

TACTICAL VERSUS STRATEGIC

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- > A large cut is expected by the RBNZ, and the market is now starting to test a sub 3 percent terminal OCR. While it's hard to argue against the spirit of this given the economic backdrop, there are some aspects to an aggressive easing that we are starting to think about tactically in association with the economic backdrop. Data releases over the week are expected to provide little cheer for the economy.

Page 5: Economic comment – a negative outlook – S&P

- > The 2009 *Budget* will be a key benchmark assessing NZ's foreign currency rating. While long-term fiscal projections are subject to a huge degree of uncertainty, using Treasury's Fiscal Strategy Model we show that it will require a combination of fiscal restraint, moving early to curb spending growth, and stronger economic performance for the fiscal position to improve in order to avert a potential downgrade. The challenge is to deliver a credible strategy for all.

Page 8: OCR Preview

- > We expect the RBNZ to cut the OCR by 100bps to a new low of 4 percent and leave the door open to more.

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- > It was again a mixed bag for data last week and while some results surprised on the upside, they still fit within a very weak trend and highlight a struggling global economy. The UK economy contracted sharply in the fourth quarter and Chinese GDP growth has fallen to its slowest rate since 2000. Asian trade data continue to highlight that world trade flows have literally ground to a halt.

Page 10: Interest rate strategy

- > Interest rates continue to fall, having closed at record lows again on Friday. However, with 129bps priced in for Thursday's *OCR Review*, a showdown is looming. We expect the fallout of a 100bp cut to be limited to the very short end – the market is likely to simply price in more for March and April. We believe it is still too soon for borrowers to extend duration.

Page 11: Currency strategy

- > Revised Fonterra payout and another large rate cut from the RBNZ this week should ensure the NZD remains on the back foot. Potentially weak data out from Australia also has the prospect of dragging the NZD lower. Our medium-term bearish view on the NZD remains.

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ECONOMIC OVERVIEW

A large cut is expected by the RBNZ, and the market is now starting to test a sub 3 percent terminal OCR. While it's hard to argue against the spirit of this given the economic backdrop, there are some aspects to an aggressive easing that we are starting to think about tactically in association with the economic backdrop. Data releases over the week are expected to provide little cheer for the economy.

What's ahead?

- > **December Credit Card spending** (Monday 1500 NZDT). Anecdotes were mixed on the retail performance over the Christmas period. ECT data was relatively subdued and we expect the credit card data to be the same.
- > **Fonterra 2008/09 payout forecast update** (Wednesday 1200 NZDT). Despite a lower NZD, sharply lower world dairy prices should see the payout forecast drop to the low \$5's.
- > **RBNZ OCR Review** (Thursday 0900 NZDT). We expect a 100bp cut. Refer to page 8 for our full preview.
- > **December Overseas Merchandise Trade** (Thursday 1045 NZDT). We expect a monthly trade deficit of \$300 million. However, this is likely to mask reasonable falls in both the level of exports and imports.
- > **December Credit Growth** (Thursday 1500 NZDT). Household claims retreated for the first time on record in November. Given the state of the housing market, another contraction cannot be ruled out.
- > **December Building Consents** (Friday 1045 NZDT). Residential building consent issuance will remain very subdued. However, it is commercial consent issuance that is now our biggest focus. We expect a downward trend to start to develop.

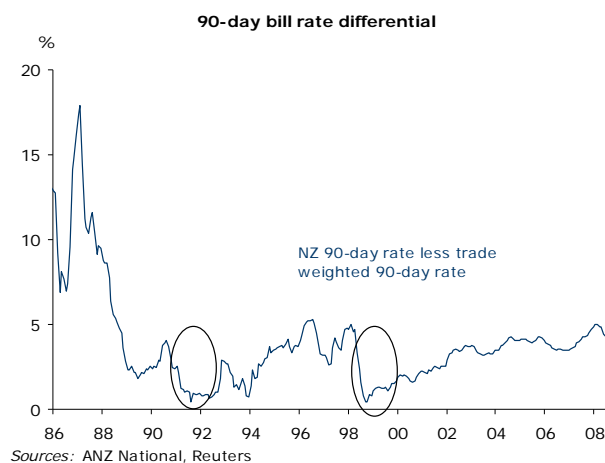
What's the view?

The January *OCR Review* takes centre stage on Thursday, and we're sitting with the consensus expecting a 100 basis point cut, with the door to be left open for more. Page 8 outlines our full expectations.

At this juncture it is the "more", and specifically how much more, that has got us thinking. Around the globe, market pricing has rates in Canada and the UK hitting 0.5 percent, close to 1 percent in the euro-zone, and obviously the US is already near zero, as is Japan. If market pricing is to be accepted, the RBA will take the cash rate to 2.25 percent, and 2.75 percent for New Zealand.

While the tenor of the data around the globe continues to print awfully, and there is no doubt we are in the midst of a deep and pronounced global recession, we can't but help wonder how far NZ rates could, and in fact should, fall.

First up, there is no doubt that at this juncture, the RBNZ needs to do more given the economic backdrop. In a strategic sense, rates need to fall – a long way - to support the economy. But it is the terminal rate and other tactical considerations that have us chewing the fat at present. Given the economic backdrop and rapidly deteriorating labour market, the market will continue to press for cuts. With offshore rates rapidly converging on sub 1 percent across the majors, there is the obvious tendency to look elsewhere, and for NZ rates to play catch-up. We suspect a fair bit of the movement we've seen in NZ rate expectations reflects this dynamic. Certainly, this convergence has been the historical experience during recessions such as 1990/92 and 1997/98.



At this time central banks also sometimes find themselves in a bit of a bind, as they are being led in part by the market itself. As noted by the BoE in the minutes from their most recent policy decision last week *"the markets had priced in a cut of 50 basis points and either leaving Bank Rate unchanged this month, or implementing a larger-than-expected cut, could damage confidence further in both financial markets and the real economy."* This doesn't mean central banks follow the market, but often it's the path of least resistance. The more the market pushes, the more the tendency to deliver – up to a point.

Certainly the experience to date is that central banks either meet the market, or deliver more given the backdrop. But once again we have to wonder how far this can extend, particularly in NZ's circumstances. Below we toss around some other strategic considerations, which we are starting to ponder:

- > **The more you front-load, the less you have in reserve.** Front-loading has certainly been

the correct policy response for now, and following Thursday, (we expect) the OCR will have been lowered a staggering 425 basis points in six months. Yet we also need to be cognisant that this downturn will be reasonably elongated, and policy has to be seen to continue acting in this environment for political economy reasons as much as anything else (central banks have operational independence, but not much more than that and best they ensure they preserve it!). Moreover, sometimes it pays to keep some bullets in reserve for that 'what-if' scenario. After all, if the unemployment rate is moving up aggressively over the entire 2009, then the RBNZ will find it tough to sit on its hands. Not only is the labour market a lagging indicator in a macro sense, it is also an indicator with the political economy of monetary policy written all over it.

