



Sure to rise

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Summary

- > Our monthly *Property Focus* publication is aimed at providing an independent appraisal of recent developments in the property market. In this issue we review the factors that are putting upwards pressure on deposit rates.

The month in review (page 2)

- > The economy is stabilising, and this heralds an end to the interest rate easing cycle, provided we do not see further global turmoil. Housing data and net migration are gathering momentum, but building consents are still to rise.

Property gauges (page 3)

- > Improving home affordability, migration gains and lower mortgage rates continue to underpin the housing market. Building consents is an obvious laggard but the latest data has reported a modest improvement – albeit off a very low base.

Economic backdrop (page 5)

- > A recovery in housing market activity has been evident over recent months and net migration has become an increasingly positive factor. But the path ahead remains littered with several large obstacles. None more so than the recent strengthening of the Kiwi dollar, which is undermining the export and rural sectors, coinciding with a depressed global backdrop.

Mortgage borrowing strategy (page 6)

- > Our favoured strategies remain unchanged from last month. The Reserve Bank remains committed to keeping the OCR low, although wholesale markets continue to price in rising interest rates. This tension, intertwined with high deposit rates, could take some time to resolve and is expected to see the yield curve continue to steepen. In this environment we continue to favour being patient and take advantage of low 6 month and 1 year fixed rates.

Feature article – Deposit focus (page 8)

- > The implications of rising deposit rates are wider than simply putting upwards pressure on borrowing rates. They are also symptomatic of a wider rebalancing process for the economy, namely the structural shift away from spending towards saving. This is a dynamic which we expect will delay the long hoped for recovery in house prices.

Key forecasts (page 11)

The month in review

The economy is stabilising, and this heralds an end to the interest rate easing cycle, provided we do not see further global turmoil. Housing data and net migration are gathering momentum, but building consents are still to rise.

The real estate market's equivalent of baker's yeast.

Unleavened growth in the mortgage market.

The central ba(n)kers serve us a doughnut.

- > **REINZ housing data – May.** The latest data reinforces the theme that has developed over the past few months of recovering momentum off a low base. While house sales fell 13.3 percent in seasonally adjusted terms, this was off a considerable surge of 22.6 percent recorded in April. In level terms, the seasonally adjusted number of house sales was 5,700 in May, over 50 percent above the sales activity in November 2008. Importantly, the median number of days to sell (a key gauge we monitor) fell to 41 days (from 44 days in April). This now only sits a touch above its historical average of 39 days and is a clear sign that underlying support is returning to the market.
- > **Net Migration – April.** Another solid monthly inflow in net migration, with a seasonally adjusted net 2,160 people arriving – representing the largest monthly inflow since January 2004. The rise was driven by less New Zealanders departing. Permanent and long-term (PLT) departures fell by 390 (in seasonally adjusted terms) in the month to 5,370. This is predominately being driven by less people moving to Australia, where PLT departures have fallen to the lowest levels since the end of 2006.
- > **Mortgage Lending – April.** Credit data for April continues to show subdued growth. Lending to households recorded a 0.2 percent monthly gain, following a 0.1 percent rise in the previous month. On a 3-month annualised basis, household credit growth was fairly constant at 3.4 percent, marginally weaker than last month's 3.5 percent increase.
- > **Building Consents – April.** There was an 11.2 percent increase in residential consent issuance in April. Excluding apartment issuance, the increase was slightly more modest, rising 4.5 percent, and remains subdued. Given the lagged relationship between consent issuance and house sales (which is typically around 3-4 months), we would expect further increases in consent issuance over the next few months. It is looking as though a base may be beginning to form but with consents at 1960's low, it's a very low base to begin with.
- > **RBNZ Monetary Policy Statement - June.** The RBNZ left the OCR unchanged at 2.50 percent. While highlighting some of the positives emerging around the globe and the expectation of the NZ economy returning to forward momentum later this year, any recovery is likely to be "slow and fragile". There was significant emphasis on the risks remaining to the downside, though the RBNZ noted some upside risks as well from net migration and a rebound in the housing market.

Assessment

Migration is now a key focal point. The latest data reported a net inflow of migrants, with some evidence of a pick up in ex-pat New Zealanders returning home, although this is not a major trend yet. Nevertheless, the Reserve Bank alluded to the rise in migration as one of the reasons to leave the OCR constant at the latest *Monetary Policy Statement*. However, while encouraged in certain aspects such as migration and housing, the RBNZ do not expect the recent momentum in household spending and the housing market to be sustained given the outlook for employment, farm incomes and high household debt. These are key judgments, but ones we concur with.

