



Change of tide

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Summary

- > Our monthly *Property Focus* publication is aimed at providing an independent appraisal of recent developments in the property market. In this issue we examine the shape of the mortgage lending curve and the ramifications for the housing market.

The month in review (page 2)

- > The housing market is showing signs of stabilising after a sizeable recovery (off lows) with volumes and days to sell stable for three months. Limited listings, however, is underpinning prices. Migration continues to rise but so, of course, is the unemployment rate.

Property gauges (page 3)

- > The retracement in house sales in October is a timely reminder that it's not all plain sailing for the real estate market. This month we introduce mortgagee sales and rental growth into the mix of the regular indicators we monitor.

Economic backdrop (page 5)

- > Our core economic views remain unchanged. While momentum continues to build, particularly in relation to the housing market, deleveraging is ongoing and is restraining aggregate momentum. The recent forecast lift in dairy farm incomes will now likely mean any adjustment in that industry occurs in a more orderly fashion, but we see most of the income boost going towards debt repayment. The economy is undergoing a significant process of change, and the greatest uncertainty at present is predicting the behavioural aspect that is inherent in every economic cycle. The more we grasp for the old normal, the greater the risk of a double dip.

Mortgage borrowing strategy (page 8)

- > We see greater value in maintaining our long-standing strategy of keeping the duration of borrowing short. While it is inevitable that short-term interest rates will rise at some stage, our strategy still applies given that a) so much is already priced into the market and b) structural changes means an upward sloping yield curve is here for the foreseeable future. If you want certainty, there is a price to pay for it.

Feature article – Skinning a cat (page 9)

- > The RBNZ's new liquidity requirements for local banks already look to be having an impact on the shape of the mortgage curve. Further regulatory and prudential changes are in the pipeline. The end result will be a steep yield curve, which gives monetary policy a lot of traction when the tightening cycle eventually starts. The flip-side is that it will result in a structural shift lower in the neutral OCR.

Key forecasts (page 13)

The month in review

The housing market is showing signs of stabilising after a sizeable recovery (off lows) with volumes and days to sell stable for three months. Limited listings, however, is underpinning prices. Migration continues to rise but so, of course, is the unemployment rate.

More time in the dry-dock is expected.

> **SNZ Household Labour Force survey - September.** The economy may be regaining forward momentum again, but this is not translating into increased labour demand as yet. Employment growth fell 0.8 percent, with full-time jobs down 0.5 percent and part-time down 1.1 percent. The unemployment rate moved from 6 percent to 6.5 percent.

> **RBNZ Mortgage Lending – September.** Housing credit growth rose 0.2 percent month-on-month - a soft read considering the rebound in the housing market. This suggests that those selling their houses are using those proceeds to pay down debt rather than leveraging up.

Surfs up.

> **SNZ Net Migration – October.** A net gain of 2,130 people was recorded, taking the 12-month total to 18,560. This is the highest annual total since August 2004. October's gains were driven by higher arrivals and an ongoing drop in departures. The compositional nature of the current migration cycle, with it predominantly driven from the departures side, means the demand impulse is less compared to past migration booms. But it is still a positive for the economy nonetheless.

An ebbing tide noted for house sales in October.

> **REINZ housing data – October.** In seasonally adjusted terms, house sales retraced 5.6 percent in October, to levels experienced a few months earlier. The median number of days to sell remained unchanged at 34 days – this is a low level by historical standards. House prices continue to rise, with the median price up 6 percent from a year ago.

An onshore swell is developing.

> **SNZ Building Consents – September.** Total residential consents issued rose 3.3 percent in the month, while consents ex-apartments rose 2.8 percent. The pace of increases is not substantial, but is generally in-line with what would be expected given the increase in house sales, low interest rates and the improvement in net migration. At the margin, you could argue a bigger increase would have been expected given the historical relationship with house sales, but volatility in the data mean it is difficult to be very firm on this.

Mortgagee sales were left high and dry.

> **Terralink Mortgagee Sales – September.** The number of mortgagee sales hit a new high, with 343 registered mortgagee sales in September. This reverses the fall in August and outstrips the previous high of 321 measured in July. This series is now included as part of the standard charts presented on page four but we would caution that compositional aspects (such as a rash of sections being put up for receivership) can distort the headline figure.

Assessment

Some of the recent oomph in the real estate markets was missing in October, with sales retracing in many regions and days to sell settling, after dropping since February. Mortgage lending remains soft, with the latest mortgage approvals data suggesting the rising mortgage curve could be starting to impact on activity. Looking at the overall market we see a lot of mixed signals. Certainly in some pockets the pricing remains competitive due to a lack of listings. But one reason for a lack of listings is that people simply don't want to take on more debt, hence the mixed picture. A key indicator we are watching at present is credit growth: so long as it remains subdued we doubt the market is set to rip away.

