NEW ZEALAND ECONOMICS
ANZ CREDIT FOCUS

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INSIDE

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DEMAND DRIVEN SUPPLY

MARCH IN REVIEW

Fighting in Libya and the Japan earthquake dominated headlines in March, contributing to significant swings in market sentiment. The Fed left policy on hold, but upped the tempo, noting that it was keeping a close eye on inflation developments. Peripheral European bond markets came under pressure as ratings agencies cut credit ratings. Meanwhile, back home, the RBNZ cut the OCR by 50 basis points, and GDP grew by +0.2 percent in Q4.

ECONOMIC AND MARKET BACKDROP

The NZ economy is navigating three events simultaneously. Our high external debt and low national savings emphasise the need to rebalance. Commodity export prices continue to hit record highs. The February 22nd earthquake resulted in significant damage and disruption. These events are complimentary in some facets but opposing in others. The economy is set to remain weak over the first half of 2011 but there remains a solid base from which a springboard style recovery is set to emerge.

PERFORMANCE MONITOR

The ANZ Debt indices performed poorly in the month of March, with capital losses almost completely wiping out gains for the Govt Bond Index, and decimating it for the Swap Index. The Corporate Bond Indices performed slightly better, courtesy of their lower durations and higher margins.

RELATIVE VALUE MONITOR

The rally in outright yields and increasingly negative swap spreads has kept pressure on Kauri asset swap levels for secondary SSA paper in 2011. However, limited contraction for roll-down the curve, lower NZD basis, higher EUR basis and tighter achievable funding levels for SSA's in USD markets means that even Kauri SSA lines that have maintained steady NZD asset swap levels are likely to have spreads that represent attractive relative value on a USD LIBOR equivalent basis.

SWAP AND BASIS SWAP SPREAD UPDATE

Swap spreads remain at very negative levels, particularly at the long end, which continues to be the focal point for government bond supply. With so much negativity already priced in, and the DMO set to have done the lion's share of unexpected earthquake funding by the end of the fiscal year, spreads are unlikely to move materially further into negative territory. Basis swap spreads continue have been stable over the past month.

GOVERNMENT BOND TENDER WATCH

The DMO issued $2.8bn of NZGS in March, the largest monthly total ever, made up almost exclusively of long bonds. This would have completed the full year requirement had the target not been extended to $15bn on March 31st. Expect the programme to be upsized again. Extra issuance has come at a cost – bid cover has fallen dramatically, and price tension has suffered. Nonetheless, there's a job to do, and the DMO are doing it.

MARCH IN REVIEW

SUMMARY

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MAJOR GLOBAL EVENTS (IN CHRONOLOGICAL ORDER)

- The US has said it would assist Libyan rebels trying to oust Gaddafi, and was considering a no-fly zone, which was later established. Secretary of State Clinton noted that "we will continue to explore all possible options for action - as we have said, nothing is off the table so long as the Libyan government continues to threaten and kill Libyan citizens". Libya later became one of two defining events (the other being the Japan earthquake) in March.

- The debate on QE heated up in March. Early in the month New York Fed President Dudley said that improving data was not a reason to remove stimulus early. In a speech he noted that "we provided additional monetary policy stimulus via the asset purchase program in order to help ensure the recovery did regain momentum", adding that "a stronger recovery with more rapid progress toward our dual mandate objectives is what we have been seeking. This is welcome and not a reason to reverse course".

- Two days later, In questions and answers following the second day of testimony before the US Congress, Federal Reserve Chairman Bernanke appeared to suggest that he hadn't ruled out a third round of quantitative easing, or QEIII for short. Not ruling something out and advocating something are certainly quite different, and there seemed to be a bit of spin in the reporting of what Bernanke had said. Indeed, when asked what conditions would lead to QEIII, he didn't specify them, noting instead that "what we'd like to see is a sustainable recovery. We don't want to see the economy falling back into a double dip or to a stall-out", adding that QEIII would be would be a decision for the FOMC, and any further action "depends again on our mandate".

- During the testimony, Bernanke also made comments about inflation, and while these were picked up by the media and commentators like ourselves, they were not the immediate focus of attention. Perhaps they should have been. Indeed, Bernanke noted "we're looking very closely at inflation both in terms of too low and too high" adding that "I want to be sure that you understand that I am very attentive to inflation and potential risks for inflation. That will certainly be a major consideration as we look to determine how to manage this policy". Less than 2 weeks later, the Fed changed tack, shifting into inflation mode at the FOMC meeting (see below).

- The US Congress approved a temporary budget bill, preventing a government shutdown that would have occurred tomorrow when the current spending authority ran out. The move gives the Democrats and Republicans a further 2 weeks to negotiate Government spending cuts.

- In the most direct hint yet of possible early action, ECB President Trichet uttered the phrase "strong vigilance" at the press conference

MARCH IN REVIEW

after the ECB rate decision. The fact that he was hawkish probably didn't come as too much of a surprise to most people. After all, Trichet has made it clear on a number of occasions that he is uncomfortable with the tendency for emergency measures (such as liquidity support and refinancing facilities) to become permanent features at the ECB. He has also made several comments about rising inflation over the past few months, and has long characterised ECB policy as "accommodative". But in the space of a month, with regard to inflation, he has gone from "very close monitoring" to "strong vigilance", adding that "the Governing Council remains prepared to act in a firm and timely manner".

- US non-farm payrolls data showed employers added 192,000 jobs in February, despite a 30,000 cut in government jobs. There was some evidence of a weather related rebound following disruptions in January. The unemployment rate fell 0.1 to 8.9 percent.
- Moody's slashed Greece's credit rating by three notches, raising the spectre that debt restructuring will have to occur sooner than originally planned (2013). The downgrade, to B1 from Ba1 took the Greek rating below that of Egypt. Moody's cited risks to Greece's fiscal consolidation programme, from poorly performing revenues and difficulties in reforming the bloated state sector. The sheer magnitude of Greece adhering to the stringent austerity measures that were a pre-condition of the €110b rescue package in May 2010 had become apparent according to Moody's.
- Outgoing ECB hawk Axel Weber noted he did not want to correct market expectations for as many as three 25 point increases in the ECB benchmark interest rate this year. Inflation may be "more sustained and more fundamental" than the ECB's latest projections suggest, Weber said. "This has to be countered in a timely way. I do see considerable future price pressures." He reiterated that the ECB should also considering withdrawing its emergency liquidity measures for banks "in the next few months", and while a rate hike in April or May was possible, it was not on auto-pilot.
- The Bank of England left the Bank Rate on hold at 0.5% as expected. As with the February meeting, the minutes later showed a 3-6 split, with regard to the Bank Rate, with Sentance, Dale and Weale all voting for hikes. There was also a split on the vote on asset purchases, with Posen the sole voter in favour of extending the programme from £200bn to £250bn.
- Gaddafi strengthened his power base, initially ousting rebels from the oil hub of Ras Lanuf. The battle for Libya continued to intensify, ultimately resulting in sanctions and a no-fly zone that remains in place.
- Japan was struck by one of the largest earthquake in its recorded history. A magnitude 9.0 quake centred near the North Eastern city of Sendai, followed shortly afterward by a devastating tsunami, crippling the Fukushima nuclear power plant. Concerns of a Chernobyl style meltdown swept through nervous markets, and contributed to the bellwether NZ 2 year swap rate moving to a record low.
- In response to the quake, The Bank of Japan injected ¥15 trillion (NZ$249 billion) of liquidity into the financial system and doubled its asset-purchase programme to ¥10 trillion (NZ$166 billion). Commenting in the decision, the Bank of Japan said that: "This time's

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earthquake has inflicted damage in a wide area. Output is likely to fall for some time. We are also worried that corporate and household sentiment will worsen".