- > **NZ is going through a cyclical downturn as well as a structural current account adjustment.** Economic reality means the RBNZ needs to respond aggressively to the first. Yet excess stimulation in the near-term risks exacerbating the inevitable structural adjustment. Remember, we spent our way into this jam, and housing investors were repeatedly warned by the RBNZ about their behaviour, an ironic situation considering the lifeline now being thrown. As noted by the Governor in 2005: *"The RBNZ remains focussed on ensuring that the inflation outlook remains consistent with the medium term target whilst recognising the macro-economic adjustments that are likely to occur in the face of a large and unsustainable current account deficit. We are concerned to see that, as far as possible, such adjustments (current account deficit) occur in as orderly a manner as possible."* Obviously a lot has changed since that speech was written. But we would not disregard the spirit in terms of the adjustment that was always pending.
- > **We would not underestimate the capacity or necessity of looking at non-OCR measures to support the economy.** This downturn is about the supply of money, not the price. Hence policymakers will be looking beyond the traditional price (OCR) instrument.
- > **A lot of the arguments for lower rates are red herrings.** Lower rates are required to weaken the currency, and lower corporate borrowing costs. The fallacy here is that the yield aspect to the currency has "switched off" – it's a risk story at present. Moreover, corporate debt issuance costs are being driven by nominal yield expectations as opposed to the wholesale interest rate curve. That is, retail investors' expectations are north of 7 percent,

so falling swap yields just widens the corporate spread.

- > **NZ is not a major economy, hence we still need some form of yield to attract the necessary capital.** For sure, interest rates are not primary drivers at present, but they are still relevant to a degree.

These sorts of considerations don't alter our general expectations for interest rates. We still expect the OCR to hit 3 percent. But they leave us musing how far the potential is to move beyond that.

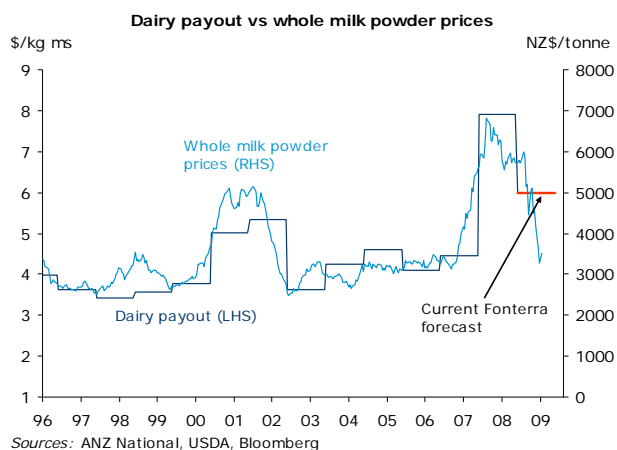
It's not that the economic picture will not justify a lower OCR. At times like these we also need to remember the old adage: a trend is your friend, especially in markets, and we always tend to be surprised how far we overshoot in either direction.

Our forecasts are grim, with the economy expected to contract by close to 2 percent over 2009 and the unemployment rate to rise to over 7 percent. But the terminal rate for the OCR – and with the market pricing in sub 3 percent and biased one way – is something we are increasingly starting to ponder. There is nothing magical about 3 percent in our eyes as a cut-off. It's simply that following such aggressive falls in the OCR (even though the transmission mechanism from monetary policy has been diluted due to the credit related nature of the current malaise), we wonder whether mitigating one evil will merely risk inflaming others. Bottom line is that we may well be entering a period where the RBNZ need to be more proactive in managing market expectations for interest rates, either in terms of how low they go, or the other aspect to policy, how long they expect to keep them there. Typically we become fixated with the OCR and forget that the real trick to policy is manipulating the yield curve.

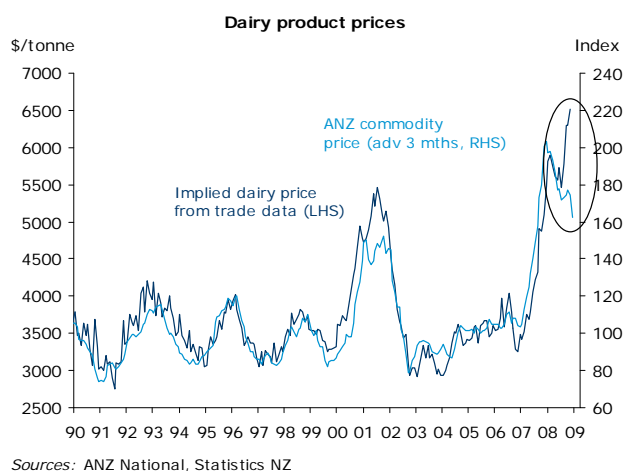
The other important event this week is an announcement from Fonterra on Wednesday on their updated expectations for the final 2008/09 season payout. Currently this sits at \$6/kg ms. However, given the trend in global milk prices, with USD skim milk powder and wholemilk powder prices down 66 percent and 63 percent respectively from their peaks, we expect this to be revised lower to nearer \$5/kg ms, despite the NZD also taking a tumble. This still looks high given where spot dairy prices are, but this season's payout is likely to still be supported by carry-over contracts. In our eyes, it is the outlook for the 2009/10 season that is now more important. While no guidance is likely to be given from Fonterra at this stage, the reality that next season's payout will likely be even lower is significant.

As far as the RBNZ goes however, the lower payout to dairy farmers is another green light to cut rates from a growth (lower terms of trade and weaker trading partner growth) and inflation (watch for

receding dairy related prices in supermarkets at some stage) perspective.



Turning to the domestic data this week, there are a couple of second-tier, but still important, releases due. The first is December overseas merchandise trade data on Thursday. There is a little more uncertainty heading into this release than normal (and that is saying something given the data is notoriously volatile) as we can foresee a number of risks to both exports and imports. On the import side, the sharply weaker domestic economy and subdued retail sector suggests imports could capitulate at some stage. This is almost a prerequisite for the adjustment the economy must go through. On the export side, we can foresee the level falling sharply. When we look around the globe and see December trade figures for other countries, it is almost as if world trade ground to a halt over the month, and we would be very surprised if NZ managed to escape unscathed. Japanese exports recorded their biggest year on year fall in December and Chinese exports also tumbled. On top of this, the trade data is yet to incorporate the fall in world dairy prices as well as widespread stories of stockpiling of dairy products.



So while the headline trade balance number will be important, and a key indicator for the December quarter current account numbers due at the end of March (something Standard & Poor's will be watching very closely), the absolute levels of

exports and imports will also be important. It is quite possible that the trade balance number could be quite reasonable, and we expect a deficit of \$300 million, despite some poor export and import results from a dollar perspective.

The other release is December building consents on Friday. There is little doubt that the level of residential consent issuance will remain very subdued, and we wouldn't rule out another new low being hit. However in our eyes, most attention should be directed to commercial consent issuance. While it has held up at a reasonable level so far to date, we suspect it will also start to head lower. The December quarter QSBO survey showed firms' building intentions at the lowest levels since 1991. Architects, obviously a good lead gauge on future building work, also reported a sharp fall in work over the next 12 months. This year looks likely to be the year where commercial construction follows its residential counterpart.

Internationally, it is a busier week for data and events, although the US earnings reporting season is bound to continue to get plenty of attention. The Australian CPI will be important, but like in NZ it is growth concerns that are now the predominant concern of policymakers. Our Australian colleagues are expecting a fall in the headline CPI of 0.2 percent, but with core inflation to remain at 0.8 percent. In the US, the FOMC are meeting and due to make a policy announcement. Seeing as interest rates have already been reduced to virtually zero, there is obviously little more they can do on that front. Markets will watch for any other non-traditional measures. Also, advanced Q4 GDP is due to be released in the US and markets are expecting a reasonable contraction, possibly in the vicinity of -6 percent annualised. Elsewhere around the globe, the key German IFO survey is due, and it is hard to see this painting anything but a gloomy picture for the world's fourth largest economy.

Recent local data...

