

NEW ZEALAND ECONOMICS MARKET FOCUS

11 July 2011

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MORE SUBSTANCE

ECONOMIC OVERVIEW

As expected last week's improvement in business sentiment continues to hold out the allure of strengthening activity. Surveyed pricing intentions rose, but capacity gauges remained contained, which appears to have bought the RBNZ some more time. An area to watch, however, is the labour market, where surveys and the hard data are increasingly pointing to a strong improvement, which will eventually weigh on capacity. GDP data (held over from last week) is expected to come in positive, an incredible feat considering seismic challenges, and testament to the momentum the economy had at the start of the year.

FINANCIAL CONDITIONS UPDATE

Our financial conditions indexes continue to flag divergent outlooks across geographies. Financial conditions point to recovering momentum in the US and NZ, both of which have been through soft patches. In both cases the implied growth from our FCI's are above the Consensus expectation. Financial conditions point to moderating growth in China and Australia, with growth projections for both economies weaker than the market consensus.

INTEREST RATE STRATEGY

All eyes are now on the US bond market following very weak June employment data. Sovereign debt concerns have also escalated, with Italy now in the firing line. Distant as these events are, they do have the potential to spill over into New Zealand, and we need to be mindful. At this stage we are treating them as risks, and we are encouraged by the domestic data flow, which continue to point to rate rises later in the year. Where the NZD goes could become more influential, particularly if it continues to make new highs amidst the global malaise.

CURRENCY STRATEGY

As the ECB seeks to double the EU rescue fund to €1.5 trillion, with Italy looking very shaky and the US debt ceiling talks stalling, it seems there is no good news for the old economies of the west. Out of this mess it seems that the darling currency is the NZ Dollar. Chinese inflation data gives cause for concern as food prices rise over 14% YOY. The earnings season in the US kicks of this week giving the "risk on/off" watchers something to focus on.

EFFECTIVE EXCHANGE RATE UPDATE

Our effective exchange rate (EER) measures take into account the world prices of our exports (e.g. commodity prices in the case of commodity exporters), adjusted for currency movements based on their main destinations. June saw less favourable trading conditions for all of the sectors we monitor, driven by lower commodity prices and a stronger NZD. There is concern that the NZD is increasingly becoming disconnected with local fundamentals even though some sectors still have real effective exchange rates in enhancing territory.

ECONOMIC OVERVIEW

SUMMARY

As expected last week's improvement in business sentiment continues to hold out the allure of strengthening activity. Surveyed pricing intentions rose, but capacity gauges remained contained, which appears to have bought the RBNZ some more time. An area to watch, however, is the labour market, where surveys and the hard data are increasingly pointing to a strong improvement, which will eventually weigh on capacity. GDP data (held over from last week) is expected to come in positive, an incredible feat considering seismic challenges, and testament to the momentum the economy had at the start of the year.

THIS WEEK'S EVENTS

SNZ Food Price Index – June (Wednesday, July 13, 10:45am). A 0.7 percent increase in food prices is expected.

REINZ housing market report - June (Thursday, July 14, 10:00am). We expect sales volumes and prices to be unchanged on last month.

BNZ Business NZ Manufacturing PMI - June (Thursday, July 14, 10.30am). The headline manufacturing PMI is expected to ease slightly from 54.7 in May.

SNZ Gross Domestic Product – 2011Q1 (Thursday, July 14, 10:45am). We expect a 0.4 percent increase in production-based GDP (+0.6 percent y/y). See our preview in last week's *Market Focus* for details.

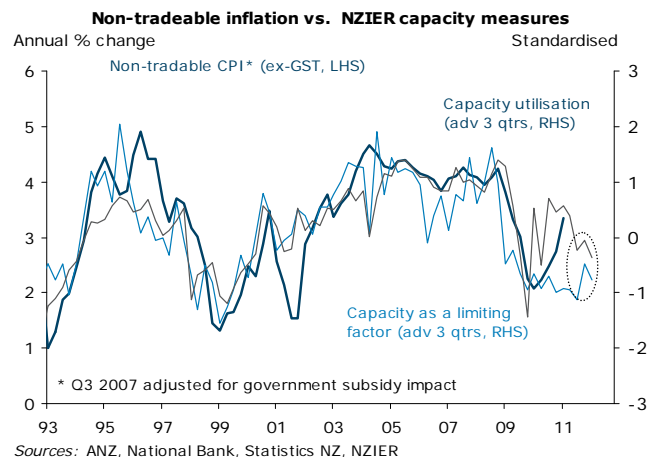
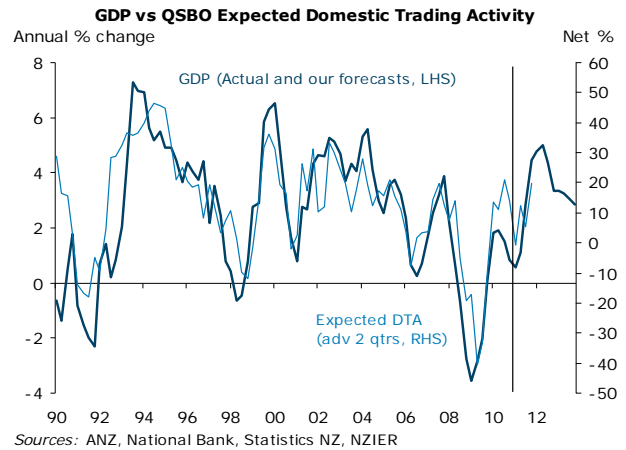
ANZ Roy Morgan Consumer Confidence – July (Thursday, July 14, 1:00pm).

WHAT'S THE VIEW?

The QSBO replicated other leading gauges such as the National Bank *Business Outlook* and holds out the prospect of a firming recovery. The improvement in past and expected domestic trading activity (to +4 and +20 respectively) is consistent with positive (and increasing) rates of growth in Q2 and Q3. Investment intentions firmed, with strengthening sentiment for architects over the next 12 months implying a fairly speedy construction sector response. **These are all messages that are consistent with the economy gaining momentum as 2011 progresses and in line with our forecasts.**

While surveyed pricing intentions firmed, capacity pressures from the QSBO remained contained and did not provide the RBNZ with a smoking gun. Encouragingly, there remains scope for the economy to move forward. This is critical as one bug-bear we have at present is the supply-side capacity of the economy. For now we're not seeing supply-side influences really influencing capacity metrics, though it is an area we

harbour some worries about given weak productivity and low rates of business investment.



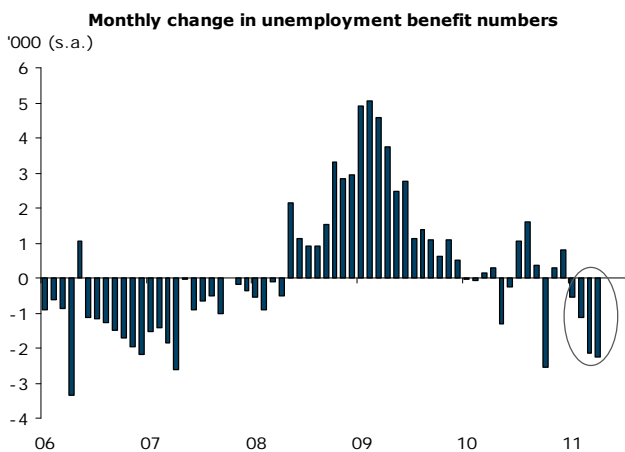
One area we did notice, however, was evidence of stronger demand for labour. QSBO gauges for hiring intentions and difficulty in finding labour (both skilled and unskilled) firmed. The labour market is a key indicator and volatility in the HLFS of late has us taking even more notice of other barometers. What we know now in regard to the labour market are:

- Skill shortages are rising. Although metrics for both skilled and unskilled labour suggest more labour market slack than post 1992 averages, they have tightened considerably since the start of the year.
- Newspaper advertising has been picking up since April. These are off lows (the job vacancy rate – the ratio of job ads to the working age population – is still dismal) so we are coy about making sweeping assessments here. However, if you include on-line advertising, which has become a substitute for the traditional newspaper medium, the picture is perkier.
- Unemployment benefit numbers for June showed a further decline (down 2,200 s.a in the month), with

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the number of people on the dole around 6,000 lower than in March. Yes, we know eligibility issues would be at work (i.e. tightened criteria) but the monthly trend still looks down. It suggests a relatively upbeat Q2 HLFS is in prospect, providing the seasonality issues have been resolved.

