INTEREST RATE STRATEGY
NEW ZEALAND LOCAL AUTHORITY UPDATE

8 August 2012

CONTRIBUTORS

Carrick Lucas
Strategist
Telephone: +64 4 802 2357
E-mail: carrick.lucas@anz.com

David Croy
Head of Markets Research, NZ
Telephone: +64 4 576 1022
E-mail: dc@anz.com

SUMMARY

Local government debt levels continue to rise and pressure on finances has risen, though balance sheets remain strong. Rising debt levels have led to an increase in debt servicing costs, although this has been offset to some extent by lower interest rates. Local authority credit spreads are significantly higher than pre-GFC levels, albeit an increasing number of councils are now benefitting from the pooling capabilities of the Local Government Funding Agency (LGFA). Councils are facing increasing pressure to rein in spending and cap the growth in rates[1]. The recently announced 'Better Local Government' reform programme will also require councils to take a prudent approach to managing debt while improving legislative frameworks and governance structures.

The pressure on both local and central government finances has risen significantly in the past few years. The central Government continues to target a return to surplus by FY2015. The baton has now been passed to local governments, with pressure rising to cap the rise in debt, rein in expenditure and limit the growth in rates charges. Rates increases have averaged more than 6 percent per annum in the past decade – twice the rate of general inflation. Households face a number of financial constraints in the current subdued economic environment, making it more difficult for councils to raise revenues through traditional means. A number of local authorities are considering asset sales to reduce debt. Pressure to tighten the purse strings is against a backdrop of historic underinvestment in infrastructure, and the necessary catch-up in capital spending plans will require additional borrowing.

Local government debt levels have quadrupled in the past decade and are expected to rise further. The sector's "Debt Cover" ratio (operating revenue as a proportion of debt) has more than halved to 70 percent since 2004. On the flipside, the "Interest Cover" ratio (debt servicing costs as a proportion of operating income) has doubled in the past five years, which is contributing to a more generalised increase in local government spending. Expenditure growth has been increasing at annual rate of 8.7 percent over the same period, outpacing revenue growth and contributing to widening operating deficits.

Despite the recent deterioration in local government finances, the starting point remains strong. The aggregate NZ local authority balance sheet remains relatively strong, with debt cover ratios considerably lower than the average corporate balance sheet. All else being equal, this should allow for greater of use of leverage given the low starting point. Positive revision to asset valuations has seen the sector's debt-to-asset ratio rise only moderately, from 5.2 percent in 2004 to 8.7 percent in 2011. Again, this stacks up favourably compared to the domestic corporate sector.

[1] While we refer to local authority "rates" in the New Zealand context, these types of payments may be referred to as levies or taxes on property owners in other jurisdictions.

LOCAL AUTHORITY UPDATE

Local authorities continue to benefit from the strong support of credit rating agencies. Of the 78 councils in New Zealand, all of those that choose to be rated by an independent credit rating agency benefit from an investment grade rating. Key positive ratings factors include the strength of New Zealand's institutional framework, the budgetary flexibility of councils, and the requirement that all debt be secured over rates. Legislation is viewed as predictable and supportive of local councils, while the institutional framework is said to promote a strong management culture and fiscal discipline. Transparency is high. Councils are required to balance budgets and provide 10-year long-term plans every three years, which in turn sets the baseline for expenditure programmes and funding strategies and the requirement that all debt must be secured over rates. In theory, councils benefit from having the power and flexibility to raise rates.

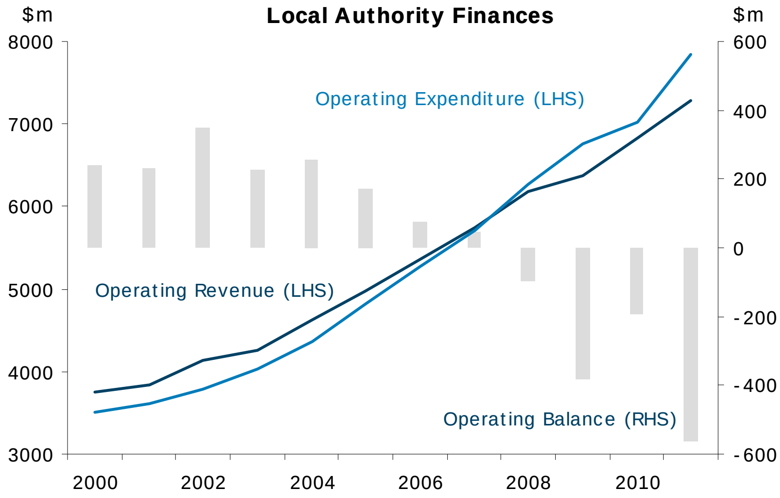
Local Government has seen some significant changes in the past few years. Auckland's regional councils have been amalgamated into a single entity (Auckland Council) and the New Zealand Local Government Funding Agency (LGFA) has been created. We take a closer look at these and other big picture themes that are set to play a key role for the sector in the years ahead. The recent adoption of 2012-2022 Long-Term Council Community Plans (LTCCPs) is also timely given the reform efforts and the challenges facing local councils.

