

## THE KITCHEN SINK

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### Page 2: Economic overview

- > The global financial system has entered a new and risky phase of the evolution of this period of credit dislocation. Policy-makers have been quick to respond and the adjustment process is now being fast-tracked. Despite this, we now expect two more successive 50 basis point cuts from the RBNZ before the end of the year.

### Page 5: Data preview – Q2 GDP

- > June quarter GDP is expected to contract by 0.5 percent, and the risk profile is tilted towards something weaker. Sectors closely aligned to the housing market are expected to drive much of the weakness. On the expenditure side, private consumption, residential investment and net exports all detract from growth. We have a further fall in GDP pencilled in for Q3.

### Page 6: Economic comment – global watch

- > US data was mixed again last week, although data took a backseat to developments occurring in financial markets. The same was the case in Europe and the UK, while it was relatively quiet in terms of data across Asia.

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- > The US Treasury's US\$700bn rescue package has seen global interest rates and stock markets rebound strongly, towards levels prevailing before last week's turmoil. However, NZ interest rates have been held down, and are likely to continue to do so as the market continues to (correctly) focus on the significant downside risks.

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- > The tenor of NZ data – including GDP this week and current account figures – are hardly currency supportive. The NZD has already retraced a long way and looks on borrowed time. But with the global scene now entering the next leg of dislocation, and a policy response, the USD finds itself under pressure. We expect a lower NZD/AUD this week.

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## ECONOMIC OVERVIEW

The global financial system has entered a new and risky phase of the evolution of this period of credit dislocation. Policy-makers have been quick to respond and the adjustment process is now being fast-tracked. Despite this, we now expect two more successive 50 basis point cuts from the RBNZ before the end of the year.

### What's ahead?

- > **August Electronic Card Transactions** (Monday 1045 NZST). Given the fall in petrol prices over the month, the value of ECT spending is likely to be soft.
- > **Q3 Westpac McDermott-Miller Consumer Confidence** (Tuesday 1400 NZST). Given the rebound in the timelier Roy Morgan survey, we expect a solid bounce.
- > **Q2 Gross Domestic Product** (Friday 1045 NZST). We expect a fall of 0.5 percent for the quarter, taking year-on-year growth to 0.6 percent. Sectors closely aligned to the housing market drive much of the weakness. See our full preview note on page 5.

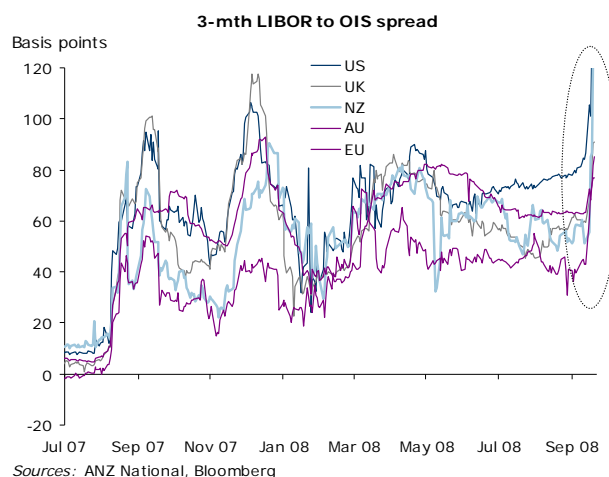
### What's the view?

In last week's *Market Focus* we discussed that we were looking for further RBNZ OCR rate cuts, but for some caution to emerge in terms of the speed of the decline. This all changed on Monday evening. We have always stated that the speed of easing will depend on the global backdrop, and we now expect more aggressive interest rate moves over the coming months, with 50 basis point cuts in both October and December before a pause at 6.5 percent (previously 7 percent) and then more cuts from mid-2009.

Looking at last week, it was a tumultuous week across the markets. We've seen Lehman Brothers file for bankruptcy, Merrill Lynch taken over by Bank of America, and the world's largest insurer get a major cash injection. Rumours are circulating regarding the viability of numerous other investment banks. It seems we are now coming to a crescendo. The flow-on effects cannot be understated as the complicated web of derivatives and swap-related structures are identified. There will be strong ripple effects. The financial system is "coupled".

The global financial system has entered a new and risky phase of the evolution of this period of credit dislocation. Until last week, strains within the financial system had been met with concerted action by central authorities to shore up (or transfer ownership of) distressed balance sheets. Financial institutions, it was believed, were too big or too

interconnected to other market participants to be allowed to fail. The bankruptcy of Lehman Brothers last week dispels this belief and heralds a period of more rapid adjustment for the global banking system. The confidence in the system will not return until investors (and other banks) believe that balance sheets are not impaired. It is this factor that has seen inter-bank lending rates increase sharply around the globe. The coming weeks could mark a fast tracking of the adjustment process as stakeholders are forced to respond.



Behind all the speculation and uncertainty, the global economy remains caught in the rip of a financial decelerator, which is impacting on the financial system. We've written about this regularly. Falling asset prices are resulting in less spending, lower profits, rising unemployment, declining risk appetites (to extremes), pressure on the financial system, falling asset prices...and the spiral is in motion. Debt is a dirty word in the current environment, particularly when in some instances there isn't even a price. The spiral is behavioural and appetites to risk and confidence reside at the heart of it. It took a circuit breaker and major event (subprime) to break the accelerator aspect of the same cycle when risk appetites were at the opposite end of the spectrum. The question on everyone's lips is whether Friday's huge rescue package from the US Government will act as the catalyst, or circuit breaker, that stops the decelerator.

On the face of it, it looks encouraging. The US Treasury is seeking approval from Congress to buy up to a massive US\$700 billion of residential and commercial mortgage related assets. After consultation with the Fed Chairman, "other assets, as deemed necessary to effectively stabilise financial markets" could also fall under the program. Short-selling of financial stocks has been banned for 10 days and the US Treasury will provide US\$50 billion as a backup for money-market funds that fall below the critical \$1 per share level. Everything – including the kitchen sink – is being thrown at this one.

