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Page 2: Economic overview

- > Q1 GDP the focus this week and with a contraction expected, a further chorus predicting the dreaded "R" is likely. This misses the point in our opinion. Instead we should be focusing on the persistence of the weakness. Productivity growth holds the key in this regard.

Page 5: Economic comment – update on liquidity conditions

- > Credit dislocation has taken a back seat to inflation concerns for the time being. However, credit markets remain far from settled, and in fact have shown some signs of deteriorating over recent weeks. While central banks have worked hard to ensure credit markets function via injecting and providing liquidity, a turn in the economic cycle and rising costs from inflation means we are entering a new stage: traditional credit risk.

Page 7: Data preview – Q1 BoP and GDP

- > We expect the current account deficit to improve to 7.4 percent of GDP on the back of higher commodity prices and oil exports. GDP is expected to contract by 0.6 percent driven by private consumption, residential investment and net exports.

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- > It was a quiet week for data globally last week. In the US, data generally surprised on the downside, this goes against a trend over recent weeks of stronger than expected data. In the UK, the big surprise was the record surge in retail sales, although most analysts are putting this down to a statistically anomaly.

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- > The local rates market will drift ahead of Friday's GDP print. We expect a relief rally even if the data prints in line with expectations. A softer print should see the market become more attuned to a July move.

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- > The FOMC interest rate decision and the local Q1 GDP release are the big events this week. The latter is likely to show a contraction and although largely priced in, will nevertheless reinforce a downward bias for the kiwi.

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ECONOMIC OVERVIEW

Q1 GDP the focus this week and with a contraction expected, a further chorus predicting the dreaded "R" is likely. This misses the point in our opinion. Instead we should be focusing on the persistence of the weakness. Productivity growth holds the key in this regard.

What's ahead?

- > **May Credit Card Spending** (Monday 1500 NZST). The early Easter this year has played havoc with monthly figures. We expect a reasonable pull-back from last month's considerable surge.
- > **Q2 Westpac McDermott-Miller Consumer Confidence** (Wednesday 1400 NZST). Following continued falls in the fortnightly Roy Morgan confidence survey, we expect the Westpac survey to post another decline as high cost of living pressures weigh on households.
- > **NZ Q1 Balance of Payments** (Thursday 1045 NZST). We expect the current account deficit to improve to 7.4 of GDP on the back of higher dairy prices and oil exports.
- > **NZ Q1 Gross Domestic Product** (Friday 1045 NZST). We expect GDP to contract by 0.6 percent. Private consumption, residential investment and net exports are all expected to detract from growth.
- > **NZ May Overseas Merchandise Trade** (Friday 1045 NZST). We expect a small monthly surplus of \$100 million to be recorded for the month.
- > **May Credit Growth** (Friday 1500 NZST). With the housing market in the doldrums, credit growth will remain weak.

What's the view?

The big local event this week is of course the GDP data to be released on Friday. Weakness is universally expected, with even Finance Minister Dr Cullen acknowledging last week at the Finance and Expenditure Committee that activity is likely to have contracted over the March quarter. We agree with him (as do all other market commentators surveyed) and expect GDP to contract by 0.6 percent over the quarter (refer to page 7 for a more detailed preview note).

But putting a negative GDP quarter aside, and also the possibility that the June quarter records negative growth too (we are biased to this occurring at this stage given poor data and other leading gauges), this is not the major issue at present. Instead the bigger picture centres on three main points. We have touched on these in the past, but will provide an update:

- > **How long weak growth persists.** We continue to be drawn to the household de-leveraging thesis, resulting in a period of consolidation given the combination of a high current account deficit,

weak balance sheets, negative savings rate and high debt servicing burden. Although there are still positives out there (tax cuts, infrastructure spending, dairy payout etc) we struggle to see these being the economy's saviour over 2009. Household's response to higher interest rates and attempts to slow them down appeared to be very non-linear (i.e. it took a lot to rein them in and for them to hit a "tipping" point). We suspect that given declining house prices removing the wealth effect from spending, and now a rising unemployment rate, it will take a lot to get them spending again, irrespective of tax cuts (which are basically petrol and milk money anyway). On the dairy front, yes the income boost is a strong positive for rural regions, but people also seem to be glossing over the pressures that are coming from on-farm costs, which are denting this income boost.

- > **The speed of the rebalancing process.** Forget the "R" word, the real message is one of rebalancing, as growth shifts from the domestic and spending side of the economy to the earnings sector. The currency (and speed of realignment) will have a big say in this regard. While we have already seen a decent adjustment in the NZD/AUD, a weaker NZD/USD remains a pre-requisite to a sustained upturn in the export sector. In the meantime we are going through a period of grumpy growth. The domestic sector is abdicating, but the export and earnings sector cannot as yet fill the void. Besides, one is 2/3rds of the economy while the other is 1/3rd so you need to see a marked pickup from the latter to provide a meaningful offset. But remember, relative price mechanisms including deposit rates, lending rates, the currency, high wages (denting demand for labour), and more correct pricing of risk are fundamentally a healthy dynamic in terms of fostering a realignment in the composition and quality to growth.
- > **How businesses respond.** We will not see a sustainable upturn for the economy until productivity growth improves. This is the next leg of the economic cycle NZ must embark on. Productivity growth, by definition, requires more output for less input. It is the number one fundamental within the economy. But, our recent productivity performance has been woeful to say the least. Good times tend to lead to complacency, and tend to hide cracks in the foundations. We can see this in a number of areas including employment growth outstripping hours worked, or firms continuing to invest in labour over 2007 when price signals were firmly in capital's favour. In many ways, the length of the downturn rests in businesses' hands. A muddle through type response will result in a muddle through path for growth in terms of the recovery. Conversely, biting the bullet, while digging a larger near-term economic hole, will invariably lead to an earlier and sharper rebound.

So there may be a growing chorus of commentators as well as media headlines discussing the dreaded "R" over the coming months. However to us, this misses the point entirely. You never really know you have been in a recession anyway until you are already starting out the other side (given the lagging nature of NZ data). Therefore, focussing entirely on the near-term economic picture is the wrong way to go about it. We should instead be looking to the medium-term and the type of recovery the economy is going to have.