This looks more collectively positive to us in terms of the general direction the labour market is headed. An improving labour market portends of accelerating income growth but of course this also moves us one step closer to the degree of monetary support being reduced. And we presume the RBNZ is following the labour market closely.



Sources: ANZ, National Bank, MSD

One of the indicators we'll be paying close attention to over the coming months is migration. The past few months net outflow of permanent and long-term migrants have undoubtedly limited the available labour pool. However, as we've pointed out previously, we have seen a net outflow of 18,000 short and long-term migrants over the past year. We find it hard to believe that the lagged effects of past labour market weakness has not had an impact on migration flows. If this is indeed the case, we would expect the improving demand for labour to translate into a turnaround in migration flows towards the end of the year. We don't see migration as the main driver of the cycle here, but when it turns it can certainly add impetus to it. Hence it's an area we continue to closely monitor.

Thursday finally sees the long-awaited release of the Q1 GDP numbers. **There is a greater degree of uncertainty around these numbers than usual, particularly over the extent of likely (downward) adjustments Statistics New Zealand will make to the GDP figures to incorporate earthquake disruptions missed by their surveys.** Last week's decision by Statistics New Zealand to delay the release another week, which was announced a day before the

scheduled release date, suggests the preliminary estimates did not pass muster and it was back to the drawing board.

We expect a positive result of around 0.4 percent (see our preview in last week's *Market Focus* for further details). Excluding seismic events a 1 percent quarter was probably on offer, and part of this rebound we suspect was simply a bounce off lows in H2 2010. Even if the GDP number comes in significantly below our Q1 pick, we remain confident that the more positive that the underlying anecdotes we are seeing across the economy will end up manifesting in the data. How it is spread "officially" between quarters given seismic events is a moot point.

While GDP is of historical relevance, we are more interested in what lies ahead. Our update on financial conditions on page 5 shows **the outlook for New Zealand remains very positive**, and consistent with the June MPS projections and the forecasts we released last week in our Quarterly Economic Forecasts. US prospects remain positive (Friday's bleak job report aside), and while prospects are for a moderation in Chinese and Australian activity, encouragingly our gauges are still pointing to a soft landing. While these measures are by no means perfect, and provide the occasional false signal, they are the best thing we have got in an uncertain world.

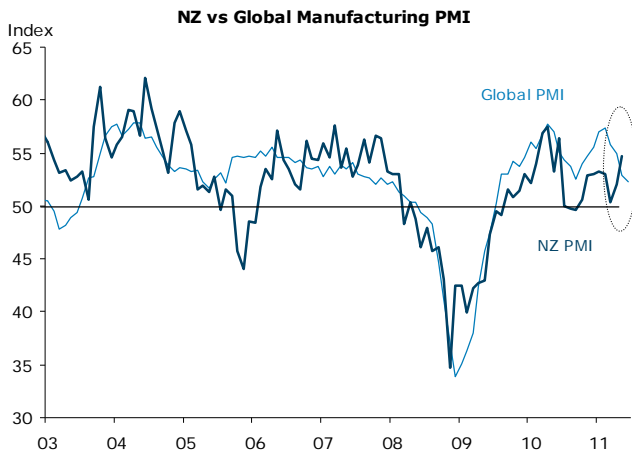
Of late, the more uncertain global uncertainties have helped blow some of the froth off commodity prices. Last week's ANZ Commodity Price Index and *GlobalDairyTrade* auction results showed a pullback of sorts, but the key takeout is that both commodity prices gauges remain at historically high levels.

Whether or not the benefits accrue to the productive sector or to consumers will depend on what happens to the NZD. **Our analysis of effective exchange rates shows quite marked differences by sector.** Pastoral farming still looks to be the star performer, with conditions in enhancing territory. It is a mixed bag for the other sectors, however, and exporters will be nervously watching the NZD. It hit a post-float high of 83.86 cents last Friday, and with the NZ story stacking up quite well compared to our competitors, has scope to move higher.

Thursday also sees the NZ manufacturing PMI for June. With the exception of the US, global gauges have eased off, with ongoing supply disruptions from the March Japanese earthquake and Tsunami likely to have been the major culprit. **A small fall in the NZ PMI is to be expected, with the high NZD/USD starting to take its toll.** Providing a buffer will be the low NZD/AUD and with primary manufacturing making up

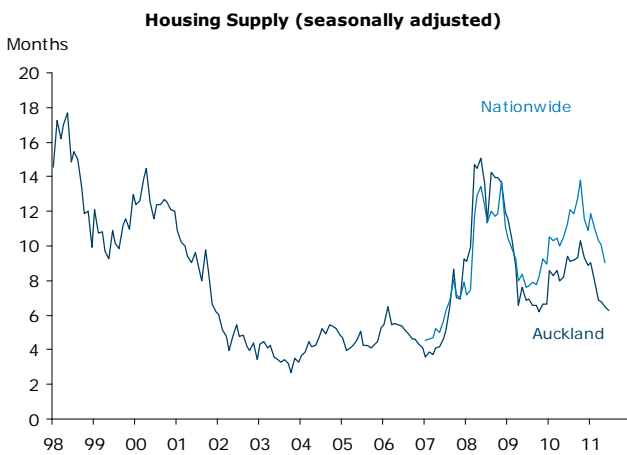
ECONOMIC OVERVIEW

about 30 percent of total New Zealand manufacturing, a strong end to the primary production season will also help.



Sources: ANZ, National Bank, Bloomberg, Business NZ

Following the 10 percent increase in May, we expect REINZ sales volumes to hold. While there is clearly scope for sales to continue recovering from historically low levels (around 25 percent below historical norms as a portion of the housing stock), a growing constraint is the shortage of listings. There are quite different regional dynamics occurring, with various pockets of strength emerging. While prices still look stretched relative to incomes, low mortgage interest rates and lower property listings continue to provide temporary support to the market.

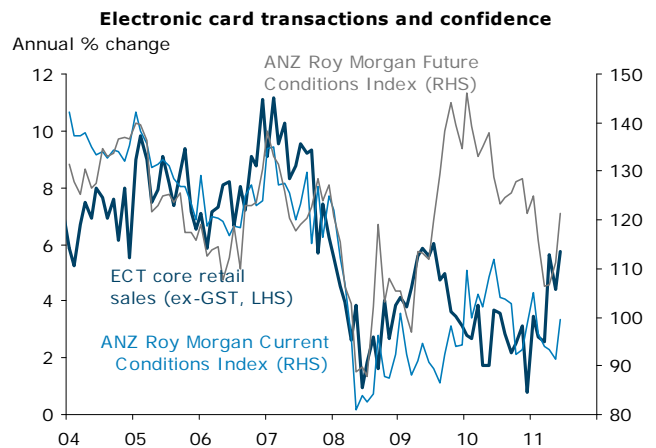


Sources: ANZ, National Bank, REINZ, www.realestate.co.nz, Barfoot

Where housing goes retail usually follows, but the recovery in June electronic card transactions has more resonance with the improvement in incomes. For this to gain traction, households must start believing there is light at the end of the tunnel after a few years of hard slog. Going by readings for consumer sentiment the view remains that things will soon get better, but not just yet. Thursday's July ANZ Roy Morgan report

for consumer confidence provides a timely update.

Our expectation for food prices is a solid 0.7 percent print, reflecting seasonal influences, the lagged effect of dairy price increases and the storm-affected spike in tomato prices. **We will be finalising our Q2 CPI pick, currently 0.8 percent, after the food price index.** It looks like annual headline inflation will top 5 percent, with the key battleground for the RBNZ being whether inflation expectations will behave themselves. If not, the RBNZ will have their work cut out for them.



