

# NEW ZEALAND ECONOMICS ANZ MARKET FOCUS

26 July 2010

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## UNUSUALLY UNCERTAIN

### ECONOMIC OVERVIEW

To paraphrase US Federal Reserve Chairman Ben Bernanke, the economic outlook remains “unusually uncertain”. We are not in the double-dip camp. But we certainly maintain the view that the global and NZ recovery process was always going to be more arduous than what many were expecting, with the odd bump along the way. This week’s array of domestic data will continue to portray a schizophrenic recovery process – a mixture of the good with the bad. Anecdotes we have received of late point to a softening in economic momentum into July. This week will be a litmus test to see if the RBNZ is getting the same vibes as us, or rigidly sticking to their view that the NZ economy is set to grow by 1 percent per quarter.

### JULY OCR PREVIEW

We expect the RBNZ to raise the Official Cash Rate (OCR) by 25bps to 3 percent. Recent developments suggest that the growth outlook will be more moderate compared to the June MPS forecasts, and we expect the tone to reflect this. However, as yet this will not be sufficient for the Bank to radically alter their view. So while softer in tone, the overall message of removing policy stimulus will remain, subject of course to economic and financial market developments. The September MPS provides an opportunity to provide a more comprehensive policy assessment, and we expect the Bank to defer material changes until then.

### BASIS SWAPS 101

NZ basis swap spreads have started widening again, reversing the trend narrowing that began in January. 10 year spreads are back out to similar levels to those seen at the peak in December last year. While changes in the basis swap are not explicitly captured in our Financial Conditions Index, it does still represent a de facto tightening in financial conditions. However, it does not appear to be a material impact at this stage when we incorporate basis swaps into our Financial Conditions Index.

### INTEREST RATE STRATEGY

Sentiment in global markets remains fickle and is swinging like a pendulum. EU stress tests have done little to provide clarity, and while US Federal Reserve Chairman Bernanke has said the situation remains “unusually uncertain”, US data has been mixed and earnings have tended to beat estimates. Closer to home, the market continues to debate the outlook for RBNZ policy, with an eye on the RBA. At the moment the market is pricing in 3 hikes by December, which still feels rich. But at the same time the longer end looks expensive despite global uncertainty.

### CURRENCY STRATEGY

The NZD is testing the upper bands of its trading range of the last 9 months. Whether or not the 0.7300 resistance level breaks will be dependant on EUR performance as the latter has struggled above 1.3000 vs USD. The key events this week are the Australian CPI on Wednesday and the RBNZ OCR decision on Thursday. The market fully expects a rate rise from Governor Bollard but it will be the tone of the press release which will dictate further currency direction.

## ECONOMIC OVERVIEW

### SUMMARY

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### THIS WEEK’S EVENTS

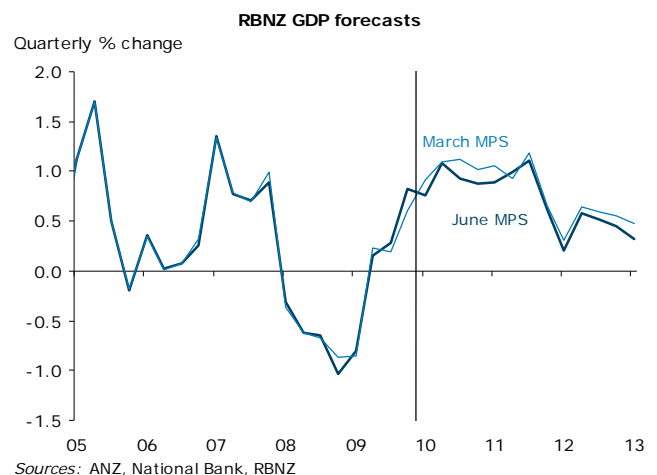
- **National Bank Business Outlook - July** (Wednesday, July 28, 3:00pm).
- **RBNZ July OCR Review** (Thursday, July 29, 9:00am). We are looking for a 25bp increase in the OCR to 3.00 percent. See our preview on page 5.
- **SNZ Merchandise Trade - June** (Thursday, July 29, 10:45am). We expect the value of exports to exceed the value of imports by around \$600m in June, the fifth consecutive monthly surplus. The annual trade surplus is expected to rise to around \$1bn.
- **RBNZ Credit Aggregates - June** (Thursday, July 29, 3:00pm). Ongoing subdued growth in household credit of around 0.2 percent is expected. Business credit will continue to contract, but at a slower rate, while agriculture credit should stabilise at current high levels.
- **SNZ Building Consents - June** (Friday, July 30, 10:45am). We are expecting a 5 percent increase in the number of residential consents, but for a weak housing market backdrop to constrain the improvement for a few more months. Non-residential consent issuance is expected to remain subdued.

### WHAT’S THE VIEW?

**We are navigating through uncharted waters, both here and overseas.** As the boost from fiscal policy stimulus and inventory rebuilding fades around the globe, question marks remain over the sustainability of the global economic expansion. Recent financial market volatility is not only a contributing factor, but it is also as a direct consequence of increasing uncertainty. There does

not appear to be a lot of substance behind financial market gyrations, with sentiment fickle and changing from day to day. Economic data relating to NZ’s major trading partners is also in a state of flux, moving from hot to cold within a short span of time. Such is the reality of trying to get growth and have the global economy deleverage at the same time. The endgame was always going to be a collision course.

**Anecdotally, we have detected a softening tone emerging from our recent travels around the country.** This is weaker than the levelling out in economic momentum being portrayed by various soft leading indicators. The change in tone reverses the improving (though somewhat sluggish at times) trend we had detected over January to June. Whilst the onset of the usual winter blues may be to blame, pressure on cashflows is an overarching theme, as is limited appetite for business investment. The saving grace at present looks to be the labour market, where demand for labour is still improving – a somewhat perplexing dichotomy with the real economy. But even this is not spilling over into increased consumer spending given weakness in housing and the dominant deleveraging dynamic. **This week will be a litmus test to see if the RBNZ is getting the same vibes as us, or is prepared to stick rigidly to their 1 percent quarterly growth forecast for the next six quarters.**



**New Zealand is not alone.** Last week’s testimony by US Federal Reserve Chairman Ben Bernanke emphasised that the economic outlook is one of continued moderate growth rather than the typical cyclical rebound. Moreover, the transition from an economy relying on policy support to a self sustaining expansion was unlikely to be a smooth one, with the economic outlook remaining “unusually uncertain”. The RBA minutes noted that the uneven pattern of

## ECONOMIC OVERVIEW

global growth and recent financial market developments had highlighted important risks. The Bank of Canada also reiterated that it expected the economic recovery to be more gradual than previously projected, with a greater emphasis on balance sheet repair to temper the pace of global growth. But the Bank of Canada still stuck to their script and delivered another hike, with the RBNZ no doubt set to do the same on Thursday.