- > **Consumers Price Index (December quarter):** The headline CPI fell by 0.5 percent, taking annual inflation to 3.4 percent.
- > **Food Price Index (December):** Food prices fell 0.2 percent in the month.
- > **Retail Trade Survey (November):** Headline retail spending was flat over the month, while core spending (excluding motor vehicle related industries) rose 0.3 percent.
- > **Electronic Card Transactions (December):** Total retail transactions fell 0.5 percent, while core retail transactions rose 0.2 percent.

A NEGATIVE OUTLOOK – S&P

The 2009 *Budget* will be a key benchmark assessing NZ's foreign currency rating. While long-term fiscal projections are subject to a huge degree of uncertainty, using Treasury's Fiscal Strategy Model we show that it will require a combination of fiscal restraint, moving early to curb spending growth, and stronger economic performance for the fiscal position to improve in order to avert a potential downgrade. The challenge is to deliver a credible strategy for all.

Standard & Poor's placement of NZ's foreign currency rating on a negative outlook has a lot of people talking, particularly given that Spain, Greece and Portugal were placed on negative watch around the same time, and their ratings were subsequently downgraded within a short space of time.

At the outset we need to note some definitional aspects. Negative *watch* means a review is taking place now, and the outcome is either no change or a downgrade quickly. A negative *outlook* has a longer-term connotation. Certainly when you look at the statements related to each you notice the key differences (our emphasis has been added to each).

S&P on **Spain** (placed on "watch", and since downgraded): *"A resolution of the CreditWatch action is likely this month pending further information from the Spanish government regarding its response to the deterioration in the structure of both the economy and its public finances"*.

S&P on **Portugal** (placed on "watch", and since downgraded): *"A resolution of the CreditWatch placement is likely this month pending further information from the Portuguese government regarding past or future improvements in the structure of both the economy and public finances."*

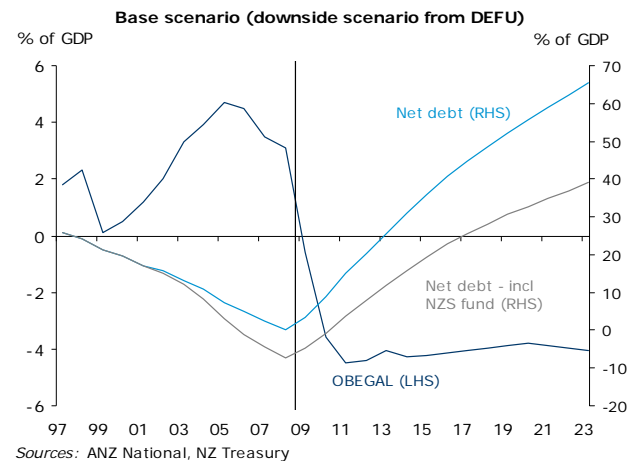
S&P on **Greece** (placed on "watch", and since downgraded): *"A resolution of the CreditWatch action is likely this month pending further information from the Greek government regarding its response to intensifying economic and fiscal pressures."*

S&P on **Ireland** (outlook changed to Negative): *"The negative outlook reflects our view of the likelihood of a downgrade if ongoing fiscal measures to recapitalize the banks and boost the economy fail to improve competitiveness, diversity, and growth prospects, thereby leaving a more difficult-to-manage debt burden ... Conversely, the negative outlook could revert to stable if the government's strategy is successful and allows public finances to return to the stronger position of recent years."*

S&P on **NZ** (outlook changed to Negative): *"In this regard, the next budget (due in May 2009) will in our view be a key indicator of the government's intent regarding medium-term expenditure cuts and reprioritizing of policy initiatives. A credible medium-term fiscal plan combined with an easing of New Zealand's external imbalances could, in our view, result in the ratings stabilizing at the existing levels. Absent such developments, the foreign currency rating could be lowered."*

Obviously, the key for NZ going forward if we are to avoid the fate of Spain, Greece and Portugal, will be the 2009 *Budget* with considerable attention set to be paid to the medium-term fiscal projections (beyond 2013).

In so far as medium-term projections are concerned, it's possible to tell any story. Tweak the assumptions and you can get the answer you want! But of course, the caveat to this is that the assumptions still need to pass the credibility (or common sense) test.



Looking at the baseline fiscal projections (and using the downside scenario noted in the Treasury's *December Economic and Fiscal Update*, which PM Key has acknowledged is now the central case), a couple of points are noteworthy:

- > The projections include sustained underlying fiscal deficits. Part of this reflects a sustained deterioration in the structural deficit, but also the dynamic that once you get into deficit, debt servicing costs progressively rise, and you end up in a vicious spiral of rising debt servicing costs as a share of expenses, as deficits breed more deficits.
- > A strong starting position is important. Even though sizeable fiscal deficits are projected, NZ's starting position is good, particularly compared to other nations. NZ's underlying operating balance is still currently in surplus and although it is projected to decrease sharply, it does take time to feed into balance sheet metrics such as debt, although obviously the speed of change will depend on how quickly

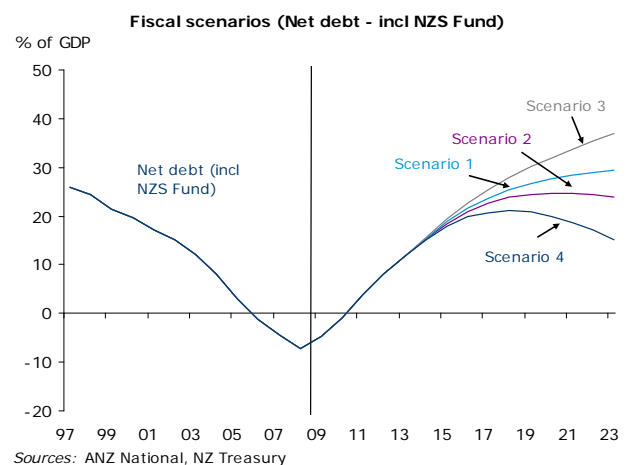
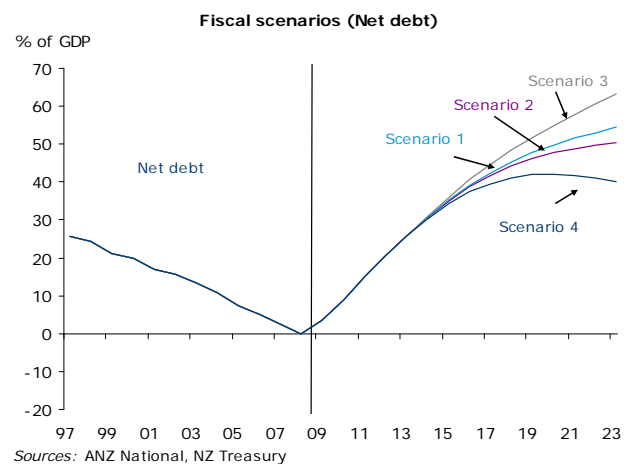
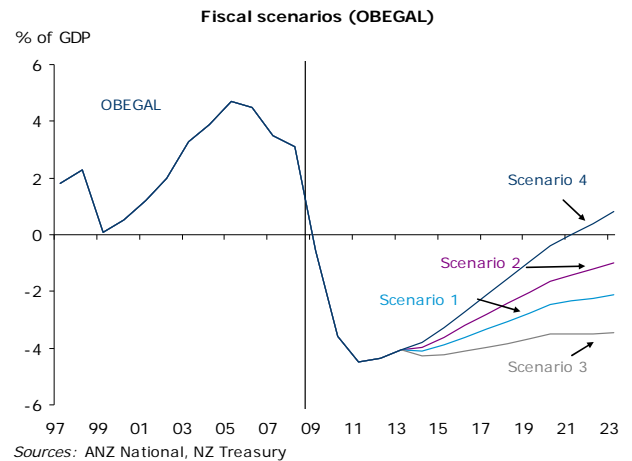
the economy deteriorates this year. Likewise we need to differentiate between net debt, and net debt including NZ Super Fund assets, as the latter has now become a big component of NZ's fiscal landscape. But clearly, sustained deficits lead to debt rising sharply, and as the Minister of Finance has noted: it's not acceptable and will not be allowed to happen.

