

# A FIRM BASE

## CONTENTS

### Page 2: Economic overview

- All partial indicators for Q4 GDP have now been received and confirm the New Zealand economy expanded strongly at the end of last year. Indicators of Q1 activity suggest a firm base has formed, which will keep the market attuned to a hike.

### Page 3: Economic comment – the rural gap

- Our regional output gap measures show that rural aligned regions continue to have the greatest level of excess demand, reinforcing the significant role commodity prices are having on this economic cycle.

### Page 4: Economic comment – subprime woes: should NZ be worried?

- Subprime concerns in the US highlight potential vulnerabilities that could emerge in a housing market slowdown. However, differences between NZ's mortgage market and the US subprime market mean NZ is unlikely to undergo similar stresses in a housing downturn. Nonetheless, a more highly leveraged NZ household highlights the potential for a sharp turn in the household sector.

### Page 6: Interest rate strategy

- The market is expected to test an April rate hike theme given strong housing market data. Strong payside bias will remain but swap yields to remain range-bound with global moves dictating.

### Page 7: Currency strategy

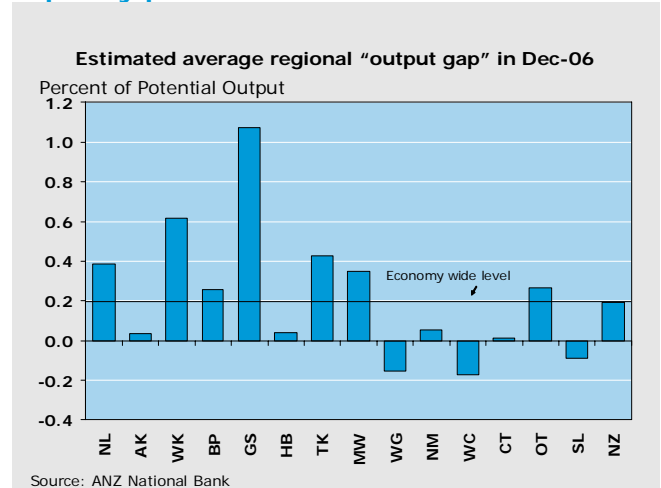
- The NZD remains caught between yield related support and oscillating risk appetites. With the NZD grinding up last week courtesy of the former, the story this week looks to be the reverse. USD/JPY and equities remain the key barometers.

### Page 8: Data timetable

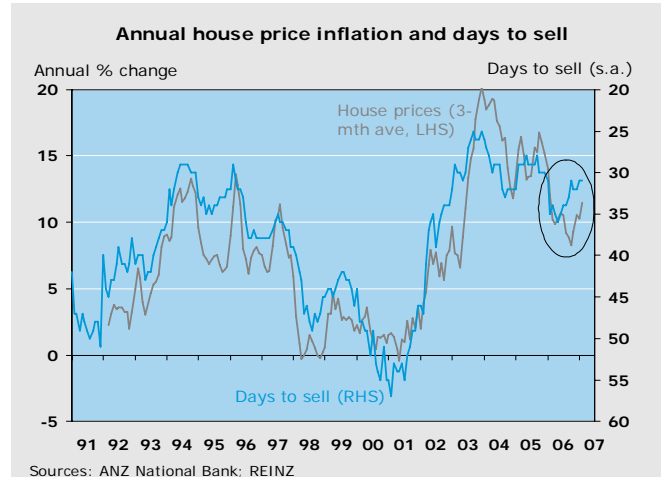
### Page 10: Data watch

### Page 11: Key forecasts

## Rural regions continue to show highest capacity pressures.



## Housing market activity will continue to concern the Reserve Bank.



## ECONOMIC OVERVIEW

All partial indicators for Q4 GDP have now been received and confirm the New Zealand economy expanded strongly at the end of last year. Indicators of Q1 activity suggest a firm base has formed, which will keep the market attuned to a hike.

### What's ahead...

- NZ February External Migration (due Tuesday 1045 NZST) is expected to show a continued stabilisation at around 14,000 per annum.
- NZ February Credit Card Billings (due Wednesday 1500 NZST) are expected to record a modest rebound after January's decline.
- The Bank of Japan and the US Federal Reserve are expected to leave rates unchanged this week.

### What's the view

Manufacturing data, the final partial indicator for December quarter GDP, was released last week and confirmed the economy expanded strongly at the end of last year. Despite weakness in the headline sales number, a rise in stock levels points to a strong rebound in manufacturing production. This will be reflected in a rebound in inventories after a large drawdown in the September quarter. We estimate that manufacturing ex-primary GDP expanded by 1.5 percent in the quarter and will contribute 0.2 percentage points to Q4 GDP. This leaves us comfortable with our 1.0 percent growth forecast for Q4 GDP, but with some upside potential.

Although the Q4 GDP result will be of interest to the Reserve Bank (their March *Monetary Policy Statement* also projected a 1.0 percent increase), their attention is likely to have shifted to indicators of Q1 activity. The Bank has acknowledged the pick-up in domestic demand and the housing market at the end of last year and stated this was the key reason for the delivery of the latest interest rate hike. However, the key for them now is whether this renewed momentum is being sustained and therefore a concern for the medium-term inflation outlook.

In this regard, the evidence for Q1 activity – while mixed to a degree – suggests a firm base is forming. January retail sales showed robust spending although no evidence of acceleration. Housing market activity remains elevated with median house prices increasing to a new record high, but sales have levelled out. The trend for building consents has clearly eased and migration looks to be stabilising around 14,000 per annum. Confidence remains perky. This backdrop will keep the market attuned to the potential for a hike, but more importantly not eager to jump on any easing band-wagon. Ultimately it is the latter area, and firmness along the yield curve which will give the

Reserve Bank comfort and time to allow the very elongated monetary policy lags to work through. The 1, 2 and 5 year swap are all around 20 basis points higher than at the end of February, while market pricing towards hikes (March a certainty, and delivered, and a follow up move a 50-50 call) is largely unchanged.