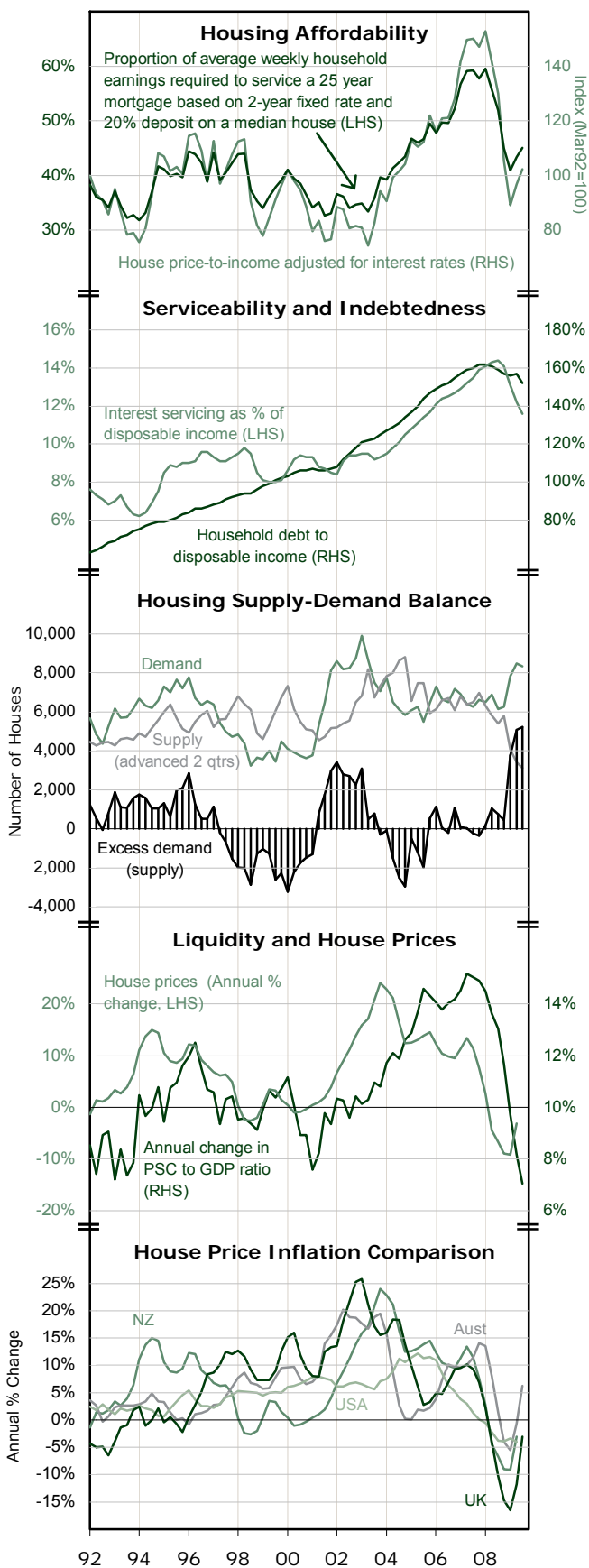
Property gauges

The retracement in house sales in October is a timely reminder that it's not all plain sailing for the real estate market. This month we introduce mortgagee sales and rental growth into the mix of the regular indicators we monitor.