LOCAL AUTHORITY FINANCES

Key Local Government Financial Statistics			
June years	**2005**	**2008**	**2011**
Expenditure (% of GDP)	3.1	3.4	3.9
Surplus (% of GDP)	*0.1*	*-0.1*	*-0.3*
Income – Rates (% of Total)	55.8	58.0	59.9
– Central Government	13.3	13.0	14.1
– Other	30.9	29.0	26.1
Expenditure – Employee costs	22.9	22.7	21.4
– Interest costs	3.3	5.1	6.5
Debt Cover (Operating Rev/Debt)	1.4	1.0	0.7
Interest Cover (Operating Rev/Interest)	30.3	19.3	14.3
Debt to equity (%)	5.4	7.0	9.6

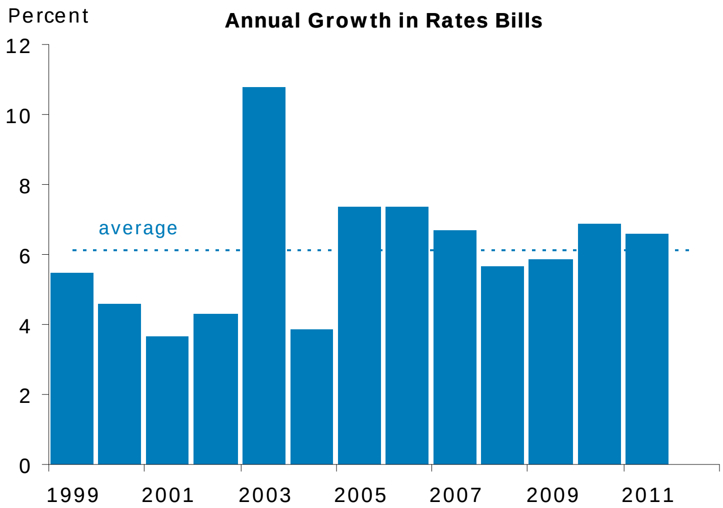
Sources: ANZ National, Statistics NZ

Local authorities recorded operating deficits in each of the past four years as expenditure growth has outpaced higher revenue. Annual revenue growth has averaged 7.0 percent since 2004 courtesy of solid rates revenue growth, while annual expenditure growth has increased at an even faster pace of 8.7 percent over the same period. Local government spending has increased from 3 to 4 percent of GDP in the past five years (equivalent to around 9.3 percent of central government spending in 2011). In the year to June 2011, operating income increased 6.5 percent compared to an 11.6 percent increase in spending on core services, leading to a $562 million widening in the operating deficit. Recent local council reform efforts should begin to address the long-term sustainability of rapid expenditure growth and widening deficits.



Source: ANZ, Statistics NZ

Rates charges have increased by an average of 6.1 percent per annum since 1999, an increase of more than twice the rate of inflation. This level of rates growth is clearly unsustainable in the current environment of central government and household belt-tightening. Councils are facing increasing pressure from both central government and ratepayers to raise rates in line with inflation and population growth. Intense debate and sensitivities towards rate increases are becoming more commonplace. There is no legal restriction on councils increasing rates although the central government reform “Better Local Government” directive will encourage councils to move down a road towards fiscal responsibility by capping expenses, limiting the annual rise in rates, and requiring councils to refocus their priorities towards core services. Asset sales are also now being proposed by some authorities as an alternative revenue source to limit rates increases. **Local Council 2012-2022 long term plans (LTCCPs) adopted in July have pitched rates growth in New Zealand’s main centres at around 3½ to 5 percent per annum.** We question whether these forecasts will match reality.

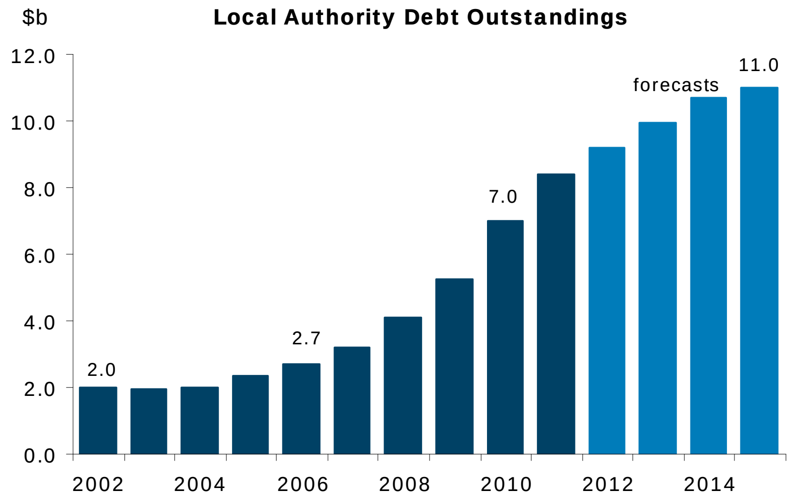


Source: Ministry of Internal Affairs

LOCAL AUTHORITY UPDATE

As a percentage of total revenue, local council income from rates has remained relatively static at around 60 percent, although pressure is now coming on non-rate revenues given the weaker economic backdrop. **Rising local authority spending growth has also been met by an increase in central government grants and subsidies** which rose to 16.1 percent of total revenue in 2011 from 12 percent a year earlier. This could suggest that more is being asked of local governments in the form of regulation and policing of community issues by the central government, although this is set to change under the “Better Local Government” reform programme which focuses on councils returning to the provision of core services.

Local government debt has quadrupled over the past decade from $2 billion in 2002 to a projected $9 billion in 2012. In per capita terms, this represents an increase from around $500 to $2,000 – relatively small numbers. While households and businesses have been reducing their exposure to debt since the global financial crisis, outstanding local authority debt is projected to rise to $11 billion by 2015 (these figures are due to be updated in September with the release of the 2012-22 Long Term Plan Analysis).