- Fitch said it saw the UK government's deficit reduction plan as credible and that the strong budgetary consolidation effort and declining fiscal risks from the UK financial sector support the UK's AAA Stable Outlook rating. However, Fitch said that inflation pressures could result in a sharper normalisation of monetary policy, with potential consequences for macroeconomic financial stability.
- The US Federal Reserve left the Fed Funds rate unchanged, maintaining its long-held view that "economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period". However, the market was taken aback somewhat by the more upbeat tone of the statement, including the comment that the committee "will pay close attention to the evolution of inflation and inflation expectations".
- Moody's cut Portugal's debt rating from A1 to A3 with a negative outlook. S&P and Fitch both followed suit later in the month, and in early April, Moody's cut its rating further, to Baa1.
- The Peoples Bank of China increased bank reserve requirements for the third time this year, lifting the reserve ratio to 20 percent for the biggest banks. The increase was effective March 25th.
- Fed rhetoric turned hawkish, with voting member Fisher noting that "I would have voted against QE2, had I had the vote", adding that "we've done a bit too much". Not long after, non voting member Pianalto said that "I expect the economy to expand at a moderate pace, slightly above the average growth rate of about 3% a year". She also noted that "I am seeing clearer signs of a virtuous cycle of growth", adding that "rising incomes end rising profits are supporting growth in retail sales and business demand, which in turn fuels more growth in incomes and profits."
- With the market fully prepared for an ECB hike in April, uber hawkish ECB Executive Board member Juergen Stark threw the cat among the pigeons when he said "given the heightened uncertainty I cannot make any commitment for the ECB", which was taken as backing away from Trichet's signalled intentions to raise rates in April. However, when asked, Trichet said he had "nothing to add". Markets unanimously expect a hike in April.
- EU leaders delayed a key decision on EFSF bailout fund. It was hoped that agreement could be made at the late March EU Summit, but it now looks like the agreement won't be finalised till June.
- Japan estimated the damage from this month's earthquake and tsunami at ¥25trn (about US$309 billion), which is almost 4 times as much as the cost of Hurricane Katrina.
- Speculation that Portugal would require a bailout heated up in late March after the parliament rejected the Budget, and the Prime Minister resigned. At the time, newswires reported that "officials with direct knowledge of the situation" believe Portugal will need between €50 and €70b, or about two-thirds the size of the Greek bailout.
- S&P downgraded Greece by two notches (to BB-) and Portugal by one

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notch (to BBB-), with both on negative outlook. S&P noted that they were concerned that if these countries refinance their debt via the European Stability Mechanism, this entity would be the take priority, shunting bond investors further down the queue.

MAJOR NZ EVENTS (IN CHRONOLOGICAL ORDER)

- Dairy prices rose at Fonterra's early March globalDairyTrade auction, with average prices rising 5.9 percent. Prices for the shorter-term contracts rose by the most, and were indicative of supply concerns.
- Prime Minister John Key confirmed that the Working for Families welfare programme was up for review in a radio interview early in March. However, he said that interest free student loans would remain. Any changes would be part of an overall re-prioritisation of government spending following the Christchurch earthquake.
- The RBNZ cut the OCR by 50 basis points to 2.50 percent, trumping market expectations of a 25 basis point cut. The bank was quick to characterise the move as an "insurance" cut, noting that they had "acted pre-emptively in reducing the OCR to lessen the economic impact of the earthquake and guard against the risk of this impact becoming especially severe". In the press release at the time the Bank also noted that "Future monetary policy adjustments will be guided by emerging economic data", and suggested that the next move would be a hike, noting that "we expect that the current monetary policy accommodation will need to be removed once the rebuilding phase materialises".
- Prices at Fonterra's mid month globalDairyTrade online auction recorded an 8.2% decline in the weighted average price from the previous event. The fall was the first decline since mid-November.
- Statistics NZ reported that GDP grew by +0.2% in Q4, narrowly avoiding a technical recession in the second half of 2010.

ISSUANCE

March continued to gain momentum with a number of issues either pricing or settling during the month. The theme of stronger rated council and bank issuance dominated. However it was pleasing to see the first corporate issue of the year, Solid Energy, in wholesale format showing that this segment of the investor market is prepared to look through the rating requirement for the right names to access supply.

Issuance over the Previous Month (in chronological order)					
Issuer	Rating	Amount	Coupon/ Yield	Tenor	Spread
Wellington City Council	AA+	$25m	FRN	5.2yrs	BKBM + 100
Rabobank	AAA	$175m	5.48%	5.0 yrs	Swap +107
Infratil	Unrated	$100m	8.50%	5.3 yrs	~Swap + 380
BNZ	AA	$400m	FRN	3.0 yrs	Swap + 130
Solid Energy	Unrated	$50m	7.00%	7.0 yrs	~Swap +220

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UPCOMING MATURITIES

Details of Forthcoming Bond Maturities				
Issuer	Rating	Maturity	Coupon %	Amount
Dunedin City Treasury	AA	15/04/11	8.70%	$90m
Westpac	AA	18/04/11	8.87%	$362m
Westpac	AA	18/04/11	FRN	$269m
Fonterra Co-Operative	AA-	21/04/11	6.64%	$100m
ANZ National	AA	27/05/11	FRN	$170m
ASB	AA	21/05/11	FRN	$325m
ASB	AA	23/05/11	8.42%	$158m
BNZ	AA	20/05/11	FRN	$170m
Morgan Stanley	A+	30/05/11	FRN	$75m
ASB	AA-	15/06/11	7.03%	$200m
Municipality Finance	AAA	23/6/11	7.73%	$275m
Export Development of Canada	AAA	10/6/11	7.50%	$200m
Housing NZ	AAA	15/6/11	8.50%	$50m

NOTABLE RATINGS ACTIONS*

3 March – Fitch stated that will "continue monitoring the potential consequences" of the Christchurch earthquake on **NZ mortgage-backed transactions**.

4 March - **Toyota Motor Corporation** was downgraded by S&P from 'AA' to 'AA-'. The downgrade was based on the view "that Toyota's profitability in the next one to two years is unlikely to recover to a level appropriate for the rating". The downgrade also covers Toyota Finance New Zealand Ltd, although both entities maintain the A-1+ short-term rating.

10 March – S&P affirmed the rating of 'BBB+' and at the same time placed **Genesis Power Ltd**. on outlook negative, a revision from stable. S&P stated that Genesis faces increasing challenges to the "company's underlying business and [the] view that the company's financial flexibility may weaken because of its uncertain funding strategy for the proposed acquisition of the Tekapo assets".

11 March – Fitch Ratings released a report suggesting that the use of **covered bonds** was set to continue "fuelled by investor's risk aversion as well as regulatory incentives".

17 March – S&P revised **Christchurch International Airport Ltd** (CIAL) from stable to negative, affirming the 'A-' and 'A-2' rating. S&P opined that the uncertain market demand facing Christchurch airport may result in negative pressure on the airport's risk profile.

18 March – **Telecom Corporation of New Zealand's** rating was affirmed at 'A' long-term and 'A-1' short-term, and also on CreditWatch with negative implications. S&P saw Telecom's CreditWatch status as a reflection of the "regulatory driven uncertainties" that remain around Telecom's

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future. The outcome was dependent on composition of assets remaining; allocation of debt; financial policy; revenue and margin outlook and strategy S&P added.

21 March – Moody's Investor Services affirmed **Air New Zealand's** Baa3 Senior Unsecured Issuer rating as well as amending the outlook to negative from positive. Moody's said that the outlook "reflects the heightened operating uncertainty and incremental effects of the recent earthquake"

22 March – Moody's warned that the RBNZ's proposed Open Bank Resolution policy "could create additional negative pressure on the supported debt and deposit ratings of **New Zealand's four major banks**". Moody's said its current credit ratings methodology assumes a degree of extraordinary or systemic support, and that if the Open Bank Resolution was passed, this assumption would no longer be relevant, and would prompt a new ratings methodology. Moody's noted that "we will have to evaluate the RBNZ's and government's likely response in case of stress at a major bank, and the practical and operations feasibility of implementing the Open Bank Resolution policy as proposed", adding that in the event of a failure, of the RBNZ and "the Government of the day, may not choose to initiate the Open Bank Resolution mechanism if it could be deemed to have an adverse effect, for example, by introducing contagion risk".

24 March – A.M. Best downgraded the financial strength rating of **AMI Insurance Limited** from 'A+ (Superior)' to 'A- (Excellent)'. A.M. Best stated that the downgrade reflects the "negative impact on AMI's capitalization, due to the latest loss development" from the Christchurch earthquake. A.M. Best understood "that capital raising initiatives are being pursued by AMI's management".

** Sources: Bloomberg, Reuters, Standard & Poor's RatingsDirect, Moody's, Fitch Ratings, ANZ.*

ECONOMIC AND MARKET BACKDROP

SUMMARY

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The economic outlook for the first half of this year remains weak, with the Christchurch earthquake having pushed back the recovery by six months. Business and consumer confidence measures have fallen, with ongoing household and agricultural sector deleveraging illustrating the ongoing mood of caution. The economy is in the midst of rebalancing. Consumer spending and retailing remain subdued. The earning side of the economy is being bolstered by record high commodity prices. Other parts of the export sector not benefiting from high export prices or the low NZD/AUD are finding the going more difficult.

Repairing an estimated $15-20b in damages from the Christchurch earthquake will be a multi-year undertaking and will require considerable resources. It is likely to check the economic rebalancing, with the upshot being a rising profile for external debt and large current account deficits. The rebuild will also put pressure on the Government balance sheet, which will require spending reprioritisation and some cuts, politically difficult in an election year.