Property gauges

Improving home affordability, migration gains and lower mortgage rates continue to underpin the housing market. Building consents is an obvious laggard but the latest data has reported a modest improvement – albeit off a very low base.

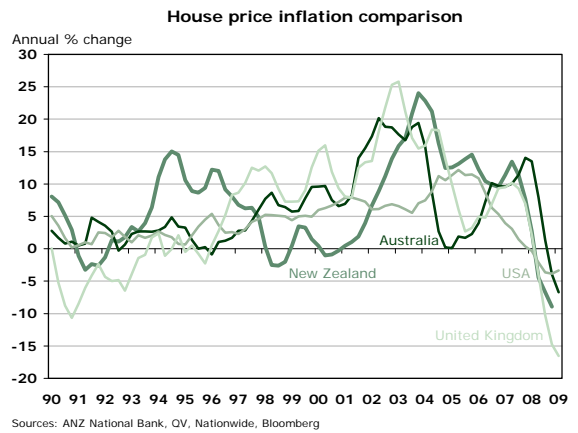
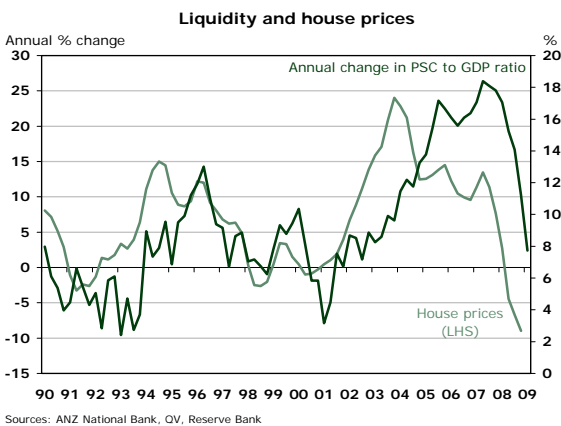
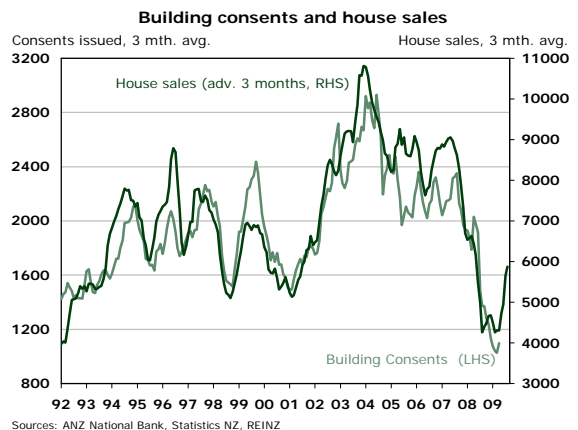
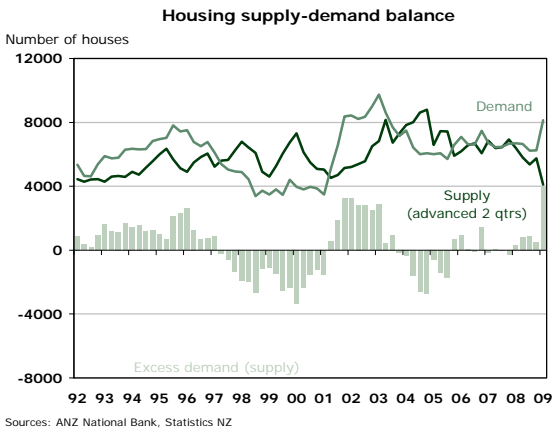
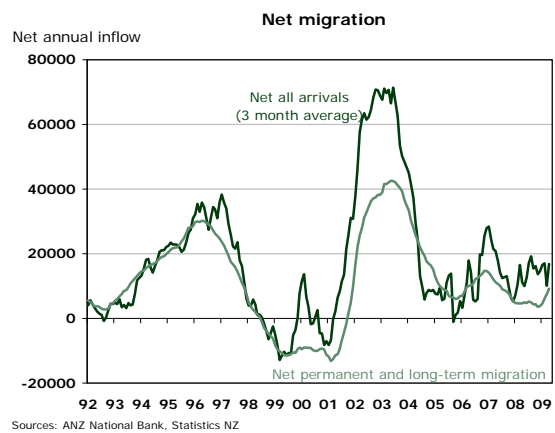
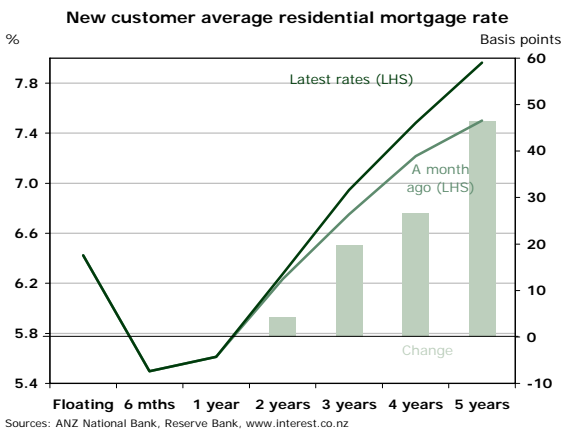
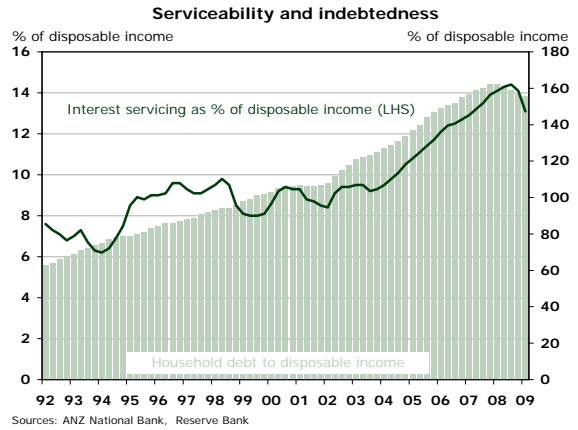
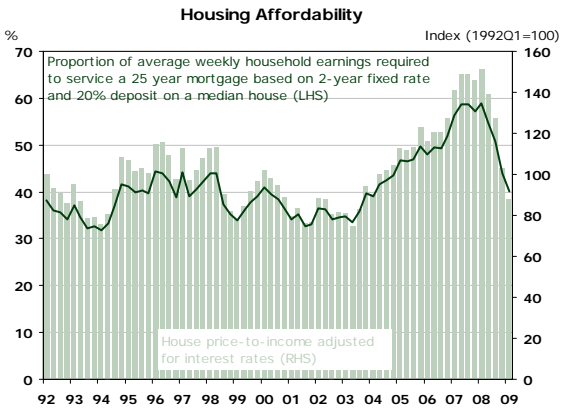
We use eight gauges to assess the state of the property market and whether warning signs are emerging.