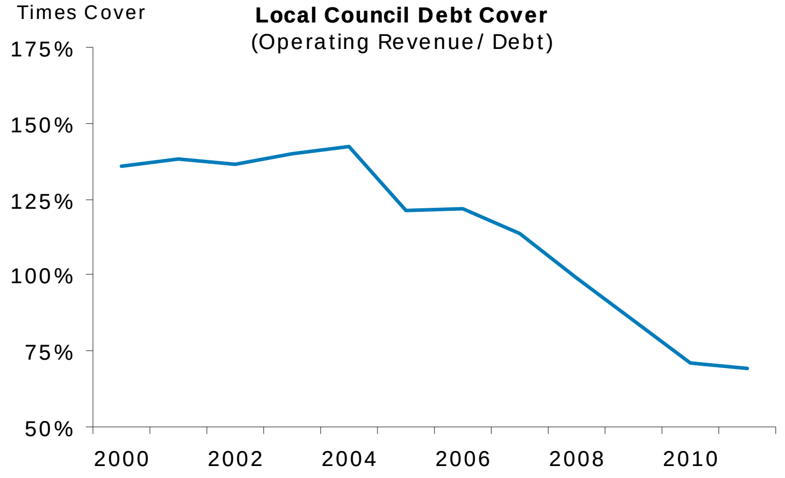


Source: Statistics NZ, Local Authority LTCCP Financial Analysis 2009/19

On an annual basis, council borrowing has increased from $0.9 billion in 2008 (0.5 percent of GDP) to around $2 billion in 2011 (1.0 percent of GDP) and is expected to rise further.

The balance sheets of the local governments remain reasonably strong despite the “Debt Cover” ratio more than halving from 1.4 times cover in 2004 to 0.7 times cover in 2011. That is, annual operating revenue now covers only 70 percent of council debt. However, debt cover remains relatively strong compared to the average New Zealand corporate balance sheet which uses greater leverage. Credit ratings agencies are increasingly paying close attention to this metric (measured as operating revenue as a proportion of debt) in their analysis of council ratings.

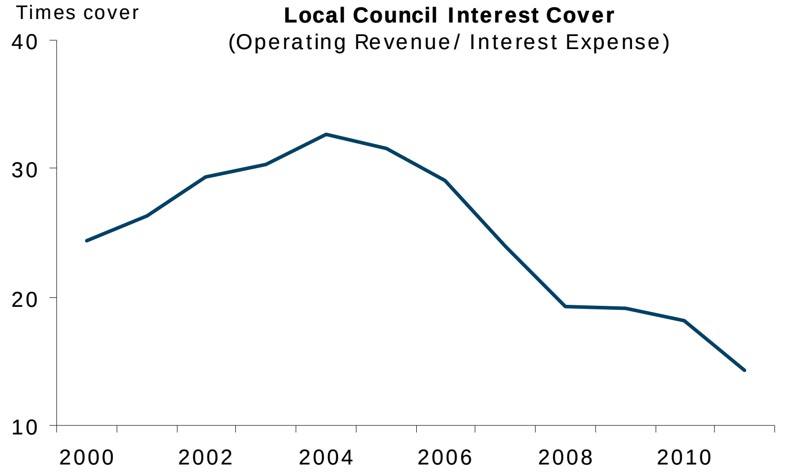
LOCAL AUTHORITY UPDATE



Source: Stats NZ

Local authority balance sheets continue to reflect a position of strength from a net wealth perspective. Asset values increased 17.1 percent to $120.6bn in the year to June 2011, while local authority equity was estimated to have increased to $110bn. This has had the effect of reducing the local authority debt-to-equity ratio from a peak of 10.3 percent in 2010 to 9.6 percent in 2011 (up from around 5 percent in 2004). The 2011 aggregate council debt-to-asset ratio of 8.7 percent remains relatively contained. While there is typically a lot of commentary directed at the liabilities side of council balance sheets, **a lot of commentary misses the size of the assets under control.** Considering that a fair proportion of the **assets are intergenerational in nature, it is wholly appropriate that debt funds their existence**.

The rapid increase in nominal debt has led to a **significant rise in interest costs, which has been one of the key factors driving expenditure growth. "Interest Cover" has more than halved in the past five years to 14.3 times operating revenue in 2011.** Interest costs now represent 6.5 percent of council expenditure and in combination with employee costs (21 percent) and other operating expenditures (50 percent) have contributed to a more generalised increased in local government spending. Again, this interest cover ratio is significantly better than the corporate average but remains one to keep an eye on. It's also worth noting that this is an average figure – Auckland Council accounts for around one-third of all local authority debt and its interest servicing costs are projected to increase from around 12 percent of operating expenditure to 21 percent in the next ten years.



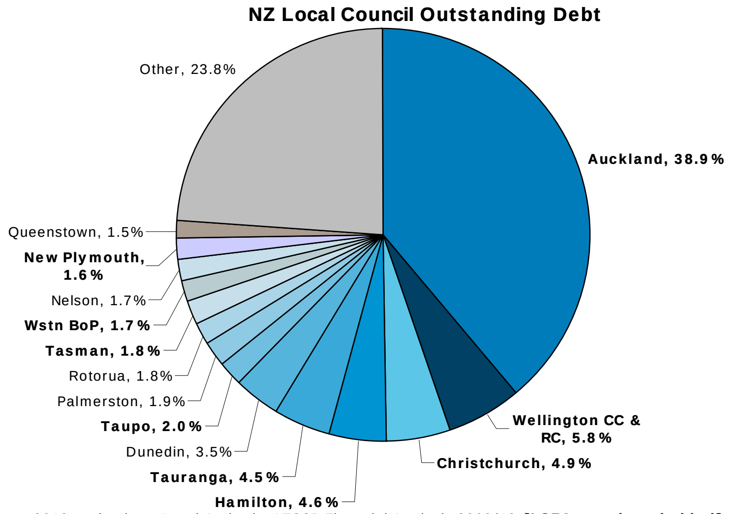
Source: Stats NZ

CREATION OF THE NZ LOCAL GOVERNMENT FUNDING AUTHORITY (LGFA)