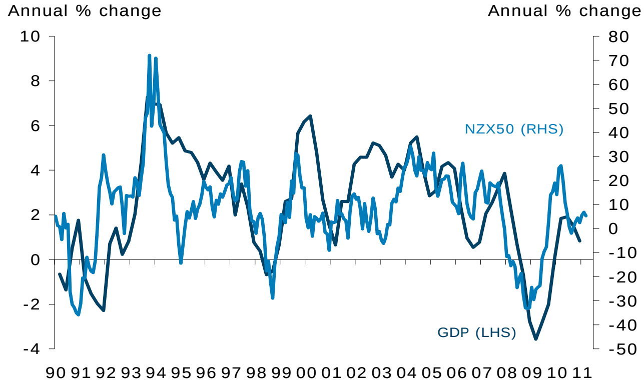
We are more optimistic over the outlook in the second half of 2011. A lower level of activity provides a larger springboard from which recovery can occur. Financial conditions are providing considerable support. Commodity prices remain strong with the Rugby World Cup set to provide another pillar of growth. A key part of our story is that there will be more economic activity from earthquake reconstruction in 2011 than most (including the RBNZ) expect. The state of emergency remains in place and the Government has moved quickly to facilitate the deployment of resources. We see momentum in a steadily rising fashion, as opposed to the consensus, which is centred on work going from zero to a boom overnight.

The RBNZ faces a delicate balancing act supporting the economy via a lower OCR, but must be alert to pending inflation pressure. Firming activity and persistent inflationary pressure are expected to result in the RBNZ removing the March MPS insurance cut, with a 25bp increase expected in December.

Indicator	Level	Direction	Comment
Hi-low beta stock index	Elevated	Rising	NZX continues to rise steadily, quake rebuilding should provide a boost.
Sovereign risk	AA+	At risk	Credit rating downgrade looks likely, but the Budget will be tight.
Macro momentum	Neutral/ Low	Will turn as rebuild begins	Confidence has been hammered, but foundations for recovery being set
Financial conditions	Extremely supportive	Continues to improve	Financial conditions are now ultra-supportive, but they need to be.
Risk aversion	Neutral	Improving	Shake up coming as global monetary policy normalisation process begins
Cost of credit	Elevated	Stable	Local bank CDS spreads remain stable. Credit growth set to slow.
Liquidity conditions	Neutral	Improving	Has improved and will continue to do so as insurance flows enter NZ.

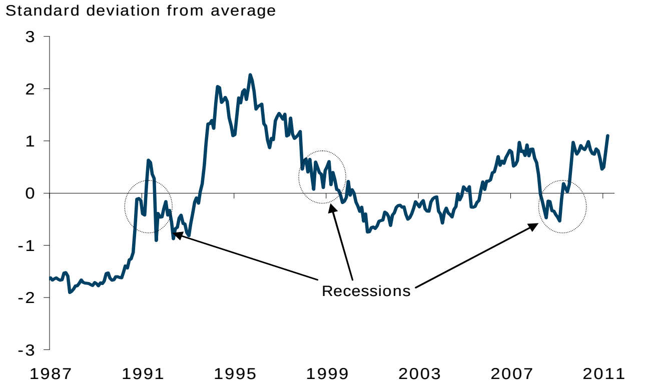
ECONOMIC AND MARKET BACKDROP

NZ equity market returns and GDP



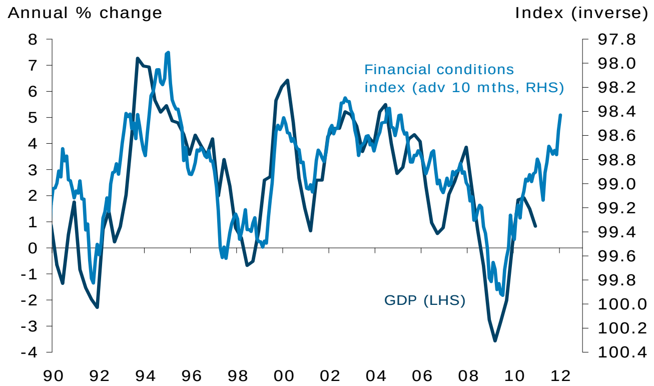
Sources: ANZ, Statistics NZ, Bloomberg

Equity beta



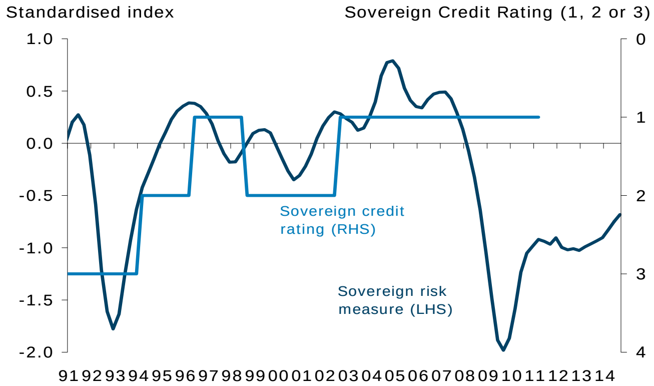
Sources: ANZ, NZX

Financial conditions and GDP



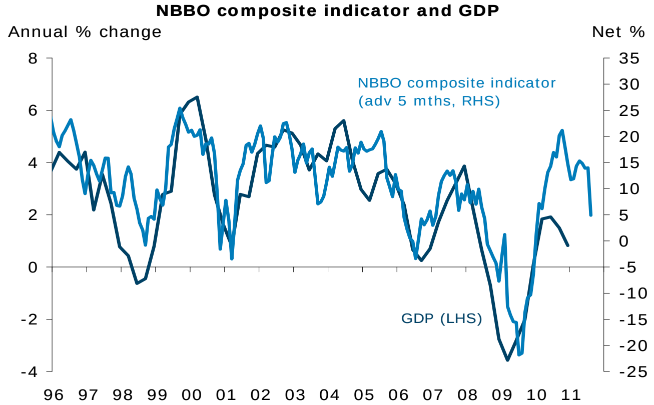
Sources: ANZ, Statistics NZ

Sovereign risk gauge



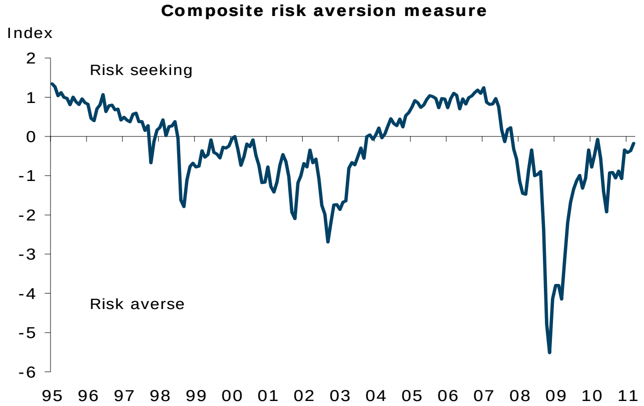
Sources: ANZ, NZ Treasury

NBBO composite indicator and GDP



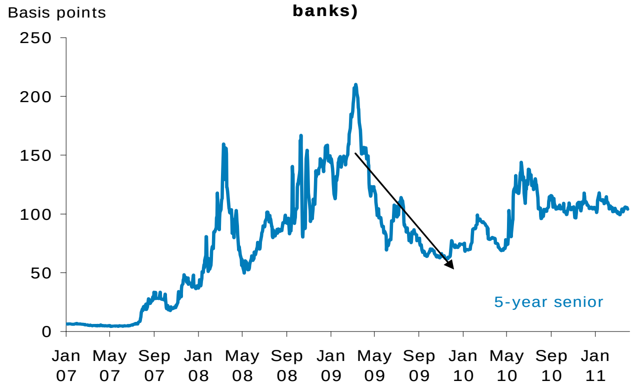
Sources: ANZ, Statistics NZ

Composite risk aversion measure



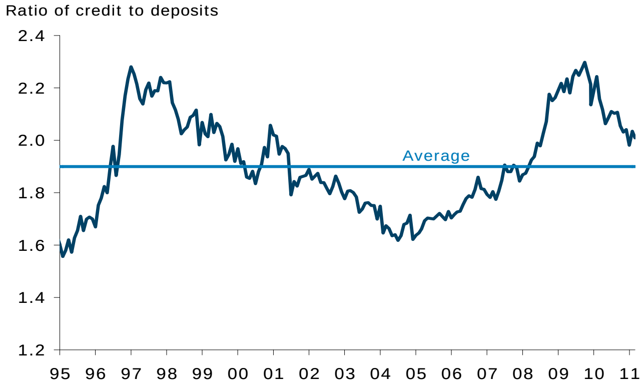
Sources: ANZ, Bloomberg

Cost of credit (CDS spread for 'Big-4' Australian banks)



Sources: ANZ, Bloomberg

Corporate (business) liquidity



Sources: ANZ, RBNZ

PERFORMANCE MONITOR

PERFORMANCE MONITOR – ANZ DEBT INDICES

The ANZ Debt indices performed poorly in the month of March, with capital losses almost completely wiping out gains for the Govt Bond Index, and decimating it for the Swap Index. The Corporate Bond Indices performed slightly better, courtesy of their lower durations and higher margins. The NZX 50 Index performed well, and was one of the better performing equity markets in the world.