Will it work? In our view it'll certainly remove some of the panic driven extreme movements we've seen over the past week, which by themselves were making the environment only worse. The same could be said for Chicken Little's regular appearances. Yet, before we start to get excited making the next leap and about calling a recovery, we need to appreciate a few dynamics. When you start seeing cash in the US spiking to 6 percent you know something is massively wrong in the first place and such action is about curbing such extremes and dislocation. But beyond issues with money markets themselves, there are a host of things to be mindful of.

First, as we've long stated, across Anglo-Saxon nations, this is by-and-large a household de-leveraging story, and it will continue to take time. Second, it's more than a US economic problem, with financial sector issues apparent in the UK and Europe. Third, we've yet to fully see the economic impact of financial system de-leveraging. Fourth, the multiplier effects from the financial system are large, and even if conditions stabilise, balance sheet consolidation will remain the order of the day, which at a minimum will take out a huge layer of growth and keep momentum sluggish. Fifth, the complicated web of derivative structures associated with various failures is still being worked through. Sixth, if the plan involves assets being transferred from weakened financial sector balance sheets in the US to the taxpayers, what is the price and what are the hooks? There seems a lot to work through. Finally, the previous "accelerator" cycle moved valuations massively beyond the economic fundamentals. It was the behavioural aspect that drove markets. This was a dynamic we certainly saw in the NZ property market. We see the same dynamic as being influential in the reverse around the globe.

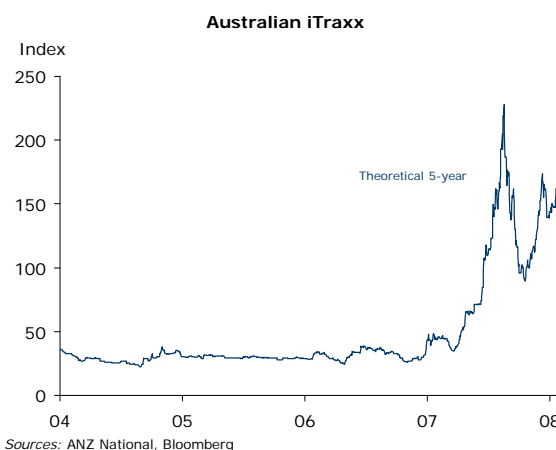
All up, this is a big list to still work through, and while we welcome the antidote being delivered in the US, we need to remember how the US got in the situation in the first place.

For NZ, a lot of uncertainty remains but we will be impacted via a number of channels:

- > Global growth will be weaker. We are now likely to see recessions in the US, Euro zone, UK, and Japan as the flow-on effect from falling asset values, and de-leveraging across the financial system flow into real economies. While recent events are centered across the financial sector, we need to appreciate that it is household balance sheets that enter this cycle in most need of consolidation. Such repair implies any recovery in the global economy will be a far more drawn out and gradual affair. While economists can debate the extent to which the developing world has decoupled from the US in an economic sense, it is clear when

looking at financial flows etc and equity market behaviour that in a financial sense, the international economy is still very coupled. For New Zealand, tourism (a wealth sensitive sector) will be key to watch. Such a dynamic will act as a major constraint on the economy's rebalancing process.

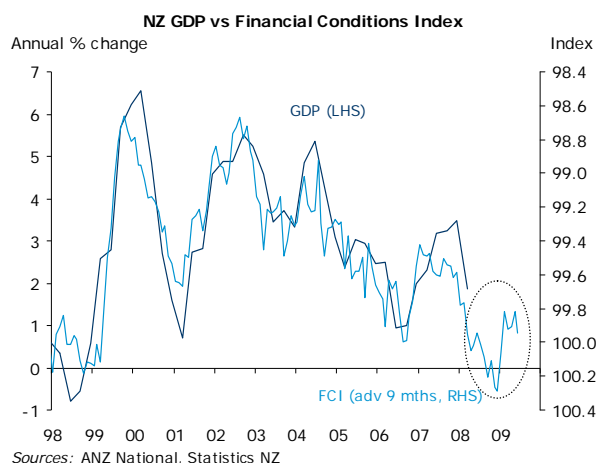
- > Commodity prices will likely remain under pressure as global demand forces dominate, although weak USD sentiment at present remains a key counter risk. A weaker NZD should not overly concern the RBNZ if commodity prices are likewise falling, although obviously Friday's spike in oil prices doesn't help. The dairy sector needs to be closely eyed. It's not just from the income side, but costs, and what has been factored into the land prices.
- > The cost of global credit will stay high as risk appetites remain on edge. The Australian iTraxx – a good proxy for local bank funding costs – surged to levels well higher than the previous peaks in March this year. Now we expect some closure and improvement across credit markets this week as the market digests Friday's news, but the bottom line is that they will likely remain elevated. This will represent a defacto tightening in monetary conditions, and more reason for the RBNZ to act aggressively to offset these costs for borrowers. Data released last week highlights NZ's Achilles heel in this type of environment, that being a stubbornly large current account deficit, which rose back to 8.3 percent of GDP in the June quarter.



Another avenue we are watching closely is the behaviour of the currency. To be fair, we shouldn't be surprised to see the recoil that we've seen over the week following the run down the elevator previously. But clearly USD sentiment at present is precariously placed and dependent on risk appetites, and this move could continue. A lower currency is an essential part of the adjustment process the NZ economy is undertaking, and shock

absorber that must respond to the altered global (credit) environment.

Last week we made reference to financial conditions having loosened, and something to keep an eye on. Recent events have seen this change, and conditions are now the same as what we were seeing over June, July and August. This, despite the 90-day rate, and 2 year swap rate, which account for close to half the index, being materially lower.