RECENT LOCAL DATA

Electronic Card Transactions - June. Retail card values rose 1.2 percent s.a. (8.7 percent y/y). Core retail card values rose 2.1 percent s.a. (8.2 percent y/y).

ANZ Commodity Price Index - June. The index declined by 1.2 percent, (+20.6 percent y/y), with seven falls, six rises and prices for four commodities unchanged. The NZD commodity price index fell 3.3 percent (+4.9 percent y/y).

NZIER QSBO - 2011Q2. The general business situation lifted to +31 s.a. (from -11). Firms experienced domestic trading activity rebounded from -5 percent to +4 percent, with expected domestic trading activity lifting to +20 s.a. (previously +5). Actual and expected average selling prices firmed (to +16 and +31 respectively). Investment and employment intentions firmed (to 7), with more difficulty in finding labour. Surveyed capacity utilisation (0.887) and capacity as a limiting factor (+6) eased on Q1 levels.

GlobalDairyTrade online auction. Dairy prices eased by an average of 6.7 percent, to US \$4.017 per tonne. Whole milk powder prices fell 6.8 percent, to US \$3,638/tonne.

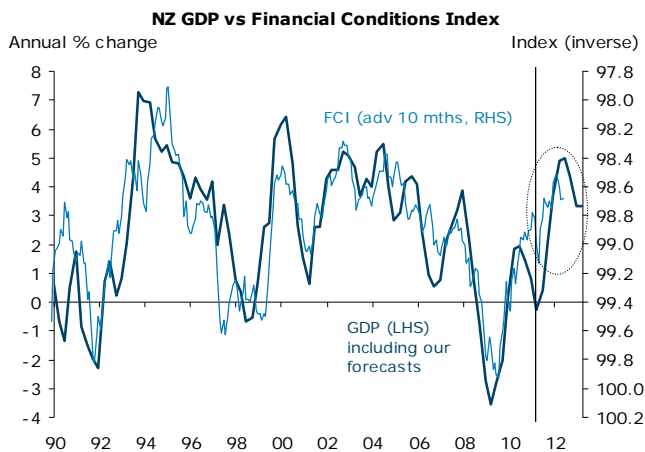
FINANCIAL CONDITIONS UPDATE

SUMMARY

Our financial conditions indexes continue to flag divergent outlooks across geographies. Financial conditions point to recovering momentum in the US and NZ, both of which have been through soft patches. In both cases the implied growth from our FCI's are above the Consensus expectation. Financial conditions point to moderating growth in China and Australia, with growth projections for both economies weaker than the market consensus.

MOMENTUM BUILDING IN NZ

Our proprietary Financial Conditions Index¹ (FCI) for NZ is supportive of a growth recovery over the next 12 months. Very low interest rates and strong commodity prices form the basis of supportive financial conditions. Partly offsetting this have been wider than usual CDS spreads for the big 4 Australasian banks and subdued growth in New Zealand asset and low credit growth.



Financial conditions were largely unchanged in early July. A higher NZD TWI and falls to equity values were offset by the firming terms of trade, and the narrowing in CDS spreads.

Financial conditions imply annual GDP growth of around 4 percent by early next year, which is consistent with the June MPS projections and our recently released Quarterly Forecasts. Why then, some would ask, do market interest rate expectations remain considerably below those implied by the RBNZ 90-day interest rate projections? June *Consensus*

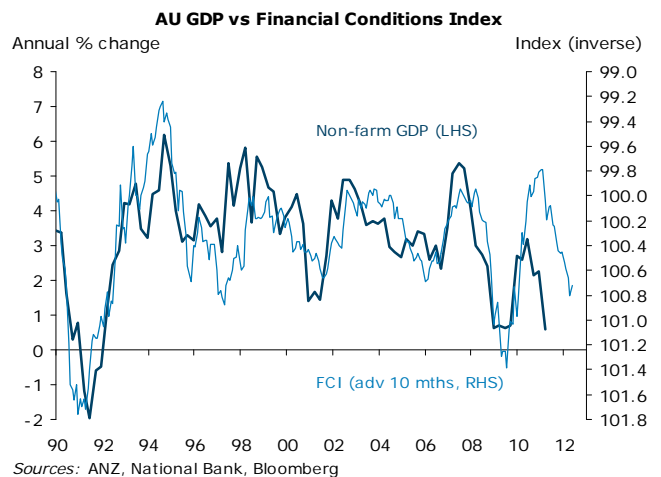
¹ A financial conditions index summarises a range of financial variables into a single series that can be used to predict the future path of the economy. Where available, our FCI includes the currency adjusted for commodity prices or terms of trade movements, interest rates, asset prices, credit growth and proxies for the cost and availability of credit.

Forecast expectations for year-on-year growth by the end of 2011 and 2012 (2.6 and 3.8 percent for annual growth respectively) are notably weaker than implied by financial conditions.

MODERATION IN AUSTRALIA

Australian financial conditions eased slightly in early July, driven by narrowing CDS spreads, lower 3-year swap yields and real short-term interest rates, and a strengthening in credit growth. Partly offsetting this was a further widening in swap spreads.

Australian financial conditions have been on a tightening trajectory, underpinned by rising short-term interest rates and a strengthening currency, which has offset strengthening commodity prices. Lower equity values and house prices have not helped, either.



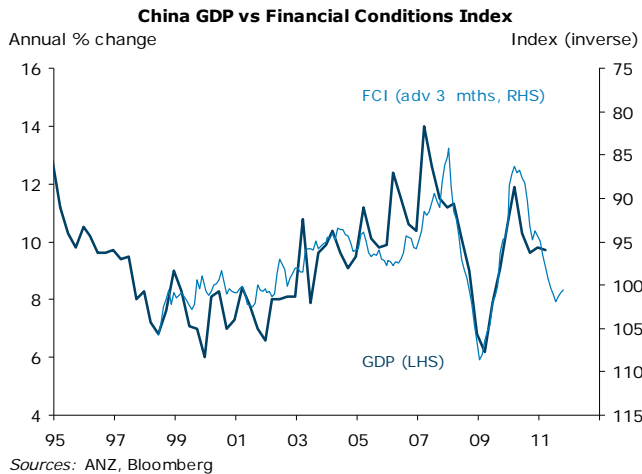
Our Australian FCI is flagging a moderate pace of expansion of around 2 percent by early 2012.

The earlier decline in activity largely reflects the impact of the Queensland floods (which are not directly captured in our FCI), and since our FCI does not directly capture the impact of the forthcoming boost to mining investment, implied growth from our FCI is likely to be closer (but still below) the 3.1 and 3.3 percent annual *Consensus Forecast* for 2011 and 2012 (3.1 and 3.3 percent respectively). Consistent with the moderation in activity implied by our FCI, has been the recent downgrade by the RBA on their growth outlook for the remainder of 2011.

A SOFT LANDING FOR CHINA?

Financial conditions eased slightly for China in July. A strengthening real exchange rate, smaller declines to real equity values over the last 12 months and higher one-year lending interest rates were offset by the acceleration in real credit growth and smaller annual falls to real house prices.