Moving to offshore developments, it is apparent that there is a lack of conviction to any moves in markets of late, resulting in choppy and volatile price action. No one has a clear view about how things could unfold, namely what is the endgame of simultaneous demand (credit) and supply (commodity) shocks. It certainly leaves us a little circumspect. Policymakers have definitely been vocal and last week was no different. Given the uncertainty, these policymakers' comments are arguably having more of an impact than would have otherwise been the case. With the Fed's interest rate decision this week, with most expecting rates to be left unchanged but the tenor of the statement to be eagerly perused, this theme is likely to continue.

Last week also saw BoE Governor King forced to write an open letter to the Chancellor (Finance Minister) as the CPI broke through the top of their target band (3 percent). In this letter, King stated that he thought the rise in inflation was temporary (even though it is expected to continue to rise) and that it would take a significant growth sacrifice to get inflation below the target within the next 12 months. This suggests he is reluctant to lift interest rates. However, in the BoE minutes released the next day (although for the meeting a couple of weeks prior) there was some discussion on whether an immediate rise in interest rates was warranted given inflation pressures. It is a clear indication of the issues policymakers are grappling with and that even they are unsure about what is the best medicine to deliver.

Closer to home, the RBA also released the minutes from their latest meeting. While the RBA left rates unchanged at its meeting in early June, the minutes suggest that they still remain on a tightening bias. At the moment, the RBA remains comfortable that the economy is slowing enough to contain inflation noting *"On balance, the Board's assessment continued to be that, on current policy settings, the necessary moderation in demand growth was likely to occur."* However, we note that the RBA would not have seen the Q1 GDP number (which was stronger than expected at their June meeting).

And finally on the international setting, and given their importance at present, we can't avoid commenting on oil prices. There were a couple of interesting developments last week. Firstly, was a move by US and British officials to impose position limits on WTI oil contracts on the London-based ICE exchange. At present the US CFTC has regulatory control over futures contracts that are traded in the US. However, they lack any power over what occurs in Europe. This

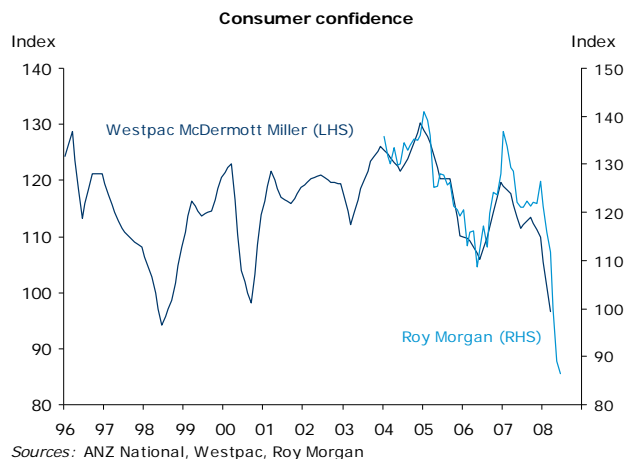
move is likely to see more transparency in terms of positions in the market and is without doubt in response to concerns speculation has driven recent price increases. The other big event last week was the move by China to raise gasoline and diesel prices by up to 18 percent, the first hike in 8 months. Emerging markets, from India to Indonesia, had been reducing their fuel subsidies of late, as soaring oil prices made those subsidies increasingly expensive. But China has been holding out until now. Although this move threatens to send Chinese inflation higher, it shows a willingness by the Chinese authorities to curb fuel demand by exposing its consumers to higher prices. It actually had a bigger impact on the market than jawboning by G8 officials and news that Saudi Arabia would be increasing oil production, sending oil prices down close to US\$5/bbl on the day of the announcement. However geopolitical concerns saw oil prices rebound again.

Moving back to local events, the data released last week was all third-tier in nature. We had Electronic Card Transactions (ECT) data show a reasonable increase for May, with total and core retail spending up 1.2 percent and 1.5 percent respectively. The data suggests core retail sales could post a rebound after consecutive monthly falls in March and April. However, we doubt the headline retail sales figure will rebound as strongly as what is suggested by the ECT data. For a start, we know that a surge in car sales boosted the headline numbers in April, which is unlikely to be repeated, particularly when there was a 15.2 percent drop in car registrations over May. The credit card spending data received this afternoon will allow us to get a clearer gauge on total retail spending for the month.

We also received External Migration data for May, which showed a reasonable surge (a net 1,010 seasonally adjusted) in permanent and long-term migrants for the month – the highest monthly inflow since November 2006. This has seen the annual total rise to 4,931 people – the highest level since the end of 2007. Monthly inflows do look like they have stabilised after appearing likely to head into negative territory a few months ago. As a reasonably important driver of medium-term housing demand, increased monthly migration inflows may provide some support to the housing market over the latter part of 2008 and into 2009. However, this is likely to be more of a base impact, rather than a catalyst for a rebound. Given other headwinds facing the housing market at present, housing market activity will remain subdued over the coming 12 months. In terms of the number of short-term visitor arrivals, they rebounded by 9.4 percent after early Easter induced weakness (down 11.8 percent) in April. However, they remain flat on a year ago. Tourism inflows are likely to be a key bellwether to watch to assess how NZ's external sector is impacted by a period of weaker global growth.

And finally, we received an update of Roy Morgan Consumer Confidence for mid-June. Confidence improved slightly. But after plummeting since early this year, a rebound in consumer confidence at some stage was inevitable. In any case, the rebound

recorded was fairly small and unconvincing. Households still feel financially worse off compared to a year ago - no surprise given the rise in food and petrol costs. The data suggests that the Westpac Consumer Confidence read for Q2, out on Wednesday this week, will show a big drop possibly to early 1990s level. If so, this will confirm that households are really battenning down the hatches.



For this week, along with the data already mentioned (credit card spending, consumer confidence and GDP), there is also the March quarter Balance of Payments, May Overseas Merchandise Trade and May Credit Growth due for release. The Balance of Payments (Thursday) is expected to record another improvement in the current account deficit to 7.4 percent of GDP (refer to our preview note on page 7). This is courtesy of the strong terms of trade boost over the quarter and also solid oil exports from the Tui field. The trade data on Friday is expected to report a small monthly trade surplus, but seeing as this data is released at the same time as GDP, it is likely to be forgotten about in the wash. Finally, the credit growth data for May will be weak. Total household claims only grew by 0.3 percent in April – the softest growth on record – and we cannot rule out something similar in May, given the continued poor performance of the housing market.

Recent data...

NZ Economic Survey of Manufacturing (March quarter): Nominal manufacturing sales rose by 3.7 percent over the quarter, while real sales rose by 0.2 percent.

