

KEY MACRO THEMES FOR 2009

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Page 2: Economic overview

- > With the economic situation deteriorating, and fiscal policy options now somewhat constrained by the desire to avoid a credit rating downgrade, greater onus now rests on monetary policy. Conditions are changing rapidly, and we have revised our forecasts following the QSBO. We now expect a 100bp RBNZ cut at the end of the month, and a terminal OCR of 3 percent. We expect data next week to reinforce economic weakness and easing inflationary pressures.

Page 4: Economic comment – key macro themes for 2009

- > In this article, we outline some of the key themes we see evolving over the year ahead, which we expect to play an influential role in New Zealand's economic prospects. Most point to a very challenging 2009, as the economy adjusts and rebalances.

Page 15: Economic comment – global watch

- > It was a mixed bag in terms of data this week but still within a broad trend of poor results. US retail sales remain weak highlighting that consumers' wallets have well and truly been put away. However, the Philadelphia Fed manufacturing gauge did show some improvement from a depressed level. House prices in the UK continue to fall. In Asia, evidence continues to mount that trade flows have slowed dramatically.

Page 16: Interest rate strategy

- > Swap rates continue to fall, having closed lower, and at record lows every day this week, taking the 3yr below 4 percent, and the 5yr below 4.25 percent. We expect this to continue as expectations of RBNZ rate cuts intensify, fuelled by the latest round of poor economic news out of the US.

Page 17: Currency strategy

- > Poor data and a potential ratings downgrade have the NZD on the back-foot. This is expected to continue, with the only potential saviour being a markedly weaker USD – something which is not looking likely at the moment.

Page 18: Data and event calendar

Page 20: Data watch

Page 21: Key forecasts

ECONOMIC OVERVIEW

With the economic situation deteriorating, and fiscal policy options now somewhat constrained by the desire to avoid a credit rating downgrade, greater onus now rests on monetary policy. Conditions are changing rapidly, and we have revised our forecasts following the QSBO. We now expect a 100bp RBNZ cut at the end of the month, and a terminal OCR of 3 percent. We expect data next week to reinforce economic weakness and easing inflationary pressures.

What's ahead?

- > **December quarter CPI** (Tuesday 1045 NZDT). A large fall in petrol prices dominates and will see the headline CPI fall by 0.3 percent. Non-tradable inflation remains the key gauge and we expect a 0.8 percent increase for the quarter.
- > **December Food Price Index** (Tuesday 1045 NZDT). While volatile on a monthly basis, annual food price growth is likely to have peaked.
- > **November Retail Sales** (Wednesday 1045 NZDT). This is shaping up to be a poor number given ECT and credit card spending indicators. We expect a 0.9 percent fall in headline sales and a 0.5 percent fall in core sales. The risk is biased towards an even weaker result and potentially an absolute shocker.
- > **December Electronic Card Transactions** (Thursday NZDT). An important indicator for how the Christmas shopping season performed. Anecdotes suggest spending was subdued.

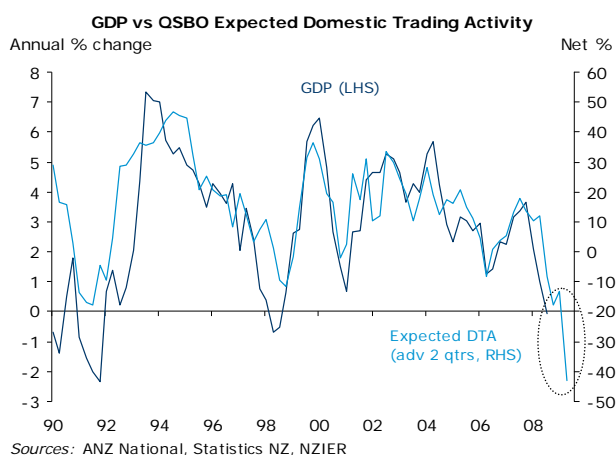
What's the view?

It has not been a pleasant start to the year for NZ economy watchers. When the first piece of major data released is arguably the worst it has been in over three decades, it does remind us (in case we had forgotten over the summer break) of the extremely challenging economic times we are in. In one word, the NZIER's Quarterly Survey of Business Opinion (QSBO) for the December quarter was dreadful and clearly shows that the economy has yet to find a base. Firms' experienced and expected trading activity fell to the lowest levels since at least 1970. Not only is Q4 GDP shaping up to record the fourth consecutive quarterly contraction (and potentially a large one at that), but 2009 Q1 is also looking negative as well. Profit expectations have slumped. Investment intentions have tumbled, with the lowest net number of firms intending to invest in buildings since 1991, and the highest number of firms intending to cut back on plant and machinery investment since at least 1975. This latter point does not bode well for the

economy's growth potential if and when conditions do recover.

We were already reasonably downbeat on the economy's prospects over 2009 when we presented our *Quarterly Economic Forecasts* last year, with an expectation of a contraction in GDP of 1.1 percent over the year. However, following the QSBO we now expect the contraction to be closer to 2 percent than 1 percent – surpassing the weakness over 1990/91 – and for the unemployment rate to rise to over 7 percent. But a flipside to our expectations of a more pronounced trough is also a sharper recovery over late 2010 and into 2011.

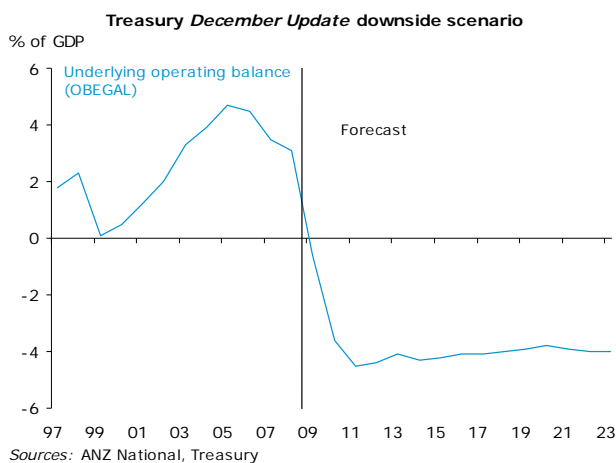
As alluded to earlier in the week, this edition of our *Market Focus* includes our key macro themes for 2009. Most are circumspect and flagging a more elongated adjustment. But in our view, a deeper downturn also lays the seeds of a more pronounced recovery (refer to page 4).



In this environment there is naturally more pressure on monetary policy to provide near-term relief, and our 75 basis point cut call for January on Monday had a shelf life of 24 hours, being revised to 100 basis points following the QSBO results. What was equally clear is that fiscal policy's ability to act in a countercyclical manner is heavily constrained, with NZ being placed on negative credit-watch by S&P. While some breathing space has been given for a few months, this year's *Budget* will be very closely perused. The Government clearly does not have the luxury of just getting the chequebook out willy-nilly.

We'll be doing some research over the coming week to see how much flexibility or scope the Government has to respond, and also what sort of steps are required to turn the fiscal position around. S&P was clearly unimpressed with expectations of sustained fiscal deficits of 4 percent of GDP out to 2020 (based on the Treasury's downside scenario in the December update). Turning such sustained deficits around represents a clear challenge when it comes to demonstrating expenditure restraint, particularly at a time fiscal

policy is expected to provide even more near-term support to the economy. The problem is simple: the greater the support provided near-term, the more significant the challenge of restraint becomes to turn the medium-term fiscal deficit around.

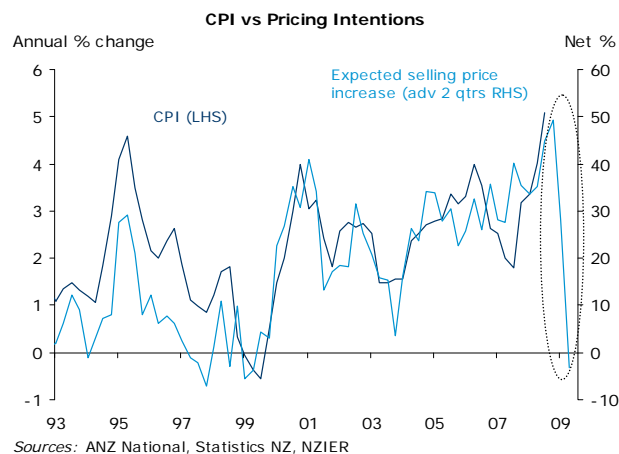


Moving to next week's events, there are a couple of important local ones. First up is the December quarter CPI release on Tuesday. The sharp fall in local petrol prices means NZ is set to join many other countries around the globe in printing a negative headline inflation rate. We expect the CPI to fall by 0.3 percent in the quarter, taking annual inflation to 3.6 percent. However, this is not the key focus. Instead it will be, as it has been for some time, on non-tradable inflation and other underlying core measures. Despite the slowing in the economy to date, domestic price pressures have remained sticky and this had not been lost on Governor Bollard, who singled out some sectors for their price increases late last year. We expect non-tradable to print at 0.8 percent for the quarter – still a relatively high result.

	Monthly Inflation Gauge (m/m%)	Implied Inflation Gauge (q/q%)	Actual non tradable CPI (q/q%)
Mar-08	0.4		1.1
Apr-08	0.3		
May-08	0.3		
Jun-08	0.4	1.0	0.9
Jul-08	1.0		
Aug-08	0.2		
Sep-08	0.2	1.4	1.3
Oct-08	0.2		
Nov-08	0.3		
Dec-08	0.1	0.6	

However, there is mounting evidence that domestic price pressures are easing. Firms' pricing intentions from the QSBO turned negative for the first time since December 1998. Builders, in particular, signalled they will be lowering their prices and this should please the RBNZ if it comes to fruition, given that construction costs was one area singled out by Dr Bollard. Even our own

monthly domestic inflation gauge (which remains experimental) is showing price pressures coming off the boil and has been pretty close to the mark when it comes to picking non-tradable inflation over the past two quarters.