Anecdotally, growth remains robust although not a boom. But a firm base to growth is placing elongated and persistent pressure on inflation trends. We are beginning our road-show tour, and the anecdotes from this are a timely gauge. They were a key reason for us calling a hike last October, which while wrong in timing was clearly right in spirit. We will report on the key nuances next week.

Against this backdrop of an upwards risk profile for interest rates, we note:

- Governor Bollard showed some apparent reluctance to increase interest rates further for fear of sending the NZD higher, noting last week *"although the TWI is influenced by a wide range of global events, in recent years we have not wished to add to upward pressure on the NZD... we have been more cautious in our OCR tightening path than might otherwise have been the case."*
- Clear direction from the Governor at the Finance and Expenditure Committee post the March *Statement*, where he noted meetings were being arranged with financial institutions, with some degree of urgency. This looks a clear desire to get the credit channel of monetary policy working for, as opposed to against, monetary policy.

Commodity prices and strength in the rural regions (refer page 3) are discounting the weight that can be placed on the first point above at present. It is also difficult to see what means the Governor has to influence credit channels. Treasury and Reserve Bank work has noted numerous problems with ancillary instruments. The credit channel of monetary policy is very pro-cyclical, which leans against the traditional monetary policy channel. Thus, the bias for rates remains up, although we remain coy about pulling the trigger.

### Data last week...

- **NZ Retail Sales (Jan).** Total sales increased 0.5 percent, while core sales rose 1.0 percent.
- **NZ Q4 Manufacturing Survey.** Total nominal sales fell 2.2 percent, while real sales fell 2.1 percent. However, a considerable increase in stock levels suggests production was strong.
- **NZ REINZ Housing Report (Feb).** House sales fell 0.3 percent (s.a.) while the median days to sell a house remained at 31. The median house price rose to a high of \$335,000.
- **NZ Business NZ PMI (Feb).** 53.9 and still showing expansion, although down 1.9 points.

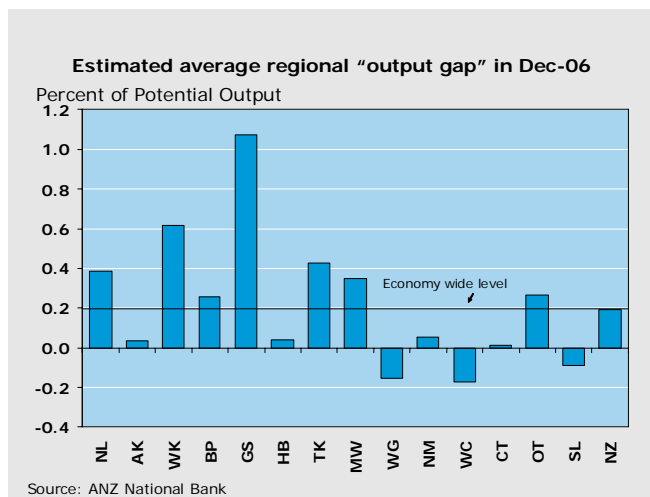
## THE RURAL GAP

Our regional output gap measures show that rural aligned regions continue to have the greatest level of excess demand, reinforcing the significant role commodity prices are having on this economic cycle.

The "output gap" is typically referred to by economists as a measure of capacity pressures or excess demand. When the gap is positive, economic activity is above its "potential" rate and inflation pressures build. Using data from the National Bank's *Regional Trends* and *Business Outlook Survey*, and Statistics New Zealand's regional unemployment data, we have updated our regional output gap measures (described in the 20 November 2006 *Market Focus*) using estimates of the output gap, unemployment gap (utilising Okun's Law) and a derived capacity utilisation gap. We then average over these three measures to smooth through volatility.

### Key messages we take from this analysis are:

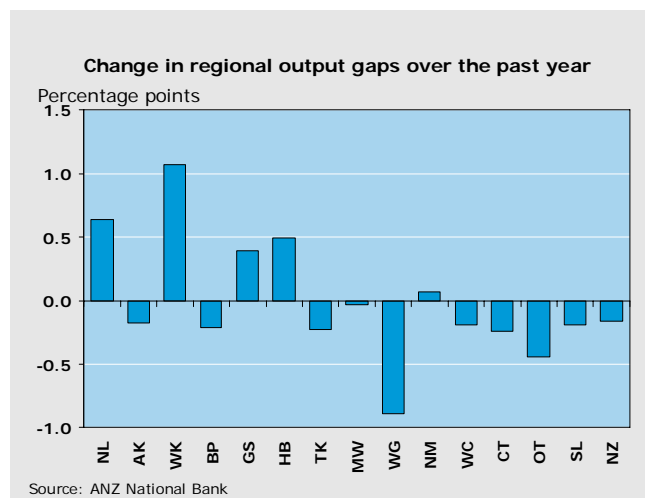
- **The economy-wide output gap is still positive, but only just.** Although excess demand has eased, economic activity is still at a level that generates inflationary pressures and is keeping the Reserve Bank on a tightening bias.
- **The rural aligned regions in the North have the greatest level of excess demand.** Gisborne, Waikato, Taranaki, Northland and Manawatu/Wanganui are the regions where the largest output gaps are present.



- **The main urban centres of Auckland and Wellington, as well as the majority of the South Island are not contributing excessively to capacity pressures.** This mirrors recent retail sales data which shows consumer spending in the Waikato region and the North Island as a whole growing faster than regions in the South Island. The December quarter QSBO report also reported a similar

story, with North Island firms more confident than those in the South.

- **Capacity pressure has intensified in some regions over the year**, and once again they tend to be rural aligned regions, including the Waikato, Gisborne, Hawke's Bay and Northland.



