# Market Focus

## New Zealand

15 September 2008

Open partnerships
Open possibilities

# LOOKING FOR STABILITY


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### Page 2: Economic overview

> The market has been quick to latch onto the aggressive move by the RBNZ and look for more of the same. While the spirit of our interest rate view continues to be tilted towards an aggressive cycle, we now find ourselves more cautious vis-à-vis the market in the near-term, a position we are comfortable with at present, despite our long-standing wariness towards the global backdrop.

### Page 5: Data preview – Q2 Current Account

> Given the global backdrop, current account figures – despite being notoriously volatile in NZ – will receive greater than normal attention. We expect a deficit of 7.7 percent of GDP, a marginal improvement on last quarter. Facing such an imbalance, global developments need to be closely watched, and the economy will struggle to reflate strongly.

### Page 6: Economic comment – global watch

> US data was mixed again last week, with consumer confidence improving, but retail spending weak. Positively, some US inflation gauges came in lower than expected. Industrial production across the UK and Europe was weaker than expected, while Asian data was mixed.

### Page 7: Interest rate strategy

> Global markets will remain volatile this week and NZ rates are expected to take a back seat whilst we see how events in the US unfold around issues on financial stability.

### Page 8: Currency strategy

> Wider USD sentiment will hold sway this week for the NZD. Both the NZD and AUD are due for a bounce, but in the current global environment we may need to move beyond September, and year (quarter)-end position squaring before this occurs. A lot depends on sentiment towards financials this week.

### Page 9: Currency comment – macro-momentum currency gauge

> Our currency macro-momentum gauge is a composite growth index that has tracked the NZD over the past decade. The gauge is currently giving a very neutral reading on the currency at present, having snapped back from the extended readings over the preceding months. We are increasingly looking for a temporary bounce in the NZD, with the AUD potentially dragging us up. But for now, it may well simply be a case of noise and intra-day volatility until the global scene stabilises.

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## ECONOMIC OVERVIEW

**The market has been quick to latch onto the aggressive move by the RBNZ and look for more of the same. While the spirit of our interest rate view continues to be tilted towards an aggressive cycle, we now find ourselves more cautious vis-à-vis the market in the near-term, a position we are comfortable with at present, despite our long-standing wariness towards the global backdrop.**

### What's ahead?

> **August External Migration** (Friday 1045 NZST). The annual inflow is expected to remain around 5,000. Watch tourism inflows.

> **Q2 Balance of Payments** (Friday 1045 NZST). The current account deficit is expected to improve slightly to 7.7 percent of GDP, from 7.8 percent in Q1.

> **August Credit Card Spending** (Friday 1500 NZST). Given slightly lower petrol prices in August, this may see the value of credit card billings ease slightly for the month.

### What's the view?

There is a TV ad that used to feature a Hilux, a dog, and a certain euphemism starting with "B" that summed up how we felt last Thursday. It wasn't just that we got the call on the RBNZ wrong – like all, it was that we'd actually warmed to the idea of 50bps in early August in our *Market Focus* but decided not to push it home. We didn't believe the RBNZ was in the same space. D'oh!

There have been the usual jibes about the decision itself, and surprise aspect to it. Some of this looks to be sour grapes. We find it hard to quibble with the spirit of what the bank are trying to achieve, despite missing the call itself. With each passing day the global scene is deteriorating, and last week was no different. Falling commodity prices, emerging markets coming under pressure, widening credit default swap spreads in the US (hmmm), a weak AUD, stronger USD despite the nationalisation of Fannie and Freddie, and declining freight rates are giving a pretty consistent steer. Each potential "test" for the oil market (a commodity bellwether) such as hurricanes, supply disruptions, and threatened reduced production are simply shrugged off as the wider global demand story weighs. Then there are repeated strains reportedly coming out of the US financial system, with a major US investment bank's share price falling 75 percent last week. As a trade and credit dependent nation, such a backdrop presents huge challenges to NZ. Even the Governor himself was on record as saying it was the worst financial crisis since the 1930s. Thankfully it's not the worst economic crisis, but clearly one impacts on the other. In this environment the RBNZ noted that "*we believe it is appropriate to lend more weight to the downside risks associated with the deteriorating global outlook, increased credit pressures, and domestic housing market correction. However, we remain mindful of the risks to inflation.*"

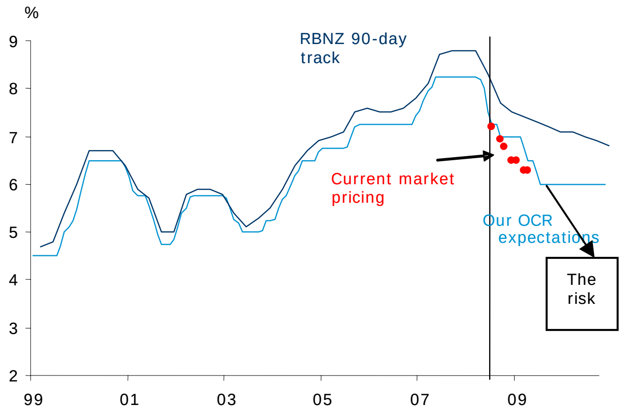
We've written at length about the whole financial accelerator and decelerator, and it remains something we are wary of. The risk remains that when we see falling asset (house) prices, this leads to less spending, lower profits, increased unemployment, and diminished appetites for risk, leading to further falls in asset prices, and so the spiral or decelerator continues. Such cycles can easily become self perpetuating. Last week's REINZ figures showed house prices were down 6 percent on a year ago, and this at a time when the unemployment rate is still historically low. The US economy has found itself in such a spiral, and while there are material differences in terms of the underlying health of the respective financial sectors in NZ and the US, the danger is that such a spiral becomes self fulfilling.

In such a situation it's a question of financial stability. As noted by the Reserve Bank in a recent bulletin article, there is considerable overlap between the objectives of monetary policy and financial stability. *"Inappropriate monetary policy can threaten financial stability, and the maintenance of price stability requires a stable financial environment." "Policy actions taken for both goals should be consistent and mutually reinforcing where possible."* The same article noted *"Timing problems still present difficulties, and on balance suggest avoidance of pre-emptive easing and readiness to act quickly once the negative consequences of a bust become clear. Again, this can only be symmetric if coupled with monetary policy tightening during the upswing."* The term bust is probably an overly emotive term for NZ, but clearly it's the case in the US, and the ripple effects around the globe have been tremendous in terms of a generic repricing of risk, which continues to flow through to the NZ economy.

Merely nudging the OCR in a gradual fashion in that environment is simply not going to be effective. For sure, central bank "surprises" should be few and far between, but that does not mean "surprises" cannot be useful and part of the policy tool-box. For surprises to be effective, they also need to be used sparingly. Fixed lending rates have moved lower, and the currency (on a TWI basis) the same following Thursday's "surprise". Monetary conditions have eased, and it's not just the fact they eased, it is the fact it was immediate, and the RBNZ got some 'bang for their buck', which matters for perception. An important aspect of policy is showing a willingness to act, and aggressively if necessary. Business cycles are as much about behaviour and confidence as monetary support, and this is where aggressive action can be important in terms of denting that potential decelerator from taking hold. Indeed, the US experience at present is that once it takes hold, it's dammed hard to correct, and that's the sort of risk we are sure no central bank wants a bar of.

So where to from here? The market (and economists) has been quick to factor a more aggressive cycle. A further 125 basis points of rate cuts are factored by June 2009, with the OCR expected to trough at 6.25 percent. Indeed, after being at the dovish end of the rate spectrum all through 2008, we suddenly find ourselves uber-hawks vis-à-vis the market, with our view the OCR is headed to 7 percent, then a pause, followed by resumption and the cash rate falling to 6 percent. Historically, this would be a mild cycle.