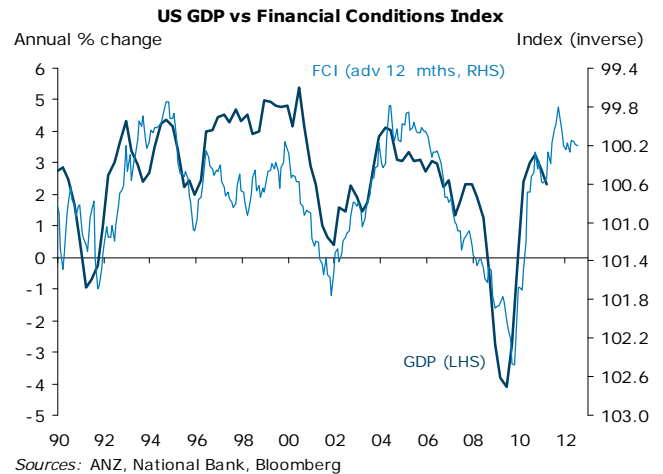
FINANCIAL CONDITIONS UPDATE



Chinese financial conditions are considerably more restrictive than this time last year, and point towards a slowdown in annual growth to around 8 percent. While “slower” it’s a rate most economies only dream of and we need to acknowledge that. Contributing to the tightening in financial conditions since the start of the year have been slower growth in real equity and property prices, which account for half of the weightings in our Chinese FCI. Debate will continue to surround what degree of slowdown is necessary in China to dampen rising inflation pressure, with figures over the weekend flagging that further policy tightening is required. We see considerable tension in China over the coming year as growth-inflation tensions are worked through. The hope is for the soft landing but in reality it’s very difficult to “land” big economies and hi beta pockets (i.e. the property market) on a dime. **Nevertheless, the slowdown implied by our FCI is more abrupt than implied by the June Consensus Forecasts, which are for annual growth to slow to 8.8 percent by the end of 2011.**

BETTER TIMES AHEAD FOR THE US?

US financial conditions were broadly unchanged so far in July and remain very supportive. Lower real equity values, a stronger terms of trade adjusted USD, a steeper yield curve and widening in swap spreads, were offset by lower real short-term interest rates, higher real credit growth and lower falls to real house prices. Financial conditions remain at levels consistent with a strengthening in annual growth to around 3½ percent in 12 months time. Historically low real interest rates and a low USD are key drivers, as are narrow swap spreads and abundant liquidity. The short-term outlook implied by our FCI is firmer than the 2.7 and 3.1 percent expectation for annual growth in 2011 and 2012 implied by *Consensus Forecasts*.



The reasonably upbeat picture implied by accommodative financial conditions has contrasted with a mixed US dataflow of late.

While the FOMC have acknowledged that the economic recovery had recently suffered a “loss of momentum”, growth is still expected to pick up in the second half of this year, as the impact of rapidly rising commodity prices fades and the Japan-related supply disruptions begin to ease. We expect forward looking data to show signs of improvement and realign somewhat with the lead provided by our financial conditions gauge over the coming months as these various one-offs are worked through.

THE REMAINDER

We also assess financial conditions across other NZ trading partners. These continue to present a mixed picture:

- **UK** - slightly easier conditions suggest growth over 2011 and 2012 in the 2 to 3 percent range.
- **Europe** - a firming FCI points to a 2012 annual growth slowdown to around 1 percent.
- **Singapore** – slightly firmer financial conditions suggest 7 percent annual growth by mid 2011.
- **HK** – firming financial conditions, implying a moderation in annual growth towards 5 percent by mid 2011.
- **Korea** – easing financial conditions, but growth is still projected to fall below 5 percent by mid 2011.

THE UPSHOT

Financial conditions measures continue to present a disparate picture across the regions.

Prospects for reasonably upbeat recoveries in New Zealand and the US, contrast with signs of moderation in Non-Japan Asia, Europe and Australia.

INTEREST RATE STRATEGY

SUMMARY

All eyes are now on the US bond market following very weak June employment data. Sovereign debt concerns have also escalated, with Italy now in the firing line. Distant as these events are, they do have the potential to spill over into New Zealand, and we need to be mindful. At this stage we are treating them as risks, and we are encouraged by the domestic data flow, which continue to point to rate rises later in the year. Where the NZD goes could become more influential, particularly if it continues to make new highs amidst the global malaise.

MARKET THEMES

- Global concerns continue to intensify, with Italian bond yields rising on contagion fears, US employment data coming in much weaker than expectations, and Chinese data pointing to softness.
- By contrast, the local outlook remains upbeat, and data this week is likely to differentiate things further.
- Roll and carry remain powerful drivers of investment, and are likely to prevent yields rising too far.

REVIEW AND OUTLOOK

There's no way to put it kindly: US jobs data on Friday night was weak no matter which way you cut it. Headline jobs growth was soft, the unemployment rate rose, and hours worked fell. **Market reaction was swift, with yields plummeting, reversing much of the recent sell-off.** Not only has the debate about what's next for the Fed just intensified, but European markets are now focussing on Italy as the next country in a spot of fiscal bother. Perhaps worse still, Chinese data shows that demand is slowing and inflation is rising, deepening fears of a hard landing there.

What's tricky for New Zealand is that all of this is happening at a time when the local outlook is improving. The obvious question now is; will global events upset the recovery here? It's too soon to say just yet, but it does raise the risks, especially with the NZD gaining ground. **It's certainly difficult to be bearish on interest rates here, despite the data flow.**

Roll and carry tend to come to the fore at times of uncertainty, on the idea that being paid to hold a "safe" trade makes it that much more attractive. Although it would be premature to conclude just yet that the US Federal Reserve is about to take further measures to bolster the economy, the 0.4 percent rise in US unemployment between March and June does put more pressure on the Fed, and the three policy options Bernanke mentioned as possibilities (QE3, cutting interest payable on excess reserves, and defining "extended period") are all supportive of carry. Given New Zealand's attractive carry characteristics, and

positive data providing NZD support, **we may well see more investment here, keeping a lid on long end yields,** especially if the US falls out of favour as a safe-haven as the debt ceiling looms.

PREFERRED BORROWING STRATEGIES

Despite market volatility, the overall picture hasn't changed much. NZ swap rates still look too low relative to the domestic outlook and the RBNZ's latest projections, and as such look like good value for borrowers. However, global uncertainty is at an extreme, and not just in the US. What is perhaps more concerning is that European markets have Italy in their sights, fearful of contagion. If this situation intensifies, the liquidity ramifications could be significant, and while NZ is in quite a different boat, we are plugged into global markets, and as such, caution is warranted. The higher NZD also poses risks to the RBNZ. Our core view remains that the RBNZ will resume raising rates in December, but there's a lot of water to flow under the bridge before then. In the meantime, we prefer to stand back, see how things unfold, and benefit from low floating rates.

GAUGES FOR NZ INTEREST RATES

GAUGE	DIRECTION	COMMENT
RBNZ / OCR	↔/↑	Market continues to shrug off RBNZ's hawkish tone.
NZ data	↑	Rebound in NZIER business confidence encouraging.
Fed Funds / front end	↔/↓	QE3 or similar now more likely. CPI this week critical.
RBA	↔/↑	Comfortable with policy here.
US 10 year	↔/↓	Has unwound half the sell-off. More beckons.
NZ swap curve	↔/↓	Get ready for substantial flattening later this year.
Flow	↔	Mild pay-side bias.
Technicals	↔	2yr stuck in 3.27/3.47 range.

MARKET EXPECTATIONS FOR RBNZ OCR (BPS)

OCR DATES	LAST WEEK	THIS WEEK
Thu 28-Jul-11	0	0
Thu 15-Sep-11	0	0
Thu 27-Oct-11	+5	+1
Thu 8-Dec-11	+16	+16
Thu 26-Jan-12	+26	+28
Thu 8-Mar-12	+38	+40
Thu 26-Apr-12	+50	+56

TRADING THEMES WE FAVOUR AT PRESENT

Given how quickly events are unfolding, and the potential for global uncertainty to cloud the domestic outlook, it's difficult to have a strong view. After all, the bond market has swung from bearish to bullish in the blink of an eye, and there is more key data this week. We're pretty circumspect, and suspect the "risk-off" phase is not yet complete, arguing for a flattening of the yield curve. March 2012 3mth FRA – 3yr flatteners make sense here, with the 3yr likely to follow global yields, and the FRA likely to remain elevated on local data. Better still, it enjoys positive roll and carry, and that's rare on flatteners.

CURRENCY STRATEGY

SUMMARY

As the ECB seeks to double the EU rescue fund to €1.5 trillion, with Italy looking very shaky and the US debt ceiling talks stalling, it seems there is no good news for the old economies of the west. Out of this mess it seems that the darling currency is the NZD. Chinese inflation data gives cause for concern as food inflation rises over 14 percent. The earnings season in the US kicks off this week, giving the "risk on/off" watchers something to focus on. NZD likely to remain bid this week, especially if Q1 GDP shows positive growth.