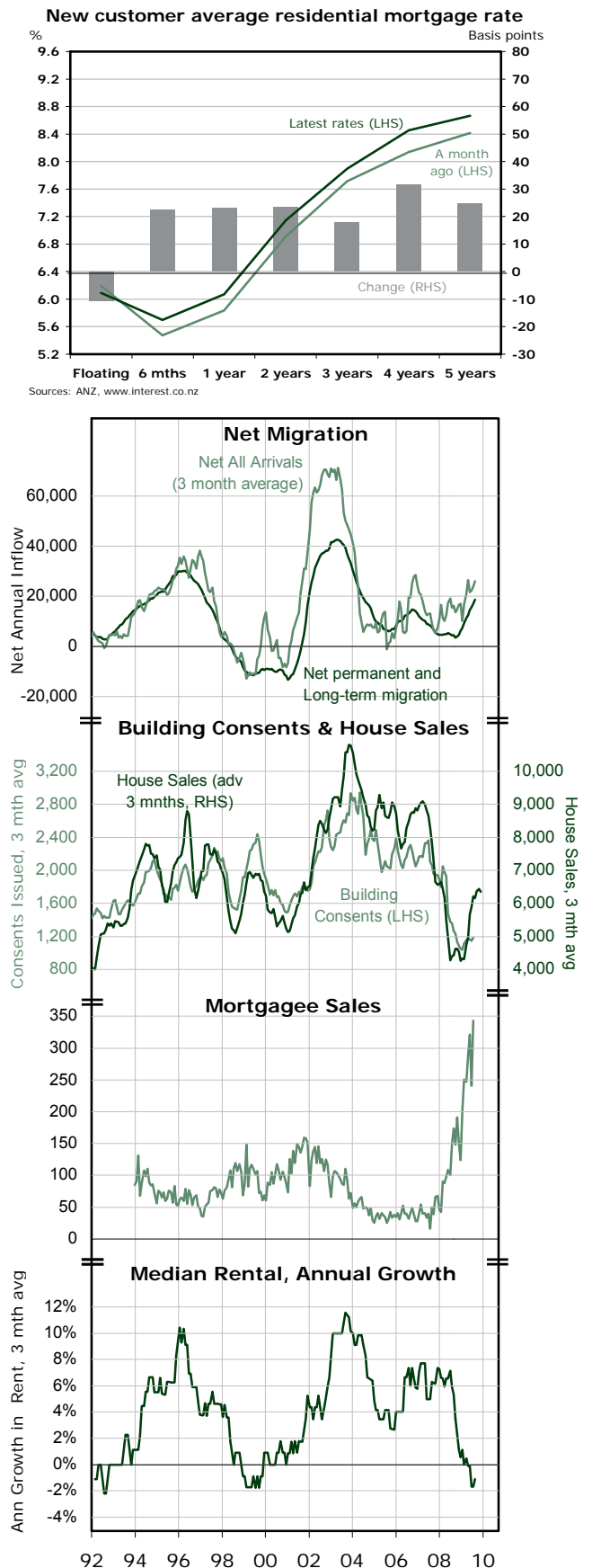
We use ten gauges to assess the state of the property market and whether warning signs are emerging.

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

Indicator	Level	Direction for prices	Comment
Affordability	Deteriorating	↔	Higher mortgage rates are putting a dent in affordability.
Serviceability / indebtedness	High but easing	↓	Improving but more de-leveraging still to come.
Interest rates	Bumping up	↔/↓	A fairly uniform lift in fixed lending rates since last month.
Migration	Building	↑	Net migration is a growing dynamic.
Supply-demand balance	One sided	↔/↑	A wide gap between the two still persists.
Consents and house sales	Glimmer of hope	↔/↑	House sales stalled in October, but so have building consents.
Liquidity	Still a way to go	↓	Liquidity is the measure that is proving to be a constraint.
Globalisation	A deep hole to recover from	↓	Prices have turned the corner, with Australia leading the charge.
Mortgagee sales	Record high	↓	New record high reached.
Median rent	Ticked up	↓	A long way in the negative but a small move up.
On balance		↓	Paused for a breather.



Sources: ANZ, Statistics NZ, REINZ, Reserve Bank, Property IQ, Bloomberg



Sources: ANZ, Statistics NZ, REINZ, Terralink, Dept of Building & Housing

Economic backdrop

Our core economic views remain unchanged. While momentum continues to build, particularly in relation to the housing market, deleveraging is ongoing and is restraining aggregate momentum. The recent forecast lift in dairy farm incomes will now likely mean any adjustment in that industry occurs in a more orderly fashion, but we see most of the income boost going towards debt repayment. The economy is undergoing a significant process of change, and the greatest uncertainty at present is predicting the behavioural aspect that is inherent in every economic cycle. The more we grasp for the old normal, the greater the risk of a double dip.

Our core economic view

A cyclical recovery is underway. Modest economic growth is expected over the second half of this year and into next year. Sectors and regions that were first to face slowing conditions are generally the ones showing earlier signs of exit, particularly in relation to the housing market and Auckland. This partly reflects the base effect off low levels. But a large proportion is the natural result of the stimulus from low interest rates, tax cuts and the added demand from growing net migration.

This is, of course, encouraging in the first instance. However, we also shouldn't lose sight of some of the structural forces shaping the outlook. Deleveraging is ongoing. Despite the solid rise in housing turnover and prices beginning to rise again, credit growth into the residential housing sector remains subdued. Households continue to face the prospects of a weakening labour market, while still elevated cost structures will likely mean the rural chequebook remains tight. The retailing environment remains tough.

In the rural regions, we suspect that the projected improvements in dairy farm incomes will also be used for debt reduction and ensure any land price adjustment in the industry now occurs in a more orderly fashion. These are healthy developments and suggest previous imbalances are slowly being corrected. However, there remains a long way to go.