**Monetary Policy expectations**



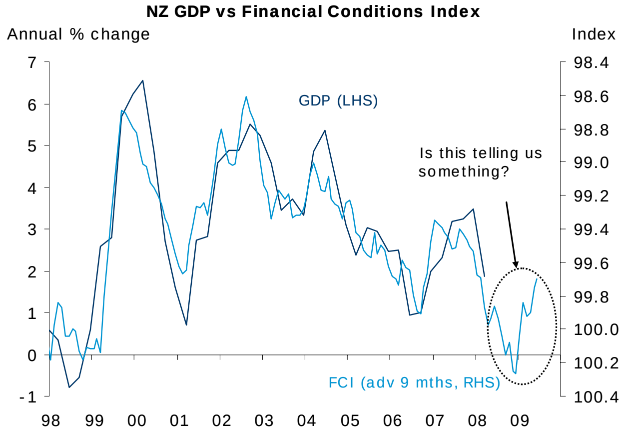

*Sources:* ANZ National, RBNZ, Bloomberg

The general spirit of our view is built around a couple of themes. We remain wary of the global environment, and hence we continue to look for a more aggressive cycle *"eventually"* relative to the market. We are not buyers of the reflationary story in NZ given widespread imbalances, despite recent signs of improving confidence and another consumer confidence survey was up sharply this morning. The front-loading of the easing cycle by the RBNZ has also been factored into our rate view for months, although now the question is obviously whether we in fact have enough factored in given Thursday's aggressive move. That is, we have a pause at 7.0 percent, whereas potentially it could be 6.5. Indeed looking at the RBNZ's *Statement*, the media release notes that *"the scale and timing of further official cash rate reductions will depend on signs of* ***declining*** *inflation pressures and on exchange rate adjustments."* Now the RBNZ also notes that *"it is likely to be early next year before we get a clear indication of the extent to which slower activity is translating into lower underlying inflation".* Connecting the dots, this suggests more rate cuts until we get the Q1 inflation read in April, which assuming 25's, means 6.5 percent for the OCR, which is where the consensus seems to have arrived. Of course, terms such as *"clear indication"* do not necessarily mirror with *"signs"* so we need to be careful extending this too far.

History tells us that the first port of call is typically neutral when central banks decide to move. Historically we've thought of this as being 6 percent (4 percent real and 2 percent inflation (middle of the band)) in New Zealand. But it's easy to run the case at present that 7 percent applies (4 percent real plus current 3 percent inflation expectations). Now we can debate this, as arguably the RBNZ should be concerned with the borrowing rate as opposed to wholesale rate, so the neutral rate should be lower. A real rate of 4 percent seems high given potential growth within the economy. But in an environment of elevated inflation expectations, and inflation remaining outside the target band until 2010, some caution with the neutral rate still needs to apply.

While the aggressive cut was a prudent path to take, it is nonetheless not without risks on the inflation front. We doubt the Q3 inflation read (due October 21) will be comforting if nuances from our monthly inflation gauge are correct. Moreover, the currency is adjusting, confidence already looks to be stabilising (a good sign for Q4), although we are obviously coy about how long it will last given the global backdrop and what we are seeing around the country. But there are certainly a host of factors to consider, and we're wary about simply extrapolating trends in a linear type fashion. This cycle is different given the interaction of different shocks. For now, financial stability is overriding inflation as the dominant goal of policy.

We've also updated our financial conditions index for the latest "spot" and it clearly show the potential for the economy to reflate, which is at odds with the inflationary dynamic as well as structural and global headwinds. Now obviously there are a host of other issues to weigh at present as well, and we suspect a deep-rooted household de-leveraging story will still dominate. We also have some concerns over how rural land values will behave given the path for commodity prices and on-farm costs at present. The economy is only part way through a reasonably elongated adjusted in our view. But when we see this sort of relationship, as we are sure the RBNZ does, it does tend to check your thinking. The Governor has shown a preparedness to run a risk before (easing in 2003 despite rising non-tradable inflation) and the current instance is no different in spirit, although the economic scenario is poles apart. But running such a gauntlet in the face of inflation is of course never risk free.




*Sources:* ANZ National, Statistics NZ

Hence, we'll include a little bit of caution in our rate projections, despite remaining very wary economic prospects. The general spirit is a declining trend, and from history we know that rate cycles always seem to end up going further than what we expect.

Looking to October, we continue to look for a 25bps cut, and follow up in December. Of course, when you cross the hurdle, and are prepared to deliver a 50bps move, the hurdle to following it up with the same is smaller. Interest rate cycles do tend to be orderly up, and the reciprocal down. Hence, we wouldn't rule out a similar move in October. But at this stage, we think the combination of the election (yes we know it shouldn't matter but November 8 is awfully close to October 23rd), another discomforting CPI read, and signs of stabilising confidence will be enough to proceed with a tad more caution. But if the global picture continues to deteriorate – which to be fair is where we see the risks – the odds will favour a 50 bps move, and there certainly won't be a pause at 7 percent, nor 6 percent.

Turning to the week ahead, it is a little quieter on the data front. The big one will be the June quarter Balance of Payments. We anticipate the quarterly seasonally adjusted current account deficit deteriorating slightly, but for the annual deficit to improve from 7.8 percent to 7.7 percent of GDP. While the direction the annual deficit is heading in is positive, the fact it still remains very large highlights the vulnerability the economy faces at present in challenging credit environment. Remember NZ has experienced is biggest terms of trade boom in 30 years, yet the deficit remains large. Any sustained improvement looks likely to be a slow grind. For our full preview note refer to page 5.

The final pieces of local data also get released on Friday. They are August External Migration and Credit Card Billings. The former is likely to show migration again finding a reasonably firm base around a 12-month total of 5,000, although the 3-month annualised rate currently sits above 9,000. As we have been stating over previous months, we will be watching the tourism inflow data reasonably closely as another gauge of global demand. The tourism sector is in our sights not only because it is one of NZ's biggest export earners, but being a luxury good is arguably more exposed to the global growth cycle. While recent currency movements will obviously be beneficial as it makes NZ a relatively cheaper destination to visit, the risk is that these benefits get wiped out as global growth slows and the wealth effect from falling asset values weighs.

Looking offshore this week, the FOMC's interest rate decision is likely to get centre stage. No change in rates is expected, although with the ever-present difficulties in the financial sector (Freddie, Fannie and now another investment bank) and the unemployment rate rising rather quickly, the tone of the statement will be closely perused. The Bank of Japan are also due to make an interest rate announcement, and the BoE and RBA are due to release minutes from their latest meetings. The market will focus on both for any signs the respective central banks will again be cutting rates. Data-wise, it is "CPI week", with Europe, US and the UK all releasing inflation statistics.

## Recent local data…

**Value of Building Work Put in Place (June quarter):** Total building volumes fell 5.8 percent.

**Overseas Trade Indices (June quarter):** The terms of trade fell 0.5 percent. Export volumes fell 3.7 percent, while import volumes rose 5.4 percent.

**REINZ House Sales (August):** In seasonally adjusted terms, house sales volumes fell 11 percent and days to sale fell slightly to 56 days. The median house price fell $10,000 to $330,000.

**RBNZ September *Monetary Policy Statement*:** The OCR was cut by a surprise 50bps.

**Food Price Index (August):** Food prices rose 2.7 percent in the month.

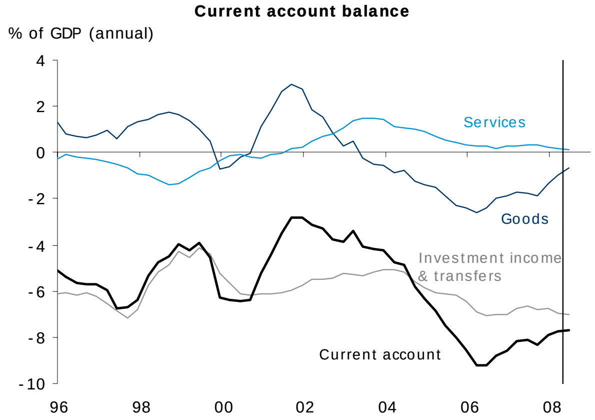
**Retail Sales (July):** Headline sales fell 0.8 percent, while core sales fell 0.2 percent.