- **The strength of rural aligned regions highlights the significant role commodity prices have played** in this economic cycle. Admittedly there are a host of other reasons behind some regions' performance including globalisation, infrastructure, Auckland trickle down (Waikato), tourism (Otago) and catch-up. But stepping back it is difficult to go past the surge in soft commodity prices, which in world price terms are 38 percent above their 21 year average. This has underpinned a doubling in rural land prices in the past five years and strong follow-on for the regions. To put this in perspective, the NZD is 15 percent above its average over the same period. Sure, we are aware of nervousness in the sector (notably meat and wool) with the chequebook being closed, a large number of rural properties being put on the market and a high NZD and increasing costs eating into profits. However, we find it difficult to go past our analysis, which shows the rural regions as the pace-setters.
- **Continued strength in commodity prices implies the rural sector could quickly reflate**, particularly if the NZD was to give ground, given where commodity prices currently reside. World prices for key exports have risen 13 percent in the past year. Dairy prices are up 40 percent in six months! Next season's dairy payout could be a monster, even with the NZD at current levels.

### The upshot

A continued slow-down in the rural sector is a necessary condition for capacity pressures to abate. While there are strong anecdotes of the chequebook being closed, strength in commodity prices suggests this may not extend into a clear moderating trend.

## SUBPRIME WOES: SHOULD NZ BE WORRIED?

**Subprime concerns in the US highlight potential vulnerabilities that could emerge in a housing market slowdown. However, differences between NZ's mortgage market and the US subprime market mean NZ is unlikely to undergo similar stresses in a housing downturn. Nonetheless, a more highly leveraged NZ household highlights the potential for a sharp turn in the household sector.**

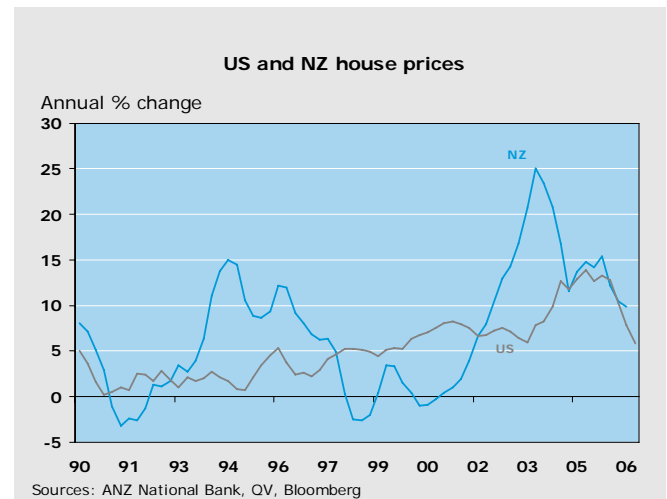
**The fallout from the US subprime mortgage market was the cause of last week's global financial market volatility.** As we noted in last week's *Market Focus*, it was the one risk which we saw as possibly having a more material effect than the global market correction of three weeks ago. Here, we make some observations on recent subprime developments and draw some analogies with the New Zealand mortgage market.

**Subprime refers to mortgages that are targeted at borrowers with no or poor credit histories** or those who do not meet 'traditional' lending criteria. Subprime borrowers pay at least 2 to 3 percent above conventional rates. There has been huge growth in the US subprime mortgage market in recent years, with subprime originations accounting for 20 percent of all mortgages during the past two years. Historically they have accounted for 10 to 12 percent of the total mortgage market.

**A slowing US housing market and higher interest rates have resulted in increased delinquencies at the subprime end of the market**, compounded by declining lending standards. The strong growth in the US housing market of the past few years, low interest rates (Fed Funds rate reached a low of 1 percent in June 2003 and stayed there for a year) and low barriers to entry saw increased competition for the subprime market. This led to lowering of standards which included no-documentation lending, 100 percent and interest only loans, negative amortisation (where debt servicing payments were not covering interest charges so the shortfall was added to the principal), and adjustable-rate mortgages where lower interest rates were offered for a fixed period before reverting to standard subprime rates. When house prices were rising, there was sufficient equity to cover any foreclosures. But when the US housing market began to turn and delinquencies rose, many defaulters were left with negative equity and lenders suffered losses as a result.

**The New Zealand property market looks equally if not more vulnerable than US equivalents.** New Zealand has experienced a larger housing cycle than the US, and is more highly leveraged (US 135 percent, NZ 160 percent

debt to income ratio). The interest bearing debt servicing burden of New Zealand households is higher than their US counterparts reflecting higher interest rates, and New Zealand household assets are less diversified compared to the US, with housing dominating the portfolio. New Zealand's poor current account position leaves it more vulnerable to a change in foreign investor sentiment. It did not take an outright fall in house prices to tip the US subprime sector over, with nationwide house price growth in the US easing from a peak of 15 percent, to under 6 percent currently.



Yet there are also key differences.

- **The US sub-prime market is fully-developed, and only developing in New Zealand.** Mortgage lending by non-bank institutions (a proxy for the riskier end) accounts for just over 5 percent of total home lending.
- **The New Zealand lending market is more heavily dominated by major players who are heavily supervised.** The top five banks account for more than 80 percent of NZ lending, and are subject to heavily monitored internal controls, governance and regulatory structures including the Reserve Bank's prudential supervision.
- **New Zealand's borrowing statistics are inflated by lending for non-housing related purposes.** Slapping it on the mortgage is a favoured way for small businesses to expand. This exaggerates debt loading stresses in the housing sector.
- **New Zealand fiscal policy is dampening financial stresses**, notably through the working for families package.
- **We noticed that some regions in the NZ property market turned aggressively (such as Nelson) in 2005** following a period of strong price rises. The US experience also suggests that the regions that experienced the

highest gains are those that could potentially show the largest falls.

Moreover, the experience from New Zealand in mid-2006 (various finance companies stresses) was that microeconomic issues and firm level difficulties need not turn into systemic issues.

**The fallout from the US subprime market appeared to be contained at present.** The Federal Reserve and US Treasury appear confident that the stresses experienced in the subprime mortgage market will be contained and any spillover into the wider economy will be minimal. The two largest underwriters of mortgage-backed securities have noted that subprime problems were largely contained and will not have a large impact on their profits. But there is still uncertainty amongst investors as to the full extent of any spillover. For now, a low unemployment rate and continued access to credit at the prime end of the market will limit any fallout.