- > **Affordability.** For new entrants into the housing market, we measure affordability using the ratio of house prices-to-income (adjusted for interest rates), and mortgage payments as a proportion of income.
- > **Serviceability / indebtedness.** For existing homeowners, serviceability relates interest payments to income, while indebtedness is measured as the level of debt relative to income.
- > **Interest rates.** Interest rates affect both the affordability of new houses and the serviceability of existing mortgage payments.
- > **Migration.** A key source of demand for new housing.
- > **Supply-demand balance.** We use dwelling consents issuance to proxy supply. Demand is derived via the natural growth rate in the population, net migration, and the average household size.
- > **Consents and house sales.** These are both key gauges of activity in the property market.
- > **Liquidity.** We look at growth in Private Sector Credit relative to GDP to assess the availability of credit in supporting the property market.
- > **Globalisation.** We look at relative property price movements between New Zealand, the US, UK and Australia in recognition of the important role that globalisation is playing in NZ's property cycle.

On an annual basis, net migration has risen to 9,176 people, more than double the level a year ago. Moreover, on a three-month annualised basis, net migration has surged, to be up just over 22,000. Obviously if sustained, this level of net migration will provide a welcome boost to domestic demand and the housing market, although the economic impetus will be less than if it had been driven solely by more arrivals.

