



NEW ZEALAND ECONOMICS NBNZ PROPERTY FOCUS

JUNE 2010

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KICK OFF

SUMMARY

Our monthly *Property Focus* publication is aimed at providing an independent appraisal of recent developments in the property market. With the RBNZ having begun to remove policy stimulus, we examine what is likely to happen to mortgage rates paid by borrowers over the next few years.

THE MONTH IN REVIEW

The RBNZ has begun the long journey of taking interest rates back to a more neutral or average setting. While few want interest rates to move up (apart from savers), early moves are merely removing support as opposed to touching on the brakes. The gradual removal of policy support is necessary as the economy moves from the recovery phase towards a durable upswing.

PROPERTY GAUGES

Our property gauges still suggest downward pressure on house prices.

ECONOMIC BACKDROP

Momentum across the economy is strengthening faster than we were anticipating a month ago – although this is not apparent in the housing market. With the strengthening outlook has come an earlier rise in the OCR, but we still envisage a gradual path from this juncture. We continue to believe structural dynamics will temper the magnitude of the economic upswing relative to history, and that the housing market is in the midst of a multi-year adjustment process.

MORTGAGE BORROWING STRATEGY

Some but not all mortgage rates have increased since the RBNZ's decision to raise the OCR by 0.25 percent at the June Monetary Policy Statement (MPS). Looking ahead, mortgage rates are likely to rise further, particularly the floating rates and shorter fixed terms. However, this is not cause for panic. As we argued in last month's edition, fixing now may make sense for some borrowers, especially those who place a high value on certainty. However, given the cost difference between fixed and floating rates, and the implications one can draw from the term structure of rates, we remain of the view that those who can afford to stay floating ought to consider doing so.

FEATURE ARTICLE – EFFECTIVE MORTGAGE RATE UPDATE

With the RBNZ starting to remove policy stimulus, the effective mortgage rate facing households is set to rise. Given the greater proportion of mortgages on floating and the steep mortgage curve, the RBNZ will have a greater impact on the effective mortgage rate compared to previous cycles. However, household behaviour in the form of staying floating versus fixed, and the extent of the OCR pass-through into mortgage rates, is set to have a greater influence on the RBNZ's policy outlook.

THE MONTH IN REVIEW

The RBNZ has begun the long journey of taking interest rates back to a more neutral or average setting. While few want interest rates to move up (apart from savers), early moves are merely removing support as opposed to touching on the brakes. The gradual removal of policy support is necessary as the economy moves from the recovery phase towards a durable upswing.

RBNZ – JUNE MONETARY POLICY STATEMENT

The RBNZ lifted the Official Cash Rate by 25 basis points on June 10th as expected. While further moves can be expected from here, the overall path for rates is dependent on three critical conditions: 1. Whether the temporary increase in inflation filters into second round effects (i.e. workers demand wage compensation). 2. Whether households and business continue to de-leverage, or re-leverage (which we define as credit growth above or below the rate of income growth). 3. The global scene. The first two are clear upside risks to interest rate settings in 2011 while the downside risks posed by the global economy have more immediate policy relevance.

REINZ HOUSING DATA – MAY

With the *Budget* being released during May it is likely that uncertainties over potential tax changes have influenced the monthly figures. Nevertheless, details of the May REINZ report were weak. House sales fell by 3.6 percent in seasonally adjusted terms in May and are 8 percent below levels pertaining to the end of last year. After moving down earlier in the year the median days to sell has been climbing in recent months and reached 43 days in May, the highest since early 2009. Prices continue to trend down from late 2009 levels, with the REINZ housing price index falling by a seasonally adjusted 1.5 percent in May (+2.3 percent y/y). Median dwelling prices also fell (-1.1 percent m/m, +3.7 percent y/y). Section prices are down 17 percent from their peak.

RBNZ MORTGAGE LENDING – APRIL

Household credit growth (which includes housing and consumer lending) held steady at 0.2 percent in the month. Compared to a year ago, household credit growth is 2.7 percent higher. Mortgage lending growth also increased by 0.2 percent in the month.

SNZ MIGRATION - MAY

On a seasonally adjusted basis, permanent and long-term (PLT) arrivals exceeded departures by 250 persons in May 2010, following a net inflow of 730 persons in April. This was the lowest monthly inflow since November 2008, and was driven by lower arrivals and a continuing pick-up in departures. Over the last few months annualised net PLT immigration has eased from over 20,000 persons to just under 8,000.

ASSESSMENT

The RBNZ's decision took centre stage earlier in the month and the key issue is where to from here. Rates will move up, just as night follows day. But we need to remember the starting position (rates being exceptionally low) and the reality that higher rates are a reflection of an improving economy, most notably the labour market. We've pencilled in a series of hikes into our forecasts over the coming months but a pause in Q4. In part this reflects our caution towards the global scene but also the realisation that the economy is undergoing considerable structural change and it is hard to be overly nervous about where rates could go given softness in the housing market at present. Put simply we don't believe the market is strong enough to sustain the huge push higher in rates that some are speculating.