MARKET THEMES

- EU debt concerns continue with bad news becoming more frequent.
- US deficit and debt ceiling negotiations keep markets on edge.
- Recent China inflation data releases to focus markets on next policy moves by PBOC.
- NZ to finally get its 1st quarter GDP data this week.

REVIEW AND OUTLOOK

The NZDUSD burst through the top of the recent range at 0.8300 to close the week with a new post float high at 0.8386. **This week's first quarter GDP release may have more focus than normal for the NZD given the last minute delay last week.** With FX markets not wanting to own USD or EUR given the growing debt and deficit concerns in both camps, the NZD appears to be a great alternative. However, locally our "closeness" to the NZD means locals are a little more reserved about buying from here. Indeed with the NZD TWI 2.5 standard deviations higher than the average level since the float in 1985, it seems risk is currently skewed. Another factor is that the RBNZ bought NZD in March (post earthquake dip to 63 in the NZD TWI) to reduce their open FX position. Has the TWI now risen enough for them to "take profit"?

More bad news from Europe has increased EUR downside risk. The ECB is seeking to increase by as much as double the size of the euro-rescue fund to €1.5 trillion. They also want to expand the fund to include Italy as that market now shows signs of strain. Indeed, an article in *Die Welt* suggested that central banks are no longer ready to buy government debt, so the rescue fund should take on that task instead.

The lack of commitment by US lawmakers to deal with the debt ceiling issue is leaving the FX markets with a sour tasting USD. While we know that the debt ceiling will be lifted (because the counterfactual is untenable) the market is looking further to the prospect of a debt to GDP ratio that

could hit 100 percent by 2021 according to a story in the FT. This is hardly encouraging.

Strong CPI data from China shows no signs of abating, leaving markets to ponder how much official action is required to stem the pressure.

Certainly with food price inflation running at an annual 14 percent rate we know there will be action. This pressure has been and will likely continue to weigh on an AUD that is already feeling downward pressures internally due to its high level and the effects this is having on Australia's export sector (inbound tourism in particular).

NZD VS AUD: MONTHLY DIRECTIONAL GAUGES		
GAUGE	DIRECTION	COMMENT
Fair value	↑	Close to our fair value estimates.
Yield	↔/↑	Yield convergence favouring AUD less.
Commodities	↑	Soft commodities have turned up supporting NZD.
Partial indicators	↔/↑	NZ business and consumer confidence on the up.
Technicals	↑	Support at 0.7680.
Sentiment	↔	Risk off.
Other	↔	Quiet week ahead. External factors to provide direction.
On balance	↔↑	Trending higher 0.7680 - 0.7830.
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	↑	NZ Bonds have more fun.
Commodities	↑	Soft commodities turned up.
Risk aversion	↔	Mixed signals.
Partial indicators	↑	NZ data better, US data worsening.
Technicals	↓	Bearish divergence.
AUD	↔/↓	AUD in correction mode.
Sentiment	↔	Post float highs encourage sellers.
Other	↔	External factors to drive NZD this week.
On balance	↔	Local sentiment to fight offshore's positive view.

EFFECTIVE EXCHANGE RATE UPDATE

SUMMARY

Our effective exchange rate (EER) measures take into account the world prices of our exports (e.g. commodity prices in the case of commodity exporters), adjusted for currency movements based on their main destinations. June saw less favourable trading conditions for all of the sectors we monitor, driven by lower commodity prices and a stronger NZD. There is concern that the NZD is increasingly becoming disconnected with local fundamentals even though some sectors still have real effective exchange rates in enhancing territory.

RESTRICTIVE CONDITIONS ALL AROUND

Conditions became more restrictive for all eight of the groups we monitor in June. The largest falls were in sectors experiencing commodity price falls, with prices for horticulture and crude oil falling heavily in June. Lower prices for dairy and beef were also influential in contributing to more restrictive conditions for dairy and meat, skins and wool. In instances where commodity prices did rise (as for forestry products and seafood), this was more than offset by the strengthening NZD, with the TWI rising 2.4 percent in June. With the NZD strengthening 2-3 percent against four of the TWI bilaterals (AUD, GDP, USD and JPY), but weakening 5 percent against the euro, the sectors with a low export exposure to the euro fared worse. Currency movement were the key reason for the deterioration in competitiveness for manufacturing and services exporters.

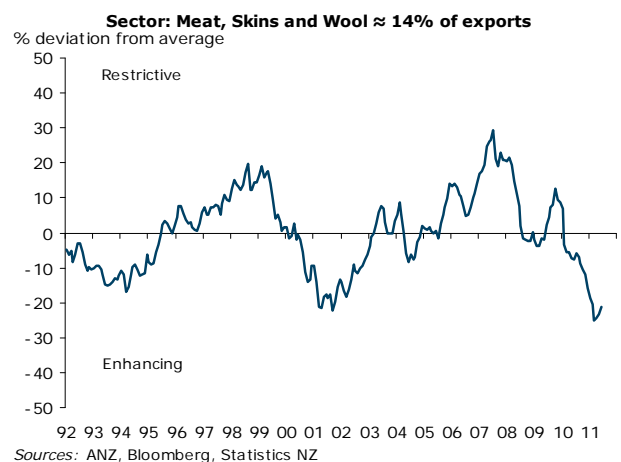
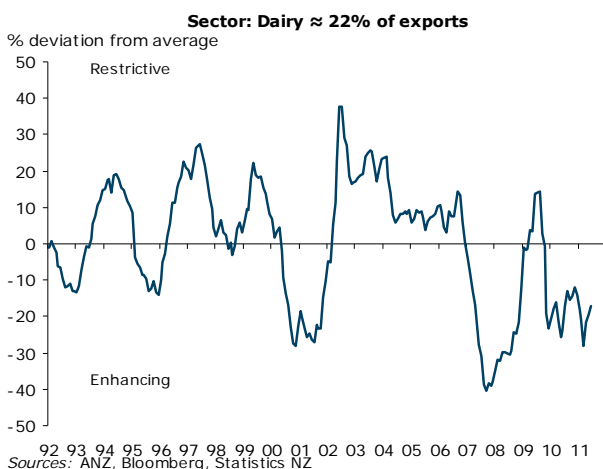
Sizeable disparities in trading conditions are evident in the various export groups.

Conditions are stimulatory for three groups: meat,

skins and wool, dairy, and seafood. The slide in oil prices since May has seen conditions for crude move into less enhancing territory since then.

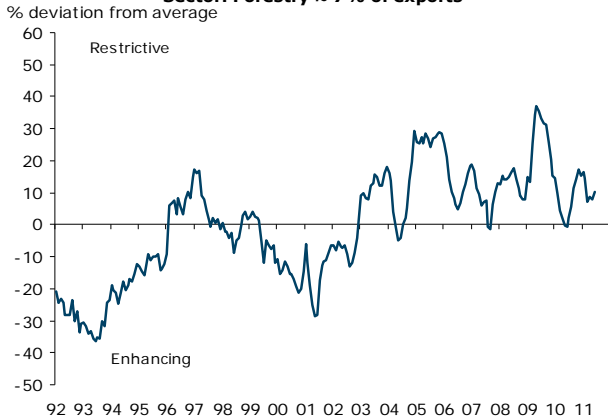
While parts of the export sector are doing well, there are still pockets of weakness, particularly for those sectors that have not benefitted from the trending higher in export commodity prices. With declines in apple and kiwifruit prices compounding the strengthening NZD, conditions continue to remain challenging for horticulture. Due to the high NZD against the USD and GBP, conditions remain very difficult for services exporters (e.g. tourism, education), with seismic events adding to the challenges facing the sector.

