

AUD to NZD swap likely to widen – and positive carry in the meantime

- The Australian market has been quiet. Middle-East protests have prevented a sell-off in the US.
- The RBA has been focusing on the strong Investment spending in Australia and the strong medium-term outlook.
- We position for this with a positive-carry 3Y spread trade between Australia and New Zealand swap.

Australian Fixed Income markets have been quiet over the past week. A small rally in the US markets has translated to a small rally in Australian markets too. Over the past week, the Australian 10Y rate has rallied 8bp and the 3Y rate has rallied 4bp.

Over the past week, the data from the US was mostly on the stronger side. The Philadelphia Fed index rose strongly and the CPI print was higher than expected. However, Retail Sales disappointed the market by only rising 0.3% when consensus had been for 0.5%. Despite the relatively good data, the growing tensions in the Middle East have prevented a sell-off from taking hold. So far, the wide-spread protests have not caused a large rally – but the geo-political concerns do appear to have prevented a sell-off.

The market appears unclear on how to react to the Middle-East protests. The protests are currently very wide-spread. Depending on which, if any, Government(s) are seriously affected the market reaction could be very different. Generally, any uncertainty tends to trigger a rally in bonds, particularly US treasuries. However, the Middle-East has a number of oil producers. If a major oil producer, like Iran, was to be destabilised, then the market might expect an oil price spike and so bonds might sell-off on inflation concerns.

When markets aren't moving particularly far, carry becomes a very important consideration. Philip Brown proposes a positive-carry Australia to New Zealand 3Y swap spread trade in his article on page 3.

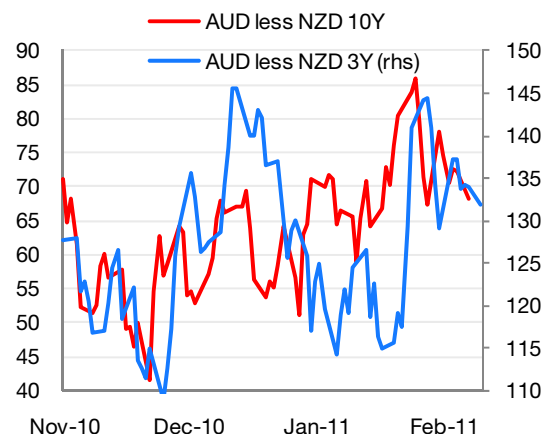
The RBA has continued to highlight that the medium-term prospects for the Australian economy are very good. Most recently, Philip Lowe did so in a speech last Monday. Governor Stevens is likely to reiterate this view when he speaks about the resources boom on Wednesday. Our underlying assessment of the RBA remains unchanged. We expect them to return to raising rates later this year. In New Zealand, we also believe the market is underestimating the chance of RBNZ rate increases, though not by as much as in Australia. We expect the AUD-NZD swap differential to trend higher as well as the trade providing positive carry.

The coming week is likely to be fairly quiet too. The US has a public holiday this evening (President's Day) and most of the Australian data scheduled is unlikely to move markets. The exceptions are Governor Stevens' speech on Wednesday and the Capex data on Thursday. The Capex data will contain the first estimate of 2011-12 expenditure. We expect both the Governor's speech and the Capex data to reinforce the RBA's recent theme of Australia's exceptionally high Investment spending. The RBA meets next Tuesday (1st March) but is very unlikely to change rates.

Contents:

| | |
|---|----|
| Key Positions..... | 2 |
| Reinstating an AUD to NZD spread trade..... | 3 |
| Key Views..... | 8 |
| CBA Forecasts:..... | 9 |
| Calendar – February 2011..... | 10 |

Australia-NZ spread trending higher again after spike



Source: Bloomberg, CBA

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Key Positions

The market has mostly marked time this week. A small rally in the long end helped our sold bond put option expire with a profit. The bond option expired 3bp in-the-money, but we had received a 10bp upfront premium.

We position for a stronger Australian economy with a positive-carry AUD-NZD spread trade.

We have also established a number of RV trades over the course of the week. We recommended receiving the 10Y AUD swap vs the 20Y*10Y forward swap. We also recommended buying the Feb-15 IBRD vs the Oct-14 at a spread of 9bp.