This is not your typical credit downturn and recovery story. The typical credit event has centred on the business sector. While aspects of this are apparent in this cycle, this time around it is household balance sheets in need of repair. And when faced with rising unemployment, this looks set to be a protracted process. Hence, policymakers and economists continue to talk in guarded tones about the U, bathtub or saucer shaped recoveries.

Yet, if history is any guide, economists will probably end up being wrong. We bank on the rational. One plus one equals two. Two plus two equals four. Or in economic-speak, people's investment and spending decisions change incrementally and gradually. Yet we all live and operate in a sometimes irrational world. Spending and investment decisions do not change incrementally. There is a tipping point at which it stops and then starts. So one plus one can equal eleven or minus eleven. Pent-up demand can quickly be unleashed when confidence picks up. Hence, economists' notorious track record at underestimating downturns, as well as recovery processes. This is a dynamic we remain very mindful of.

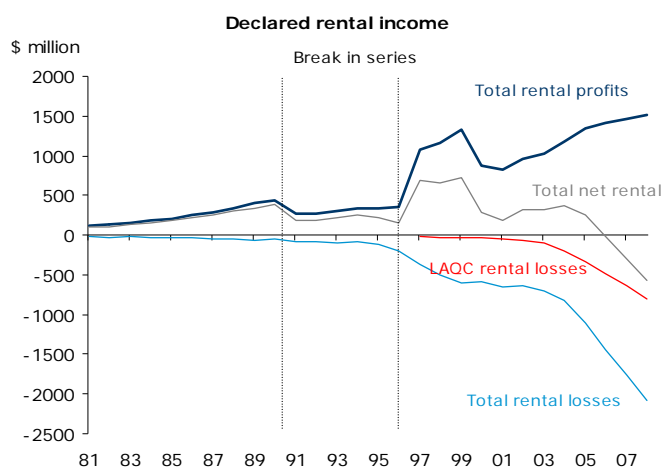
Probably the most difficult task ahead of us at present is trying to "predict" the behavioural aspect within the economic cycle. Economic trends are about combinations of economics, finance and human behaviour. The difficulty in the current instance is that you have an economy undergoing deep structural change as we adjust to a new normal. Human nature

however, wants to go back and grasp the “old”, as in the way things were pre-crisis. The problem is that the period in the lead-up to the global financial crisis was abnormal, characterised by excesses in risk taking, credit growth and rising asset prices, and unlikely to be repeated again.

We see this sort of dynamic every day. One scribe notes the process of learning as similar to watching a teenager learn from a mistake: faced with two choices, the path chosen is likely to be the one that is most fun and least painful. And so it applies to the general economy in terms of how we “learn”. Across the corporate world we see leaders recognising that a step-change is required if NZ’s medium-term positive potential is to be unlocked. We are optimistic about the opportunities that NZ’s natural resource base and the growing importance of Asia will bring. But that requires a sacrifice up front in terms of earnings, and we all know how conditioned the market, and hence CEO behaviour, can become to hitting those near-term benchmarks. The existing level of government services is unsustainable given the income (tax) base. But where is the hurry to forge ahead with the hard decisions when you are judged in the court of public opinion?

Policymakers have made it clear that we are not going back to “banking as usual” (G20 communiqué), and Dr Bollard has been equally specific about NZ not returning to our borrow and spend habits of old. And it is not just the Official Cash Rate that will be used to make sure it doesn’t. New liquidity rules are just the start. Rather than growth at double the rate of GDP and income, credit growth and house prices should grow in line at most. But with such changes comes big implications for the balance between expected capital gains, and yield and cashflow.

Over the coming weeks we’ll be eying closely the recommendations that come out of various reviews, particularly in relation to tax and property. A capital gains tax has been completely ruled out but it’s hard to see the current rules in regards to Loss Attributing Qualifying Companies (LAQCs) staying unchanged, especially given the explosion in the number of active LAQCs, rising to nearly 130,000 in 2008 from 63,400 in 2003.



Sources: ANZ, IRD, The Treasury

The total LAQC losses claimed over that period has risen from \$0.7b to \$2.3b (not all associated with investment property). During periods when the government was running substantial surpluses, such loss claims did not have a material bearing on the overall fiscal position. But with the Treasury’s latest Long-Term Fiscal Statement projecting ongoing deficits and net debt rising past 200 percent of GDP by 2048, recent trends in rental and LAQC losses claimed cannot go on. So while we – as a nation – might be loathe to introduce a capital gains tax on housing or land tax, it would be

truly astonishing if we stood by and let the current trends in losses on residential property continue. Otherwise, the onus is on the remainder of the tax payers – via our general tax contribution – to fill the void.