The other important domestic data release is November retail sales. Given that Electronic Card Transactions and Credit Card billings data both reported negative results in November (down 2.3 percent and 0.8 percent respectively), we expect a reasonably large 0.9 percent fall in retail spending for the month. Part of this is driven by lower petrol prices. However, underlying core spending (which excludes auto-related industries) is expected to fall by 0.5 percent. However, given the large collapse we've seen in business confidence across the retail sector of late we wouldn't be surprised if the numbers were far weaker, as reality appeared to have literally sunk in pre-Christmas. Certainly the anecdotes are strong when it comes to stories of people still spending, but less when it comes to the choice of goods.

Internationally, next week it is relatively quiet in the US, with the major release being housing starts. In Europe, a number of ECB officials are giving speeches, while for the UK, December CPI and Q4 GDP are due for release.

Recent local data...

- > **NZIER QSBO (December quarter):** Very weak, with all activity gauges suggesting the economy is far from finding a base. However, this is also freeing up spare capacity and resulting in falling pricing intentions.
- > **Building Consents (November):** Residential consent issuance rose by 4.3 percent, while ex-apartment issuance fell by 4.0 percent. \$398 million of non-residential consents were issued.
- > **REINZ House Sales (December):** In seasonally adjusted terms, house sales rose by 26.8 percent and the median number of days to sell rose 2 days to 49. The median house price fell to \$328,500 from \$337,500.

KEY MACRO ISSUES FOR 2009

In this article, we outline some of the key themes we see evolving over the year ahead which we expect to play an influential role in New Zealand's economic prospects. Most point to a very challenging 2009, as the economy adjusts and rebalances.

There are a host of assumptions that underpin any set of economic forecasts. Some of these are cyclical in nature, some are structural. From the outset we have to acknowledge some **BIG** picture macro assumptions that underpin or anchor our view – particularly in regard to the international environment.

Our baseline assumption is that the worst has passed for the credit crisis itself, but the actual healing process will prove to be elongated (with the odd spike of nervousness). That is, credit conditions will take time to return to more "normal" settings, and by normal we mean levels that were apparent a decade ago as opposed to between 2001 to 2006. However, the real economic consequences are likely to linger for some time, probably for another 24 months. The process of de-leveraging around the globe will continue to be a significant influence. Inflation concerns are dead, at least now. Recoupling as opposed to decoupling will dominate. The current credit malaise is truly global, hence no region has the ability to drag the others out as we navigate the deepest and most pronounced global recession in close to 30 years (and arguably longer).

But we need to acknowledge that our ability to "add value" on the international scene beyond those who actually sit in the major economies is limited, just as we would not expect a foreign player to have those extra insights into NZ that the locals have. That doesn't mean we don't have insights, rather that we can get more bang for our buck by focusing on relating the **BIG** picture themes (global de-leveraging, a return to the fundamentals etc) to NZ specific circumstances and dynamics.

What follows are our seven major themes for the New Zealand economy in 2009, which implicitly underpin our economic and financial market views.

1. **First-up we need to accept that the environment has changed and the time for complacency has ended.**

Over 2008 we were often surprised at the complacency towards global developments. Facing the biggest financial crisis in 80 years, NZ's Achilles' heel, namely a huge external liability position, meant that the economy was already under the spotlight and set for a rough ride. This didn't mean anyone needed to push the panic button (and "Chicken Little" style analysis does

more harm than good), but neither did it mean trying to bury one's head in the sand.

Of course as people start to wake up to the scale of the global crisis, the danger is that we see an overreaction, which risks intensifying the economic cycle as non-linear and behavioural (confidence) aspects take over.

But clearly, just as in dealing with grief, the cycle of change evolves slowly. First comes denial, then anger, and after that grief. We appear somewhere between legs one and two.

A lot of the change we envisage will involve getting back to basics and adhering to traditional fundamentals – such as traditional loan-to-value ratios, focusing on cash-flow, and lowering expectations towards potential capital gains from asset prices. Relationships and trust, as opposed to purely price, will become more influential. For many, this will merely be a case of going back to the way things were. This is true, to a degree. We also expect considerable structural changes across the global economy over the coming decades. Facing a once in a generation crisis, we struggle to see the world remaining as it was.

Changes will likely include the growing importance of scale and certainty. Once again, trust will form the linchpin of relationships. We fully expect to see shifts in global monetary policy mandates, which are likely to involve an implicit targeting of asset prices.

There also looks to be some key negative risks as well, notably when it comes to attitudes towards protectionism and an inevitable rise in regulation (particularly of financial institutions). These sorts of changes, and less capital accumulation in the near-term, have us increasingly thinking about the supply side capacity of the global economy (and NZ) going forward. After all, it is the trend rate of growth that is more important in the long run than the cycle. Some small nudge lower in long-term potential growth rates seem warranted, but at this stage, "small" is the appropriate term.

In such an environment of inevitable change, it is all about concentrating on the basics: relationships, identifying areas of comparative advantage and driving productivity growth. But the first step is moving beyond blame and accepting that the environment has changed for good.

2. **Do not underestimate the significance of NZ's current account rebalancing process.**

NZ's external position is poor. The current account deficit – or the difference between what we save and what we invest as a nation – sits at 8.6

percent of GDP, and we see a real risk that it breaches 9 percent this year. This is one of the highest deficits in the developed world. Years of running these deficits have left NZ with a large stock of net foreign liabilities, which is currently just below 90 percent of GDP.

Even prior to current global malaise, the unbalanced nature of growth always meant that the NZ economy was set for an “adjustment” at some stage. This will be where the composition of growth shifts away from the spending side of the economy towards the earnings side, giving some much needed spine to growth. Such adjustments typically involve a fall in the currency to stimulate the export sector (and discourage imports), and a substantial contraction in the domestic economy.

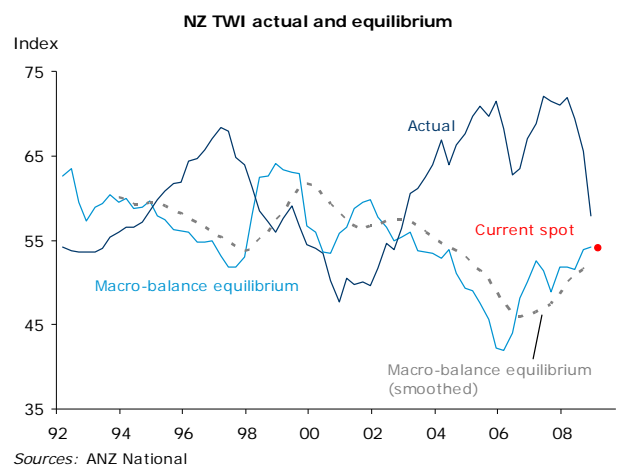
We tend to think about the magnitude of any required current account adjustment as being sufficient to stabilise the ratio of net foreign liabilities to GDP. This broadly requires a current account deficit of around 4.5 to 5 percent of GDP. Moreover, with a relatively low trade elasticity with respect to the currency (0.4), this requires a larger volume response (on both export and imports) in order to see a substantial improvement in the current account.

The current global predicament, which is essentially a process of de-leveraging and a return to more traditional fundamentals, adds three dynamics to NZ’s current account realignment process.

- > **NZ can no longer look towards a steady and orderly baton change** and reorientation from the domestic to the export sector over 2009. Given the global backdrop which involves weak demand and declining commodity prices, a weak export sector and unchanged domestic demand will make the external position worse, not better.
- > **We doubt merely stabilising the external position will be sufficient** in the current global environment, where attention to fundamentals is more prevalent and investors are literally being spoilt for choice. S&P’s decision to place NZ on negative credit watch this week, in light of the widening external imbalances, reinforces this point. Investors (and ratings agencies) will need to see improvements both in the flow (current account itself) and the stock of external liabilities. Hence we expect a more aggressive current account realignment process, which involves a more pronounced currency cycle and a deeper contraction in domestic demand.
- > **It is unrealistic to expect a de-leveraging domestic economy to fill the growth void left by a struggling tradable sector in**

2009. Certainly policymakers are taking aggressive action to underpin the domestic economy via interest rate cuts, tax cuts and more fiscal stimulus. But such action needs to be interpreted within the scale of global developments, deteriorating job prospects (refer theme 5), and the state of the NZ economy. Indeed, a case can be made for policymakers to stand aside and let the adjustment pan out. But we know that this goes against both the economic and political reality. Even central banks – acting aggressively to support households – are aware that while they have independence, that independence is operational only and is at the discretion of the government of the day. Finally, it would be truly ironic if the nation managed to spend its way out of a spending–fuelled jam, given that this is what got us into trouble in the first place!

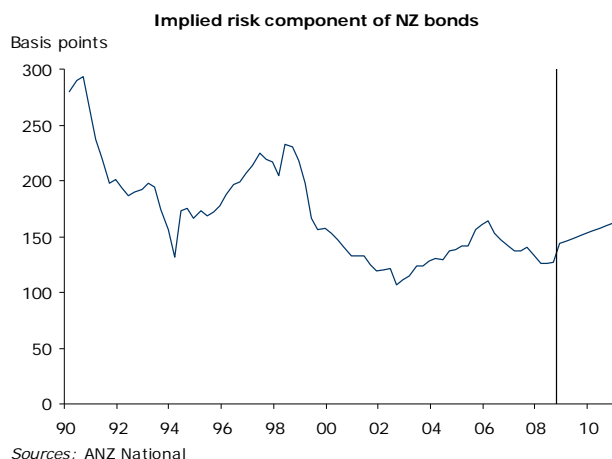
Typically, commentators and economists such as ourselves tend to focus on the currency related aspects of a current account rebalancing process. **Our expectations for the NZD/USD heading below 45 cents and for the NZD/JPY to head towards the low 40s** certainly entail this. The anchor to our currency forecasts centres on macro or external balance notions of currency equilibrium.



But the implications go far wider.

- > **A rebalancing process for the economy means lower growth and hence lower earnings over the coming years.** We are not equity market analysts and will leave that to the experts. But the historical experience has been that the equity market tends to languish during periods of current account realignment.
- > **A rising risk premium for the economy will not be solely centred on the currency market.** The old rules now apply – those wanting to borrow money for longer will have to pay more. Instead of the yield curve being overly flat (or even inverted), reflecting the

weight of money, it will be overly steep, reflecting a shortage of money. So while policy rates may fall (partly to compensate for this very effect), the reality is that absolute interest rates paid by everyday risky borrowers (and that's you and me!) will be higher over the medium-term. The implied risk component from our long-run interest rate model flags a rising trend given the deteriorating fiscal position, but it is important to note that the overall level remains low compared to history (on the assumption net government debt manages to peak around 25 percent of GDP).