PROPERTY GAUGES

Our property gauges still suggest downward pressure on house prices.

We use ten gauges to assess the state of the property market, and for signs that changes 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.

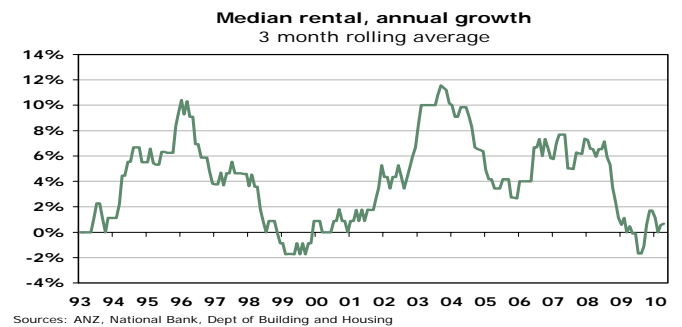
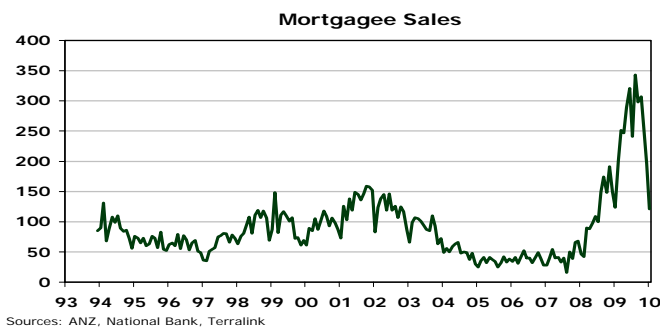
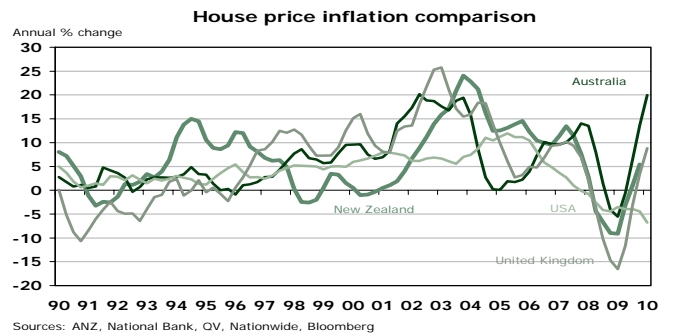
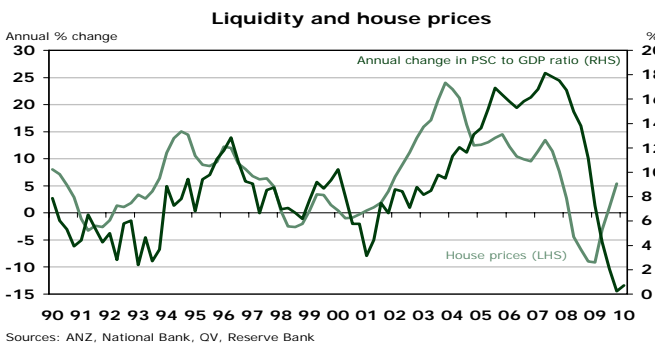
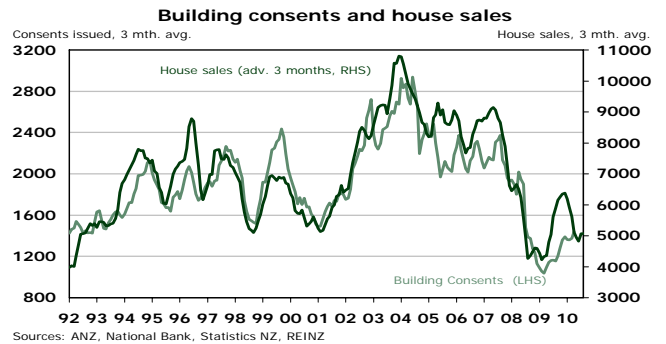
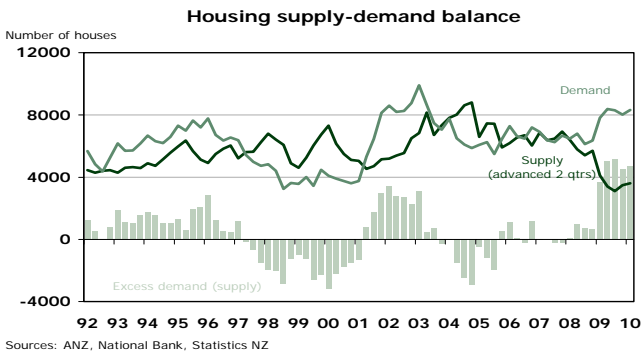
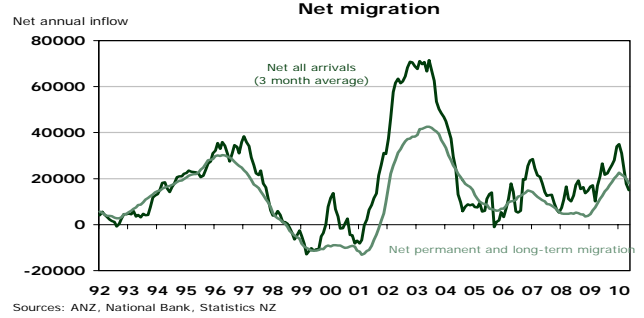
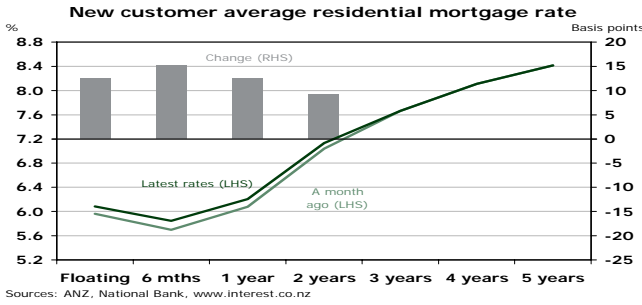
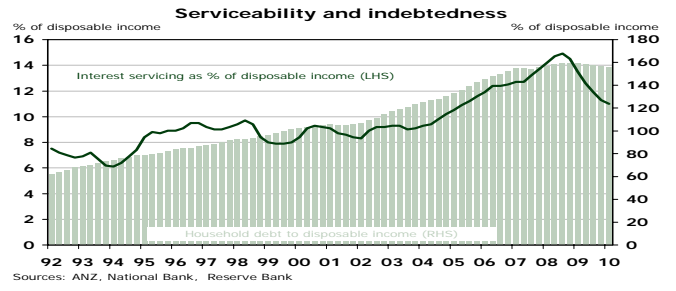
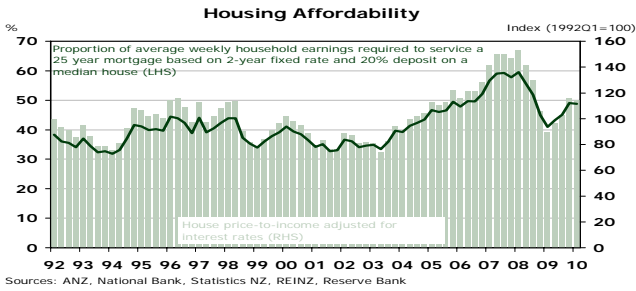
GLOBALISATION. We look at relative property price movements between New Zealand, the US, UK and Australia in recognition of the important role that globalisation is playing in NZ's property cycle.