The Local Government Funding Agency (LGFA) was incorporated in December 2011, creating a new fixed interest asset class for NZ wholesale and retail investors. The LGFA is a Council Controlled Organisation (CCO) operating under the Local Government Act 2002 and the specially created Local Government Borrowing Act 2011. Its primary purpose is to achieve a lower cost of funds for councils, and access to diversified funding sources (including foreign currency) for participating NZ local authorities. The LGFA benefits from a very strong AA+ (local currency) investment grade credit rating – on a par with the New Zealand Government rating. Standard & Poor's rating is premised on the view that there is an "extremely high likelihood of extraordinary support from the New Zealand government" but also reflects the LGFA's strong standalone profile. The LGFA also benefits from access to a $500m liquidity line from the NZDMO and its bonds are repo-eligible with the RBNZ.

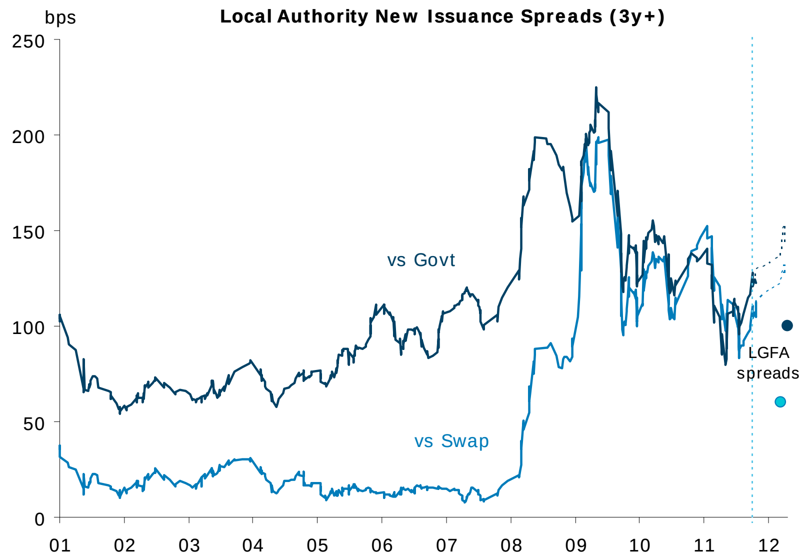
LGFA issuance now funds a large portion of the issuance needs of its 18 local government shareholders. A majority have committed to funding 80 percent of their borrowing needs through the LGFA, although Auckland Council has so far only committed one third (minimum) of its own funding needs (due in most part to concentration limits within the LGFA structure). LGFA shareholders hold around three-quarters of outstanding local authority debt, with the largest councils yet to join up to the central funding agency including Dunedin City Treasury, Palmerston North, Rotorua, Nelson, Queenstown-Lakes and Kapiti Coast. The LGFA hopes to raise the number of participating Local Authorities to 30 by the end of 2012 and as many as 40 by September 2013.

LOCAL AUTHORITY UPDATE



Source:2012 projection - Local Authority LTCCP Financial Analysis 2009/19 **[LGFA members bolded]**

Credit Spreads on local authority debt increased dramatically following the onset of the global financial crisis (GFC). The concept of a central funding agency for NZ local authorities had been under consultation for many years, but it was not until the GFC-induced spike in funding costs that the creation of the LGFA began to really gain traction. Prior to 2007, councils were able to issue medium-to-long term debt at margins of less than 20 bps over swap. However, local authority margins blew out to nearer 200bps above swap in 2009 with lower-rated councils being forced to fund at levels in excess of 250bps over swap. An improvement in credit conditions in the post-GFC world has seen individual issuer spreads narrow back towards 100-150bps over swap, but they remain wide and relatively volatile by historical standards.



LOCAL AUTHORITY UPDATE

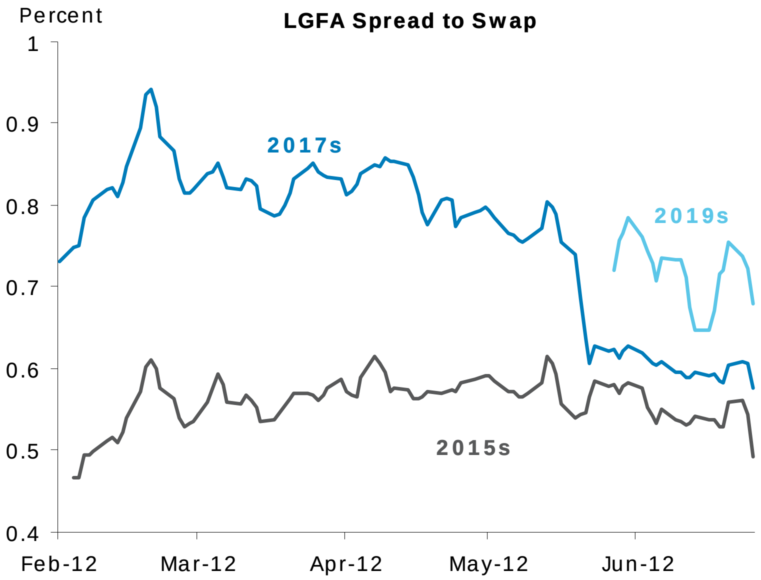
LGFA PRIMARY ISSUANCE

The LGFA has issued $980m of bonds in five tenders held in 2012, attracting an average spread to swap of 75bps. The average spread to swap in the past two tenders narrowed to around 65-70bps above swap.