The only uncertainty at present is whether the process of learning occurs voluntarily (orderly) or it gets forced upon us, which leads to a disorderly adjustment. The whole behavioural aspect that is inherent in every economic cycle will have a huge say. If 2010 is a tough year, then we'll be euphoric over prospects for the subsequent five. A tough year will tell us the message is sinking in. Balance sheets are being repaired. Savings rates are lifting. This is about setting the scene for a sustainable and robust expansion which lays the foundation for a strong property market. However, if we set the world on fire in the coming twelve months, and momentum associated with the Rugby World Cup carries us through 2011 (provided we do not exit in the quarter finals or earlier!), then we'd put strong odds on a double dip in 2012. And in that regard, the biggest risk we see over the coming few months is that complacency starts to set in.

Mortgage borrowing strategy

We see greater value in maintaining our long-standing strategy of keeping the duration of borrowing short. While it is inevitable that short-term interest rates will rise at some stage, our strategy still applies given that a) so much is already priced into the market and b) structural changes means an upward sloping yield curve is here for good. If you want certainty, there is a price to pay for it.

Our view

Our long-standing strategy of keeping the duration of borrowing short still applies. This may appear a little odd given prospects for a rising Official Cash Rate over the coming year, but is justified by two dynamics.

- > **The market is already pre-empting a fairly rapid rise in interest rates.** The market is pricing in around a 50 percent chance of a 25 basis point hike by March and a total of 150 basis points of tightening out until September 2010. Such “expectations” are implicitly now embedded in fixed rates. Our core view continues to centre around a later start to the tightening cycle, and one of smaller magnitude given challenges we continue to envisage.
- > **There are structural changes to be mindful of.** New liquidity rules now require banks to source more term funding. The longer the term, the typically higher the (deposit) price. If investors expect to receive a higher compensation (yield) for “locking” in for a longer term, then of course borrowers seeking certainty (long-term rates) end up paying the flip-side of this transaction. But these changes also mean a higher cost of funds for banks, and thus lending rates. This means what we consider to be a normal Official Cash Rate will be lower over the coming cycle. The steep sloping yield curve is encouraging more people to float, giving the RBNZ considerable policy traction when they do decide to hike. There will be the inevitable moans when they do, but by getting more policy traction they shouldn't need to raise the OCR as far as previously.

Brace for higher rates, but do not panic when they appear. Our regular breakeven analysis is presented on the table below. Once again they show that a lot of hikes have been priced into the market. For example, if the 1 year rate is 6.20 percent and the 2 year rate is 7.25 percent, then the breakeven 1 year rate in one year's time is 8.30 percent. This implies that if you choose to fix for one year at 6.20 percent, and in one year's time re-fix at a rate less than 8.30 percent, the decision would have been a better one than fixing for two years at 7.25 percent. Another way of stating this, is that based on current pricing, the market is implying the 1 year mortgage rate will rise to 7.04 percent in six months time and then 8.30 percent six months after that. We see this as a possible, but unlikely, scenario given our expectations towards the monetary policy outlook.

Fixed Mortgage Rate		Break-evens			
Term	Current	in 6mths	in 1year	in 18mths	in 2years
6 months	5.99%	6.41%	7.67%	8.93%	9.10%
1 year	6.20%	7.04%	8.30%	9.02%	9.47%
18 months	6.69%	7.67%	8.57%	9.29%	9.57%
2 years	7.25%	8.03%	8.89%	9.41%	9.75%
3 years	7.99%	8.62%	9.27%	9.52%	9.58%
4 years	8.50%	8.90%	9.26%		
5 years	8.65%				

Feature comment – Skinning a cat

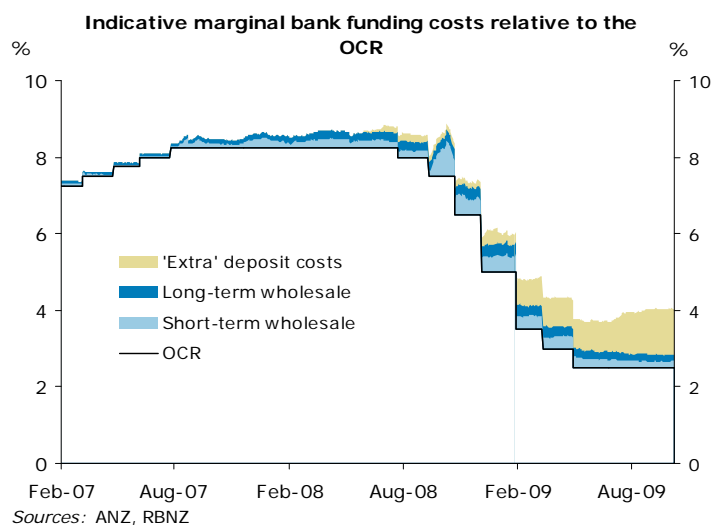
The RBNZ's new liquidity requirements for local banks already look to be having an impact on the shape of the mortgage curve. Further regulatory and prudential changes are in the pipeline. The end result will be a steep yield curve, which gives monetary policy a lot of traction when the tightening cycle eventually starts. The flip-side is that it will result in a structural shift lower in the neutral OCR.

