

NEW ZEALAND ECONOMICS MARKET FOCUS

16 May 2011

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PROSPERITY THROUGH AUSTERITY

ECONOMIC OVERVIEW

Last week's spending-centric data suggests a solid core of support for firming retail spending, though uncertainty surrounds how much substance is behind it. Thursday's consumer confidence figures may shed some light on the issue. We expect mixed messages to remain in the dataflow for another six weeks. The 2011 Budget is expected to confirm a strict line on expenditure restraint, and a quicker return to surplus than seemed likely only a few months ago. The challenge is to ensure improving Government saving does not contribute to deteriorating household and business sector savings performance and a blow-out in the current account deficit. An improving fiscal position is a necessary but not a sufficient condition to divert two ratings agencies' watchful eyes from NZ's credit rating.

BUDGET 2011 PREVIEW

We expect the well-flagged tight fiscal story to manifest in actual outcomes in the 2011 Budget. We view this, in itself – ratings pressure aside – as a sign of the structural change that is occurring across society. Suddenly saving and frugality is becoming fashionable. With no new spending allocation for this year's Budget and the cutting back on some key programmes, we suspect that the Government could surprise most by how quickly they can get back into the black. As always, however, the challenge will be to ensure the forecast spending restraint is matched by reality. We think the Budget will do enough to avert a credit rating downgrade – for now. But we doubt that S&P and Fitch will remove NZ from negative outlook until more inroads are made into the country's large net external liability position. This looks challenging when you consider the realities of rebuilding destroyed domestic capital stock. The Budget should be supportive of the RBNZ taking a patient approach to removing policy accommodation.

INTEREST RATE STRATEGY

Budget 2011 is the must-see event this week. Austerity will be the main theme, lending support to both the short end of the swap curve, and for NZ Government bonds. US interest rates remain volatile. While there are good fundamental arguments in favour of higher yields, with the Fed on hold, and inflation seemingly well-behaved, the focus has switched back to carry, keeping a lid on yields.

CURRENCY STRATEGY

Thursday's Budget will be the key focus for NZD. While an earlier return to surplus will avert a credit rating downgrade, any positive spin off on the NZD will likely be short-lived. Continued uncertainty surrounding EUR sovereign debt risk, not helped by the arrest of the IMF head, mean risk will stay off the table. EUR looks vulnerable to further moves to the downside. As we creep ever closer to the end of QE2, the currency markets have one less reason to sell USD.

ECONOMIC OVERVIEW

SUMMARY

Last week's spending-centric data suggests a solid core of support for firming retail spending, though uncertainty surrounds how much substance is behind it. Thursday's consumer confidence figures may shed some light on the issue. We expect mixed messages to remain in the dataflow for another six weeks. The 2011 Budget is expected to confirm a strict line on expenditure restraint, and a quicker return to surplus than seemed likely only a few months ago. The challenge is to ensure improving Government saving does not contribute to deteriorating household and business sector savings performance and a blow-out in the current account deficit. An improving fiscal position is a necessary but not a sufficient condition to divert two ratings agencies' watchful eyes from NZ's credit rating.

NEXT WEEK'S EVENTS

- **globalDairyTrade online auction** (Wednesday, May 18, 6:00am). We expect whole milk powder prices to ease towards US \$3,800 from \$3,859 per tonne.
- **SNZ Producer Price Index – Q1** (Wednesday, May 18, 10:45am). Higher oil and commodity prices should boost input prices by 1 percent. Output prices should rise by around 0.8 percent.
- **SNZ Capital Goods Price Index – Q1** (Wednesday, May 18, 10:45am). The high NZD/USD should lower capital prices by 0.3 percent. Construction costs could fall, but look set to firm over 2011.
- **ANZ – Roy Morgan Consumer Confidence - May** (Thursday, May 19, 1:00pm).
- **May 2011 Budget** (Thursday, May 19, 2:00pm). A weaker starting point, but continued expenditure restraint will pave the way to an eventual return to surplus. See our preview on page 5.
- **SNZ External Migration – April** (Friday, May 20, 10:45am). A net PLT outflow of 300 persons is expected. Visitor arrival numbers should remain weak.

WHAT'S THE VIEW?

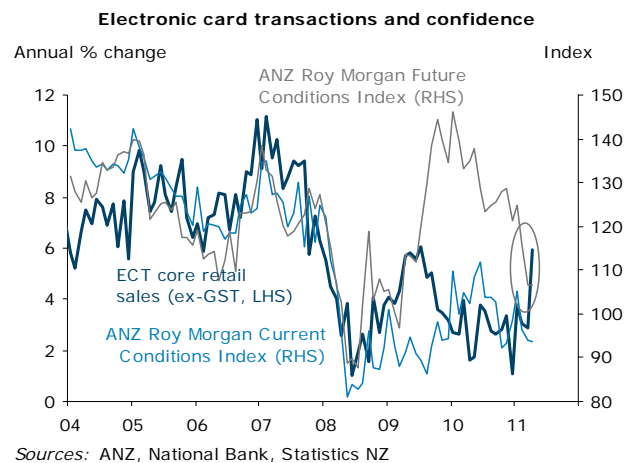
The theme of mixed sector and regional performances continues to be highlighted in recent local data.

The April Electronic Card Transaction (ECT) data was consistent with earlier signs of improving momentum in retail spending. Importantly, strength in April followed a solid March, whereas the

common pattern in such surveys is one good month followed by a weaker one. Durables, consumables, and perhaps surprisingly, hospitality were particularly strong.

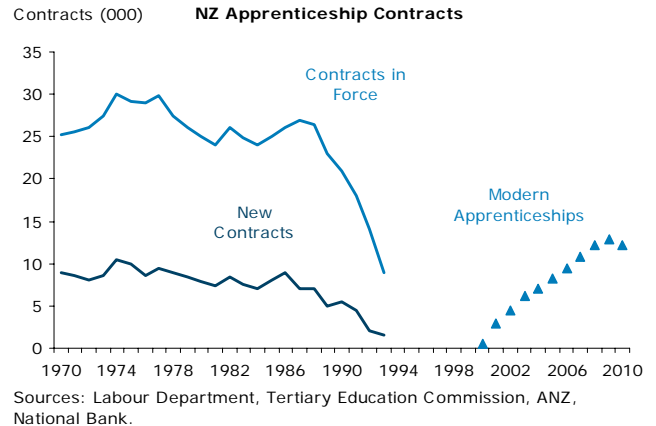
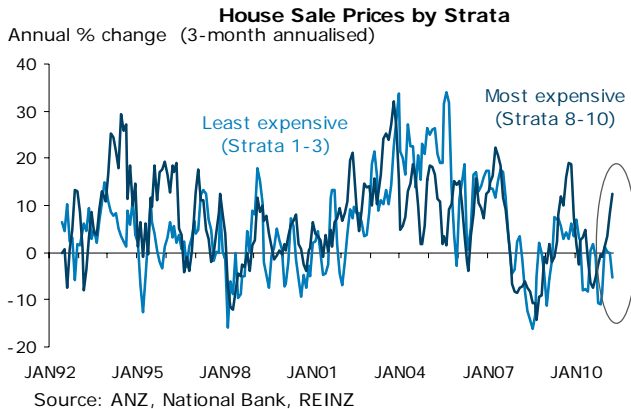
At this stage we are somewhat coy about getting overly excited about retail prospects, despite having a more upbeat view on the general economy. For sure the improvement is encouraging and while deleveraging has been driving a wedge between incomes and spending growth, this is rapidly becoming a matter of choice for many, rather than an absolute necessity. Yet when you consider a) price increases chewing into disposable income, b) some likely durable-related replenishment post the quake, and c) the ECT survey itself (we don't consider it the equal of a proper retail trade survey), the jury remains out on how much underlying substance there is behind the numbers.