Our analysis is illustrative only as it does not take into account currency hedging, particularly for sectors such as dairy. And even within sector groups, trading conditions are likely to be quite variable. The low NZD/AUD, for example, is likely to benefit manufacturers selling to the Australian market, and trans-Tasman tourism. Conversely, a NZD/USD above the 75 cent level (it hit a post-float high last weekend and is currently hovering around 83.5 cents) makes the going tough for firms selling into USD-denominated markets, especially those with little pricing power, or those not benefiting from historically high export commodity prices. **The picture is also complicated by the fact that some exporters have imported inputs, providing a natural buffer against exchange rate moves.** This is difficult to measure and is not taken into account in this analysis.



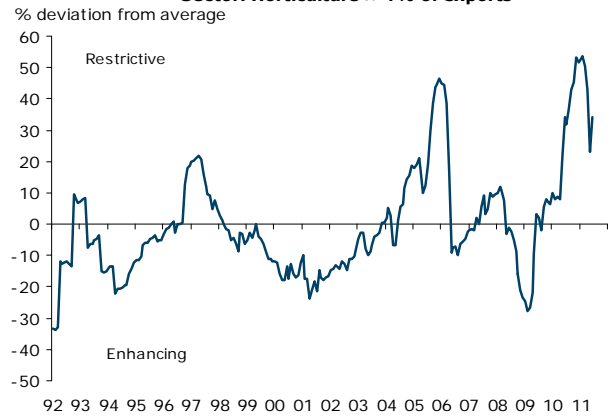
EFFECTIVE EXCHANGE RATE UPDATE

Sector: Forestry \approx 7% of exports



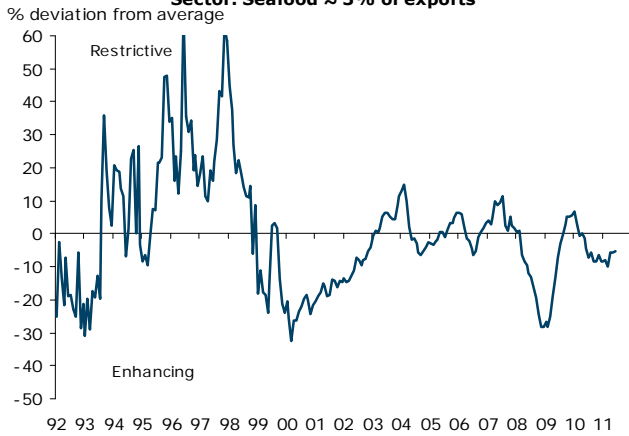
Sources: ANZ, Bloomberg, Statistics NZ

Sector: Horticulture \approx 4% of exports



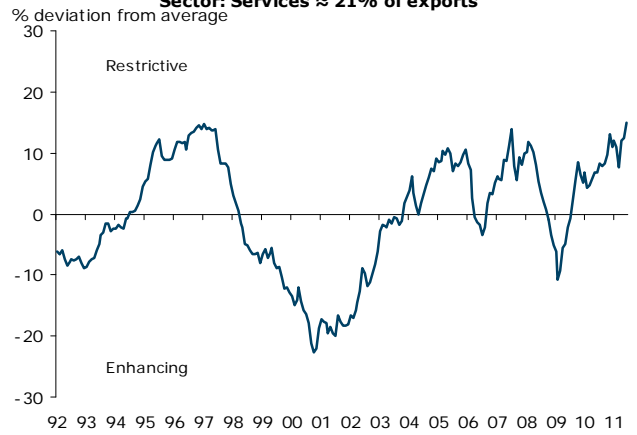
Sources: ANZ, Bloomberg, Statistics NZ

Sector: Seafood \approx 3% of exports



Sources: ANZ, Bloomberg, Statistics NZ

Sector: Services \approx 21% of exports



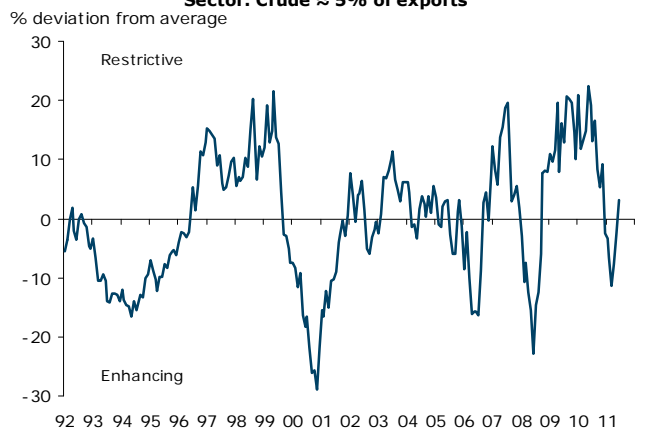
Sources: ANZ, Bloomberg, Statistics NZ

Sector: Manufacturing \approx 20% of exports



Sources: ANZ, Bloomberg, Statistics NZ

Sector: Crude \approx 5% of exports



Sources: ANZ, Bloomberg, Statistics NZ

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
11-Jul	NZ	NZ Card Spending - Retail MoM - JUN	--	1.2%(a)	10:45
	NZ	NZ Card Spending - Total MoM - JUN	--	0.8%(a)	10:45
	NZ	QV House Prices YoY% - JUN	--	-0.9%(a)	12:00
	AU	Home Loans MoM - MAY	4.5%	4.8%	13:30
	AU	Investment Lending - MAY	--	-1.6%	13:30
	AU	Owner-Occupied Home Loan Value MoM - MAY	--	6.3%	13:30
	JN	Consumer Confidence - JUN	35.5	34.2	17:00
	JN	Machine Tool Orders (YoY) - JUN P	--	34.0%	18:00
	CH	Actual FDI (YoY) - JUN	--	13.4%	UNCONFIRMED
	CH	Foreign Exchange Reserves - JUN	\$3233.0B	\$3044.7B	UNCONFIRMED
	CH	New Yuan Loans - JUN	622.5B	551.6B	UNCONFIRMED
	CH	Money Supply - M0 (YoY) - JUN	--	15.4%	UNCONFIRMED
	CH	Money Supply - M1 (YoY) - JUN	13.0%	12.7%	UNCONFIRMED
	CH	Money Supply - M2 (YoY) - JUN	15.3%	15.1%	UNCONFIRMED
	NZ	REINZ Housing Price Index - JUN	--	3186.2	UNCONFIRMED
	NZ	REINZ Housing Price Index MoM% - JUN	--	-1.8%	UNCONFIRMED
	NZ	REINZ House Sales YoY% - JUN	--	10.8%	UNCONFIRMED
12-Jul	UK	BRC Sales Like-For-Like YoY - JUN	-1.4%	-2.1%	11:01
	UK	RICS House Price Balance - JUN	-25%	-28%	11:01
	JN	Tertiary Industry Index (MoM) - MAY	0.7%	2.6%	11:50
	JN	Domestic CGPI (MoM) - JUN	-0.2%	-0.1%	11:50
	AU	NAB Business Conditions - JUN	--	1	12:30
	AU	NAB Business Confidence - JUN	--	6	12:30
	GE	Consumer Price Index (MoM) - JUN F	0.1%	0.1%	18:00
	GE	Consumer Price Index (YoY) - JUN F	2.3%	2.3%	18:00
	GE	CPI - EU Harmonised (MoM) - JUN F	0.0%	0.0%	18:00
	GE	CPI - EU Harmonised (YoY) - JUN F	2.4%	2.4%	18:00
	UK	DCLG UK House Prices (YoY) - MAY	--	-0.3%	20:30
	UK	Visible Trade Balance GBP/Mn - MAY	-£7336	-£7389	20:30
	UK	Trade Balance Non EU GBP/Mn - MAY	-£4250	-£4339	20:30
	UK	Total Trade Balance (GBP/MIn) - MAY	-£2700	-£2762	20:30
	UK	CPI (MoM) - JUN	0.2%	0.2%	20:30
	UK	CPI (YoY) - JUN	4.5%	4.5%	20:30
	UK	Core CPI YOY - JUN	3.3%	3.3%	20:30
	UK	Retail Price Index - JUN	235.8	235.2	20:30
	US	NFIB Small Business Optimism - JUN	91.5	90.9	23:30
	JN	BOJ Target Rate - JUL	--	0.10%	UNCONFIRMED
13-Jul	US	Trade Balance - MAY	-\$44.1B	-\$43.7B	00:30
	US	IBD/TIPP Economic Optimism - JUL	44.2	44.6	02:00
	US	Minutes of FOMC Meeting - JUN			06:00
	NZ	Food Prices (MoM) - JUN	--	0.5%	10:45
	AU	Westpac Consumer Confidence s.a. (MoM) - JUL	--	-2.6%	12:30
	AU	Westpac Consumer Confidence Index - JUL	--	101.2	12:30
	CH	Industrial Production YTD YoY - JUN	13.9%	14.0%	14:00
	CH	Industrial Production (YoY) - JUN	13.1%	13.3%	14:00
	CH	Fixed Assets Inv Excl. Rural YTD YoY - JUN	25.7%	25.8%	14:00
	CH	Real GDP YTD (QoQ) - 2Q	--	2.1%	14:00
	CH	Real GDP YTD (YoY) - 2Q	9.5%	9.7%	14:00