MORTGAGEE SALES. We look at how mortgagee sales are tracking for an indication of distress in the property market.

RENTAL GROWTH. We look at growth in the median market rent as an indication of whether it is a better time to buy versus rent, and how rental yields are shaping up for the property investor.

| Indicator | Level | Direction for prices | Comment |
|-------------------------------|-----------------|----------------------|---|
| Affordability | Slipping | ↓ | Rising interest rates have dented affordability. |
| Serviceability / indebtedness | Easing | ↓ | Borrowers continue to pay down debt. |
| Interest rates | Nudging up | ↔/↓ | OCR has started the journey upward. Mortgage rates have moved up as well. |
| Migration | Easing | ↔ | Still a slight inflow although gains are easing fast. |
| Supply-demand balance | Out of kilter | ↔/↑ | A wide excess demand imbalance still prevails. It's relevant but credit and de-leveraging is more dominant at this stage. |
| Consents and house sales | Headwinds ahead | ↔/↑ | House sales still low as uncertainty weighs. Pick-up in consents welcome but still some way to go. |
| Liquidity | Illiquid | ↓ | Demand for credit still subdued. Households continue to de-leverage. |
| Globalisation | Lagging behind | ↔ | The Australian housing market is in a world of its own with 20 percent growth. US house prices are still struggling. |
| Mortgagee sales | Falling | ↔ | Big drop in mortgagee sales suggest less desperate sellers out there. |
| Median rent | Still flat | ↔ | No signs of any upward pressure on rents at present. |
| On balance | | ↔/↓ | Supply-demand dynamics are positive but NZ is taking the opportunity to get its house (i.e. balance sheet) in order. How long this continues will be one factor influencing how quickly interest rates will rise. |

PROPERTY GAUGES



ECONOMIC BACKDROP

Momentum across the economy is strengthening faster than we were anticipating a month ago – although this is not apparent in the housing market. With the strengthening outlook has come an earlier rise in the OCR, but we still envisage a gradual path from this juncture. We continue to believe structural dynamics will temper the magnitude of the economic upswing relative to history, and that the housing market is in the midst of a multi-year adjustment process.