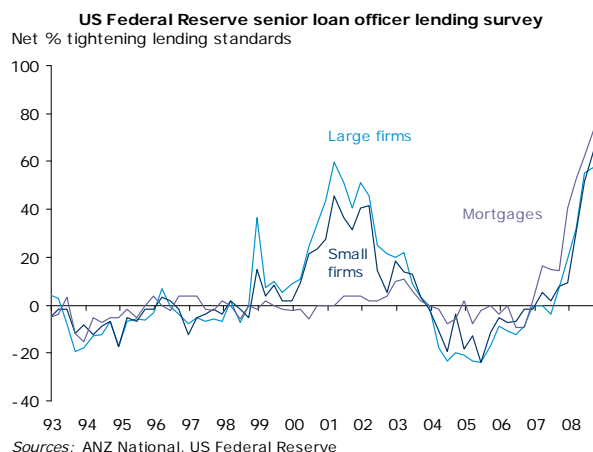
> **Who funds the deficit matters.** Over the past decade, it has been primarily the private sector that has funded the current account deficit, largely through financial intermediaries. There is no doubt we are set to see a switch in the funding of NZ's current account deficit from the private "growth" sector to the public sector. Typically we'd call this "growth" neutral, although we need to appreciate that private sector funding gets distributed into asset prices (and hence drives the wealth effect for spending), whereas public sector funding is directed into other areas, such as infrastructure. Indeed, a dollar of government investment does not completely offset a dollar of private sector investment, owing to the higher multiplier effect from the latter. More worrying are the trends in sovereign credit default swap spreads (a measure of default risk), which have widened considerably, including for New Zealand. Recent rating agency actions will only compound this issue and we now live in a world where global investors are literally spoilt for choice. Rather worrying is that a home bias is starting to emerge when it comes to investment decisions. In this environment everyone is naturally looking domestically for cash and funding, as opposed to looking offshore. But with everyone locally competing aggressively for cash, this is putting upward pressure even on the cost of borrowing domestically. While many

commentators tend to focus on wholesale lending rates, the more appropriate barometer is actually deposit rates. The problem in NZ's case is that we always end up going back to the same issue: a limited pool of domestic savings. It's like playing musical chairs; someone misses out.

3. The credit channel of monetary policy will play a huge role.

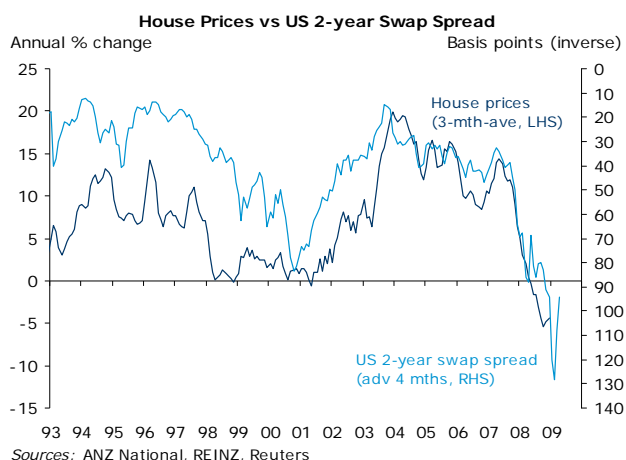
A rapidly expanding piece of economic literature over the past decade has been devoted to the credit channel of monetary policy. This channel works in addition to the conventional monetary transmission mechanism. Generally, the credit channel operates via two means. The first is the balance sheet channel, which sees deteriorating financial conditions affect borrowers' net worth by reducing current cash flows or securable assets, thereby influencing their external finance premium. The second is the bank (or any financial intermediary) channel, which influences investment behaviour via the cost and availability of credit. **At the heart of the channel is appetites towards risk, including the borrowers' side.**

Both domestically and internationally, we have seen the credit channel at work over the preceding years. The credit channel boosted the economy (and asset prices) beyond expectations at the top of the cycle, and in fact kept the economic cycle going far longer than expected. A spiral of rising asset prices, spending, profits, employment, confidence (exuberance), exceptional appetites for risk, rising asset prices...and so on took hold until a circuit breaker (in this case, the US subprime crisis) came along to turn the credit cycle. Subsequently we are seeing the reciprocal cycle take hold as the combination of falling asset prices, altered lending standards (lower loan-to-value ratios and stricter criteria), altered risk appetites, re-priced credit risk and a capital preservation mentality amongst financial institutions take hold. This can be seen from the US Federal Reserve's survey of senior loan officers.



The significance of the credit channel should not be underestimated.

- > **The channel has been hugely influential in determining asset valuations on the way up.** This is evident in the relationship between global swap spreads (this has historically been a proxy for credit availability, cost and risk appetites in general) and NZ house prices. While people point to migration and interest rates as being influential drivers, the reality is that the former was slowing since 2005 and debt servicing burdens continued to rise. But this did not stop house prices from reaching ever frothier levels. Only when the US swap spread started to rise and the credit cycle turned sharply, along with risk appetites, did NZ house prices start to head lower. These risk appetites were not just about the supply of credit from offshore, but also the demand, as bullet proof attitudes towards property prices in particular manifested. Of course we have seen swap spreads narrow of late, which is technically a positive. However, we also need to appreciate that this looks more “technical” than “real”. The recent disconnect between swap spreads and credit spreads mean that the narrowing in the former in recent months likely overstate any improvement in actual credit conditions. Risk appetites remain flaky.



- > **Modern macroeconomic models are not adequately equipped to handle the dynamics of the credit channel**, due to its behavioural aspects which are difficult to put into simple equations. Hence, the science or model driven aspects (not that policymakers are overly prone to this) to “policy” decisions is taking a back-seat as pragmatism prevails. Not quite “seat of the pants” stuff, but certainly a lot more art, intuition and the odd bit of hope.
- > **The strong counter that the credit channel is having against the traditional monetary transmission channel means that it falls on central banks to do more on the policy front.** We have already seen this with very

aggressive actions by central banks around the globe, and the bias remains to do more. The RBNZ still has ammunition up its sleeve. But with fiscal policy in a potential rating downgrade bind, the onus rests on the Governor to make more use of all the tools at his disposal.

- > **Monetary policy can lose traction at times like this.** Lower interest rates are all fine and well. But they will do little to ease the pain when cashflow is tight or non-existent. A worker who has lost his job, or a business facing losses will still have trouble servicing their debt obligations.
- > **There is also a reciprocal to doing more when the credit channel is “tight”.** When credit conditions eventually return to normal, financial conditions will ease rapidly as liquidity is finally unleashed and credit is allowed to flow freely once again. Central banks will then need to quickly return policy towards neutral to guard against an overshoot on the other side. The RBNZ will be no different and interest rates will certainly not be moving up in the 25 basis point increments that we saw during the last tightening cycle.

In New Zealand, we see both the direct and indirect consequences of the credit channel.

In terms of the direct channel, it has been well documented that providers of finance in some areas (such as motor vehicle retailing) have withdrawn in some instances; mezzanine based finance has disappeared from all but a few; access to consumer finance has become tougher; and 20 percent deposits are now stock standard for new housing loans across the core banking system. All are dynamics that will constrain spending and activity – significantly.

But it is arguably the indirect channel that is even more relevant. Lending appetites and the perceived overall health of the financial system around the globe determine risk appetites in general, and the cost and availability of term funding to current account deficit nations (and even good players). This makes the global process of de-leveraging all the more important for NZ’s prospects. While stage one of the recovery looks to have been cleared; as evidenced by narrowing OIS-Libor or “TED” spreads, we still await the all clear from two other areas: First, a clear earnings reporting season of no negative surprises (i.e. all the skeletons are out of the closet) so investors can price instruments and businesses with a degree of certainty. Second, house prices in the US need to stop falling, which is critical to halting rising traditional “credit” risk.

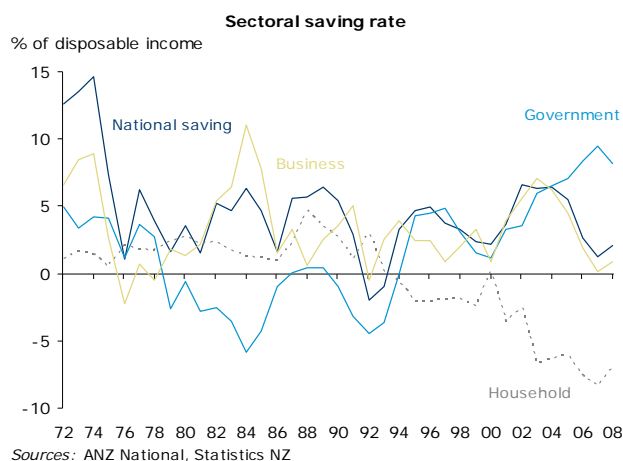
The issue goes wider. As global players increasingly withdraw from peripheral

markets and focus on their home patches (one form of de-leveraging), the onus rests more on local players – particularly for current account deficit nations – to fill leveraging voids. The ability to fill such voids is not only constrained by the access and cost of global credit, but the dynamics of the current account rebalancing process outlined in theme two.

4. Beyond the financial crisis itself, this is a household story.

Stepping beyond the credit crisis itself, it is household balance sheets that are in need of repair. Indeed, this is a fundamental distinction (and abstracting from some isolated sectors) from previous credit cycles, which have tended to be business centric.