New liquidity rules for banks come into force from April next year, setting the minimum core-funding ratio at 65 percent initially. This will then increase to 75 percent by mid-2012. Under this policy, banks have to fund a minimum portion of their balance sheet through domestic retail deposits or wholesale funding (domestic and offshore) with maturities in excess of 1 year. The impacts of the changes are:

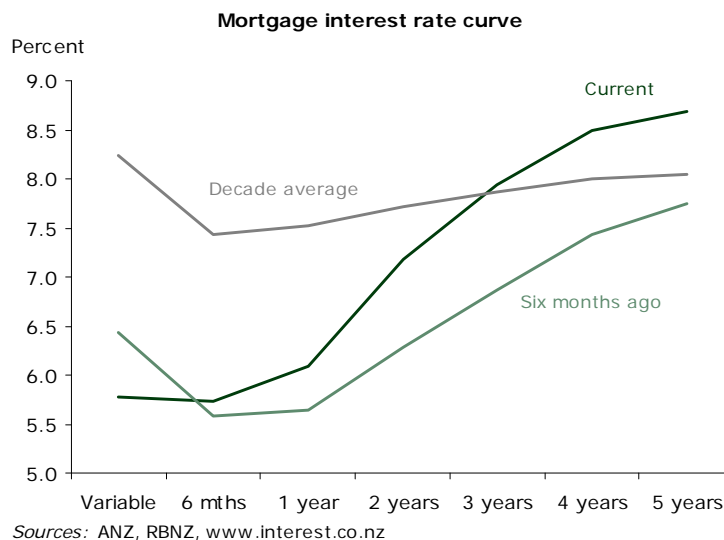
- > **NZ banks are lengthening their funding profiles.** Between 2005 and 2007, the proportion of NZ registered banks' total funding (NZD and foreign exchange) with maturities greater than 1 year averaged 6.5 percent of total funding¹. This has now more than doubled to sit at 13.6 percent at the end of September. If just non-resident funding is looked at, the increase is even more apparent, with 23 percent of total non-resident funding in excess of 1 year, compared with the 2005-07 average of 12 percent. To be fair, the global financial crisis would have forced this change on banks given that many short-term offshore money markets effectively closed. However, we also suspect the new proposed liquidity requirements from the RBNZ are playing a role. If this is in fact the case, we would expect recent trends to continue or at least remain at current elevated levels.
- > **Competition for retail deposits continues.** Retail deposit rates have risen further, particularly for longer-dated rates. While some of this will likely reflect market expectation, and therefore pricing of an earlier start to the RBNZ tightening cycle, this does not explain the fact that there remains a large gap between wholesale and retail deposit rates. The 'spread' between the 5-year retail deposit rate and the 5-year wholesale (swap) rate is now around 100 basis points. This compares to an average of -30 basis points between 2000 and mid-2008. This dynamic is repeated across other maturities.

The end result is higher funding costs for banks. While offshore money markets have improved, longer-term funding remains reasonably elevated (though off their peaks). Because NZ banks have been lengthening the term profiles of their offshore funding (as discussed above), this effectively means that the cost of offshore funding has remained higher than otherwise would have been the case. Intense competition for retail deposits, leading to significant rises in domestic deposit rates, adds to the upward pressure on banks' funding costs.

¹ This is not to be confused with the "core funding ratio". Refer to <http://www.rbnz.govt.nz/finstab/banking/regulation/3675928.pdf> for a complete definition of this ratio. The calculations here are just for illustrative purposes and are not part of the new liquidity requirements.