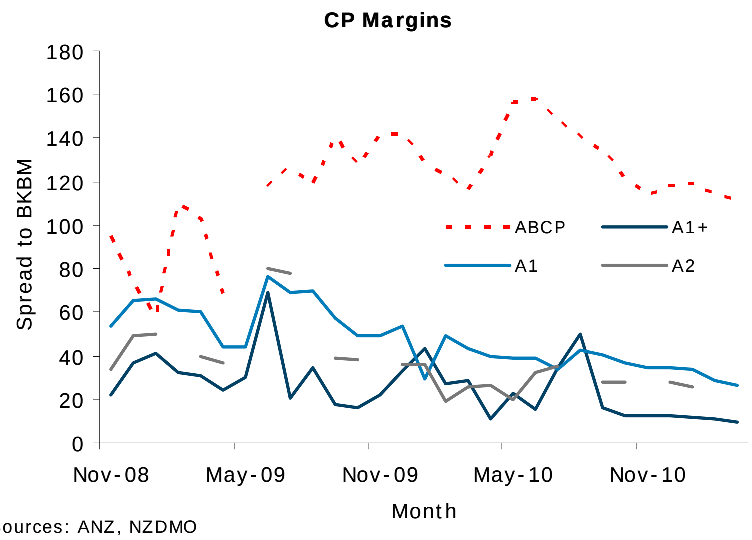
ANZ Index Returns for Periods Ended Last Month

Index	Last month	Last 3 months	Last 12 Months
ANZ Govt Bond Index	0.04%	2.21%	6.92%
ANZ All Swap Index	0.14%	2.33%	8.33%
ANZ Corp A Grade	0.57%	2.77%	8.77%
ANZ Corp Investment	0.58%	2.82%	9.06%
NZX 50 Gross Index	2.06%	3.95%	5.26%

Source: Bloomberg and NZX

COMMERCIAL PAPER

- Port of Tauranga Ltd. (BBB+/Stable/A-2) returned to the market for the first time since late-2007. The secured paper was well received with bid-cover of 2.75 times and a weighted average of +22.9bps. POT will look to maintain supply in the market.
- Auckland Council (AA/Stable/A-2) tendered 70m following on from the 100m issued in February. With the forthcoming bond issuance, it is likely that the Council will use the bond to repay a portion of this paper.
- New Zealand Post Ltd. (AA-/Stable/A-1+) tendered at the lowest spread since October 2008 at +7.8.



Sources: ANZ, NZDMO

Continued overleaf /

PERFORMANCE MONITOR

3-month Commercial Paper Margins for the Previous Month				
Margin	A-1+ (excl ABCP)	A-1	A-2	A1+ ABCP
Median	9.9	26.2	22.9	112.0
Low	7.8	25.4	24.7	113.0
High	12.0	27.0	-	115.0

Source: ANZ

Upcoming Commercial Paper Maturities			
Issuer	Rating	Maturity	Amount
Telstra	A-1	13-Apr	$50.0m
CHCH City Holdings	A-1+	18-Apr	$26.0m
Hutt City	A-1+	20-Apr	$12.0m
Watercare	A-1+	19-Apr	$10.0m
Auckland Council	A-1+	21-Apr	$10.0m
RFS	A-1+x	8-Apr	$20.1m
RFS	A-1+x	26-Apr	$24.8m
AIAL	A-2	15-Apr	$36.0m
AIAL	A-2	19-Apr	$26.0m
CCC	A-1+	29-Apr	$5.0m
Auckland Council	A-1+	15-Apr	$70.0m

Commercial Paper Issuance Details for the Previous Month				
Issuer	Rating	Maturity	Amount	Weighted Average Margin (bps)
Telstra	A-1	1-Jun	$40.0m	25.4
Telstra	A-1	9-Jun	$50.0m	27.0
NZ Post	A-1+	2-Jun	$20.0m	7.8
NPDC	A-1+	9-Jun	$10.0m	10.0
WRCH	A-1+	13-Jun	$45.0m	12.4
Auckland Council	A-1+	15-Apr	$70.0m	11.5
DCT	A-1+	15-Jun	$20.0m	8.2
Hutt	A-1+	20-Jun	$11.0m	9.0
DCT	A-1+	20-Jun	$11.0m	8.0
Watercare	A-1+	20-Jun	$50.0m	12.0
RFS	A-1+x	8-Jun	$25.3m	111.0
RFS	A-1+x	23-Jun	$23.3m	113.0
AIAL	A-2	15-Jun	$20.0m	24.7
POT	A-2	16-Jun	$20.0m	22.9

** Asset-backed*

RELATIVE VALUE MONITOR

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The rally in outright yields and increasingly negative swap spreads have kept pressure on Kauri asset swap levels for secondary SSA paper in 2011. However, limited contraction for roll-down the curve, lower NZD basis, higher EUR basis and tighter achievable funding levels for SSA's in USD markets means that even Kauri SSA lines that have maintained steady NZD asset swap levels are likely to have spreads that represent attractive relative value on a USD LIBOR equivalent basis.

To illustrate, we present indicative asset swap offers in selected Kauri SSA issues with bonds of comparable tenors in the Kangaroo and USD markets. In addition, we also show where each issue would swap back to USD LIBOR at current market levels. Broadly speaking, two things stand out. First, all names asset swap to significantly cheaper levels in NZD than AUD or USD. Second, even when swapped back to USD LIBOR, NZD issues swap back at substantially better margins. Nonetheless, for buy and hold relative value seekers, these opportunities look extremely attractive when compared to their same-name counterpart issues in other currencies.

Asset swap levels of selected Kauri SSAs

Bond	Currency	Issue Size	NZD Spread to 3mth BKBM	AUD Spread to 3mth BBSW	USD Spread to 3mth LIBOR
IFC 7.75 23Aug12	NZD	500m	18		2
IFC 7.50 28Feb13	AUD	1bn		-7	-15
IFC 3.50 15May13	USD	1bn			-13
KBN 5.75 20Jul14	NZD	150m	54		26
KBN 6.00 21Oct14	AUD	875m		34	15
KBN 2.875 27Oct14	USD	1bn			5
EUROF 7.125 22May13	NZD	275m	50		27
EUROF 6.00 28Jan14	AUD	1.3bn		22	7
EUROF 1.875 28May13	USD	1bn			10
RENTEN 5.59 23Sep14	NZD	150m	55		26
RENTEN 6 15Jul14	AUD	1.2bn		24	8
RENTEN 2.25 11Mar14	USD	1bn			-3
IBRD 5.375 15Dec14	NZD	1.025 bn	30		2
IBRD 5.50 21Oct14	AUD	1.4bn		11	-5
IBRD 1.125 25Aug14	USD	4.2bn			-26.5
NIB 7.50 15Apr15	NZD	300m	41		9
NIB 6 6Apr15	AUD	625m		28	8
NIB 2.625 6Oct14	USD	1bn			-11

SWAP AND BASIS SWAP SPREAD UPDATE

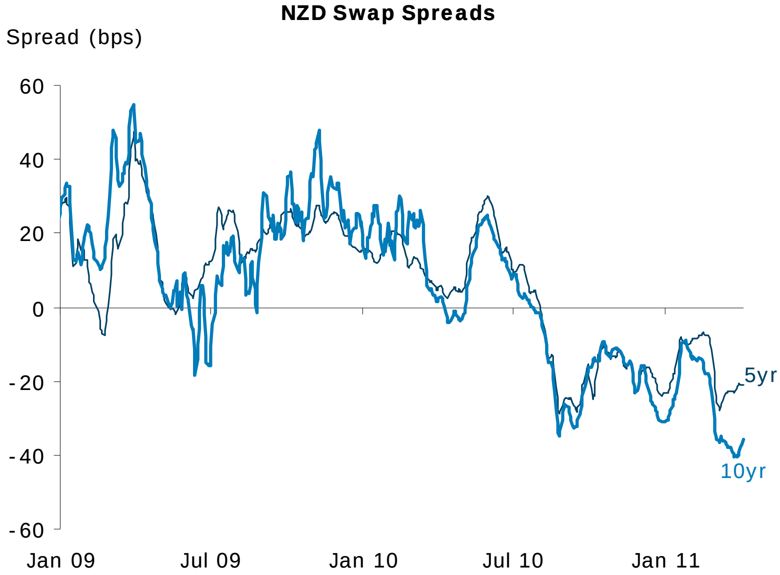
SUMMARY

Swap spreads remain at very negative levels, particularly at the long end, which continues to be the focal point for government bond supply. With so much negativity already priced in, and the DMO set to have done the lion's share of unexpected earthquake funding by the end of the fiscal year, spreads are unlikely to move materially further into negative territory. Basis swap spreads continue have been stable over the past month, having collapsed following the Christchurch earthquake.