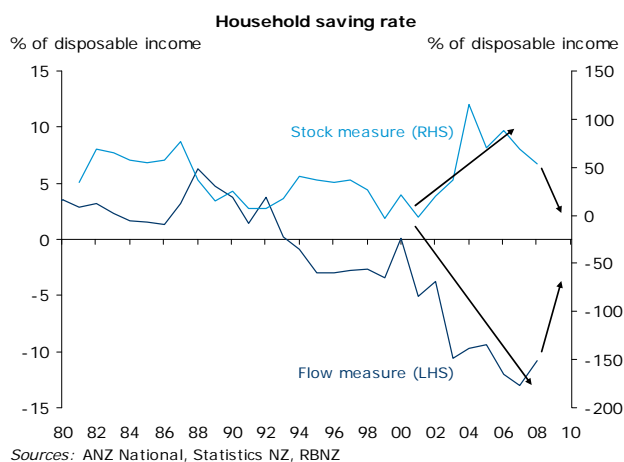
Given the limited sectoral balance sheet information in NZ, probably the easiest way to illustrate the point is via a breakdown of the savings rate between households, businesses and government. Even then, we caution that the data is somewhat iffy. Nonetheless, looking at the broad trends in the savings breakdown highlights a few notable aspects. **Households have been consistent dis-savers since the early 1990's, and materially so since 2000.** Public sector savings has increased in tandem with the deterioration in household saving over that time (a Ricardian effect at work perhaps?). The business sector has very much remained net positive savers with the odd exception.



Looking at other indicators such as debt to income and debt servicing ratios, all point to the household sector being in a vulnerable state. This not only impacts on the dynamics of the downturn, but also on any expected recovery. For sure, steps can be taken to assist those in vulnerable positions, such as term refinancing and repayment holidays. But this is merely shuffling growth from one-year to the next, as opposed to altering the reality. We have already seen the first legs of the downturn, largely contained to the consumer and housing related sectors. But so far it

has been largely of the "recession lite" variety. Household de-leveraging is a fundamentally different proposition to business sector equivalents. It is a simple question of levers. Facing weak balance sheets, businesses typically enter into lock-down mode, start cutting costs, deferring investment, and stream-lining inventories etc. Non-core assets can be disposed of in extreme cases. Households on the other hand, only have one lever to pull, and that is to reduce non-discretionary income. Hence, a household de-leveraging process takes longer to play through.

Of course, the detractors can always point to stock based measures of household savings, which has shown an improvement over the period when the flow based measure of household savings has been declining. That is, the large paper gains on the back of house price increases encouraged households to spend more than they earn. But three-quarters of NZ households' total assets are tied up in housing, and with the housing market now correcting, the stock measure of savings is set to fall sharply over the year ahead. In fact, we've already started to see this, with the Spicers Household Savings Indicators showing a 3.9 percent decline in household net worth in the September 2008 quarter, led by falling house prices.



In our eyes this only makes the outlook for house prices even more important in influencing the outlook for consumer spending. For if the dis-saving by households over the past decade was premised on the assumption that house prices never fall, then 2008 and 2009 is a huge wake up call. Falling household net worth, driven by lower house prices, risks creating a vicious circle where households seek to save more to compensate. While such a response is intended to repair their balance sheet, the resulting reduction in consumer spending will lead to lower activity, profits, less employment, further falls in house prices and so forth (economists refer to this as the paradox of thrift). Indeed, there is every chance that non-linear effects start to take a

strong hold, particularly when the negative wealth effect takes over.

There are a couple of other important aspects to this household story. **First, sectors heavily tied to the consumer and housing sectors will remain under pressure throughout this year, as household wallets remain firmly shut.**

Domestic demand will continue to be a material drag on growth prospects in 2009, until such time as household balance sheets are back in reasonable shape.

Second, traditional credit shocks have tended to be business centric, and financial institutions have typically responded by reallocating capital away from the high beta asset to the low beta asset (traditionally housing). When coupled with aggressive interest rate cuts and a more productivity driven mantra from businesses, this has tended to sow the seeds of a recovery (traditionally a V-shaped one). However, there is no real benchmark for us to compare how financial institutions will respond this time around given that it is households (the historically low beta asset) that are most vulnerable. In addition, the low beta asset has limited scope to drag out the high beta asset given existing balance sheet positions. Hence, its another reason to watch the entire credit channel of monetary policy outlined in theme three.

5. The next leg of the cycle: productivity / jobs.

The recession which started in early 2008 was unusual in the sense that it was driven by the household sector. Drought conditions also contributed, along with high petrol prices, high food prices, the lagged effects of previous monetary policy tightening, and a housing market starting to correct. But in general the 2008 recession was reasonably narrowly concentrated, although broadened as the year progressed. In the early stages, firms were naturally looking towards the historical definition of a recession where two successive quarters of negative growth was followed by recovery. Employment was showing its natural lagged response, but with flat growth over the first three quarters of 2008, the general expectation (or perhaps hope) was that the dip would prove to be short-lived. That is now clearly unrealistic.

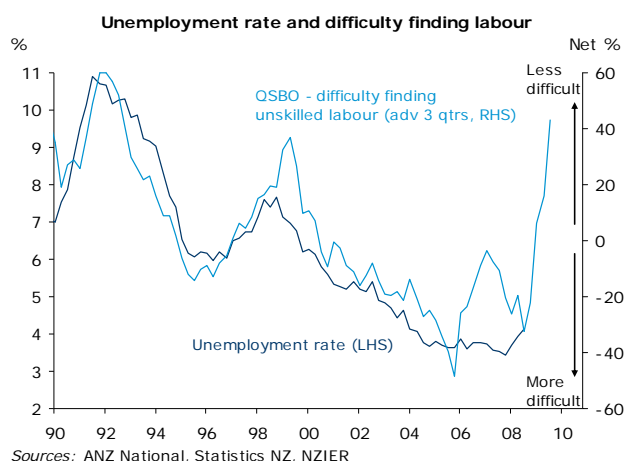
Going forward, five dynamics are dominating our thinking on employment prospects:

- > **There has been a huge concentration risk** within employment over the past five years, with two thirds of all new jobs accounted for by construction, retailing, and business services. These sectors are implicitly linked to the property cycle and "spending" side of the economy – the very sectors that remain in the

firing line of the inevitable current account rebalancing process. While labour shortages are still apparent in select industries, including education, agriculture, health and IT, the reality is that most of the labour input growth within the economy over the past five years has been either directly or indirectly hinged to the property market, with an apparent implicit expectation that the market only moves one way.

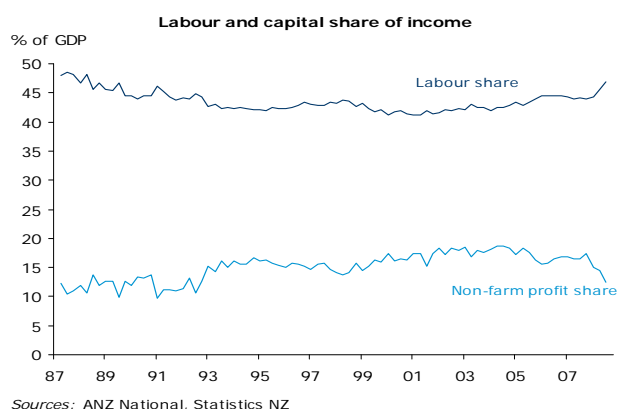
- > **Firms have been hoarding staff,** with employment growth outstripping hours worked since mid-2005, resulting in a fall in the number of hours worked per employee. While some of this will reflect the tightness of the labour market itself (and being forced to offer more flexible approaches to working), this dynamic does not fit with the part-time/full-time split, nor other measures of under-employment.
- > **The recession is deepening and broadening beyond the household sector,** with global events now engulfing the tradable sector. With corporate profits already taking a dent from last year's domestic recession, there is less headroom to absorb the impact of the global credit crisis and the resulting downturn in the global economy. This is being exacerbated by declining asset prices (including equity values) which is forcing management to take a sterner cost conscious line to support earnings.
- > **The recession is now expected to be of considerable length,** with a minimum of five quarters. No longer can firms look towards a recovery as justification for holding on to underutilised resources.
- > **Around 40 percent of the current labour force has not seen or experienced anything like current economic conditions.** Across a lot of nations it's been close to 17 years since unemployment rates have been set to move up so rapidly. This inexperience "dynamic", which in part has manifested in a lack of a savings buffer, is a key risk in our view in terms off setting of non-linear type responses.

The resulting rise in the unemployment rate, perhaps towards 8 percent (our official view is just over 7), represents the next leg of vulnerability for the domestic economy. If consumers and the housing market were already giving way when the unemployment rate was low, then a rapid deterioration in the job market and much smaller wage increases over the coming year will exacerbate weakness in domestic demand.



On the one hand, businesses know that by shedding labour, they could inadvertently cause the downturn to intensify, further worsening their financial situation. But on the other hand, doing nothing in the face of declining profits is not an option either. **Businesses are caught in a "prisoner's dilemma",** where a higher payoff can be gained from cooperating (in this case, all retaining staff), but in practice they find it extremely difficult (though not impossible) to coordinate their activities **and the resulting outcome is a Pareto-suboptimal solution** (i.e. higher unemployment rate and weaker growth).

Another way to think about labour force dynamics is the relative shares of income (GDP) across the economy. The past seven years has seen labour's share steadily rise as the unemployment rate fell to a historical low and wages rose, and the share accruing to non-farm profits fell. As a more cost conscious attitude prevails, we fully expect to see the trend in these relative shares reverse.



If there is a positive spin to be put on the resulting increase in the unemployment rate, it will eventually be reflected in better productivity performance. In the first instance, job shedding tends to add to productivity merely by taking out that low marginal worker. However, we need to remember that owing to concentration risks noted earlier, a lot of the reduction in employment is likely to come from less productive (earnings)

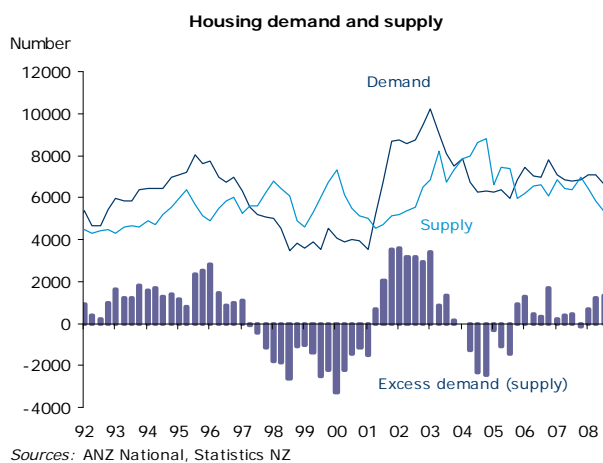
pockets of the economy. In some instances this will free up resource availability for more productive areas. In a cruel twist of fate, this will not only sow the seeds on a more pronounced downturn, but also lay the groundwork for a stronger recovery. Commentators can point to interest rates, the currency and fiscal policy all they want as drivers of the business cycle. The reality is that a necessary condition for a turn in the business cycle and a sustained strong economic performance is better productivity growth. The seeds of this are starting to be sown – slowly – but this process will accelerate over 2009 and start to bear fruit from mid-2010.