Maturity	Volume on Issue	Bid Cover Ratio	Average Successful Yield (%)	Spread to Swap (bps)	Spread to NZGS (bps)
Apr-2015	$165m	3.4	3.79	57	78
Dec-2017	$605m	5.3	4.54	82	107
Mar-2019	$210m	4.6	4.09	70	104
	$980m	**4.5**		**+75**	**+102**

Demand for LFGA issued bonds has been very strong, with an average bid-cover ratio of 4.5 times (this compares to a 2.4 bid-cover ratio for NZGS in 2012). Issuance in the first three tenders was concentrated on the 4/15 and 12/17 mid-curve bonds, with the more recent rally in interest rates allowing the LGFA to issue a longer-dated 3/19 bond at lower nominal yields.

Margins on the LGFA bonds have narrowed slightly from the initial February 2012 issuance spreads. The market is now marking LGFA bonds on a spread versus swap (originally the LFGA bonds were marked on a spread to NZGS as both securities shared identical coupons and maturities). The spread to swap on the LGFA 4/15 has been little changed at around 50bps year to date. In contrast, the spread to swap on the LGFA 12/17s has narrowed from 87bps in the initial tender to 70bps in July. The LGFA 3/19 bond has been a more recent addition to the issuance programme and was most recently issued at 70bps above swap.



This translates to an average funding cost of around 75bps over swap (or 100 basis points above NZGS), although the average spread to swap has narrowed to 65-70bps above swap in the past two tenders. Demand for LGFA bonds has primarily come from bank balance sheets and domestic wholesale investors. **Over the longer term the LGFA hopes to achieve a funding spread of 50bps above NZGS by mid 2013 and 40bps over NZGS from 2014 (or around 75bps over swap at current**

levels). These targets look ambitious in the current market environment and we would expect some mid-ground to be found as liquidity improves and the investor base broadens. The LGFA has the potential to issue into offshore markets if pricing stacks up, and this should serve to diversify the investor base over time and lead to spreads compressing to levels closer to those achieved by Kauri issuers.

Member councils are in turn charged a margin above the cost of funds achieved by the LGFA at tender. The highest rated participating local authorities (those with AA ratings) are charged a margin of no more than 40bps and unrated councils look to be charged a margin of up to 60bps above swap (based on a differential credit scale and financial metrics of individual councils). This equates to an all-up cost to member councils of around 110-130bps above swap. More recently, previously unrated councils have received (or are hoping to receive) an investment grade credit rating so as to benefit from the LGFA differential pricing scale. Palmerston North City Council is a case in point and was assigned an AA long-term rating by Standard & Poor's on 27 June 2012.

The benefits of LGFA issuance to member councils extend beyond a cheaper average cost of funding. The volatility of local authority credit spreads has narrowed and smaller member councils can access cheaper funding by leveraging off the scale of a central funding agency. The probability that a smaller council will be forced to borrow at a margin of 250bps above swap at times of capital market turmoil is also significantly diminished. Larger benefits may accrue over time if the LGFA is able to hit its long-term target for a margin of 40bps above NZGS. **The advent of the LGFA has created a two-tiered market for local authority issuance.** LGFA issuance has made up approximately three-quarters of local authority issuance in the year to date, with issuance from other local authorities relatively sporadic. Auckland Council has been the only issuer of note in recent months, benefiting from somewhat of a scarcity premium. Recently, its March 2016 issue was tapped at around 100bps over swap and the council issued 10 year bonds at 140bps over swap. The advent of LGFA issuance has also led to a compression in credit spreads for smaller councils who can now borrow at a margin of around 140bps for 5 years. The New Zealand fixed income market lacks diversification, and issuers can often benefit from a name-specific premium given the structure of typical investor mandates.

2012-22 LONG TERM COUNCIL COMMUNITY PLANS

Demands and expectations of local government will remain high. Every three years local councils are required to formulate Long-Term Council Community Plans (LTCCPs) based on a ten year horizon. Long-term planning is embedded within local authority financial management and supports transparency and accountability of the sector, looking out for the following 10 years. This ensures comprehensive budgeting and long-term capital and financial planning.

2012-22 draft council plans were adopted on 1 July 2012 with a majority targeting a reduction in costs and limits on both debt levels and rates growth in accordance with local council reform initiatives.

On the back of reform efforts introduced by central government, local councils are starting to move towards plans for long-term debt sustainability and capping the growth in expenditure and rates increases. These themes are reflected in a number of recently adopted 2012-22 long term plans.

CASE STUDIES:

Hamilton City Council's 2012-22 long-term plan puts significant emphasis on improved fiscal responsibility and governance. The council has set out plans to return to surplus within 5 years, limit rates increases to 3.8 percent per annum over the next ten years, and caps debt at $440m (from a projected peak of $700m). To meet these ambitious targets the council will need to cut costs, sell some assets, and increase user charges. By 2015 the council expects to be saving $15m (or 10 percent of operating costs) per annum, and the plan is being viewed as a blueprint by some commentators.

Tauranga City Council's 2012-22 long-term plan aims to limit rates increases and demonstrate fiscal responsibility. Tauranga City Council has agreed to put a limit on future rates increases from 2013-14 - set at no more than projected CPI plus 2 percent. Current projections would see annual average rates increases of 3.6 percent over the next ten years. The council is also projecting a reduction in debt/revenue from 248 percent to 174 percent over the next ten years, to be achieved through surpluses and selling off surplus property assets. Nominal debt is projected to rise by $40 million over the same period.