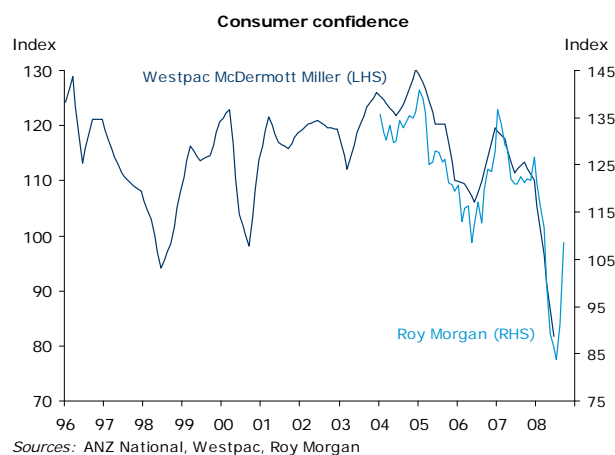
Of course this doesn't necessarily mean the RBNZ needs to cut rates. Central banks such as the BoE and ECB have been at pains to highlight the dual roles and tools policymakers have, whereby financial stability and prudential issues are dealt with by targeted responses towards the financial system, and not necessarily the interest rate lever, which looks after inflation (and it remains an issue). While the Fed acted aggressively last week they didn't cut the Fed funds rate, although at 2 percent, they obviously have limited scope to. Yet we also see a huge degree of overlap between financial stability and the macro-economy. There is a huge difference between a cash rate in NZ and other nations (along with economic performance), and the bottom line is that the RBNZ needs to get the currency down.

With the hurdle to one 50bp cut being passed, the hurdle to a follow up will be far lower. While some of the traditional inflation targetters may be having kittens over acting aggressively, pragmatism needs to weigh. Consider this: if we can navigate the biggest financial crisis since the 1930s (the Governor's words) with only a mild recession, and inflation peaking at 5 percent but remaining outside the target band for a couple of years, then in five years time we'll no doubt view this as an economic success. Enough said.

Looking towards the events of this week, there is the potential for local data to get overshadowed. This will particularly be the case if the pace of offshore developments is anything like what we saw last week. Nevertheless, there are a couple of

important releases. The major one will be the June quarter GDP release on Friday. We expect GDP to contract by 0.5 percent for the quarter. Sectors closely aligned to the housing market (construction, retail and finance and business services) act as the biggest drags on growth over the quarter. Yes, this will be the second consecutive negative quarter, which means, by definition, the economy is in recession. But this is yesterday's news. The key is now how long it will be until we start to recover. We will be monitoring things like inventory accumulation to assess whether any run-down will impact on September quarter growth. Refer to page 5 for our full preview.

The other piece of data out is the Westpac consumer confidence measure for the September quarter on Tuesday. The timelier Roy Morgan survey has shown a solid rebound, and we expect the same for the Westpac measure. This survey is likely to have been taken prior to the recent bout of global turbulence, so is potentially likely to overstate the current state of optimism.



Offshore, there are a number of policy officials due to speak from both the US and also Europe and we are sure the markets will be interested in hearing what their take on recent developments is. Data-wise, it is relatively quiet in the US with the big focus on housing market data, while in Europe the German IFO survey and key PMI data will be key.

### Recent local data...

**Economic Survey of Manufacturing (Q2):** Total manufacturing sales volumes fell 1.0 percent, largely driven by meat and dairy manufacturing.

**Balance of Payments (Q2):** The seasonally adjusted current account deficit widened by \$1,097 million to \$4,623 million. The annual deficit sits at 8.3 percent of GDP.

**External Migration (August):** A net 440 people arrived over the month taking the annual total to 4,938.

**Credit Card Spending (August):** Total billings eased 0.1 percent.

## Q2 GDP PREVIEW

(due Friday 26 September 10.45am)

	ANZ National	RBNZ	Market
Quarterly % change	-0.5	-0.2	-0.5
Annual % change	0.6	0.9	0.6
Ann. avg. % change	2.3	2.4	2.3

June quarter GDP is expected to contract by 0.5 percent, and the risk profile is tilted towards something weaker. Sectors closely aligned to the housing market are expected to drive much of the weakness. On the expenditure side, private consumption, residential investment and net exports all detract from growth. We have a further fall in GDP pencilled in for Q3.

**We expect headline (production-based) GDP growth to fall by 0.5 percent for Q2.** This follows a 0.3 percent fall in Q1, and will take annual growth to 0.6 percent. Market expectations have gradually moved lower over recent weeks and are now in line with our prediction. This is weaker than the RBNZ's September *Monetary Policy Statement* forecast of a 0.2 percent fall.

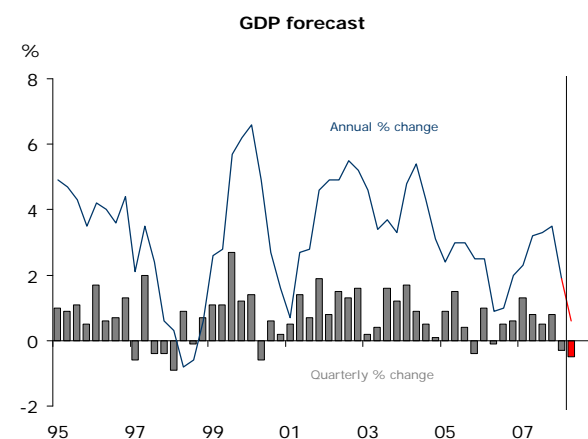
**Sectors closely aligned to the housing market drive much of the weakness.** Construction, distribution (wholesale and retail trade), and finance and business services are all expected to have weighed on activity over the quarter. This is not really much of a surprise given the weakness now occurring in the housing market and we see some risk that the finance and business service sector could be weaker than what we have factored in. This sector has showed surprising robustness over 2007 (1 percent plus growth per quarter) despite the fact the housing market was slowing. Although there was a small contraction in Q1, the risk is that it could "snap-back" further.

**On an expenditure basis, private consumption and residential investment are the big drags.** Again this is a weak housing market story, although high cost of living pressures and have also weighed heavily on private consumption as less money is available for discretionary spending. Net exports are expected to fall with OTI data showing export volumes down 3.7 percent, while at the same time import volumes up 5.4 percent. Not all of this import strength should be counted in the SNA accounts due to definitions of ownership, but even accounting for this, imports are likely to have risen solidly. Providing an offset to this weakness will be government consumption, other fixed asset investment and inventories.