6. Forget house prices: concentrate on land prices.

When it comes to asset values, the conversation inevitably turns to house prices. It's hardly surprising given housing's dominance in the typical household balance sheet. We often hear predictions ranging from house prices will never fall, to expectations of a 30 percent decline.

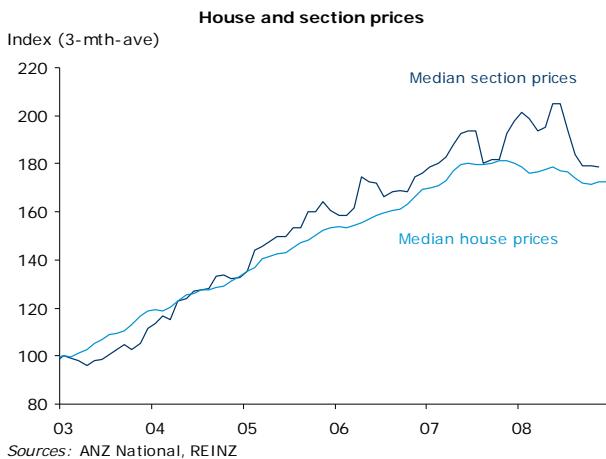
However, there are a few aspects to the house price story that are not widely understood.

NZ has not experienced a housing bubble in a similar sense to the United States. Traditional housing bubbles result in excess supply. It's well documented that the US has a huge stock of houses relative to underlying demand, which is causing a huge drag on house prices. However, looking at NZ's housing fundamentals (which can be expressed as a combination of underlying population growth, migration and depreciation on the existing stock), no such excess supply exists. In fact, there has been an increasing excess demand building up due to the slump in building consents of late (with the exception of certain localities and there is certainly no shortage of beach houses!).



This does not mean that NZ has not experienced a bubble. Certainly when you see house prices at close to eight times the average

wage, it is difficult to argue that we did not experience a bubble of some sorts. Yet we need to appreciate where it has come from. Most of the rise in house prices have come from the price of land, which between 2003 and 2007 has increased by 106 percent, while overall house prices has risen 79 percent over that time. In fact at their peak, section prices were up 112 percent. (NB: data in this area is rather limited and volatile).



Some commentators point to restricted land supply and land use restrictions as reasons for section prices outstripping house prices. This is true to a degree. But it is hard to see such dynamics being the key influence when you look at the performance of rural property. Similarly the various property hot spots around the country (typically holiday or beachside destinations) that have definitely not had any shortage of land! Anecdotally this is easy to see on our travels around the country, and some regions have close to a decades worth of supply of land on the market. Our *Property Focus* publication regular tracks the composition of real estate listings (using TradeMe data, notably section's share of total listings), and what we've seen over the past year is that ratio rising from 18 percent to 25 percent, indicating a excess supply of land.

A lot of this has been driven by the general expectation prices never fall, only rise, a failure to differentiate between nominal and real prices, and relative insensitivity to real interest rates. Under such an assumption, chasing capital gains is the way to go, and if punters believe double-digit gains are on the cards, there is every incentive to keep piling in, irrespective of what interest rates are doing. The fact that property prices did rise strongly at the start only fuelled such expectations along with the ripple effects from lending from certain pockets in high risk areas. The historical experience has been that nominal house prices have seldom fallen, but when adjusted for inflation, house prices actually fell 40 percent during the late 1970's collapse. While everyone focuses on the benefit of the nominal value they often forget that the difference

between nominal and real house prices manifests through inflation. So even during the nominal house price growth of the 1970's, investors were actually worse off as they faced double-digit borrowing rates.

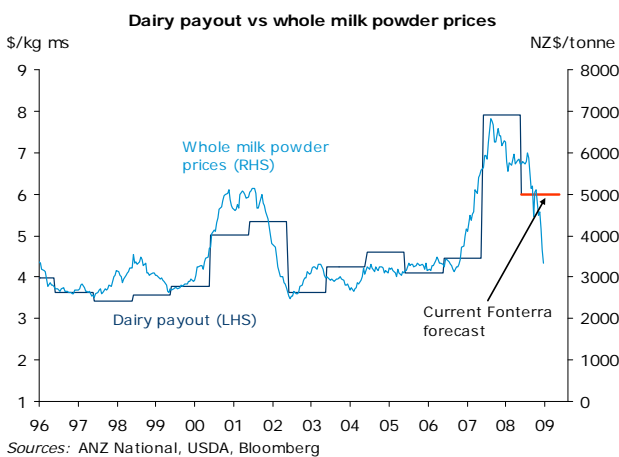
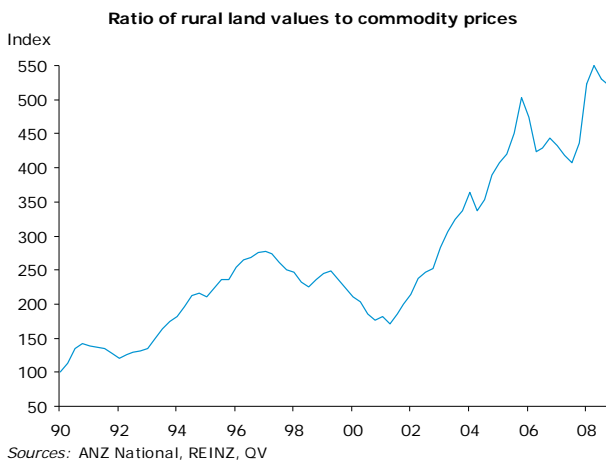
Such price expectations about property extended into rural land prices as well.

Certainly, the strong dairy payouts of the past few years helped cement an expectation of rising farm incomes, helping to argue for ever higher rural land prices. This caused a spillover into neighbouring land prices, and when coupled with easy and relatively cheap access to credit, helped prolong the property cycle.

A key theme we will be watching in 2009 is the performance of rural land prices, which have had an element of the same "it's all about capital gains" mantra. For sure it's hard to go past the reality that: the world has to eat; NZ has a strong comparative advantage in food production; water will become an increasingly valuable commodity; and structural changes around the globe, including the growing importance of Asia, are of huge benefit to NZ. But fundamentals and particularly cash-flow are still the key aspects of any investment decision and such gains tend to slowly accumulate over time. The numbers we were running on dairy conversions suggested economic returns on capital at less than the cost of funds. The business case relied on long-term capital gains, which historically had been significant. While capital gain was adding to wealth, it only added to cash when the asset was realised. It did not fund the cash flow in the interim. Cash flow has now become more important in a tighter credit environment.

The past decade has seen a steady rise in the ratio of rural land prices to commodity prices, which means not only a good news "Asia and commodity price story" has already been built in, but a rather exceptional one at that.

What is clear at present is that rural land prices are going to face considerable downward pressure, with a weak global environment now manifesting in a cyclical unwind (within a structural upwards trend in our view) in commodity prices. **No where is this more apparent than in the dairy sector,** with the payout under considerable downwards pressure and a figure close to \$5 per kg/milk solid is looking likely for the 2008/09 season amidst growing stories of stockpiling and unsold supplies. Indeed, it may well even be that the 2009/10 payout is even lower.



We see three implications from an unfolding in land prices.

- > **The land aspect is key to linking our expectation that consumption as a share of GDP can continue to ease, even if residential investment – via the fundamentals – starts to find a floor.** That is, property prices will continue to fall even when we see actual building activity pick-up, with the corresponding negative wealth effect weighing on consumer spending.
- > **The rural cheque-book is heavily pro-cyclical.** With rural incomes set to fall this year and possibly next, this will kick off a multiplier effect across rural regions. The uncertainty at present due to rapidly declining commodity prices mean we could see a sharp correction to rural land prices, which could trigger another leg in the regions. Moreover, we foresee strong ripple effects from weakening dairy prices across other land use and areas as well.
- > **Weakening rural land prices will place downward pressure on regional house prices.** Rural house prices have outperformed urban equivalents since 2004, and part of this reflects the spillover from rising rural land and

commodity prices. We see a strong reciprocal effect acting over 2009.

7. The alphabet of recoveries: a BIG U.

Beyond the crisis itself, we need to think about the inevitable recovery. As a scribe once noted; it's always darkest before dawn. All the bad news can be overpowering.

First-up, we need to be mindful of distinguishing between the business cycle and the longer-term trend. Looking beyond the business cycle, once NZ navigates the inevitable rebalancing process (which is the most challenging one we have faced in a long time), there is a need to appreciate the strong medium-term story for the NZ economy. The massive wealth shift occurring around the globe that is seeing Asia grow in importance can only be good news for NZ. While commodity prices are going through a corrective phase at present, we remain long-term commodity bulls. Asia looks set to remain a key engine for global growth over the next decade and given NZ's close proximity (and an exporter of products that Asia is increasingly demanding) NZ stands to benefit. Throw in the increasing importance that clean water has as a natural resource base, in a world where water will become scarcer, and there is huge potential for NZ to leverage off; just not in our usual borrow and spend sense.