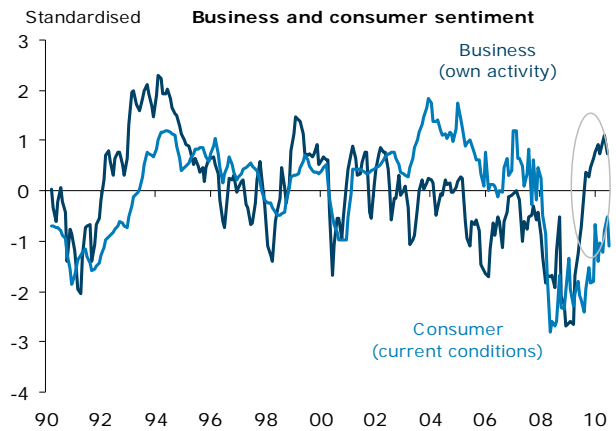
**This week, the July OCR decision takes centre stage.** We are expecting the RBNZ to deliver a 25bp hike which will take the OCR to 3 percent, in line with the consensus view. Looking at the key judgements the RBNZ detailed in June, namely: the economy and households continuing to deleverage; there being limited spill over from the one-off spike in inflation; and the global economy continuing to grow robustly – we have really only had new information on the latter. The economic data on this front is not exactly panning out as expected, although to be fair there has been the odd positive surprise, such as the performance on the Chinese and various other Asian economies. And the dataflow out from Europe has been encouraging of late.

Rather than rely on quantitative numbers such as Consensus Forecasts (which are notoriously lagging), the qualitative view of recent global movements is of building downside risk. **This is not of sufficient critical mass yet to go against the RBNZ's June judgement.** But it just seems a question of time before it does.

**We continue to look for a pause in the tightening cycle before year end.** Prospects for a reasonable Q2 HLFS employment result still leave us erring towards another hike in September. But even then it is in the *probable* category as opposed to *highly likely*. Don't get us wrong – last month's movement up in the OCR is the start of a long journey towards policy normalisation, and rates will no doubt overshoot just as they undershoot. We simply disagree with the market, which says all the hikes are going to be front-loaded and the endgame is five percent. **If we are right about the global economic recovery process and flow-on to the NZ economy, the upward path for the OCR will surely be an elongated journey.**

**Beyond the OCR decision, the National Bank Business Outlook to be released on Wednesday afternoon will take centre stage.** The July reading should be a bit of a bellwether as it was taken after the equity market conundrums we saw in June (and as we've noted previously, leading indicators have been well correlated to equity gyrations over the past few years, in somewhat of a

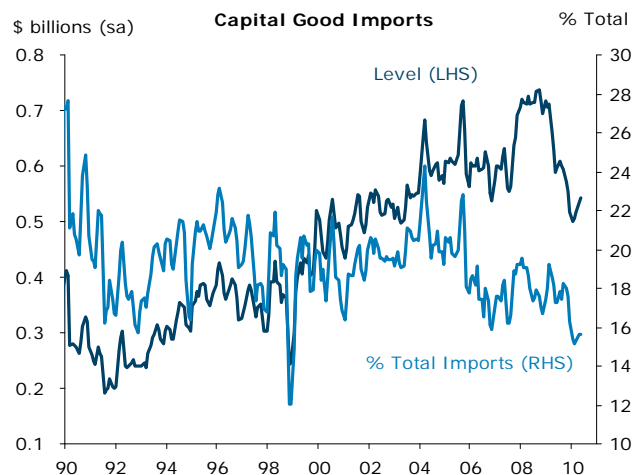
"blind leading the blind" mantra).



Source: ANZ, National Bank, Westpac McDermott Miller

**Merchandise trade data is expected to highlight the two-speed nature of the current expansion.**

We anticipate a large monthly trade surplus of around \$600m, with export values being buoyed by high commodity prices. Low domestic spending by households and businesses is expected to contribute to sluggish demand for imports. We have been closely watching the trend in capital good imports. What we are seeing does not provide a degree of comfort about the supply-side capacity of the economy. Last week's weak net migration figures highlighted the risks of supply side capacity being constrained by lower labour inputs and rising skill shortages.



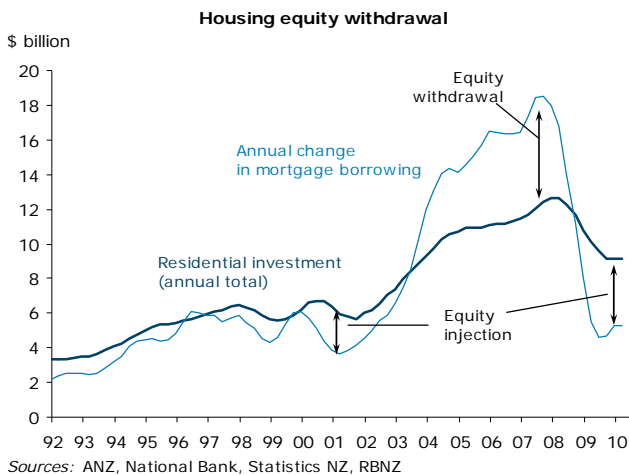
Sources: ANZ, National Bank, Statistics NZ

**The RBNZ credit aggregates are expected to highlight that the process of balance sheet repair is ongoing.** The ongoing deleveraging of the business sector has coincided with a period of weak business spending. This is not a favourable development for building productive capacity. As the Bank of Canada statement alluded to, higher

## ECONOMIC OVERVIEW

business investment is important for a more balanced recovery. This is a missing ingredient for a more sustainable and durable recovery in New Zealand.

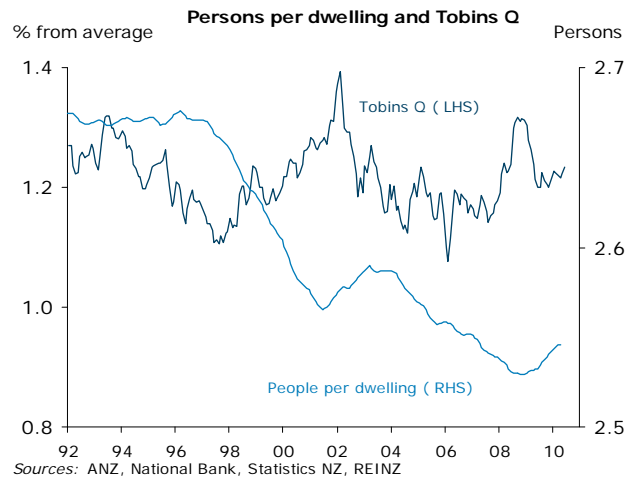
**Households are expected to continue with the process of getting their balance sheets in shape.** In the absence of capital gains, more of the heavy lifting is being done by curtailing spending. During the housing boom, households were able to extract money from rising house prices via housing equity withdrawal. At its peak in mid-2007, over \$6bn a year was withdrawn to fund consumption or invest in other areas. This situation has now turned around and households are now injecting around \$4b a year (i.e. we are now in housing equity injection territory). This represents a \$10bn turnaround in less than three years, with households now paying down debt rather than increasing it. In the current environment this appears to be a prudent strategy.



**Dwelling consents for June are anticipated to show a partial reversal from the weakness in May.** We expect a 5 percent increase in the number of residential consents, which is a mild rebound considering the low level of activity at present. With the costs of purchasing a residential section and building a new home high in relation to the cost of purchasing an existing home (known as the Tobin's Q), not to mention a large inventory of unsold homes still on the market, we do not expect a sustained rebound in residential building activity until the housing market finds its feet. The way things are shaping up, this could be a 2011 story. A consequence of this could be that people per dwelling continues to trend higher over the next year or so.

