved beyond firms experiencing lower sales and demand for their goods and services. Businesses have responded by reducing productive capacity. Given the obvious attention being paid to corporate balance sheets (last week's focus on a few corporates did not go unnoticed) businesses are now forced to respond. That means cutting investment and fewer jobs. And remember, this economic cycle is not fundamentally about corporate balance sheets. It is primarily about household de-leveraging, a process that has only just started, which will only accentuate the demand aspect as well.

Lastly, the current situation is not only a reflection of economic dynamics. It is rapidly becoming a symptom of game theory, as behavioural aspects to the economic cycle take over. The most widely referred to example of game theory is the *prisoner's dilemma*¹. The best solution is for everyone to hold their breath (co-operate) and ride through the biggest global downturn of our time. In short, don't pull down the shutters for fear of making it worse. Unfortunately, when you look at the payoff matrix from game theory, the rational choice leads the two players to defect (in an economic sense, "react" to try to gain a strategic advantage) even though they would benefit more if they played co-operatively. And so it extends to the economy.

For what it's worth, we hope our assessment over the coming year is wrong. No one likes to envisage these sorts of adjustments and outcomes. But we can't go past the 500 pound gorilla sitting on our shoulder: it's called a current account deficit, and it needs to come down, in an environment where the earnings sector is constrained by the global environment. Either it takes place sharply, or the adjustment extends over a number of years. That is, growth averages closer to 1½ to 2 percent for

¹ In the classic prisoner's dilemma, the only possible equilibrium for the game is for all players to defect (ie not co-operate with each other). It does not matter what the other player does, one player will always gain a greater payoff by defecting, all things being equal.

five years as growth rebalances. In reality we expect to see a combination of both.

We envisage a lot of volatility over the coming years. 2010 is likely to be inversely proportional to 2009 as bungy dynamics take hold. Yes, monetary and fiscal stimulus will gain traction at some stage, particularly housing volumes (not prices), which will merely be a first-in-first-out dynamic. But apart from looking at cyclical signs of recovery such as confidence, recovering building consents, and house sales etc, we will also be keeping a close eye on structural measures including savings rates, the current account deficit, composition to imports, and the ratio of consumption to GDP. These are more deep-rooted indicators of sustainability that will give us the heads-up on the quality of any recovery and whether it can be sustained. We keep harping on about it but NZ is facing two challenges, namely a cyclical downturn, intertwined with a structural adjustment. This means that we need to not only be mindful about the downturn itself, but also the average rate of growth expressed over a number of years as the piper is paid.

Now that we've got that off our chest, it's on to the week ahead, which should be quite an interesting one, with much more local data due for release. First up is the RBNZ's *Survey of Expectations* on Wednesday. The RBNZ was concerned about the elevated level of inflation expectations as little as 12 months ago, as high inflation rates threatened to become entrenched. The backdrop has obviously changed dramatically, with a sharply weaker domestic and global economy resulting in easing inflation pressures. We expect a lower headline inflation rate to see the key 2-year ahead inflation expectations measure ease to 2.2 percent, from its current level of 2.7 percent. This will be a level the Bank will be much more comfortable with.

The first NBNZ *Business Outlook* survey for 2009 is due this week and as we have written about in the past, this is one of the best leading gauges on the economy. The big uncertainty is whether there are any signs of recovery (or stabilisation) following many indicators within the survey hitting historical lows in December. This survey is the first important piece of economic information for the March quarter.

The other data due are all slightly less important (although should still be very interesting nonetheless). Overseas merchandise trade for January on Thursday is expected to show another monthly trade deficit (we expect a deficit of \$200 million). However, while the headline trade balance is important for assessing how the economy is rebalancing, we will also be very interested in the absolute level of export and imports. In December, the 'level' of trade surprised with its resilience, particularly when compared with other countries' trade figures, which showed capitulation. NZ

exports in the next few months will be weighed down by timing issues around dairy exports, which are yet to fully show the decline in global prices. Imports too could be impacted by an expectation of a sharp fall in the volume of crude oil imported (with 450 million tonnes imported in December compared with the monthly average of 350 million tonnes since 2000).

January residential building consent issuance out on Friday should remain very weak, and while we would not rule out another monthly fall (therefore recording another new historical low), we are expecting to see some signs of stabilisation. However, we will be more interested in how commercial consents are tracking. While they have remained at an elevated level (although to be fair, it is also not really growing), we are expecting to see it trend lower as the credit-centric nature of the economic environment begins to bite.

Finally, January external migration data on Friday is expected to show visitor arrival numbers being impacted by the global economic slowdown. This will particularly be the case for visitors from countries that have borne the brunt of the slowdown to date (US, UK, Europe). Visitors from Australia, on the other hand, may hold up okay if Australians decide to travel closer to home, rather than heading over to Europe or the US. In terms of permanent net migration, the risks do appear to the downside at present. However, we are also aware of the potential for a pending influx of people given the deteriorating job prospects offshore enticing ex-pats home (or stopping New Zealanders from leaving). This could be one of the factors that contribute to a stronger period of growth over 2010 and 2011.

Internationally this week, the German IFO survey and US durable goods spending will be the key focus. There are also a number of speeches from Fed and ECB policymakers.

Recent local data...

- > **Producer Price Index (December quarter):** Input prices fell 2.2 percent, taking annual growth to 9.7 percent. Output prices rose 1.4 percent, taking annual growth 9.9 percent.
- > **Capital Goods Price Index (December quarter):** The index rose 1.1 percent in the quarter.
- > **NBNZ Regional Trends (December quarter):** Total economy-wide economic activity fell 0.1 percent – the fourth consecutive quarterly contraction.
- > **NZ Government Financial Statements (Six Months Ended Dec 2008):** The OBEGAL, at \$0.1b, is \$1.1b below forecast.

FISCAL PENNY(LESS)

An even weaker fiscal position is flagged when the Treasury's *December Update* downside scenario (which is now their central view) is updated with our own set of core economic projections. We envisage operating deficits approaching 6 percent of GDP. Net debt rises rapidly, albeit off a zero base. Such projections limit the scope for fiscal policy to act further at this juncture. It also highlights the challenge policymakers face when it comes to showing a "credible medium-term strategy" to rating agencies.