Key Trades

| Trade | Entry | Curent | Profit | Target | Stop | Comment |
|--|---|------------------|---------------------|--------|--------|--|
| Buy the NSWTC Jun-20 (Government Guaranteed) as an ASW | -12bp (3-Feb-10) | -9bp | -3bp | -35bp | 0bp | Hold: A long-term buy-and-hold trade. |
| OTM Conditional Steepener. 6M*2Y vs 6M*10Y. Buy 100m 6M*2Y 3.75% receiver. Sell 24.1M 6M*10Y 4.28% receiver. | 3.75% and 4.28% 0.4bp premium (25-Aug-10) | 5.31 and 6.11 | -0.4bp (premium) | | | Hold: Expires this week. Currently way out of the money and very unlikely to go back into the money. |
| Buy the Suncorp Metway Govt Guaranteed Apr-11 Floater. | TM of 29.5bp | 11bp | +18.5bp | 0bp | 40bp | Hold: This bond is Government Guaranteed. It should be much tighter. Repurchases of GG bank bonds becoming common. |
| Sell 3M, 20bp OTM bond put on Apr-20 ACGB, strike is 5.61% | 5.61 / 10bp (15 Nov-10) | 5.64 (15 Feb) | 7bp | | | Exit – Trade expired: A small rally saw the trade expire 7bp ahead. |
| Buy the Jun-16 vs the May-13 and May-21 | +11bp (24-Jan-11) | +14.5bp | -3.5bp | +3bp | +15bp | Hold: PCA analysis suggests this is likely to fall. A flattening would also assist the trade. |
| But the KfW Dec-19 vs the IBRD Oct-19 | 33.5bp (31-Jan-11) | 28bp | +5.5bp | 20bp | 40bp | Hold: The EU Sovereign CDS is improving, but the spread has not yet moved in AUD. |
| Receive 10Y AUD-USD basis vs 3Y | 8bp (31-Jan-11) | 9bp | -1bp | 3bp | 10bp | Hold: The mismatch between issuance and borrowing suggests the curve should flatten |
| Pay the ASW of the ACGB Oct-14 | 31bp (14-Feb-11) | 31bp | 0bp | 40bp | 25bp | Hold: We replace our 3Y EFP with this ASW instead. The bonds have lagged swap. |
| Buy the Feb-15 IBRD vs the Oct-14 IBRD | 9bp (15-Feb-11) | 7bp | 2bp | 2bp | 12bp | New Trade: The IBRD curve is too steep compared to the ACGB curve |
| Receive the 10Y swap vs the 20Y*10Y | -175bp (17-Feb-11) | -174bp | 1bp | -145bp | -195bp | New Trade: The 30Y is too low in yield, the 20Y*10Y has pulled away from the 10Y spot rate. |
| Pay the AUD 3Y rate vs the NZD 3Y rate (carry 2.9bp per month) | 132bp (21-Feb-11) | | | 160bp | 115bp | New Trade: The spread is relatively stable but should trend wider. There is strong positive carry so we can hold the trade for the medium term. |



Reinstating an AUD to NZD spread trade

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- We think the RBA is likely to be more hawkish than the RBNZ. We pay AUD rates against NZD.
- The steeper curve in NZ makes this a positive carry trade. The highest carry is at the 2Y and 3Y points.
- The 2Y NZD rate is being held down by bank receiving – we prefer to implement the trade at the 3Y point.

NZ outlook weaker than Australia

The New Zealand data has been relatively weak over the past few weeks. The market is even pricing a small chance of a rate cut over the next couple of RBNZ meetings. In contrast, the Australian market is, in our view, underpricing the chance of aggressive RBA tightening. We recommend paying AUD 3Y swap against NZD to capture this divergence (the trade also has excellent carry characteristics).

We used a similar rationale to implement a 10Y spread trade in November 2010. However, on February 7, we exited our 10Y NZD to AUD swap position at 81bp. We only exited the trade because we thought we had identified a short-term spike in the spread. As we expected, the spread has now fallen back down into its recent range. (See Figure 1.) At the time, we highlighted our intention to return to the trade if the spread got back down to the mid 60s. While the spread has not gotten quite that low, we thought it was worth reviewing the trade.