The value of non-residential consents is expected to track sideways. Without additional support from government spending, there does not seem to be a lot going on. The construction sector critically needs building consent issuance to trend much higher over

the coming months to offset a tail-end of non-residential activity in 2011 as existing projects are completed. At present, there does not appear to be a lot of projects in the pipeline.



### RECENT LOCAL DATA

- **SNZ External Migration – June.** Permanent and long-term (PLT) migration eased to a net inflow of 70 persons (16,504 annual), with PLT arrivals down 2.5 percent and departures broadly unchanged. Overseas visitor arrivals picked up by 0.3 percent, with a 6.9 percent increase in arrivals from Australia offset by a 4.6 percent fall in visitor arrivals from other destinations.
- **RBNZ Credit Card Billings - June.** The value of billings on cards in New Zealand increased by 1.0 percent in June (4.5 percent y/y), with spending on overseas cards surging by 2.7 percent (4.9 percent y/y) and spending on domestic cards increasing by 0.8 percent (4.4 percent y/y).
- **ANZ-Roy Morgan Consumer Confidence – July.** Consumer sentiment fell 6.4 points to 115.6. Current conditions eased by 7.8 points to 104.0, whereas future conditions fell 5.4 points to 123.4

## JULY OCR PREVIEW

### SUMMARY

We expect the RBNZ to raise the Official Cash Rate (OCR) by 25bps to 3 percent. Recent developments suggest that the growth outlook will be more moderate compared to the June MPS forecasts, and we expect the tone to reflect this. However, as yet this will not be sufficient for the Bank to radically alter their view. So while softer in tone, the overall message of removing policy stimulus will remain, subject of course to economic and financial market developments. The September MPS provides an opportunity to provide a more comprehensive policy assessment, and we expect the Bank to defer material changes until then.

### THE JOURNEY CONTINUES

After the 25bp hike in June, **we expect the RBNZ to follow-through with a further 25bp hike on Thursday, which will take the OCR to 3 percent.**

**Three key judgements underpinned the June MPS projections**, namely households continuing to deleverage, there being limited second round impacts from the temporary spike in inflation, and global (and implicitly NZ) growth continuing to be robust and not materially impacted by events offshore. The first two judgements have little bearing on the immediate policy outlook. The final judgement has the most immediate policy relevance and **the RBNZ will have been following overseas developments carefully.** These are now pointing to a more moderate and uneven pace of global recovery than assumed a few months ago. We expect the RBNZ to adopt a similar approach to the Bank of Canada and to note that while the global recovery is proceeding, it is not yet self sustaining.

**The RBNZ are expected to reiterate that the expansion in domestic economic activity is underway and is expected to continue.** Key to this will be improved export sector earnings, and recovering business and residential investment from historical troughs. Household spending will remain cautious, but retail discounting will boost volumes. In our view, however, downside risks are building with recent events indicating that the pace of economic expansion in the NZ economy is continuing at a more moderate pace than the 1 percent per quarter forecast in the June MPS. The outlook for business investment and household spending remains subdued, and while commodity export prices remain high there are signs of a downward correction.

**The July assessment will reaffirm that underlying CPI inflation is expected to track within the target range.** Recent inflation data has been reassuring, but with headline inflation set to

move above 5 percent over the next 12 months (largely due to the increase in GST from 1 October), a key challenge for the RBNZ will be managing inflation expectations during this period. With the labour market recovery underway, the Bank will be keen to contain any second round impacts on prices and wages throughout the economy.

### WHAT NEXT?

We expect the spirit of the July hike to be couched more in terms of removing policy stimulus. **However, the Bank should remain mindful that financial conditions are less accommodative than implied by a 3 percent cash rate.** Despite recent falls, fixed mortgage lending rates remain considerably above variable rates. Moreover, the NZD exchange rate remains in restrictive territory and is tracking higher than the RBNZ's projections, with the TWI at 68.1 at the time of writing compared to the forecast average of 65.6 in Q3. Offshore funding costs have also widened of late. Net on net, financial conditions have tightened in the past month, although the tightening seen to date is not flagging an ominous shift in economic direction (refer *Market Focus* of July 12).

**The RBNZ will continue to signal a gradual removal of policy stimulus.** Historical experience would usually warrant a more aggressive tightening cycle. But more restrictive fiscal policy settings, less accommodative financial conditions and the positively sloped yield curve afford the RBNZ the luxury of a little more patience.

**The RBNZ will want to maintain the necessary degree of flexibility over the policy outlook,** and will reiterate that further removal of monetary stimulus is dependent on economic and financial market developments. Events have moved significantly since the June MPS projections were finalised and a reassessment of the policy outlook would benefit from a full projection round, at which time key labour market data would be available. So we expect the potential for material changes to be deferred until the September MPS.

### MARKET IMPLICATIONS

Currently, the market has fully priced in a 25bp hike in July, with a further two 25bp hikes priced in by December. For now we suspect the RBNZ will be keen to publish a statement that will generate minimal market reaction. We're of the view that the downside risks at present are more tangible, and expect a pause in the tightening cycle before year end.

# BASIS SWAP 101

## SUMMARY

NZ basis swap spreads have started widening again, reversing the trend narrowing that began in January. 10 year spreads are back out to similar levels to those seen at the peak in December last year. While changes in the basis swap are not explicitly captured in our Financial Conditions Index, it does still represent a de facto tightening in financial conditions. However, it does not appear to be a material impact at this stage when we incorporate basis swaps into our Financial Conditions Index. Basis swaps are esoteric to many, and we felt a brief explanation of them and what drives the market would be useful.

## WHAT IS THE BASIS SWAP MARKET?

Sometimes known as bills-LIBOR swaps, basis swaps are a form of derivative where a set of floating interest payments in one currency are swapped for a set of floating payments in another currency (almost always USD).

While basis swaps are similar to vanilla interest rate swaps, there are three key differences. The first and most obvious difference is that unlike a vanilla swap, where both legs are in the same currency, the two legs of a basis swap are in different currencies. The second difference is that in a basis swap, there is an exchange of principal. The third difference is that in a basis swap, both legs are normally floating<sup>1</sup>.

## WHY ARE THEY USED?

Basis swaps are used in any situation where somebody wishes to swap a set of interest flows in one currency for flows in another. One obvious example would be where a NZ company decided to raise funds offshore by issuing a USD bond. There could be many reasons for wanting to do this – including diversifying funding sources and accessing investor appetite that may not be available onshore. By attaching a basis swap to an offshore bond issue, the company can hedge this debt into a NZD principal amount with NZD interest payments, effectively creating a NZD loan.

## WHY IS THE PRINCIPAL EXCHANGED?

Theoretically speaking, there is a notional principal exchange in a vanilla interest rate swap. However, in practice, because both legs are denominated in the same currency and are of equal value, they cancel each other out, so no actual exchange takes place. Basis swaps are “constructed” in a similar manner to

vanilla interest rate swaps, but because the two legs are in different currencies, the principal is exchanged at the beginning of the transaction, and then re-exchanged back at the end (at the same exchange rate) so as to remove any exchange rate risk from the transaction as a whole<sup>2</sup>. If this exchange did not take place, dealers would need to continuously hedge the currency risk in the swap during its life, making it inefficient.