OUR CORE ECONOMIC VIEW

We are continuing to take heart from what we are seeing across the economy. At one extreme the economy has received a barrage of good news over the past month. Export prices are at record highs and the terms of trade are rising. The dairy payout for 2010/11 looks on track to exceed \$7 per kg of milk solids, demand out of Asia for sectors such as forestry remains strong and manufacturing activity is on the up with Australia taking a huge proportion of our upper end non-commodity exports. At the other extreme, retailing and the housing market remains weak, with the commercial property market treading water. This combination is sufficient to give the economy reasonable momentum but all sectors are not sharing in the recovery process equally.

At the same time we need to be mindful of global risks. Sovereign risk concerns continue to percolate. We won't go into detail but leave readers with two simple observations. You don't get out of a financial crisis in 18 months and those with an excessive amount of debt remain the weak gazelles the market continues to pick off. The gazelles in the first instance were banks, but this has now moved to sovereigns.

Beyond the global picture, we continue to watch the local mix to growth. And in that regard we like what we are seeing. Growth is earning centric as opposed to spending dominated. Credit growth remains weak and well below the rate of income growth which tells us the economy is de-leveraging, with households and firms seeking to improve balance sheet positions. This is a critical part of ensuring the upswing has legs as opposed to becoming a flash-in-the-pan affair. The income boost provided by recovering global demand, stronger commodity prices and a booming terms of trade will filter through to the domestic economy. But this looks more like a 2011 theme.

Housing remains the economic laggard. This is out of sorts with historical **cyclical** recoveries but reflects the **structural** dynamic that is having a huge bearing on this economic cycle: the economy needs to de-leverage and the opportunity cost of deleveraging is growth. As the Governor of the RBNZ noted last week, "We believe New Zealanders have decided they are over-exposed to property assets and to high debt, and they are prepared to constrain consumption to improve their savings. The question is how much rebalancing they contemplate, and for how long." In fact the RBNZ's June Monetary Policy Statement was relatively firm in regard to what needs to occur, noting that their core forecast assumed the household sector continued to deleverage (read: credit growth remains below income growth). An implication from this was a preparedness to use the interest rate lever if this doesn't occur. The RBNZ has already started the journey taking interest rates higher but that can take place gradually or quickly. This will of course present challenges to the property market but needs to be read in conjunction with positives including tax cuts, improving economic momentum and a stronger labour market.

The million dollar question for the housing market is what does activity look like if credit is not the key driver? Property bulls point to demand-supply imbalances with building consent issuance insufficient to cover natural growth in the population. We think the supply-demand situation is somewhat exaggerated but agree with the general spirit. While the looming shortage of dwellings will be influential, it will not be the dominating influence over the next year or two. In our view, the rise in household debt from 60 to 160 percent of income over the past few decades has been the primary driver of house prices (and falling rental yields), which has enabled house prices to grow in excess of income growth or nominal GDP. There is going to be an obvious tension going forward.

How do we get a supply-side response without necessitating higher house prices and much higher interest rates? This seems like an oxymoron since more supply should dampen prices, but house prices tend to move in line with measures of housing activity. The past month has seen tax regime changes, global credit jitters and the RBNZ wave the stick about the need for New Zealanders (i.e. households) to save more. All will present near-term challenges but if tackled effectively will set the foundations for a more robust future.

Whichever way you cut it, the endgame for the property market seems clear: yields and cash-flow need to go up.

MORTGAGE BORROWING STRATEGY

Some but not all mortgage rates have increased since the RBNZ's decision to raise the OCR by 0.25 percent earlier this month. Looking ahead, mortgage rates are likely to rise further, particularly the floating rates and shorter fixed terms. The curve will flatten. However, this is not cause for panic. As we argued in last month's edition, fixing now may make sense for some borrowers, especially those who place a high value on certainty. However, given the cost difference between fixed and floating rates, and the implications one can draw from the term structure of rates, we remain of the view that those who can afford to stay floating and favouring short term rates ought to consider doing so.