## Q2 CURRENT ACCOUNT PREVIEW
(due Friday 19 September 10.45am)

| | ANZ National | RBNZ | Market |
|---|---|---|---|
| Quarter | **-3,092** | | -3,303 |
| Annual | **-13,880** | | -14,090 |
| % of GDP | **-7.7%** | -7.6% | -7.8% |

**Given the global backdrop, current account figures – despite being notoriously volatile in NZ – will receive greater than normal attention. We expect a deficit of 7.7 percent of GDP, a marginal improvement on last quarter. Facing such an imbalance, global developments need to be closely watched, and the economy will struggle to reflate strongly.**

**A small improvement in the annual current account deficit to 7.7 percent of GDP is expected.** This follows a deficit of 7.8 percent of GDP in Q1. The improvement in the annual balance is entirely a result of a reduction in the goods and services deficit. The impact of previously high commodity prices (particularly for dairy, though drought constrained when it comes to production) and solid oil exports from the Tui oil field endowment over the past 12 months support the goods balance. We expect the investment income deficit to come in broadly similar to last quarter.




*Sources:* ANZ National, Statistics NZ

**The quarterly seasonally adjusted deficit is expected to widen.** Not only did the terms of trade fall slightly in the quarter (-0.5 percent), but seasonally adjusted import volume growth well outpaced its export counterpart. OTI data shows that exports fell 3.7 percent, while imports rose 5.4 percent. To be fair, the import numbers were boosted by the importation of an oil platform which is unlikely to be included in the Balance of Payment accounts. But even stripping this out, import growth was far stronger than exports.

**Going forward, it's difficult to entertain a material improvement in the deficit.** Dairy volumes will recover this season, and lower oil prices (despite also exporting oil) will also help the net trade position. Yet the terms of trade look to have peaked, guidance from the tourism sector for the coming season is luke-warm as the global spending dollar is restrained, and it's costing the nation more to borrow. This is not just each marginal current account dollar, but the roll-off of the existing stock, with most of New Zealand's debt of relatively short-term maturity.

**Is the deficit a problem?** Typically we get asked whether the deficit is "sustainable", a rather loose term in our eyes. Of course New Zealand could run a deficit on our current account perpetually without ever going broke. There are, of course, limits to how much additional debt we can incur every year. The trick is that we need to maintain the stock of net foreign liabilities (NFL) in proportion to our potential output (i.e. we need the ratio of net foreign liabilities to GDP to be constant over the business cycle). To do this, New Zealand's trade balance to GDP must be greater than the excess of the real interest rate over the growth rate multiplied by the ratio of net foreign liabilities to GDP. The higher the debt burden, the more we must sell to the rest of the world to avoid going broke. Equally, the higher the interest costs on our foreign borrowings (or dividend stream if we have used equity finance) the more we must export to pay our way. But if we can somehow grow faster, we can grow our way out of debt.

**The deficit is "excessive".** With an outstanding stock of net foreign liabilities of around 90 percent of GDP, a back-of the-envelope calculation shows that if our potential growth rate is 2-3 percent and our real cost of overseas capital is 4-5 percent then we need to maintain a trade surplus of around 2 percent of GDP to stay solvent. Over the last half-a-century our trade balance has not been high enough to keep us on the straight and narrow. Therefore, the overall current account deficit is at levels we'd consider "excessive" and not sustainable.

**From a macro perspective, there are two important implications.** First, an improvement in the current account deficit is an inevitable part of the rebalancing process the economy is undertaking. Historically, improvements in the deficit have been dominated by import adjustments as opposed to export competitiveness. Hence, looking at the domestic economy, there looks another leg to go. Second, NZ will remain very susceptible to swings in global sentiment. One major difference between NZ and Australia at present is that the latter has seen a material improvement in their current account deficit of late (from 7.0 to 4.4 percent of GDP).

**From a market perspective**, the current account figures will represent a further reminder to jittery investors whom continue to de-leverage marginal investments. The services balance may also get some attention if (as we expect) it highlights more downside risk to Q2 GDP.

## 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, with consumer confidence improving, but retail spending weak. Positively, some US inflation gauges came in lower than expected. Industrial production across the UK and Europe was weaker than expected, while Asian data was mixed.

| Country / Area | Indicator | Mkt | Actual | Last | Outturn vs market |
|---|---|---|---|---|---|
| **US** | Consumer Credit (Jul) | $8.5B | $4.6B | $11.0B | Weaker |
| | Pending Home Sales (Jul) – mom | -1.5% | -3.2% | 5.8% | Stronger |
| | Wholesale Inventories (Jul) | 0.7% | 1.4% | 0.9% | Stronger |
| | Import Price Index (Aug) – mom | -1.8% | -3.7% | 0.2% | Weaker |
| | Producer Price Index (Aug) – mom | -0.5% | -0.9% | 1.2% | Weaker |
| | Advance Retail Sales (Aug) | 0.2% | -0.3% | -0.5% | Weaker |
| | University of Michigan Confidence (Sep P) | 64.0 | 73.1 | 63.0 | Stronger |
| | | | | | |
| **Europe** | Sentix Investor Confidence (Sep) | -18.3 | -20.2 | -15.3 | Weaker |
| | Industrial Production (Jul) – mom | -0.2% | -0.3% | -0.2% | Weaker |
| | | | | | |
| **UK** | PPI Input (Aug) – mom | -1.2% | -2.0% | -1.4% | Weaker |
| | PPI Output (Aug) – mom | 0.1% | -0.6% | 0.5% | Weaker |
| | Industrial Production (Jul) – mom | -0.1% | -0.4% | -0.1% | Weaker |
| | | | | | |
| **Asia Ex-Japan** | | | | | |
| *China* | Producer Price Index (Aug) – yoy | 9.8% | 10.1% | 10.0% | Stronger |
| | Consumer Price Index (Aug) – yoy | 5.4% | 4.9% | 6.3% | Weaker |
| | Exports (Aug) – yoy | 20.6% | 21.1% | 26.9% | Stronger |
| | Imports (Aug) – yoy | 28.7% | 23.1% | 33.7% | Weaker |
| | Retail Sales (Aug) – yoy | 23.0% | 23.2% | 23.3% | In-line |
| | Industrial Production (Aug) - yoy | 14.5% | 12.8% | 14.7% | Weaker |
| *South Korea* | Consumer Confidence (Aug) | - | 91.2 | 84.6 | - |
| | Producer Price Index (Aug) – yoy | - | 12.3% | 12.5% | - |
| | Unemployment Rate (Aug) | - | 3.2% | 3.2% | - |
| | Bank of Korea Repo Rate | 5.25% | 5.25% | 5.25% | In-line |
| *Thailand* | Consumer Confidence (Aug) | - | 70.5 | 71.8 | - |
| *Malaysia* | Industrial Production (Jul) – yoy | 2.1% | 1.8% | 2.2% | Weaker |
| *Philippines* | Total Exports (Jul P) – yoy | 5.0% | 4.3% | 8.8% | Weaker |
| *Taiwan* | Total Exports (Aug) – yoy | 6.5% | 18.4% | 8.0% | Stronger |
| | Total Imports (Aug) – yoy | 19.0% | 39.9% | 12.3% | Stronger |
| *India* | Industrial Production (Jul) - yoy | 6.0% | 7.1% | 5.4% | Stronger |
| *Indonesia* | Consumer Confidence (Aug) | - | 89.3 | 82.1 | - |
| | | | | | |
| **Japan** | M3 Money Supply (Aug) – yoy | 0.9% | 1.0% | 0.8% | Stronger |
| | Leading Index CI (Jul P) | 91.9 | 91.6 | 91.3 | Weaker |
| | Coincident Index (Jul P) | 102.5 | 103.3 | 101.6 | Stronger |
| | Machine Orders (Jul) – mom | -3.6% | -3.9% | -2.6% | Weaker |
| | GDP (2Q F) - qoq | -0.8% | -0.7% | -0.6% | Stronger |
| | | | | | |
| **Australia** | NAB Business Conditions (Aug) | - | -3 | -5 | - |
| | Home Loans (Jul) – mom | 0.0% | -0.2% | -3.7% | Weaker |
| | Employment Change (Aug) | 5.0K | 14.6K | 18.7K | Stronger |
| | Unemployment Rate (Aug) | 4.4% | 4.1% | 4.3% | Stronger |