**Looking forward, we expect quarterly outturns to be volatile, and are not buying into a reflation theme.** We have pencilled in a further contraction in GDP in the September

quarter. However, we envisage a lot of "noise" in the upcoming data. Some technical aspects such as drought, electricity generation, manufacturing, could play havoc with the quarterly data and there is the possibility of a solid rebound in Q4 growth. However, along with the recent improvements in consumer and business confidence, we do not buy into the 'reflation' theme yet. Stripping back the volatility, the underlying growth picture will remain a subdued one for some time as the economy rebalances.

Looking at the big picture, this slowdown and "adjustment" is a story of household de-leveraging and one that suggests the slowdown will be protracted and a "U" shaped cycle. Moreover, we are increasingly erring towards a "W" type economic cycle given recent global events. Last week's poor current account deficit figures have acted to reinforce this bias.



Q2 2008 GDP	Estimated	
	Percentage change from previous quarter	Percentage point contribution to change
Agriculture	-1.5	-0.1
Fishing, Forestry and Mining	-0.6	0.0
Manufacturing	0.8	0.1
Electricity, Gas and Water	-2.5	0.0
Construction	-4.5	-0.2
Wholesale Trade	-2.0	-0.2
Retail, Accommodation and Restaurants	-1.5	-0.1
Transport and Communication	0.6	0.1
Finance, Insurance and Business Service	-0.6	-0.2
Government Administration and Defence	0.3	0.0
Personal and Community Services	0.2	0.0
Unallocated and Balancing Item	...	0.1
<b>Gross Domestic Product</b>	<b>-0.5</b>	<b>-0.5</b>

### Financial market implications

**Friday's GDP figures look to have more downside risk,** although we are going to be coy about how we interpret it. Stock movements etc can lead to a lot of shuffling between quarters. **We see little in the data to alter market expectations of a 50 basis point cut in October.** If anything, the bias is to intensify calls for aggressive action, although we need to respect global developments since Friday and be mindful with how these unfold over the week.

## GLOBAL WATCH

We present a table of global data outturns over the past week given the significance of the international backdrop at present. US data was mixed again last week, although data took a backseat to developments occurring in financial markets. The same was the case in Europe and the UK, while it was relatively quiet in terms of data across Asia.

Country/ Area	Indicator	Mkt	Actual	Last	Outturn vs market
<b>US</b>	Industrial Production (Aug)	-0.3%	-1.1%	0.1%	Weaker
	CPI (Aug) – mom	-0.1%	-0.1%	0.8%	In-line
	NAHB Housing Market Index (Sep)	17	18	16	Stronger
	FOMC Interest Rate Decision	2.00%	2.00%	2.00%	In-line
	Housing Starts (Aug)	950K	895K	954K	Weaker
	Current Account (2Q)	-\$180.0B	-\$183.1B	-175.6B	Weaker
	Initial Jobless Claims (w/e Sep 14)	440K	455K	445K	Weaker
	Philadelphia Fed (Sep)	-10.0	3.8	-12.7	Stronger
	Leading Indicators (Aug)	-0.2%	-0.5%	-0.7%	Weaker
	<b>Europe</b>	Labour Costs (2Q) – yoy	3.5%	2.7%	3.5%
CPI (Aug) – mom		-0.2%	-0.1%	-0.2%	Stronger
ZEW Survey (Economic Sentiment) (Sep)		-55.0	-40.9	-55.7	Weaker
Trade Balance s.a. (Jul)		-3.5B	-6.4B	-3.5B	Weaker
<b>UK</b>	CPI (Aug) – mom	0.5%	0.6%	0.0%	Stronger
	DCLG House Prices (Jul) – yoy	-2.1%	-0.3%	0.6%	Stronger
	Jobless Claims Change (Aug)	23.0K	32.5K	27.8K	Weaker
	Retail Sales (Aug) – mom	-0.5%	1.2%	0.9%	Stronger
	M4 Money Supply (Aug P) - mom	0.7%	1.4%	0.9%	Stronger
<b>Asia Ex-Japan</b>					
<i>China</i>	Benchmark Lending Rate	-	7.20%	7.47%	-
	Reserve Requirement Ratio	-	16.5%	17.5%	-
<i>Hong Kong</i>	Unemployment Rate (Aug)	3.3%	3.2%	3.2%	Stronger
<i>South Korea</i>	Export Price Index (Aug) – mom	-	-1.4%	0.1%	-
	Import Price Index (Aug) – mom	-	-4.4%	1.1%	-
<i>Malaysia</i>	Manufacturing Sales (Jul) – yoy	-	15.0%	18.1%	-
<i>Philippines</i>	Unemployment Rate (Jul)	-	7.4%	8.0%	-
	Balance of Payments (Aug)	-	-\$54M	\$142M	-
<i>Indonesia</i>	Wholesale Price Index (Jul) – yoy	-	35.2%	34.7%	-
	M2 Money Supply (Jul) – yoy	-	14.0%	17.0%	-
<b>Japan</b>	BoJ Policy Rate	0.50%	0.50%	0.50%	In-line
	Consumer Confidence Households (Aug)	31.5	30.0	31.4	Weaker
	Tertiary Industry Index (Jul) – mom	0.5%	1.2%	-1.0%	Stronger
	Leading Index CI (Jul F)	91.6	91.4	91.6	Weaker
	Coincident Index CI (Jul F)	103.3	103.5	103.3	Stronger
<b>Australia</b>	Westpac Leading Index (Jul) – mom	-	0.2%	0.1%	-

## INTEREST RATE STRATEGY

The US Treasury's US\$700bn rescue package has seen global interest rates and stock markets rebound strongly, towards levels prevailing before last week's turmoil. However, NZ interest rates have been held down, and are likely to continue to do so as the market continues to (correctly) focus on the significant downside risks.