OUR VIEW

With some mortgage rates now on the rise, many borrowers will be wondering if this is the end of the golden weather. To be sure, this winter has been a severe one. And even though we do expect mortgage rates to continue rising for some time, it's not all bad news. We say this for two main reasons. First, it's worth reiterating that floating mortgage rates fell to a 45 year low and stayed there for much longer than many people thought likely. Not only has this delivered enormous savings to a lot of people, but as we argue later, it has led to radical changes in borrower behaviour. Second, while rates are heading higher, they should do so gradually, and in a limited fashion, ironically in part due to some of the behavioural changes. For many the considerations will be the same as they always have been – i.e. choosing between fixed and floating, and then selecting a term. Fixing will provide certainty, but breakevens remain high, suggesting that mortgage rates need to rise very quickly in order for fixing to be beneficial from a purely financial viewpoint. For example, as was the case last month, if you are thinking of fixing for 2 years at 7.20%, you could compare that against, say, fixing for 6 months now, and then looking to fix again in 6 months for 18 months. So long as the 18 month rate is 7.57% or less in 6 months (and it is 6.79% right now), you will be better off fixing for 6 months. Similarly, thinking again about the next 2 years, you could fix for 1 year at 6.45%, and then fix again for 1 year in 1 year. So long as you could re-fix at 7.95% or less, you'd be better off fixing for just 1 year.

| Mortgage Rates | | Breakevens | | | |
|----------------|---------|------------|--------|-----------|----------|
| Term | Current | in 6mths | in 1yr | in 18mths | in 2 yrs |
| Floating | 5.99% | | | | |
| 6 months | 6.10% | 6.80% | 7.47% | 8.43% | 8.68% |
| 1 year | 6.45% | 7.14% | 7.95% | 8.55% | 8.97% |
| 18 months | 6.79% | 7.57% | 8.19% | 8.79% | 9.06% |
| 2 years | 7.20% | 7.84% | 8.46% | 8.90% | 9.20% |
| 3 years | 7.79% | 8.31% | 8.78% | 9.13% | 9.37% |
| 4 years | 8.20% | 8.63% | 9.01% | | |
| 5 years | 8.50% | | | | |

As we hinted at earlier, the very choices borrowers make collectively will have a bearing on how much rates need to rise, and in that regard, these choices can become self-fulfilling. We say self-fulfilling because how much the RBNZ raises rates depends on how borrowers respond. As an extreme, consider the scenario where every mortgage borrower decided to fix today for, say, 3 years. If this occurred and the step up to a 3yr rate proved insufficient to temper domestic demand, the RBNZ may be tempted to raise rates. In theory, this action would have no immediate impact on consumer behaviour because everyone was on a fixed rate. The RBNZ may in turn need to raise the OCR by a lot more so as to have a bigger impact on new borrowers, and on business borrowers who had not fixed. By contrast, consider the other extreme – where every mortgage borrower made a commitment to themselves to stay floating for, say, the next 3 years. If this occurred, and the RBNZ decided to raise the OCR, this would impact all borrowers, potentially necessitating less action overall. We expect things to pan out more in line with the latter scenario. This is because we suspect few borrowers have the appetite to pay a higher fixed rate, particularly while the level of uncertainty surrounding global events, house prices and the job market remain high. **If we're right, the collective response by borrowers should reinforce the RBNZ's assertion (made on several occasions) that the OCR is not likely to rise by as much this cycle.**

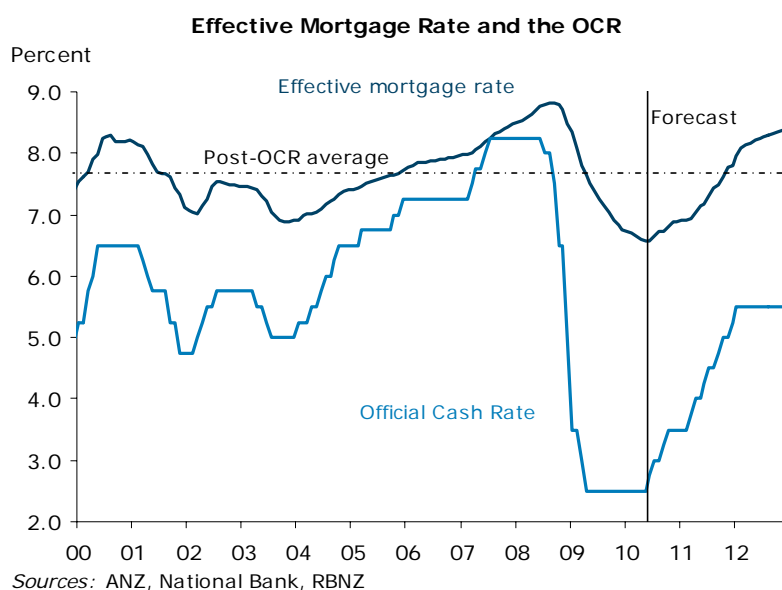
Alternatively we can think about the shape of the yield curve. The curve is set to flatten over the coming months as floating and short-term rates rise. This would normally encourage borrowers to stampede into fixed rates. However, breakevens don't support this. But we'll leave borrowers with another angle, namely deposit rates which are banks' funding costs. If you think 1 year deposit rates are going to end up higher than 5 year deposit rates then by definition the deposit curve will "invert" and the value play will be long term fixed rate mortgages. But we struggle to see the logic in that. Banks need more long-term deposits, and investors expect to be compensated more for a 5 year deposit relative to a 1 year deposit. Borrowers are simply playing the reciprocal trade.