# INTEREST RATE STRATEGY

**Global markets will remain volatile this week and NZ rates are expected to take a back seat whilst we see how events in the US unfold around issues on financial stability.**

## Market themes…

> The RBNZ cuts 50bps, against expectations of a 25bp cut. The RBNZ are front loading the easing cycle, and while a welcome response, this is not a risk-free strategy to pursue.

> US curve now starting to think the Fed might have to cut again.

> Global markets will remain volatile as we wait for the outcome surrounding the health of US investment bank Lehman Brothers.

## Review and outlook…

The RBNZ's decision to cut by 50bps was a surprise to many, including us. Despite the likelihood that inflation will continue to track higher in the near term, the RBNZ feels that weaker global growth prospects, falling asset prices, and the prospect of a prolonged period of household balance sheet adjustment will keep inflation in check in the medium term. However, deteriorating financial market conditions pose significant downside risks.

While we expect the RBNZ to pause once the cash rate gets to 7 percent (before we see follow up moves), all the risks would appear to the downside, and as such, the market is right to be expressing a more rapid easing profile.

Last week's 50bp cut has gone some way to validate our concerns the market was being too dismissive of offshore moves, evidenced by the fact that NZ interest rates virtually stood still while most other interest rate markets rallied. The fact that the RBNZ has cited financial considerations as a motivation for more aggressive action, suggests that the local market needs to be more mindful of global moves. With Treasury yields at low levels, and "chomping at the bit" to rally further, we think there is considerable scope for the NZ long end to follow suit. Prospects for the long end look good, and being "long the long end" remains our preferred strategy.

**Gauges for NZ interest rates**

| Gauge | Direction | Comment |
|---|---|---|
| RBNZ | ↔/↓ | RBNZ surprise 50bps cut last week will keep the front end supported. |
| NZ data | ↔ | Next weeks GDP data may extend the move lower in yields. |
| Fed Funds/ front end | ↔/↓ | The market has pushed out the first hike to June 2009 but is also starting to think maybe a cut by December. |
| RBA | ↔ | Market pricing is now consistent with a follow up cut next month, and a second one by Christmas. |
| US 10 year | ↔/↓ | Notes will be volatile ahead of any discussion around Lehman Brothers. |
| NZ swap curve | ↔/↓ | The long end can follow global yields lower – but the short end can't realistically anticipate any more easings in the near term. |
| Flow | ↔/↓ | Steepners have been favoured post the RBNZ last Thursday. |
| Technicals | ↔ | The RBNZ has cleared the way for lower yields. |

**Borrowing strategies we favour at present**

Keep cover short in duration. 1yr and 2yr yields incorporate an expectation of lower rates, and offer immediate cost savings. The level of rates remains historically high, and there's not enough of a saving to make the long end appealing.

**Market expectations for RBNZ OCR (bps)**

| OCR dates | Last week | This week |
|---|---|---|
| Thu 23-Oct-08 | -50 | -27 |
| Thu 4-Dec-08 | -74 | -53 |
| Thu 22-Jan-09 | -96 | -78 |
| Thu 5-Mar-09 | -116 | -93 |
| Thu 23-Apr-09 | -117 | -107 |
| Thu 4-Jun-09 | -135 | -120 |
| Thu 23-Jul-09 | - | -130 |

**Trading themes we favour at present**

Use any back up in yields as an opportunity to extend duration, especially in the front to mid part of the curve. Steepeners will be favoured.

## CURRENCY STRATEGY

**Wider USD sentiment will hold sway this week for the NZD. Both the NZD and AUD are due for a bounce, but in the current global environment we may need to move beyond September, and year (quarter)-end position squaring before this occurs. A lot depends on sentiment towards financials this week.**

### Market themes…

> USD sentiment waxing and waning.

> Commodities remain heavy.

> Financial stability in the frame.

### Review and outlook…

Phew, what a week! We mentioned in last week's *Market Focus*, that volatility was likely to continue, and that is exactly what transpired. The NZD, as well as many other currencies again experienced some big moves. The NZD started the week near 0.68, was sold down to below 0.6450, before recovering to over 0.6650. Of course, the RBNZ's surprise 50bp rate cut contributed to the volatility. However, the global backdrop is also having a big say. Risk aversion, US financial sector concerns, "Septemberitis", falling commodity prices and weak global growth are dictating currency markets.

This week starts as last week ended, with speculation surrounding the survival of another large US investment bank. Government officials as well as some key Wall Street players are rumoured to be discussing the investment bank's future. What eventuates from these discussions is likely to dominate currency movements early in the week. The pace of developments in the US financial sector also appears to be accelerating and there is almost a philosophy of simply getting it sorted. A bailout or rescue plan will likely see risk aversion ease and demand for the safe-haven USD and JPY currencies reduce. However, if no plan is forged, then risk aversion will continue and likely see the NZD, AUD, remain under pressure. Deep in the backdrop there is also the growing realistion that it's a US problem, so being bullish the greenback in that sort of environment – despite "recoupling" is not clear cut.

There remains a significant amount of uncertainty, and risk appetites will no doubt wax and wane. Equity futures in the US are pointing to a bleak Monday to start the week but no one is sure how this should flow to the USD. The big picture prognosis for the kiwi still looks bearish given commodity prices (dairy prices are lower again and oil has fallen below US$100/bbl with ease) and the global backdrop. Last weeks surprise 50 bps cut by the RBNZ was also a timely reminder to those still thinking about carry. Yet we are also wary that the NZD (and AUD) have moved a long way and are due to bounce. The USD tested, but failed to break key Dollar Index resistance at 80.40 last week and this may be crucial. For now, we think caution is the order of the day.

Technically, the top in the USD looks in place and the EUR seems ready to retest up towards 1.4600 minimum. AUD/USD also looks like the base is solid below 0.800, for a retracement to 0.8600. Given this scenario the NZD could spend the rest of September in a 0.6500-0.6900 range.