NZ Electronic Card Transactions (May): Total retail ECT spending rose 1.2 percent, while core retail ECT spending (which excludes motor vehicle-related industries) rose 1.5 percent.

NZ External Migration (May): There was a net monthly inflow of 1,010 people (seasonally adjusted), taking the annual total to 4,931.

Roy Morgan Consumer Confidence (Mid-June): Headline confidence improved to 87.5 from 85.4 in the last survey.

UPDATE ON LIQUIDITY CONDITIONS

Credit dislocation has taken a back seat to inflation concerns for the time being. However, credit markets remain far from settled, and in fact have shown some signs of deteriorating over recent weeks. While central banks have worked hard to ensure credit markets function via injecting and providing liquidity, a turn in the economic cycle and rising costs from inflation means we are entering a new stage: traditional credit risk.

Markets remain on a roller coaster. Conditions stabilised in April and early May. However, recent weeks have been notable for barometers on liquidity conditions beginning to deteriorate once again. The S&P VIX index – a measure of risk aversion – has been pushing higher after reaching a six-month low in April. Credit and swap spreads, although off their peaks, have also begun to widen again as have credit default swap spreads for US and European corporates. Probably most worrying for central banks is that short-term inter-bank lending rates remain elevated. All up, it remains a case of credit sentiment improving, but still jittery and far from the “carefree” environment over 2006 and early 2007.

Further bouts of volatility are to be expected, as the international environment continues to navigate through uncertain times. Excesses built up over a number of years were hardly going to disappear immediately. Encouragingly, writedowns and credit losses continue to be disclosed, with a total of US\$390.9 billion announced to date. One reason markets have taken a more sanguine view to the

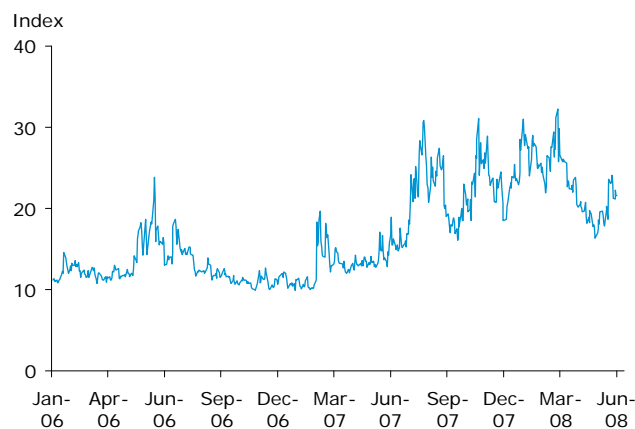
latest credit events has been the ability of some institutions to raise capital. To date, US\$309 billion of capital has been raised, with over 50 percent of this coming in the June quarter alone. However, total writedowns estimates are as high as US\$1 trillion, so there seems a long way to go.

We also need to remain aware of the potential for credit dislocation entering stage two, namely traditional credit risk in relation to the economic cycle. Stage two emanates from the combination of weaker growth (the initial flow-on from credit dislocation) being exacerbated by tighter lending standards, even weaker growth, and lower profits, particularly as inflation increases costs and erodes margins.

A new credit risk is now apparent, namely inflation. Central bank rhetoric has stiffened considerably. The ECB is now prepared to tighten in response, and the market is now priced for more than 50 basis points of hikes before year end from the Fed. In fact, excluding the RBNZ, almost all central banks are expected to hike rates. It's a simple equation; too much inflation means less room for growth. Indeed it's been interesting to eye Fed rhetoric of late which points to a preparedness to let the unemployment rate rise as inflationary waters are navigated. Inflation is not growth friendly. This warns of stage two. Traditional credit risk via the economic cycle.

Another bout of volatility and equity markets under pressure

VIX Index



Sources: ANZ National, Bloomberg

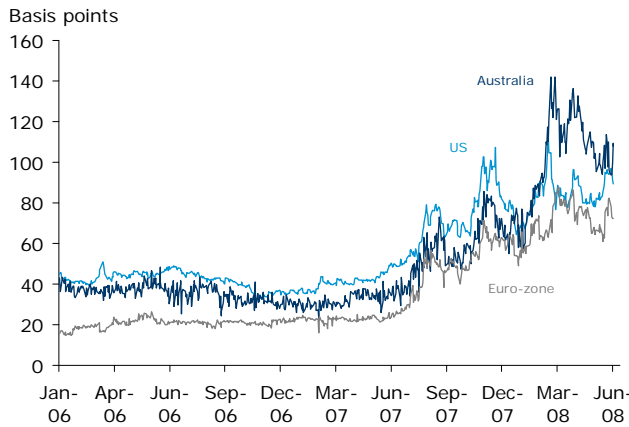
Global equity markets



Sources: ANZ National, Bloomberg

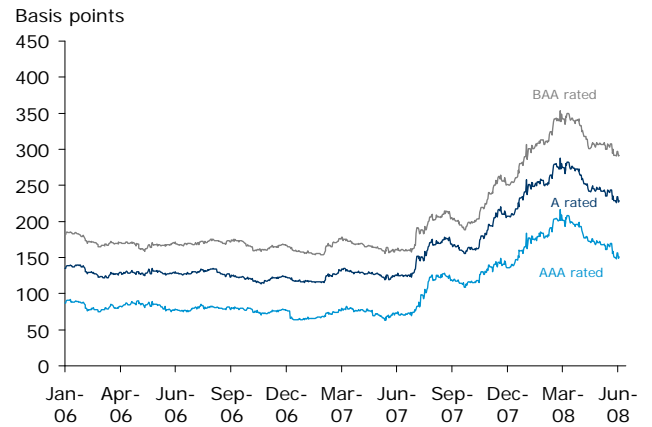
Although off their peaks, credit and swap spreads remain wide