Auckland Council's long term plan shows debt is expected to rise from $4.8b to $12.5b in the next ten years as Auckland looks to borrow to fund part of its proposed $20.2b capital plan (largely targeted at new transport projects including the City Rail Link). Interest costs are currently 12 percent of operating expenditure, although projected to rise to as much as 21 percent over the forecast horizon. Rates are projected to rise by 3.6 percent in 2012 and 4.9 percent per annum out to 2022. The current year sees the introduction of a single rating system, meaning a quarter of a million households will face an average 8.1 percent increase in rates, while 187,000 households will face an average 4.9 percent rates decrease. Auckland's financial strategy aims to balance its operating budget by reducing expenditure on existing services with efficiency gains of $97 million projected in the period to 2018. Net debt is projected to peak at around 240 percent of revenue in 2020 against a proposed policy limit of 275 percent (currently 175 percent). Interest costs are projected to peak at around 14.5 percent of revenue in 2020 against a policy limit of 15 percent. The council has proposed setting limits on its borrowings to maintain debt at sustainable levels and maintain a credit rating of at least "A+". The council plans to diversify its funding sources offshore and via the LGFA channel, and protect against higher interest rates by hedging at least 50 percent of debt at fixed rates. Standard & Poor's removed Auckland Council from negative watch in February 2012 affirming its current AA rating.

Christchurch City Council's situation is unique with significant new borrowing required to fund the earthquake rebuild. Rates increases of 7.8 percent have been included as part of the council's 2012/13 annual plan, although new projects proposed in the recently released Christchurch Central Development Unit (CCDU) plan will put additional pressure on council finances. Despite the rise in rates, the level is still well below that in a majority of other New Zealand metropolitan centres. Prudent financial management in the past will allow the council to borrow to fund a majority of rebuild costs, but partial asset sales have also been touted as a means for funding part of the rebuild, new sports facilities and new library. The council has investments worth $1.57 billion including majority stakes in Orion, Lyttleton Port, the Christchurch Airport, Red Bus, City Care and Enable Networks. Debt is projected to rise from $500 million to around $1.4

billion by 2017 which is likely to put further pressure on the council's AA credit rating (on negative outlook after the 2011 downgrade). The council continues to target net debt of less than 100 percent of total revenue (67 percent in 2012/13).

Finally, an example of how not to manage council finances. **Kaipara District Council has proposed an average rates increase of 31 percent in 2012/13** in an effort to halve the council's $83 million debt (to be followed by 2-5 percent rates increases in subsequent years). The surge in rates is due to a blowout in costs associated with the Mangawhai Community Wastewater Scheme which came in at $65m (three times over budget). Operating costs and interest payable on the $58 million of debt associated with the scheme will lead to a further accumulation of debt without immediate action. Thus, the council plans a significant hike to rates in the coming year in an effort to move toward a more sustainable financial position. A popular rates revolt now threatens with ratepayers complaining to police and a group of 2000 residents marching through Mangawhai. A number of Mangawhai property owners are expected to sell up.

All are examples of reality setting in. While a host of attention centres around the altered behaviour of household's and Government's having to live within their means, the stark reality is that **the global finance crisis had more far reaching consequences** and **the local authority sector is not immune**. We expect the above case studies to become more common-place and for more extensive pressure for consolidation across local authorities.

BETTER LOCAL GOVERNMENT REFORM

"Better Local Government" is an eight point reform programme released by the Government in March 2012 aimed at improving the council legislative framework. The reforms will require New Zealand's 78 councils to improve their efficiency in the delivery of public services and related governance structures. Local government debt has more than quadrupled in the past decade and the reforms will also be critical to New Zealand's future in that both central government and councils will be forced to take a more prudent approach to managing public debt. This is already starting to happen with a number of 2012-22 Long Term Council Plans looking to cap debt levels and limit the growth in spending and rates. There have, however, been pockets of resistance as can be expected when there are political dynamics involved. Long-term debt sustainability and a strong institutional framework are key factors for investors and credit rating agencies alike.

The first four points of the "Better Local Government" work programme were included in the Local Government Act 2002 Amendment Act introduced to Parliament on 30 May 2012 and due to be passed by September.

a) **Refocus the purpose of local government** to meet the current and future needs of communities for good quality local infrastructure, public services and performance of regulatory functions in a way that is most cost effective for households and businesses.

b) **Introduce fiscal responsibility requirements**: The Bill will legislate for fiscal responsibility requirements in respect of income and expenditure, and prudent debt levels, to be developed in consultation with Local Government New Zealand. The requirements **are likely to include limits to debt and growth in operational expenditure,** although details have yet to be finalised. The failure to adhere to the requirements would then trigger new Crown assistance and intervention powers.

c) **Strengthen council governance** in relation to staff numbers and remuneration, extending some aspects of the Auckland governance innovations.

d) **Streamline council reorganisation procedures.**

The “Better Local Government” reform programme follows completion of Auckland Council governance reforms and supersedes the previous Minister of Local Government’s review of the local government system called “Smarter Government, Stronger Communities: Towards Better Local Governance and Public Services”. A second reform bill covering other areas of local government reform such as is proposed for 2013.

In our view, the recently announced local authority reform efforts are a step in the right direction. Despite the low starting point, council debt has risen significantly in the past decade with annual expenditure growth of 8.7 percent outstripping even the 6 percent growth in annual rates bills. Many local authorities have become entrenched in the supply of non-core services; spending money on services that central government believes are well outside the scope that was originally intended. Ironically, at the same time, many of the services that members of the public regard to be core services (rubbish removal is an example) have been contracted out. Such initiatives have reduced fixed costs. However this has been offset by variable costs rising more sharply than generalised inflation as private sector providers look to turn a profit on these services.