**NZD vs AUD: monthly directional gauges**

| Gauge | Direction | Comment |
|---|---|---|
| Fair value | ↔ | Growth differentials still favouring AUD but closing. |
| Yield | ↓ | RBNZ trumps RBA with 50. |
| Commodities | ↔ | Commodities weak for both. |
| Partial indicators | ↓ | NZ indicators still worse. |
| Technicals | ↔ | Range trading. |
| Sentiment | ↔/↓ | Japanese margin traders still net long AUD. |
| Other | ↔ | AUD in the RBA's hands. |
| **On balance** | ↓ | **Aus curve relative to NZ still looks odd in terms of pricing for rate cuts** |

**NZD vs USD: monthly directional gauges**

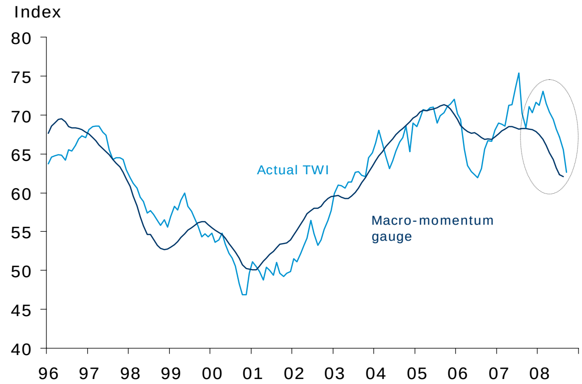
| Gauge | Direction | Comment |
|---|---|---|
| Fair value – long-term | ↓ | Fair value 0.65 given a structural shift in commodity prices. |
| Fair value – short-term | ↑ | NZD starting to look cheap in cyclical sense now. |
| Yield | ↔ | RBNZ trumps with a 50, but market now thinking about Fed as well. |
| Commodities | ↓ | The big one to watch closely. |
| Risk aversion | ↔/↓ | Still weak as Septemberitis weighs. |
| Partial indicators | ↓ | US data stabilising, NZ data still very weak. |
| Technicals | ↔ | 0.65-0.69 range. |
| AUD | ↔/↑ | Watch out for recoil. |
| Sentiment | ↔ | Changes daily. |
| Other | ↑ | US financials may weigh on USD sentiment. |
| **On balance** | ↔ | **We don't like the kiwi story, but the USD has issues** |

## MACRO-MOMENTUM CURRENCY GAUGE

**Our currency macro-momentum gauge is a composite growth index that has tracked the NZD over the past decade. The gauge is currently giving a very neutral reading on the currency at present, having snapped back from the extended readings over the preceding months. We are increasingly looking for a temporary bounce in the NZD, with the AUD potentially dragging us up. But for now, it may well simply be a case of noise and intra-day volatility until the global scene stabilises.**

**Over a year ago we developed a currency macro-momentum gauge** in recognition of the fact currencies are hugely responsive to more timely data nowadays. Our gauge is in effect an extension of our leading and composite growth indicators, overlaid on the NZ dollar. The macro-momentum gauge uses timely indicators that we know the currency market tends to react to. These include monthly trend information from confidence surveys, retail sales, the housing market, commodity prices and imports. We use two measures for each – one being directional (positive or negative), and the other the relative magnitude of either weakness or strength. The measures are then weighted to give us an impression of the overall tenor of the data. The results are then overlaid on the currency (on a TWI basis) using cumulative movements. We use cumulative movements because ultimately it is the trend in the data over time that is influential, such as sustained weakness or strength. Just as sub-par performance sees a share price fall, sub-par (trend) performance over time should see a currency decline. A simple regression links the index more explicitly to the actual TWI.

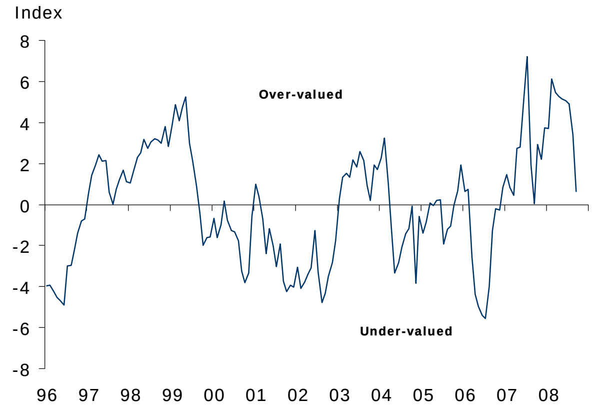
**Currency Macro-Momentum Gauge**




*Sources:* ANZ National

Put simply, our indicator gives a useful guide and benchmark as to whether the NZD has diverged materially from where it should be in a cyclical sense, and whether the tenor of the data says it should be going up or down.

**Currency Macro-Momentum Gauge - deviation from TWI**

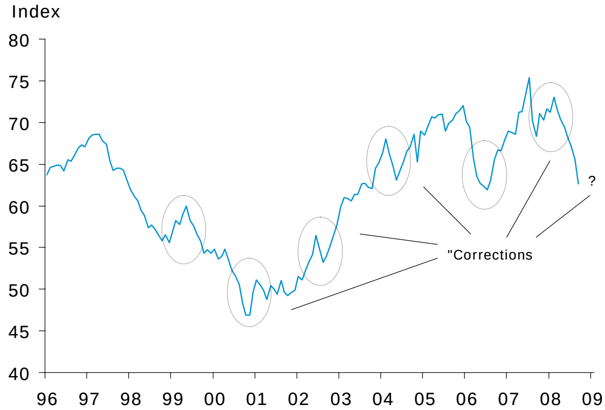



*Sources:* ANZ National

**The gauge is currently giving a very neutral reading on the currency at present** having snapped back from the extended readings over the preceding months. That does not mean the trend will not remain south, merely that the rubber band influence and potential to snap back is no longer as pressing as an influence.

**It is difficult to paint a positive kiwi story at present** given 'Septemberitis' (de-risking), de-leveraging that is occurring, commodity price developments, the aggressive move by the RBNZ, and wider global backdrop. Our core view continues to centre on a weaker NZD. A lower NZD is an inevitable part of the rebalancing process the NZ economy is embarking on. We are very bearish the kiwi in the medium-term.

**NZD Trade Weighted Index**

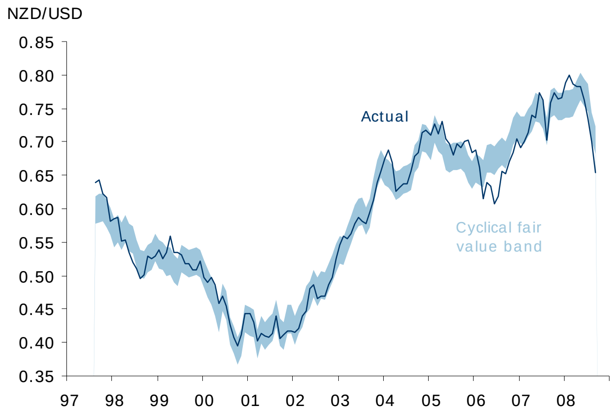



*Sources:* ANZ National

**However, we increasingly of the view that we will see a bounce in the NZD at some stage.** In saying this we are mindful of a host of factors. First, history is littered with such experiences. Even during the Asian crisis, we saw a decent bounce in the NZD, and it went against the grain of what was happening in commodity markets. Positioning can play a key role. Currency trends are never ruler extrapolations. Second, the AUD has seen the largest correction in its history, falling 17 cents in two months and so is "due" a bounce. Third, problems around the global remain US centric (despite recoupling), and this makes us wary just how far a recovering USD can extend. Fourth, policymakers have shown a tendency to follow the kitchen sink style approach to financial problems, and we shouldn't discount the incentives on them to underpin a recovery. This includes the potential for Chinese policymakers to stimulate their region, with of course positive flow-on for commodities. Finally, a lot of central banks desire a lower currency (especially current account deficit nations), but can ill afford to have them move too far given the inflationary consequences.

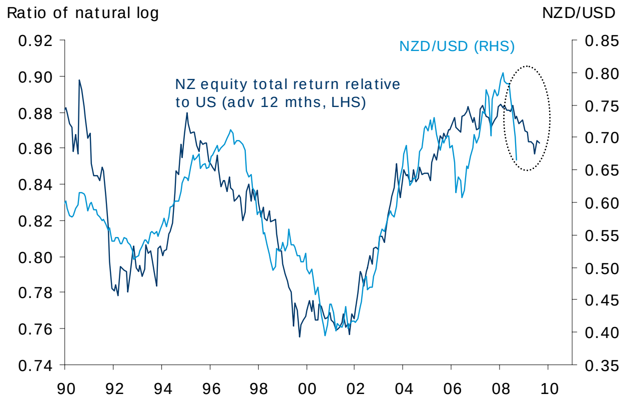
**For now, we are holding fire.** When we eye our currency momentum gauge, more structural estimates of fair value, or cyclical based models, none are really giving overarching bounce messages yet, despite the fact we have seen pretty substantial moves of late. Our NZD/USD (cyclical) fair value model is extended, but not really relative to history. Even relative equity performance (as both the currency and equities are forward looking to a degree (or should be)), is giving no clear directional messages relative to historical relationships. The NZD/USD looks in the zone in terms of where it should be. We could always present an array of yield charts, but these tend to flick-on and flick-off every 12 months, which yield gap is appropriate or flavour of the month changes, and the dynamics are not very stable. The same with risk and commodity measures.