2-year swap spreads



Sources: ANZ National, Bloomberg

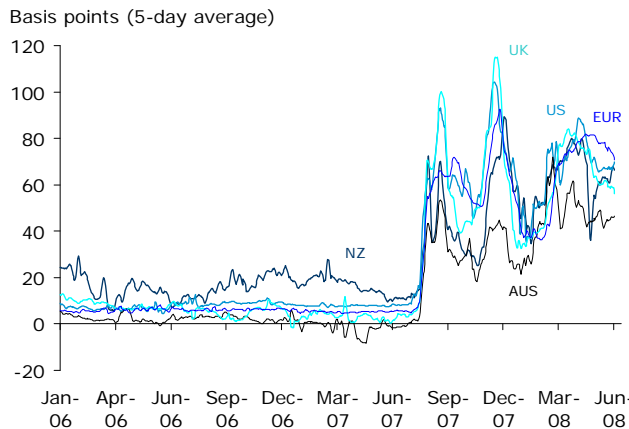
US corporate bond spreads



Sources: ANZ National, Bloomberg

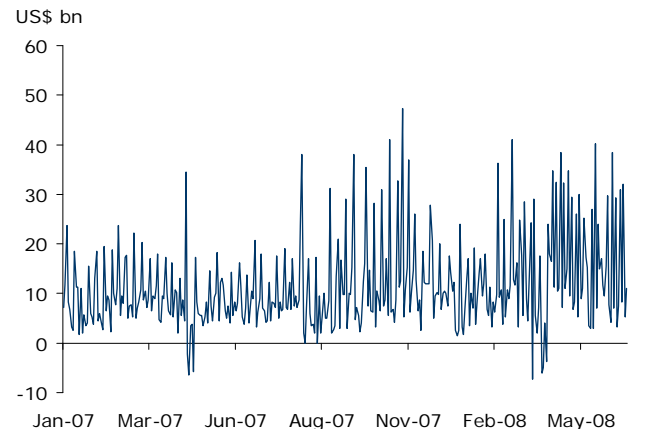
Inter-bank interest rates remain elevated, despite continued liquidity injections

3-month LIBOR-OIS spreads



Sources: ANZ National, Bloomberg

Daily US Federal Reserve Open Market Operations



Sources: ANZ National, Bloomberg

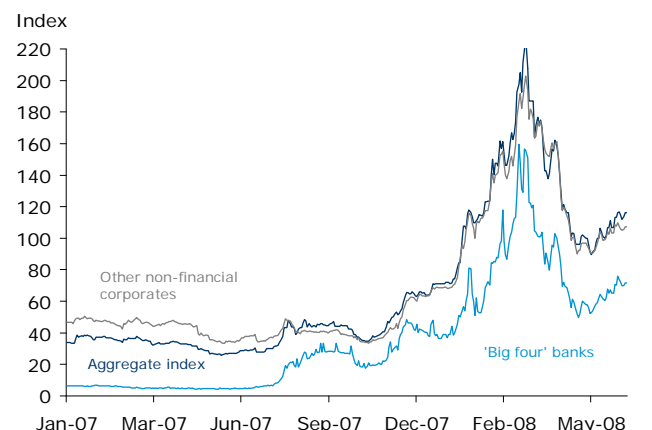
Credit default swap spreads remain well above pre-crisis levels

US brokers CDS spreads



Sources: ANZ National, Bloomberg

iTraxx Australia 5 year



Sources: ANZ National, Bloomberg

DATA PREVIEW

Current account – March 2008 quarter (due Thursday 26 June 10.45am)

	ANZ National	RBNZ	Market
Quarter	-\$1,543m	-	-\$1,655m
Annual	-\$13,169m	-	-\$13,249m
% of GDP	-7.4	-7.6	-7.5

In a similar story to Q4, the current account is expected to show an improvement on the back of higher commodity prices and oil exports. But the investment income deficit will continue to weigh.

We are expecting the annual current account deficit to show an improvement from 7.9 percent of GDP in the December 2007 quarter to 7.4 percent in the March quarter. As was the case in the December quarter, the main driver of the expected improvement is from stronger export values, courtesy of higher commodity prices and solid oil exports from the Tui oil field. The annual goods and services deficit is expected to improve to 0.6 percent of GDP – the smallest deficit since the end of 2004.

A big uncertainty (as always) is the investment income deficit. We expect it to have deteriorated slightly over the quarter, and remain above 7 percent of GDP on an annual sense. There is the potential for the income New Zealanders earned on their investments offshore to have been adversely affected by the financial market turbulence early this year. This is likely to be offset somewhat by lower profits from foreign-owned firms in NZ affected by the weaker economy and pressure on margins. However, with debt making up the majority of NZ's foreign liabilities, the rise in offshore funding costs will be the main driver of the larger investment income deficit.

Looking forward, with the domestic economy now turning rapidly, weaker household consumption growth and slowing business investment are likely to see less import demand. At the same time, a weaker NZD (which is already at a seven-year low against the AUD) will eventually help provide a boost to export and tourism growth - although this may be tempered somewhat by a weaker global economy. Nevertheless, a lower goods and services deficit rests at the heart of an improved current account balance – a positive dynamic. Of course, the massive investment income deficit – with much of it made up of debt serving obligations – is likely to remain large for some time.

Financial market implications

After being forgotten for too long, current account deficits are now back in the spotlight, given the altered global credit environment. We have already seen large responses (played out through currencies) in Iceland and the US. Though moving in the right direction, NZ's current account deficit remains unsustainable. However baring a major surprise, it is unlikely to get too much attention from financial markets, with the GDP release the major focus the next day.

GDP – March 2008 quarter (due Friday 27 June 10.45am)

	ANZ National	RBNZ	Market
QoQ	-0.6	-0.3	-0.3
YoY	1.8	2.1	2.1
Ann. Ave.	3.0	3.1	3.1

The GDP report will confirm an economy heading backwards with weakness being broad-based. Private consumption, residential investment and net exports are all expected to detract from growth. Current indicators for the June quarter look no better.

We expect GDP to fall by 0.6 percent for the March 2008 quarter. This is at the bottom end of market expectations, and below the RBNZ's June *Monetary Policy Statement* forecast of -0.3 percent. All market commentators surveyed are expecting a negative result.

On the production side, housing-centric areas are at the centre of the weakness. Construction, retail/wholesale and business services are all expected to be soft. The impact of the drought is also expected to show, with agriculture and primary food manufacturing expected to detract 0.3 percentage points from growth. An increased reliance on thermal generation should also see electricity generation add less to growth given thermal has a lower value added component than hydro generation.

On the expenditure side, private consumption expenditure is expected to be flat at best, given the fall in retail sales over the quarter. Residential investment is likely to post a large decline, as will non-residential investment. Net exports are expected to detract from growth. This is offset to some degree by a rebuild in inventories following a large unwind in December.

Looking towards the June quarter, activity looks little better. Whether it be the housing market, consumer and business sentiment, poor retailing as households' wallets are squeezed or just anecdotes we are hearing, the weakness over the March quarter does not appear to be a flash in the pan. The economy is slowing sharply and the March quarter contraction looks set to spillover into the June quarter.