- > The projections already include a degree of spending restraint. Within the projections are allowances for new initiatives, which are effectively allocations for future Budgets. The projections assume this allowance grows in line with the CPI, or 2 percent beyond 2013 and the primary forecast horizon. While demographic and other factors obviously make up a big proportion of spending and are still captured, the implicit assumption within the forecasts is that real per capita spending will remain constant – a major divergence from recent experience.
- > The projections include a relatively conservative growth assumption with real GDP growth averaging 2.3 percent per year. But achieving this will still require labour productivity growth to be higher (1.5 percent) than what we have seen over the past decade.

Now we can tweak the assumptions by a couple of aspects. As noted earlier, it's possible to get any fiscal outcome you want! This can either be through growth, or through spending restraint, and all foster a turn in the fiscal position. We present four different scenarios below:

- > **Scenario one: go for growth.** Labour productivity growth improves from the base scenario of 1.5 percent to 2.0 percent per year, taking average GDP growth to 2.8 percent from 2013 to 2025.
- > **Scenario two: commit to a lower operating provision – early.** This scenario assumes the government acts early and makes a cut to the projection year's (2014) operating provision for future Budgets (\$1.0 billion from \$1.7 billion), but still assumes growth in spending (this provision) in line with the CPI. Real per capita spending remains constant, but at a lower starting point. The reduction is beyond the short-term horizon where there is obvious pressure to maintain and provide counter-cyclical fiscal policy support, but still close enough so benefits have time to accumulate from 2014 to 2023. With health typically accounting for 40 percent of such an operating provision, lowering it from \$1.7 billion to \$1 billion will prove challenging, particularly if continued reductions in tax rates are also to be financed.

- > **Scenario three: claw our way back slowly.** Rather than having the operating provisions grow in line with inflation from 2014 to 2023, they remain constant from the base of \$1.7 billion. This is implicitly a scenario of falling real per capita spending but no correction to recent spending trends in the size of the starting provision.
- > **Scenario four: the kitchen sink.** A combination of both scenarios one and two.



In terms of the scenarios, some key results are noteworthy. The fiscal position is hard to turn around and under most scenarios, sustained deficits

are projected for a considerable period. Even under a “go for growth and spending restraint” scenario, deficits are predicted out to 2021, albeit of considerably lower magnitude than the baseline. Net debt (including the NZS Fund) rises, but has the luxury of coming off a low base, although it is still far higher. There is clear value in moving early (scenario 2) as opposed to moving late and trying to gradually claw your way back. This in itself highlights that while spending need not be cut, the allowance for new initiatives in the future will have to be far smaller than what we have seen over recent history. This will involve some difficult choices considering recent spending trends.

Unsurprisingly, the greatest ‘bang for your buck’ is derived from a combination of the growth and spending restraint (scenario four). This fosters an improvement in the underlying operating balance to close to zero, and net debt (including the NZS Fund) to around 20 percent of GDP. But it is still a scenario that takes time to turn things around.

While it’s possible to get any answer you like out of such modelling by merely changing the input assumptions, the obvious constraint is that the scenarios and assumptions have to contain a degree of credibility. While tempting to put in more extreme scenarios such as 3 percent plus trend growth or even more spending restraint, such scenarios face “credibility” tests, an area S&P will no doubt be attuned to.

The upshot

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

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

OCR PREVIEW

(due 9.00am 29 January)

We expect the RBNZ to cut the OCR by 100bps to a new low of 4 percent and leave the door open to more.

Given the deterioration in the domestic and international economic outlook, another big rate cut is on the cards. It is becoming very clear that the NZ economy is far from getting out of recession just yet, as Governor Bollard had expected (hoped?) at the time of the December *Monetary Policy Statement (MPS)*. Indeed, the OSBO survey suggests the economy not only likely contracted in Q4 last year, but that this could extend into Q1 this year as well. The Bank's 0.6 percent GDP growth forecast for calendar 2009 is now looking decidedly optimistic.

The international outlook has also taken another turn for the worse. The dataflow since the *MPS* points to a sharp synchronised downturn in NZ's major trading partners. Based on the latest *Consensus Forecasts*, NZ trading partner GDP growth for calendar 2009 is -0.2 percent, and likely to be revised down in the months ahead given the recent weak data prints. This is a substantial difference from the 1.1 percent trading partner growth assumption underlying the *MPS*.

Crucially, we are finally getting evidence of easing domestic inflation pressures. The Governor was still expressing disquiet over stubbornly high domestic inflation in certain non-contestable sectors of the economy (local body rates and electricity prices were singled out) at the *MPS*. Indeed, this point was reiterated in a speech shortly following the *MPS*. But the softer prints for core inflation measures in the Q4 CPI report point to early signs that domestic inflation pressures are finally easing. Electricity prices are still rising, and local body rates increases will continue to run above inflation given the pressures on council budgets. But construction costs fell for the first time since 1999, and both the trimmed mean and weighted median measures showed modest rises of 0.2 and 0.5 percent respectively. Headline CPI inflation is set to fall sharply in the coming quarters towards the bottom of the RBNZ target band, partly thanks to lower petrol prices.

The medium-term inflation outlook has vastly improved. Resource slack is opening up rapidly in the economy. Capacity utilisation showed a large decline in Q4, and labour shortages are a thing of the past. With the economy set to contract further in the near-term, a considerable negative output gap is opening up. In a mechanical sense, this will drive medium-term inflation much lower in the RBNZ's modelling framework, despite the TWI being lower than the December projections.

Certainly, a recent pricing intentions survey is already pointing to strong demand pull forces at work, as more firms seek to actually reduce their prices in the face of weakening demand. As such, **while there is still some lingering price pressures in certain areas, inflation is now no longer an issue for the RBNZ, and will not be a stumbling block to further easings.**

With a rate cut this week well warranted, the question is how big? The market has quickly moved from an expectation of 50bps earlier this month to pricing in 129bps currently. While we think the RBNZ will be reluctant to disappoint the market, we are also mindful of how quickly market pricing has changed, and it seems like a race at present to pick the trough in rates! The RBNZ has already massively front-loaded the easing cycle with 325bps of rate cuts since July last year. Importantly, the RBNZ is now getting policy traction via the mortgage curve, which has pre-empted future policy moves. In addition, there is already stimulus in the system via a lower NZD and fiscal policy. While it would never pay to rule out another "exceptional" cut in rates given the economic environment, we must not lose sight of how far rates has come, the massive loosening in overall financial conditions, and the implementation of non-OCR measures to date. In addition, 100 basis points is still what we'd consider "exceptional".

We suspect the tone of the communication to maintain a huge degree of flexibility, but be perhaps marginally more hawkish relative to current market pricing. Market pricing is for a terminal cash rate of sub-3 percent. While it is hard to argue with the spirit of this, and central banks are maintaining flexibility from month to month in lieu of how quickly conditions are unfolding, we are now entering a period where the Reserve Bank may need to be more proactive in managing market expectations as to interest rates, either in terms of how low they go, or the other aspect to policy, how long they expect to keep them there. Typically we become fixated with the OCR and forget that the real trick to policy is manipulating the yield curve.