In our 26 January edition of the *Market Focus*, we presented some modelling work on various alternatives available to the government to turn the deteriorating fiscal position around. The modelling was anchored off the Treasury's *2008 December Update* downside scenario (which is now noted as being the central track), and based on comments from the Minister of Finance that such projected deficits would not be allowed to eventuate.

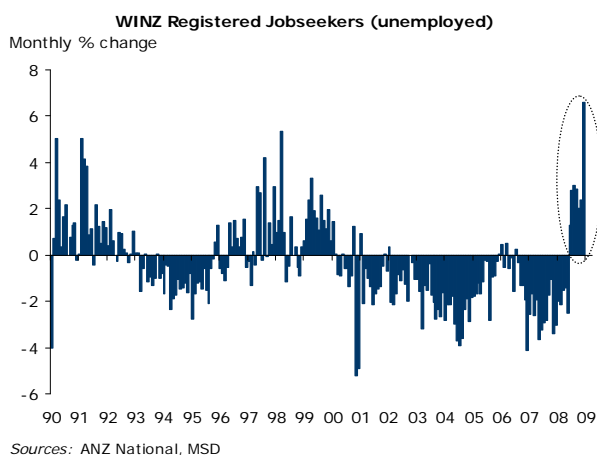
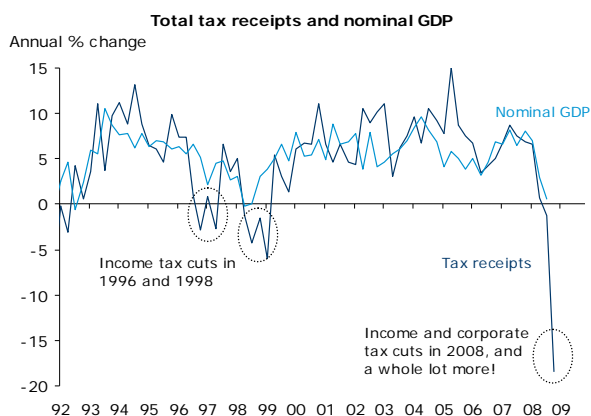
The Treasury's downside scenario envisaged GDP growth troughing at -0.3 percent in the March 2010 year. Beyond that, a relatively strong recovery and two years of 4 percent plus growth was forecast as pent-up demand, looser monetary conditions and one-offs such as the Rugby World Cup supported growth. Growth averages 2.7 percent per year over the coming four years. Treasury expects the unemployment rate to peak at 7.2 percent but then to improve to 4.8 percent by March 2013. Collectively it's a classic business cycle where a downturn is followed by a spring-loaded recovery as pent-up demand *et al* is unleashed.

Our own economic assessment is far more down-beat. We envisage the economy contracting 2.0 percent in the year to March 2010, and growth averaging closer to 2 percent per year over the next four years. The unemployment rate heads near 8 percent, and remains high for some time.

Why the differences? Fast moving global developments (or more aptly deteriorations) account for much of the difference in the near-term view; as do various behavioural aspects to the economic cycle. Collectively they suggest a far deeper trough. But beyond that, and despite considerable stimulus in the pipeline, we struggle to see the economy performing as strongly on average, as the inevitable current account rebalancing process plays out. We could throw in a more conservative assessment towards potential growth as well given prospects for limited capital accumulation. But it is the current account issue and de-leveraging process that will constrain how far the economy can grow on average for a number of years, in our view. Or put another way, once we

navigate a global shock, we still have internal imbalances to address.

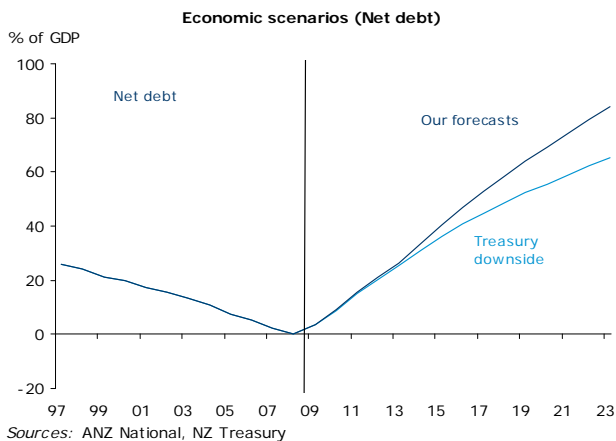
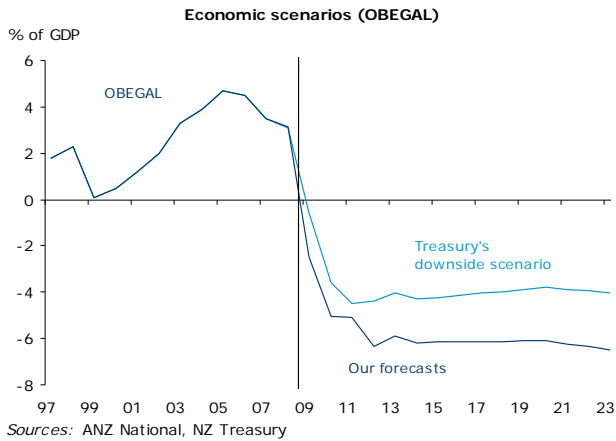
Last week's fiscal numbers also showed some worrying trends. Tax receipts capitulated in the December quarter (NB: some of this will reflect tax cuts, but the trend is a concern), and the number of registered jobseekers at WINZ is rising rapidly. While this may reflect a far weaker economy, the danger is also that structural aspects to the government's operating balance were overstated. Indeed, the last pure business cycle and deep recession in NZ (1991/92) saw corporate profits fall off a cliff, and it is corporate profits driving tax receipts lower again.



To be fair to the Treasury, the economic environment has deteriorated rapidly since their forecast was finalised and we are sure that their next update will show lower economic projections. In fact, they foreshadowed this in a recent monthly report stating that "*growth appears to be developing in line with the December Update downside scenario, at least in the near term, with recent international developments pointing to further downside risk*" [our emphasis].

Obviously, differing economic assumptions imply considerable shifts in the fiscal projections. So using our own economic projections, what does it show?