Financial market implications

Although the market is already expecting a soft print, an outturn in line with expectations could still see a relief rally in rates and the NZD come under pressure. From a risk-reward perspective, there is the potential for a larger reaction to a weaker number. Certainly, a print close to our forecast will see the markets become more attuned to the possibility of a July RBNZ move, although the global inflation backdrop remains a sticking point to an early move.

GLOBAL WATCH

We present a table of global data outturns over the past week given the significance of the international backdrop at present. It was a quiet week for data globally last week. In the US, data generally surprised on the downside, this goes against a trend over recent weeks of stronger than expected data. In the UK, the big surprise was the record surge in retail sales, although most analysts are putting this down to a statistically anomaly.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
US	Empire Manufacturing (Jun)	-2.0	-8.7	-3.2	Weaker
	NAHB Housing Market Index (Jun)	19	18	19	Weaker
	Producer Price Index (May) – mom	1.0%	1.4%	0.2%	Stronger
	Housing Starts (May)	980k	975k	1,008k	Weaker
	Industrial Production (May)	0.1%	-0.2%	-0.7%	Weaker
	Philadelphia Fed (Jun)	-10.0	-17.1	-15.6	Weaker
	Leading Indicators (May)	0.0%	0.1%	0.1%	Stronger
Europe	CPI (May) – mom	0.6%	0.6%	0.3%	In-line
UK	CPI (May) – mom	0.4%	0.6%	0.8%	Stronger
	Retail Sales (May) – mom	-0.1%	3.5%	-0.3%	Stronger
	M4 Money Supply (May P) – mom	0.5%	0.4%	0.5%	Weaker
	M4 Sterling Lending (May P)	18.7B	4.8B	28.8B	Weaker
Asia Ex-Japan					
<i>China</i>	Industrial Production (May) – yoy	16.0%	16.0%	15.7%	In-line
	Fixed Assets Investment Urban YTD (May) – yoy	25.6%	25.6%	25.7%	In-line
<i>Singapore</i>	Non-oil Domestic Exports (May) – mom	1.2%	-9.8%	1.6%	Weaker
<i>Malaysia</i>	CPI (May) – yoy	3.4%	3.8%	3.0%	Stronger
Japan	Tertiary Industry Index (Apr) – mom	0.6%	1.8%	0.0%	Stronger
	All Industry Activity Index (Apr) – mom	0.4%	0.8%	0.3%	Stronger
Australia	Dwelling Starts (1Q)	-	-3.3%	4.2%	-

INTEREST RATE STRATEGY

The local rates market will drift ahead of Friday's GDP print. We expect a relief rally even if the data prints in line with expectations. A softer print should see the market become more attuned to a July move.

Market themes...

- > Lack of major domestic data sees rates market drift.
- > Global yields choppy. US bonds driven by equity market moves.
- > Market paring back rate hike expectations for Fed and ECB. BoE minutes surprise with hawkishness.

Review and outlook...

It was a nothing week for the NZ rates market. The absence of any major data to provide a steer meant the market was dictated to by offshore moves. Volumes were light and there was a lack of any conviction in the trading, with participants mostly sitting on the sidelines waiting for this Friday's Q1 GDP print. The moves in the NZ market last week were small compared to those of offshore. The US swap market rallied 9-19bps, but this came after selling off massively the week prior. The Australian swaps market rallied 3-11bps.

A reassessment of central bank policies was behind last week's offshore moves, with markets paring back some of the aggressive rate hikes priced in for the Fed and ECB. The RBA minutes were read as more dovish, and painted a picture of the RBA being patient. The BoE's minutes on the other hand, surprised with some members discussing pre-emptive rate hikes. While markets will remain choppy as they re-think future central bank moves, one thing is clear – the risk profile for global rates is up, while NZ stands out as the only central bank preparing to lower rates this year.

Moving to this week, trading is expected to be uneventful early on as the market drifts, with offshore moves dominating. We could well see some early action with the release of the Westpac consumer confidence survey on Wednesday. But this will only confirm the more timely Roy Morgan survey, which shows consumers straining under higher cost of living pressures. And even Thursday's balance of payments data is of more interest to the currency market than for rates. So it will be a case of light volumes and nothing trades until Friday's big event.

The market is already expecting a negative GDP print. However, even an outturn in line with expectations could still see a relief rally. After all, it will confirm that the economy went backwards, and indicators to date do not look that good for Q2. A much weaker print however, will get the market excited and start contemplating the possibility of a July move. As we have mentioned last week, a move in July should not be discounted. While inflation is still problematic, market pricing will move to price in greater odds for

July that currently the case should the GDP data come in weaker.

In offshore news, the major event is the FOMC decision on Thursday. A no change is widely tipped, but the tone will be closely perused. Expect inflation to replace growth as the predominant concern.

Gauges for NZ interest rates yields

Gauge	Direction	Comment
RBNZ	↓	Market looking for September easing but July a real possibility.
NZ data	↓	Q1 GDP data key event this week.
Fed Funds/front end	↔	Market again reassessing Fed, paring back rate hike expectations.
RBA	↔	RBA seem comfortable with current policy settings for now.
US 10 year	↔	Equities dictating bond moves at the moment.
NZ swap curve	↔/↓	Curve bias is still to steepen, given weak GDP print expected.
Flow	↔	Flows to be light as participants await GDP data. Bias towards receive side.
Technicals	↔/↓	Technically the picture is primed for a downward move given soft NZ data.

Borrowing strategies we favour at present

The domestic dataflow continue to back a September start to the easing cycle. Hence, we stick to our preferred strategy which is for borrowers to target the 1-year space, which benefits from positive pick-up. If borrowers are still worried about inflation (oil prices) delaying the easing cycle, they can consider borrowing in the 2-year space.

Probability of 25bps increase as implied by market pricing

OCR dates	Last week	This week
Thu 24-Jul-08	-22	-28
Thu 11-Sep-08	-78	-96
Thu 23-Oct-08	-154	-176
Thu 4-Dec-08	-222	-252
Thu 22-Jan-09	-286	-324
Thu 5-Mar-09	-346	-388
Thu 23-Apr-09	-398	-436

Trading themes we favour at present

Stick with core strategy of receiving the belly of the curve (3-5 year), and buy September bank bill futures as a play on a July move.

CURRENCY STRATEGY

The FOMC interest rate decision and the local Q1 GDP release are the big events this week. The latter is likely to show a contraction and although largely priced in, will nevertheless reinforce a downward bias for the kiwi.