**This does not mean New Zealand gets off scott free.** The fallout from the US subprime market has the potential to spread to other sectors of the US economy, and the US economy remains the bellwether for global growth. We expect continued repricing of risk, although we would characterise this as a move from an exceptional period of low volatility and risk seeking era, to a still low and but more cautious environment.

## Financial Market Implications

We remain wary of reading too much into US subprime activities. In our eyes it looks analogous to the industry and firm specific difficulties across a few NZ finance companies in mid 2006. Differences between the New Zealand mortgage market and the sub-prime market in the US suggest that we will be unlikely to undergo similar stresses. Nonetheless, given the larger housing cycle that New Zealand is going through, and the more indebted nature of New Zealand households, it does highlight the greater vulnerability in the New Zealand market and potential to turn sharply.

## INTEREST RATE STRATEGY

**The market is expected to test an April rate hike theme given strong housing market data. Strong payside bias will remain but swap yields to remain range-bound with global moves dictating.**

### Market themes...

- Payside bias to remain strong.
- Flows to play dominant role this week.
- Lack of local data means offshore moves and sentiment to dictate.

### Outlook...

The market is back to pricing in a reasonable chance of a further rate hike, with a 50 percent probability priced in by June. Strong housing market data released last week showed no signs of the moderation that the Reserve Bank is looking for. Comfortingly, it did not show an acceleration either, but the rise in median house prices to a new record high will be a concern. There is a lack of any major local data this week to provide direction for the rates market, but the dataflow in the lead-up to the OCR *Review* on 26 April is likely to print on the strong side. This reinforces the upside risk we see to rates, and will keep the bias strongly towards the payside.

Globally, the tightening cycle continues, with the Swiss and Norwegian central banks hiking rates and maintaining a tightening bias. ECB officials continue to talk hawkishly and there is a chance that ECB rates could go past 4 percent. The RBA sees their recent inflation forecast as still higher than ideal, with inflation risks pointed to the upside. The market has now priced in a 50 percent probability of a hike by July, after earlier ruling out any chance of a rate hike.

In the US, despite worries about the subprime mortgage market and its effect on the US economy, the fact that core inflation remains elevated at 2.7 percent and capacity utilisation remains high reduces the prospects of the Fed cutting interest rates anytime soon. The market continues to test an early easing theme, with over 50 percent probability of a June cut priced in and two cuts fully priced in by the end of the year. This week's FOMC decision will be crucial in revealing the Fed's thinking on current developments. We expect the Fed to maintain their tightening bias, despite downgrading their assessment of US economic growth.

Flows and mortgage book paying are expected to play the dominant role in the interest rate market this week. Offshore moves, particularly subprime worries, will dictate.

| Gauges for NZ interest rates yields |           |  |
|-------------------------------------|-----------|--|
| Gauge                               | Direction | Comment  |
| RBNZ                                | ↔/↑       | March delivered. Case of wait and see for follow-up.                   |
| NZ data                             | ↔         | No major data this week to provide direction.                          |
| Fed Funds/front end                 | ↓         | Market testing mid-year Fed cuts but inflation to be a sticking point. |
| RBA                                 | ↑         | Risk of rates rising given RBA concerns on inflation risks.            |
| US 10 year                          | ↔/↓       | Tug-of-war between persistent inflation and subprime worries.          |
| NZ swap spreads                     | ↔         | Mortgage and corporate flows should see EFPs test wider                |
| Flow                                | ↔         | Reaching receive side levels with 2-year above 7.85 percent.           |
| Technicals                          | ↔         | NZ IRS markets have decoupled from global markets. NZD key.            |

### Borrowing strategies we recommend at present

NZ yields continued to grind higher last week as the market digested the possibility of another hike over coming months. Clients should look to utilise the inverted New Zealand yield curve between 3-5 years to deliver some savings over floating rates while protect themselves against the possibility of the New Zealand economy continuing to surprise in staying stronger for longer than was initially anticipated. Extendable swaps that take a view on the market can offer clients a pickup on ordinary swap pricing over the next couple of years.

### Probability of 25bps increase as implied by market pricing

| OCR dates     | Last week | This week |
|---------------|-----------|-----------|
| Thu 26-Apr-07 | 20        | 40        |
| Thu 7-Jun-07  | 36        | 52        |
| Thu 26-Jul-07 | 36        | 52        |
| Thu 13-Sep-07 | 44        | 52        |
| Thu 25-Oct-07 | 32        | 52        |
| Thu 6-Dec-07  | 20        | 44        |
| Thu 24-Jan-08 | 8         | 36        |

### Trading themes we favour at present

We favour curve inversion trades. The brunt of payside pressure will come in the 1 and 2-year, and should there be further weakness in global equities the long end will bear the brunt of it.

## CURRENCY STRATEGY

**The NZD remains caught between yield related support and oscillating risk appetites. With the NZD grinding up last week courtesy of the former, the story this week looks to be the reverse. USD/JPY and equities remain the key barometers.**

### Market themes...

- Yield demand remains firm but risk appetites are oscillating.
- NZD rides in the AUD's pouch.
- USD under pressure via subprime woes.
- Chinese raise rates, reinforces Asian crosses.

### Outlook...

The NZD remains caught in the rip of yield related support and oscillating risk appetites. Ranges continue to etch out, although considerably more volatile than normal.

The domestic story remains one of yield related support. The RBNZ's tightening bias makes it unlikely that interest rate differentials close from the NZ side anytime soon. Further support is being provided by improving soft commodity prices, which are insulating key pockets of the rural economy from the impact of NZD strength. In any normal environment the NZD would be headed up.

However, internationally, the story remains one of unease. Asset prices are priced for the goldilocks of economic outcomes (strong growth and low inflation). Yet the current macro pulse continues to suggest otherwise. The US economy no longer looks invincible, and there are disconcerting inflation signals around the globe when looking at unit labour cost, productivity, intermediate input and soft commodity price inflation. None suggest inflation is a problem, but the mere prospect of stickiness will present valuation challenges to markets. Equities and commodities look set to remain vulnerable to large swings in sentiment in this environment, risk appetites to wax and wane, and volatility to remain high. In this environment any topside prodding in the NZD looks capped.