### Market themes...

- > Global interest rate markets experienced an almost unprecedented week of volatility last week. US Treasuries traded to a low of 1.36 percent on Thursday, but closed at 2.17 percent on Friday.
- > NZ interest rates have been less volatile, and while there will be some upward pressure over the next few days as the rescue package gets digested, the focus remains on downside risks and the long term de-leveraging process, which will ultimately drive rates lower.
- > The market is now "fully priced" for another 50bp cut from the RBNZ next month, with two 25bp cuts priced for December and January. While these expectations are reasonable, if anything they're a bit light – we expect 50bps apiece in *both* October and December.

### Review and outlook...

Last week was a roller-coaster ride in global interest rate markets, with the bellwether US 2yr Treasury trading in a 93bps range between 1.36 percent and 2.29 percent as the market contemplated the collapse or near collapse of a number of financial institutions, and the subsequent government response. By contrast, NZ interest rates have been reasonably stable, and look set to continue to fall. While US interest rates have rebounded, NZ interest rates remain "sticky" to the downside.

We have always flagged financial stability as the major downside threat to our initial forecast of a short burst of mild interest rate cuts, followed by a pause. In this regard, recent developments are at least as disturbing as any scenario we could have envisaged, and as a consequence, we now expect the RBNZ to deliver two more 50bp cuts in October and December, before pausing for a short time.

Sentiment had been on the mend according to a number of surveys, but events like those occurring in the US right now tend to be very de-stabilising. From the householder's perspective, it only reinforces the message that de-leveraging is both healthy and necessary, and as this process unfolds, it should drive interest rates lower.

### Gauges for NZ interest rates

Gauge	Direction	Comment
RBNZ	↔/↓	50bp cuts seem likely in Oct and Dec. The hurdle to 50bp cuts is lower now we've had one.
NZ data	↔/↓	GDP will be the focus this week. We're at consensus, but with downside risks.
Fed Funds/ front end	↔/↓	It's not about Fed funds, it's about liquidity and financial stability. And it looks bad.
RBA	↔	Under the same pressure as the RBNZ. Will be cutting to offset rising loan margins.
US 10 year	↔/↓	Looks like a dead cat bounce higher in yields. Suspect there is still another leg to go in the adjustment.
NZ swap curve	↔/↓	Steeptenors may seem "intuitive" at this stage of the cycle, however there's a lot of congestion, and the long end is driving yields.
Flow	↔/↓	Steeptenors being unwound.
Technicals	↔	Volatile.

### Borrowing strategies we favour at present

Our advice to keep duration of cover short remains appropriate – after all we expect rates to keep falling. The more stability becomes an issue, the lower the cash rate goes, which will support sound businesses into the downturn. The inverted curve means forward starting swaps yields are below their spot equivalents. Borrowers who need to hedge may consider forward-start swaps, but note that this doesn't provide immediate interest rate relief.

### Market expectations for RBNZ OCR (bps)

OCR dates	Last week	This week
Thu 23-Oct-08	-27	-51
Thu 4-Dec-08	-53	-76
Thu 22-Jan-09	-78	-100
Thu 5-Mar-09	-93	-121
Thu 23-Apr-09	-107	-125
Thu 4-Jun-09	-120	-137
Thu 30-Jul-09	-130	-140

### Trading themes we favour at present

Our favoured strategy last week of being "long the long end" is paying dividends, and we continue to expect it to. Intuition says that the curve should steepen as the easing cycle develops, but it's too soon. Not only is that a congested trade, but this easing cycle is set to be intensified by financial stability, and that means pressure in long end yields to fall as an extended adjustment gets priced in.

## CURRENCY STRATEGY

The tenor of NZ data – including GDP this week and current account figures – are hardly currency supportive. The NZD has already retraced a long way and looks on borrowed time. But with the global scene now entering the next leg of dislocation, and a policy response, the USD finds itself under pressure. We expect a lower NZD/AUD this week.

### Market themes...

- > US Government “rescue” package providing a big boost to sentiment.
- > USD under pressure and attention now turns back to commodities.
- > Risk appetites improving but off panic driven extremes.
- > The NZD to underperform the AUD as fundamentals gain greater traction.

### Review and outlook...

Another incredibly crazy week. Currency markets were basically held hostage to wider global credit market gyrations, risk and equity sentiment and an apparent lack of liquidity. With US stocks experiencing their biggest daily drop in seven years, but also the largest two-day rally since October 1987 last week alone, it was little wonder that currency markets were also incredibly volatile.

First up, the domestic backdrop for the NZD is hardly encouraging, despite some stabilisation in lead indicators. Last week’s current account deficit figures showed the economy remains vulnerable considering where credit markets reside. This week’s GDP figures are expected to be poor, and carry downside risk.

Yet, the NZD starts this week on the front foot. The proposal by the US Government to buy up to US\$700 billion of residential and commercial mortgage related assets has provided a big boost to risk appetites. Uncertainty remains, and the proposal still requires Congressional approval, yet it appears officials are now tackling the heart of the problem – bad mortgage debt and assets tied to it. Markets are about confidence and this proposal looks partly targeted at shoring up sentiment and being the “circuit breaker”. The USD is now back under pressure and carry trade flows are increasing. A lot of this looks to be merely recoil with the EUR/USD and AUD/USD etc oversold. However, we now find ourselves in an environment where equity markets have soared, and commodity prices are rising again. When you see big events, or circuit breakers, trends are to be respected. As noted on page 3, we believe there are still a number of issues to progress, but we’ll respect the

potential for recoil for now. We do note that the NZD/USD has retraced a long way already.

Just how far commodities and equities extend over the coming week remains key to watch. Given the complicated web of derivative-based structures that have been put in place over preceding years, the economic scene will no doubt see more “surprises”. We struggle to see a strong reflationary theme and sustained recovery in appetites in this environment. Kiwi looks on borrowed time.

Technically, the top for NZD/AUD looks very much in place at 0.8450 and we really don’t expect the market to trade above 0.8360 again. First target downside is the 0.8085 support. NZD/USD has levels of resistance from 0.6920 to 0.6970.