Continued on following page

DATA EVENT CALENDAR

DATE	COUNTRY	DATA/EVENT	MKT.	LAST	NZ TIME
13-Jul	CH	Real GDP (QoQ) - 2Q	- -	2.1%	14:00
	CH	Real GDP (YoY) - 2Q	9.3%	9.7%	14:00
	CH	Retail Sales YTD YoY - JUN	16.7%	16.6%	14:00
	CH	Retail Sales (YoY) - JUN	17.0%	16.9%	14:00
	UK	Jobless Claims Change - JUN	15.0K	19.6K	20:30
	UK	Average Weekly Earnings 3M/YoY - MAY	2.1%	1.8%	20:30
	UK	Weekly Earnings ex Bonus 3M/YoY - MAY	2.0%	2.0%	20:30
	UK	ILO Unemployment Rate (3mths) - MAY	7.7%	7.7%	20:30
	EC	Euro-Zone Ind. Prod. wda (YoY) - MAY	4.8%	5.2%	21:00
	EC	Euro-Zone Ind. Prod. sa (MoM) - MAY	0.4%	0.2%	21:00
14-Jul	US	Import Price Index (MoM) - JUN	-0.6%	0.2%	00:30
	US	Import Price Index (YoY) - JUN	13.2%	12.5%	00:30
	US	Monthly Budget Statement - JUN	-\$65.0B	-\$57.6B	06:00
	NZ	Business NZ PMI - JUN	- -	54.7	10:30
	NZ	GDP QoQ - 1Q	0.3%	0.2%	10:45
	NZ	GDP YoY - 1Q	0.5%	0.8%	10:45
	NZ	Non Resident Bond Holdings - JUN	- -	61.2%	15:00
	EC	Euro-Zone CPI - Core (YoY) - JUN	1.5%	1.5%	21:00
	EC	Euro-Zone CPI (MoM) - JUN	0.0%	0.0%	21:00
	EC	Euro-Zone CPI (YoY) - JUN	2.7%	- -	21:00
15-Jul	US	Producer Price Index (MoM) - JUN	-0.2%	0.2%	00:30
	US	PPI Ex Food & Energy (MoM) - JUN	0.2%	0.2%	00:30
	US	Producer Price Index (YoY) - JUN	7.4%	7.3%	00:30
	US	PPI Ex Food & Energy (YoY) - JUN	2.2%	2.1%	00:30
	US	Advance Retail Sales - JUN	0.0%	-0.2%	00:30
	US	Retail Sales Less Autos - JUN	0.1%	0.3%	00:30
	US	Retail Sales Ex Auto & Gas - JUN	0.4%	0.3%	00:30
	US	Initial Jobless Claims - 9 JUL	412K	418K	00:30
	US	Continuing Claims - 2 JUL	3675K	3681K	00:30
	US	Business Inventories - MAY	0.8%	0.8%	02:00
	EC	Euro-Zone Trade Balance sa - MAY	-3.3B	-2.9B	21:00
	EC	Euro-Zone Trade Balance - MAY	- -	-4.1B	21:00
16-Jul	US	Consumer Price Index (MoM) - JUN	-0.1%	0.2%	00:30
	US	CPI Ex Food & Energy (MoM) - JUN	0.2%	0.3%	00:30
	US	Consumer Price Index (YoY) - JUN	3.6%	3.6%	00:30
	US	CPI Ex Food & Energy (YoY) - JUN	1.6%	1.5%	00:30
	US	CPI Core Index SA - JUN	- -	224.387	00:30
	US	Consumer Price Index NSA - JUN	- -	225.964	00:30
	US	Empire Manufacturing - JUL	5.0	-7.79	00:30
	US	Industrial Production - JUN	0.3%	0.1%	01:15
	US	Capacity Utilization - JUN	77.0%	76.7%	01:15
	US	U. of Michigan Confidence - JUL P	72.5	71.5	01:55

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: Last week's QSBO confirmed the considerable resilience in the New Zealand economy, and held out the prospect of continued improvement. While capacity pressures remain contained, the recovery in the demand for labour is an area to watch. Export commodity prices eased, but remain at levels supportive for the economic rebalancing to take place. This week sees the release of the Q1 GDP data, which is expected to confirm an expansion in activity despite seismic interruptions. Data over the coming months should show continued improvement, albeit with global ructions and uncertainties over the pace of earthquake reconstruction suggest a bumpy road ahead.

DATE	DATA/EVENT	ECONOMIC SIGNAL	COMMENT
Wed 13 July (10:45am)	Food Price Index – June	Heading higher	Seasonal increases, higher dairy prices and storm-affected rises in tomato prices will underpin a 0.7 percent monthly increase.
Thur 14 July (10:00am)	REINZ Housing Market data – June	Set to move higher	Prices and activity flat, with looming shortages in property listings set to push prices higher.
Thur 14 July (10:30am)	Manufacturing PMI – June	Expansion	We expect a headline measure in the low 50's but are conscious of weakness in overseas gauges.
Thur 14 July (1:00pm)	ANZ/Roy Morgan Consumer Confidence	- -	- -
Thur 14 July (10:45)	Gross Domestic Product – 2011Q1	Up	We expect a 0.4 percent rise in activity. Sector performance will be mixed, with solid retail and manufacturing offset by weaker construction activity. Services sector activity will be mixed.
Mon 18 July (10:45am)	Consumers Price Index – 2011Q2	5 percent+	A 0.8 percent increase is expected, taking annual CPI inflation to 5.1 percent. Annual inflation ex one-offs should hit 2.6 percent.
Thur 21 July (10:45am)	International Travel and Migration - June	Down	We expect a net outflow of 200 persons. Ash clouds and not much snow will contribute to a 2-3 percent fall in visitor numbers.
Thur 21 July (3:00pm)	RBNZ Credit Statistics – June	Up	A monthly increase of approximately 1.0 percent is envisaged. Spending on overseas cards should fall.
Tue 26 July (10:45am)	Overseas Merchandise Trade - June	Another surplus	We expect a monthly surplus of \$500m, with the annual surplus to widen towards \$1800m.
Wed 27 July (1:00pm)	National bank Business Outlook - June	- -	- -
Thur 28 July (9:00am)	RBNZ OCR Review	On hold	We expect the OCR to be maintained at 2.5 percent. We expect the first RBNZ hike at the December <i>MPS</i> .
Fri 29 July (10:45am)	Building Consents – June	Climbing	We expect a 3 percent increase in residential consent numbers.
Fri 29 July (3:00pm)	RBNZ Credit Aggregates -June	Flat	Low annual rates of credit growth expected, with business credit climbing and agricultural credit easing.
Mon 1 Aug (1:00pm)	ANZ Commodity Price Index	- -	- -
Tue 2 Aug (10:45)	Labour Cost Index – Q2	Growing	We expect private sector salary and wage rates to rise 0.5 percent (2.1 percent y/y).
Tue 2 Aug (10:45)	Quarterly Employment Survey – Q2		Private sector hourly earnings should rise 0.5 percent (2.4 percent y/y). Filled jobs and paid hours should rise 0.2 percent.
Wed 3 Aug (6:00am)	<i>GlobalDairyTrade</i> dairy auction	Holding	We expect dairy and whole milk powder prices to hold around current levels.
Thur 4 Aug (10:45)	Household labour Force Survey – Q2	Improving	A 0.5 percent increase in employment is expected, with the unemployment rate to fall to around 6.4 percent.
On Balance		On the up	Soft leading gauges and less uncertainty over the future of Christchurch point towards a better Q2 and beyond.