FEATURE ARTICLE - EFFECTIVE MORTGAGE RATE UPDATE

With the RBNZ starting to remove policy stimulus, the effective mortgage rate facing households is set to rise. Given the greater proportion of mortgages on floating and the steep mortgage curve, the RBNZ will have a greater impact on the effective mortgage rate compared to previous cycles. However, household behaviour in the form of staying floating versus fixed, and the extent of the OCR pass-through into mortgage rates, is set to have a greater influence on the RBNZ's policy outlook.

TURNING AROUND

The effective mortgage rate (EMR) facing households has troughed, and is set to rise now that the RBNZ has started to increase interest rates. During the easing cycle, the EMR went from a peak of 8.83 percent in September 2008 to 6.60 percent in April 2010, which is the last available data. We estimate that this will reduce to around 6.57 percent this month, which will mark the low. At present, around 33 percent of mortgage loans by value are on floating rates. We assume that the 25bp increase in the OCR in June will translate into a similarly sized increase in the average floating rate, and will contribute to an immediate 8bp increase in the EMR. **To date, not all of the major banks have moved in response to the OCR increase, and the pass-through when it comes may not be one-for-one.**



In assessing where the EMR will head to going forward, we note the following three points:

- **The mortgage curve will flatten.** However, this is cold comfort to households. Fixed mortgage rates in the three year and above space are above historical average rates, and not many are opting for them as a result. Even the once popular two year rate, at 7.3 percent, is not that far below average levels. With future OCR increases already priced into the mortgage curve, longer term fixed rates will remain largely unchanged, with floating and shorter-fixed rates set to move up, causing the curve to flatten.
- **There is nowhere to hide.** Those rolling off their fixed rate mortgages in the coming weeks and months are coming off a weighted average rate of around 6.8 percent. There is still savings to be had by floating or fixing up to 1-year, but not much. Any window of opportunity for savings is set to shut quickly when the RBNZ delivers another hike in July. We believe getting the entire mortgage curve towards where rates are rolling off (6.8 percent) appears a logical first step for policy. This could be achieved with 3 to 4 hikes.
- **Removing stimulus, not tightening.** Based on our forecast of the OCR heading towards 3.5 percent by October, followed by a pause before a resumption in policy tightening in Q1 next year, the EMR does not reach its average level until late 2011. However, the slope is clearly still far more pronounced than what was seen between 2004 and 2008.

What our estimates show is that despite a much lower starting point, the RBNZ is able to bring the EMR towards average levels fairly quickly. It took the RBNZ around two years to get the EMR from a trough of 6.88 percent at the end of 2003 towards average levels. This time around, it can be done in half that time frame. This reinforces the greater potency that monetary policy has this time around, due to the steep yield curve and the growing proportion of mortgages on floating and short term fixed rates.

Going forward, we will be closely watching two dynamics. The first is household behaviour and the choice between going floating or fixing their mortgages. The latter could deliver more immediate monetary

policy traction, but also poses challenges down the track. The second is the pass-through from a higher OCR to physical borrowing rates. As yet, not all the major banks have passed on the OCR increase to retail mortgage rates. At this juncture, it is not just the OCR itself, but also how competitive the deposit space continues to be which will be influential. Our working assumption is that it remains a competitive market with competition for domestic based funding ensuring deposit rates broadly mirror changes in the OCR, and hence the same for borrowing rates. However, we do suspect the correlation will be less than one-to-one, and this is something the RBNZ will need to take into account in setting the physical OCR.

| | OUTSTANDING MORTGAGE (\$M) * | WEIGHTED AVERAGE RATE (%) | | RATE NOW (%) ^ | POST OCR AVG. (%) |
|----------|------------------------------|---------------------------|----------|----------------|-------------------|
| Floating | 53,761 | 5.80 | Floating | 5.99 | 8.2 |
| <1-yr | 58,991 | 6.85 | 6-mth | 6.10 | 7.4 |
| 1<2-yr | 32,342 | 6.98 | 1-year | 6.45 | 7.5 |
| 2<3-yr | 11,593 | 7.80 | 2-year | 7.20 | 7.7 |
| 3<4-yr | 4,788 | 6.91 | 3-year | 7.79 | 7.9 |
| 4<5-yr | 1,437 | 7.20 | 4-year | 8.20 | 8.0 |
| 5-yr + | 155 | 7.11 | 5-year | 8.50 | 8.1 |

* As at April 2010

^ Current ANZ Rates.