NZD vs AUD: monthly directional gauges		
Gauge	Direction	Comment
Fair value	↔/↓	Growth differentials still favouring AUD but closing.
Yield	↓	RBNZ set to trump RBA with 50.
Commodities	↔	Path for commodities now USD dependent.
Partial indicators	↓	NZ indicators still worse.
Technicals	↓	Top in place 0.8450.
Sentiment	↔/↓	Squaring of AUD complete.
Other	↓	AUD oversold.
<b>On balance</b>	↓	<b>Recovery gone too far.</b>

NZD vs USD: monthly directional gauges		
Gauge	Direction	Comment
Fair value – long-term	↓	Fair value 0.65 given a structural shift in commodity prices.
Fair value – short-term	↔	NZD close to fair-value in cyclical sense now.
Yield	↓	RBNZ looks a 50 while Fed relying on non-rate levers.
Commodities	↔	If USD is not going up, commodities not down. But global growth is weak.
Risk aversion	↔	Still ‘Septemberitis’ but people like good news.
Partial indicators	↓/↔	NZ data still very weak.
Technicals	↔	Good resistance 0.6920-70.
AUD	↑	Recoil underway.
Sentiment	↔	Changes daily.
Other	↓/↔	Current account deficits will be punished.
<b>On balance</b>	↔	<b>On borrowed time, but could hang in there.</b>

## DATA AND EVENT CALENDAR

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
22-Sep	EU	ECB's Trichet Speaks in Bratislava	-	-	02:00
	UK	Rightmove House Prices (Sep) – mom	-	-2.3%	11:01
	JN	BoJ Monetary Policy Meeting Minutes for August	-	-	11:50
		All Industry Activity Index (Jul) – mom	0.8%	-0.9%	11:50
	AU	New Motor Vehicle Sales (Aug) - mom	-	-3.4%	13:30
23-Sep	US	Fed's Fisher Speaks in Texas on US Economy, Finance Industry	-	-	03:30
	<b>NZ</b>	<b>Westpac McD-M Consumer Confidence (3Q)</b>	<b>-</b>	<b>81.7</b>	<b>14:00</b>
	GE	PMI Manufacturing (Sep A)	49.2	49.7	19:30
		PMI Services (Sep A)	50.7	51.4	19:30
	EU	PMI Manufacturing (Sep A)	47.3	47.6	20:00
		PMI Services (Sep A)	48.0	48.5	20:00
		PMI Composite (Sep A)	47.8	48.2	20:00
		ECB's Liikanen Speaks in Helsinki	-	-	20:00
		Industrial New Orders s.a. (Jul) – mom	-0.6%	-0.3%	21:00
24-Sep	US	Richmond Fed Manufacturing Index (Sep)	-12	-16	02:00
		House Price Index (Jul) – mom	-0.2%	0.0%	02:00
	JN	BSI Large All Industry (3Q) - qoq	-	-15.2	11:50
		BSI Large Manufacturing (3Q) - qoq	-	-15.1	11:50
	AU	DEWR Skilled Vacancies (Sep) – mom	-	-1.7%	13:00
	GE	IFO - Business Climate (Sep)	94.3	94.8	20:00
		IFO - Current Assessment (Sep)	101.9	103.2	20:00
		IFO – Expectations (Sep)	87.3	87.0	20:00
	EU	ECB Current Account s.a. (Jul)	-	-8.2B	20:00
25-Sep	US	Existing Home Sales (Aug)	4.94M	5.00M	02:00
		Existing Home Sales (Aug) - mom	-1.2%	3.1%	02:00
		Bernanke Testifies at Congress's Joint Economic Committee	-	-	02:00
	EU	ECB's Stark Speaks in Berlin	-	-	04:00
		Bank of Spain Governor Miguel Angel Fernandez Ordonez speaks	-	-	12:00
		M3 Money Supply s.a. (Aug) – yoy	9.1%	9.3%	20:00
	JN	Adjusted Merchandise Trade Balance (Aug)	¥112.5B	¥172.4B	11:50
		Corp Service Price (Aug) – yoy	1.2%	1.3%	11:50
		BoJ Board Member Noda to Speak in Kushiro	-	-	13:30
	AU	RBA Semi-Annual Financial Stability Review	-	-	13:30
	GE	GfK Consumer Confidence Survey (Oct)	1.5	1.5	18:10
26-Sep	US	Durable Goods Orders (Aug)	-1.8%	1.3%	00:30
		Durables Ex Transportation (Aug)	-0.5%	0.7%	00:30
		Initial Jobless Claims (w/e Sep 21)	448K	455K	00:30

Continued over page

Date	Country	Data/Event	Mkt.	Last	Time (NZST)
26-Sep cont.	US	Continuing Claims (w/e Sep 14)	3,505K	3,478K	00:30
		New Home Sales (Aug)	510K	515K	02:00
		New Home Sales (Aug) - mom	-1.0%	2.4%	02:00
		Paulson, Bernanke Testify on Fannie Takeover at House Panel	-	-	04:00
		Fed's Warsh Speaks at Chicago International Banking Conference	-	-	05:00
		Fed's Fisher Speaks to Investors, Economists in New York	-	-	11:30
	GE	ECB's Bini Smaghi Speaking in Frankfurt	-	-	03:00
	<b>NZ</b>	<b>GDP (2Q) – qoq</b>	<b>-0.5%</b>	<b>-0.3%</b>	<b>10:45</b>
		<b>GDP (2Q) - yoy</b>	<b>0.6%</b>	<b>1.9%</b>	<b>10:45</b>
	JN	National CPI (Aug) - yoy	2.1%	2.3%	11:30
		National CPI Ex-Fresh Food (Aug) - yoy	2.4%	2.4%	11:30
		National CPI Ex Food, Energy (Aug) - yoy	0.2%	0.2%	11:30
	EU	ECB's Gonzalez-Paramo Speaks at Chicago Federal Reserve Bank	-	-	11:45
27-Sep	US	GDP (Annualized) (2Q F)	3.3%	3.3%	00:30
		Personal Consumption (2Q F)	1.7%	1.7%	00:30
		GDP Price Index (2Q F)	1.2%	1.2%	00:30
		Core PCE (2Q F) - qoq	2.1%	2.1%	00:30
		University of Michigan Confidence (Sep F)	70.5	73.1	02:00
		Fed's Bullard To Speak at Tennessee Economic Meeting	-	-	02:00
	GE	ECB's Bini Smaghi Speaking in Frankfurt	-	-	01:00
	EU	ECB's Wellink Speaks at Federal Reserve Bank of Chicago	-	-	05:15

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 big focus on the calendar is the Q2 GDP release and we expect another negative quarter. However, this weak domestic story is almost yesterday's news. The RBNZ's focus looks to be offshore and with credit market developments. Therefore, these will be critical to watch.