As a result, the mortgage yield curve has steepened, driven by higher longer-term mortgage rates. We now have the unusual situation of the floating rate at 40-year lows, but fixed rates of 3-year duration or longer, above their decade averages. Even the once popular 2-year fixed rate is not much lower than its decade average (around 50bps below). Furthermore, the steepness of the curve, as measured by the difference between the 5-year rate and the floating rate, is the biggest it has ever been at around 290bps. **Further proposed changes to the regulatory and prudential landscape will only serve to put upward pressure on bank funding costs, and therefore borrowing rates.**



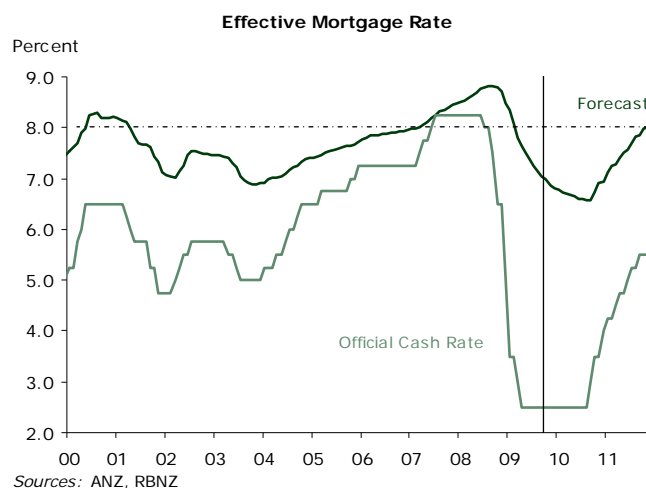
Given the shape of the mortgage curve, we can expect a greater proportion of mortgages to be on floating or shorter term fixed rates over the coming months. Currently, 23 percent of all mortgages are floating, and some 38 percent are fixed for 1-year or less (compared to 15 percent and 25 percent respectively in February 2007, just before the last tightening cycle). These percentages are set to increase further, which will give monetary policy more potency. With the mortgage curve expected to stay upward sloping (though it will flatten once the RBNZ starts to hike rates), there is nowhere for mortgage holders to run, unlike in the previous tightening cycle.

	Mortgage as at Sep 09 (\$m)	Weighted average rates (%)		Advertised rates (%) [^]
Floating	36,355	6.21	Floating	5.77
< 1 year	60,070	7.29	6-mth	5.74
1 < 2 year	31,583	7.25	1-year	6.08
2 < 3 year	20,145	7.31	2-year	7.18
3 < 4 year	4,632	8.41	3-year	7.94
4 < 5 year	5,356	6.77	4-year	8.5
5 years +	280	7.79	5-year	8.69

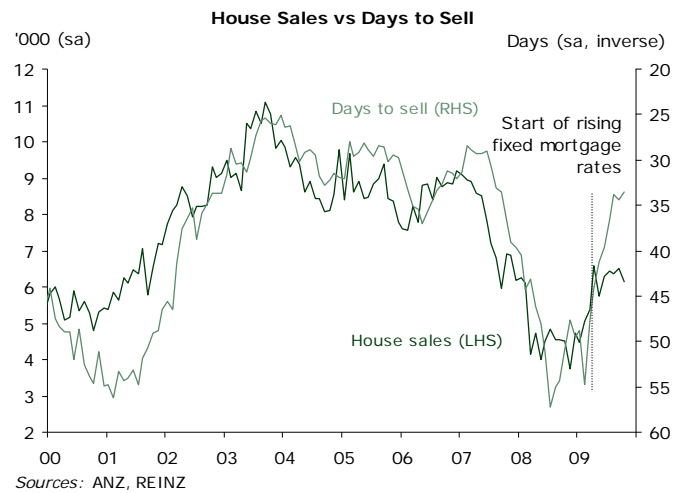
[^] Average headline mortgage rates of the five major banks

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

This means the effective mortgage rate households face is set to rise quickly when the RBNZ starts to tighten policy. In September, the effective mortgage rate (EMR) fell to 7.05 percent from 7.15 percent in the previous month, still above the 6.9 percent bottom at the end of 2004. However, the lagged impact of the RBNZ's aggressive easing is still flowing through, and we do expect the EMR to continue falling towards 6.5 percent, as those rolling off fixed rate mortgages refinance at lower rates. But based on our forecasts of the OCR rising from September towards 5.5 percent by Q3 2011, the EMR will rise towards 8 percent in quick fashion. It is not just the level, but the speed at which the EMR changes that will have the greatest impact.



The shape of the mortgage curve and prospects for higher rates already look to be weighing on housing market activity. Housing turnover, after rebounding strongly since early this year, looks to have stabilised, although it remains below average levels. The days to sell a house has also remained steady at a low 34 days (seasonally adjusted) over the past three months. New housing loan approvals data have been largely static, and in recent weeks have eased towards last year's levels after being ahead for most of the year. House prices look to be the outlier, still rising and up 9 percent since the January low. But a shortage of listings looks to be the main driver, as good quality stock is snapped up at a premium. With the "sweet spot" for the housing market (from a buyers' perspective) having passed (early this year, house prices were off 10 percent and fixed mortgage rates were sub-6 percent), and the regulatory and tax climate to contend with, activity could continue to move sideways in the near-term.