We agree that the purpose and scope of council activities needs to be narrowed and redefined to limit the acceleration in council expenditure. In the current environment of austerity, ratepayers and the wider voting public are right to demand accountability and transparency from their local councils. A shift toward central government enforcing staff and remuneration caps and refocusing council responsibilities toward core activities is also a step in the right direction. As are improved institutional and governance structures, and the proposed introduction of prudent fiscal management rules. Council reform is likely to be a slow-moving iterative process and we watch this space with interest.

IMPORTANT NOTICE

IMPORTANT NOTICE: The distribution of this document or streaming of this video broadcast (as applicable, "publication") may be restricted by law in certain jurisdictions. Persons who receive this publication must inform themselves about and observe all relevant restrictions.

COUNTRY/REGION SPECIFIC INFORMATION:

AUSTRALIA. This publication is distributed in Australia by Australia and New Zealand Banking Group Limited (ABN 11 005 357 522) ("ANZ"). ANZ holds an Australian Financial Services licence no. 234527. A copy of ANZ's Financial Services Guide is available at http://www.anz.com/documents/AU/aboutANZ/FinancialServicesGuide.pdf and is available upon request from your ANZ point of contact. If trading strategies or recommendations are included in this publication, they are solely for the information of 'wholesale clients' (as defined in section 761G of the Corporations Act 2001 Cth). Persons who receive this publication must inform themselves about and observe all relevant restrictions.

BRAZIL. This publication is distributed in Brazil by ANZ only for the information of the Central Bank of Brazil. No securities are being offered or sold in Brazil under this publication, and no securities have been and will not be registered with the Securities Commission – CVM.

BRUNEI. JAPAN. KUWAIT. MALAYSIA. SWITZERLAND. TAIPEI. This publication is distributed in each of Brunei, Japan, Kuwait, Malaysia, Switzerland and Taipei by ANZ on a cross-border basis.

EUROPEAN ECONOMIC AREA ("EEA"): UNITED KINGDOM. ANZ is authorised and regulated in the United Kingdom by the Financial Services Authority ("FSA"). This publication is distributed in the United Kingdom by ANZ solely for the information of persons who would come within the FSA definition of "eligible counterparty" or "professional client". It is not intended for and must not be distributed to any person who would come within the FSA definition of "retail client". Nothing here excludes or restricts any duty or liability to a customer which ANZ may have under the UK Financial Services and Markets Act 2000 or under the regulatory system as defined in the Rules of the FSA. **GERMANY.** This publication is distributed in Germany by the Frankfurt Branch of ANZ solely for the information of its clients. Other EEA countries. This publication is distributed in the EEA by ANZ Bank (Europe) Limited ("ANZBEL") which is authorised and regulated by the FSA in the United Kingdom, to persons who would come within the FSA definition of "eligible counterparty" or "professional client" in other countries in the EEA. This publication is distributed in those countries solely for the information of such persons upon their request. It is not intended for, and must not be distributed to, any person in those countries who would come within the FSA definition of "retail client".

FIJI. For Fiji regulatory purposes, this publication and any views and recommendations are not to be deemed as investment advice. Fiji investors must seek licensed professional advice should they wish to make any investment in relation to this publication.

HONG KONG. This publication is distributed in Hong Kong by the Hong Kong branch of ANZ, which is registered by the Hong Kong Securities and Futures Commission to conduct Type 1 (dealing in securities), Type 4 (advising on securities) and Type 6 (advising on corporate finance) regulated activities. The contents of this publication have not been reviewed by any regulatory authority in Hong Kong. If in doubt about the contents of this publication, you should obtain independent professional advice.

INDIA. This publication is distributed in India by ANZ on a cross-border basis. If this publication is received in India, only you (the specified recipient) may print it provided that before doing so, you specify on it your name and place of printing. Further copying or duplication of this publication is strictly prohibited.

NEW ZEALAND. This document is intended to be of a general nature, does not take into account your financial situation or goals, and is not a personalised adviser service under the Financial Advisers Act 2008.

PEOPLE'S REPUBLIC OF CHINA. If and when the material accompanying this publication does not only relate to the products and/or services of Australia and New Zealand Bank (China) Company Limited ("ANZ China"), it is noted that: This publication is distributed by ANZ or an affiliate. No action has been taken by ANZ or any affiliate which would permit a public offering of any products or services of such an entity or distribution or re-distribution of this publication in the People's Republic of China ("PRC"). Accordingly, the products and services of such entities are not being offered or sold within the PRC by means of this publication or any other method. This publication may not be distributed, re-distributed or published in the PRC, except under circumstances that will result in compliance with any applicable laws and regulations. If and when the material accompanying this publication relates to the products and/or services of ANZ China only, it is noted that: This publication is distributed by ANZ China in the Mainland of the PRC.

SINGAPORE. This publication is distributed in Singapore by the Singapore branch of ANZ solely for the information of "accredited investors", "expert investors" or (as the case may be) "institutional investors" (each term as defined in the Securities and Futures Act Cap. 289 of Singapore). ANZ is licensed in Singapore under the Banking Act Cap. 19 of Singapore and is exempted from holding a financial adviser's licence under Section 23(1)(a) of the Financial Advisers Act Cap. 100 of Singapore. In respect of any matters arising from, or in connection with the distribution of this publication in Singapore, contact your ANZ point of contact.