The key to sustained improvement in the retail sector will be the willingness of households to convert decent income growth into spending. **This week's ANZ-Roy Morgan Consumer Confidence Report will provide a timely update about whether sentiment is following the more upbeat tone evident in retail spending.**



Better momentum in retail spending may also hinge on a more sustained housing market recovery. After a decidedly mixed April REINZ report, the jury remains out, with sales volumes outside of Canterbury down more than 3 percent, and properties still taking a long time to sell. However, pricing trends continue to show wide divergences, with the top end of the market (which includes a lot of Auckland suburbs) holding up well. Prices in cheaper suburbs are still trending down. This sort of dichotomy fits with the schizophrenic nature of the economy in general: some good and some not so.

ECONOMIC OVERVIEW



Manufacturing data for April showed signs of improving sentiment but with strong regional divergences. Confidence reached its highest point since late last year in the Northern region, but the picture was less upbeat further south. A key takeout of the survey was that firms are starting to see the Christchurch rebuild as an opportunity to expand.

We are still closely following events in Christchurch, and note recent media reports that the first batch of temporary accommodation is now ready to be moved on-site. While small in number (around 20), work only started a few weeks ago and it's the real spirit of what is going on that is probably more important. With the work done locally and using a lot of New Zealand made materials, it is the start of the rebuilding effort that will complement the economic activity generated from demolition and relocation work. **Whereas the consensus seems to be focused on the rebuild itself as the catalyst for the construction sector's revival we are looking at reconstruction-related work in general,** including: the triage of core services, modular housing, refits, housing repairs (as opposed to rebuilds), businesses looking at short-term premises – the list goes on. These are gaining momentum now. So the idea that construction work in the area is a 2012 story doesn't gel with us. Yes, 2012 is the rebuild story. But 2011 will be full of reconstruction.

We're encouraged by last week's announced addition of an extra 3,000 places for construction related training. As we've noted previously, the demand aspects to the rebuild is one thing; it's a massive slew of work. But a corresponding issue is making sure there is sufficient supply-side capacity to accommodate the work.

There are also pricing-side repercussions from seismic events and we are already starting to see them. The announced 50 percent increase in dwelling insurance by a few providers last week will not have a substantial direct impact on the CPI (0.1 percent at most). It gets more interesting, however, if other insurance costs also move higher and if firms pass higher costs onto their customers. **The RBNZ has scope under the Policy Targets Agreement (clause 3) to look through these price rises but they are worth keeping an eye on for second-round effects.** Yes, we also know that the demand side of the equation curtails the pass-through, but the persistence of various one-offs and realities of a 5 percent plus headline rate have us somewhat uncomfortable about the inflation outlook. And we've typically been at the dovish end of the inflation spectrum! **Unless inflation expectations are anchored with concrete, higher headline inflation could spill over into wage and price setting throughout the economy.** This would make the RBNZ's job considerably more difficult.

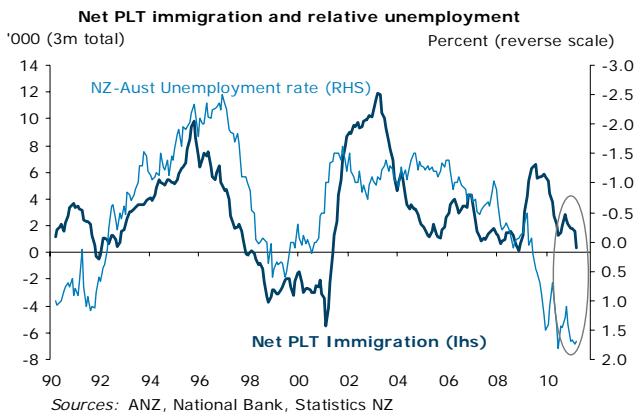
The major local event this week is the 2011 New Zealand Budget on Thursday. Our preview is on page 5. **Our expectation is that the Budget will be tighter than many expect, and we would not rule out a forecast return to surplus by 2013/14.** Recent comments by the Minister of Finance and the PM have suggested that the Budget will outline a credible path to surplus, with expenditure restraint an important component. Given our high external debt and a large fiscal deficit this year, the cupboard for election sweeteners is bare. This is probably just as well, given that most of the electorate (and rating agencies for that matter) will be looking for the Government to display some leadership and knuckle down. **We also believe the Budget will be used as a sounding board to signal the Government's**

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intentions after the election. These are likely to involve more substantive changes than tinkering around the edges, with more focus on delivering an environment that offers a better chance of improving economic performance.

A key factor behind New Zealand's relatively upbeat medium-term prospects has been the structural shift higher in export commodity prices. We are expecting whole milk powder prices to remain around the US\$3,800 per tonne mark in this week's *globalDairyTrade* online auction.

Producer prices and capital goods price data will highlight differences in inflation for various parts of the economy. We expect high commodity prices to underpin a higher increase in input than output prices, with implied margins expected to narrow slightly as a result. The high NZD/USD has been effective in restraining price increases for imported capital goods, and we expect this to continue for some time. This is a positive development towards building the supply side capacity of the economy. Construction cost inflation is expected to remain almost non-existent, but we expect this to pick up over the remainder of the year.



Finally, external migration data for April will be keenly awaited to see how enduring the net outflows in March prove. We are expecting a net PLT outflow of 300 persons and will be closely watching net PLT departures to Australia for signs of future direction. This annual net outflow is currently 36,500 persons and rising. Overseas visitor numbers are expected to remain low, on account of low Asian visitor numbers. A sustained net population outflow will alleviate looming dwelling shortages and dampen domestic spending but may also adversely impact on the supply side of the economy if it exacerbates skill shortages. Implications for capacity pressures and inflation are not as clear-cut as they may seem.