Financial market implications

The market is priced for a bigger move than we're forecasting, giving scope for a sell-off. **However, we expect the reaction to be minor, and confined to the very short end of the curve, as the market is likely to just "push out", rather than "price out" rate cuts.** Similarly, while the NZD may experience a fillip, we expect it to be reasonably short-lived, eventually giving way to negative medium term fundamentals, as we discussed at length in last week's "key themes" research piece.

GLOBAL WATCH

It was again a mixed bag for data last week and while some results surprised on the upside, they still fit within a very weak trend and highlight a struggling global economy. The UK economy contracted sharply in the fourth quarter and Chinese GDP growth has fallen to its slowest rate since 2000. Asian trade data continue to highlight that world trade flows have literally ground to a halt.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	NAHB Housing Market Index (Jan)	9	8	9	Weaker
	Housing Starts (Dec)	605K	550K	625K	Weaker
	Continuing Jobless Claims (w/e Jan 11)	4555K	4607K	4497K	Stronger
	House Price Index (Nov) – mom	-1.2%	-1.8%	-1.1%	Weaker
Euro-zone	ZEW Survey (Economic Sentiment) (Jan)	-46.0	-30.8	-46.1	Weaker
	Industrial New Orders (Nov) – mom	-5.0%	-4.5%	-4.7%	Stronger
	PMI Manufacturing (Jan A)	33.1	34.5	33.9	Stronger
	PMI Services (Jan A)	41.5	42.5	42.1	Stronger
UK	CPI (Dec) – mom	-0.9%	-0.4%	-0.1%	Stronger
	Jobless Claims Change (Dec)	81.0K	77.9K	75.7K	Stronger
	M4 Money Supply (Dec P) – mom	0.9%	1.7%	1.2%	Stronger
	GDP (4Q A) – qoq	-1.2%	-1.5%	-0.6%	Weaker
	Retail Sales (Dec) - mom	-0.7%	1.6%	0.3%	Stronger
Asia Ex-Japan					
<i>China</i>	GDP (4Q) – yoy	6.8%	6.8%	9.0%	In-line
	Producer Price Index (Dec) – yoy	-0.1%	-1.1%	2.0%	Weaker
	CPI (Dec) – yoy	1.6%	1.2%	2.4%	Weaker
	Retail Sales (Dec) – yoy	19.5%	19.0%	20.8%	Weaker
	Industrial Production (Dec) – yoy	4.2%	5.7%	5.4%	Stronger
<i>South Korea</i>	GDP (4Q P) – qoq	-2.1%	-5.6%	0.5%	Weaker
<i>Singapore</i>	CPI (Dec) – mom	-0.1%	-0.6%	-0.2%	Weaker
	Industrial Production (Dec) – yoy	-10.3%	-13.5%	-6.6%	Weaker
	GDP (4Q F) – qoq annualised	-12.9%	-16.9%	-12.5%	Weaker
<i>Hong Kong</i>	Unemployment Rate (Dec)	4.0%	4.1%	3.8%	Weaker
<i>Taiwan</i>	Unemployment Rate (Dec)	4.9%	5.0%	4.6%	Weaker
	Export Orders (Dec) – yoy	-37.1%	-33.0%	28.5%	Stronger
<i>Malaysia</i>	Industrial Production (Dec) - yoy	-31.2%	-32.4%	-28.4%	Weaker
	CPI (Dec) – yoy	5.0%	4.4%	5.7%	Weaker
	Overnight Rate	2.75%	2.50%	3.25%	Weaker
<i>Thailand</i>	Customs Exports (Dec) – yoy	-	-14.6%	-20.5%	-
	Customs Imports (Dec) – yoy	-	-6.5%	2.0%	-
<i>Vietnam</i>	Exports YTD (Jan) – yoy	-	-24.2%	29.5%	-
	Imports YTD (Jan) – yoy	-	-44.8%	27.5%	-
Japan	Tertiary Industrial Index (Nov) – mom	-0.8%	-0.9%	0.4%	In-line
	Consumer Confidence (Dec)	27.0	26.7	28.7	Weaker
	BoJ Target Rate	0.10%	0.10%	0.10%	In-line
	All Industry Activity Index (Nov) – mom	-2.2%	-2.3%	-0.5%	In-line
Australia	Westpac Consumer Confidence (Jan)	-	-2.2%	7.5%	-
	Import Price Index (4Q) – qoq	5.9%	10.8%	5.0%	Stronger
	Export Price Index (4Q) – qoq	7.0%	15.9%	13.8%	Stronger

INTEREST RATE STRATEGY

Interest rates continue to fall, having closed at record lows again on Friday. However, with 129bps priced in for Thursday's *OCR Review*, a showdown is looming. We expect the fallout of a 100bp cut to be limited to the very short end – the market is likely to simply price in more for March and April. We believe it is still too soon for borrowers to extend duration.

Market themes...

- > Complacency is high, with the setting of new record low yields now a daily occurrence. As such, a retracement is highly likely. The *OCR Review* could be the catalyst, but the fallout will be limited.
- > Global bond markets have started to respond to upcoming issuance, and the possibility that traditional funding sources (i.e. China and East Asia) may not have the same appetite.
- > Issuance is a factor in New Zealand, but that's likely to be manifested in narrower swap spreads. This likely won't deter the swap market from rallying further.
- > Interest rates are low by historical standards, enticing some borrowers. But that argument has been valid for some time now, and thankfully we weren't swayed by it.

Review and outlook ...

Beyond the obvious risk of a corrective retracement that goes hand in hand with a move lower in interest rates like the one just witnessed, it is difficult to craft a credible scenario involving interest rates moving higher on a sustainable basis. True, there is plenty of easing "priced in", both for Thursday, and for the easing cycle as a whole. But at the same time, the US housing market remains in a downward spiral, which is keeping the brakes on demand, and in turn, on trade and the global economy, which New Zealand is so dependent on.

And with the "credit crunch" as yet unresolved, it's difficult to see the interest rate cycle turning just yet. If there is any lesson to be learned from recent events, it is to expect the unexpected, and with the OCR still at 5 percent, there's still plenty monetary policy can do, and political pressure will only become greater. The market is currently pricing in an end point of 2.75 percent, and while that seems low, with the US and Japan at close to zero, it's still high in a relative sense. That's not to say that the OCR may, or even needs to, go beyond 2.75 percent, but it certainly doesn't need to go higher, especially if margins remain under pressure, which again, just argues for more monetary policy accommodation.

Borrowing strategies we favour at present

Tempting as it may be to hedge now, the case for doing so doesn't completely stack up. Interest rates are low by historical standards, but we don't believe that's a strong argument to start extending hedges. By contrast, other arguments are flaky. The curve is positively sloped beyond 1yr, encouraging short hedges. There are no signs that the economic cycle may have turned, which gives us no confidence that a retracement in swap rates will be sustainable; or that business cashflow will improve. Margins remain high, and may even contribute to a steeper yield curve (esp. as the Government's funding requirement starts to rise), but as this is likely to feature in RBNZ policy deliberations, so it's not clear that fixing makes sense. By March, the picture (and the RBNZ's attitude) will be much clearer so for now we favour keeping the duration of hedges short.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ	↔	Hard to be bullish with over 100bps priced in for Thurs.
NZ data	↓	CPI weaker, Retail stronger. But tone, anecdotes weak.
Fed Funds/ front end	↔	Quant Easing on the agenda, and not just for the Fed.
RBA	↔	Incoming news (esp on commodity side not good, but massive cuts priced in.
US 10 year	↔↑	Funding starting to concern. Hasn't been evident in NZ yet, but only matter of time.
NZ swap curve	↔↓	Bull steepening, reinforced by increased NZGS issuance, possible credit downgrade.
Flow	↓	Almost a one way street. Small corporate paying offset by massive receiving.
Technicals	↓	5yr below 4% significant.

Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 29-Jan-09	-99	-129
Thu 5-Mar-09	-166	-193
Thu 23-Apr-09	-190	-213
Thu 4-Jun-09	-197	-220
Thu 30-Jul-09	-199	-228
Thu 10-Sep-09	-205	-229
Thu 29-Oct-09	-208	-236

Trading themes we favour at present

Despite our bullish overall view, with 129bps priced in, we favour a neutral stance going into Thursday's *OCR Review*. The curve is pricing 3mth bills rising after Sep, which we think is a bit soon. Consider investing in 12/15 FRAs against borrowing 6/9s.

CURRENCY STRATEGY

Revised Fonterra payout and another large rate cut from the RBNZ this week should ensure the NZD remains on the back foot. Potentially weak data out from Australia also has the prospect of dragging the NZD lower. Our medium-term bearish view on the NZD remains.

Market themes...

- > Signs of easing NZ inflation pressure weigh on the NZD.
- > But a commodity bounce end of last week provided a lift to commodity currencies.
- > Risk appetites reduced in light of poor global economic data and corporate earnings news.
- > Speculation of central bank interventions offshore sees volatile trading in the majors.

Review and outlook...

The NZD was under pressure last week as risk appetites continued to wane. With global economic data still printing below expectations, particularly out of Asia, risky assets have been shunned by investors. Narrowing yield differentials also weighed on the NZD, as the rates market moved to price in close to 130bps of easing this week by the RBNZ, and a terminal cash rate of near 2.75 percent.

Despite several probes below the key 0.52 level against the USD, that support level has managed to hold for now. We think it will only be a matter of time before that level gives way, and that could happen this week. Two key events that will keep the NZD on the back foot are Fonterra's updated dairy payout forecast for this season (out on Wednesday at 1200 NZDT) and the RBNZ's OCR decision (on Thursday at 0900 NZDT). The former will likely see a downward revision from \$6/kg ms towards the low \$5's, while the latter will see another big rate cut with the door open to more.

We expect the NZD to be dragged down by the AUD this week, with business confidence and inflation data out of Australia set to weigh on the AUD. The one saving grace for the antipodean currencies is a continuation of the global commodity price rally seen at the end of last week. Gold prices reached US\$900/oz at one stage and oil prices moved past US\$46/bbl. After recent sharp declines, a rebound in commodity prices was to be expected at some stage. Whether it can continue will have an important bearing on the NZD in the near-term.

However, the commodity prices that are rallying will be of limited benefit to the NZ economy – the softs that NZ mainly exports continue to fall, with the latest USDA dairy prices out last Friday showing

another 5 percent decline from a fortnight ago. The Fonterra announcement this week should certainly reinforce the dichotomy between hard and soft commodities.

Technically, the 0.5175 level has become critical. A third rejection of this level, coupled with correlated currencies doing better and a bounce in the CRB all suggest the consolidation between 0.5200 and 0.5550 is not yet complete. 0.8000 is major support on the NZD/AUD cross with a 0.8000/0.8200 range expected until data surprises.

NZD vs AUD: monthly directional gauges

Gauge	Direction	Comment
Fair value	↔	Back in the fair value zone.
Yield	↔/↓	More than 100bp from RBNZ priced in.
Commodities	↔/↓	Hards rallying, but USDA dairy prices still falling.
Partial indicators	↓	NZ indicators worse for now.
Technicals	↓	Major support at 0.80.
Sentiment	↓	All eyes on Fonterra payout revision this week.
Other	↓	NZ inflation showing signs of easing.
On balance	↔/↓	Further declines expected, though near-term consolidation likely.

NZD vs USD: monthly directional gauges

Gauge	Direction	Comment
Fair value – long-term	↔/↓	Erring towards macro-balance fair value models in this environment. They say low 0.50s.
Fair value – short-term	↔	Slightly below our cyclical fair value level.
Yield	↓	Market testing big rate cut from RBNZ this week.
Commodities	↓	NZ's commodity basket not joining the global rally.
Risk aversion	↔/↓	High on the back of global recession concerns.
Partial indicators	↔	NZ's starting to compete with the US's.
Technicals	↔/↓	Support at 0.5175 critical.
AUD	↔/↓	AUD not spared.
Sentiment	↔/↓	Very poor.
Other	↔/↓	Asian data printing very weak, putting USD higher by default.
On balance	↔/↓	Next leg lower.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
26-Jan	NZ	Performance of Services Index (Nov)	-	-	10:30
		Credit Card Spending (Dec) - yoy	-	-0.7%	15:00
	EC	ECB's Gonzalez-Paramo Speaking in Madrid	-	-	23:00
27-Jan	US	Leading Indicators (Dec)	-0.2%	-0.4%	04:00
		Existing Home Sales (Dec) - mom	-2.0%	-8.6%	04:00
	JN	BoJ Monetary Policy Meeting Minutes for December	-	-	12:50
	AU	NAB Business Confidence (Dec)	-	-30	13:30
		NAB Business Conditions (Dec)	-	-17	13:30
		Producer Price Index (4Q) – qoq	0.4%	-	13:30
	GE	IFO - Business Climate (Jan)	81.0	82.6	22:00
		IFO - Current Assessment (Jan)	85.0	88.8	22:00
		IFO – Expectations (Jan)	77.5	76.8	22:00
	EC	ECB Current Account s.a. (Nov)	-	-6.4B	22:00
28-Jan	US	S&P/CS Composite-20 (Nov) - yoy	-18.4%	-18.0%	03:00
		Consumer Confidence (Jan)	39.0	38.0	04:00
		Richmond Fed Manufacturing Index (Jan)	-53	-55	04:00
	EC	ECB Council Member Liikanen Speaks in Helsinki	-	-	04:30
	NZ	Fonterra Cooperative Expected to Announce Revised Milk Payout	-	\$6.00	12:00
	AU	Westpac Leading Index (Nov) – mom	-	-0.1%	12:30
		Consumer Prices (4Q) - qoq	-0.4%	1.2%	13:30
		Consumer Prices (4Q) - yoy	3.6%	5.0%	13:30
		RBA Trimmed Mean (4Q) - qoq	0.8%	-	13:30
		RBA Trimmed Mean (4Q) - yoy	4.4%	-	13:30
		RBA Weighted Median (4Q) - qoq	0.8%	-	13:30
		RBA Weighted Median (4Q) - yoy	4.4%	-	13:30
	GE	GfK Consumer Confidence Survey (Feb)	2.0	2.1	20:10
29-Jan	US	FOMC Rate Decision	0.25%	0.25%	08:15
	NZ	RBNZ Official Cash Rate	4.00%	5.00%	09:00
		Trade Balance (Dec)	-100.0M	-520.0M	10:45
		Imports (Dec)	3.80B	4.21B	10:45
		Exports (Dec)	3.76B	3.69B	10:45
		Money Supply M3 (Dec) – yoy	-	9.4%	15:00
	JN	Large Retailers' Sales (Dec)	-5.2%	-3.2%	12:50
		Retail Trade (Dec) - mom	-0.8%	-0.1%	12:50
		BoJ Deputy Governor Nishimura to Speak in Utsunomiya City	-	-	14:30
	GE	ILO Unemployment Rate (Dec)	7.2%	7.1%	20:00
		Unemployment Change (000s) (Jan)	30K	18K	21:55