Market themes...

- > Fed rate hike expectations pared back of late – weighing on the greenback.
- > FOMC decision this week is critical.
- > Q1 GDP negative. Q2 looks no better – reinforcing downward bias for the kiwi.

Review and outlook...

The NZD remains in the down-channel that has been in place since March. However, it appears to lack the ability to break through this at present for a sustained move lower, despite domestic data continuing to paint a very gloomy near-term economic picture. The NZD has rebounded off support at 0.7450, with a weak USD and yield demand providing support.

The lack of comment on FX from G8 officials along with some slightly weaker economic data last week (housing starts and Philly Fed) has seen the USD give back some of its recent gains. A realisation by the market that the interest rate increases priced in for the Fed before the end of the year may have been overdone has also weighed on the greenback.

Stepping back, it still looks to be the case that currency markets lack any real conviction at present as they remain hostage to wider global credit/inflation gyrations. It is interesting to note that the relationship between the NZD and equity sentiment has broken down of late. Stock markets around the globe are under pressure and the Dow has closed below the 12,000 for the first time since mid-March. The local equity market is off close to 11 percent since early April. Although not a factor at present, equity sentiment remains key to watch.

Looking forward to this week, there are two big events (one international and the other local) that have the potential to be watershed moments for the NZD. The first (on Thursday NZST) is the FOMC interest rate announcement. Interest rates are unlikely to be changed, but what they say in their accompanying statement will be all important. Given that the market is still pricing in close to three interest rate hikes before the end of this year, the risk appears that the market may be disappointed. However, with Fed officials of late stating that they are keen on a stronger USD, it will be interesting to see any specific comments directed at the USD in the statement.

The big local event this week is the release of March quarter GDP on Friday. A weak result is all but priced in by the market. However, we suspect that the market is still a tad optimistic despite the consensus expecting a small decline. Nevertheless, negative GDP results do not occur often and even an outcome in line

with expectations should see the downward bias for the NZD remain, particularly when looking forward to the June quarter, which looks no better based on leading indicators. It should also see the NZD/AUD continue to push lower this week.

These two events are likely to gain the lion's share of attention this week. However, other data that will be important will be the German IFO, Japanese CPI and US housing data. Locally, consumer confidence and balance of payments data are also released and are worth keeping an eye on. The latter particularly so, given the altered global credit environment.

Technically, the recent bounce from lows around 0.7450 looks like a corrective move within the overall downtrend on the daily chart. Resistance at 0.7650 capped the bounce last week and above that the 0.7690 level will find technical sellers. Initial support is found at the 200 hour m.a. of 0.7550. The NZD/AUD remains in its well entrenched downtrend with 0.8050 providing stiff resistance.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↓	Growth differentials favouring AUD.
Yield	↓	RBA to hike. RBNZ cut.
Commodities	↔	Same picture for both.
Partial indicators	↓	Better across the Tasman.
Technicals	↓	Solid resistance at 0.8050.
Sentiment	↓	Terms of trade says it all.
Other	↓	GDP data to start the next leg lower?
On balance	↓	Trend is clear.

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 (and rising) given a structural shift in commodity prices.
Fair value – short-term	↔	Yield and commodity story factored.
Yield	↔	FOMC and Q1 NZ GDP key.
Commodities	↔	The big one to watch.
Risk aversion	↔/↓	Credit concerns surfacing again.
Partial indicators	↓	NZ data now looking weaker than US.
Technicals	↔/↓	Range with bearish bias.
AUD	↔/↑	RBA to hike again?
Sentiment	↓	Market wants to believe Fed is done.
Other	↔	Inflation all round.
On balance	↔/↓	RBNZ will need to cut to break range.

DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
23 Jun	UK	Rightmove House Prices (Jun) - mom	-	1.2%	11:01
		BBA Loans for House Purchase (May)	-	38704	20:30
	JN	BSI Large Manufacturing (2Q) - qoq	-	-12.9	11:50
		BSI Large All Industry (2Q) - qoq	-	-9.3	11:50
	AU	New Motor Vehicle Sales (May) - mom	-	-0.8%	13:30
	NZ	Credit Card Spending (May) - yoy	-	8.3%	15:00
	GE	PMI Manufacturing (Jun A)	53.2	53.6	19:30
		PMI Services (Jun A)	53.1	53.8	19:30
		IFO - Business Climate (Jun)	102.5	103.5	20:00
		IFO - Current Assessment (Jun)	109.0	110.1	20:00
		IFO - Expectations (Jun)	96.3	97.3	20:00
24 Jun	GE	GfK Consumer Confidence Survey (Jul)	4.6	4.9	18:10
25 Jun	US	Former Fed Chairman Greenspan Speaks in South Africa	-	-	00:30
		S&P/CS Composite-20 (Apr) - yoy	-15.9%	-14.4%	01:00
		Consumer Confidence (Jun)	56.4	57.2	02:00
		Richmond Fed Manufacturing Index (Jun)	-6	-3	02:00
		House Price Index (Apr) - mom	-0.5%	-0.4%	02:00
	JN	Adjusted Merchandise Trade Balance (May)	¥413.4B	¥609.2B	11:50
26 Jun	US	Durable Goods Orders (May)	0.0%	-0.5%	00:30
		Durables Ex Transportation (May)	-0.9%	2.5%	00:30
		New Home Sales (May)	512K	526K	02:00
		New Home Sales (May) - mom	-2.7%	3.3%	02:00
		FOMC Interest Rate Decision	2.00%	2.00%	06:15
	US	Fed Vice Chairman Kohn Speaks at ECB Conference	-	-	23:30
	NZ	Current Account Balance (1Q)	-1.67B	-3.41B	10:45
		Current Account (1Q) - % of GDP	-7.5%	-7.9%	10:45
		Westpac Consumer Confidence (2Q)	-	96.5	14:00
	AU	Conference Board Leading Index (Apr)	-	-0.4%	12:00
		Job vacancies (May)	-	-2.5%	13:30
	GE	Import Price Index (May) - mom	1.5%	0.9%	18:00
	UK	Total Business Investment (1Q F) - qoq	-1.4%	-1.4%	20:30
		BOE's King, Gieve, Tucker, Besley, Barker to Testify	-	-	20:45
27 Jun	US	GDP QoQ (Annualized) (1Q F)	1.0%	0.9%	00:30
		Initial Jobless Claims (w/e Jun 22)	377K	381K	00:30
		Continuing Claims (w/e Jun 15)	3,120K	3060K	00:30
		Fed's Bullard Speaks at ECB Conference on Monetary Policy	-	-	01:00
		Help Wanted Index (May)	19	19	02:00