RECENT LOCAL DATA

- **Crown Statements for the 9 months to March 31.** The deficit on the operating balance excluding gains and losses (OBEGAL) climbed to \$10.17b, \$1.3b larger than forecast. The operating deficit, at \$3.3b, was narrower than expected, with net public debt at 20.2 percent of GDP, close to the HYEPU forecast.
- **SNZ Electronic Card Transactions – April.** The value of Retail Electronic Card Transactions rose a seasonally adjusted 1.5 percent (+9.5 percent y/y). Core retail ECT spending rose a seasonally adjusted 1.6 percent (+8.1 percent y/y.)
- **RBNZ Financial Stability Report – May 2011.** “New Zealand’s financial system is more resilient and positioned to support economic growth, but still faces a volatile and uncertain environment”.
- **REINZ Housing Market Report – April.** Sales volumes rose 0.3 percent s.a, with volumes outside of Canterbury declining 3.3 percent s.a. The house price index rose a seasonally adjusted 1.3 percent (-0.4 percent y/y), with the seasonally adjusted days to sale broadly unchanged at 45.
- **SNZ Food Price Index – April.** Food prices rose 0.1 percent, to be 6.1 percent higher than 12 months earlier.
- **BNZ Business NZ Manufacturing PMI – April.** The manufacturing PMI ticked up to 51.5 from 50.2, with increases in four of five components. Employment eased to 49.9, the only component below 50.

BUDGET 2011 PREVIEW

SUMMARY

We expect the well-flagged tight fiscal story to manifest in actual outcomes in the 2011 Budget. We view this, in itself – ratings pressure aside – as a sign of the structural change that is occurring across society. Suddenly saving and frugality is becoming fashionable. With no new spending allocation for this year's Budget and the cutting back on some key programmes, we suspect that the Government could surprise most by how quickly they can get back into the black. As always, however, the challenge will be to ensure the forecast spending restraint is matched by reality. We think the Budget will do enough to avert a credit rating downgrade – for now. But we doubt that S&P and Fitch will remove NZ from negative outlook until more inroads are made into the country's large net external liability position. This looks challenging when you consider the realities of rebuilding destroyed domestic capital stock. The Budget should be supportive of the RBNZ taking a patient approach to removing policy accommodation.

A RECORD WE DON'T WANT

This week's Budget will reveal the largest ever underlying fiscal deficit of over \$16bn, equivalent to 8 percent of GDP, for 2010/11. No doubt this will attract a lot of headlines. But it is important not to get too hung up on this number. There are a few extraordinary events that have resulted in a deficit of that size. The economic recovery has been more sluggish than expected, with the economy effectively stalling over the second half of last year, though just managing to avoid a technical recession. This has seen the tax take come in below Treasury forecasts. Then, the February 22 earthquake in Christchurch resulted in a further blow to the fiscal position. Reduced near-term economic activity as a result of the earthquake will result in lost revenue, while unexpected costs dealing with the earthquake aftermath has pushed up spending.

The 2010/11 underlying fiscal figures are also inflated by the accounting treatment of EQC's liability for the earthquakes, which totals \$3bn. The funds are already there, accumulated through past levies on insurance premiums, but it is still put through the Government's bottom line. The EQC liability from the September 2010 and February 2011 quakes is a one-off and will not occur in subsequent years. Even so, deficits of 8 percent of GDP are not sustainable going forward. The question is how quickly the deficit is reduced, and when a return to surplus can be reached.

Helping the fiscal outlook going forward will be an upgrade to Treasury's economic forecasts

from 2012/13, courtesy of higher commodity prices and increased activity from the earthquake rebuilding. Of course, in the near term, the Treasury's forecasts will be downgraded from 3.4 percent in the HYEPU to 2.2 percent for 2011/12. But we should see a lift in the growth forecasts from 2.9 percent to around 4 percent for 2012/13, and from 2.7 percent to 3.2 percent for 2013/14.

THE FOCUS

The Government has indicated that Budget 2011 will focus on three main areas:

- Building faster economic growth around higher national savings;
- Setting a credible path back to surplus and repaying debt; and
- Rebuilding Christchurch over the next few years.

Clearly, the rebuilding of Christchurch will be top priority and in many ways has been a game changer in terms of allocations elsewhere. In fact we'd go as far to say that a lot of sacred cow related policies (i.e. student loans, KiwiSaver) are no longer quite so sacred as a result of the quakes. The direct cost to the Government of fixing up earthquake-damaged infrastructure and land, and other spending to support the Canterbury region is estimated at \$5.5bn (not including the \$3bn from EQC). Most of this spending will be capital in nature, and will not directly impact on the underlying operating deficit. But it will have to be borrowed. Getting the funds to pay for the Christchurch rebuilding is not an issue, and the Government is committed to using its balance sheet to full effect, as it should.

Getting back in the black is the next step. Here, the Government has already hinted at what is in store in order to reduce the deficit. They have ruled out a levy to help fund the earthquake reconstruction, or any tax increases of any type. **So the burden of fiscal adjustment will fall squarely on the spending side.**

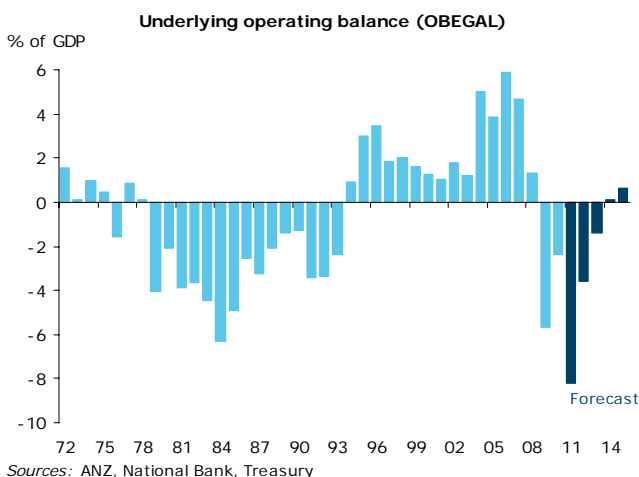
Budget 2011 will be a "zero budget" in the sense that there is no new current spending allocation. Historically, this is not only remarkable, it's unheard of. Any new spending initiatives will be funded from reprioritisation and savings from elsewhere. This is compared to \$1.1bn for new discretionary spending per year previously allocated for the Budget. In the previous eight Budgets, new operating spending averaged around \$2.6bn a year. To keep current increases in current spending to \$1.1bn was tight, but achieving no overall increases will be austere, considering the \$800m per year of

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additional spending usually needed to keep health and education ticking over. It requires major reprioritisation and savings initiatives in other areas. **And to really make inroads into the deficit, even more savings need to be found.**

Both the Minister of Finance and the Prime Minister have already flagged cutbacks to Government funding for Working for Families, student loans and KiwiSaver. Working for Families will be made less generous for higher income earners, though we do not think the savings here will be that large. Student loans will remain interest-free, with savings to come through stricter targeting and more stringent repayment criteria. But to provide real incentives to pay back the debt would require interest to be charged on the debt, which is probably politically a step too far at this stage.