**NZD/USD actual vs modelled**




*Sources:* ANZ National, Bloomberg

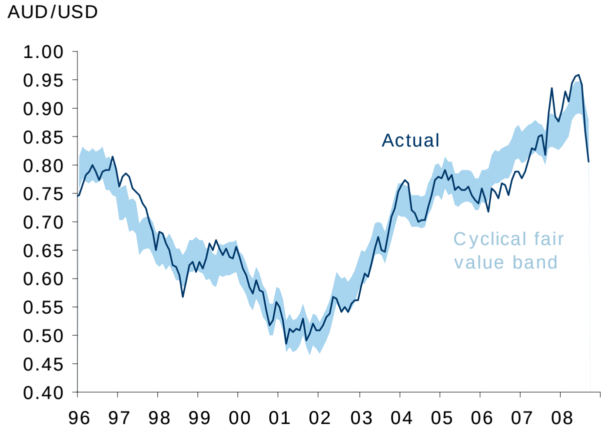
**Relative equity returns and currency**




*Sources:* ANZ National, Reuters, Global Financial Data

**The AUD is one we are keeping a close eye on**, both for the potential to drag the NZD/USD up, but also see the NZD/AUD return lower. Our (NZ) cyclical model is saying fair value is now around 85 cents. It's fallen 7 cents in three months after peaking at 92 cents, largely on declines in inputs including commodity prices and various yield and risk measures. The "gap" of disequilibrium between spot and "fair value" is now 4 cents (although it did blow to 5 cents (a historical trigger level) when the AUD/USD hit sub 80 cents). This is "wide" by historical standards so on its own suggests the rubber band is getting tight, and we could see a snap back, which is what we are starting to see now. Of course, this by itself this does not necessarily mean the AUD needs to lift further even though it looks very oversold. It may well be the case that cyclical (and less liquid) inputs such as commodity prices are still playing catch-up and actually lagging the currency market. i.e. fair value lagging is still falling. This is something we are keeping close eye on for both the NZD and AUD. Other markets are sometimes converging on currency sentiment as opposed to the other way around.

**AUD/USD actual vs modelled**




*Sources:* ANZ National, Bloomberg

**In terms of thinking about fair value and the like in this environment, we believe it pays to be very careful in any interpretation and assessments, especially when looking for rubber-band style bounces and corrections.** Cyclical inputs are too volatile and fast moving in the current environment to be relied upon heavily. They are merely indicative when it comes to broad direction considering the huge array of forces at present. **For now, we expect to see a lot of noise and intraday volatility.**

## DATA AND EVENT CALENDAR

| Date | Country | Data/Event | Mkt. | Last | Time (NZST) |
|---|---|---|---|---|---|
| 15-Sep | **NZ** | **Manufacturing Activity (2Q)** | **-** | **3.7%** | **10:45** |
| | | **Performance of Services Index (Aug)** | **-** | **-** | **12:00** |
| | | **Non Resident Bond Holdings (Aug)** | **-** | **77.6%** | **15:00** |
| | AU | Dwelling Starts (2Q) | - | -3.3% | 13:30 |
| | EU | Labour Costs (2Q) - yoy | 3.5% | 3.3% | 21:00 |
| | GE | ECB's Trichet Speaks in Frankfurt | - | - | 21:00 |
| 16-Sep | EU | ECB's Tumpel-Gugerell Speaks in Vienna | - | - | 00:00 |
| | | Euro-Zone CPI (Aug) - mom | -0.2% | -0.2% | 21:00 |
| | | Euro-Zone CPI (Aug) - yoy | 3.8% | 4.0% | 21:00 |
| | | Euro-Zone CPI - Core (Aug) - yoy | 1.7% | 1.7% | 21:00 |
| | | ZEW Survey (Econ. Sentiment) (Sep) | -55.0 | -55.7 | 21:00 |
| | US | Empire Manufacturing (Sep) | 1.0 | 2.8 | 00:30 |
| | | Industrial Production (Aug) | -0.3% | 0.2% | 01:15 |
| | | Capacity Utilization (Aug) | 79.6% | 79.9% | 01:15 |
| | AU | RBA Board Minutes from September meeting | - | - | 13:30 |
| | JN | Consumer Confidence (Aug) | - | 31.6 | 17:00 |
| | | Consumer Confidence Households (Aug) | 31.5 | 31.4 | 17:00 |
| | GE | Consumer Price Index (Aug F) - mom | -0.3% | -0.3% | 18:00 |
| | | ZEW Survey (Econ. Sentiment) (Sep) | -53.0 | -55.5 | 21:00 |
| | | ZEW Survey (Current Situation) (Sep) | -15.0 | -9.2 | 21:00 |
| | UK | CPI (Aug) - mom | 0.5% | 0.0% | 20:30 |
| | | CPI (Aug) - yoy | 4.6% | 4.4% | 20:30 |
| | | Core CPI (Aug) - yoy | 1.9% | 1.9% | 20:30 |
| | | RPI (Aug) - yoy | 0.4% | 5.0% | 20:30 |
| | | DCLG UK House Prices (Jul) - yoy | -2.1% | 0.6% | 20:30 |
| 17-Sep | US | Consumer Price Index (Aug) - mom | -0.1% | 0.8% | 00:30 |
| | | CPI Ex Food & Energy (Aug) - mom | 0.2% | 0.3% | 00:30 |
| | | Consumer Price Index (Aug) - yoy | 5.5% | 5.6% | 00:30 |
| | | CPI Ex Food & Energy (Aug) - yoy | 2.6% | 2.5% | 00:30 |
| | | Net Long-term TIC Flows (Jul) | $55.0B | $53.4B | 01:00 |
| | | NAHB Housing Market Index (Sep) | 17 | 16 | 05:00 |
| | | FOMC Interest Rate Decision | 2.00% | 2.00% | 06:15 |
| | AU | Westpac Leading Index (Jul) - mom | - | 0.1% | 12:30 |
| | | Preliminary BoP Imports (Aug) - mom | - | 5.0% | 13:30 |
| | | RBA Governor Stevens Speaks in Sydney | - | - | 15:30 |
| | JN | BOJ Target Rate | 0.50% | 0.50% | - |
| | UK | Bank of England Minutes | - | - | 20:30 |
| | | Claimant Count Rate (Aug) | 2.8% | 2.7% | 20:30 |