Describing the cashflows is probably best done by way of an example. Let’s say you entered a 10m 5 year NZD/USD basis swap where you agreed to pay BKBM + 40bps in return for receiving LIBOR flat at a NZD/USD exchange rate of 0.7200. At the outset you would receive NZD 10m from your counterparty, and you would pay them USD 7.2m. At each quarterly rate set you would pay interest at a rate of BKBM +40bps on NZD 10m, and receive interest at a rate of LIBOR on USD 7.2m. Upon maturity, you would then give back the NZD 10m, and receive back the USD 7.2m.

Another way to think of a basis swap is to think of it as a modified FX forward (sometimes known as a FX swap). Because a FX forward is a single period transaction, and the interest rate on both legs is known at the outset, for simplicity, market convention dictates that the interest rate differential is incorporated into the forward rate via the forward points. Any “foregone” interest in the higher rate currency is made up for via the forward point discount.

But because a basis swap has multiple rate set dates, and these rates are not known in advance, it is not possible to incorporate them into the far leg exchange rate. In essence then, a basis swap can be thought of as a floating rate FX forward. Instead of incorporating the floating points into a forward rate (i.e. the final principal exchange) the parties exchange interest flows along the way, keeping the final principal exchange rate the same as the initial exchange. Since no interest is “foregone” in the high interest currency, there is no need for this to be reflected in an adjusted forward exchange rate.

## THE “CONVERSION FACTOR”

Many dealers refer to a conversion factor that is applied to the margin over and above the interbank

<sup>1</sup> While it is possible to fix one or both legs in a basis swap and book it up as a single deal, in practice this actually involves adding a vanilla interest rate swap to the floating leg to make it fixed. Once this is done, the swap is then known as a cross currency interest rate swap.

<sup>2</sup> Once the initial exchange has occurred, there is exchange rate risk on the swap itself, but from a hedger’s perspective this typically is not of concern. For example, if the swap is a hedge on, say, an offshore loan, any change in the domestic value of the offshore loan principal will be offset by an equal and opposite change in the value of the final principal exchange of the basis swap. However any change in the value of the swap itself will have implications for counterparty exposure.

## BASIS SWAP 101

margin. That is, if you want to swap a given margin over (or under) LIBOR to NZD, a conversion factor will be applicable to that margin. However the conversion factor does not apply to the interbank rate itself.

For example, if the interbank 5yr NZD/USD basis swap is trading at +40bps, this means that if you wanted to swap interest payments at LIBOR flat to NZD, you could do so if you paid NZD BKBM +40bps. However, if you wanted to swap interest payments at USD LIBOR + 100bps to NZD, the 100bp margin would be subject to a conversion factor of 1.0987 times. As a result, USD LIBOR +100bps would swap back to NZD at BKBM +149.87bps<sup>3</sup>. In reality, the market does not quote or trade conversion factors. What actually happens is that the cashflows on both legs are discounted on their respective zero-coupon curves and the NZD margin is adjusted until the present value of the swap equals zero. Conversion factors are often used as this makes it possible to quickly estimate what a given USD spread converts to in NZD.

### WHAT DETERMINES THE CONVERSION FACTOR?

While the conversion factor is somewhat theoretical, we often get asked why NZD basis points tend to be larger than USD basis points (i.e. the conversion factor is greater than 1). There are several reasons for this, but the main reason is the fact that NZ interest rates are higher than US interest rate. As a result, the present value of any margin discounted on the USD zero-coupon curve will be greater than the same margin discounted on the NZD curve. As a result, the NZD margin must be increased to compensate. The relative slopes of the two yield curves also has an impact, as does the term of the swap. But as a general rule, if NZ rates are higher than US rates, the longer the swap and/or the steeper the NZ curve is relative to the US curve, the larger the conversion factor will be.

### WHY DOES THE MARKET TRADE AWAY FROM "PAR"

In a perfect world, basis swap spreads would trade at par, or very close to it. If spreads started to trade away from par in any market, arbitrageurs would leap on any mis-pricing, quickly restoring any anomalies. However, the reality is quite different and basis swaps trade from par courtesy of amongst other things, different tax rules, barriers to capital

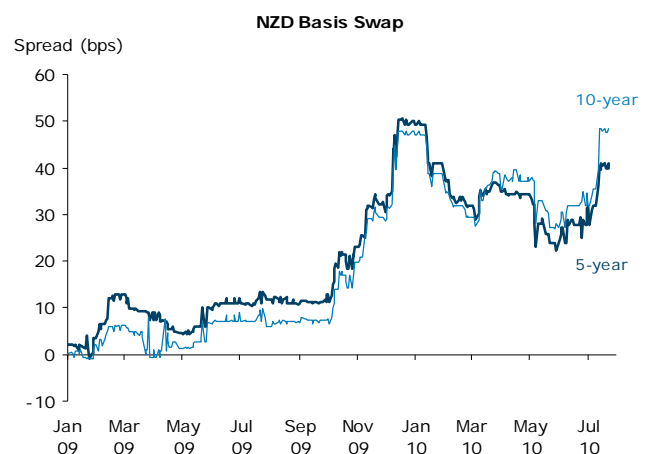
movement, and an inequality in the supply and demand for capital. Given these considerations and a general lack of liquidity, this makes it a very flow-driven market, subject to significant swings in supply and demand.

During periods when there was strong offshore demand for NZD denominated bonds (like Uridashi and Eurokiwi bonds) the basis swap often traded in negative territory as receivers outnumbered payers. Because the issuers of Uridashi and Eurokiwi bonds tend to be foreign entities, they have no ultimate need for NZD, and typically swap their exposures back to USD. This receive side flow tends to push the basis swap spread lower.

The opposite is likely to occur if there is persistent pay side pressure emanating from offshore issuance by NZ banks and corporates, which often occurs when domestic investor appetite for debt is low. Because the borrowers are NZ based, they have no ultimate need for the USD raised offshore, and typically swap the proceeds back to NZD. This pay side flow tends to push basis swap spreads higher. If a situation like this does occur, the opportunities for domestic investors to purchase foreign bonds and swap them back to NZD can be significant. However not all investors have the ability to take advantage of this perceived anomaly – for example, they may be prohibited from owning foreign bonds, or cannot transact basis swaps. This dynamic means that the market can often trade away from par for a significant period of time.

### RECENT DEVELOPMENTS AND IMPLICATIONS

As the graph below shows, basis swaps have started moving higher again recently, led by the long end. 10 year basis swaps are now back at the highs seen last December.



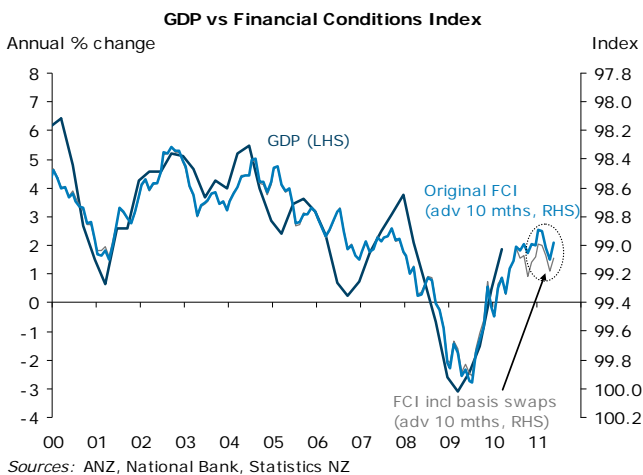
Sources: ANZ, National, Bloomberg

<sup>3</sup> The 149.87bp margin is made up of the 40bp (where the market is trading) plus the 100bp USD margin multiplied by the conversion factor. That is,  $100 \times 1.0987 + 40 = 149.87\text{bps}$ .