Sources: ANZ, National Bank, RBNZ, www.interest.co.nz

We also note some scare-mongering that floating mortgage rates could go to 9 percent. This is based on the RBNZ's projections of a 6 percent 90-day bank bill rate and existing 3 percent gap between the floating mortgage rates and the 90-day bank bill rate being maintained. The existing 90-day bank – floating mortgage rate spread is symptomatic of higher deposit rates (in part reflecting the RBNZ's new core funding ratio requirement for banks) and market unease as the after-effects of the global financial crisis linger. Despite the OCR moving down there was simply a floor where deposit rates would not move below, otherwise no-one would put their money in the bank! We fully expect to see continued aggressive competition in the deposit market, but deposit rates are unlikely to match upward movements in the OCR one for one. This looks even more likely when we consider banks have pretty well achieved the requirements the RBNZ laid out in the Core Funding Ratio.¹ The global after-effects of the financial crisis will no doubt linger but over time these should settle down. One can debate the relative merits of a higher 90-day bank bill rate (OCR) and the current spread to mortgage rates until the proverbial cows come home. But to assume the spread is going to remain this wide and the OCR is going to need to go to 6 percent just seems a little heroic to us. If spreads are maintained around these sorts of levels then it'll be a reflection of where the global economy resides and of continued dislocation across credit markets. All else being equal this should mean less of a push on the OCR. Our core view involves a halfway house. The OCR moves up gradually, but this is somewhat premised on global healing taking place over a number of years which means the implicit credit risk associated with borrowing comes in.

¹The RBNZ's new Liquidity Policy (BS13) took effect 1st April 2010. The main change was the requirement for banks to maintain a Core Funding Ratio (CFR) of at least 65% initially, rising to 75% over time. In practical terms, this requires banks to fund at least 65% of loans and advances via either retail or long term wholesale funding (i.e. not via short term wholesale funding). This has seen intense competition for retail term deposits and an increase in long term funding activity, placing upward pressure on retail rates and steepening the yield curve, something the RBNZ has explicitly noted may temper the need for the degree of tightening seen in past cycles. For more information on BS13 see <http://www.rbnz.govt.nz/finstab/banking/regulation/3675928.pdf>

KEY FORECASTS

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

| | | Mortgage Rate (%) | | | | | | | | | | | | | |
|------------------------|------|-------------------|------|------|------|------|------|------|------|------|------|------|------|------|------|
| | | 5.75 | 6.00 | 6.25 | 6.50 | 6.75 | 7.00 | 7.25 | 7.50 | 7.75 | 8.00 | 8.25 | 8.50 | 8.75 | 9.00 |
| Mortgage Size (\$'000) | 200 | 290 | 297 | 304 | 311 | 319 | 326 | 333 | 341 | 348 | 356 | 364 | 371 | 379 | 387 |
| | 250 | 363 | 371 | 380 | 389 | 398 | 407 | 417 | 426 | 435 | 445 | 455 | 464 | 474 | 484 |
| | 300 | 435 | 446 | 456 | 467 | 478 | 489 | 500 | 511 | 522 | 534 | 545 | 557 | 569 | 581 |
| | 350 | 508 | 520 | 532 | 545 | 558 | 570 | 583 | 596 | 610 | 623 | 636 | 650 | 664 | 677 |
| | 400 | 580 | 594 | 608 | 623 | 637 | 652 | 667 | 682 | 697 | 712 | 727 | 743 | 758 | 774 |
| | 450 | 653 | 669 | 684 | 701 | 717 | 733 | 750 | 767 | 784 | 801 | 818 | 836 | 853 | 871 |
| | 500 | 725 | 743 | 761 | 778 | 797 | 815 | 833 | 852 | 871 | 890 | 909 | 928 | 948 | 968 |
| | 550 | 798 | 817 | 837 | 856 | 876 | 896 | 917 | 937 | 958 | 979 | 1000 | 1021 | 1043 | 1064 |
| | 600 | 870 | 891 | 913 | 934 | 956 | 978 | 1000 | 1022 | 1045 | 1068 | 1091 | 1114 | 1137 | 1161 |
| | 650 | 943 | 966 | 989 | 1012 | 1036 | 1059 | 1083 | 1108 | 1132 | 1157 | 1182 | 1207 | 1232 | 1258 |
| | 700 | 1015 | 1040 | 1065 | 1090 | 1115 | 1141 | 1167 | 1193 | 1219 | 1246 | 1273 | 1300 | 1327 | 1355 |
| | 750 | 1088 | 1114 | 1141 | 1168 | 1195 | 1222 | 1250 | 1278 | 1306 | 1335 | 1364 | 1393 | 1422 | 1451 |
| | 800 | 1160 | 1188 | 1217 | 1246 | 1274 | 1304 | 1333 | 1363 | 1393 | 1424 | 1454 | 1485 | 1517 | 1548 |
| | 850 | 1233 | 1263 | 1293 | 1323 | 1354 | 1385 | 1417 | 1448 | 1480 | 1513 | 1545 | 1578 | 1611 | 1645 |
| 900 | 1306 | 1337 | 1369 | 1401 | 1434 | 1467 | 1500 | 1534 | 1567 | 1602 | 1636 | 1671 | 1706 | 1742 | |
| 950 | 1378 | 1411 | 1445 | 1479 | 1513 | 1548 | 1583 | 1619 | 1655 | 1691 | 1727 | 1764 | 1801 | 1838 | |
| 1000 | 1451 | 1486 | 1521 | 1557 | 1593 | 1630 | 1667 | 1704 | 1742 | 1780 | 1818 | 1857 | 1896 | 1935 | |