Unsurprisingly, the underlying operating balance (OBEGAL) deteriorates further and remains around -6 percent of GDP for the entire forecast period (compared with -4 percent under the Treasury assumptions). Net core crown debt also increases and reaches over 80 percent of GDP compared with 65 percent based on Treasury's projections.



In so far as medium-term projections are concerned, it is possible to tell any story. Tweak the assumptions and you can get the answer you want! But of course, the caveat to this is that the assumptions still need to pass the credibility test and it is the spirit and trends in such projections that are more important than the numbers themselves. Massively deteriorating fiscal positions are rapidly becoming the norm around the globe. So NZ's projected deterioration is not necessarily anything new. However, given the extent of external liabilities (or poor current account position) and attention from rating agencies (with S&P having NZ on a negative outlook), fiscal policy needs to be relatively squeaky clean when it comes to demonstrating prudence.

When we look at the implications from this sort of analysis, a couple of points are noteworthy:

- > **The Budget 2009 numbers will be ugly.** While we don't expect the Treasury's updated economic forecasts to be as downbeat as our own, they will be revised lower. This will flow-

on to the fiscal numbers, in terms of bigger deficits, more borrowing, and larger bond tender programmes. It must be remembered that these numbers do not even take into account the possibility of more "skeletons", with repeated media nuances of downside "surprises".

- > **Fiscal policy is heavily constrained at this point in time.** The government continues to face the dilemma of having its hands tied at a time when the economy is in need of support. This does not mean fiscal policy is impotent. One reason for the sharp deterioration in the fiscal accounts is due to the large stimulus measures already being delivered (tax cuts, infrastructure etc) and we sometimes gloss over the fact that fiscal policy is already playing a huge role in terms of running an expansionary stance at present. But from this juncture, either the government ploughs ahead with support, leveraging its own balance sheet irrespective of potential ratings outcomes, or its ability to assist is constrained to shuffling expenditure between years as opposed to incrementally delivering more stimulus.
- > **It is incredibly difficult to turn the fiscal numbers around.** In our previous piece we noted that individual strategies based around stronger growth, spending restraint or combinations of the two only really lead to small marginal improvements in the fiscal position. Sustained deficits would be here for some time. This latest analysis ups-the-ante on the sort of "response" required to address worrying trends.

The upshot

In so far as the conclusion goes, we'll let the numbers speak for themselves, but also re-state what we said a few weeks ago.

Our simple scenarios highlight that turning the fiscal position around, using a set of credible assumptions, will still prove to be challenging. On that basis we have to take Standard and Poor's (S&P) at their word that NZ's rating could be lowered and it will remain a key risk.

The other aspect to watch over the coming months, and the second leg to S&P's commentary centred on "an easing of NZ's external imbalances". Rather disconcertingly, the current account deficit is expected to widen over the coming quarters. By the time the Budget comes around (and NZ is releasing December quarter current account figures at the end of March), we are likely to see a current account deficit (as a percentage of GDP) with a 9 in front of it. This will only accentuate the increasing importance of demonstrating a credible strategy when it comes to fiscal policy.

THE REGIONAL GAP

According to our regional output gap measures, resource pressures are easing rapidly. While some regions are still recording a positive output gap, particularly in the South Island, the message is that pressure is easing across all regions. An implication from this is that weakness across the economy is very broad based.

The linkage between excess demand and inflation pressure is well known. Economists frequently talk about the "output gap", noting that when the output gap is positive (i.e. actual economic growth exceeds "potential"), inflation pressures build. The period of strong growth recorded in NZ in recent years prior to 2008 has seen a positive output gap open up and inflation pressures emerge. Seeing these pressures, the RBNZ tightened monetary policy by raising the OCR. Of course, interest rates have now been cut sharply in response to, among other things, the global backdrop.

We have updated our regional output gap measures. To refresh readers' memories, the regional output gaps are estimated using data from the National Bank's *Regional Trends and Business Outlook* survey, and Statistics NZ's regional unemployment data.¹

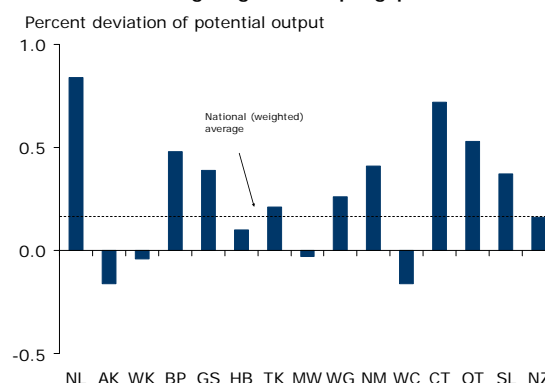
Here are some key messages from the analysis:

- > The economy-wide output gap is "neutral". Of the three gap measures we estimate, the activity gap was well in negative territory, while the unemployment and capacity gaps were still slightly positive. To be fair, some of this may be owing to normal business cycle lags.
- > Four of the 14 regions reported negative output gaps in the December quarter. Looking at the composition, the activity gap measure was negative across every single region. The capacity gap was slightly more mixed, with some regions still recording positive capacity pressures, while the unemployment gap was positive across all the regions, reflecting a still historically low unemployment rate.
- > The South Island is by far still experiencing the greater capacity pressures compared with the rest of the country. In fact, the West Coast

was the only South Island region to report a negative average output gap. The Canterbury region recorded the largest positive output gap across the country in the December quarter.

- > The bellwether Auckland region recorded the most negative output gap in the December quarter, as was the case in the September quarter. Given the nature of the economic slowdown (being centred on housing and consumer centric sectors), this result is not at all surprising. A standout was also the Northland region, with the second largest positive output gap, despite experiencing the sharpest fall in activity across the country.

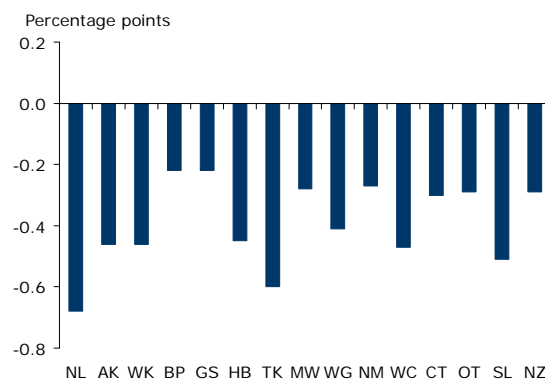
Estimate average regional "output gap" in Dec 08



Source: ANZ National

- > All the regions experienced a reduction in capacity pressures in the December quarter, with Northland leading the charge.