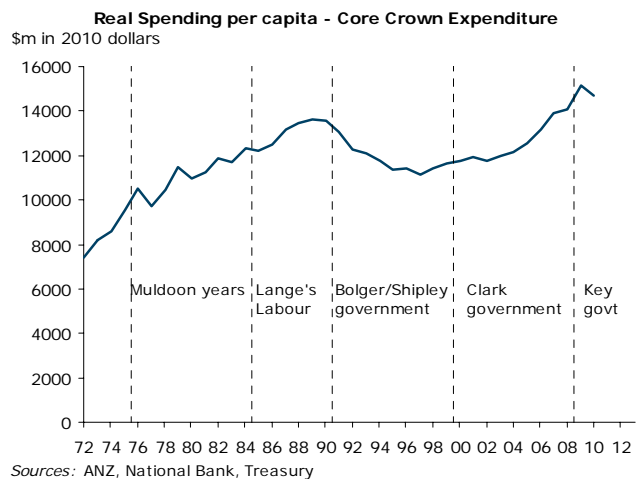
KiwiSaver potentially offers scope for the most savings. The \$1,000 kick-start stays, but the Member Tax Credit will be reduced or potentially dropped altogether, potentially saving \$1bn a year. But the employer and employee contributions will likely rise to ensure that the overall amount paid into the scheme is not affected. If so, this effectively redistributes the burden from the Government to employers and employees. However, any changes to KiwiSaver will only occur after the election and at a time when the economy is truly recovering, which suggests a fiscal impact from 2012/13.



Based on what the Government has indicated so far, we think the deficit for 2011/12 will likely be halved to under 4 percent of GDP. A tight fiscal rein, savings from KiwiSaver and some help from booming commodity prices will see a return to surplus, quite possibly by 2013/14, which is much earlier than most expect. The fact that ACC has managed to find \$0.6bn in savings over four years will have helped as well. Still, it would be a

remarkable turnaround if this could be achieved, and will certainly take pressure off a prospective credit rating downgrade.

No doubt a tighter Budget will mean that the fiscal stance will turn contractionary from next fiscal year. And there will be questions about whether government services will suffer as a result of the spending freeze. But it is important to put government spending into perspective. Real core Crown expenditure on a per capita basis has increased from \$11,100 in 1996/97 to a peak of \$15,200 in 2008/09. It has reduced slightly to \$14,700 in 2009/10, but is still very elevated relative to history. Even a lowering of real spending per capita over the next few years will still leave it at a fairly high level compared to historical norms.



WHERE ARE THE GOODIES?

There is no doubt that the Budget will be austere. The attention so far has been on which areas the Government will cut back on. **But there will be some new initiatives.** The largest pre-Budget announcements so far have been:

- \$42m over four years for boosting trades training for the Canterbury region;
- \$54.5m over four years for new initiatives for maternity services and to help new mothers and their babies;
- \$55.2m over four years for a Youth Employment Package to help young people into work.

But we suspect that there will be a major announcement that will be unveiled at the Budget. After all, there has to be something to cover one of the Budget's main themes, which is "Building faster economic growth around higher national savings". What has been publicly flagged clearly falls short of that. Quite what "deep dark

BUDGET 2011 PREVIEW

secret" lurks in next week's Budget we don't know. **What we do know is that it is an election year Budget, and while the Government wants to portray themselves as sound fiscal managers, they will want a major policy initiative as a trump card.** After all, last year's Budget surprised with a cut to the corporate tax rate from 30 percent to 28 percent. We think the Government will have something up their sleeves this Thursday.

IMPLICATIONS

A much tighter fiscal rein and quicker return to surplus mean that a credit rating downgrade will likely be averted, or at least further time will be bought. However, we doubt that S&P and Fitch will remove NZ from negative outlook, though they surprised us 2 years ago and could do so again. While an improving fiscal position will allay some of the credit rating agencies' concerns, they will likely want to see more inroads being made into the country's large net external liability position, which currently stands at 81.7 percent of GDP. Any improvement will take time, but a return to surplus by the Government will certainly help, alongside ongoing deleveraging by the household sector.

Key on the day will be the projected path for the current account deficit by Treasury. From 2013, current account deficits below 4 percent of GDP are hard to achieve, given that rebuilding Christchurch will increase import penetration. And such figures will keep ratings agencies attuned to the external as opposed to the local (read: sovereign) situation. NZ is world-class on the latter but problematic in regard to the former. And this puts ratings agencies in somewhat of a pickle, for they are rating the latter, but the former can quickly undermine the latter.

Those looking for game changing policies to lift the economy's potential growth rate will be disappointed. For sure we expect some movements in the right direction – policies around water, the Rugby World Cup and tourism will be trumpeted. Initiatives, yes, but not step change material. The reality is that the Government has had to deal with a lot of unexpected events that have weakened the fiscal position. It doesn't matter which political party takes the reins over the next decade: they are all in a fiscal strait-jacket. While some may boast of magic potions, the reality is that none exist: they are mere snake-oil.

The large amount of pre-funding in 2010/11 that the DMO has already done reduces the funding requirements for the next financial year. We expect an increase in the size of the 2011/12 bond tender programme to \$15bn. But with an improving fiscal position thereafter, we see lower bond tender programmes further out. Demand for NZ government bonds has been strong, and investors are likely to view the Government's commitment to returning to surplus quickly as very positive.

The Budget should be supportive towards expectations the RBNZ need not be overly aggressive. Prospects for a sustained tightening in fiscal policy should take pressure off monetary policy on average over the next cycle. However, we expect the 2011 Budget to deliver little to alter our expectations the RBNZ will ultimately need to move in 2011 as opposed to 2012. Simply put: more action early means less later.