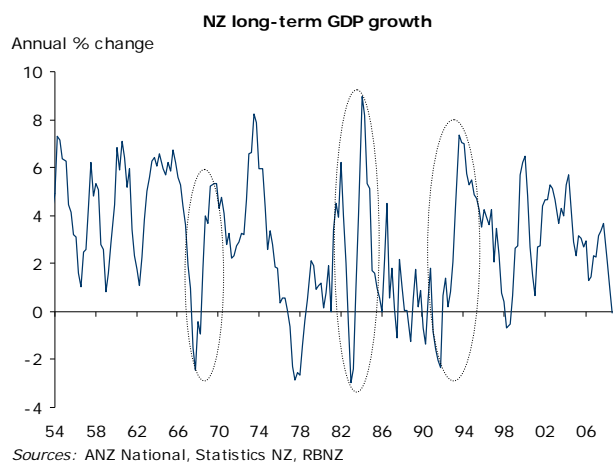
In terms of the business cycle, the obvious question is how long the adjustment lasts, and what indicators we should be on the look out for. The answer to the first question is how long is a piece of string? **Certainly, we see little reason for cheer or rejoicing in 2009.** In terms of the second, confidence gauges will be critical. But from a more structural aspect, we will be keeping a close eye on the current account deficit, the composition for imports, the savings rate and the ratio of consumption to GDP to name a few. All will provide indications from a structural perspective on the cycle. **A cyclical recovery cannot take hold until we see structural improvements across a number of areas.**

Around mid 2008 we started to formally call an L shaped economic cycle; largely on the back of what we perceived as an elongated adjustment period for the economy, and the household sector in particular. This is a theme that continues to resonate within our view as detailed in theme four above.

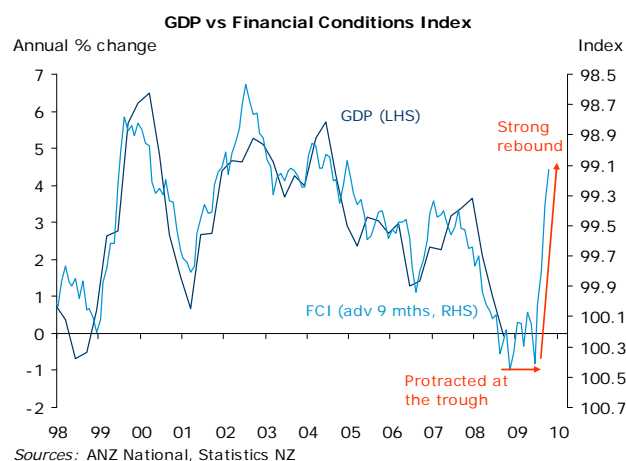
But we also need to be cognisant of other developments:

- > **We are clearly now set for a deeper trough in the cycle itself,** with recent indicators clearly showing that the deceleration in the economy is intensifying (or the recession worsening). **When it comes to economies**

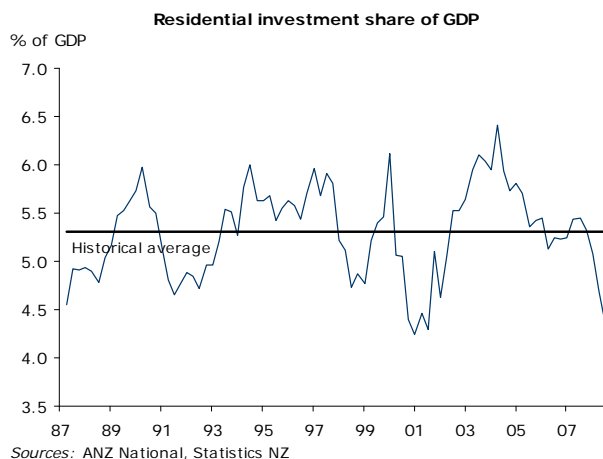
and cycles there is a clear bungy dynamic at work: the more you fall, the closer you get to the bounce, and bounces tend to be inversely proportional to the fall in the first place. Even during very sharp economic corrections seen during 1967, 1982/83 and 1990/91, the corresponding recoveries have been sharp.



- > **There is a huge non-linear dynamic in every economic cycle and we expect this effect will be particularly pronounced this time around.** Economists tend to rely on “linear” type models which mean we have an inherent tendency to underestimate both the booms and busts. A quick look at some of the BIG picture drivers of NZ’s economic cycle between 2002 and 2007 (the credit channel of monetary policy, labour hoarding, spiralling asset prices and anticipations of continued double-digit gain) and you realise just how important the whole behavioural and confidence aspect to the economic cycle has been. But these dynamics cut both ways, with the potential to “switch” back on when conditions stabilise.
- > **Financial conditions have loosened – a lot.** Monetary policy’s effectiveness may be diluted in the current environment, but it is not totally impotent. The RBNZ has already cut the OCR aggressively, and will do more this year to support the economy. The currency has similarly responded by falling, and the resulting easing in financial conditions point to a recovery by late 2009. This is even if we alter the weights in our financial conditions index to reflect a stronger credit or (negative) wealth related channel. An end of year recovery still looks six months too early to us given the structural challenges, but we like the spirit of what our gauge is saying: a protracted and elongated trough relative to history, but then sharp recovery.



- > **There is a base effect at work.** GDP growth looks to have contracted for at least five consecutive quarters from Q1 2008, and the level of activity is nearing a low point whereby any pick-up will result in a technical bounce in the growth rate. Particularly with natural population growth of 1 percent per year, which provides natural support. If there is a positive surprise factor to be had over late 2009 and into 2010, it may well be that net migration could rebound in a similar fashion to post September 11, as poor prospects offshore encourage more New Zealanders to stay home, and even worse economic conditions in some countries encourage more to head to our shores or come home.
- > **Some cyclical components of the economy are already at levels where pent-up demand is being flagged.** For example, the sharp decline in the ratio of residential investment to GDP has brought it towards historical lows. And while building consents numbers suggest more near-term weakness to come for residential investment, it is running below natural population demand and the depreciation on the existing stock; a condition which cannot continue for too long.



- > **History has shown that strong pent up demand can lead to a strong rebound in**

activity. This ranges from shortages in new housing stock and the need for consumers to replace durable goods, to businesses needing new plant and machinery because they have held off investing. Pent up demand tends to build during the downturn, and is typically unleashed at around the same time once the recovery takes hold, leading to a very rapid rebound in growth. For now, this is looking very much like a late 2010 story. In addition, with the Rugby World Cup being held in NZ in 2011, preparations in the lead-up for the event will further add to activity. For sure, we are still eyeing pent-up-demand dynamics within the scheme of the current account rebalancing process. But we can't ignore the former completely.

This combination has us shifting from an L to a BIG U; that is, a deeper contraction, but one which leads to a sharper (quicker) improvement in certain structural areas, helping to lay the groundwork for a more pronounced recovery.

The bottom line

All up, our BIG picture macro themes for this year point to a very challenging 2009. We should not under-estimate the scale of the rebalancing process facing the economy. Much of this is being pre-determined by global events, but a lot still rests in our own backyard, namely correcting a huge current account deficit. The latter is a theme that weighs heavily within our economic and financial forecasts. The piper will be paid. The sooner he is, the quicker life will move on, and the stronger the inevitable recovery. While we have not taken a lot of joy in penning these themes, we hope that the more informed people are to the challenges ahead, the smoother the inevitable transition will be.

GLOBAL WATCH

It was a mixed bag in terms of data this week but still within a broad trend of poor results. US retail sales remain weak highlighting that consumers' wallets have well and truly been put away. However, the Philadelphia Fed manufacturing gauge did show some improvement from a depressed level. House prices in the UK continue to fall. In Asia, evidence continues to mount that trade flows have slowed dramatically.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	Import Price Index (Dec) – mom	-5.3%	-4.2%	-7.0%	Stronger
	Advance Retail Sales (Dec)	-1.2%	-2.7%	-1.8%	Weaker
	Business Inventories (Nov)	-0.5%	-0.7%	-0.6%	Weaker
	PPI (Dec) – mom	-2.0%	-1.9%	-2.2%	In-line
	Continuing Jobless Claims (w/e Jan 4)	4620K	4497K	4611K	Stronger
	Empire Manufacturing (Jan)	-25.0	-22.2	-25.8	Stronger
	Philadelphia Fed (Jan)	-35.0	-24.3	-32.9	Stronger
Euro-zone	Industrial Production (Nov) – mom	-2.1%	-1.6%	-1.2%	Stronger
	CPI (Dec) – mom	-0.1%	-0.1%	-0.5%	In-line
	ECB Interest Rate Decision	2.00%	2.00%	2.50%	In-line
UK	RICS House Price Balance (Dec)	-74%	-73%	-76%	In-line
	DCLG House Prices (Nov) – yoy	-8.5%	-8.6%	-7.4%	In-line
Asia Ex-Japan					
<i>China</i>	Exports (Dec) – yoy	-5.3%	-2.8%	-2.2%	Stronger
	Imports (Dec) – yoy	-20.0%	-21.3%	-17.9%	Weaker
	Money Supply – M2 (Dec) – yoy	15.0%	17.8%	14.8%	Stronger
<i>South Korea</i>	Unemployment Rate (Dec)	-	3.3%	3.3%	-
	Export Price Index (Dec) – mom	-	-4.4%	-3.3%	-
	Import Price Index (Dec) – mom	-	-5.7%	-6.6%	-
<i>Singapore</i>	Retail Sales (Nov) – mom	-5.5%	-5.2%	-2.1%	In-line
<i>Indonesia</i>	Consumer Confidence (Dec)	-	90.6	96.3	-
	Money Supply – M2 (Nov)	-	18.3%	17.8%	-
<i>Philippines</i>	Total Exports (Nov P) – yoy	-16.6%	-11.9%	-14.8%	Stronger
	Money Supply – M3 (Nov) – yoy	-	14.6%	13.1%	-
Japan	Money Supply – M3 (Dec) – yoy	1.7%	1.8%	1.7%	In-line
	Eco Watchers Survey: Current (Dec)	20.4%	15.9%	21.0%	Weaker
	Machine Orders (Nov) – mom	-8.0%	-16.2%	-4.4%	Weaker
	Domestic CGPI (Dec) – mom	-1.5%	-1.2%	-1.9%	Stronger
Australia	ANZ Job Advertisements (Dec) – mom	-	-9.7%	-8.6%	-
	Home Loans (Nov) – mom	1.0%	1.3%	1.3%	Stronger
	Employment Change (Dec)	-20.0K	-1.2K	-15.6K	Stronger
	Unemployment Rate (Dec)	4.5%	4.5%	4.4%	In-line

INTEREST RATE STRATEGY

Swap rates continue to fall, having closed lower, and at record lows every day this week, taking the 3yr below 4 percent, and the 5yr below 4.25 percent. We expect this to continue as expectations of RBNZ rate cuts intensify, fuelled by the latest round of poor economic news out of the US.

Market themes...