Continued over page

| Date | Country | Data/Event | Mkt. | Last | Time (NZST) |
|---|---|---|---|---|---|
| 17-Sep cont. | UK | Jobless Claims Change (Aug) | 23.0K | 20.1K | 20:30 |
| | | Avg Earnings inc bonus (Jul) - 3M/YoY | 3.4% | 3.4% | 20:30 |
| | | ILO Unemployment Rate (3mths) (Jul) | 5.4% | 5.4% | 20:30 |
| | EU | Trade Balance s.a. (Jul) | -3.5B | -3.0B | 21:00 |
| 18-Sep | US | Current Account Balance (2Q) | -$180.0B | -$176.4B | 00:30 |
| | | Housing Starts (Aug) | 950K | 965K | 00:30 |
| | | Building Permits (Aug) | 925K | 937K | 00:30 |
| | JN | Tertiary Industry Index (Jul) - mom | 0.4% | -0.8% | 11:50 |
| | | BoJ Monthly Report | - | - | 17:00 |
| | | Nationwide Department Sales (Aug) - yoy | - | -2.5% | 17:30 |
| | | BOJ Governor Shirakawa to Speak in Tokyo | - | - | 18:00 |
| | AU | RBA Foreign Exchange Transactions (Aug) | - | A$300M | 13:30 |
| | UK | Retail Sales (Aug) - mom | -0.5% | 0.8% | 20:30 |
| | | Public Finances (PSNCR) (Aug) | 6.5B | -12.6B | 20:30 |
| | | Public Sector Net Borrowing (Aug) | 9.0B | -4.8B | 20:30 |
| | | M4 Money Supply (Aug P) - mom | 0.7% | 0.9% | 20:30 |
| | | M4 Sterling Lending (Aug P) | 14.2B | 12.4B | 20:30 |
| | EU | Construction Output s.a. (Jul) - mom | - | -0.6% | 21:00 |
| 19-Sep | US | Initial Jobless Claims (w/e Sep-14) | 440K | 445K | 00:30 |
| | | Continuing Claims (w/e Sep-7) | 3,528K | 3,525K | 00:30 |
| | | Philadelphia Fed (Sep) | -10.0 | -12.7 | 02:00 |
| | | Leading Indicators (Aug) | -0.2% | -0.7% | 02:00 |
| | **NZ** | **Visitor Arrivals (Aug)** | **-** | **2.1%** | **10:45** |
| | | **Current Account Balance (2Q)** | **-3.50B** | **-2.160B** | **10:45** |
| | | **Current Account Deficit-% of GDP (2Q)** | **-7.8%** | **-7.8%** | **10:45** |
| | | **Credit Card Spending (Aug) - yoy** | **-** | **3.8%** | **15:00** |
| | JN | Leading Index CI (Jul F) | - | 91.6 | 17:00 |
| | | Coincident Index CI (Jul F) | - | 103.3 | 17:00 |
| | GE | Producer Prices (Aug) - mom | -0.5% | 2.0% | 18:00 |
| | EU | ECB's Stark Speaks in Rome | - | - | 19:00 |
| 20-Sep | US | Fed's Evans Speaks on Economy at Swiss Central Bank Conference | - | - | 05:00 |

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 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 |
|---|---|---|---|
| Fri 19 Sep (10.45) | Balance of Payments (Q2) | Slow grind | The current account deficit is expected to record a small improvement over the quarter as a result of a lower annual trade deficit. But it is hard to see a further improvement over the coming year. |
| Fri 19 Sep (10.45) | External Migration (Aug) | Stabilising | The annual inflow is expected to remain around its current 5,000 level. The timelier 3-mth annualised rate has been improving and currently sits around 9,000. |
| Fri 19 Sep (15.00) | Credit Card Billings (Aug) | Weak | Given slightly lower petrol prices in August, this may see the value of credit card billings ease slightly for the month. Volatility aside, the underlying trend for retailing should remain weak. |
| Mon 22 Sep (10.45) | Electronic Card Transactions (Aug) | Weak | Similar themes to the credit card data. |
| Fri 25 Sep (10.45) | Gross Domestic Product (Q2) | Contraction | We have pencilled in activity falling by 0.5 percent for the quarter, with residential investment and private consumption again expected to be weak. The risk is pointed to a larger contraction. |
| 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 *Business Outlook* (Sep) | - | - |
| Thu 2 Oct (15.00) | ANZ Commodity Price Index (Sep) | - | - |
| **On Balance** | | **Contracting economy yesterday's news with some signs of stabilisation in confidence. But will it take hold?** | **Still a lot of imbalances to work through.** |

## 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 | **-0.5** | **-0.2** | **0.2** | **0.3** | **0.5** | **0.5** |
| GDP (% yoy) | 3.2 | 3.3 | 3.5 | 1.9 | **0.6** | **-0.2** | **-0.8** | **-0.2** | **0.8** | **1.5** |
| CPI (% qoq) | 1.0 | 0.5 | 1.2 | 0.7 | 1.6 | **1.2** | **0.8** | **0.9** | **0.9** | **0.7** |
| CPI (% yoy) | 2.0 | 1.8 | 3.2 | 3.4 | 4.0 | **4.8** | **4.4** | **4.7** | **4.0** | **3.4** |
| Employment (% qoq) | 0.3 | -0.1 | 0.9 | -1.3 | 1.3 | **-0.6** | **-0.1** | **0.0** | **0.1** | **0.1** |
| Employment (% yoy) | 1.5 | 1.5 | 2.5 | -0.2 | 0.7 | **0.2** | **-0.7** | **0.6** | **-0.6** | **0.0** |
| Unemployment Rate (% sa) | 3.6 | 3.5 | 3.4 | 3.7 | 3.9 | **4.2** | **4.5** | **4.6** | **4.9** | **5.1** |
| Current Account (% GDP) | -8.1 | -8.3 | -7.9 | -7.8 | **-7.6** | **-7.4** | **-7.2** | **-6.8** | **-6.4** | **-6.1** |
| Terms of Trade (% qoq) | 0.4 | 3.7 | 2.7 | 4.1 | -0.5 | **-1.0** | **0.0** | **-1.5** | **-1.2** | **-1.0** |
| Terms of Trade (% yoy) | 2.3 | 8.4 | 8.5 | 11.3 | 10.6 | **5.7** | **2.9** | **-2.7** | **-3.7** | **-3.7** |

## KEY ECONOMIC INDICATORS

| | Nov-07 | Dec-07 | Jan-08 | Feb-08 | Mar-08 | Apr-08 | May-08 | Jun-08 | Jul-08 | Aug-08 |
|---|---|---|---|---|---|---|---|---|---|---|
| Retail Sales (% mom) | 1.7 | 0.0 | 0.3 | -0.7 | -1.0 | 1.3 | -1.3 | 1.0 | -0.8 | .. |
| Retail Sales (% yoy) | 7.2 | 5.4 | 6.3 | 7.7 | -1.0 | 4.1 | 1.0 | 1.5 | 2.5 | .. |
| Credit Card Billings (% mom) | 1.1 | 0.7 | -0.4 | 0.7 | -2.5 | 2.9 | -0.9 | -0.4 | 0.4 | .. |
| Credit Card Billings (% yoy) | 9.4 | 7.7 | 8.6 | 7.9 | 3.5 | 8.0 | 5.9 | 3.4 | 3.8 | .. |
| Car Registrations (% mom) | -3.7 | -2.7 | 9.8 | -8.5 | -12.8 | 11.4 | -13.5 | 1.4 | -7.5 | .. |
| Car Registrations (% yoy) | 2.3 | 1.4 | 1.7 | 1.9 | -13.2 | -1.0 | -20.6 | -15.9 | -27.1 | .. |
| Building Consents (% mom) | 0.5 | -4.3 | 3.7 | -6.4 | -14.3 | 82.7 | -41.8 | -18.8 | 4.8 | .. |
| Building Consents (% yoy) | -4.7 | -6.6 | -5.0 | -17.7 | -27.5 | 31.1 | -27.0 | -47.0 | -35.1 | .. |
| REINZ House Price (% yoy) | 6.7 | 4.5 | 4.0 | 0.7 | 1.6 | -1.1 | -1.4 | -2.2 | -1.4 | -5.7 |
| Household Lending Growth (% mom) | 0.8 | 0.7 | 0.7 | 0.9 | 0.4 | 0.4 | 0.4 | 0.3 | 0.3 | .. |
| Household Lending Growth (% yoy) | 12.8 | 12.3 | 11.9 | 11.6 | 10.8 | 9.9 | 9.3 | 8.4 | 7.7 | .. |
| Roy Morgan Consumer Confidence | 121.9 | 126.6 | 121.2 | 116.0 | 111.7 | 99.9 | 89.2 | 86.5 | 83.9 | 91.4 |
| NBNZ Business Confidence | -19.6 | -24.9 | .. | -43.9 | -57.9 | -54.8 | -49.7 | -38.7 | -43.2 | -20.5 |
| NBNZ Own Activity Outlook | 15.7 | 18.2 | .. | 2.4 | -6.4 | -3.8 | -4.4 | -4.0 | -8.2 | 4.7 |
| Trade Balance ($m) | -628 | 39 | -311 | 243 | -43 | -293 | -168 | -207 | -781 | .. |
| Trade Balance ($m annual) | -5691 | -5307 | -4793 | -4422 | -4526 | -4604 | -4781 | -4469 | -4443 | .. |
| ANZ World Commodity Price Index (% mom) | 0.8 | 0.0 | -1.4 | 1.1 | 2.0 | -0.3 | 0.9 | 0.0 | 1.8 | -3.3 |
| ANZ World Commodity Price Index (% yoy) | 35.9 | 30.9 | 27.4 | 26.9 | 26.9 | 20.7 | 18.7 | 11.6 | 8.7 | 3.6 |
| Net Migration (sa) | 460 | 30 | 120 | 260 | 540 | 480 | 960 | 480 | 850 | .. |
| Net Migration (annual) | 6588 | 5491 | 4799 | 4643 | 4678 | 4666 | 4931 | 4732 | 5201 | .. |