Several of the property market indicators are on a "roll". (no bun intended)

Indicator	Level	Direction for prices	Comment
Affordability	Improving	↔	Mortgage rate cuts have resulted in an improvement in housing affordability. The big uncertainty remains job security.
Serviceability / indebtedness	Turned	↓	Debt serviceability is following an improvement in affordability, but has a way to go yet.
Interest rates	Bottomed?	↔/↓	The recent falls in mortgage rates have provided a kick start to real estate activity but rates are now rising.
Migration	On the up	↑	Improvement in net migration looks poised to provide some support, although this has been due to less NZers leaving.
Supply-demand balance	Unbalanced	↔/↑	Skewed in one direction.
Consents and house sales	A base forming?	↔/↑	House sales are on the up, leaving building consents behind.
Liquidity	Slowing	↓	The slowdown is taking a long time to be reflected in the data.
Globalisation	Pounded	↓	After some vigorous kneading, global house prices will "need" plenty of time to rise to the desired level.
On balance		↓	Is there enough rising agent in the latest batch of house market dough? Correction is still yet to fully pan out.



Economic backdrop

A recovery in housing market activity has been evident over recent months and net migration has become an increasingly positive factor. But the path ahead remains littered with several large obstacles. None more so than the recent strengthening of the Kiwi dollar, which is undermining the export and rural sectors, coinciding with a depressed global backdrop.

Our core economic view

Business confidence has returned to positive territory, and strong net migration gains could yet provide the economy with a much needed lift. However, we remain coy over extending this exuberance too far. The data relating to the domestic sector may be encouraging, but prospects for the tradable sector look anything but. With the global backdrop still weak and the NZ dollar remaining above post-float averages, the tradable sector is unlikely to provide the engine of growth for the economy. Like us, the Reserve Bank is not buying into the "green shoots" hype. In the Bank's prognosis of the current economic environment, reported in last week's *Monetary Policy Statement (MPS)*, the Bank still sees downside risks to activity and inflation, and there was no mention at all of "green shoots". The Governor did identify some clear upside opportunities for activity, with the biggest source of potential upside being the turnaround in migration. The word "migration" got a mention nine times in the *Statement*.

The RBNZ reiterated that they expect to keep the Official Cash Rate low through to late 2010 and the door remains well open to further cuts. The pick-up in the housing market, which was also mentioned extensively in the *MPS*, is coming off historical lows and current housing turnover levels remain below average. But to be sure, the general populace appear to have taken on a generally upbeat (or should we say less dire) economic outlook, and this has fed the recovery in the real estate market over recent months. The property market looks to be moving beyond merely stabilising, with activity picking up, days to sell falling, and house price declines drying-up. We note that the rejuvenation in the housing market is yet to rub off on retail spending, which remains weak despite tax cuts. We aren't expecting a dramatic recovery and stabilisation is unlikely to be across the board. The de-leveraging environment, higher unemployment and rising longer-term fixed rate mortgages will be a true test for the housing market over winter.

A recovery in business and consumer confidence is a welcome development. Whether this will be sustained in the coming months is the big question. Households and businesses may be bearing the brunt of the global recession at present, but the effects from a lower dairy payout and its associated multiplier effect, alongside any adverse impact of swine flu on the tourism sector, are yet to be felt. These are the 2009 stories, where heartland NZ will see the flow-on consequences. Spending in rural regions has been more sluggish compared to their urban counterparts of late, and this is prior to the reduced Fonterra forecast payout. With the rural wallet firmly shut, we can expect rural economies to feel the effect soon. The high NZ dollar is doing our manufacturing sector no favours. But it may be some time before this shows up in the economic data. Unemployment is rising – rapidly. For the next few months, we can continue to expect further evidence of stabilisation and the green shoots growing taller. It's only natural after an extended period of weakness that leads to pent-up demand being accumulated. But as we head into winter, we just have to watch out for frost. Key areas to watch include unemployment, the global scene and land prices.

Further baking could be required, even after the oven timer has gone off.

Will it land butter-side up or butter-side down?