SWAP SPREADS

Long end swap spreads moved out to record negative spreads in late March, with the 10 year spread trading at -42.5 basis points immediately following the DMO's decision to upsize the March 24th tender at short notice. This sort of knee-jerk reaction is entirely understandable, and we expect the market to remain jittery for some time to come yet. Even so, the question has to be, can spreads move to lower (i.e. more negative) extremes in future?

NZD Swap Spreads



Sources: ANZ, Bloomberg

From the outset we should make it clear that it's quite possible. Not only is liquidity in the EFP market reasonably low, but flow tends to be lumpy at times, leaving the market prone to price spikes. We are also mindful of the risk the withdrawal of liquidity may have on global bond markets. With key central banks like the Fed, the ECB and the BOE all inching closer to pulling the trigger on the so-called exit strategy, it is difficult to imagine liquidity will not take a hit, or at least some portfolio realignment not taking place. Indeed, there is an extraordinary amount of excess liquidity to be mopped up, which surely poses a risk to pricing of real money assets like bonds, particularly given the role that carry has played in investment decisions.

Despite these risks, in a broad sense we are beginning to question how much more negative swap spreads can go. The bears will point to ongoing issuance (which will inevitably be concentrated at the long end) and the potential for a credit rating downgrade. Those are all very valid points, but they are all also old news, and when we scan through the last few issues of

SWAP AND BASIS SWAP SPREAD UPDATE

the *Credit Focus*, we have covered each of them in detail. In other words, they are all priced in, and in fact, a closer look at the facts suggests that the news flow will start to turn the other way in months to come.

To be sure, let's look at how things stand, by considering the various arguments:

1) **The potential for a credit rating downgrade:** The risk of this cannot be underestimated, but then again, anyone who would be surprised if it did happen has been asleep at the wheel. After all, S&P and Fitch both have New Zealand on negative outlook. It should not be surprising then that we think this risk is pretty well fully priced in. Of course, there is the other angle, and that's the real possibility that the Government finds enough savings and crafts a plan in the Budget which the rating agencies give the benefit of the doubt to. Even if it's only a temporary reprieve, our sense is that the market expects a downgrade within weeks of the Budget, and if one is not forthcoming, we may see a relief rally in bonds. The market certainly doesn't seem well placed to take an "as you were" announcement by rating agencies in its stride. Timing is key – if the European sovereign debt situation stabilises, markets will probably gloss over a downgrade here in NZ. Conversely, if sovereign debt concerns escalate, markets will react more negatively.

2) **Funding and supply:** The Treasury estimate the damage bill from the two earthquakes could be as high as $20bn. We assume the Crown's share of that will be around $5bn (in addition to the $3bn that will be funded from EQC reserves). Add to that perhaps a further $1bn of costs relating to the relief effort and perhaps $1bn for the impact of a lower tax take and the near term cost could be as much as $7bn. But remember, the HYEFU estimates had already incorporated the impact of the first quake, so we need to be careful not to double count things. Moreover, if the DMO continues issuing $500bn of bonds per week, by the end of the fiscal year they will have issued $20.4bn of bonds. That's $7bn more than the HYEFU estimate, and effectively closing the gap. Issuance volumes in years to come are certainly expected to be well below this year's.

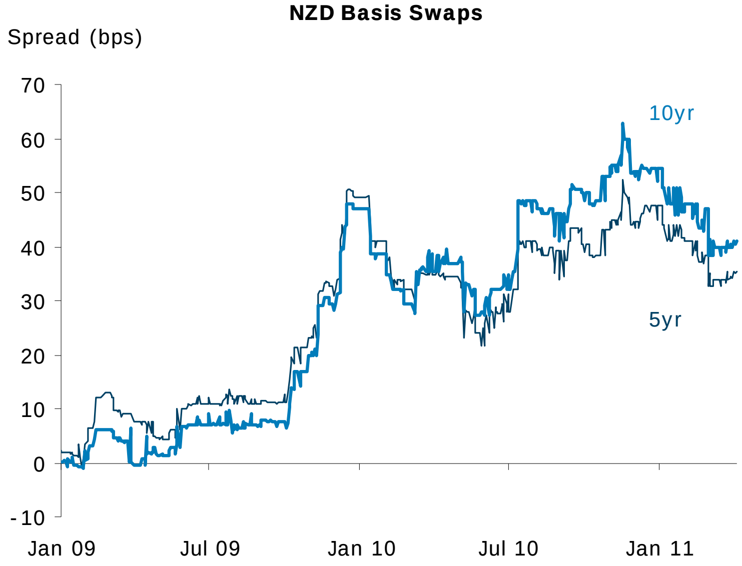
3) **Positioning and carry:** For most investors, the need to repo bonds means it is not practical to be short the bond and long the swap (i.e. positioned for swap spreads inverting further). By contrast, being long the bond and short the swap has positive roll and carry of about 1 basis point per month for the 2015s, 2017s and 2019s. Moreover, if ever the market was eagerly watching a "get ready" trade from the sidelines like a lion stalking a wounded zebra, it is the NZGS asset swap.

4) **Rising inflation risks and corporate paying:** We have not seen it yet, but with the major central banks looking to normalise policy and the RBNZ quite vocal about the hurdle for a follow up rate cut being high, the focus is now on when, not if the RBNZ will raise rates next. In the past fortnight the market has completely priced out any chance of further cuts. And if the ECB raises rates later this week, and the Fed starts warning of rising inflation pressures, we would not be surprised to see corporate paying start to intensify, even with the curve as steep as it is. The OCR is, after all, negative in real terms, and by now it should be clear that low interest rates will not last forever. Inflation expectations are critical, and next month we expect to publish some research in this publication on the statistical drivers of inflation expectation measures around the globe.

SWAP AND BASIS SWAP SPREAD UPDATE

That's not to say that swap spreads are about to normalise, but it is debatable how much more bad news there is to come, and it is starting to look like the market may be more vulnerable to a correction rather than a further blow-out. And as we noted last month, with most of the flow now at the long end of the curve, short end spreads can continue normalising.

BASIS SWAPS



Sources: ANZ, Bloomberg

Basis swap spreads have been reasonably stagnant over the past month, and although we see some intuition in spreads continuing to narrow, this is not without its risks. We would regard these risks as contingent risks, but they are worthy of a mention. The first is obvious – and that's the potential for offshore issuance related flow. This tends to be lumpy, but when it comes, it can have an impact on pricing. The second is less obvious, even though in hindsight it won't be. Although it seems out-of-left-field at the moment, we can't discount the possibility that the government may look to directly tap offshore markets for funding as it seems to term out its debt. This could either be offered in foreign currency, which would need to be swapped back to NZD, or in NZD at a margin that reflected where the basis was trading. Although the former has more flow risk than the latter (the government would be more inclined to swap their exposure back, but global investors may be comfortable with NZD risk), it would add pressure on basis swap spreads, particularly at the long end, where we would expect flow to be concentrated.

When we look at ways for the government to innovate and diversify funding arrangements, we would also not rule out a move back to infrastructure bonds, similar to the old Auckland Harbour Board and Lyttleton Tunnel bonds issues in the past. These could have recourse to the infrastructure project as well as being government guaranteed. We doubt there is sufficient demand onshore to make this possible, but offshore issuance in foreign currency remains a possibility, with obvious pressure on basis swap spreads.

Still, beyond these contingent risks, we believe there is a mild bias for spreads to continue narrowing, driven by a shrinking of bank balance sheets, as we discussed in last month's issue. To reiterate, this is mostly a view on deleveraging. Although we are now less convinced that the Budget will lead to more deleveraging (primarily because consumers may feel they don't have the choice to do so), this is probably offset to some extent by the recent fall in mortgage rates, which will have freed household cashflow up significantly. Still, as reinsurance money flows into New Zealand, this is likely to be associated with large scale debt repayment (by those with homes that have been written off) as well as large scale liquidity accumulation. If this does lead to a shrinking of bank balance sheets, we are likely to see a dramatic reduction in pay side pressure in the basis swap market, particularly in the middle part of the curve.