Housing market indicators for May 2010 (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 | 6.4 | 5.7 | 123 | (-26%) | 65 | Biggest drop in sales and takes longest |
| Auckland | 1.1 | -0.1 | 1,764 | (-4%) | 36 | Fastest off the blocks for a sale |
| Waikato/BOP/Gisborne | -1.5 | -1.0 | 675 | (-8%) | 55 | All going in the wrong direction |
| Hawke's Bay | 6.3 | -3.0 | 174 | (+4%) | 46 | Taking longer but at least its selling |
| Taranaki | 2.1 | -0.1 | 224 | (+7%) | 56 | Biggest monthly rise in sales |
| Manawatu-Wanganui | 5.4 | -2.8 | 152 | (+3%) | 53 | Big fall in days to sell |
| Wellington | 1.0 | -0.5 | 535 | (-10%) | 43 | Less selling for lower and taking longer |
| Nelson-Marlborough | -0.2 | -1.1 | 215 | (+5%) | 47 | Sales up two months in a row |
| Canterbury/Westland | 6.8 | -2.3 | 696 | (-6%) | 38 | Days to sell unchanged |
| Otago | 1.3 | 2.7 | 72 | (-20%) | 57 | Second largest slump in sales |
| Central Otago Lakes | 4.4 | -1.2 | 229 | (+3%) | 45 | Sales stabilising but prices falling |
| Southland | 9.3 | 1.2 | 127 | (-7%) | 37 | Biggest annual house price gain |
| NEW ZEALAND | 3.8 | -1.4 | 4,994 | (-4%) | 43 | Sales and prices down |

Key forecasts

| Economic indicators | Actual | | | Forecast | | | | | | |
|--------------------------|--------|--------|--------|----------------------|--------|--------|--------|--------|--------|--------|
| | Jun 09 | Sep 09 | Dec 09 | Mar 10 | Jun 10 | Sep 10 | Dec 10 | Mar 11 | Jun 11 | Sep 11 |
| GDP (Ann Avg % Chg) | -2.2 | -2.3 | -1.6 | -0.4 | 0.8 | 2.0 | 2.6 | 2.9 | 3.3 | 3.4 |
| CPI Inflation (%) | 1.9 | 1.7 | 2.0 | 2.0 | 2.4 | 2.0 | 5.0 | 5.3 | 5.4 | 5.3 |
| Unemployment Rate (%) | 5.9 | 6.5 | 7.1 | 6.0 | 6.3 | 6.0 | 5.6 | 5.4 | 5.0 | 4.8 |
| Interest rates | Actual | | | Forecast (end month) | | | | | | |
| | Apr 10 | May 10 | Latest | Sep 10 | Dec 10 | Mar 11 | Jun 11 | Sep 11 | Dec 11 | Mar 12 |
| Official Cash Rate | 2.50 | 2.50 | 2.75 | 3.25 | 3.50 | 3.75 | 4.25 | 4.75 | 5.25 | 5.50 |
| 90-Day Bank Bill Rate | 2.7 | 2.9 | 3.2 | 3.7 | 3.8 | 4.2 | 4.7 | 5.2 | 5.7 | 5.8 |
| Floating Mortgage Rate | 6.0 | 6.0 | 6.3 | 6.8 | 7.0 | 7.3 | 7.8 | 8.3 | 8.6 | 8.7 |
| 1-Yr Fixed Mortgage Rate | 6.2 | 6.3 | 6.4 | 6.6 | 6.7 | 7.1 | 7.6 | 8.0 | 8.4 | 8.4 |
| 2-Yr Fixed Mortgage Rate | 7.2 | 7.2 | 7.3 | 7.3 | 7.4 | 7.6 | 7.9 | 8.4 | 8.6 | 8.6 |
| 5-Yr Fixed Mortgage Rate | 8.5 | 8.5 | 8.5 | 8.5 | 8.5 | 8.5 | 8.6 | 8.9 | 8.9 | 8.9 |

IMPORTANT NOTICE

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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