Change in regional output gaps over the past quarter



Source: ANZ National

The upshot

While some regions continue to report positive output gaps, this mostly reflects lags in the labour market. A key implication from our latest results is that general capacity pressure is easing nationwide. This suggests to us that weakness across the economy is now very broad based.

Note: NL=Northland, AK=Auckland, WK=Waikato, BP=Bay of Plenty, GS=Gisborne, HB=Hawke's Bay, TK=Taranaki, MW=Manawatu-Wanganui, WG=Wellington, NM=Nelson-Marlborough, WC=West Coast, CT=Canterbury, OT=Otago, SL=Southland.

¹ The estimates are generated using estimates of the output gap, unemployment gap and a derived capacity utilisation gap from the NBNZ *Business Outlook* survey. We chose a broad approach for two reasons. First it minimises some of the error that may surround simple regional activity statistics (which are only partial indicators). Second, the Reserve Bank uses a similar combination to derive its multivariate filter measure of the output gap for the entire economy. For each input we use a band-pass filter to derive the business cycle – a standard statistical technique that is available on modern statistical software. The regional unemployment rates are advanced two quarters prior to filtering as this is a lagging indicator. Individual output gap measures across activity, unemployment and capacity utilisation for each region are then given an equal weighting.

GLOBAL WATCH

Key forward looking indicators (US Philadelphia Fed and Euro-zone PMI surveys) have deteriorated further suggesting the global economy is yet to find a base. Asian trade flows remain very weak and global Q4 GDP prints (Japan, Taiwan, Indonesia) have continued the trend of very poor results.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	Net Long-Term TIC Flows (Dec)	\$20.0B	\$34.8B	-\$25.6B	Stronger
	NAHB Housing Market Index (Feb)	8	9	8	Stronger
	Import Price Index (Jan) – mom	-1.2%	-1.1%	-5.0%	In-line
	Housing Starts (Jan)	529K	466K	560K	Weaker
	Industrial Production (Jan)	-1.5%	-1.8%	-2.4%	Weaker
	PPI (Jan) – mom	0.3%	0.8%	-1.9%	Stronger
	Continuing Jobless Claims (w/e Feb-8)	4830K	4987K	4817K	Weaker
	Leading Indicators (Jan)	0.1%	0.4%	0.2%	Stronger
	Philadelphia Fed (Feb)	-25.0	-41.3	-24.3	Weaker
	CPI (Jan) - mom	0.3%	0.3%	-0.8%	In-line
Euro-zone	ZEW Survey (Economic Sentiment) (Feb)	-27.5	-8.7	-30.8	Stronger
	PMI Manufacturing (Feb A)	35.0	33.6	34.4	Weaker
	PMI Services (Feb A)	42.5	38.9	42.2	Weaker
UK	CPI (Jan) – mom	-1.0%	-0.7%	-0.4%	Stronger
	DCLG House Prices (Dec) – yoy	-10.1%	-10.2%	-8.5%	In-line
	Public Finances (Jan)	-7.7B	-25.1B	19.9B	Weaker
	Retail Sales (Jan) - mom	-0.1%	0.7%	1.7%	Stronger
Asia Ex-Japan					
<i>South Korea</i>	Department Store Sales (Jan) – yoy	-	16.8%	-5.8%	-
<i>Singapore</i>	Electronic Exports (Jan) – yoy	-35.3%	-38.4%	-25.4%	In-line
	Non-Oil Domestic Exports (Jan) – yoy	-34.5%	-34.8%	-20.8%	In-line
<i>Hong Kong</i>	Unemployment Rate (Jan)	4.3%	4.6%	4.1%	Weaker
<i>Taiwan</i>	GDP (4Q) – yoy	-6.8%	-8.4%	-1.1%	Weaker
	Benchmark Interest Rate	-	1.25%	1.50%	-
<i>Indonesia</i>	GDP (4Q) – qoq	-2.5%	-3.6%	3.7%	Weaker
<i>Thailand</i>	Customs Exports (Jan) – yoy	-	-26.5%	-14.6%	-
<i>Malaysia</i>	Manufacturing Sales (Dec) – yoy	-	-20.8%	-1.9%	-
	CPI (Jan) – yoy	4.1%	3.9%	4.4%	Weaker
<i>Philippines</i>	M3 Money Supply (Dec) – yoy	-	15.6%	14.6%	-
Japan	GDP (4Q P) – qoq	-3.1%	-3.3%	-0.6%	Weaker
	Industrial Production (Dec F) – mom	-	-9.8%	-9.6%	-
	Tertiary Industry Index (Dec) – mom	-1.5%	-1.6%	-1.1%	In-line
	BoJ Target Rate	0.10%	0.10%	0.10%	In-line
	All Industry Activity Index (Dec) - mom	-2.7%	-2.7%	-2.4%	In-line
Australia	Retail Sales Ex-Inflation (4Q)	1.0%	0.8%	0.1%	Weaker

INTEREST RATE STRATEGY

NZ interest rates have consolidated over the past week, but remain biased downward. Increased issuance and the possibility of a RBA pause may slow progress, but the poor overall macro picture suggests rates will keep falling. For borrowers, this implies that there is no rush to extend hedges, while for investors, it adds to the appeal of steepeners.

Market themes ...

- > While the prospect of massive government bond issuance looms large, capital losses in equity and real estate make the opportunity cost of investing in bonds low.
- > We get the sense that the penny hasn't dropped yet. The road ahead will be rough. Interest rates don't tend to rise in a recession.

Review and outlook ...

Interest rates have been fairly stable over the past week, unsure quite what to make of conflicting information. On the one hand, interest rates are under pressure from the enormous supply of government debt that lies ahead, and on the other hand, demand for safe-haven assets are keeping a lid on yields. Looking ahead, we tend to think the latter force will be more dominant – interest rates tend to stay low in a recessionary environment.