Positioning is likely to continue having a major say. IMM positioning data released on Friday night shows overall net short US dollar positions increased to US\$7.5bn in the week ending 13 March (from US\$4.6bn the previous week). Concerns emanating from the US subprime lending market have prompted speculators to cut back on risky trades (often resulting in buying back of yen - net yen short positions were cut from 62,886 contracts to 52,853 contracts). At the same time, speculative net long positioning in the euro and AUD increased over the week.

Yen strength on the back of Chinese interest rate moves over the weekend (raising their benchmark one-year lending rate by 27 basis points to 6.39 percent and the one-year deposit rate to 2.79 percent) along with ongoing concerns about the subprime situation should continue to erode USD support, and the USD/JPY looks vulnerable.

Key technical levels to watch in the NZD/USD remain 0.7040 (the early March high) and 0.6880 (daily uptrend support from 6 March). A break of either side opens the door. With the NZD grinding up last week courtesy of yield, the story this week looks to be about risk, and the bottom end of the ranges to be the targets. Keep a close eye on developments in the USD/JPY as USD weakness may alter the tone.

| NZD vs AUD: monthly directional gauges |           |  |
|--|-----------|--|
| Gauge                                  | Direction | Comment  |
| Fair value                             | ↓         | Above the 0.85-0.88 zone.                                    |
| Yield                                  | ↓         | AUD to outperform on hawkish RBA Deputy Governor's comments. |
| Commodities                            | ↔         | Base metals remain strong, but dairy rising.                 |
| Partial indicators                     | ↔         | Talk of rate cuts in Aus turns to talk of rate hikes.        |
| Technicals                             | ↔         | Consolidating in middle of broad range. 0.8700 key.          |
| Sentiment                              | ↔         | Tough talk from RBA helps AUD.                               |
| Other                                  | ↔         | AUD/USD 0.80 very important level.                           |
| <b>On balance</b>                      | ↔         | <b>Broad consolidation, downside bias.</b>                   |

| NZD vs USD: monthly directional gauges |           |  |
|--|-----------|--|
| Gauge                                  | Direction | Comment  |
| Fair value – long-term                 | ↓         | Fair value moving higher given a structural shift in commodity prices. |
| Fair value – short-term                | ↔         | NZD more fairly valued on commodity models.                            |
| Yield                                  | ↑         | NZ yield attractive. Period.   |
| Commodities                            | ↔         | Insulation from dairy prices, forestry improving.                      |
| Risk aversion                          | ↓         | Talk that US equities begin next leg lower.                            |
| Partial indicators                     | ↔         | US CPI strong, but growth concerns remain.                             |
| Technicals                             | ↔         | Caught in sideways drift between yield/USD weakness and risk aversion. |
| AUD                                    | ↔/↑       | AUD strength dragging NZD higher.                                      |
| Sentiment                              | ↔         | Wariness.  |
| Other                                  | ↔         | Range defined.   |
| <b>On balance</b>                      | ↔         | <b>Carry vs risk aversion.</b>   |

## DATA AND EVENT CALENDAR

| Date   | Country   | Data/Event   | Mkt.    | Last         | Time (NZST)  |
|--------|-----------|--|---------|--------------|--------------|
| Mar 19 | JN        | Nationwide Department Store Sales (Feb) – yoy                  | -       | 0.0%         | 17:30        |
|        | US        | Treasury's Kimmitt Talks About Trade and the Economy in Berlin | -       | -            | 20:00        |
| Mar 20 | US        | NAHB Housing Market Index (Mar)                                | 38      | 40           | 05:00        |
|        | <b>NZ</b> | <b>Visitor Arrivals</b>  | -       | <b>-3.2%</b> | <b>10:45</b> |
|        | AU        | Dwelling Starts (4Q)   | -0.8%   | 0.3%         | 12:30        |
|        | JN        | Bank of Japan Target Rate                                      | 0.5%    | 0.5%         | -            |
|        |           | Bank of Japan to Release Monthly Economic Survey               | -       | -            | 18:00        |
|        |           | BoJ Governor Fukui to Hold Press Conference                    | -       | -            | 18:30        |
|        | GE        | Producer Prices (Feb) – mom                                    | 0.3%    | 0.0%         | 19:00        |
|        |           | Producer Prices (Feb) – yoy                                    | 2.8%    | 3.2%         | 19:00        |
|        | UK        | CPI (Feb) – mom  | 0.3%    | -0.8%        | 21:30        |
|        |           | CPI (Feb) – yoy  | 2.7%    | 2.7%         | 21:30        |
|        |           | CPI – core (Feb) – yoy   | 1.7%    | 1.6%         | 21:30        |
|        |           | RPI (Feb) – mom  | 0.5%    | -0.5%        | 21:30        |
|        |           | RPI (Feb) – yoy  | 4.3%    | 4.2%         | 21:30        |
|        |           | RPI – ex Mortgage Interest Payments (Feb) – yoy                | 3.5%    | 3.5%         | 21:30        |
|        |           | Public Sector Net Borrowing (Feb)                              | 2.3B    | -10.3B       | 21:30        |
|        |           | Public Finances (PSNCR) (Feb)                                  | 2.0B    | -21.4B       | 21:30        |
|        |           | M4 Money Supply (Feb P) – mom                                  | 0.8%    | 0.9%         | 21:30        |
|        |           | M4 Money Supply (Feb P) – yoy                                  | 12.8%   | 13.0%        | 21:30        |
|        |           | M4 Sterling Lending (Feb P)                                    | 15.6B   | 31.6B        | 21:30        |
|        | EU        | Construction Output (Jan) – mom                                | -       | 0.5%         | 22:00        |
|        |           | Construction Output (Jan) – yoy                                | -       | 6.9%         | 22:00        |
| Mar 21 | US        | Housing Starts (Feb)   | 1,450k  | 1,408k       | 00:30        |
|        |           | Building Permits (Feb)   | 1,550k  | 1,568k       | 00:30        |
|        | AU        | ABC Westpac Leading Index (Jan) – mom                          | -       | 0.6%         | 11:30        |
|        |           | New Motor Vehicle Sales (Feb) – mom                            | -       | 5.3%         | 12:30        |
|        | <b>NZ</b> | <b>Credit Card Spending (Feb) – yoy</b>                        | -       | <b>6.7%</b>  | <b>15:00</b> |
|        | EU        | ECB's Trichet Speaking to European Parliament in Brussels      | -       | -            | 20:00        |
|        | UK        | Bank of England Minutes  | -       | -            | 21:30        |
| Mar 22 | UK        | UK Chancellor of the Exchequer Makes Budget Statement          | -       | -            | 00:30        |
|        |           | Retail Sales (Feb) – mom                                       | 0.5%    | -1.8%        | 21:30        |
|        |           | Retail Sales (Feb) – yoy                                       | 3.7%    | 3.3%         | 21:30        |
|        | US        | FOMC Rate Decision   | 5.25%   | 5.25%        | 06:15        |
|        | JN        | Merchandise Trade Balance (Feb)                                | ¥711.5B | -¥1.9B       | 11:50        |
|        |           | Adjusted Merchandise Trade Balance (Feb)                       | ¥425.6B | ¥1,086.2B    | 11:50        |
|        | EU        | Euro-Zone Trade Balance (Jan)                                  | -1.0B   | 2.5B         | 22:00        |