GOVERNMENT BOND TENDER WATCH

SUMMARY

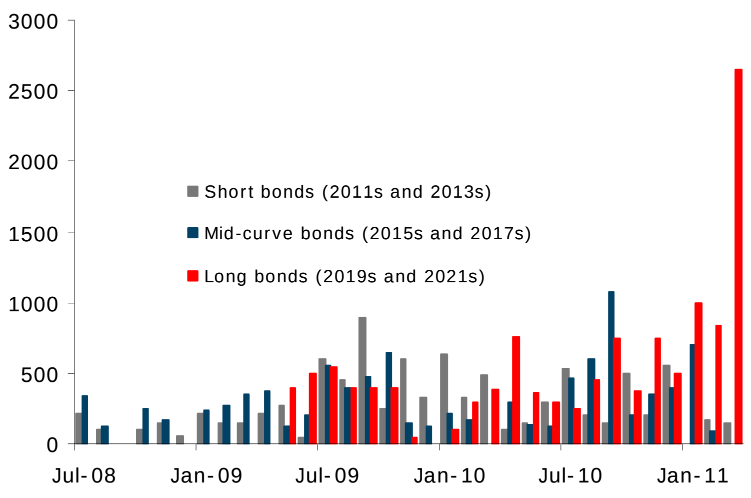
The DMO issued a whopping \$2.8bn of NZGS in March, the largest monthly total ever. What's more, it was almost exclusively long bonds. This takes total issuance for the year to \$13.9bn, which would have completed the full year requirement had the target not been extended to \$15bn on March 31st. Expect the programme to be upsized again before the Budget, as well as at the Budget. This may sound alarming, but it is more a reflection of demand, than supply. But the extra issuance has come at a cost – bid cover has fallen dramatically, and price tension has suffered. Nonetheless, there's a job to do, and the DMO are doing it.

March was notable for a number of reasons, and it was not just the massive ramping up in issuance that caught our eye. The DMO also made two subtle procedural changes to the way it issues bonds. The first was the DMO's decision to increase the size of the March 24th tender on the day (by adding an extra \$200m of 2019s and an extra \$300m of 2021s to the offering).

To be sure, the DMO has always had the right to do this, but we cannot recall it having ever happened before, and it certainly took the market by surprise. We understand investors approached the DMO directly requesting the tender be increased, which the DMO duly accommodated, noting at the time "we are offering the additional March 2019 and May 2021 bonds due to strong investor demand that became apparent after we made our [original] announcement". But while the news did come as a mild surprise, the fact that it was investor demand, as opposed to the imperative to fund that led to the increase substantially diminishes the negative impact normally associated with increased supply (which we discuss again later).

The second change was the reduction in the time between bids closing and results getting announced from 30 minutes to 15 minutes, which took effect at the March 31st tender. Although the DMO have not committed absolutely to this (noting that the delay will be shortened "15 minutes, or as soon as possible after that time", we regard this is a positive step forward. While it itself it may not lead to more demand, by substantially reducing the waiting time, it just reduces another impediment to getting involved.

The changing face of NZGS issuance

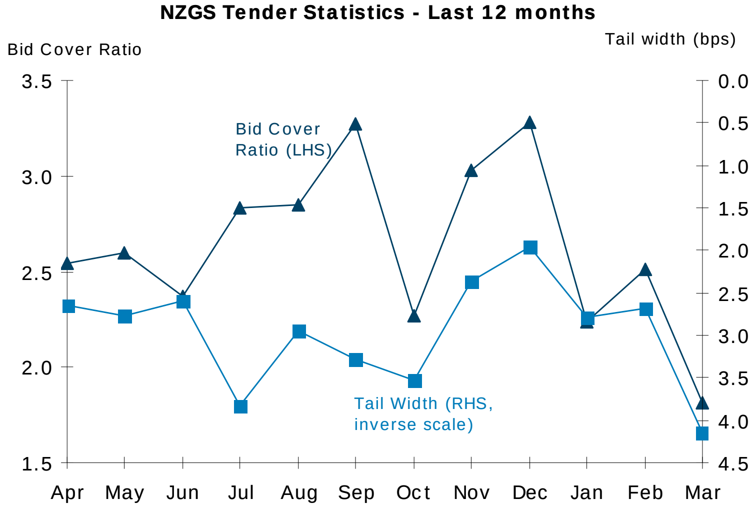


Sources: ANZ, NZDMO

GOVERNMENT BOND TENDER WATCH

Looking more closely at issuance in March, and the months leading up to it, one trend stands out. As we have alluded to in the past, not only has issuance volume increased, the composition of it has changed too. More specifically, the duration of issuance has increased markedly, with $2.65bn of last month's $2.8bn of issuance in long bonds. We would expect this to continue – as we have long argued, when you've got some debt to raise, you may as well term it out, especially with rates as low as they are at the moment, and with other sovereign debt markets as jittery as they are. If you don't, and you raise cheaper short or medium term debt, you might save a bit of money, but the rollover risk jumps enormously, as does the perception that you're constantly in the market issuing.

The DMO also increased the size of this year's bond tender programme, raising the target from $13.5bn to $15bn. In our view this was inevitable – indeed, by the time the announcement was made on March 30th, the DMO had already issued $13.15b of bonds, and in announcing a tender of $750m that week, it would have exceeded its target. As such, we did not view the news as particularly negative. But it wasn't just the inevitability of the announcement that diminished its shock value, so too is the reason why issuance has been ramped up. Indeed, while it is clear that the government needs to increase issuance, they wouldn't be able to do so had demand not been there in the fist place. Call it demand driven supply if you will, which may sound like an oxymoron. But one way to test demand is to offer up supply, and as such, it's a legitimate thing to do. But as we argue later, it does shift the relativities somewhat. Finally, we should also note that the DMO have now issued $13.9bn of bonds this fiscal year. If they continue to sell around $500m of bonds per week, as they have since the earthquake, we can expect another increase in the programme within the next 2-3 weeks. At that point, the Budget will be about 4 weeks away, and unless the DMO want to issue yet another increase prior to the Budget, we'd expect the programme to be increased to around $17bn in a few weeks, with a final revision (which could run close to $20bn) at the Budget.



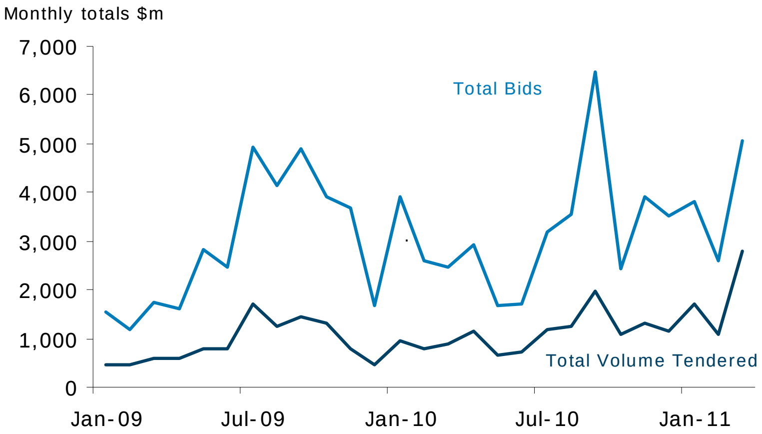
Sources: ANZ, NZDMO

However, while the level of issuance has increased markedly, and has largely been a satiation of investor demand, it has also come at a cost. As the chart above shows, key metrics of demand and price tension have slipped, with overall bid cover falling below 2 times for the first time in at least a year, and tail width widening to above 4 basis points.

GOVERNMENT BOND TENDER WATCH

But if these metrics are deteriorating, how do we reconcile this against our assertion that demand remains strong? We don't think it is, and it is clear from the high visual correlation between total bids and the amount tendered that there is an element of "if you build it they will come" at play here. Of course, the more this gets tested, the more you get erosion of price tension (and the chart on the previous page demonstrates that perfectly). However, the reality is that there is a limit to supply, and even though we have noted that total issuance for the year may be close $20bn, if that is achieved, that's about $7bn more than the HYEFU target, and if we assume the Crown's earthquake liability (i.e. the bit that's not covered by the EQC, reinsurance, and private insurance) is about $8bn, then the lion's share of this will have been funded, and we will revert back to relatively sedate issuance targets of around $10bn per annum. The point – don't get too bearish, increased issuance won't go on for ever.

NZGS Tender Statistics



Sources: ANZ, NZDMO

Summary of NZGS Issuance for the Previous Month						
Date	**Bonds Offered**	**Bid Cover**	**Tail ~**	**Tension ^**	**Bids Accepted**	**Comment**
3 Mar	$100m 2019 $150m 2021	2.7 3.5	1 2	0.0 -1.0	$100m $150m	The strongest tender of the month by far.
11 Mar*	$200m 2019 $400m 2021	2.2 2.3	3 2	0.0 -1.5	$200m $400m	Good tender, particularly given volume.
17 Mar	$50m 2019 $200m 2021	1.6 1.2	7 7	6.5 5.5	$75m $175m	Very poor tender, low bid cover, wide tails.
24 Mar	$150m 2013 $400m 2019 $400m 2021	2.0 1.5 1.6	2 4 6	1.5 1.0 2.0	$150m $400m $400m	Super-sized at the last minute, significantly diluting bid cover ratio.
31 Mar	$400m 2019 $350m 2021	1.2 1.6	5 5	3.0 2.0	$400m $350m	Looks to have stretched the market.
Total	**$2,800m**	**1.81**	**4.14**	**1.44**	**$2,800m**	**Biggest issuance month ever, bid cover and tails suffered accordingly**

Source: ANZ, Debt Management Office.