It would be an exaggeration to say this in the calm before the storm, but it certainly feels like it. The market has certainly undergone a major change in sentiment. Always eager to get on the next move, the market has automatically assumed that because the last big move was down, the next must be up. We're not so sure, and we think a satiric cartoon we saw of a fellow collecting a bounty of beached fish as the tide went out suddenly in the shadow of a tsunami summed things up well. People are relishing the prospect of lower interest rates, cheap petrol and massive discounts on electronics and home ware, conveniently wondering what caused this supposed stroke of good luck. But when the extent of the global downturn and the resultant downsizing of productive capacity (for me and you, that's investment and jobs) hits home, we wonder what there will be to cheer about.

But what's this got to do with interest rates? For one it's having an impact on the tone of commentary and anecdotes, and by implication, expectations and market pricing. This phase is likely to be short-lived though, especially if US jobs numbers, which now have a decidedly exponential feel about them, continue deteriorating. With few things to cheer about on the domestic front, and the realisation that the Government is increasingly finding its hands tied, expect attitudes towards interest rates to change very quickly.

Borrowing strategies we favour at present

The broad thrust of our thinking hasn't changed, and we continue to favour keeping duration short relative to benchmark. If anything, global developments make us even less inclined to add to the duration of hedge cover at current levels. Quantitative easing (QE) implies lower, not higher term rates, and this will trickle down to New Zealand. Also, it's not necessarily that we think interest rates have a lot lower to go, it's more that we find it difficult to envisage a scenario where rates will rise on a sustainable basis. In this environment, we see no need to "rush" to fix just because rates are close to historic lows. Keeping duration short (or floating) enables participation in lower rates at the short end of the curve, which seems appropriate in this uncertain environment.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ	↔	What's priced in fair, market will always gun for more.
NZ data	↔/↓	A lull in data has seen focus shift to poor global news.
Fed Funds/ front end	↔/↓	Possibility Fed moves to buy Treasuries and UK follow.
RBA	↔/↑	Upbeat talk from Stevens & Edey suggest slower pace of easings going forward.
US 10 year	↔/↓	Fear is stronger than greed and keeping a lid on yields.
NZ swap curve	↔/↑	Steepeners still relevant – policy drive short end, issuance holds back 10yr.
Flow	↔/↓	Lingering receive interest.
Technicals	↔/↓	Short term range trade. Medium term rally potential.

Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 12-Mar-09	-67	-69
Thu 30-Apr-09	-102	-121
Thu 11-Jun-09	-112	-130
Thu 30-Jul-09	-116	-131
Thu 10-Sep-09	-117	-125
Thu 29-Oct-09	-111	-127
Thu 10-Dec-09	-106	-131

Trading themes we favour at present

The 2yr – 10yr swap curve has steepened to record levels, and is set to continue doing so as the short end follows policy, and the long end is held back by global long term inflation concerns and issuance. QE will limit the global steepening, but if it becomes widespread, NZ policy is likely to be easier. With policy likely to be loose for longer, any backup in long dates OIS make for good receive opportunities.

CURRENCY STRATEGY

National Bank *Business Outlook* survey later this week will provide some domestic data for the currency market to chew on. But it will again be offshore events and risk related flows that dominate. More wide ranges and another test of the key 0.50 level for the NZD look on the cards.

Market themes...

- > Concerns about Western banks' exposures to Eastern Europe triggers increased risk aversion.
- > Talk of US bank nationalisations send equities sharply lower.
- > Economic dataflow continue to print very weak.
- > End of week retracement of USD may be short-lived.

Review and outlook...

Volatility in currency markets took a step up with news about Eastern European economic woes triggering worries about the extent of exposures by Western banks. To add to the mix, ongoing uncertainty amongst US financial institutions has raised talk of bank nationalisations. Despite the US government playing down such talk, equities sold off aggressively as risk continues to be taken off the table.

Despite a big retracement in the USD at the end of last week, the USD remains the default safe haven currency. Jitters over Europe has seen the EUR under pressure, and the currency would have been knocking on the key 1.25 level were it not for a last minute squeeze. Similarly for the GBP, ongoing weakness in the UK economy and the BoE seeing a weaker pound as a necessary part of the rebalancing of the economy means there is a limit to how far the GBP can squeeze higher. We expect another test of the 1.41 level in the near term.

Closer to home, the AUD gained some support from RBA Governor Stevens' relatively more upbeat comments on the Australian economy. While the cash rate still has lower to go, the pace and magnitude will be much less as the RBA has already factored in a lot of the upcoming bad data. Still, how the current contract price negotiations by the mining companies go may still keep the AUD down.

For the NZD this week, we think another test of the 0.50 level against the USD is on the cards.

Certainly, there is still a strong risk of a sharp short squeeze higher in the NZD, given that real money remains short on the kiwi. On a positive side, USDA dairy prices appear to be stabilising, albeit at low levels. But as the slump in the Government's tax take indicates, the NZ economy remains very weak and this week's January trade data will again

highlight the economy's still large external imbalance. We expect offshore events and risk related flows to dominate the NZD again this week in the lead-up to the National Bank *Business Outlook* on Thursday, which will give the first read on how Q1 is faring.

From a technical perspective, the NZD continues to struggle and is expected to trade at a lower range of 0.4960 to 0.5170 for the week ahead. The NZD/AUD cross appears happy to trade the current 0.7800 to 0.8050 range, though we still see downside potential.

NZD vs AUD: monthly directional gauges

Gauge	Direction	Comment
Fair value	↔	Back in the fair value zone.
Yield	↔	Markets looking at similar end-points for cash rates.
Commodities	↔/↓	Hards outperforming softs.
Partial indicators	↓	NZ indicators still worse but Australia's can't be far behind.
Technicals	↓	0.7800-0.8050 range.
Sentiment	↔/↓	Risk aversion dominating.
Other	↔	Dairy prices look to be stabilising.
On balance	↔/↓	Further declines expected, though likely to be a slow grind down.