Date	Data/Event	Economic Signal	Comment
Mon 22 Sep (10.45)	Electronic Card Transactions (Aug)	Weak	Given the fall in petrol prices over the month, the value of ECT spending is likely to be soft. This was foreshadowed by Credit Card Billings last week.
Tue 23 Sep (14.00)	Westpac McDermott-Miller Consumer Confidence (Q3)	Bounce	This survey is likely to have been taken prior to this recent bout of financial market turmoil and therefore is likely to record a solid bounce in line with the timelier Roy Morgan confidence survey.
Fri 25 Sep (10.45)	Gross Domestic Product (Q2)	Contraction	We expect a fall of 0.5 percent for the quarter, with residential investment and private consumption again expected to be weak. We see downside risk to this estimate.
Mon 29 Sep (10.45)	Overseas Merchandise Trade (Aug)	Monthly deficit	Another monthly trade deficit is expected, although the annual deficit should continue to slowly improve.
Tue 30 Sep (10.45)	Building Consents (Aug)	Weak	Rebound, although the level of residential building consent issuance is likely to remain low. Commercial consent issuance is now also a key area to watch.
Tue 30 Sep (15.00)	NBNZ <i>Business Outlook</i> (Sep)	-	-
Thu 2 Oct (15.00)	ANZ Commodity Price Index (Sep)	-	-
Mon 13 Oct (10.45)	Retail Trade Survey (Aug)	Still weak	There may be a bounce from last month's weakness. However, with lower petrol prices, and soft spending foreshadowed by Credit Card Billings, this bounce is likely to be muted. The underlying trend will remain weak.
Tue 14 Oct (10.00)	NZIER Quarterly Survey of Business Opinion (Q3)	Mixed	Headline confidence is likely to have improved in line with recent reads from the NBNZ <i>Business Outlook</i> . However, recent financial market turmoil may impact. Activity measures such as own activity, employment and investment are also likely to have risen, but remain at low levels.
<b>On Balance</b>		<b>Contracting economy yesterday's news with some signs of stabilisation in confidence. But will it take hold given global events?</b>	<b>Still a lot of imbalances to work through.</b>

## SUMMARY OF KEY ECONOMIC FORECASTS

	Jun-07	Sep-07	Dec-07	Mar-08	Jun-08	Sep-08	Dec-08	Mar-09	Jun-09	Sep-09
GDP (% qoq)	0.8	0.5	0.8	-0.3	<b>-0.5</b>	<b>-0.2</b>	<b>0.2</b>	<b>0.3</b>	<b>0.5</b>	<b>0.5</b>
GDP (% yoy)	3.2	3.3	3.5	1.9	<b>0.6</b>	<b>-0.2</b>	<b>-0.8</b>	<b>-0.2</b>	<b>0.8</b>	<b>1.5</b>
CPI (% qoq)	1.0	0.5	1.2	0.7	1.6	<b>1.2</b>	<b>0.8</b>	<b>0.9</b>	<b>0.9</b>	<b>0.7</b>
CPI (% yoy)	2.0	1.8	3.2	3.4	4.0	<b>4.8</b>	<b>4.4</b>	<b>4.7</b>	<b>4.0</b>	<b>3.4</b>
Employment (% qoq)	0.3	-0.1	0.9	-1.3	1.3	<b>-0.6</b>	<b>-0.1</b>	<b>0.0</b>	<b>0.1</b>	<b>0.1</b>
Employment (% yoy)	1.5	1.5	2.5	-0.2	0.7	<b>0.2</b>	<b>-0.7</b>	<b>0.6</b>	<b>-0.6</b>	<b>0.0</b>
Unemployment Rate (% sa)	3.6	3.5	3.4	3.7	3.9	<b>4.2</b>	<b>4.5</b>	<b>4.6</b>	<b>4.9</b>	<b>5.1</b>
Current Account (% GDP)	-8.4	-8.7	-8.2	-8.0	-8.3	<b>-7.7</b>	<b>-7.9</b>	<b>-7.9</b>	<b>-7.6</b>	<b>-7.3</b>
Terms of Trade (% qoq)	0.4	3.7	2.7	4.1	-0.5	<b>-1.0</b>	<b>0.0</b>	<b>-1.5</b>	<b>-1.2</b>	<b>-1.0</b>
Terms of Trade (% yoy)	2.3	8.4	8.5	11.3	10.6	<b>5.7</b>	<b>2.9</b>	<b>-2.7</b>	<b>-3.7</b>	<b>-3.7</b>