- > By definition, swap rates now offer outstanding value for borrowers, having never been this low. However we remain concerned about margin pressure, which argues for caution.
- > We suspect there would have been more paying had the market not rallied so quickly.
- > As such, a bounce is possible, but it's difficult to build a credible fundamental argument supporting a turn in the economic cycle, so, expect any spikes higher to be short-lived.
- > Swap spreads are under immense pressure, and look set to "go negative" as issuance puts pressure on NZGS yields. However it would be a mistake to read this compression as a sign that things are improving.

Review and outlook ...

Even though swap yields have inched (or was that tumbled?) lower over the course of the past few days, we see no reason why it can't continue. Soft economic data continues to pour in both offshore and domestically, and while leading indicators like the QSBO continue to point South, there's no sign things are about to change. If anything, follow-on issues like rising unemployment look set to dampen activity further, and suggest that the "rebalancing" has some way to go yet. Of course, one could argue that given the size of the move in interest rates, this is now priced in. It may be, but then again, if the American, British and European experience is anything to go by, its clear that central bank policy has to go deep into "brave" and uncharted waters. It is also becoming clear that NZ interest rates need to fall if the NZD is to correct lower, as it fundamentally must.

Swap spreads have been the hot topic of the week, and as detailed in our *Discussion Paper* (which we can make available on request) earlier this week, we see scope for a further contraction in spreads. Swap yields have become disconnected from NZGS yields, to the extent that the whole concept of a swap spread has changed. It's no longer a building block of prices, but rather a by-product. A swap is a derivative, and reflects the markets view on the future of interest rates, and for now, expectations continue to inch lower. By contrast, bond yields may need to go higher to attract investors.

Borrowing strategies we favour at present

The only rationale we can see for fixing now is that interest rates are at record lows. Then again, swap rates have inched to record lows just about every day this week, so we're not sure what sort of accolade that is. As detailed in our *Borrower's Strategy*, this isn't a compelling reason to hedge given that this is a once in a lifetime shock, and give pressures on margins. In some ways, floating is the new fixed. Fixing now just exposes you to fluctuating margins. However, if the RBNZ takes action to offset widening margins, the only way to benefit is to stay floating. This is a very powerful argument in favour of caution. It is also becoming increasingly apparent that the RBNZ have more, rather than less work to do, hence we shifted our forecast to a 100bp cut later this month.

Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ	↓↓	We expect a 100bp cut this month. It's almost priced in, but it will still spur on bulls.
NZ data	↓↓	This week's QSBO has really shaken things. Outlook not pretty, compounded by US.
Fed Funds/ front end	↔	FF to 0%, and staying there. Quant easing and Fed desire to see lending margins fall now the focus. BKBM lower.
RBA	↔	Speculation over a Jan cut has died down slightly.
US 10 year	↔/↓	US data and Beige Book awful. Fed still undecided about buying bonds, but in reality they have no choice.
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	↓	Solid downside momentum.

Market expectations for RBNZ OCR (bps)

OCR dates	Last (19 Dec)	This week
Thu 29-Jan-09	-67	-99
Thu 5-Mar-09	-131	-166
Thu 23-Apr-09	-151	-190
Thu 4-Jun-09	-157	-197
Thu 30-Jul-09	-156	-199
Thu 10-Sep-09	-156	-205
Thu 29-Oct-09	-156	-208

Trading themes we favour at present

Core long positions and steepeners remain appropriate, particularly in physical bonds, where funding will pressure the long end.

CURRENCY STRATEGY

Poor data and a potential ratings downgrade have the NZD on the back-foot. This is expected to continue, with the only potential saviour being a markedly weaker USD – something which is not looking likely at the moment.

Market themes...

- > NZD hit by poor domestic news.
- > Being placed on negative watch reinforces that the yield-currency link must be broken.
- > Paring back of risk appetites globally following dismal offshore data and earnings news also weighed.
- > A resurgent USD only added to the NZD's woes.

Review and outlook...

The NZD was hit with a triple whammy of negative news this week. First up was the awful QSBO survey on Tuesday, which points to the downturn extending into the first half of this year. The rates market rallied hard on the back of this throughout the week, narrowing the NZ-US 2-year swap differential by over 50bps. Just as the market was still digesting the QSBO implications, then came the S&P announcement on Wednesday that NZ was being placed on negative credit-watch, joining illustrious counterparts such as Greece, Portugal and Spain. At the same time the outlook for the US, Australia and others was affirmed as stable. The latter merely reinforces the widening gap between NZ and Australian fundamentals, and the inevitable adjustment that must follow in the cross. A move sub 80 cents looks inevitable. On top of all that, risk appetites evaporated as poor global data and news reminded the markets that the real economic effects of the financial crisis are far from over.

From here on in, the NZD will struggle and remain on the backfoot. A potential credit downgrade will overhang the kiwi, as will narrow yield spreads as the rates market starts to toy with a sub-3 percent terminal OCR. But as we have mentioned numerous times in the past, the economic fundamentals point to the need for a much lower NZD. The external imbalances in the NZ economy – with a current account deficit of 8.6 percent of GDP – requires the NZD to stay low for a period of time if it is to correct. Potential ratings action merely affirms that NZ requires a different mix to monetary conditions, namely higher long-term yields, a more traditional upwards sloping yield curve and a far weaker currency.

We continue to be drawn towards our macro-balance or external balance fair value models suggests a currency in the low 0.50s. When you

consider that the currency has a tendency to overshoot, as well as undershoot, any long-term fundamental fair value models, we should not be surprised to see the NZD head below 0.50 and stay there for a while.

For now, there is the danger of a short squeeze burst higher given the sharp moves seen this week. Technically, 0.5570 caps the NZDUSD with support at 0.52. A break of this will open up a move towards 0.50. On the NZDAUD, we will not be surprised to see the key 0.80 support level get taken out in the near-term, opening up a move to test the August 2008 low of 0.7750.

NZD vs AUD: monthly directional gauges

Gauge	Direction	Comment
Fair value	↔	Back in the fair value zone.
Yield	↔/↓	100bp from RBNZ at least at the end of this month.
Commodities	↔/↓	NZ's commodity basket underperforming Australia's.
Partial indicators	↓	NZ indicators simply awful.
Technicals	↓	Major support at 0.80.
Sentiment	↓	All watching the dairy story.
Other	↓	NZ on negative watch, but Australia unchanged.
On balance	↓	The move lower has finally occurred, and more to come.

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	↔	Moved slightly below our cyclical fair value level.
Yield	↓	Market looking at sub-3 percent terminal OCR.
Commodities	↓	Falling across the board.
Risk aversion	↔/↓	Rising fast on poor global data early in the year.
Partial indicators	↔	NZ's starting to compete with the US's.
Technicals	↔/↓	Support at 0.5200.
AUD	↔/↓	AUD not spared.
Sentiment	↔/↓	Very poor.
Other	↔/↓	USD strengthening by default with euro area nations on ratings watch.
On balance	↔/↓	Next leg lower.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
19-Jan	AU	TD Securities Inflation (Dec) - mom	-	-0.6%	12:30
		Preliminary BoP Imports (Dec) – mom	-	2.0%	13:30
	UK	Rightmove House Prices (Jan) – mom	-	-2.3%	13:01
	JN	Industrial Production (Nov F) – mom	-	-8.1%	17:30
		Capacity Utilization (Nov F) – mom	-	-3.9%	17:30
	EC	European Commission Releases Economic Growth Forecasts	-	-	22:45
		Construction Output (Nov)	-	0.1%	23:00
20-Jan	EC	ECB's Trichet Speaks in Paris	-	-	00:50
		ZEW Survey (Econ. Sentiment) (Jan)	-	-46.1	23:00
	NZ	Food Prices (Jan) – mom	-	0.8%	10:45
		Consumer Prices (3Q) – qoq	-0.4%	1.5%	10:45
		Consumer Prices (3Q) – yoy	3.6%	5.1%	10:45
	JN	Tertiary Industry Index (Nov) – mom	-	0.4%	12:50
		Consumer Confidence (Dec)	-	28.7	18:00
		Machine Tool Orders (Dec F) – yoy	-	-71.90%	19:00
		Convenience Store Sales (Dec)	-	7.4%	20:00
	UK	CPI (Dec) – mom	-0.9%	-0.1%	22:30
		CPI (Dec) – yoy	2.6%	4.1%	22:30
		Core CPI (Dec) - yoy	1.5%	2.0%	22:30
		RPI (Dec) - yoy	0.6%	3.0%	22:30
		RPI Ex Mort Interest Payments (Dec) - yoy	2.4%	3.9%	22:30
	GE	ZEW Survey (Econ. Sentiment) (Jan)	-42.5	-45.2	23:00
		Zew Survey (Current Situation) (Jan)	-73.0	-64.5	23:00
21-Jan	EC	ECB's Nowotny, Sramko Speak in Brussels	-	-	07:00
		ECB's Trichet, Czechs' Kalousek Speak at EU Parliament Panel	-	-	21:00
		ECB's Trichet Speaks in Brussels	-	-	22:30
	UK	BoE's King to Make Speech in Nottingham	-	-	09:20
		Bank of England Minutes	-	-	22:30
		Claimant Count Rate (Dec)	3.5%	3.3%	22:30
		Jobless Claims Change (Dec)	80.0K	75.7K	22:30
		Average Earnings inc bonus (Nov) - 3M/YoY	3.4%	3.3%	22:30
		ILO Unemployment Rate (3mths) (Nov)	6.1%	6.0%	22:30
		M4 Money Supply (Dec P) - mom	-	1.2%	22:30
		Public Sector Net Borrowing (Dec)	10.5B	16.0B	22:30
		Public Finances (PSNCR) (Dec)	-	10.3B	22:30
		BoE's Tucker to Testify to Treasury Committee	-	-	22:45
	NZ	Retail Sales (Nov) - mom	-0.9%	-1.3%	10:45