NZD vs USD: monthly directional gauges

Gauge	Direction	Comment
Fair value – long-term	↔/↓	Erring towards macro-balance fair value models in this environment. They say low 0.50s.
Fair value – short-term	↔/↑	Moved below short-term fair value model.
Yield	↓	Differential still narrowing.
Commodities	↔/↓	Dairy prices appear to be stabilising at low levels.
Risk aversion	↔/↓	To remain high given bank concerns.
Partial indicators	↔	NZ's starting to compete with the US's.
Technicals	↔/↓	0.4960 to 0.5170 range.
AUD	↔/↑	Some support from RBA Stevens' testimony.
Sentiment	↔	Fickle.
Other	↔/↓	USD still king of safe haven destinations despite end of week retracement.
On balance	↔/↓	Consolidation in the near-term, before the next leg lower.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
23-Feb	NZ	Credit Card Spending (Jan) - yoy	-	-3.9%	15:00
	JN	Supermarket Sales (Jan) - yoy	-	-2.8%	18:00
	EC	ECB's Trichet Speaks at Securities Regulators Forum in Paris	-	-	21:00
24-Feb	EC	ECB's Gonzalez-Paramo speaks in Madrid	-	-	00:00
	US	Dallas Fed Manufacturing Activity (Feb)	-52.5%	-50.5%	04:30
		Fed's Fisher Speaks in Rhode Island on Financial Crisis	-	-	05:30
		Fed's Lockhart Speaks on US Economy in Orlando, Florida	-	-	06:40
	JN	BoJ Monetary Policy Meeting Minutes for January	-	-	12:50
		Corp Service Price (Jan) - yoy	-2.5%	-2.5%	12:50
	AU	Preliminary BoP Imports (Jan) – mom	-	-2.0%	13:30
	GE	IFO - Business Climate (Feb)	83.0	83.0	22:00
		IFO - Current Assessment (Feb)	84.9	86.8	22:00
		IFO – Expectations (Feb)	81.1	79.4	22:00
	EC	ECB Current Account (Dec) – s.a.	-	-16.0B	22:00
		Industrial New Orders (Dec) - mom	-4.9%	-4.5%	23:00
	UK	Total Business Investment (4Q P) – qoq	-4.2%	-1.3%	22:30
25-Feb	US	S&P/CS Composite-20 (Dec) – yoy	-18.3%	-18.2%	03:00
		Consumer Confidence (Feb)	35.0	37.7	04:00
		House Price Index (Dec) - mom	-1.6%	-1.8%	04:00
		Richmond Fed Manufacturing Index (Feb)	-49	-49	04:00
		Bernanke Report on Economy & Fed Policy	-	-	04:00
	JN	Adjusted Merchandise Trade Balance (Jan)	-¥489.8B	-¥148.8B	12:50
		Small Business Confidence (Feb)	-	24.8	18:00
	AU	Wage Cost Index (4Q) – qoq	0.9%	0.9%	13:30
		Construction Work Done (4Q)	-1.5%	4.4%	13:30
	NZ	RBNZ 2yr Inflation Expectation (1Q)	-	2.7%	10:45
	GE	GDP (4Q F) – qoq	-2.1%	-2.1%	20:00
	UK	GDP (4Q P) – qoq	-1.6%	-1.5%	22:30
		Index of Services (3mth/3mth) (Dec)	-1.0%	-0.4%	22:30
26-Feb	US	Existing Home Sales (Jan) - mom	1.3%	6.5%	04:00
	NZ	Trade Balance (Jan)	-450.0M	-347.0M	10:45
		Imports (Jan)	3.70B	4.20B	10:45
		Exports (Jan)	3.25B	3.85B	10:45
		Money Supply M3 (Jan) – yoy	-	6.3%	15:00
		NBNZ Business Confidence (Feb)	-	-	15:00
	AU	Conference Board Leading Index (Dec)	-	-1.0%	12:00
		Private Capital Expenditure (4Q) - qoq	-3.0%	0.6%	13:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
26-Feb cont.	JN	BoJ Board Member Noda to Speak in Naha City	-	-	14:30
	GE	ILO Unemployment Rate (Jan)	7.3%	7.2%	20:00
		GfK Consumer Confidence Survey (Mar)	2.0	2.2	20:10
		Unemployment Change (000's) (Feb)	60K	56K	21:55
		Unemployment Rate (Feb)	7.9%	7.8%	21:55
	EC	M3 Money Supply (Jan) – yoy	6.9%	7.3%	22:00
		Business Climate Indicator (Feb)	-3.20	-3.16	23:00
		Consumer Confidence (Feb)	-31	-31	23:00
		Economic Confidence (Feb)	68.5	68.9	23:00
		Industry Confidence (Feb)	-34	-34	23:00
		Services Confidence (Feb)	-22	-22	23:00
	UK	BoE's King, Tucker, Haldane, Bailey to testify	-	-	23:30
27-Feb	NZ	New Zealand Employment Summit	-	-	-
		Visitor Arrivals (Jan) - mom	-	3.9%	10:45
		Building Permits (Jan) - mom	-	-6.0%	10:45
	EC	ECB's Trichet Speaks on Europe's Competitiveness in Dublin	-	-	02:00
		CPI (Jan) – mom	-0.8%	-0.1%	23:00
		Unemployment Rate (Jan)	8.1%	8.0%	23:00
	US	Durable Goods Orders (Jan)	-2.5%	-2.6%	02:30
		Durables Ex Transportation (Jan)	-2.2%	-3.6%	02:30
		Initial Jobless Claims (w/e Feb-22)	625K	627K	02:30
		Continuing Claims (w/e Feb-15)	5011K	4987K	02:30
		New Home Sales (Jan) – mom	-2.1%	-14.7%	04:00
	JN	Jobless Rate (Jan)	4.6%	4.4%	12:30
		Household Spending (Jan) - yoy	-5.8%	-4.6%	12:30
		National CPI (Jan) - yoy	0.0%	0.4%	12:30
		National CPI Ex-Food, Energy (Jan) - yoy	-0.2%	0.0%	12:30
		Industrial Production (Jan P) - mom	-1.0%	-9.8%	12:50
		Retail Trade (Jan) - mom	-0.2%	-1.9%	12:50
		Vehicle Production (Jan) - yoy	-	-25.2%	17:00
		Housing Starts (Jan) - yoy	-15.0%	-5.8%	18:00
		Construction Orders (Jan) – yoy	-	-27.3%	18:00
	AU	Private Sector Credit (Jan) - mom	0.3%	-0.3%	13:30
28 Feb	US	GDP (Annualised) (4Q P)	-5.4%	-3.8%	02:30
		Chicago Purchasing Manager (Feb)	33.0	33.3	03:45
		University of Michigan Confidence (Feb F)	56.0	56.2	04:00
		Fed's Yellen, Bullard Comment on Oil Prices and Policy	-	-	04:00

Key: AU: Australia, EC: Euro-zone, GE: Germany, JN: Japan, NZ: New Zealand, UK: United Kingdom, US: United States. Sources: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. (Note: all surveys are preliminary and subject to change).