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
27 Jun cont.	US	Existing Home Sales (May)	4.96M	4.89M	02:00
		Existing Home Sales (May) – mom	1.3%	-1.0%	02:00
	NZ	GDP (1Q) - qoq	-0.3%	1.0%	10:45
		GDP (1Q) - yoy	2.1%	3.7%	10:45
		Trade Balance (May)	150.0M	-334.0M	10:45
		Imports (May)	3.70B	4.13B	10:45
		Exports (May)	3.95B	3.80B	10:45
		Money Supply M3 (May) - yoy	-	4.5%	15:00
	JN	Jobless Rate (May)	4.0%	4.0%	11:30
		Household Spending (May) - yoy	-2.0%	-2.7%	11:30
		National CPI (May) - yoy	1.3%	0.8%	11:30
		National CPI Ex-Fresh Food (May) - yoy	1.4%	0.9%	11:30
		National CPI Ex Food, Energy (May) - yoy	0.0%	-0.1%	11:30
		Industrial Production (May P) - mom	2.8%	-0.2%	11:50
		Retail Trade (May) - mom	-0.5%	-0.1%	11:50
		Vehicle Production (YoY)	-	5.4%	16:00
	AU	Reserve Bank Assistant Governor Debelle Speaks in Sydney	-	-	16:30
	UK	GDP (1Q F) - qoq	0.4%	0.4%	20:30
		Current Account (1Q)	-12.1B	-8.5B	20:30
28 Jun	US	Personal Income (May)	0.4%	0.2%	00:30
		Personal Spending (May)	0.7%	0.2%	00:30
		PCE Deflator (May) - yoy	3.2%	3.2%	00:30
		PCE Core (May) - mom	0.2%	0.1%	00:30
		PCE Core (May) - yoy	2.1%	2.1%	00:30
		University of Michigan Confidence (Jun F)	56.8	56.7	02:00

Key: AU: Australia, EU: 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 have now shifted to an easing bias and interest rates look set to be moved lower later this year. The dataflow over the next four weeks is likely to confirm a very weak economy, with GDP this week the big one to watch. However, despite a favourable demand-pull backdrop, close attention needs to be paid to cost-push forces such as the currency and commodity prices. The CPI in four weeks time is shaping up as a critical read, particularly the non-tradable component.

Date	Data/Event	Economic Signal	Comment
Mon 23 Jun (15.00)	Credit Card Spending (May)	Weak	An early Easter this year has led to significant volatility in recent monthly outturns. A pullback is expected following the April surge.
Wed 25 Jun (14.00)	Westpac McDermott Miller Confidence	Weakening	Following continued falls in the fortnightly Roy Morgan confidence survey, we expect the Westpac survey to post another decline as high cost of living pressures weigh on households.
Thu 26 Jun (10.45)	Balance of Payments (Mar qtr)	Improving	We expect a further improvement in the current account deficit for the quarter on the back of higher dairy prices and oil exports.
Fri 27 Jun (10.45)	Gross Domestic Product (Mar qtr)	Negative	We expect a -0.6 percent print. Private consumption, residential investment and net exports are all expected to detract from growth. Q2 is not looking any better.
Fri 27 Jun (10.45)	Overseas Merchandise Trade (May)	Small surplus	A small monthly trade surplus is expected to be recorded for the month.
Fri 27 Jun (15.00)	Credit Growth (May)	Weak	With the housing market in the doldrums, credit growth will remain weak.
Mon 30 Jun (10.45)	Building Consents (May)	Correction	Given the surprising surge last month, we expect a relatively large downward correction in May.
Mon 30 Jun (15.00)	NBNZ <i>Business Outlook</i> (Jun)	-	-
Thu 3 Jul (15.00)	ANZ Commodity Price Index (Jun)	-	-
Tue 8 Jul (10.00)	NZIER Quarterly Survey of Business Opinion (Jun qtr)	Weak	We expect headline confidence and activity gauges to continue to deteriorate, in line with the National Bank <i>Business Outlook</i> . Capacity utilisation is also expected to fall following last quarter's surprising surge. However, pricing intentions should remain elevated.
circa 11 Jul	REINZ Housing Report (Jun)	Weak	Recent data has shown the number of house sales continuing to fall, but prices remaining elevated. Until vendors become more realistic with their price expectations, sales will remain well down.
Mon 14 Jul (10.45)	Retail Sales (May)	Small rebound	Core retail sales are likely to rebound slightly following two soft months. However, headline sales are likely to be weak driven by a fall in motor vehicle sales.
Tue 15 Jul (10.45)	Consumers Price Index (Jun qtr)	High	Petrol and food prices are likely to contribute close to 1 percentage point alone to the CPI increase in the quarter. Non-tradable inflation will be key and we will be closely watching housing-related components to see if any softening is occurring.
On Balance		An economy heading backwards, but with inflation	Growth indicators are awful. But inflation needs to be watched.

SUMMARY OF KEY ECONOMIC FORECASTS

	Mar-07	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09
GDP (% qoq)	1.2	0.9	0.5	1.0	-0.6	-0.2	0.2	0.3	0.3	0.5
GDP (% yoy)	2.3	3.2	3.3	3.7	1.8	0.7	0.4	-0.3	0.6	1.3
CPI (% qoq)	0.5	1.0	0.5	1.2	0.7	1.4	1.2	0.9	0.5	0.7
CPI (% yoy)	2.5	2.0	1.8	3.2	3.4	3.8	4.6	4.3	4.1	3.4
Employment (% qoq)	1.4	0.5	-0.3	0.9	-1.3	0.2	-0.2	0.0	0.1	0.1
Employment (% yoy)	1.8	1.5	1.6	2.5	-0.2	-0.6	-0.4	-1.3	0.1	0.0
Unemployment Rate (% sa)	3.7	3.6	3.5	3.4	3.6	3.8	4.0	4.2	4.3	4.5
Current Account (% GDP)	-8.2	-8.1	-8.4	-7.9	-7.4	-6.9	-6.5	-6.5	-6.5	-6.5
Terms of Trade (% qoq)	1.5	0.4	3.7	2.7	4.1	0.0	-1.0	-0.1	-1.5	-1.2
Terms of Trade (% yoy)	4.5	2.3	8.4	8.5	11.3	10.8	5.8	2.9	-2.6	-3.8