~ Tail refers to the total "width" of the successful range. For example, if the successful range is 5.70% to 5.73%, the tail is considered to be 4bp, spanning 5.70%, 5.71%, 5.72% and 5.73%

^ Tension refers to the "width" of the successful range using the market mid rate during bidding as the lower bound. This removes the distortion "below market" bid can have on tails. Using the same example as above, if the market mid rate was at 5.72% during bidding, the tension is considered to be 2bp, spanning 5.72% and 5.73%. That's a better representation of what happened, as although the tail was 4bp wide, it was because some bids were below market.

MONTH END CORPORATE BOND PRICING

Issuer	S&P Rating	Maturity	Coupon (%)	Mid yield (%)	Spread to swap	Spread to Govt
NZ Government	AAA	15-Nov-11	6.00%	2.59%	8	
NZ Government	AAA	15-Apr-13	6.50%	3.45%	-13	
NZ Government	AAA	15-Apr-15	6.00%	4.40%	-20	
NZ Government	AAA	15-Dec-17	6.00%	5.21%	-35	
NZ Government	AAA	15-Mar-19	5.00%	5.50%	-45	
NZ Government	AAA	15-May-21	6.00%	5.68%	-35	
ANZNB Callable sub	AA-	15-Sep-11	7.16%	5.19%	255	259
ANZNB Callable sub	AA-	2-Mar-12	7.60%	5.08%	235	232
ANZNB Callable sub	AA-	23-Jul-12	8.23%	5.17%	225	217
ANZNB Senior	AA	18-Sep-12	5.63%	3.95%	95	85
ANZNB Senior	AA	18-Jun-13	6.32%	4.48%	108	96
ANZNB Senior	AA	9-Jun-14	8.50%	5.13%	125	114
ANZNB Senior	AA	31-Mar-15	6.60%	5.64%	145	126
ANZNB Senior	AA	13-Jul-15	6.51%	5.77%	150	130
ANZNB Senior	AA	16-Feb-16	6.32%	6.04%	158	138
ANZNB Senior	AA	16-Feb-18	6.85%	6.55%	165	130
AfDB	AAA	28-Feb-13	7.75%	3.65%	40	28
AMP	A-	15-May-14	9.80%	6.44%	260	248
ASB Bank	AA	23-May-11	8.42%	3.09%	50	58
ASB Bank	AA	16-Jul-13	8.52%	4.54%	110	97
ASB Bank	AA	18-Nov-13	5.51%	4.77%	115	104
ASB Bank	AA	17-Sep-14	8.22%	5.28%	130	115
ASB Bank	AA	20-Oct-15	6.10%	5.93%	157	137
ASB Bank Callable sub	AA-	15-Jun-11	7.03%	4.68%	205	216
ASB Bank Callable sub	AA-	15-Nov-12	8.77%	5.34%	225	215
Asian Development Bank	AAA	29-Jan-14	5.38%	4.02%	30	20
Auckland Healthcare	AA	15-Sep-15	7.75%	5.36%	103	83
AIAL	A-	29-Jul-11	6.83%	3.64%	100	109
AIAL	A-	7-Nov-12	7.19%	4.33%	125	115
AIAL	A-	28-Feb-14	7.25%	5.21%	145	135
AIAL	A-	27-Nov-14	7.00%	5.51%	145	129
AIAL	A-	7-Nov-15	7.25%	5.92%	155	135
AIAL	A-	15-Nov-16	8.00%	6.23%	160	135
Auckland Council	AA	15-Nov-11	8.50%	3.21%	55	63
Auckland Council	AA	24-Mar-14	6.42%	4.69%	90	80
Auckland Council	AA	24-Mar-15	6.28%	5.15%	97	78
Auckland Council	AA	18-Apr-17	5.79%	5.79%	107	78
Bank of America Corp	A	8-Mar-12	7.53%	4.84%	210	207
Bank of New Zealand	AA	15-Sep-11	7.50%	3.24%	60	64
Bank of New Zealand Callable sub	AA-	15-Jun-12	8.42%	5.16%	230	222
Bank of New Zealand	AA	15-Sep-12	7.50%	3.95%	95	86
Bank of New Zealand	AA	27-May-13	8.56%	4.47%	110	97

MONTH END CORPORATE BOND PRICING

Issuer	S&P Rating	Maturity	Coupon (%)	Mid yield (%)	Spread to swap	Spread to Govt
Bank of New Zealand (GG)	AAA	20-Feb-14	4.78%	4.30%	55	45
Bank of New Zealand	AA	27-May-15	8.68%	5.76%	152	133
Bank of New Zealand (CB)	AAA	30-Jun-15	6.00%	5.30%	104	84
Bank of New Zealand	AA	13-Aug-15	6.17%	5.82%	152	132
Bank of New Zealand	AA	15-Sep-16	6.91%	6.25%	166	142
Bank of New Zealand (CB)	AAA	30-Jun-17	6.43%	6.00%	124	93
CHCH City Council	AA+	2-Nov-12	5.75%	3.84%	77	67
CHCH City Council	AA+	20-Apr-15	6.08%	5.35%	115	95
Citigroup Inc	A	18-May-12	7.83%	5.02%	220	213
Contact Energy	BBB	15-May-14	8.00%	5.64%	180	168
Contact Energy	BBB	13-Apr-17	7.86%	6.86%	215	186
Council of Europe	AAA	15-Nov-11	7.75%	2.91%	25	33
Council of Europe	AAA	12-Jun-14	5.50%	4.37%	49	37
Council of Europe	AAA	30-Apr-18	7.50%	5.70%	77	41
Dunedin City Tsy	AA	15-Apr-11	8.70%	2.72%	20	22
Dunedin City Tsy	AA	14-Jun-13	5.56%	4.20%	80	68
Dunedin City Tsy	AA	15-Nov-16	6.79%	5.73%	110	85
Dunedin City Tsy	AA	15-Oct-17	7.81%	6.02%	120	87
Dunedin City Tsy	AA	17-Dec-18	6.85%	6.37%	135	93
EIB	AAA	31-Jul-12	7.75%	3.21%	28	19
EIB	AAA	19-Feb-13	5.00%	3.58%	35	23
EIB	AAA	15-Dec-17	7.50%	5.56%	70	36
EDC	AAA	23-Jun-11	7.50%	2.89%	25	37
Eurofima	AAA	22-May-13	7.13%	3.88%	51	39
Fonterra Cooperative	A+	21-Apr-11	6.64%	2.93%	40	43
Fonterra Cooperative	A+	21-Apr-14	6.86%	4.93%	110	100
Fonterra Cooperative	A+	10-Mar-15	7.75%	5.36%	122	101
Fonterra Cooperative	A+	4-Mar-16	6.83%	5.72%	125	105
Genesis Energy	BBB+	15-Mar-14	7.25%	5.23%	145	135
Genesis Energy	BBB+	15-Mar-16	7.65%	6.08%	160	140
Genesis Energy	BBB+	15-Sep-16	7.19%	6.34%	175	151
IADB	AAA	15-Apr-15	7.50%	4.53%	33	13
IADB	AAA	15-Dec-17	6.25%	5.41%	55	21
IAG	A+	21-Nov-12	9.11%	6.65%	355	345
IBRD (World bank)	AAA	16-Jul-12	7.06%	3.06%	15	7
IBRD (World bank)	AAA	30-Jul-14	7.50%	4.23%	30	17
IBRD (World bank)	AAA	15-Dec-14	5.38%	4.39%	31	14
IFC	AAA	23-Aug-12	7.75%	3.14%	18	9
IFC	AAA	19-Mar-15	5.38%	4.52%	35	16
IFC	AAA	15-Dec-17	6.25%	5.40%	54	19
Kiwibank Ltd Callable sub	A+	20-Mar-12	7.72%	5.05%	230	226
Kiwibank Ltd Callable sub	A+	30-Sep-13	8.75%	5.85%	230	219
Kommunalbanken	AAA	3-Jul-14	5.75%	4.46%	55	43