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: The February NBNZ *Business Confidence* survey this week is the next key release and will provide a good gauge on how the economy has performed in the March quarter to date. Indicators of December quarter GDP are expected to reinforce the likelihood of a sizable contraction.

Date	Data/Event	Economic Signal	Comment
Wed 25 Feb (15.00)	RBNZ Survey of Expectations (Mar qtr)	Inflation concerns easing	Expectations of future inflation outcomes are expected to fall in light of declining headline inflation. We think the key 2-year ahead reading will fall from 2.7 percent to 2.2 percent.
Thu 26 Feb (10.45)	Overseas Merchandise Trade (Jan)	Watching export levels	A monthly trade deficit of \$200m is expected. However, we will be watching the absolute level of exports given the weakness in the global economy and slowing in global trade flows.
Thu 26 Feb (15.00)	NBNZ <i>Business Outlook</i> (Feb)	-	-
Thu 26 Feb (15.00)	Credit Growth (Jan)	De-leveraging	Household credit growth is expected to remain very weak, as households de-leverage and balance sheet repair continues.
Fri 27 Feb (10.45)	Building Consents (Jan)	Another record low?	Residential consent issuance could start to stabilise at these very depressed levels. However, we expect commercial consent issuance to now also trend lower.
Fri 27 Feb (10.45)	External Migration (Jan)	Visitor arrivals heading downhill	We will be watching permanent departures closely for signs of a turnaround. Visitor arrivals are also expected to continue to head lower in the face of the global economic slowdown.
Wed 4 Mar (15.00)	ANZ Commodity Price Index (Feb)	-	-
Mon 9 Mar (10.45)	Value of Building Work Put in Place (Dec qtr)	Sharply lower residential construction	Residential construction work put in place is likely to contract sharply again. Non-residential construction will be key to watch.
Tue 10 Mar (10.45)	Electronic Card Transactions (Feb)	Still an underlying weak trend	The data can be volatile on a monthly basis. Nevertheless, we expect the trend of underlying weakness to remain.
circa 11 May	REINZ House Sales (February)	House price weakness	House sales to show some further signs of stabilisation, but house prices should face downward pressure.
Wed 11 Mar (10.45)	Overseas Trade Indexes (Dec qtr)	Terms of trade down again	While a lower NZD will see both export and import prices rise in the quarter (despite lower global commodity prices), import prices are likely to outperform and see the terms of trade fall.
Thu 12 Mar (10.45)	RBNZ <i>Monetary Policy Statement</i>	75bp cut	The domestic economy remains very weak, but it is the global scene that continues to concern. We expect a 75bp cut and for the door to be left open for more. We will be looking for any guidance on how long rates will remain low.
Fri 13 Mar (10.45)	Retail Trade Survey (Jan)	Still subdued	A small recovery may be possible after the fall recorded in December. Nevertheless, the broad trend will remain one of consumers' wallets generally remaining shut.
Mon 16 Mar (10.45)	Economic Survey of Manufacturing (Dec qtr)	Weak again	Recent PMI surveys as well as jobs growth for the manufacturing sector have been weak. This survey should reinforce this.
Fri 20 Mar (10.45)	External Migration (Feb)	Tourism under pressure	Visitor arrivals should remain under downward pressure given the global backdrop.
Fri 20 Mar (15.00)	Credit Card Spending (Feb)	Underlying weakness	While volatile on a monthly basis, the underlying trend should remain soft.
On Balance		Flow-on from the global scene in the dataflow.	No signs of a base. Prospects still deteriorating.

SUMMARY OF KEY ECONOMIC FORECASTS

	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
GDP (% qoq)	0.8	-0.3	-0.2	-0.4	-0.9	-1.5	-0.5	0.0	0.1	0.5
GDP (% yoy)	3.7	2.1	1.0	-0.1	-1.8	-2.9	-3.2	-2.9	-1.9	0.1
CPI (% qoq)	1.2	0.7	1.6	1.5	-0.5	0.3	0.8	0.6	0.7	0.5
CPI (% yoy)	3.2	3.4	4.0	5.1	3.4	3.0	2.2	1.3	2.5	2.7
Employment (% qoq)	1.0	-1.3	1.2	0.1	0.9	-1.5	-1.0	-0.8	-0.3	0.0
Employment (% yoy)	2.5	-0.2	0.7	1.0	0.9	0.7	-1.5	-2.4	-3.6	-2.1
Unemployment Rate (% sa)	3.4	3.7	3.9	4.2	4.6	5.1	6.1	6.8	7.2	7.6
Current Account (% GDP)	-8.2	-8.0	-8.4	-8.6	-9.0	-8.9	-7.9	-7.1	-6.6	-6.6
Terms of Trade (% qoq)	2.9	4.2	-0.4	-2.3	-1.6	-2.8	-2.8	-2.4	-1.7	-1.2
Terms of Trade (% yoy)	8.8	11.6	10.7	4.4	-0.2	-6.8	-9.0	-9.1	-9.3	-7.8