Mortgage borrowing strategy

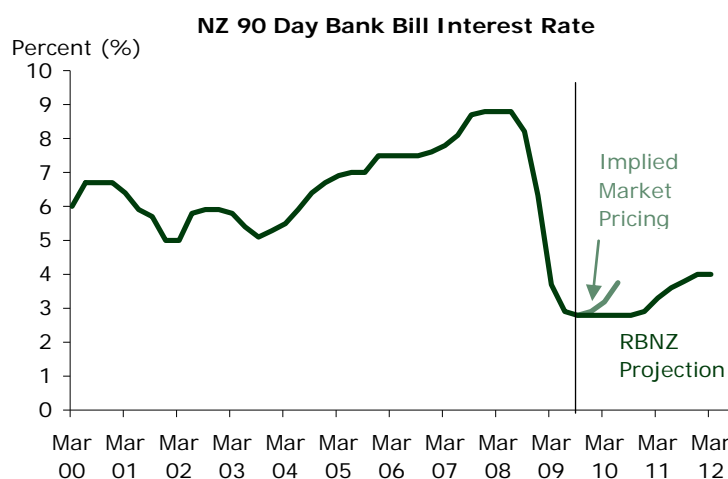
Our favoured strategies remain unchanged from last month. The Reserve Bank remains committed to keeping the OCR low, although wholesale markets continue to price in rising interest rates. This tension, intertwined with high deposit rates, could take some time to resolve and is expected to see the yield curve continue to steepen. In this environment we continue to favour being patient and take advantage of low 6 month and 1 year fixed rates.

Our view

Mortgage borrowing rates continue to be influenced by contrasting forces. At one extreme we have continued upwards pressure on deposit rates, and the longer the term, the higher the rate required, which is manifesting in a steep yield curve. On the same side we have wholesale interest rates (or expectations of what the RBNZ is going to be doing in the future) that are now pricing in a pretty aggressive rise in rates over 2010. At the other end we have the Reserve Bank reinforcing its lower for longer message regarding the Official Cash Rate (OCR).

These forces are leading to a lot of tension within the mortgage market, most notably pressure on the curve to continue to steepen. That is, long-term rates rising more than short-term rates. Looking forward, we expect such pressure to remain.

Our core economic view remains unchanged on last month. We broadly concur with the RBNZ in terms of their outlook for the economy, where they note, "it is likely to be some time before the recovery becomes self sustaining and monetary policy support can be withdrawn". Hence, the market, which is pricing in the OCR headed towards 4 percent over 2010 looks to be getting ahead of itself. Assuming the Reserve Bank is correct, we'd expect such pressure to dissipate, which should assist short-term borrowing rates. But it is deposit rates that are more influential on lending rates at present, particularly longer-dated rates, and we struggle to see this easing any time soon.



Last month we introduced the concept of break-even analysis. To refresh, in the context of mortgage rates, it is the calculation of a set of future mortgage rates that are mathematically implied by the set of current interest

rates. In terms of the table below, the current set of mortgage rates implies that the one year fixed rates will rise from 5.50 percent to 5.96 percent in six months, and then to 7.00 percent six months after that. If you choose to fix for two years at 6.25 percent, instead of one year at 5.50 percent, you are basically saying that you expect the one year rate to rise to 7 percent in one year's time.

Fixed Mortgage Rate		Break-evens			
Term	Current	in 6mths	in 1year	in 18mths	in 2years
6 months	5.45%	5.55%	6.37%	7.63%	8.10%
1 year	5.50%	5.96%	7.00%	7.87%	8.47%
18 months	5.79%	6.52%	7.37%	8.19%	8.57%
2 years	6.25%	6.91%	7.74%	8.34%	8.75%
3 years	6.99%	7.54%	8.17%	8.72%	9.15%
4 years	7.50%	8.03%	8.61%		
5 years	7.99%				

All breakeven rates are higher than current rates, so the decision for borrowers is really about making the most of near-term cash-advantages, whilst remaining mindful of not giving it all back (and then some) a few years down the track.

However, given the magnitude of the rises in the break-evens, it's still hard to go against the spirit and benefit of keeping borrowing short-term, a simple strategy in a steep yield curve environment.

The obvious risk is that rates could rise markedly down the track. To that we have two responses:

- > Rates do not only need to rise, they need to rise markedly, as detailed in the break-evens.
- > We need to appreciate the strategy that the Reserve Bank is trying to employ, which is two-fold. Firstly, they want to continue providing monetary support to the economy, and the way they maximise this is to get short-term rates down in the current environment. Second, they are wary of the monetary policy transmission channel to the economy. It seems perverse, but if a greater proportion of borrowers are benefiting from being on a short-term rate, then monetary policy will of course have far more effectiveness when the tightening cycle starts. This will actually reduce pressure on the Reserve Bank to hike so aggressively.