MONTH END CORPORATE BOND PRICING

Issuer	S&P Rating	Maturity	Coupon (%)	Mid yield (%)	Spread to swap	Spread to Govt
Auckland Council (Manukau)	AA	15-Sep-15	6.90%	5.33%	100	80
Auckland Council (Manukau)	AA	29-Sep-17	6.52%	5.96%	115	82
Meridian Energy (MEL010)	BBB+	16-Mar-15	7.15%	5.52%	135	116
Meridian Energy (MEL020)	BBB+	16-Mar-17	7.55%	6.40%	170	142
Merrill Lynch (BofA)	A	4-Sep-13	7.16%	5.66%	215	203
Mighty River Power*	BBB+	15-May-13	8.36%	4.64%	130	116
Mighty River Power	BBB+	12-Oct-16	7.55%	6.31%	170	146
Morgan Stanley	A	6-Sep-12	6.86%	5.03%	205	195
Morgan Stanley	A	30-May-14	7.95%	6.34%	247	236
Municipality Finance	AAA	10-Jun-11	7.73%	2.93%	30	41
NIB	AAA	26-Feb-14	5.25%	4.08%	32	22
NIB	AAA	15-Apr-15	7.50%	4.69%	49	29
NZ Post	AA-	15-Nov-11	7.10%	3.16%	50	58
NZ Post Callable sub	A	15-Nov-14	7.50%	6.90%	285	270
Powerco Limited*	BBB	28-Sep-12	6.59%	4.96%	195	185
Powerco Limited*	BBB	29-Mar-13	6.39%	5.28%	200	186
Powerco Limited*	BBB	29-Jun-15	6.53%	6.24%	200	178
Powerco Limited*	BBB	28-Sep-17	6.74%	6.88%	210	174
QTC	AA+	18-Sep-17	7.13%	5.61%	80	47
Rabobank NZ	AAA	15-Aug-11	7.65%	3.24%	60	67
Rabobank NZ	AAA	3-May-12	7.68%	3.51%	72	65
Rabobank NZ	AAA	19-Apr-13	5.47%	4.17%	85	72
Rabobank NZ	AAA	4-Sep-14	6.32%	4.97%	100	86
Rabobank NZ	AAA	1-Mar-16	5.48%	5.54%	107	87
Rentenbank	AAA	15-Nov-11	6.69%	2.92%	26	34
Rentenbank	AAA	15-Apr-13	7.75%	3.72%	41	28
Rentenbank	AAA	23-Sep-14	5.59%	4.53%	54	40
Rentenbank	AAA	15-Dec-17	7.49%	5.64%	78	44
Solid Energy	NR	7-Dec-16	8.00%	6.64%	200	174
Tauranga CC	A+	2-Dec-13	7.05%	4.49%	85	74
Tauranga CC	A+	15-Apr-16	6.25%	5.59%	109	89
Telecom (TCNZ Finance Ltd)	A	22-Mar-13	6.92%	5.10%	182	169
Telecom (TCNZ Finance Ltd)	A	15-Jun-13	8.50%	5.30%	190	178
Telecom (TCNZ Finance Ltd)	A	15-Jun-15	8.65%	6.25%	200	180
Telecom (TCNZ Finance Ltd)	A	22-Mar-16	7.04%	6.48%	200	180
Telstra Corp Ltd	A	24-Nov-11	6.99%	3.37%	70	77
Telstra Corp Ltd	A	24-Nov-14	7.15%	5.35%	130	114
Telstra Corp Ltd	A	11-Jul-17	7.52%	6.47%	170	139
Toyota Finance NZ	AA-	5-Aug-11	7.34%	3.19%	55	63
Transpower Finance	AA	12-Nov-19	7.19%	6.29%	115	74
Transpower Finance	AA	10-Jun-20	6.95%	6.36%	115	76
Vector Ltd (VCT050)	BBB+	15-Oct-14	7.80%	5.66%	170	150
Auckland Council (Waitakere)	AA	30-Mar-12	5.50%	3.39%	65	58

MONTH END CORPORATE BOND PRICING

Issuer	S&P Rating	Maturity	Coupon (%)	Mid yield (%)	Spread to swap	Spread to Govt
Auckland Council (Waitakere)	AA	2-Oct-14	6.68%	4.95%	95	81
Warehouse (WHS010)	NR	15-Jun-15	7.37%	6.60%	235	215
Watercare Services	AA	19-Oct-11	6.86%	3.18%	53	57
Watercare Services	AA	15-May-14	6.79%	4.95%	110	99
Watercare Services	AA	16-Feb-15	5.74%	5.39%	125	107
Watercare Services	AA	18-May-16	7.14%	5.90%	138	117
Wellington International Airport	BBB+	15-Nov-13	7.50%	6.06%	245	234
Wellington Regional Council	AA	17-Feb-12	6.21%	3.23%	50	49
Wellington Regional Council	AA	16-Dec-13	5.60%	4.41%	75	64
Westpac NZ	AA	18-Apr-11	8.87%	2.87%	35	37
Westpac NZ	AA	19-Dec-11	7.24%	3.29%	60	65
Westpac NZ	AA	28-Nov-13	7.05%	4.73%	110	99
Westpac NZ (GG)	AAA	22-Jul-14	5.74%	4.47%	55	42

Note: (*) denotes quarterly coupons; (a) denotes price

MONTH END HYBRID BOND PRICING

Unrated and Hybrid Issues	S&P Rating	Maturity	Coupon (%)	Mid yield (%)	Spread to swap	Spread to Govt
ANBHA	A+	Perp		108.50		
APN Media (NZ) Ltd	NR	15-Mar-16	7.86%	8.02%	357	334
ASBPA	A-	Perp		72.20		
ASBPB	A-	Perp		68.00		
BISHA	A+	Perp		103.95		
BNZ Income Sec (II)	A+	Perp		107.00		
Prime Infrastructure (PIN020)	Ba3	30-Nov-12	9.00%	10.10%	699	688
CBA	A+	15-Apr-15	8.82%	93.20		
Fletcher Building (FBU210)	NR	15-Mar-12	7.50%	6.85%	411	406
Fletcher Building (FBF050)	NR	15-May-14	9.00%	7.15%	330	319
Fletcher Building (FBF060)	NR	15-May-16	9.00%	7.30%	278	257
Fonterra Perpetual	A	Perp	8.52%	80.50		
Goodman Fielder NZ Ltd	NR	16-May-16	7.54%	6.69%	220	197
GPG* (GFN030)	NR	15-Nov-12	8.30%	8.60%	552	541
GPG* (GFN020)	NR	15-Dec-13	9.00%	8.70%	506	494
Greenstone Energy (GEF010)	NR	15-Oct-16	7.35%	7.29%	268	244
Infratil* (IFT140)	NR	15-May-11	8.25%	7.00%	443	450
Infratil* (IFT040)	NR	15-Nov-11	8.50%	7.90%	525	532
Infratil* (IFT060)	NR	15-Nov-12	7.75%	7.77%	469	458
Infratil* (IFT070)	NR	15-Sep-13	8.50%	8.10%	459	445
Infratil* (IFT013)	NR	15-Nov-15	8.50%	8.52%	417	394
Infratil* (IFT090)	NR	15-Feb-20	8.50%	9.17%	403	360
Infratil	NR	Perp	9.00%	60.50		
Kiwi Capital Securities	BBB	Perp		102.50		
Rabobank (RBOHA)	AA-	Perp		75.00		
Rabobank (RCSHA)	AA-	Perp		107.65		
Sky City* (SKC030)	NR	15-May-15	7.25%	7.00%	280	258
SKY TV (SKTFA)	NR	16-Oct-16	8.34%	90.50		
Trustpower* (TPW020)	NR	15-Sep-12	8.50%	6.65%	366	356
Trustpower* (TPW060)	NR	15-Mar-14	8.50%	6.95%	319	307
Trustpower*	NR	15-Dec-14	7.60%	6.53%	247	229
Trustpower*	NR	15-Dec-16	8.00%	7.10%	248	220
Trustpower* (TPW100)	NR	15-Dec-17	7.10%	6.90%	207	170
Vector Ltd (VCT040)	BBB-	15-Jun-12	8.00%	6.65%	379	371
Works Infrastructure* (WKS010)	NR	15-Jun-12	9.80%	18.75%	1590	1581
Works Finance (WKS020)	BBB-	15-Sep-12	9.65%	7.34%	435	425
PGG Wrightson* (PWF030)	NR	8-Oct-11	8.25%	6.60%	397	398

Note: (*) denotes quarterly coupons; (a) denotes price

IMPORTANT NOTICE

NEW ZEALAND 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.
- OnePath (NZ) Limited, as a wholly owned subsidiary of the Bank, is an associated person of the Bank. OnePath and its related companies may receive remuneration from a third party relating to a security sold by the Investment Adviser.
- Direct Broking Limited (DBL), as a wholly owned subsidiary of the Bank, is an associated person of the Bank. DBL 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

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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.

NEW ZEALAND 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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