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
29-Jan cont.	GE	Unemployment Rate s.a. (Dec)	7.7%	7.6%	21:55
	EC	Euro-Zone M3 s.a. (Dec) – yoy	7.6%	7.8%	22:00
		Business Climate Indicator (Jan)	-3.50	-3.17	23:00
		Consumer Confidence (Jan)	-31	-30	23:00
		Economic Confidence (Jan)	65.4	67.1	23:00
		Industrial Confidence (Jan)	-34	-33	23:00
		Services Confidence (Jan)	-18	-17	23:00
30-Jan	US	Durable Goods Orders (Dec)	-2.0%	-1.0%	02:30
		Durables Ex Transportation (Dec)	-2.7%	1.2%	02:30
		Initial Jobless Claims (w/e Jan 25)	575K	589K	02:30
		Continuing Claims (w/e Jan 18)	4615K	4607K	02:30
		New Home Sales (Dec) – mom	-3.0%	-2.9%	04:00
	NZ	Building Permits (Dec) - mom	-	4.3%	10:45
		Reserve Bank Governor Alan Bollard Speaks	-	-	12:00
	AU	Conference Board Leading Index (Nov)	-	-0.5%	12:00
		Private Sector Credit (Dec) – mom	0.5%	0.4%	13:30
	JN	Jobless Rate (Dec)	4.1%	3.9%	12:30
		Household Spending (Dec) - yoy	-3.6%	-0.5%	12:30
		National CPI (Dec) - yoy	0.4%	1.0%	12:30
		National CPI Ex-Fresh Food (Dec) - yoy	0.3%	1.0%	12:30
		National CPI Ex Food, Energy (Dec) - yoy	0.0%	0.0%	12:30
		Industrial Production (Dec P) - mom	-9.0%	-8.5%	12:50
		Vehicle Production (Dec) - yoy	-	-20.4%	17:00
		Housing Starts (Dec) - yoy	-7.7%	0.0%	18:00
		Construction Orders (Dec) - yoy	-	-12.5%	18:00
	UK	Net Consumer Credit (Dec)	0.7B	0.8B	22:30
		Mortgage Approvals (Dec)	26K	27K	22:30
		M4 Money Supply (Dec F) - mom	-	1.7%	22:30
	EC	CPI Estimate (Jan) – yoy	1.4%	1.6%	23:00
		Unemployment Rate (Dec)	7.9%	7.8%	23:00
31-Jan	US	GDP (Annualized) (4Q A) - qoq	-5.5%	-0.5%	02:30
		Personal Consumption (4Q)	-3.5%	-3.8%	02:30
		Core PCE (4Q) – qoq	1.3%	2.4%	02:30
		Employment Cost Index (4Q)	0.7%	0.7%	02:30
		Chicago Purchasing Manager (Jan)	34.7	34.1	03:45
		University of Michigan Confidence (Jan F)	61.9	61.9	4:00

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

NEW ZEALAND DATA WATCH

Key focus over the next four weeks: The RBNZ's decision is obviously the big event of the week and another aggressive interest rate cut is expected. The domestic data flow is likely to remain very poor, particularly labour market data in a fortnight's time, and highlight that the economy is far from finding a base.

Date	Data/Event	Economic Signal	Comment
Mon 26 Jan (15.00)	Credit Card Spending (Dec)	How did Christmas spending period go?	Anecdotes were mixed on the retail performance over the Christmas period. ECT data was relatively subdued and we expect the credit card data to be the same.
Thu 29 Jan (09.00)	RBNZ <i>OCR Review</i>	100bp cut	Given falling commodity prices and a deteriorating global economy, on top of a QSBO survey that shows the economy is far from finding a base, the bias remains for monetary policy to continue acting aggressively.
Thu 29 Jan (10.45)	Overseas Merchandise Trade (Dec)	Weak exports and imports	A trade deficit is typically recorded in December months and this is likely to be the case again. However, the level of both exports and imports are likely to be the more telling picture as a gauge of overall flows.
Thu 29 Jan (15.00)	Credit Growth (Dec)	Another negative?	With the housing market remaining weak, there is little doubt that credit growth will also remain soft and near record lows.
Fri 30 Jan (10.45)	Building Consents (Dec)	A very low level	Residential consent issuance will remain at a very subdued level, which is consistent with activity in the housing market. Key to watch now is the performance of commercial consents.
Mon 2 Feb (10.45)	LCI & QES (Dec quarter)	Wage growth still elevated, but at its peak	Wage growth is likely to have peaked.
Thu 5 Feb (10.45)	HLFS (Dec quarter)	Continuing to turn	This has the potential to be a nasty one. We expect employment to fall and for the unemployment rate to rise sharply.
Thu 12 Feb (10.45)	Food Price Index (Jan)	Easing	While volatile on a monthly basis due to weather and seasonal aspects, annual food price inflation is likely to have peaked given lower global commodity prices.
Fri 13 Feb (10.45)	Retail Trade Survey (Dec)	Anecdotes suggest subdued	While we will wait for the credit card data to make a final call, anecdotes from the Christmas shopping period were mixed. People still spent, but on cheaper goods. We expect another weak result.
Mon 16 Feb (10.45)	Producer Price Index (Dec qtr)	Passed the peak	Like with the CPI, producer price inflation is likely to have peaked. We expect output prices to fall by around 0.6 percent, and input prices to be relatively flat – still indicative of margin pressure.
Wed 18 Feb (10.45)	External Migration (Dec)	Visitor arrivals heading downhill	Another net outflow of permanent migration cannot be ruled out for the month. Visitor arrivals are also expected to continue to head lower in the face of the global economic slowdown.
On Balance		Flow-on from the global scene starting to appear in the dataflow.	Weakness extending into early 2009.

SUMMARY OF KEY ECONOMIC FORECASTS

	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
GDP (% qoq)	0.8	-0.3	-0.2	-0.4	-0.6	-1.0	-0.3	0.0	0.2	0.6
GDP (% yoy)	3.7	2.1	1.0	-0.1	-1.5	-2.2	-2.3	-1.9	-1.1	0.5
CPI (% qoq)	1.2	0.7	1.6	1.5	-0.5	0.0	0.8	0.6	0.7	0.5
CPI (% yoy)	3.2	3.4	4.0	5.1	3.4	2.7	1.9	0.9	2.1	2.6
Employment (% qoq)	0.9	-1.3	1.3	0.1	-1.5	-1.0	-0.6	-0.5	-0.2	0.0
Employment (% yoy)	2.5	-0.2	0.7	1.0	-1.4	-1.1	-3.0	-3.6	-2.3	-1.3
Unemployment Rate (% sa)	3.4	3.7	3.9	4.2	4.7	5.2	5.7	6.1	6.6	6.9
Current Account (% GDP)	-8.2	-8.0	-8.4	-8.6	-8.9	-8.8	-7.7	-7.0	-6.5	-6.5
Terms of Trade (% qoq)	2.9	4.2	-0.4	-2.3	-3.1	-1.6	-1.7	-1.6	-1.1	-0.7
Terms of Trade (% yoy)	8.8	11.6	10.7	4.4	-1.8	-7.2	-8.5	-7.8	-5.9	-5.0