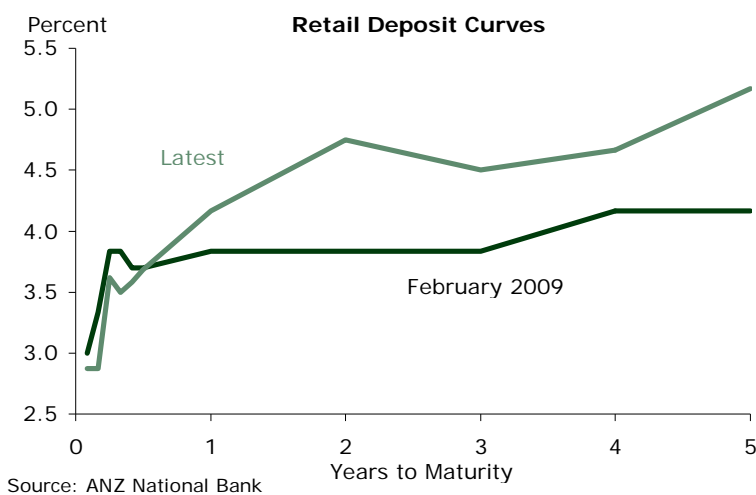
Feature comment – Deposit focus

The implications of rising deposit rates are wider than simply putting upwards pressure on borrowing rates. They are also symptomatic of a wider rebalancing process for the economy, namely the structural shift away from spending towards saving. This is a dynamic which we expect will delay the long hoped for recovery in house prices.

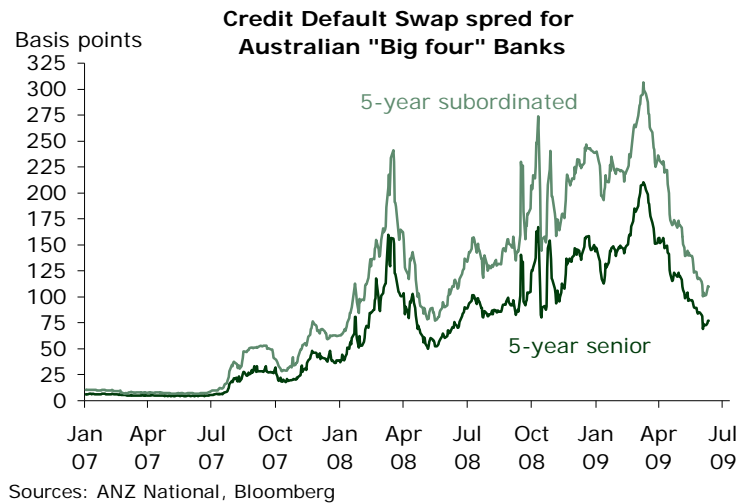
Overview

When people talk about interest rates, attention naturally turns to either the Official Cash Rate (OCR) or actual borrowing rates, and normally one follows from the other.

Yet the wider interest rate story at present is being driven by deposit rates and we all know they have moved up massively of late, as have longer-term borrowing rates. This is despite the Reserve Bank cutting the OCR in April.



Reasons for the rises in deposit rates are varied. At one extreme we have seen a structural shift around the globe in the pricing of risk, which is shifting the pendulum away from borrowers towards savers. The latter now hold the balance of power. Higher offshore funding costs (including the cost of the Government guarantee) means banks have started to find it cheaper to chase funds domestically as opposed to offshore. That is, if it was costing in some instances 200 basis points above the wholesale interest rate curve to borrow overseas for term money, then there was effectively an arbitrage available whereby financial intermediaries were incentivised to offer up to this amount in order to attract deposits locally. Of course, in reality it's not exactly that simple, but in practice this is how things have basically been operating.



Of course, offshore funding pressure has now started to ease (although part of this reflects the positive impact of having a Government guarantee, which still needs to be paid!), which is naturally leading to questions about a lower cost of funds, leading to the potential for borrowing rates to fall.