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

## SUMMARY OF KEY MARKET FORECASTS

| | Actual | | Current | Forecast (end month) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| **NZ FX rates** | Jul-08 | Aug-08 | 15-Sep-08 | Dec-08 | Mar-09 | Jun-09 | Sep-09 | Dec-09 | Mar-10 | Jun-10 |
| NZD/USD | 0.756 | 0.710 | 0.667 | 0.650 | 0.680 | 0.650 | 0.630 | 0.610 | 0.590 | 0.580 |
| NZD/AUD | 0.785 | 0.803 | 0.815 | 0.756 | 0.819 | 0.813 | 0.808 | 0.803 | 0.797 | 0.806 |
| NZD/EUR | 0.479 | 0.474 | 0.466 | 0.451 | 0.486 | 0.478 | 0.470 | 0.469 | 0.461 | 0.468 |
| NZD/JPY | 80.7 | 77.7 | 70.9 | 70.2 | 74.8 | 71.5 | 70.6 | 69.5 | 67.9 | 68.4 |
| NZD/GBP | 0.380 | 0.375 | 0.370 | 0.365 | 0.384 | 0.369 | 0.362 | 0.353 | 0.343 | 0.339 |
| NZ$ TWI | 67.2 | 65.5 | 63.2 | 61.1 | 65.0 | 63.1 | 61.9 | 60.9 | 59.6 | 59.6 |
| **NZ interest rates** | Jul-08 | Aug-08 | 15-Sep-08 | Dec-08 | Mar-09 | Jun-09 | Sep-09 | Dec-09 | Mar-10 | Jun-10 |
| OCR | 8.18 | 8.00 | 7.50 | 7.00 | 7.00 | 6.75 | 6.25 | 6.00 | 6.00 | 6.00 |
| 90 day bill | 8.46 | 8.20 | 7.80 | 7.40 | 7.30 | 6.80 | 6.30 | 6.20 | 6.20 | 6.20 |
| 10 year bond | 6.17 | 6.13 | 5.86 | 5.90 | 5.90 | 5.80 | 5.60 | 5.70 | 5.80 | 6.00 |
| **International** | Jul-08 | Aug-08 | 15-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 | 2.82 | 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 | 7.25 | 7.00 | 7.00 | 6.80 | 6.50 | 6.40 | 5.90 | 5.90 |

## KEY RATES

| | 12 Aug | 8 Sep | 9 Sep | 10 Sep | 11 Sep | 12 Sep |
|---|---|---|---|---|---|---|
| Official Cash Rate | 8.00 | 8.00 | 8.00 | 8.00 | 7.50 | 7.50 |
| 90 day bank bill | 8.22 | 8.06 | 8.07 | 8.04 | 7.83 | 7.80 |
| NZGB 07/09 | 6.92 | 6.82 | 6.81 | 6.79 | 6.62 | 6.59 |
| NZGB 11/11 | 6.26 | 6.05 | 6.01 | 5.91 | 5.73 | 5.75 |
| NZGB 04/13 | 6.26 | 6.00 | 5.96 | 5.87 | 5.74 | 5.74 |
| NZGB 12/17 | 6.19 | 6.00 | 5.96 | 5.88 | 5.84 | 5.83 |
| 2 year swap | 7.28 | 7.24 | 7.23 | 7.19 | 7.00 | 6.94 |
| 5 year swap | 7.04 | 7.01 | 7.00 | 6.96 | 6.87 | 6.83 |
| RBNZ TWI | 64.6 | 64.5 | 63.4 | 63.9 | 62.5 | 62.7 |
| NZD/USD | 0.6976 | 0.6812 | 0.6624 | 0.6686 | 0.6500 | 0.6535 |
| NZD/AUD | 0.7947 | 0.8204 | 0.8228 | 0.8293 | 0.8154 | 0.8142 |
| NZD/JPY | 76.85 | 74.04 | 71.14 | 71.70 | 69.84 | 70.02 |
| NZD/GBP | 0.3659 | 0.3807 | 0.3774 | 0.3795 | 0.3715 | 0.3716 |
| NZD/EUR | 0.4687 | 0.4730 | 0.4703 | 0.4729 | 0.4658 | 0.4667 |
| AUD/USD | 0.8778 | 0.8303 | 0.8051 | 0.8062 | 0.7972 | 0.8026 |
| EUR/USD | 1.4884 | 1.4401 | 1.4085 | 1.4137 | 1.3953 | 1.4004 |
| USD/JPY | 110.16 | 108.69 | 107.40 | 107.24 | 107.44 | 107.14 |
| GBP/USD | 1.9065 | 1.7892 | 1.7553 | 1.7619 | 1.7496 | 1.7584 |
| Oil | 114.44 | 106.47 | 106.35 | 103.23 | 102.66 | 100.95 |
| Gold | 811.85 | 814.30 | 799.85 | 775.80 | 755.50 | 752.30 |
| Electricity (Haywards) | 21.05 | 12.89 | 6.90 | 4.88 | 7.53 | 5.24 |
| Milk futures (US$/contract) | 139 | 130 | 130 | 129 | 129 | 128 |
| Baltic Dry Freight Index | 6992 | 5492 | 5255 | 5026 | 4893 | 4800 |

## DISCLOSURE INFORMATION

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

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

***Qualifications, experience and professional standing***

**Experience**

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

**Relevant professional body**

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

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

**Professional indemnity insurance**

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

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

The insurer is ANZcover Insurance Pty Limited.

**Dispute resolution facilities**

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

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

***Criminal convictions***

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

- Convicted of an offence under the Securities Markets Act 1988, or the Securities Act 1978 or of a crime involving dishonesty (as defined in section 2(1) of the Crimes Act 1961);
- A principal officer of a body corporate when that body corporate committed any of the offences or crimes involving dishonesty as described above;
- Adjudicated bankrupt;
- Prohibited by an Act or by a court from taking part in the management of a company or a business;
- Subject of an adverse finding by a court in any proceeding that has been taken against them in their professional capacity;
- Expelled from or has been prohibited from being a member of a professional body; or
- Placed in statutory management or receivership.

***Fees***

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

***Other interests and relationships***

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

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

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

***Securities about which investment advice is given***

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

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

## PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

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

Investment property (other than money) may be delivered to the Bank by lodging the relevant property (for example, share certificates) with any branch of the Bank offering a safe custody service, or by posting (using registered post) the documents or other property to a branch of the Bank, identifying your name, account number and investment purpose.

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

**Record Keeping**

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

**Auditing**

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

**Use of Money and Property**

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

## DISCLAIMER

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

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



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