Implications

The housing market is faced with structural changes to the shape of the mortgage curve. New liquidity requirements, along with further proposed regulatory and prudential changes that are in the pipeline, look set to keep upward pressure on borrowing rates. This is independent of any increases in the OCR. With a growing proportion of mortgages on floating or shorter fixed rates, the lags in the monetary policy transmission mechanism are becoming shorter. Monetary policy is set to have more potency. This is one reason the RBNZ will have confidence in keeping rates low for a while, to give the economy more time to recover. And it is also why we believe the neutral OCR rate is now closer to 5 percent than 6 percent.

Statistical Annex

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

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

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

	House prices (Ann % change)	3mth % chng	No of sales (s.a.)	Mthly % chng	Avg days to sell (s.a.)	Comment
Northland	-7.7	-4.5	123	(-20%)	53	Selling prices and volumes retraced a tad in October
Auckland	5.1	2.6	2,103	(-8%)	33	Recent real estate momentum stalled in October
Waikato/BOP/Gisborne	4.0	1.0	771	(-17%)	46	Average selling price hits an 18-month high of \$328k
Hawke's Bay	3.0	9.7	234	(-3%)	39	Average sale prices have gained some traction recently
Taranaki	-3.5	4.1	156	(-13%)	34	The number of sales have dropped to a seven month low
Manawatu-Wanganui	-2.2	-0.9	297	(-1%)	33	Sale numbers fell below 300 for first time since March
Wellington	12.5	5.6	756	(+1%)	30	The Wellington real estate market outshone in October
Nelson-Marlborough	-1.5	-1.0	211	(-13%)	33	The average selling price edged down to a six month low
Canterbury/Westland	6.2	4.5	964	(-2%)	31	The 3-month price change highest since December 2006
Otago	2.2	6.9	247	(-12%)	32	The median time to sell a house remains at a 2-year low
Central Otago Lakes	1.7	3.6	83	(-20%)	64	Sales numbers plummets to the lowest since February
Southland	-8.9	1.2	156	(-1%)	33	Annual change in house prices was the country's lowest
NEW ZEALAND	6.0	3.4	6,151	(-6%)	34	The heat in the market has been reduced to a simmer

Key forecasts

Economic indicators	Actual				Forecast					
	Mar 09	Jun 09	Sep 09	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11
GDP (Ann Avg % Chg)	0.0	-1.1	-1.8(f)	-2.0	-1.3	-0.2	1.0	1.9	2.4	2.5
CPI Inflation (%)	3.4	3.0	1.9	1.7	2.5	2.5	2.7	2.1	2.5	2.8
Unemployment Rate (%)	4.7	5.0	6.0	6.5	6.8	7.0	7.1	7.1	7.0	6.9
Interest rates	Actual				Forecast (end month)					
	Sep 09	Oct 09	Latest	Dec 09	Mar 10	Jun 10	Sep 10	Dec 10	Mar 11	Jun 11
Official Cash Rate	2.7	2.8	2.5	2.5	2.5	2.5	3.0	4.0	4.5	5.0
90-Day Bank Bill Rate	2.8	2.8	2.8	2.8	2.8	2.8	3.6	4.5	5.0	5.5
Floating Mortgage Rate	6.3	5.8	5.8	5.8	5.8	5.8	6.3	7.3	7.8	8.3
1-Yr Fixed Mortgage Rate	5.7	6.0	6.1	6.1	6.1	6.1	6.7	7.2	7.5	7.8
2-Yr Fixed Mortgage Rate	6.7	7.1	7.2	7.2	7.2	7.2	7.6	7.9	8.1	8.3
5-Yr Fixed Mortgage Rate	8.5	8.7	8.7	8.7	8.7	8.7	8.9	9.0	9.0	9.1

DISCLOSURE INFORMATION

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

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

Qualifications, experience and professional standing**Experience**

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

Relevant professional body

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

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

Professional indemnity insurance

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

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

The insurer is ANZcover Insurance Pty Limited.

Dispute resolution facilities

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

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

Criminal convictions

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

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

Fees

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

Other interests and relationships

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

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

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

Securities about which investment advice is given

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

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

PROCEDURES FOR DEALING WITH INVESTMENT MONEY OR INVESTMENT PROPERTY

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

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

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

Any investment money lodged with the Bank for the purchase of securities offered by the Bank, its subsidiaries or any third parties will be deposited in accordance with your instructions, to your nominated

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

Record Keeping

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

Auditing

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

Use of Money and Property

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

DISCLAIMER

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

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

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