OUR EXPECTATION OF THE TREASURY'S BUDGET 2011 FORECASTS

June years	2010	2011(f)	2012(f)	2013(f)	2014(f)	2015(f)
OBEGAL (\$bn)	-6.3	-16.3	-7.6	-3.1	0.1	1.6
- as % of GDP	-3.3	-8.2	-3.6	-1.4	0.1	0.6
Operating Balance (\$bn)	-4.5	-10.3	-5.6	-1.6	1.6	3.1
- as % of GDP	-2.4	-5.2	-2.7	-0.7	0.7	1.2
Net Core Crown Debt (\$bn)	26.7	42.5	55.0	65.0	70.0	72.0
- as % of GDP	14.1	21.4	26.1	29.0	29.7	29.0
Core Crown residual cash (\$bn)	-9.0	-16.1	-16.5	-11.5	-7.6	-7.0
Bond Tender Programme (\$bn)	12.4	20.0	15.0	10.0	7.0	7.0

INTEREST RATE STRATEGY

SUMMARY

Budget 2011 is the must-see event this week. Austerity will be the main theme, lending support to both the short end of the swap curve, and for NZ Government bonds. US interest rates remain volatile. While there are good fundamental arguments in favour of higher yields, with the Fed on hold, and inflation seemingly well-behaved, the focus has switched back to carry, keeping a lid on yields.

MARKET THEMES

- The Budget is the key domestic event this week. The PM has hinted that it will be austere. If so, expectations of rate hikes may be delayed. It will also provide even more support for NZGS bonds.
- How much lower can US bond yields go? Carry is set to dominate flows in the short term, but if the recent slowing in momentum is temporary, yields have a lot of adjusting to do.

REVIEW AND OUTLOOK

Price action in the local market was reasonably subdued last week, even if it was largely one-way flow, with investors latching on to the view that this week's aptly nicknamed "zero Budget" will do little to lift near-term economic activity. We tend to concur. Although we believe the economy (particularly the export sector) has a stronger base of underlying support than is widely assumed, the near-term impact of an austere Budget on consumers suggests caution. As such, expect ongoing pressure for short-end rates to fall.

NZGS demand remains strong. Participation in last week's tender was down, but that was to be expected given how far yields had rallied. Looking ahead, an austere Budget should provide support – especially given that if the Budget is in line with our projections, a credit rating downgrade should be averted.

A showdown looks to be looming in the US bond market. Although much has been made of the recent rally in US bond yields, the truth is that yields have been fluctuating all year. As such, the circa 40bp rally in US 10 year Treasury bond yields has been overplayed – it's as much an unwind of the March sell-off as it is a rally in its own right. But it is interesting that yields have made new lows for the year this month. This has coincided with weaker manufacturing and jobs data. While this data is disturbing, it may be more indicative of higher energy prices and auto sector supply chain disruptions stemming from the Japan quake, than a genuine cyclical slowdown. While weak concurrent data and a relaxed Fed attitude will likely see carry play a more prominent role in shaping market pricing in the near

future, unless one is prepared to write off a US recovery, **it would seem the medium-term risks to US bond yields lies decisively to the upside.**

PREFERRED BORROWING STRATEGIES

Swap rates have been reasonably stable over the past week, but will be biased lower this week following what is set to be an austere Budget. But with inflation pressures bubbling away in the background, and evidence mounting that economic activity in areas other than Christchurch is picking up, the medium-term risk to swap rates is higher. As such, we favour incrementally adding to hedges as rates move lower, particularly at the long end of the curve. Short-term hedges are cheaper, but with the RBNZ set to keep policy on hold for most of the year, and raise rates gradually rather than sharply, it is debatable how much protection short-end hedges provide. The long end is also more vulnerable to rising global rates, which is where the balance of medium term risks lie.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔	Light data schedule ahead.
NZ data	↔/↓	Budget will be austere.
Fed Funds / front end	↔	Fed seem in no hurry to hike, CPI data subdued.
RBA	↔/↓	Jobs data last week suggests delayed hike.
US 10 year	↔	Carry still the main focus.
NZ swap curve	↔/↑	Likely to steepen into Budget on austerity.
Flow	↔/↓	NZGS demand still strong. Receivers dominate swaps.
Technicals	↔/↓	Swap spreads will struggle through par initially.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 9-Jun-11	0	0
Thu 28-Jul-11	+1	0
Thu 15-Sep-11	+3	+2
Thu 27-Oct-11	+12	+9
Thu 8-Dec-11	+20	+18
Thu 26-Jan-12	+33	+30
Thu 8-Mar-12	+44	+44

TRADING THEMES WE FAVOUR AT PRESENT

Demand for NZGS bonds remains strong, and although bid cover ratios slipped at last week's tender, price tension remains. With the supply tap set to be turned off abruptly (see our Budget Preview on page 5), expect bonds to continue outperforming swap. As such, we continue to favour NZGS asset swaps. If the Budget is as austere as we think it might be, with the RBA potentially on the sidelines for a little longer, consider a NZ flattening/AU steepening 2s10s box trade if the NZ curve steepens significantly into/after the Budget, as we suspect it may.

CURRENCY STRATEGY

SUMMARY

Thursday's Budget will be the key focus for NZD. While an earlier return to surplus will avert a credit rating downgrade, any positive spin off on the NZD will likely be short-lived. Continued uncertainty surrounding EUR sovereign debt risk, not helped by the arrest of the IMF head, mean risk will stay off the table. EUR looks vulnerable to further moves to the downside. As we creep ever closer to the end of QE2, the currency markets have one less reason to sell USD.

MARKET THEMES

- NZ Budget a focus but external factors will be the main drivers for NZD.
- The re-emergence of concerns over Greece will continue to undermine EUR.
- The end of QE2 creeps closer, lessening reasons to sell USD.
- Commodities retain a soft bias.

REVIEW AND OUTLOOK

The NZ Budget will be a focus for this week. **An early return to surplus may be positive for the NZD, as that means a credit rating downgrade will be avoided. But the reality is that external factors will likely provide more direction.** The decline in global commodity prices that has occurred since the last Fonterra *globalDairyTrade* auction will be reflected in this week's auction (Wednesday morning). While the level of dairy prices is still high, our expectation of a small decline could undermine the NZD, which is hovering near support levels. Technically, we have strong support at 0.7820/30 which if broken, could take the NZD to a new trading zone of 0.7550 to 0.7700.

The EUR continues to look sick on more Greek woes and position unwinding. The waters surrounding the Greek situation and the IMF's response became even murkier as the IMF head was arrested in New York. Greece is seeking a relaxation of EU loan terms to avoid default. Technically the EUR continues to be a poor performer and ended its second week in a row with a very weak finish. The current direction now seems well entrenched and can see a move to the 1.3650/1.3900 range.

US data continues to improve but the gulf between headline and core inflation continues to widen. Confidence indicators are improving and Fed officials seem to be acknowledging economic improvements. However they are very reluctant to signal in any way the end of the current monetary accommodation. **FX markets often lead other**

asset classes at major inflection points, and with this in mind, we need to be cognisant of the possibility that the unwinding of the large short USD positioning may have begun.