Continued over page

| Date         | Country | Data/Event   | Mkt.  | Last  | Time (NZST) |
|--------------|---------|--|-------|-------|-------------|
| Mar 22 cont. | EU      | Euro-Zone Trade Balance s.a. (Jan)                           | 2.3B  | 0.7B  | 22:00       |
|              |         | Industrial New Orders (Jan) – mom                            | -1.0% | 2.8%  | 22:30       |
|              |         | Industrial New Orders (Jan) – yoy                            | 8.4%  | 1.6%  | 22:30       |
| Mar 23       | US      | Leading Indicators (Feb)                                     | -0.4% | 0.1%  | 02:00       |
|              |         | Fed's Kroszner Speaks on Credit Markets in North Carolina    | -     | -     | 04:00       |
|              |         | Fed's Lacker Gives Introductory Remarks at Conference        | -     | -     | 04:00       |
|              | AU      | Conference Board Leading Index (Jan)                         | -     | 0.2%  | 11:00       |
|              | JN      | All Industry Activity Index (Jan) – mom                      | -0.1% | 0.0%  | 11:50       |
|              | EU      | ECB Euro-Zone Current Account (Jan)                          | 2.5B  | 2.3B  | 21:00       |
|              |         | Euro-Zone Current Account (Jan) – n.s.a.                     | -     | 5.0B  | 21:00       |
|              |         | ECB's Stark Speaks at Conference in Berlin                   | -     | -     | 23:00       |
| Mar 24       | US      | Fed's Lacker Moderates Panel on Liquidity Risk at Conference | -     | -     | 00:30       |
|              |         | Fed's Plosser Speaks to N.J. Bankers in West Palm Beach      | -     | -     | 01:15       |
|              |         | Existing Home Sales (Feb)                                    | 6.35m | 6.46m | 02:00       |
|              |         | Existing Home Sales (Feb) – mom                              | -2.5% | 3.0%  | 02:00       |
|              |         | Fed's Geithner Speaks at Credit Markets Symposium            | -     | -     | 03:30       |
|              |         | Fed's Lacker Give Introductory Remarks at Conference         | -     | -     | 03:30       |
|              |         | Fed's Mishkin Speaks on Inflation Dynamics in San Francisco  | -     | -     | 14:15       |
|              | EU      | ECB's Papademos Speaks in Amsterdam                          | -     | -     | 02:00       |

Key: AU: Australia, CA: Canada, EU: European Union, GE: Germany, JP: Japan, NZ: New Zealand, UK: United Kingdom, US: United States.

Source: Dow Jones, Reuters, Bloomberg, ANZ National Bank. All \$ values in local currency. Na= not available. (Note: all surveys are preliminary and subject to change).

## NEW ZEALAND DATA WATCH

**Key focus over next four weeks:** All partial indicators for December quarter GDP have now been released and confirmed that the economy likely expanded strongly at the end of 2006. However, the key focus remains Q1 and whether this strength has been sustained. Reads on Q1 to date have been mixed and partial indicators released in the coming weeks will paint a clearer picture. In this regard, the February National Bank *Business Outlook* due at the end of the month is key.