## BASIS SWAP 101

While the basis swap market may seem esoteric and abstract, significant changes in basis swap spreads can have an impact on financial conditions. This is because many NZ banks and corporates rely on global markets for funding, and on the basis swap market for swapping those funds into NZD. As a result, any widening in spreads has a direct impact on the overall cost of funds, particularly if this is not offset by changes elsewhere. In the past 3 months both basis swap spreads and funding spreads have widened, in effect doubling the impact on overall funding costs.

We do not explicitly include the basis swap market in our Financial Conditions Index. In order to try and gauge the impact, we have modified our Financial Conditions Index to try and explicitly incorporate the widening in basis swap. We currently use the CDS spread for the big four Australian banks in our Financial conditions index to proxy the cost of funds for the NZ banking sector. Since the basis swap is simply part of the overall funding cost, we have added the basis to the CDS spread in our Financial Conditions Index calculations. Unsurprisingly, the widening in the basis swap has resulted in tighter financial conditions, but at this stage, the impact is not what we would regard as material.



# INTEREST RATE STRATEGY

## SUMMARY

Sentiment in global markets remains fickle and is swinging like a pendulum. EU stress tests have done little to provide clarity, and while US Federal Reserve Chairman Bernanke has said the situation remains “unusually uncertain”, US data has been mixed and earnings have tended to beat estimates. Closer to home, the market continues to debate the outlook for RBNZ policy, with an eye on the RBA. At the moment the market is pricing in 3 hikes by December, which still feels rich. But at the same time the longer end looks expensive despite global uncertainty.

## MARKET THEMES

- Thursday’s OCR Review will be critical to market direction – no so much the (likely) hike, but the tone of comments. We suspect we’ll see the market tone down how much is priced in.
- By contrast, Australian CPI could be the catalyst for an earlier RBA move. This could add upward pressure on NZ rates despite RBNZ comments.
- US 10yr Treasuries continue to fluctuate around 3 percent, but uncertainty remains high, and we doubt the flight to safety appeal will disappear.

## REVIEW AND OUTLOOK

**Benchmark global rates like the US Treasury bond yield have come off their lows, but remain very low, highlighting significant uncertainty.**

The results of the EU bank stress tests have received mixed reviews, but then again, sometimes pleasing the market is like pleasing a madman – you can’t. In many ways the tests were doomed from the start. Too many passes would have meant the tests were too lenient, too many failures would have confirmed what we knew – that Europe had problems. **The fact that markets were thinking like this is very telling of the state of sentiment – i.e. a lack of conviction.**

Closer to home, all eyes are on the RBNZ and on Australian CPI data this week. **The tone of RBNZ comments will have to be pretty stern to justify the rate hikes that are priced in – up front, though not necessarily further out. We don’t debate the need to get the OCR towards “neutral”, but the path will be slow and steady, not all up front as the market is pricing in.** That said, stronger AU CPI may hinder the NZ market’s ability to move lower.

**Flow has been fairly light, and we’re surprised by the lack of mortgage related paying** in the wake of recent cuts to fixed rates. Whether this is the public voting with their wallets (choosing the

cheapest rate) or the public saying they don’t think rates will move up too far (less likely), either way it shows a lack of conviction, which is a bit of a worry!

## PREFERRED BORROWING STRATEGIES

Global interest rates continue to fall, and have taken NZ long end rates with them. 5 and 10yr swap rates are converging on 4.75% and 5.25% respectively. Those who need to hedge should consider these maturities, which offer outstanding value relative to other points on the curve, and in comparison with historical averages. But the growth outlook is not as robust as it was even a month ago, and the desire for some flexibility has probably increased for most businesses. Maintaining a high degree of exposure to floating rates makes sense in the current environment, particularly with credit margins and basis swap spreads under pressure again. Deteriorating credit conditions could lead to less aggressive OCR rises, so some caution is required when hedging with swaps.

## GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔/↓	OCR hike this week likely, but outlook from here circumspect and conditional.
NZ data	↔/↓	Universal disappointment. Momentum slowing.
Fed Funds / front end	↔/↓	Bernanke thinks the outlook is “unusually uncertain”.
RBA	↔/↑	It’s not a case of <i>if</i> , but more <i>when</i> they hike next.
US 10 year	↔/↓	Risk on/risk off highlights uncertainty. 10yr UST holding below 3%.
NZ swap curve	↔/↓	3 rate hikes by Dec too much. Rates biased lower.
Flow	↔/↓	Complete lack of mortgage paying speaks volumes.
Technicals	↔	2yr struggling through 4.20.

## MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 29-Jul-10	+20	+26
Thu 16-Sep-10	+39	+42
Thu 28-Oct-10	+55	+59
Thu 9-Dec-10	+71	+73
Thu 27-Jan-11	+81	+87
Thu 10-Mar-11	+99	+104
Thu 28-Apr-11	+115	+110

## TRADING THEMES WE FAVOUR AT PRESENT

We prefer to be long the short end ahead of the RBNZ OCR Review. While a hike is likely, we doubt the tone will be consistent with the 3 hikes by December that are priced in. Volatility aside, US Treasury yields should benefit from an ongoing safe-haven bid, keeping a lid on the NZ long end, even though they have overshot the mark, and are trading as though we’ll be in permanent recession.

# CURRENCY STRATEGY

## SUMMARY

The NZD is testing the upper bands of its trading range of the last 9 months. Whether or not the 0.7300 resistance level breaks will be dependant on EUR performance as the latter has struggled above 1.3000 vs USD. The key events this week are the Australian CPI on Wednesday and the RBNZ OCR decision on Thursday. The market fully expects a rate rise from Governor Bollard but it will be the tone of the press release which will dictate further currency direction.

## MARKET THEMES

- RBNZ OCR Review press release to dictate next NZD direction.
- European banking stress tests are out but really delivered nothing to the market. EUR looks stretched towards 1.3000 vs USD.
- USD downward correction now looks mature given it now looks increasingly unlikely we will see any further QE from the Fed.
- Australian CPI will likely be strong which should undermine NZDAUD.

## REVIEW AND OUTLOOK

**The NZD held the week above the 200 day moving average but the next major level is 0.7325.** Given the tired nature of the USD selloff and the view that currencies remain rangebound, expect the 0.7325 level to hold. The RBNZ OCR Review will deliver another 25bp rate raise but the tone of the press release will be key. Expect this to be a little downbeat as data continues to be soft as households continue to deleverage.

### **The European banking stress tests are now behind us and we can now look to the data.**

Indeed, it seems that the terms of reference for the stress tests were a bit too narrow to be useful. Data has been a bit better than expected, particularly from northern Europe, helping maintain the EUR at current levels. Technically however the EUR rally looks tired so expect 1.3000 vs USD to hold.

**The Fed gave us a "more of the same" statement last week.** Rates lower for longer remains the key theme although we get a sense they would prefer to avoid any further QE. Without more QE, the USD selloff looks tired.

**This week we get the second half of the Trans-Tasman relative CPI story.** We expect the Australian CPI due Wednesday to be a strong number and should undermine the NZDAUD cross. A break down through 0.8080 should deliver a sub 80 cent

cross but don't look for too much more than that with good support around 0.7920.