The AUD continues to suffer following last week's weak employment report. The EUR selloff has also assisted the AUD's fall. If past performance is a guide, then we can expect the release of the RBA board minutes to give some support as the RBA continues to be very upbeat regarding the mining boom and Asia. However, any AUD support should be seen as only temporary with the bias still towards the downward.

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value	↑	Close to our fair value estimates.
Yield	↔/↓	RBNZ on hold for a while.
Commodities	↓	Weak commodities leave NZD and AUD vulnerable.
Partial indicators	↓	RBNZ and RBA in opposing directions again.
Technicals	↔	Support at 0.7350.
Sentiment	↔	Commodities out, USD in.
Other	↑	Terms of trade continue to support.
On balance	↔	Rangebound 0.7350 - 0.7500.

NZD VS USD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value – long-term	↔/↓	Above structural fair value of 0.67.
Fair value – short-term	↔/↓	Still above our cyclical fair value estimates.
Yield	↓	Yield differentials suggest NZD should be lower.
Commodities	↓	Weak commodities eaves NZD and AUD vulnerable.
Risk aversion	↔	Risk gauges turning higher.
Partial indicators	↔	Economic data still patchy.
Technicals	↓	Short term high in place.
AUD	↔/↓	AUD in correction mode.
Sentiment	↓	Commodity currencies out of favour, risk off.
Other	↑	Strong demand for NZ bonds.
On balance	↔/↑	External factors and technical picture weigh on NZD.

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
16-May	NZ	Performance Services Index - MAY	- -	50.8	10:30
	UK	Rightmove House Prices (MoM) - MAY	- -	1.70%	11:01
	UK	Rightmove House Prices (YoY) - MAY	- -	0.10%	11:01
	AU	Home Loans - MAR	2.00%	-5.60%	13:30
	AU	Investment Lending - MAR	- -	-2.30%	13:30
	AU	Owner-Occupied Home Loan Value - MAR	- -	-4.80%	13:30
	JN	Consumer Confidence - APR	36.7	38.6	17:00
	EC	Euro-Zone CPI - Core (YoY) - APR	1.50%	1.30%	21:00
	EC	Euro-Zone CPI (MoM) - APR	0.60%	1.40%	21:00
	EC	Euro-Zone CPI (YoY) - APR	2.80%	2.80%	21:00
	EC	Euro-Zone Trade Balance sa - MAR	- -	-2.4B	21:00
17-May	US	Empire Manufacturing - MAY	19.7	21.7	00:30
	US	Total Net TIC Flows - MAR	- -	\$97.7B	01:00
	US	Net Long-term TIC Flows - MAR	\$32.6B	\$26.9B	01:00
	US	NAHB Housing Market Index - MAY	17	16	02:00
	AU	Reserve Bank's Board May Minutes - MAY	- -	- -	13:30
	CH	Actual FDI (YoY) - APR	36.10%	32.90%	14:00
	UK	DCLG UK House Prices (YoY) - MAR	- -	0.70%	20:30
	UK	CPI (MoM) - APR	0.70%	0.30%	20:30
	UK	CPI (YoY) - APR	4.10%	4.00%	20:30
	UK	Core CPI YOY - APR	3.20%	3.20%	20:30
	UK	Retail Price Index - APR	234.6	232.5	20:30
	GE	Zew Survey (Current Situation) - MAY	87.5	87.1	21:00
	EC	ZEW Survey (Econ. Sentiment) - MAY	17.3	19.7	21:00
	GE	ZEW Survey (Econ. Sentiment) - MAY	4.5	7.6	21:00
18-May	US	Housing Starts - APR	568K	549K	00:30
	US	Building Permits - APR	587K	594K	00:30
	US	Housing Starts MOM% - APR	3.50%	7.20%	00:30
	US	Building Permits MOM% - APR	0.30%	11.20%	00:30
	US	Industrial Production - APR	0.40%	0.80%	01:15
	US	Capacity Utilization - APR	77.60%	77.40%	01:15
	NZ	Producer Prices- Inputs (QoQ) - 1Q	- -	0.90%	10:45
	NZ	Producer Prices- Outputs (QoQ) - 1Q	- -	0.20%	10:45
	JN	Tertiary Industry Index (MoM) - MAR	-5.80%	0.80%	11:50
	AU	Westpac Consumer Confidence Index - MAY	- -	105.3	12:30
	AU	DEWR Skilled Vacancies MoM - MAY	- -	1.70%	13:00
	AU	Wage Cost Index QoQ - 1Q	1.10%	1.00%	13:30
	AU	Wage Cost Index YoY - 1Q	4.00%	3.90%	13:30
	UK	Bank of England Minutes - MAY	- -	- -	20:30
	UK	Claimant Count Rate - APR	4.50%	4.50%	20:30
	UK	Jobless Claims Change - APR	0.0K	0.7K	20:30
	UK	Average Weekly Earnings 3M/YoY - MAR	2.00%	2.00%	20:30
	UK	ILO Unemployment Rate (3mths) - MAR	7.80%	7.80%	20:30
	EC	Construction Output SA MoM - MAR	- -	-0.70%	21:00
	EC	Construction Output WDA YoY - MAR	- -	3.50%	21:00
19-May	US	Minutes of FOMC Meeting - APR	- -	- -	06:00
	JN	Housing Loans YoY - 1Q	- -	3.20%	11:50
	JN	GDP Deflator YoY - 1Q P	-1.90%	-1.60%	11:50