That is complicated by five aspects:

- > The level remains high, with credit default swap spreads for the "Big four" Australian banks currently around 80bps, which is still well above pre-crisis levels. In the current global market it is fair to say some nervousness still surrounds whether the financial crisis has completely passed. As noted above, this excludes Government guarantee fees, and the imposition of the guarantee is one reason spreads have narrowed.
- > New Zealand is already overly reliant on offshore capital, so we cannot continue to borrow offshore willy-nilly, even if it is getting cheaper relative to recent extremes seen. The prudent thing to do is in fact fund domestically. As the Reserve Bank noted in their May *Financial Stability Report*, "...debt levels are high in New Zealand, and there is significant reliance on offshore financing. Following an extended period of large current account deficits, net international liabilities had increased to more than 90 percent of GDP by the end of 2008... ...the scale of New Zealand's external debt liabilities implies significant exposure to developments in international capital markets."
- > There is intense competition for cash domestically from other areas including corporate issuance.
- > Retail investors target nominal as opposed to real returns. A year ago 90-day, 1 and 2 year deposit rates sat around 6.5 to 8 percent. Annual inflation was 5 percent. Now, 90-day, 1 and 2 year rates sit at 4 to 5.5 percent, and the Reserve Bank's latest projections had headline inflation falling to 1 percent in 2009. Investors are actually better off in a real sense under the latter scenario, but this is certainly not the perception with expectations driven by nominal yields as opposed to being driven by real expectations.
- > There is the "cricket" syndrome when it comes to investors' expected returns. The ball has to go over the fence as opposed to being

prepared to build an innings in singles. Talk to any overseas investor and they will tell you that 3 to 5 percent real return is money for jam. Not so in NZ, where investors have become conditioned to double-digit stuff, and most of it related to the housing market. Given this combination, there is still continued pressure to secure deposits (from a limited national savings pool) and hence continued pressure on deposit rates to move up. This then has flow-on pressure to borrowing rates.

It's not our job to defend banks (thankfully we maintain independence in Economics, so our releases are not vetted) so we'll leave that part of the discussion there. What we believe is more relevant is the relative signal that rising deposit rates are sending about the outlook for the economy. It is at this juncture that people are missing the point about what interest rates are telling us. A key theme underpinning our macroeconomic view is one of rebalancing. That is, the reallocation of resources and the focus of growth away from a model of debt fuelled consumption and towards export and earnings centric growth. Rising deposit rates – as a relative price mechanism encouraging saving for tomorrow as opposed to spending for today – are merely reflective of that process. When there is a limited pool of something such as savings, Economics 101 tells us that the price has to go up, which is precisely what is happening.

It's all a part of getting the current account deficit down, and reducing New Zealander's debt burden. As far as interest rates go, the most important benchmark we check each day in terms of testing our macroeconomic assessment are deposit rates. The more intense the pressure we see across deposits, then the more we become convinced that a de-leveraging dynamic – a critical part of improving New Zealand's poor current account position and increasing national savings – is taking hold.

In this sort of macro environment it's difficult to paint an overly optimistic view of general asset prices over the coming year at least, and we all know that the historical experience when it comes to housing is 4 to 5 years of boom followed by four years of weakness or consolidation. For sure, areas such as migration are issues providing support and stimulus. But time and time again we keep going back to the major driver of house prices, and it is credit, or the intermediation from running a huge current account deficit over the past decades.

Yet we also need to think over the medium-term here. Assuming New Zealand is no longer allowed to run excessive current account deficits (i.e. moving beyond the cycle), and the ratio of household debt to income is no longer set to continue rising, then not only is the cyclical outlook for the housing market different. We also have to ask how we can expect house prices to perform on average over the cycle. That is, don't think about house price gains double that of income growth. This is the major "change" investors need to accept. Action and changes when it comes to deposit rates, with competition fierce for a limited pool of savings, are simply telling us that this dynamic is starting to take hold.

This doesn't make us property "bears", but we are simply realists in terms of informing people of some of the big picture issues developing and unfolding. We urge a bit of patience. Adjustments, whether they be corrective or a case of rebalancing, always take time to play out.

Statistical Annex

Weekly mortgage repayments table (based on 25-year term)