| Date               | Data/Event   | Economic Signal                                 | Comment   |
|--------------------|--|---|---|
| Tue 20 Mar (10.45) | External Migration (Feb)                               | Steady  | After an easing in recent migration gains, we expect annual migration to stabilise at around 14,000 per annum.  |
| Wed 21 Mar (15.00) | Credit Card Billings (Feb)                             | Steady  | A modest rebound expected after January's decline, but not strongly accelerating away.  |
| Mon 26 Mar (10.45) | Merchandise Trade (Feb)                                | Imbalanced                                      | An improvement in the monthly trade deficit is expected. Exports to be supported by higher commodity prices, although higher oil prices will add to imports.                                    |
| Wed 28 Mar (1.00)  | Westpac McDermott Miller Consumer Confidence (Mar qtr) | Increasing                                      | With a still buoyant labour market, and consumer spending remaining solid, consumer confidence is likely to have increased in the quarter.  |
| Wed 28 Mar (10.45) | Building Consents (Feb)                                | Easing  | We expect building consents to continue its recent easing trend.  |
| Thu 29 Mar (10.45) | Balance of Payments (Dec qtr)                          | Large   | We expect the current account deficit to post a slight improvement although still remain at an unsustainable level.   |
| Thu 29 Mar (15.00) | Credit Growth (Feb)                                    | Strong  | Credit growth continues to show limited evidence of slowing. We expect another 1.0 percent month.   |
| Fri 30 Mar (10.45) | Gross Domestic Product (Dec qtr)                       | Strong  | Q4 GDP growth is shaping up to print at 1.0 percent after a weak result in Q3, driven by domestic demand with the net external sector subtracting from growth.                                  |
| Fri 30 Mar (15.00) | National Bank <i>Business Outlook</i> (Mar)            | -   | -   |
| Thu 5 Apr (15.00)  | ANZ Commodity Price Index (Mar)                        | -   | -   |
| Tue 10 Apr (10.00) | NZIER Quarter Survey of Business Opinion (Mar qtr)     | Continued strenght                              | Despite the recent increase in interest rates, confidence is likely to remain strong. Further pull-back in capacity utilisation is also expected, although it will remain at an elevated level. |
| Fri 13 Apr (10.45) | Retail Trade Survey (Feb)                              | Stabilisation                                   | Consumer spending is expected to show further modest increases, although trend measures will continue to stabilise and show limited evidence of acceleration.                                   |
| <b>On Balance</b>  |  | <b>Q4 strength but early signs of Q1 mixed.</b> | <b>Strong momentum end of last year. Still questions over 2007. Partials relating to Q1 mixed to date, with the Reserve Bank's 0.8 percent GDP forecast looking a tad high at this stage.</b>   |

### NZ Economics

**Cameron Bagrie**  
Chief Economist  
+64 4 802 2212

**Sean Comber**  
Economist  
+64 4 802 2286

**Philip Borkin**  
Economist  
+64 4 802 2199

**Khoon Goh**  
Interest Rate Strategist  
+64 4 802 2357

**Steve Edwards**  
Economist  
+64 4 802 2217

**Kevin Wilson**  
Rural Economist  
+64 4 802 2361

## SUMMARY OF KEY MARKET FORECASTS

| NZ FX rates       | Actual |        | Current   | Forecast (end month) |        |        |        |        |        |        |
|-------------------|--------|--------|-----------|----------------------|--------|--------|--------|--------|--------|--------|
|                   | Jan 07 | Feb 07 | 19 Mar 07 | Mar 07               | Jun 07 | Sep 07 | Dec 07 | Mar 08 | Jun 08 | Sep 08 |
| NZD/USD           | 0.695  | 0.694  | 0.695     | 0.700                | 0.680  | 0.640  | 0.620  | 0.600  | 0.580  | 0.550  |
| NZD/AUD           | 0.888  | 0.887  | 0.875     | 0.909                | 0.895  | 0.853  | 0.849  | 0.833  | 0.817  | 0.786  |
| NZD/EUR           | 0.535  | 0.530  | 0.522     | 0.530                | 0.523  | 0.496  | 0.481  | 0.472  | 0.464  | 0.447  |
| NZD/JPY           | 83.7   | 83.7   | 80.9      | 84.0                 | 79.6   | 72.3   | 68.2   | 64.8   | 61.5   | 59.4   |
| NZD/GBP           | 0.355  | 0.354  | 0.358     | 0.361                | 0.354  | 0.337  | 0.328  | 0.321  | 0.312  | 0.299  |
| NZ\$ TWI          | 69.1   | 68.9   | 68.1      | 69.5                 | 67.7   | 63.7   | 61.7   | 60.0   | 58.2   | 55.8   |
| NZ interest rates | Jan 07 | Feb 07 | 19 Mar 07 | Mar 07               | Jun 07 | Sep 07 | Dec 07 | Mar 08 | Jun 08 | Sep 08 |
| OCR               | 7.25   | 7.25   | 7.50      | 7.50                 | 7.50   | 7.50   | 7.50   | 7.50   | 7.50   | 7.50   |
| 90 day bill       | 7.70   | 7.74   | 7.90      | 7.80                 | 7.70   | 7.60   | 7.60   | 7.60   | 7.60   | 7.60   |
| 10 year bond      | 5.93   | 5.96   | 5.92      | 5.80                 | 6.00   | 6.10   | 6.10   | 6.00   | 6.00   | 5.90   |
| International     | Jan 07 | Feb 07 | 19 Mar 07 | Mar 07               | Jun 07 | Sep 07 | Dec 07 | Mar 08 | Jun 08 | Sep 08 |
| US Fed funds      | 5.25   | 5.25   | 5.25      | 5.25                 | 5.25   | 5.25   | 4.75   | 4.75   | 4.75   | 5.00   |
| US 3-mth          | 5.36   | 5.35   | 5.35      | 5.32                 | 5.40   | 5.00   | 4.60   | 4.75   | 4.90   | 5.25   |
| AU cash           | 6.25   | 6.25   | 6.25      | 6.25                 | 6.25   | 6.25   | 6.25   | 6.25   | 6.25   | 6.25   |
| AU 3-mth          | 6.39   | 6.35   | 6.36      | 6.30                 | 6.40   | 6.40   | 6.40   | 6.40   | 6.40   | 6.40   |