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
19-May	JN	Nominal GDP (QoQ) - 1Q P	-0.80%	-0.70%	11:50
	JN	GDP Annualized - 1Q P	-2.00%	-1.30%	11:50
	JN	Gross Domestic Product (QoQ) - 1Q P	-0.50%	-0.30%	11:50
	NZ	ANZ Consumer Confidence Index - MAY	- -	101.4	13:00
	NZ	ANZ Consumer Confidence MoM - MAY	- -	0.00%	13:00
	AU	Average Weekly Wages (QoQ) - FEB	1.20%	1.10%	13:30
	AU	Average Weekly Wages (YoY) - FEB	3.80%	3.90%	13:30
	JN	Capacity Utilization (MoM) - MAR	- -	2.90%	16:30
	JN	Industrial Production (MoM) - MAR F	- -	-15.30%	16:30
	JN	Industrial Production YOY% - MAR F	- -	-12.90%	16:30
	JN	Tokyo Dept. Store Sales (YoY) - APR	- -	-21.50%	17:30
	UK	Retail Sales Ex Auto Fuel(MoM) - APR	0.80%	0.20%	20:30
	UK	Retail Sales Ex Auto Fuel(YoY) - APR	2.20%	0.90%	20:30
	UK	Retail Sales w/Auto Fuel (MoM) - APR	0.80%	0.20%	20:30
	UK	Retail Sales w/Auto Fuel (YoY) - APR	2.50%	1.30%	20:30
	UK	CBI Trends Total Orders - MAY	-9	-11	22:00
	UK	CBI Trends Selling Prices - MAY	- -	36	22:00
	US	Mortgage Delinquencies - 1Q	- -	8.22%	UNCONFIRMED
	US	MBA Mortgage Foreclosures - 1Q	- -	4.63%	UNCONFIRMED
20-May	US	Initial Jobless Claims - 14 MAY	420K	434K	00:30
	US	Continuing Claims - 7 MAY	3723K	3756K	00:30
	US	Existing Home Sales - APR	5.20M	5.10M	02:00
	US	Existing Home Sales MoM - APR	2.00%	3.70%	02:00
	US	Leading Indicators - APR	0.10%	0.40%	02:00
	US	Philadelphia Fed. - MAY	20	18.5	02:00
	NZ	Net Migration SA - APR	- -	-530	10:45
	NZ	Credit Card Spending SA (MoM) - APR	- -	-1.60%	15:00
	NZ	Credit Card Spending (YoY) - APR	- -	1.50%	15:00
	JN	All Industry Activity Index (MoM) - MAR	-6.10%	0.70%	16:30
	GE	Producer Prices (MoM) - APR	0.60%	0.40%	18:00
	GE	Producer Prices (YoY) - APR	6.00%	6.20%	18:00
	EC	Euro-Zone Current Account nsa - MAR	- -	-9.5B	20:00
	EC	ECB Euro-Zone Current Account SA - MAR	- -	-7.2B	20:00
	JN	BOJ Target Rate - MAY	- -	0.10%	UNCONFIRMED
21-May	EC	Euro-Zone Consumer Confidence - MAY A	-12	-11.6	02:00
	JN	Coincident Index CI - MAR F	- -	103.6	17:00
	JN	Leading Index CI - MAR F	- -	99.5	17:00

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

Sources: Dow Jones, Reuters, Bloomberg, ANZ, National Bank. All \$ values in local currency.

Note: All surveys are preliminary and subject to change.

LOCAL DATA WATCH

Key focus over the next few weeks: Recent household-centric data has revealed the resilience of retail spending. This week's Budget will be tight, with a forecast 2013/14 return to surplus possible. Data over the coming months will remain noisy, but we will watch for signs of strengthening in interest rate sensitive sectors.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 18 May (6:00am)	<i>globalDairyTrade</i> auction	Holding up	We expect whole milk powder prices to hold up at around the US \$3,800 per tonne level.
Wed 18 May (10:45am)	Producers Price Index – 2011Q1	Up	Higher oil and commodity prices should boost input prices by 1 percent. Output prices should rise by around 0.8 percent.
Wed 18 May (10:45am)	Capital Goods Price Index – 2011Q1	Down	The high NZD/USD should lower capital prices by 0.3 percent. Construction costs could fall, but look set to firm over 2011.
Wed 18 May (1:00pm)	ANZ-Roy Morgan Consumer Confidence	- -	- -
Thur 19 May (1:00pm)	May 2011 Budget	Tough talk	Expenditure restraint and an improving economy will deliver a forecast return to surplus, possibly as soon as 2013/14.
Fri 20 May (10:45am)	International Travel and Migration – April	Seismic hit	A net PLT outflow of 300 persons is expected. Visitor arrival numbers should remain weak.
Mon 30 May (10:45am)	Overseas Merchandise Trade- April	Holding firm	Seasonal patterns and high commodity prices are expected to deliver a monthly surplus of around \$650m.
Tue 31 May (1:00pm)	National Bank Business Outlook	- -	- -
Wed 1 June (6:00am)	<i>globalDairyTrade</i> auction	Consolidation	We expect whole milk powder prices to consolidate around the US \$3,700-3,800 per tonne level.
Wed 1 June (10:45am)	Overseas Trade Indexes – 2011Q1	TOT positive, GDP negative	A 2 percent increase in the terms of trade is expected. Export volumes should remain flat, with import volumes up 5 percent.
Wed 1 June (1:00pm)	ANZ Commodity Price Index - May	- -	- -
Fri 3 June (10:45am)	Building Consents – April	Building	Residential consents are expected to rise 5 percent. Strengthening construction sector activity will be a feature of H2.
Thur 8 June (10:45am)	SNZ Value of Building Work Put in Place – Q1	Down in the dumps	We expect a 7 percent decline in residential volumes. A 3 percent fall in non-residential building volumes is expected.
Thur 9 June (9:00am)	RBNZ June MPS	Patience	The RBNZ will be in no hurry to move the OCR higher. A more detailed set of projections will show a stronger pick-up in activity over 2012, but with core inflation under control.
Fri 10 June (10:45am)	REINZ housing market data – May	Creeping up	We expect a small increase in volumes, but with strong regional divergences. The upward trend in prices should run out of puff.
Fri 10 June (10:45am)	Electronic Card Transactions - May	Rolling along	Past readings have shown the resilience of retail spending. A 0.3 percent increase in retail spending is expected.
Wed 15 June (10:45am)	Retail Trade Survey - Q1	Up	Retail volumes are expected to rise 1.5 percent, with core volumes up 1.0 percent.
Thur 16 June (10:45am)	SNZ Wholesale Trade – Q1	Sideways	We expect a 0.2 percent increase in wholesale trade volumes.
Thur 16 June (10:45am)	SNZ Economic Survey of Manufacturing – Q1	Down	Ex-primary manufacturing volumes are expected to fall 2 percent. Primary manufacturing volumes should track sideways.
Thur 16 June (1:00pm)	ANZ-Roy Morgan Consumer Confidence	- -	- -
On Balance		Mixed	A real economy and pricing side dichotomy may start to emerge. Recent signs of life in housing and retail.