KEY ECONOMIC INDICATORS

	Aug-07	Sep-07	Oct-07	Nov-07	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08
Retail Sales (% mom)	0.3	1.1	-0.4	1.8	0.0	0.2	-0.6	-1.2	1.0	..
Retail Sales (% yoy)	6.3	4.1	5.8	7.2	5.4	6.3	7.7	-1.0	4.1	..
Credit Card Billings (% mom)	0.9	1.9	-0.4	1.1	0.7	-0.2	0.8	-3.6	4.4	..
Credit Card Billings (% yoy)	8.6	9.3	7.7	9.5	7.6	8.6	8.1	3.3	8.3	..
Car Registrations (% mom)	1.0	-6.7	5.6	-3.6	-2.7	5.3	-4.2	-13.0	12.3	-15.2
Car Registrations (% yoy)	10.9	0.1	4.7	2.3	1.4	1.7	1.9	-13.2	-1.0	-20.6
Building Consents (% mom)	5.9	-10.5	-5.3	0.9	-4.1	3.9	-5.5	-14.4	82.1	..
Building Consents (% yoy)	0.0	-15.5	-16.1	-4.5	-6.5	-5.2	-17.7	-27.1	30.9	..
REINZ House Price (% yoy)	12.9	12.3	8.0	6.7	4.5	4.0	0.7	1.6	-1.1	-1.4
Household Lending Growth (% mom)	0.9	0.8	0.9	0.9	0.7	0.7	0.8	0.5	0.3	..
Household Lending Growth (% yoy)	13.6	13.2	13.0	12.8	12.3	11.9	11.6	10.8	9.9	..
Roy Morgan Consumer Confidence	122.4	121.3	122.0	121.9	126.6	121.2	116.0	111.7	99.9	89.2
NBNZ Business Confidence	-33.8	-26.5	-12.9	-19.6	-24.9	..	-43.9	-57.9	-54.8	-49.7
NBNZ Own Activity Outlook	16.7	17.2	20.3	15.7	18.2	..	2.4	-6.4	-3.8	-4.4
Trade Balance (\$m)	-947	-572	-774	-628	39	-311	244	-44	-334	..
Trade Balance (\$m annual)	-6336	-6282	-5883	-5691	-5307	-4793	-4421	-4525	-4645	..
ANZ World Commodity Price Index (% mom)	1.4	0.4	1.8	0.8	0.0	-1.4	1.1	2.0	-0.3	1.0
ANZ World Commodity Price Index (% yoy)	36.3	35.7	37.8	35.9	30.9	27.4	26.9	26.9	20.7	18.7
Net Migration (sa)	740	630	220	440	0	90	250	530	510	1010
Net Migration (annual)	8730	8309	7517	6588	5491	4799	4643	4678	4666	4931

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)						
	Apr-08	May-08	23-Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
NZD/USD	0.791	0.778	0.761	0.770	0.750	0.720	0.680	0.640	0.630	0.620
NZD/AUD	0.851	0.819	0.798	0.762	0.721	0.720	0.723	0.719	0.724	0.738
NZD/EUR	0.502	0.500	0.487	0.494	0.484	0.468	0.453	0.441	0.450	0.456
NZD/JPY	81.1	81.1	81.5	80.1	78.0	75.6	73.4	70.4	69.3	69.4
NZD/GBP	0.399	0.395	0.385	0.393	0.389	0.379	0.364	0.346	0.346	0.344
NZ\$ TWI	70.4	69.4	68.0	67.8	65.9	64.0	61.9	59.6	59.6	59.7
NZ interest rates	Apr-08	May-08	23-Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
OCR	8.25	8.25	8.25	8.00	7.50	7.00	6.50	6.00	6.00	6.00
90 day bill	8.87	8.72	8.68	8.20	7.70	7.10	6.60	6.20	6.20	6.20
10 year bond	6.48	6.43	6.47	6.30	5.70	5.60	5.60	5.40	5.30	5.40
International	Apr-08	May-08	23-Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10
US Fed funds	2.00	2.00	2.00	2.00	1.75	1.75	1.75	2.25	2.75	3.25
US 3-mth	2.85	2.68	2.80	2.50	2.00	1.75	2.00	2.50	3.00	3.50
AU cash	7.25	7.25	7.25	7.50	7.75	7.75	7.75	7.75	7.25	6.75
AU 3-mth	7.80	7.79	7.82	7.90	8.10	8.10	8.10	7.80	7.20	6.70

KEY RATES

	20 May	16 Jun	17 Jun	18 Jun	19 Jun	20 Jun
Official Cash Rate	8.25	8.25	8.25	8.25	8.25	8.25
90 day bank bill	8.64	8.65	8.64	8.65	8.65	8.68
NZGB 07/09	6.70	7.04	7.08	7.05	7.05	7.08
NZGB 11/11	6.42	6.63	6.63	6.59	6.50	6.50
NZGB 04/13	6.38	6.46	6.46	6.43	6.40	6.41
NZGB 12/17	6.38	6.42	6.43	6.41	6.40	6.44
2 year swap	7.81	7.91	7.86	7.84	7.87	7.90
5 year swap	7.48	7.55	7.51	7.50	7.54	7.57
RBNZ TWI	68.8	67.8	67.9	68.0	68.1	68.3
NZD/USD	0.7717	0.7513	0.7557	0.7562	0.7585	0.7614
NZD/AUD	0.8060	0.8001	0.8027	0.8006	0.8006	0.8008
NZD/JPY	80.36	81.33	81.49	81.62	81.70	82.19
NZD/GBP	0.3956	0.3848	0.3844	0.3872	0.3870	0.3861
NZD/EUR	0.4974	0.4877	0.4869	0.4879	0.4873	0.4909
AUD/USD	0.9574	0.9390	0.9415	0.9445	0.9474	0.9508
EUR/USD	1.5516	1.5404	1.5520	1.5498	1.5564	1.5510
USD/JPY	104.13	108.25	107.84	107.93	107.71	107.95
GBP/USD	1.9508	1.9522	1.9660	1.9532	1.9601	1.9720
Oil	127.15	134.84	134.52	133.99	136.54	131.88
Gold	906.10	872.35	884.15	882.45	892.70	897.95
Electricity (Haywards)	28.70	25.42	28.39	30.21	34.07	34.55
Milk futures (US\$/contract)	139	144	144	144	144	142
Baltic Dry Freight Index	11793	9419	9413	9437	9474	9428

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