**The NZD/EUR and NZD/GBP crosses both now look to have medium term tops in place (deliberately repeated from last week as it is still relevant).** Both failed retests during the week, which coincided with a continuation of improving German data. NZD/EUR now looks to be capped at 0.5680, and 0.4750 to be the top out for the NZD/GBP. We expect both these crosses to target 4 month lows.

### NZD VS AUD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value	↔	Not that far off fair value.
Yield	↔/↑	RBA on hold, RBNZ to hike.
Commodities	↔	Dairy price declined. Wheat prices up but of no major benefit to NZ.
Partial indicators	↓	Australian data outperforming NZ's.
Technicals	↓	Resistance above 0.83 major.
Sentiment	↔	Still tracking equity market moves.
Other	↔/↓	Q2 CPI in Australia next week to be important.
<b>On balance</b>	↔	<b>Range trade 0.78-0.83.</b>

### NZD VS USD: MONTHLY DIRECTIONAL GAUGES

GAUGE	DIRECTION	COMMENT
Fair value – long-term	↔/↓	Above structural fair value of 0.66.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↔/↑	US not hiking for a while.
Commodities	↔/↓	Early signs of NZ commodities correcting?
Risk aversion	↔	Following US earnings season and sovereign downgrades.
Partial indicators	↔/↓	NZ data weak of late.
Technicals	↔/↓	Blow out top in place.
AUD	↔	Election to see AUD sidelined.
Sentiment	↔	NZD more aligned to offshore moves.
Other	↔/↓	Market no longer short NZD.
<b>On balance</b>	↔/↓	<b>Medium term top in place at 0.73.</b>

## DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
26-Jul	UK	Hometrack Housing Survey (MoM) - JUL	- -	0.10%	11:01
	UK	Hometrack Housing Survey (YoY) - JUL	- -	2.10%	11:01
	JN	Merchnds Trade Balance Total - JUN	¥690.9B	¥324.2B	11:50
	AU	Producer Price Index (QoQ) - 2Q	0.80%	1.00%	13:30
	AU	Producer Price Index (YoY) - 2Q	1.50%	-0.10%	13:30
27-Jul	US	Chicago Fed Nat Activity Index - JUN	- -	0.21	00:30
	US	New Home Sales - JUN	311K	300K	02:00
	US	New Home Sales MoM - JUN	3.70%	-32.70%	02:00
	US	Dallas Fed Manf. Activity - JUL	-2.50%	-4.00%	02:30
	AU	Conference Board Leading Index - MAY	- -	- -	12:00
	GE	GfK Consumer Confidence Survey - AUG	3.5	3.5	18:00
	GE	Import Price Index (YoY) - JUN	8.60%	8.50%	18:00
	EC	Euro-Zone M3 s.a. (YoY) - JUN	-0.10%	-0.20%	20:00
28-Jul	US	S&P/CaseShiller Home Price Ind - MAY	- -	144.56	01:00
	US	S&P/CS 20 City MoM% SA - MAY	0.15%	0.44%	01:00
	US	S&P/CS Composite-20 YoY - MAY	3.90%	3.81%	01:00
	US	Richmond Fed Manufact. Index - JUL	11	23	02:00
	US	Consumer Confidence - JUL	51	52.9	02:00
	AU	Consumer Prices (QoQ) - 2Q	1.00%	0.90%	13:30
	AU	RBA Trimmed Mean (QoQ) - 2Q	0.80%	0.80%	13:30
	AU	Consumer Prices (YoY) - 2Q	3.40%	2.90%	13:30
	AU	RBA Trimmed Mean (YoY) - 2Q	3.00%	3.00%	13:30
	AU	RBA Weighted Median (QoQ) - 2Q	0.80%	0.80%	13:30
	AU	RBA Weighted Median (YoY) - 2Q	3.00%	3.10%	13:30
	<b>NZ</b>	<b>NBNZ Business Confidence - JUL</b>	- -	<b>40.2</b>	<b>15:00</b>
	<b>NZ</b>	<b>NBNZ Activity Outlook - JUL</b>	- -	<b>38.5</b>	<b>15:00</b>
	EC	ECB Publishes Bank Lending Survey - APR			20:00
29-Jul	US	Durable Goods Orders - JUN	1.00%	-1.10%	00:30
	US	Durables Ex Transportation - JUN	0.40%	0.90%	00:30
	GE	Consumer Price Index (MoM) - JUL P	0.30%	0.10%	- -
	GE	CPI - EU Harmonised (MoM) - JUL P	0.20%	0.00%	- -
	GE	CPI - EU Harmonised (YoY) - JUL P	1.10%	0.80%	- -
	US	Fed's Beige Book - JUL	- -	- -	06:00
	<b>NZ</b>	<b>RBNZ Official Cash Rate - JUL</b>	<b>3.00%</b>	<b>2.75%</b>	<b>09:00</b>
	<b>NZ</b>	<b>Trade Balance - JUN</b>	<b>368M</b>	<b>814M</b>	<b>10:45</b>
	<b>NZ</b>	<b>Imports - JUN</b>	<b>3.36B</b>	<b>3.39B</b>	<b>10:45</b>
	<b>NZ</b>	<b>Exports - JUN</b>	<b>3.50B</b>	<b>4.20B</b>	<b>10:45</b>
	<b>NZ</b>	<b>NZ Trade Balance 12 Mth YTD - JUN</b>	<b>729.5</b>	<b>91</b>	<b>10:45</b>
	JN	Retail Trade MoM SA - JUN	0.40%	-2.00%	11:50
	AU	HIA New Home Sales (MoM) - JUN	- -	-6.40%	13:00
	<b>NZ</b>	<b>Money Supply M3 YoY - JUN</b>	- -	<b>-3.10%</b>	<b>15:00</b>
	UK	Nat'wide House prices sa (MoM) - JUL	-0.30%	0.10%	18:00
	UK	Nat'wide House prices nsa(YoY) - JUL	7.00%	8.70%	18:00
	GE	Unemployment Rate (s.a) - JUL	7.60%	7.70%	19:55
	UK	Net Consumer Credit - JUN	0.2B	0.3B	20:30
	UK	Net Lending Sec. on Dwellings - JUN	1.0B	1.2B	20:30
	UK	Mortgage Approvals - JUN	48.8K	49.8K	20:30
	UK	M4 Money Supply (MoM) - JUN F	- -	0.00%	20:30