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZDT)
21-Jan cont.	NZ	Retail Sales Ex-Auto (Nov) - mom	0.0%	0.8%	10:45
	AU	Westpac Consumer Confidence (Jan)	-	-	12:30
	JN	Leading Index CI (Nov F)	-	81.5	18:00
		Coincident Index CI (Nov F)	-	94.9	18:00
	GE	Producer Prices (Dec) - mom	-1.1%	-1.5%	20:00
22-Jan	EC	ECB's Bini Smaghi Speaking in Strasbourg	-	-	02:30
		ECB Publishes Jan. Monthly Report	-	-	22:00
		Industrial New Orders (Nov) - mom	-5.0%	-4.7%	23:00
	US	NAHB Housing Market Index (Jan)	9	9	07:00
	NZ	NZ Card Spending (Dec) – mom	-	-2.3	10:45
		Business NZ PMI (Dec)	-	35.4	11:30
	JN	Adjusted Merchandise Trade Balance (Dec)	-	-¥367.6B	12:50
		BoJ Target Rate	0.1%	0.10%	16:00
	AU	Consumer Inflation Expectation (Jan)	-	-	13:00
		New Motor Vehicle Sales (Dec) – mom	-	-5.2%	13:30
23-Jan	EC	ECB's Tumpel-Gugerell Speaks in Brussels	-	-	02:00
		PMI Manufacturing (Jan A)	33.5	33.9	22:00
		PMI Services (Jan A)	41.7	42.1	22:00
		PMI Composite (Jan A)	-	38.2	22:00
	US	Housing Starts (Dec)	605K	625K	02:30
		Building Permits (Dec)	610K	616K	02:30
		Initial Jobless Claims (w/e Jan 18)	-	524K	02:30
		Continuing Claims (w/e Jan 11)	-	4497K	02:30
		House Price Index (Nov) – mom	-1.2%	-1.1%	04:00
	JN	All Industry Activity Index (Nov) – mom	-	-0.5%	12:50
		BoJ Monthly Report	-	-	18:00
	AU	Import price index (4Q) – qoq	-	5.0%	13:30
		Export price index (4Q) – qoq	-	13.8%	13:30
	GE	PMI Manufacturing (Jan A)	32.0	32.7	21:30
		PMI Services (Jan A)	45.5	46.6	21:30
	UK	GDP (4Q) – qoq	-1.2%	-0.6%	22:30
		GDP (4Q) - yoy	-1.4%	0.3%	22:30
		Retail Sales (Dec) - mom	-0.7%	0.3%	22:30
		Index of Services (3mth/3mth) (Nov)	-	-0.2%	22:30

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: While they are unlikely to have much of an influence on the ultimate decision, the key releases prior to the RBNZ's *OCR Review* are Q4 CPI and November Retail Sales next week. Falling headline CPI, easing non-tradable inflation and poor retail spending will all add to expectations of a big move by the RBNZ. Further out, the next big focus will be the Q4 labour market data, which we expect to show extreme weakness.

Date	Data/Event	Economic Signal	Comment
Tue 20 Jan (10.45)	CPI (Dec quarter)	Falling petrol prices pulls down headline	Sharply lower petrol prices are expected to see the headline CPI fall 0.3 percent. However, key will once again be underlying and non-tradable inflation, with the latter expected to rise by 0.8 percent.
Wed 21 Jan (10.45)	Retail Trade Survey (Nov)	Weak	ECT data for November was poor. Coupled with lower petrol prices, headline sales should record a reasonable fall in the month.
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.
Thu 29 Jan (09.00)	RBNZ <i>OCR Review</i>	100bp cut	Given falling commodity prices and the global economic outlook, 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)	Watching imports	A trade deficit is typically recorded in December months and this is likely to be the case again. However, given lower oil prices and an expectation that import demand will capitulate, the deficit could potentially be a small one.
Thu 29 Jan (15.00)	Credit Growth (Dec)	Still very subdued	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. However, annual growth rates will remain elevated for a time yet.
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 developments, annual food price inflation is likely to have peaked.
Fri 13 Feb (10.45)	Retail Trade Survey (Dec)	Anecdotes suggest subdued	While we will wait for the ECT data to make a final call, anecdotes from the Christmas shopping period were generally that spending was relatively subdued.
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	-0.3	-0.5	0.8	0.6	0.7	0.5
CPI (% yoy)	3.2	3.4	4.0	5.1	3.6	2.4	1.6	0.6	1.7	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	-1.5	-1.7	-1.6	-1.1	-0.7
Terms of Trade (% yoy)	8.8	11.6	10.7	4.4	-1.8	-7.1	-8.4	-7.7	-5.8	-5.0

KEY ECONOMIC INDICATORS

	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08	Oct-08	Nov-08	Dec-08
Retail Sales (% mom)	-1.0	1.3	-1.1	0.8	-0.7	0.3	0.3	-1.3
Retail Sales (% yoy)	-1.0	4.1	1.0	1.5	2.5	-0.9	2.2	0.7
Credit Card Billings (% mom)	-0.5	-0.3	0.5	-0.1	0.1	-0.2	1.1	-1.4	-0.8	..
Credit Card Billings (% yoy)	5.9	5.5	6.0	4.0	4.2	2.5	2.3	1.2	-0.7	..
Car Registrations (% mom)	-12.8	12.2	-14.0	1.4	-7.2	-3.4	10.9	-0.4	-20.0	14.1
Car Registrations (% yoy)	-13.2	-1.0	-20.6	-15.9	-27.1	-30.5	-15.6	-19.9	-34.4	-23.7
Building Consents (% mom)	-13.5	80.4	-42.4	-12.9	-1.1	-7.1	9.2	-19.7	4.3	..
Building Consents (% yoy)	-26.9	29.8	-27.1	-45.5	-34.4	-43.2	-28.5	-42.9	-39.4	..
REINZ House Price (% yoy)	1.6	-1.1	-1.4	-2.2	-1.4	-5.7	-6.1	-4.3	-4.1	-4.8
Household Lending Growth (% mom)	0.4	0.3	0.5	0.2	0.3	0.4	0.2	0.2	-0.1	..
Household Lending Growth (% yoy)	10.8	9.9	9.2	8.4	7.7	7.2	6.6	5.9	4.8	..
Roy Morgan Consumer Confidence	111.7	99.9	89.2	86.5	83.9	91.4	108.6	99.7	99.0	102.9
NBNZ Business Confidence	-57.9	-54.8	-49.7	-38.7	-43.2	-20.5	1.6	-42.3	-43.0	-35.0
NBNZ Own Activity Outlook	-6.4	-3.8	-4.4	-4.0	-8.2	4.7	16.7	-11.4	-14.1	-21.5
Trade Balance (\$m)	-43	-293	-169	-215	-797	-848	-1253	-996	-520	..
Trade Balance (\$m annual)	-4526	-4604	-4782	-4478	-4468	-4369	-5050	-5272	-5164	..
ANZ World Commodity Price Index (% mom)	2.0	-0.3	0.9	0.0	1.8	-3.4	-5.1	-7.6	-7.4	-7.4
ANZ World Commodity Price Index (% yoy)	26.9	20.7	18.7	11.6	8.7	3.5	-2.1	-11.1	-18.3	-24.3
Net Migration (sa)	550	500	960	460	780	360	-20	-20	-590	..
Net Migration (annual)	4678	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	16-Jan-09	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10	Sep-10
NZD/USD	0.566	0.557	0.539	0.520	0.470	0.450	0.440	0.450	0.460	0.480
NZD/AUD	0.860	0.831	0.809	0.825	0.810	0.804	0.815	0.833	0.821	0.828
NZD/EUR	0.445	0.414	0.410	0.426	0.392	0.381	0.386	0.409	0.438	0.457
NZD/JPY	55.0	50.9	48.5	47.8	43.2	41.4	41.4	43.2	45.1	48.0
NZD/GBP	0.369	0.373	0.367	0.347	0.318	0.313	0.314	0.321	0.329	0.338
NZ\$ TWI	57.5	55.1	53.8	53.5	49.4	47.9	47.8	49.6	51.1	53.1
NZ interest rates	Nov-08	Dec-08	16-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	3.25	3.25	3.25	3.25	3.75	4.75
90 day bill	6.24	5.22	4.32	3.80	3.60	3.50	3.50	3.50	4.30	5.30
10 year bond	5.71	4.87	4.49	4.60	4.80	4.90	5.00	5.30	5.30	5.80
International	Nov-08	Dec-08	16-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	1.09	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	3.74	4.00	3.80	3.70	3.80	3.80	3.80	4.20

KEY RATES

	16 Dec	12 Jan	13 Jan	14 Jan	15 Jan	16 Jan
Official Cash Rate	5.00	5.00	5.00	5.00	5.00	n/a
90 day bank bill	5.16	4.69	4.52	4.47	4.34	n/a
NZGB 07/09	4.53	3.81	3.60	3.58	3.38	n/a
NZGB 11/11	4.64	4.15	4.04	4.02	3.80	n/a
NZGB 04/13	4.69	4.35	4.26	4.24	4.06	n/a
NZGB 12/17	5.00	4.71	4.70	4.68	4.54	n/a
2 year swap	4.75	4.23	4.00	3.81	3.73	n/a
5 year swap	5.10	4.62	4.44	4.32	4.21	n/a
RBNZ TWI	54.9	57.6	55.8	55.2	53.4	n/a
NZD/USD	0.5584	0.5868	0.5647	0.5560	0.5349	n/a
NZD/AUD	0.8344	0.8452	0.8333	0.8227	0.8114	n/a
NZD/JPY	50.54	52.87	50.50	49.80	47.58	n/a
NZD/GBP	0.3648	0.3889	0.3821	0.3816	0.3666	n/a
NZD/EUR	0.4073	0.4378	0.4234	0.4193	0.4065	n/a
AUD/USD	0.6692	0.6943	0.6777	0.6758	0.6592	n/a
EUR/USD	1.3709	1.3402	1.3337	1.3261	1.3160	n/a
USD/JPY	90.51	90.10	89.42	89.57	88.96	n/a
GBP/USD	1.5306	1.5090	1.4779	1.4570	1.4591	n/a
Oil	44.61	37.65	37.65	37.77	37.43	n/a
Gold	835.10	817.15	826.50	824.95	810.05	n/a
Electricity (Haywards)	4.03	2.48	4.63	n/a	n/a	n/a
Milk futures (US\$/contract)	86	86	84	84	84	n/a
Baltic Dry Freight Index	828	889	911	920	908	n/a

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

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