## KEY RATES

|                         | 16 Feb | 12 Mar | 13 Mar | 14 Mar | 15 Mar | 16 Mar |
|-------------------------|--------|--------|--------|--------|--------|--------|
| Official Cash Rate      | 7.25   | 7.50   | 7.50   | 7.50   | 7.50   | 7.50   |
| 30 day bank bill        | 7.61   | 7.76   | 7.76   | 7.76   | 7.76   | 7.78   |
| 90 day bank bill        | 7.76   | 7.88   | 7.89   | 7.89   | 7.88   | 7.90   |
| NZGB 07/09              | 6.57   | 6.76   | 6.77   | 6.76   | 6.79   | 6.84   |
| NZGB 11/11              | 6.35   | 6.49   | 6.49   | 6.46   | 6.49   | 6.54   |
| NZGB 04/13              | 6.15   | 6.21   | 6.21   | 6.17   | 6.20   | 6.25   |
| NZGB 12/17              | 5.92   | 5.86   | 5.86   | 5.80   | 5.84   | 5.89   |
| 1 year swap             | 7.92   | 7.97   | 7.98   | 7.97   | 7.97   | 8.01   |
| 2 year swap             | 7.74   | 7.82   | 7.83   | 7.81   | 7.83   | 7.88   |
| 5 year swap             | 7.34   | 7.47   | 7.48   | 7.45   | 7.48   | 7.53   |
| RBNZ TWI                | 68.7   | 68.6   | 68.5   | 67.5   | 68.2   | 68.1   |
| NZD/USD                 | 0.6936 | 0.6929 | 0.6948 | 0.6848 | 0.6926 | 0.6939 |
| NZD/AUD                 | 0.8854 | 0.8875 | 0.8845 | 0.8766 | 0.8808 | 0.8772 |
| NZD/JPY                 | 83.31  | 81.94  | 81.62  | 79.53  | 81.21  | 81.09  |
| NZD/GBP                 | 0.3534 | 0.3583 | 0.3597 | 0.3550 | 0.3578 | 0.3579 |
| NZD/EUR                 | 0.5283 | 0.5283 | 0.5270 | 0.5192 | 0.5238 | 0.5218 |
| AUD/USD                 | 0.7834 | 0.7807 | 0.7855 | 0.7812 | 0.7863 | 0.7910 |
| EUR/USD                 | 1.3130 | 1.3115 | 1.3185 | 1.3189 | 1.3223 | 1.3299 |
| USD/JPY                 | 120.11 | 118.26 | 117.47 | 116.14 | 117.25 | 116.86 |
| GBP/USD                 | 1.9627 | 1.9339 | 1.9315 | 1.9291 | 1.9356 | 1.9389 |
| Oil                     | 57.92  | 58.94  | 58.94  | 58.03  | 58.15  | 57.52  |
| Gold                    | 669.75 | 650.40 | 650.60 | 641.10 | 645.30 | 646.80 |
| Electricity Price Index | 4.09   | 6.56   | 6.47   | 6.44   | 6.38   | 6.11   |

## Important Notice

Australia and New Zealand Banking Group Limited is represented in:

AUSTRALIA by:

Australia and New Zealand Banking Group Limited ABN 11005 357 522

10th Floor 100 Queen Street, Melbourne 3000, Australia

Telephone +61 3 9273 6224 Fax +61 3 9273 5711

UNITED KINGDOM by:

Australia and New Zealand Banking Group Limited

ABN 11 005 357 522

Minerva House, PO Box 7, Montague Close, London, SE1

9DH, United Kingdom

Telephone +44 20 7378 2121 Fax +44 20 7378 2378

UNITED STATES OF AMERICA by:

ANZ Securities, Inc. (Member of NASD and SIPC)

6th Floor 1177 Avenue of the Americas

New York, NY 10036, United States of America

Tel: +1 212 801 9160 Fax: +1 212 801 9163

NEW ZEALAND by:

ANZ National Bank Limited

Level 7, 1-9 Victoria Street, Wellington, New Zealand

Telephone +64 4 802 2000

In Australia and the UK, ANZ Investment Bank ("ANZIB") is a business name of Australia and New Zealand Banking Group Limited, ABN 11 005 357 522 ("ANZ Bank"), which holds an Australian Financial Services licence no. 234527 and is authorised in the UK by the Financial Services Authority ("FSA"). In New Zealand, ANZ Investment Bank is a business name of ANZ National Bank Limited WN / 035976 ("ANZ NB").

This document is being distributed in the United States by ANZ Securities, Inc. ("ANZSI") (an affiliated company of ANZ Bank), which accepts responsibility for its content. Further information on any securities referred to herein may be obtained from ANZSI upon request. Any US person(s) receiving this document and wishing to effect transactions in any securities referred to herein should contact ANZSI, not its affiliates.

This document is being distributed in the United Kingdom by ANZ Bank for the information of its market counterparties and intermediate customers only. It is not intended for and must not be distributed to private customers. In the UK, ANZ Bank is regulated by the FSA. Nothing here excludes or restricts any duty or liability to a customer, which ANZ Bank may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the FSA. This document is issued on the basis that it is only for the information of the particular person to whom it is provided. This document may not be reproduced, distributed or published by any recipient for any purpose. This document does not take into account your personal needs and financial circumstances. Under no circumstances is this document to be used or considered as an offer to sell, or a solicitation of an offer to buy. In addition, from time to time ANZ Bank, ANZ NB, ANZSI, their affiliated companies, or their respective associates and employees may have an interest in any financial products (as defined by the Australian Corporations Act 2001), securities or other investments, directly or indirectly the subject of this document (and may receive commissions or other remuneration in relation to the sale of such financial products, securities or other investments), or may perform services for, or solicit business from, any company the subject of this document. If you have been referred to ANZ Bank, ANZ NB, ANZSI or their affiliated companies by any person, that person may receive a benefit in respect of any transactions effected on your behalf, details of which will be available upon request. The information herein has been obtained from, and any opinions herein are based upon, sources believed reliable.

The views expressed in this document accurately reflect the author's personal views, including those about any and all of the securities and issuers referred to herein. The author however makes no representation as to its accuracy or completeness and the information should not be relied upon as such. All opinions and estimates herein reflect the author's judgement on the date of this document and are subject to change without notice. No part of the author's compensation was, is or will directly or indirectly relate to specific recommendations or views expressed about any securities or issuers in this document. The author's compensation will, be based upon, among other factors, the overall profitability of ANZ, including profits from investment banking revenues.

ANZ Bank, ANZ NB, ANZSI, their affiliated companies, their respective directors, officers, and employees disclaim any responsibility, and shall not be liable, for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly (and whether in tort (including negligence), contract, equity or otherwise) out of or in connection with the contents of and/or any omissions from this communication except where a Liability is made non-excludable by legislation. Where the recipient of this publication conducts a business, the provisions of the Consumer Guarantees Act 1993 (NZ) shall not apply.