Continued on following page

# DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
29-Jul	UK	M4 Money Supply (YoY) - JUN F	- -	3.00%	20:30
	EC	Business Climate Indicator - JUL	0.39	0.37	21:00
	EC	Euro-Zone Indust. Confidence - JUL	-5	-6	21:00
	EC	Euro-Zone Consumer Confidence - JUL F	-14	-14	21:00
	EC	Euro-Zone Economic Confidence - JUL	99.1	98.7	21:00
	EC	Euro-zone Services Confidence - JUL	5	4	21:00
	<b>NZ</b>	<b>AON 1-Year Inflation Expect - JUL</b>	- -	<b>3.40%</b>	<b>23:59</b>
30-Jul	US	Initial Jobless Claims - 24 JUL	460K	464K	00:30
	US	Continuing Claims - 17 JUL	4500K	4487K	00:30
	<b>NZ</b>	<b>Building Permits MoM - JUN</b>	- -	<b>-9.60%</b>	<b>10:45</b>
	UK	GfK Consumer Confidence Survey - JUL	-20	-19	11:01
	JN	Nomura/JMMA Manufacturing PMI - JUL	- -	53.9	11:15
	JN	Jobless Rate - JUN	5.20%	5.20%	11:30
	JN	Overall Hhold Spending (YoY) - JUN	-0.80%	-0.70%	11:30
	JN	Natl CPI YoY - JUN	-0.70%	-0.90%	11:30
	JN	Industrial Production YOY% - JUN P	18.90%	20.40%	11:50
	JN	Industrial Production (MoM) - JUN P	0.20%	0.10%	11:50
	JN	Loans & Discounts Corp YoY - JUN	- -	-3.50%	11:50
	AU	Private Sector Credit MoM% - JUN	0.40%	0.50%	13:30
	AU	Private Sector Credit YoY% - JUN	3.10%	2.70%	13:30
	CH	MNI Business Condition Survey - JUL	- -	63.51	13:35
	JN	Vehicle Production (YoY) - JUN	- -	30.60%	16:00
	JN	Housing Starts (YoY) - JUN	1.80%	-4.60%	17:00
	JN	Construction Orders (YoY) - JUN	- -	9.20%	17:00
	GE	Retail Sales (MoM) - JUN	-0.20%	0.40%	18:00
	GE	Retail Sales (YoY) - JUN	1.00%	-2.40%	18:00
	EC	Euro-Zone Unemployment Rate - JUN	10.00%	10.00%	21:00
	EC	Euro-Zone CPI Estimate (YoY) - JUL	1.70%	1.40%	21:00
31-Jul	US	GDP QoQ (Annualized) - 2Q A	2.50%	2.70%	00:30
	US	Personal Consumption - 2Q A	2.40%	3.00%	00:30
	US	GDP Price Index - 2Q A	1.10%	1.10%	00:30
	US	Core PCE QoQ - 2Q A	1.00%	0.70%	00:30
	US	Employment Cost Index - 2Q	0.50%	0.60%	00:30
	US	Chicago Purchasing Manager - JUL	56	59.1	01:45
	US	U. of Michigan Confidence - JUL F	67	66.5	01:55
	US	NAPM-Milwaukee - JUL	57	59	02:00
	CH	PMI Manufacturing - JUL	- -	52.1	13:00

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:** Last week's data suggested the support to spending from population inflow was abating, with consumer sentiment also tracking lower. On Thursday we expect the RBNZ to continue removing policy stimulus with a 25 basis point hike. Other data will highlight that the economic rebalancing is continuing. We expect data over the next few weeks to point towards a moderate rate of expansion for Q2, but we will be more focused on what the soft gauges are telling us about Q3.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 28 Jul (3:00pm)	National Bank Business Outlook - Jul	- -	- -
Thur 29 July (9:00am)	RBNZ July OCR	+25	We expect the RBNZ to continue the journey of removing policy accommodation.
Thur 29 July (10:45am)	SNZ Overseas Merchandise Trade – June	Surplus	We expect a monthly trade surplus of around \$600m, the fifth consecutive monthly surplus. The annual trade surplus is expected to rise to around \$1bn.
Thur 29 July (3:00pm)	RBNZ Credit Aggregates – Jun	Deleveraging	We anticipate a modest tick-up in private sector credit. Sector lending is expected to remain subdued.
Fri 30 <sup>th</sup> July (10:45am)	SNZ Building Consents – June	Up	Much of the 9.6 percent fall in the number of May residential consents should be reversed. Given a weak housing market backdrop, consent issuance is likely to remain low for some time.
Mon 2 Aug (3:00pm)	ANZ Commodity Price Index – July	- -	- -
Tue 3 Aug (10:45am)	SNZ Labour Cost Index and Quarterly Employment Survey – Q2	Improving	Earnings growth is expected to pick-up from decade lows as skill shortages become more acute. The number of filled jobs is anticipated to increase by 0.3 percent.
Thur 5 Aug (10:45am)	SNZ Household Labour Force Survey – Q2	Gradual	A repeat of the barnstorming Q1 surge in employment is unlikely. We expect a more modest 0.3 increase. Stronger growth in the labour force sees the unemployment rate rise to 6.3 percent.
Tue 10 Aug (10:45am)	SNZ Electronic Card Transactions – July	Damp	June Card spending was supported by higher spending on apparel as the wet winter had an impact. We expect retail values to remain subdued in July.
Thur 12 Aug (10:45am)	SNZ Food Price Index – July	Climbing	The June monthly rise was partly driven by the lagged effects of strengthening meat and dairy commodity export prices. Further price increases are in the pipeline with the rebuilding of retail margins expected to push food prices higher.
Fri 13 Aug (10:00am)	REINZ Housing Market Statistics – July	Battling	Sales volumes and house prices to remain subdued. Low affordability and deleveraging remain formidable headwinds.
Fri 13 Aug (10:45am)	SNZ Retail Trade Survey – Q2	Boosted by discounting	Some bounce back in monthly sales is probable given the weak May figures. Growth in nominal retail spending will be around 0.5 percent in Q2, with retail discounting and lower food prices expected to produce a similar increase in retail volumes.
Thur 19 Aug (10:45am)	SNZ Capital Goods Price and Producer Price Indexes – Q2		High export commodity prices will continue boosting producer prices. Implied margins are expected to remain under pressure. Capital goods prices are expected to record a small increase.
Thur 19 Aug (3:00pm)	ANZ – Roy Morgan Consumer Confidence - Aug	- -	- -
Fri 20 Aug (10:45am)	SNZ – External Migration - Jul		We expect net PLT migration of around zero persons, although there is a risk of a net PLT outflow if departures retain the strengthening trend. Visitor arrivals are expected to recover in seasonally adjusted terms as volcanic ash disruptions recede.
<b>On Balance</b>		<b>Building</b>	<b>Recovery continuing but not firing on all cylinders</b>

# ECONOMIC FORECASTS AND INDICATORS

	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11
GDP (% qoq)	0.3	0.9	0.6	<b>0.7</b>	<b>1.5</b>	<b>-0.1</b>	<b>1.1</b>	<b>1.3</b>	<b>1.6</b>	<b>0.5</b>
GDP (% yoy)	-1.5	0.5	1.9	<b>2.5</b>	<b>3.7</b>	<b>2.7</b>	<b>3.2</b>	<b>3.9</b>	<b>4.0</b>	<b>4.6</b>
CPI (% qoq)	1.3	-0.2	0.4	0.3	<b>1.1</b>	<b>2.8</b>	<b>0.6</b>	<b>1.0</b>	<b>0.8</b>	<b>0.5</b>
CPI (% yoy)	1.7	2.0	2.0	1.8	<b>1.6</b>	<b>4.6</b>	<b>4.8</b>	<b>5.6</b>	<b>5.3</b>	<b>3.0</b>
Employment (% qoq)	-0.7	0.0	1.0	<b>0.2</b>	<b>0.4</b>	<b>0.6</b>	<b>0.6</b>	<b>0.7</b>	<b>0.6</b>	<b>0.4</b>
Employment (% yoy)	-1.8	-2.4	-0.1	<b>0.6</b>	<b>1.7</b>	<b>2.2</b>	<b>1.8</b>	<b>2.3</b>	<b>2.5</b>	<b>2.3</b>
Unemployment Rate (% sa)	6.5	7.1	6.0	<b>6.3</b>	<b>6.0</b>	<b>5.6</b>	<b>5.4</b>	<b>5.0</b>	<b>4.9</b>	<b>4.9</b>
Current Account (% GDP)	-3.2	-2.9	-2.4	<b>-2.9</b>	<b>-3.7</b>	<b>-2.8</b>	<b>-3.0</b>	<b>-3.1</b>	<b>-2.9</b>	<b>-2.9</b>
Terms of Trade (% qoq)	-1.6	5.8	5.8	<b>3.9</b>	<b>2.4</b>	<b>1.0</b>	<b>-0.6</b>	<b>-0.6</b>	<b>0.1</b>	<b>-1.0</b>
Terms of Trade (% yoy)	-14.1	-8.2	-0.2	<b>14.4</b>	<b>19.1</b>	<b>13.7</b>	<b>6.8</b>	<b>2.2</b>	<b>-0.2</b>	<b>-2.0</b>