KEY ECONOMIC INDICATORS

	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09
Retail Sales (% mom)	1.2	-1.1	0.8	-0.7	0.4	0.3	-1.2	0.2	-1.0	..
Retail Sales (% yoy)	4.1	1.0	1.5	2.5	-0.9	2.2	0.7	-4.1	-0.9	..
Credit Card Billings (% mom)	-0.3	0.4	-0.1	0.1	-0.4	1.3	-1.7	-1.0	-2.2	..
Credit Card Billings (% yoy)	5.5	6.0	3.9	4.2	2.4	2.5	1.0	-0.9	-3.9	..
Car Registrations (% mom)	10.8	-13.4	1.4	-7.2	-3.6	11.2	-1.3	-19.9	12.9	-8.0
Car Registrations (% yoy)	-1.0	-20.6	-15.9	-27.1	-30.5	-15.6	-19.9	-34.4	-23.7	-36.5
Building Consents (% mom)	81.9	-42.3	-12.6	-1.8	-6.8	8.4	-19.2	4.0	-5.9	..
Building Consents (% yoy)	30.5	-26.8	-46.0	-34.4	-43.1	-28.3	-43.1	-39.5	-41.0	..
REINZ House Price (% yoy)	-1.1	-1.4	-2.2	-1.4	-5.7	-6.1	-4.3	-4.1	-4.8	-4.4
Household Lending Growth (% mom)	0.3	0.5	0.2	0.3	0.4	0.2	0.1	-0.1	0.2	..
Household Lending Growth (% yoy)	9.9	9.2	8.4	7.7	7.2	6.6	5.8	4.7	4.2	..
Roy Morgan Consumer Confidence	99.9	89.2	86.5	83.9	91.4	108.6	99.7	99.0	102.9	103.7
NBNZ Business Confidence	-54.8	-49.7	-38.7	-43.2	-20.5	1.6	-42.3	-43.0	-35.0	..
NBNZ Own Activity Outlook	-3.8	-4.4	-4.0	-8.2	4.7	16.7	-11.4	-14.1	-21.5	..
Trade Balance (\$m)	-293	-169	-215	-797	-848	-1252	-995	-588	-347	..
Trade Balance (\$m annual)	-4604	-4782	-4478	-4468	-4369	-5048	-5269	-5230	-5615	..
ANZ World Commodity Price Index (% mom)	-0.3	0.9	0.0	1.8	-3.4	-5.1	-7.6	-7.4	-7.4	-4.3
ANZ World Commodity Price Index (% yoy)	20.7	18.7	11.6	8.7	3.5	-2.1	-11.1	-18.3	-24.3	-26.5
Net Migration (sa)	490	940	450	780	360	-30	-20	-450	270	..
Net Migration (annual)	4666	4931	4732	5201	4938	4403	4329	3569	3814	..

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

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Dec-08	Jan-09	23-Feb-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
NZD/USD	0.557	0.553	0.509	0.500	0.450	0.430	0.410	0.420	0.430	0.440
NZD/AUD	0.831	0.816	0.791	0.794	0.776	0.768	0.759	0.778	0.768	0.759
NZD/EUR	0.414	0.417	0.398	0.400	0.375	0.364	0.360	0.382	0.410	0.419
NZD/JPY	50.9	50.0	47.5	44.0	38.7	36.6	34.9	36.1	37.8	39.6
NZD/GBP	0.373	0.382	0.354	0.357	0.341	0.331	0.328	0.336	0.344	0.349
NZ\$ TWI	55.1	54.9	51.9	51.0	47.2	45.5	44.3	45.8	47.3	48.3
NZ interest rates	Dec-08	Jan-09	23-Feb-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
OCR	5.42	5.12	3.50	2.75	2.50	2.50	2.50	2.50	3.00	4.00
90 day bill	5.22	4.37	3.29	3.10	2.90	2.80	2.80	2.80	3.60	4.60
10 year bond	4.87	4.49	4.58	4.30	4.60	4.70	4.80	5.20	5.20	5.70
International	Dec-08	Jan-09	23-Feb-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.00	1.50
US 3-mth	1.43	1.18	1.25	1.20	0.90	0.70	0.50	0.70	1.25	1.75
AU cash	4.25	4.25	3.25	3.00	2.75	2.50	2.50	2.50	2.50	3.50
AU 3-mth	4.15	3.46	3.08	3.50	2.80	2.80	2.80	3.20	3.90	4.40

KEY RATES

	20 Jan	16 Feb	17 Feb	18 Feb	19 Feb	20 Feb
Official Cash Rate	5.00	3.50	3.50	3.50	3.50	3.50
90 day bank bill	4.29	3.39	3.35	3.27	3.28	3.29
NZGB 07/09	3.34	3.18	3.15	3.15	3.10	3.10
NZGB 11/11	3.56	3.56	3.59	3.53	3.55	3.55
NZGB 04/13	3.84	3.96	3.98	3.92	3.94	3.94
NZGB 12/17	4.36	4.63	4.62	4.55	4.57	4.57
2 year swap	3.68	3.34	3.29	3.23	3.27	3.29
5 year swap	4.11	4.05	4.02	3.99	4.02	4.04
RBNZ TWI	53.6	52.7	52.4	52.1	52.5	51.8
NZD/USD	0.5336	0.5193	0.5136	0.5090	0.5121	0.5050
NZD/AUD	0.8053	0.7966	0.7957	0.7969	0.7972	0.7875
NZD/JPY	48.19	47.56	47.44	46.90	47.94	47.56
NZD/GBP	0.3734	0.3648	0.3612	0.3572	0.3587	0.3546
NZD/EUR	0.4098	0.4065	0.4056	0.4042	0.4068	0.3999
AUD/USD	0.6626	0.6519	0.6455	0.6387	0.6424	0.6413
EUR/USD	1.3022	1.2775	1.2662	1.2594	1.2589	1.2629
USD/JPY	90.32	91.58	92.37	92.14	93.61	94.18
GBP/USD	1.4291	1.4234	1.4220	1.4251	1.4278	1.4240
Oil	34.56	37.63	36.97	34.96	34.67	39.60
Gold	829.00	937.55	951.85	967.50	979.45	971.60
Electricity (Haywards)	4.55	9.16	3.35	4.75	5.13	2.38
Milk futures (US\$/contract)	84	n/a	83	83	83	82
Baltic Dry Freight Index	872	1846	1895	1986	2057	2099

NEW ZEALAND DISCLOSURE INFORMATION

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

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

Qualifications, experience and professional standing

Experience

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

Relevant professional body

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

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

Professional indemnity insurance

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

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

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

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

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

Criminal convictions

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

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

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

Fees

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

Other interests and relationships

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

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

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

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

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

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody

service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

NEW ZEALAND DISCLAIMER

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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