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	0.7	1.5	1.8	0.7	0.9	0.9	0.8	0.7
GDP (% yoy)	0.8	0.6	1.1	2.8	4.5	4.8	5.0	4.4	3.3	3.3
CPI (% qoq)	2.3	0.8	0.8	0.8	0.7	0.6	0.8	0.7	0.6	0.8
CPI (% yoy)	4.0	4.5	5.1	4.8	3.1	2.9	2.9	2.7	2.6	2.9
Employment (% qoq)	-0.4	1.4	0.0	0.4	0.6	0.7	0.5	0.5	0.4	0.4
Employment (% yoy)	1.3	1.8	2.0	1.4	2.4	1.7	2.2	2.3	2.1	1.8
Unemployment Rate (% sa)	6.7	6.6	6.4	6.1	6.0	5.7	5.5	5.4	5.3	5.3
Current Account (% GDP)	-4.1	-4.2	-4.3	-4.2	-3.7	-3.9	-4.1	-4.4	-4.7	-4.8
Terms of Trade (% qoq)	0.8	0.9	2.9	3.1	1.0	-0.8	-0.9	-0.8	-0.8	-0.8
Terms of Trade (% yoy)	12.3	6.8	7.8	7.9	8.0	6.2	2.3	-1.6	-3.2	-3.3

	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
Retail ECT (% mom)	1.9	0.9	1.0	-0.8	2.4	-0.2	1.4	1.4	-0.7	1.2
Retail ECT (% yoy)	5.0	4.8	6.3	4.4	5.7	6.2	6.6	10.0	6.8	9.0
Credit Card Billings (% mom)	1.1	0.6	0.1	-1.8	3.7	-0.4	-1.3	1.8	0.6	..
Credit Card Billings (% yoy)	4.3	4.6	3.8	2.0	5.6	5.3	1.7	6.1	5.1	..
Car registrations (% mom)	2.6	-3.9	13.0	-8.5	0.9	-1.7	-0.2	-5.6	3.3	..
Car registrations (% yoy)	19.2	9.4	23.5	6.4	6.8	2.8	-1.0	-10.5	-3.7	..
Building consents (% mom)	0.7	-1.8	8.5	-18.8	9.2	-9.6	2.5	-1.2	2.3	..
Building consents (% yoy)	-9.4	-17.5	-8.9	-26.4	-14.9	-28.9	-26.2	-32.2	-22.0	..
REINZ House Price Index (% yoy)	-1.3	-3.5	-1.9	-1.6	-2.6	-0.7	-1.8	-0.4	-0.7	..
Household Lending Growth (% mom)	0.2	0.0	0.0	0.0	0.1	0.1	-0.1	0.2	0.1	..
Household Lending Growth (% yoy)	2.3	2.0	1.8	1.6	1.6	1.5	1.2	1.2	1.2	..
ANZ Roy Morgan Consumer Confidence	116.4	113.6	114.5	112.2	117.1	108.1	101.4	101.4	103.3	112.5
NBNZ Business Confidence	13.5	23.7	33.2	29.5	..	34.5	-8.7	14.2	38.3	46.5
NBNZ Own Activity Outlook	26.7	30.5	35.3	34.5	..	36.6	14.7	29.5	39.7	38.7
Trade Balance (\$m)	-455	-220	-177	-218	9	184	586	1148	605	..
Trade Balance (\$m ann)	978	1259	1363	1172	909	765	744	1232	1067	..
ANZ World Commodity Price Index (% mom)	2.6	3.0	2.1	1.6	4.3	2.7	4.7	1.6	0.4	-1.2
ANZ World Commodity Price Index (% yoy)	25.1	23.1	13.1	12.1	16.3	20.3	23.5	19.8	19.6	20.6
Net migration (sa)	1000	400	600	720	440	450	-520	-120	-350	..
Net migration (annual)	13914	12610	11519	10451	8689	8249	6554	5508	4625	..

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	Apr-11	May-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZD/USD	0.810	0.824	0.834	0.80	0.81	0.79	0.77	0.75	0.73	0.73
NZD/AUD	0.738	0.772	0.778	0.74	0.75	0.75	0.75	0.74	0.74	0.74
NZD/EUR	0.547	0.572	0.587	0.58	0.60	0.59	0.57	0.55	0.53	0.54
NZD/JPY	65.75	67.16	67.31	68.0	70.5	70.3	70.1	69.8	69.4	70.1
NZD/GBP	0.485	0.501	0.520	0.50	0.52	0.51	0.49	0.47	0.46	0.46
NZ\$ TWI	68.6	70.9	72.2	70.4	71.8	70.9	69.4	67.8	66.4	66.8
INTEREST RATES	Apr-11	May-11	Today	Sep-11	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13
NZ OCR	2.50	2.50	2.50	2.50	2.75	3.25	3.50	3.75	4.00	4.25
NZ 90 day bill	2.68	2.69	2.66	2.70	3.10	3.70	3.80	4.20	4.30	4.80
NZ 10-yr bond	5.44	5.11	5.11	5.20	5.50	5.70	6.00	6.20	6.10	6.20
US Fed funds	0.25	0.25	0.25	0.25	0.25	0.75	1.50	2.00	2.00	2.50
US 3-mth	0.27	0.25	0.25	0.35	0.35	0.85	1.60	2.10	2.10	2.60
AU Cash Rate	4.75	4.75	4.75	4.75	4.75	5.00	5.00	5.25	5.25	5.50
AU 3-mth	4.92	5.02	4.98	5.00	5.00	5.20	5.20	5.50	5.50	5.70

	8 Jun	4 Jul	5 Jul	6 Jul	7 Jul	8 Jul
Official Cash Rate	2.50	2.50	2.50	2.50	2.50	2.50
90 day bank bill	2.64	2.65	2.66	2.66	2.66	2.66
NZGB 04/13	3.22	3.22	3.21	3.20	3.20	3.22
NZGB 04/15	4.06	4.04	4.03	4.01	4.02	4.03
NZGB 03/19	4.92	4.95	4.94	4.93	4.93	4.95
NZGB 05/21	5.13	5.15	5.14	5.13	5.13	5.15
2 year swap	3.36	3.40	3.40	3.38	3.38	3.40
5 year swap	4.41	4.46	4.46	4.43	4.44	4.46
RBNZ TWI	70.0	71.3	71.3	71.4	71.4	71.8
NZD/USD	0.8171	0.8298	0.8284	0.8291	0.8270	0.8317
NZD/AUD	0.7667	0.7726	0.7747	0.7728	0.7696	0.7723
NZD/JPY	65.33	67.01	67.13	67.04	66.94	67.60
NZD/GBP	0.4979	0.5159	0.5163	0.5155	0.5173	0.5215
NZD/EUR	0.5576	0.5700	0.5719	0.5736	0.5773	0.5800
AUD/USD	1.0657	1.0740	1.0693	1.0729	1.0746	1.0769
EUR/USD	1.4655	1.4557	1.4486	1.4454	1.4326	1.4339
USD/JPY	79.95	80.75	81.03	80.86	80.94	81.28
GBP/USD	1.6412	1.6085	1.6046	1.6084	1.5987	1.5949
Oil (US\$/bbl)	99.18	94.81	94.99	96.92	96.67	98.70
Gold (US\$/oz)	1540.95	1493.00	1494.61	1516.10	1531.51	1531.30
Electricity (Haywards)	2.81	6.03	5.34	4.74	5.52	5.46
Baltic Dry Freight Index	1434	1419	1428	1443	1453	1449
Milk futures (USD)	161	156	156	156	153	153

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