Mortgage Size (\$'000)	Mortgage Rate (%)													
	5.00	5.25	5.50	5.75	6.00	6.25	6.50	6.75	7.00	7.25	7.50	7.75	8.00	8.25
100	135	138	142	145	149	152	156	159	163	167	170	174	178	182
150	202	207	212	218	223	228	234	239	244	250	256	261	267	273
200	270	276	283	290	297	304	311	319	326	333	341	348	356	364
250	337	345	354	363	371	380	389	398	407	417	426	435	445	455
300	404	415	425	435	446	456	467	478	489	500	511	522	534	545
350	472	484	496	508	520	532	545	558	570	583	596	610	623	636
400	539	553	566	580	594	608	623	637	652	667	682	697	712	727
450	607	622	637	653	669	684	701	717	733	750	767	784	801	818
500	674	691	708	725	743	761	778	797	815	833	852	871	890	909
550	741	760	779	798	817	837	856	876	896	917	937	958	979	1000
600	809	829	850	870	891	913	934	956	978	1000	1022	1045	1068	1091
650	876	898	920	943	966	989	1012	1036	1059	1083	1108	1132	1157	1182
700	944	967	991	1015	1040	1065	1090	1115	1141	1167	1193	1219	1246	1273
750	1011	1036	1062	1088	1114	1141	1168	1195	1222	1250	1278	1306	1335	1364
800	1078	1105	1133	1160	1188	1217	1246	1274	1304	1333	1363	1393	1424	1454
850	1146	1174	1204	1233	1263	1293	1323	1354	1385	1417	1448	1480	1513	1545
900	1213	1244	1274	1306	1337	1369	1401	1434	1467	1500	1534	1567	1602	1636
950	1281	1313	1345	1378	1411	1445	1479	1513	1548	1583	1619	1655	1691	1727
1000	1348	1382	1416	1451	1486	1521	1557	1593	1630	1667	1704	1742	1780	1818

Housing market indicators for May 2009 (based on REINZ data)

	House prices (Ann % change)	3mth % chng	No of sales (s.a.)	Mthly % chng	Avg days to sell (s.a.)	Comment
Northland	-1.1	1.7	155	(+4%)	65	House sales rise the fastest, to hit a 15-month high
Auckland	0.6	2.8	1,967	(-11%)	36	First positive annual price growth since January 2008
Waikato/BOP/Gisborne	0.6	1.5	833	(-9%)	52	Joint strongest growth in house prices over the past year
Hawke's Bay	-2.0	0.5	226	(-6%)	54	Median time to sell a house improves to a 12-month low
Taranaki	-8.4	0.3	174	(-1%)	46	A drop but still the 2nd highest level of sales in 15 mths
Manawatu-Wanganui	-2.0	-1.3	318	(+1%)	51	One of only two regions to record a rise in sale numbers
Wellington	-2.1	1.4	612	(-9%)	39	Sale price below a year ago but at an 11-month high
Nelson-Marlborough	-2.0	3.6	241	(-4%)	46	Recent house price growth above the NZ benchmark
Canterbury/Westland	-3.7	-0.5	886	(-11%)	42	Joint largest drop in the number of house sales
Otago	-8.3	1.2	213	(-11%)	33	Quickest time to sell a house returns to Otago
Central Otago Lakes	-12.8	-3.6	84	(-7%)	76	Double whammy: greatest time to sell and drop in prices
Southland	-10.0	6.0	157	(-4%)	39	Strongest rate of price growth over the past 3 months
NEW ZEALAND	-2.2	2.9	5,700	(-13%)	41	House sales ease but underlying strength remains

Key forecasts

Economic indicators	Actual			Forecast						
	Sep 08	Dec 08	Mar 09	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
GDP (Ann Avg % Chg)	1.7	0.3	-1.0(e)	-2.1	-2.8	-2.8	-2.0	-0.8	0.8	2.4
CPI Inflation (%)	5.1	3.4	3.0	2.1	1.1	2.2	2.4	2.2	2.3	2.3
Unemployment Rate (%)	4.3	4.7	5.0	5.6	6.4	7.0	7.5	7.7	7.9	7.8
Interest rates	Actual			Forecast (end month)						
	Apr 09	May 09	Latest	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10
Official Cash Rate	3.0	2.5	2.5	2.50	2.50	2.50	2.50	2.50	2.50	2.75
90-Day Bank Bill Rate	3.1	2.8	2.8	2.7	2.8	2.8	2.8	2.8	2.8	3.2
Floating Mortgage Rate	6.4	6.4	6.4	6.4	6.0	6.0	6.0	6.0	6.0	6.3
1-Yr Fixed Mortgage Rate	5.8	5.6	5.6	5.6	5.8	5.9	5.9	5.9	5.9	6.1
2-Yr Fixed Mortgage Rate	6.3	6.3	6.3	6.3	6.3	6.4	6.5	6.6	6.7	6.8
5-Yr Fixed Mortgage Rate	7.5	7.7	8.0	8.0	8.0	8.0	8.0	8.0	8.1	8.1

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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