UNITED ARAB EMIRATES. This publication is distributed in the United Arab Emirates ("UAE") or the Dubai International Financial Centre (as applicable) by ANZ. This publication: does not, and is not intended to constitute an offer of securities anywhere in the UAE; does not constitute, and is not intended to constitute the carrying on or engagement in banking, financial and/or investment consultation business in the UAE under the rules and regulations made by the Central Bank of the United Arab Emirates, the Emirates Securities and Commodities Authority or the United Arab Emirates Ministry of Economy; does not, and is not intended to constitute an offer of securities within the meaning of the Dubai International Financial Centre Markets Law No. 12 of 2004; and, does not constitute, and is not intended to constitute, a financial promotion, as defined under the Dubai International Financial Centre Regulatory Law No. 1 of 200. ANZ DIFC Branch is regulated by the Dubai Financial Services Authority ("DFSA"). The financial products or services described in this publication are only available to persons who qualify as "Professional Clients" or "Market Counterparty" in accordance with the provisions of the DFSA rules. In addition, ANZ has a representative office ("ANZ Representative Office") in Abu

IMPORTANT NOTICE

Dhabi regulated by the Central Bank of the United Arab Emirates. ANZ Representative Office is not permitted by the Central Bank of the United Arab Emirates to provide any banking services to clients in the UAE.

UNITED STATES. If and when this publication is received by any person in the United States or a "U.S. person" (as defined in Regulation S under the US Securities Act of 1933, as amended) ("US Person") or any person acting for the account or benefit of a US Person, it is noted that: ANZ Securities, Inc. ("ANZ S") is a member of FINRA (www.finra.org) and registered with the SEC. Also, ANZ S's address is 277 Park Avenue, 31st Floor, New York, NY 10172, United States of America (Tel: +1 212 801 9160 Fax: +1 212 801 9163). This publication is distributed in the United States by ANZ S (a wholly owned subsidiary of ANZ, which accepts responsibility for its content. Information on any securities referred to in this publication may be obtained from ANZ S upon request. Any US Person receiving this publication and wishing to effect transactions in any securities referred to in this publication must contact ANZ S, not its affiliates.

DISCLAIMER

Except if otherwise specified above, this publication is issued and distributed in your country/region by ANZ, on the basis that it is only for the information of the specified recipient or permitted user of the relevant website (collectively, "recipient"). This publication may not be reproduced, distributed or published by any recipient for any purpose. It is general information and has been prepared without taking into account the objectives, financial situation or needs of any person. Nothing in this publication is intended to be an offer to sell, or a solicitation of an offer to buy, any product, instrument or investment, to effect any transaction or to conclude any legal act of any kind. If, despite the foregoing, any services or products referred to in this publication are deemed to be offered in the jurisdiction in which this publication is received or accessed, no such service or product is intended for nor available to persons resident in that jurisdiction if it would be contradictory to local law or regulation. Such local laws, regulations and other limitations always apply with non-exclusive jurisdiction of local courts. Before making an investment decision, recipients should seek independent financial, legal, tax and other relevant advice having regard to their particular circumstances.

The views and recommendations expressed in this publication are the author's. They are based on information known by the author and on sources which the author believes to be reliable, but may involve material elements of subjective judgement and analysis. Unless specifically stated otherwise: they are current on the date of this publication and are subject to change without notice; and, all price information is indicative only. Any of the views and recommendations which comprise estimates, forecasts or other projections, are subject to significant uncertainties and contingencies that cannot reasonably be anticipated. On this basis, such views and recommendations may not always be achieved or prove to be correct. Indications of past performance in this publication will not necessarily be repeated in the future. No representation is being made that any investment will or is likely to achieve profits or losses similar to those achieved in the past, or that significant losses will be avoided. Additionally, this publication may contain 'forward looking statements'. Actual events or results or actual performance may differ materially from those reflected or contemplated in such forward looking statements. All investments entail a risk and may result in both profits and losses. Foreign currency rates of exchange may adversely affect the value, price or income of any products or services described in this publication. The products and services described in this publication are not suitable for all investors, and transacting in these products or services may be considered risky. ANZ and its related bodies corporate and affiliates, and the officers, employees, contractors and agents of each of them (including the author) ("Affiliates"), do not make any representation as to the accuracy, completeness or currency of the views or recommendations expressed in this publication. Neither ANZ nor its Affiliates accept any responsibility to inform you of any matter that subsequently comes to their notice, which may affect the accuracy, completeness or currency of the information in this publication.

Except as required by law, and only to the extent so required: neither ANZ nor its Affiliates warrant or guarantee the performance of any of the products or services described in this publication or any return on any associated investment; and, ANZ and its Affiliates expressly disclaim any responsibility and shall not be liable for any loss, damage, claim, liability, proceedings, cost or expense ("Liability") arising directly or indirectly and whether in tort (including negligence), contract, equity or otherwise out of or in connection with this publication.

If this publication has been distributed by electronic transmission, such as e-mail, then such transmission cannot be guaranteed to be secure or error-free as information could be intercepted, corrupted, lost, destroyed, arrive late or incomplete, or contain viruses. ANZ and its Affiliates do not accept any Liability as a result of electronic transmission of this publication.

ANZ and its Affiliates may have an interest in the products and services described in this publication as follows:

- They may receive fees from customers for dealing in the products or services described in this publication, and their staff and introducers of business may share in such fees or receive a bonus that may be influenced by total sales.
- They or their customers may have or have had interests or long or short positions in the products or services described in this publication, and may at any time make purchases and/or sales in them as principal or agent.
- They may act or have acted as market-maker in products described in this publication.

ANZ and its Affiliates may rely on information barriers and other arrangements to control the flow of information contained in one or more business areas within ANZ or within its Affiliates into other business areas of ANZ or of its Affiliates.

Please contact your ANZ point of contact with any questions about this publication including for further information on the above disclosures of interest.

This document has been prepared by ANZ National Bank Limited. ANZ (part of ANZ National Bank Limited), Level 7, 1 Victoria Street, Wellington 6011, New Zealand, Ph 64-4-802 2357, Fax 64-4-496 8639, e-mail nzeconomics@anz.com, http://www.anz.co.nz