	Oct-09	Nov-09	Dec-09	Jan-10	Feb-10	Mar-10	Apr-10	May-10	Jun-10	Jul-10
Retail Sales (% mom)	0.1	0.7	-0.5	0.7	-0.5	0.6	-0.3	0.4	..	..
Retail Sales (% yoy)	-0.2	2.4	2.0	2.3	2.4	4.4	2.7	1.9	..	..
Credit Card Billings (% mom)	0.2	0.8	-1.2	1.5	-0.3	0.7	-1.6	1.9	1.0	..
Credit Card Billings (% yoy)	-0.3	1.6	1.9	2.7	1.1	5.2	0.7	3.4	4.5	..
Car Registrations (% mom)	0.3	2.2	6.8	-0.7	0.2	5.2	3.2	-3.5	6.1	..
Car Registrations (% yoy)	-16.8	2.4	0.3	15.9	31.4	31.7	40.5	30.5	35.8	..
Building Consents (% mom)	11.2	0.6	-3.8	-2.7	6.1	-0.2	8.3	-9.5	2.0	..
Building Consents (% yoy)	26.5	20.3	22.7	35.2	29.9	33.4	32.0	11.1	25.9	..
REINZ House Price (% yoy)	6.0	5.2	9.6	7.7	6.1	7.6	4.7	3.7	3.7	..
Household Lending Growth (% mom)	0.4	0.0	0.2	0.2	0.1	0.2	0.2	0.2	..	..
Household Lending Growth (% yoy)	2.6	2.7	2.7	2.7	2.7	2.8	2.7	2.5	..	..
ANZ-Roy Morgan Consumer Confidence	125.9	121.5	118.6	131.4	123.6	121.8	121.9	126.0	122.0	115.6
NBNZ Business Confidence	48.2	43.4	38.5	..	50.1	42.5	49.5	48.2	40.2	..
NBNZ Own Activity Outlook	30.5	33.7	36.9	..	41.9	38.6	43.0	45.3	38.5	..
Trade Balance (\$m)	-501.5	-280.4	-26.4	271.1	327.8	607.1	665.4	814.2	..	..
Trade Balance (\$m annual)	-1176	-863	-549	-176	-330	-161	182	91	..	..
ANZ World Commodity Price Index (% mom)	4.7	10.9	2.6	0.4	4.0	1.8	5.4	2.8	-1.2	..
ANZ World Commodity Price Index (% yoy)	-1.3	18.2	31.0	37.4	49.8	50.9	55.1	55.0	53.3	..
Net Migration (sa)	2140	1750	1690	1840	1000	940	730	250	70	..
Net Migration (annual)	18560	20021	21253	22588	21618	20973	19954	17967	16504	..

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	May-10	Jun-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZD/USD	0.681	0.685	0.726	0.700	0.710	0.720	0.730	0.730	0.720	0.710
NZD/AUD	0.805	0.815	0.811	0.795	0.789	0.783	0.777	0.777	0.783	0.789
NZD/EUR	0.553	0.560	0.564	0.579	0.602	0.632	0.652	0.652	0.643	0.634
NZD/JPY	62.11	60.54	63.54	66.50	68.16	69.84	71.54	73.00	72.00	71.71
NZD/GBP	0.468	0.458	0.471	0.479	0.486	0.483	0.480	0.474	0.462	0.449
NZ\$ TWI	66.0	66.6	68.1	68.1	69.3	70.7	71.7	71.8	71.1	70.5
INTEREST RATES	May-10	Jun-10	Today	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12
NZ OCR	2.50	2.75	2.75	3.25	3.25	3.50	4.00	4.50	5.00	5.50
NZ 90 day bill	2.93	3.13	3.27	3.50	3.50	3.90	4.40	4.90	5.40	5.80
NZ 10-yr bond	5.56	5.34	5.40	5.40	5.40	5.60	5.80	6.20	6.20	6.10
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.75	1.25
US 3-mth	0.54	0.53	0.49	0.40	0.35	0.35	0.35	0.60	0.85	1.35
AU Cash Rate	4.50	4.50	4.50	4.75	5.00	5.25	5.50	5.75	6.00	6.00
AU 3-mth	4.87	4.92	4.83	5.00	5.30	5.60	6.00	6.00	6.20	6.10

	23 Jun	19 Jul	20 Jul	21 Jul	22 Jul	23 Jul
Official Cash Rate	2.75	2.75	2.75	2.75	2.75	2.75
90 day bank bill	3.09	3.24	3.24	3.26	3.26	3.26
NZGB 11/11	3.78	3.71	3.77	3.80	3.75	3.78
NZGB 04/13	4.35	4.21	4.26	4.28	4.23	4.26
NZGB 12/17	5.27	5.08	5.13	5.14	5.09	5.13
NZGB 05/21	5.50	5.33	5.38	5.39	5.36	5.40
2 year swap	4.31	4.14	4.14	4.22	4.18	4.22
5 year swap	5.05	4.75	4.75	4.82	4.77	4.81
RBNZ TWI	67.9	66.6	66.9	67.4	67.2	67.9
NZD/USD	0.7048	0.7064	0.7124	0.7165	0.7125	0.7246
NZD/AUD	0.8083	0.8150	0.8117	0.8125	0.8137	0.8115
NZD/JPY	63.81	61.22	62.01	62.41	61.62	62.97
NZD/GBP	0.4753	0.4614	0.4665	0.4690	0.4693	0.4740
NZD/EUR	0.5745	0.5473	0.5492	0.5562	0.5578	0.5618
AUD/USD	0.8719	0.8668	0.8777	0.8818	0.8756	0.8929
EUR/USD	1.2267	1.2907	1.2972	1.2883	1.2774	1.2897
USD/JPY	90.53	86.67	87.05	87.11	86.49	86.91
GBP/USD	1.4828	1.5311	1.5270	1.5276	1.5181	1.5288
Oil (US\$/bbl)	77.15	75.96	76.53	77.32	76.27	79.01
Gold (US\$/oz)	1238.95	1192.48	1183.65	1189.20	1182.65	1195.75
Electricity (Haywards)	3.66	5.84	6.66	9.07	8.19	7.57
Milk futures (US\$/contract)	122	117	117	117	117	117
Baltic Dry Freight Index	2515	1732	1761	1781	1801	1826

# 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;

## IMPORTANT NOTICE

- 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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