KEY FORECASTS AND RATES

	Dec-10	Mar-11	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
GDP (% qoq)	0.2	-0.4	0.1	1.4	1.8	0.7	0.9	0.9	0.8	0.7
GDP (% yoy)	0.8	-0.3	-0.3	1.3	2.9	4.1	4.9	4.4	3.3	3.3
CPI (% qoq)	2.3	0.8	1.0	0.8	0.7	0.6	0.8	0.7	0.6	0.8
CPI (% yoy)	4.0	4.5	5.3	5.0	3.3	3.1	2.9	2.7	2.6	2.9
Employment (% qoq)	-0.4	1.4	-0.2	0.4	0.5	0.5	0.4	0.5	0.4	0.4
Employment (% yoy)	1.3	1.8	1.8	1.2	2.1	1.2	1.8	1.9	1.8	1.7
Unemployment Rate (% sa)	6.7	6.6	6.6	6.3	6.3	6.2	6.2	6.0	6.0	6.0
Current Account (% GDP)	-2.3	0.3	0.2	-1.8	-1.6	-4.7	-5.0	-5.3	-5.6	-5.8
Terms of Trade (% qoq)	0.6	2.5	1.5	1.5	0.6	-0.8	-0.8	-0.8	-0.8	-0.8
Terms of Trade (% yoy)	12.2	8.3	7.8	6.3	6.2	2.8	0.5	-1.9	-3.3	-3.3

	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11
Retail ECT (% mom)	0.3	-0.6	2.3	0.8	0.9	-0.8	2.4	0.0	1.6	1.5
Retail ECT (% yoy)	4.4	1.7	5.0	4.8	6.3	4.4	5.7	6.2	6.6	10.0
Credit Card Billings (% mom)	-1.1	0.8	0.8	0.5	0.0	-1.0	2.6	-0.4	-0.5	..
Credit Card Billings (% yoy)	2.7	2.4	4.3	4.2	3.1	2.1	4.8	4.4	2.2	..
Car registrations (% mom)	-6.3	0.1	2.8	-3.8	12.4	-7.9	0.7	-1.7	-0.5	-5.7
Car registrations (% yoy)	16.0	19.0	19.2	9.4	23.5	6.4	6.8	2.8	-1.0	-10.5
Building consents (% mom)	3.3	-17.6	0.9	-2.0	8.0	-18.4	9.0	-9.8	2.2	..
Building consents (% yoy)	25.1	-3.1	-9.4	-17.5	-9.1	-26.5	-14.9	-29.0	-26.3	..
REINZ House Price Index (% yoy)	1.8	0.9	-1.3	-3.5	-1.9	-1.6	-2.6	-0.7	-1.8	-0.4
Household Lending Growth (% mom)	0.2	0.1	0.2	0.1	0.0	0.0	0.1	0.1	-0.1	..
Household Lending Growth (% yoy)	2.5	2.3	2.3	2.0	1.8	1.6	1.6	1.5	1.2	..
ANZ Roy Morgan Consumer Confidence	115.6	116.3	116.4	113.6	114.5	112.2	117.1	108.1	101.4	101.4
NBNZ Business Confidence	27.9	16.4	13.5	23.7	33.2	29.5	..	34.5	-8.7	14.2
NBNZ Own Activity Outlook	32.4	25.7	26.7	30.5	35.3	34.5	..	36.6	14.7	29.5
Trade Balance (\$m)	-186	-430	-455	-220	-177	-218	10	193	464	..
Trade Balance (\$m ann)	585	871	978	1259	1363	1172	911	775	631	..
ANZ World Commodity Price Index (% mom)	-0.8	-1.4	2.8	3.5	4.5	2.0	3.8	2.7	4.8	1.6
ANZ World Commodity Price Index (% yoy)	47.3	38.6	32.9	31.4	23.7	23.0	27.2	25.9	29.6	25.4
Net migration (sa)	980	850	1000	540	590	720	440	470	-540	..
Net migration (annual)	15221	14507	13914	12610	11519	10451	8689	8249	6554	..

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	Mar-11	Apr-11	Today	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
NZD/USD	0.762	0.810	0.787	0.76	0.77	0.75	0.74	0.72	0.71	0.70
NZD/AUD	0.737	0.738	0.745	0.72	0.71	0.72	0.73	0.72	0.72	0.73
NZD/EUR	0.538	0.547	0.559	0.54	0.56	0.56	0.56	0.54	0.53	0.52
NZD/JPY	63.31	65.75	63.69	64.6	66.2	66.0	66.6	66.2	66.0	66.5
NZD/GBP	0.475	0.485	0.486	0.47	0.48	0.47	0.47	0.46	0.45	0.45
NZ\$ TWI	66.7	68.6	68.4	66.6	67.8	67.1	67.0	65.7	64.9	64.4
INTEREST RATES	Mar-11	Apr-11	Today	Jun-11	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12
NZ OCR	2.50	2.50	2.50	2.50	2.50	2.75	3.25	3.50	3.75	4.00
NZ 90 day bill	2.63	2.68	2.69	2.70	2.70	3.10	3.70	3.80	4.20	4.30
NZ 10-yr bond	5.66	5.44	5.23	5.50	5.70	5.90	6.10	6.20	6.20	6.10
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.25	0.75	1.50	2.00	2.00
US 3-mth	0.30	0.27	0.26	0.35	0.35	0.35	0.85	1.60	2.10	2.10
AU Cash Rate	4.75	4.75	4.75	5.00	5.00	5.25	5.25	5.50	5.75	5.75
AU 3-mth	4.93	4.92	5.04	5.30	5.30	5.50	5.60	5.80	6.00	6.00

	13 Apr	9 May	10 May	11 May	12 May	13 May
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.65	2.66	2.66	2.66	2.68	2.68
NZGB 04/13	3.60	3.21	3.23	3.27	3.23	3.22
NZGB 04/15	4.56	4.16	4.18	4.22	4.18	4.15
NZGB 03/19	5.64	5.03	5.04	5.11	5.07	5.04
NZGB 05/21	5.78	5.22	5.23	5.30	5.27	5.24
2 year swap	3.45	3.36	3.35	3.36	3.35	3.33
5 year swap	4.64	4.47	4.45	4.48	4.47	4.46
RBNZ TWI	68.3	68.1	68.2	68.3	68.5	68.7
NZD/USD	0.7853	0.7924	0.7933	0.7953	0.7916	0.7930
NZD/AUD	0.7511	0.7362	0.7362	0.7326	0.7436	0.7461
NZD/JPY	66.00	63.84	63.78	64.31	64.24	64.14
NZD/GBP	0.4830	0.4835	0.4838	0.4861	0.4834	0.4882
NZD/EUR	0.5426	0.5507	0.5534	0.5523	0.5563	0.5586
AUD/USD	1.0455	1.0763	1.0776	1.0856	1.0645	1.0629
EUR/USD	1.4472	1.4390	1.4335	1.4400	1.4230	1.4195
USD/JPY	84.05	80.57	80.40	80.86	81.15	80.88
GBP/USD	1.6260	1.6388	1.6397	1.6361	1.6375	1.6245
Oil (US\$/bbl)	105.75	96.87	100.32	103.39	98.53	98.53
Gold (US\$/oz)	1457.75	1503.70	1509.20	1523.70	1504.50	1503.30
Electricity (Haywards)	4.71	3.08	5.31	6.07	6.45	6.75
Baltic Dry Freight Index	1324	1348	1344	1334	1320	1306
Milk futures (USD)	160	162	162	160	160	160

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.
- OnePath (NZ) Limited, as a wholly owned subsidiary of the Bank, is an associated person of the Bank. OnePath and its related companies 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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