KEY ECONOMIC INDICATORS

	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08	Jan-09
Retail Sales (% mom)	1.2	-1.2	0.9	-0.7	0.3	0.4	-1.3	0.0	..	..
Retail Sales (% yoy)	4.1	1.0	1.5	2.5	-0.9	2.2	0.7	-4.1	..	..
Credit Card Billings (% mom)	-0.3	0.5	-0.1	0.1	-0.2	1.1	-1.4	-0.8	..	..
Credit Card Billings (% yoy)	5.5	6.0	4.0	4.2	2.5	2.3	1.2	-0.7	..	..
Car Registrations (% mom)	12.2	-14.0	1.4	-7.2	-3.4	10.9	-0.4	-20.0	14.1	..
Car Registrations (% yoy)	-1.0	-20.6	-15.9	-27.1	-30.5	-15.6	-19.9	-34.4	-23.7	..
Building Consents (% mom)	80.4	-42.4	-12.9	-1.1	-7.1	9.2	-19.7	4.3	..	..
Building Consents (% yoy)	29.8	-27.1	-45.5	-34.4	-43.2	-28.5	-42.9	-39.4	..	..
REINZ House Price (% yoy)	-1.1	-1.4	-2.2	-1.4	-5.7	-6.1	-4.3	-4.1	-4.8	..
Household Lending Growth (% mom)	0.3	0.5	0.2	0.3	0.4	0.2	0.2	-0.1	..	..
Household Lending Growth (% yoy)	9.9	9.2	8.4	7.7	7.2	6.6	5.9	4.8	..	..
Roy Morgan Consumer Confidence	99.9	89.2	86.5	83.9	91.4	108.6	99.7	99.0	102.9	103.7
NBNZ Business Confidence	-54.8	-49.7	-38.7	-43.2	-20.5	1.6	-42.3	-43.0	-35.0	..
NBNZ Own Activity Outlook	-3.8	-4.4	-4.0	-8.2	4.7	16.7	-11.4	-14.1	-21.5	..
Trade Balance (\$m)	-293	-169	-215	-797	-848	-1253	-996	-520	..	..
Trade Balance (\$m annual)	-4604	-4782	-4478	-4468	-4369	-5050	-5272	-5164	..	..
ANZ World Commodity Price Index (% mom)	-0.3	0.9	0.0	1.8	-3.4	-5.1	-7.6	-7.4	-7.4	..
ANZ World Commodity Price Index (% yoy)	20.7	18.7	11.6	8.7	3.5	-2.1	-11.1	-18.3	-24.3	..
Net Migration (sa)	500	960	460	780	360	-20	-20	-590	..	..
Net Migration (annual)	4666	4931	4732	5201	4938	4403	4329	3569	..	..

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

SUMMARY OF KEY MARKET FORECASTS

NZ FX rates	Actual		Current	Forecast (end month)						
	Nov-08	Dec-08	26-Jan-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
NZD/USD	0.566	0.557	0.529	0.520	0.470	0.450	0.440	0.450	0.460	0.480
NZD/AUD	0.860	0.831	0.805	0.825	0.810	0.804	0.815	0.833	0.821	0.828
NZD/EUR	0.445	0.414	0.408	0.426	0.392	0.381	0.386	0.409	0.438	0.457
NZD/JPY	55.0	50.9	46.9	47.8	43.2	41.4	41.4	43.2	45.1	48.0
NZD/GBP	0.369	0.373	0.384	0.347	0.318	0.313	0.314	0.321	0.329	0.338
NZ\$ TWI	57.5	55.1	53.3	53.5	49.4	47.9	47.8	49.6	51.1	53.1
NZ interest rates	Nov-08	Dec-08	26-Jan-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
OCR	6.72	5.42	5.00	3.50	3.00	3.00	3.00	3.00	3.50	4.50
90 day bill	6.24	5.22	4.13	3.60	3.40	3.30	3.30	3.30	4.10	5.10
10 year bond	5.71	4.87	4.28	4.60	4.80	4.90	5.00	5.30	5.30	5.80
International	Nov-08	Dec-08	26-Jan-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
US Fed funds	1.00	0.25	0.25	0.25	0.25	0.25	0.25	0.50	1.00	1.50
US 3-mth	2.22	1.43	1.17	1.20	0.90	0.70	0.50	0.70	1.25	1.75
AU cash	5.25	4.25	4.25	3.50	3.25	3.00	3.00	3.00	3.00	3.50
AU 3-mth	4.72	4.15	3.60	4.00	3.80	3.70	3.80	3.80	3.80	4.20

KEY RATES

	23 Dec	19 Jan	20 Jan	21 Jan	22 Jan	23 Jan
Official Cash Rate	5.00	5.00	5.00	5.00	5.00	5.00
90 day bank bill	5.08	4.31	4.29	4.14	4.17	4.13
NZGB 07/09	4.42	3.38	3.34	3.33	3.33	3.33
NZGB 11/11	4.48	3.70	3.56	3.53	3.53	3.46
NZGB 04/13	4.55	3.97	3.84	3.81	3.81	3.74
NZGB 12/17	4.89	4.47	4.36	4.34	4.34	4.27
2 year swap	4.51	3.83	3.68	3.60	3.61	3.53
5 year swap	4.85	4.28	4.11	4.06	4.06	4.00
RBNZ TWI	56.0	54.7	53.6	53.3	53.0	53.2
NZD/USD	0.5741	0.5535	0.5336	0.5293	0.5269	0.5279
NZD/AUD	0.8403	0.8109	0.8053	0.8058	0.8041	0.8082
NZD/JPY	51.78	50.40	48.19	47.64	46.85	46.95
NZD/GBP	0.3868	0.3713	0.3734	0.3782	0.3786	0.3824
NZD/EUR	0.4100	0.4139	0.4098	0.4073	0.4052	0.4074
AUD/USD	0.6832	0.6826	0.6626	0.6569	0.6553	0.6532
EUR/USD	1.4003	1.3372	1.3022	1.2996	1.3003	1.2959
USD/JPY	90.20	91.05	90.32	90.00	88.91	88.94
GBP/USD	1.4843	1.4907	1.4291	1.3995	1.3917	1.3806
Oil	31.10	34.65	34.56	38.57	42.56	42.33
Gold	845.50	836.00	829.00	850.40	852.60	854.95
Electricity (Haywards)	1.75	4.96	4.55	2.89	1.50	n/a
Milk futures (US\$/contract)	86	n/a	84	84	84	84
Baltic Dry Freight Index	784	868	872	900	945	980

NEW ZEALAND DISCLOSURE INFORMATION

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

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

Qualifications, experience and professional standing

Experience

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

Relevant professional body

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

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

Professional indemnity insurance

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

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

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

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

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

Criminal convictions

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

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

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

Fees

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

Other interests and relationships

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

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

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

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

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

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

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

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

NEW ZEALAND DISCLAIMER

The Bank does not provide investment advice tailored to an investor's personal circumstances. It is the investor's responsibility to understand the nature of the security subscribed for, and the risks associated with that security. To the maximum extent permitted by law, the Bank excludes liability for, and shall not be responsible for, any loss suffered by the investor resulting from the Bank's investment advice.

Each security (including the principal, interest or other returns of any security) the subject of investment advice given to the investor by the Bank or otherwise, is not guaranteed, secured or underwritten in any way by the Bank or any associated or related party except to the extent expressly agreed in the terms of the relevant security.

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