## KEY ECONOMIC INDICATORS

	Dec-07	Jan-08	Feb-08	Mar-08	Apr-08	May-08	Jun-08	Jul-08	Aug-08	Sep-08
Retail Sales (% mom)	0.0	0.3	-0.7	-1.0	1.3	-1.3	1.0	-0.8	..	..
Retail Sales (% yoy)	5.4	6.3	7.7	-1.0	4.1	1.0	1.5	2.5	..	..
Credit Card Billings (% mom)	0.6	0.1	0.3	-0.4	-0.3	0.6	0.0	0.2	-0.1	..
Credit Card Billings (% yoy)	8.3	8.8	7.5	5.9	5.4	6.0	4.0	4.2	2.6	..
Car Registrations (% mom)	-2.8	10.2	-8.9	-12.8	11.4	-13.4	1.1	-7.7	..	..
Car Registrations (% yoy)	1.4	1.7	1.9	-13.2	-1.0	-20.6	-15.9	-27.1	..	..
Building Consents (% mom)	-4.3	3.7	-6.4	-14.3	82.7	-41.8	-18.8	4.8	..	..
Building Consents (% yoy)	-6.6	-5.0	-17.7	-27.5	31.1	-27.0	-47.0	-35.1	..	..
REINZ House Price (% yoy)	4.5	4.0	0.7	1.6	-1.1	-1.4	-2.2	-1.4	-5.7	..
Household Lending Growth (% mom)	0.7	0.7	0.9	0.4	0.4	0.4	0.3	0.3	..	..
Household Lending Growth (% yoy)	12.3	11.9	11.6	10.8	9.9	9.3	8.4	7.7	..	..
Roy Morgan Consumer Confidence	126.6	121.2	116.0	111.7	99.9	89.2	86.5	83.9	91.4	108.6
NBNZ Business Confidence	-24.9	..	-43.9	-57.9	-54.8	-49.7	-38.7	-43.2	-20.5	..
NBNZ Own Activity Outlook	18.2	..	2.4	-6.4	-3.8	-4.4	-4.0	-8.2	4.7	..
Trade Balance (\$m)	39	-311	243	-43	-293	-168	-207	-781	..	..
Trade Balance (\$m annual)	-5307	-4793	-4422	-4526	-4604	-4781	-4469	-4443	..	..
ANZ World Commodity Price Index (% mom)	0.0	-1.4	1.1	2.0	-0.3	0.9	0.0	1.8	-3.3	..
ANZ World Commodity Price Index (% yoy)	30.9	27.4	26.9	26.9	20.7	18.7	11.6	8.7	3.6	..
Net Migration (sa)	30	120	280	550	500	960	460	810	440	..
Net Migration (annual)	5491	4799	4643	4678	4666	4931	4732	5201	4938	..

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)						
	Jul-08	Aug-08	22-Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
NZD/USD	0.756	0.710	0.690	0.650	0.680	0.650	0.630	0.610	0.590	0.580
NZD/AUD	0.785	0.803	0.824	0.756	0.819	0.813	0.808	0.803	0.797	0.806
NZD/EUR	0.479	0.474	0.476	0.451	0.486	0.478	0.470	0.469	0.461	0.468
NZD/JPY	80.7	77.7	73.7	70.2	74.8	71.5	70.6	69.5	67.9	68.4
NZD/GBP	0.380	0.375	0.376	0.365	0.384	0.369	0.362	0.353	0.343	0.339
NZ\$ TWI	67.2	65.5	64.9	61.1	65.0	63.1	61.9	60.9	59.6	59.6
NZ interest rates	Jul-08	Aug-08	22-Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
OCR	8.18	8.00	7.50	6.50	6.50	6.25	6.00	6.00	6.00	6.00
90 day bill	8.46	8.20	7.85	6.90	6.80	6.30	6.20	6.20	6.20	6.20
10 year bond	6.17	6.13	5.81	5.70	5.70	5.60	5.60	5.70	5.80	6.00
International	Jul-08	Aug-08	22-Sep-08	Dec-08	Mar-09	Jun-09	Sep-09	Dec-09	Mar-10	Jun-10
US Fed funds	2.00	2.00	2.00	1.75	1.75	1.75	1.75	2.25	2.75	3.50
US 3-mth	2.79	2.81	3.21	2.00	1.75	2.00	2.50	3.00	3.50	4.00
AU cash	7.25	7.25	7.00	6.75	6.75	6.50	6.25	6.25	5.75	5.75
AU 3-mth	7.76	7.27	7.49	7.00	7.00	6.80	6.50	6.40	5.90	5.90

## KEY RATES

	19 Aug	15 Sep	16 Sep	17 Sep	18 Sep	19 Sep
Official Cash Rate	8.00	7.50	7.50	7.50	7.50	7.50
90 day bank bill	8.17	7.74	7.68	7.72	7.82	7.85
NZGB 07/09	6.89	6.50	6.44	6.40	6.10	6.10
NZGB 11/11	6.25	5.66	5.60	5.68	5.53	5.58
NZGB 04/13	6.25	5.66	5.60	5.68	5.56	5.62
NZGB 12/17	6.18	5.77	5.70	5.77	5.62	5.68
2 year swap	7.26	6.83	6.80	6.89	6.87	6.93
5 year swap	7.01	6.76	6.68	6.80	6.77	6.83
RBNZ TWI	66.0	63.2	62.0	63.0	63.1	64.0
NZD/USD	0.7085	0.6694	0.6507	0.6588	0.6652	0.6724
NZD/AUD	0.8148	0.8150	0.8245	0.8293	0.8399	0.8317
NZD/JPY	77.81	70.70	67.89	69.79	69.43	71.84
NZD/GBP	0.3800	0.3712	0.3628	0.3697	0.3657	0.3729
NZD/EUR	0.4824	0.4644	0.4575	0.4656	0.4636	0.4737
AUD/USD	0.8695	0.8214	0.7892	0.7944	0.7920	0.8085
EUR/USD	1.4688	1.4414	1.4224	1.4149	1.4348	1.4194
USD/JPY	109.82	105.62	104.34	105.94	104.37	106.84
GBP/USD	1.8646	1.8031	1.7936	1.7818	1.8190	1.8032
Oil	112.92	101.19	95.52	91.49	97.39	97.50
Gold	791.65	781.50	773.45	780.60	860.50	845.10
Electricity (Haywards)	22.70	4.22	3.48	4.20	7.87	n/a
Milk futures (US\$/contract)	137	128	128	127	127	124
Baltic Dry Freight Index	7543	4747	4760	4856	4958	4975

**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.

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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.

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

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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.

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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.

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- 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.

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- 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.

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- 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.

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