We think the underlying rationale for the original trade continues to apply. It is likely the RBA will raise rates more than is priced into the curve. However, we will not implement the trade in the exact same way as we did before. Changes in the shape of the NZ front end now make the 3Y the best place to implement the spread in our opinion, rather than the 10Y.

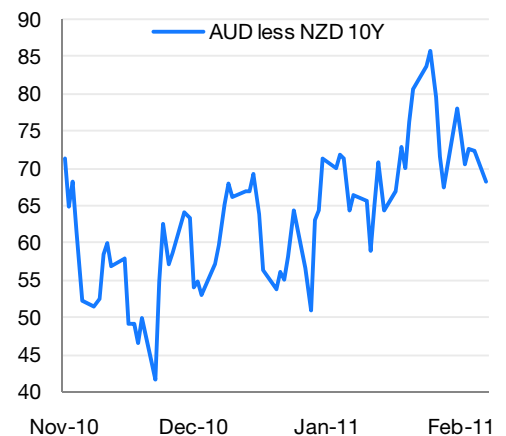
The RBA and the RBNZ

Our economists expect the RBA will raise rates much more than is currently priced into the IB curve. (See Figure 2.) We expect the RBA to raise rates a further three times this year for a total of 75bp by year end. The market is pricing just over 30bp of rate hikes. That's a difference of 45bp.

In New Zealand, a similar dynamic is at play, though it is smaller in magnitude. The market is expecting slightly more than one rate hike by year end. Our economists (ASB Bank) are looking for rate increases in September and December. (See Figure 3.) The NZ market is underpricing our economists by about 20bp for the expected end-2011 cash rate.

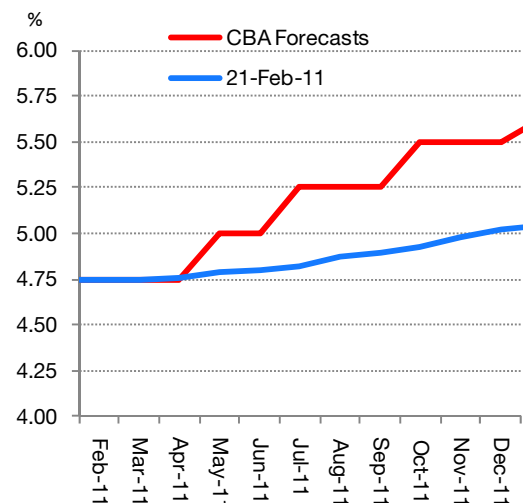
RBA likely to raise rates more than priced

Figure 1 – AUD to NZD 10Y swap



Source: CBA, Bloomberg

Figure 2 – CBA forecasts of the RBA and expected pricing



Source: CBA, Bloomberg



In both NZ and Australia our economists expect more rate hikes than priced by the market. The near-term effect is larger in the case of the RBA though. The economists' expected trajectory in 2012 is for even more hikes in New Zealand while the RBA is likely to be more sedate. However, we don't believe the New Zealand market could move towards that kind of pricing in the short-term.

We have deliberately used the same scale in Figures 2 and 3 to emphasise that the discrepancy between the market expectation and our forecasts is larger in Australia than in NZ. Although we expect a sell-off in both markets eventually, the AUD curve looks like it has further to go. Our preference is to be paid AUD rates vs NZ in some fashion.

RBNZ likely to raise rates more than priced too – but by smaller margin than RBA

Our NZ economists also point out that a rate cut by the RBNZ over the next few months is not out of the question, if the data is particularly poor. A rate cut is not part of our core forecasts and not part of the expected path, but it is a risk. The market pricing hints at it, but there is not much more than a 5% chance of it priced. Should the data produce the perfect storm and the RBNZ lower rates, then the spread between AUD and NZD swaps would widen across the curve, but particularly at the front end.

RBNZ hikes are, in part, linked to RBA because the economies are linked

We should also point out that the expected RBNZ rate hikes are connected to the expected RBA rate hikes. The strength of some NZ industries, like manufacturing and tourism, has a direct causal link to the Australian economy. Australian demand explicitly feeds these industries. Other sections of the NZ economy, like food exports, correlate with the Australian economy because both are driven by demand in Asia. If China weakens noticeably then Australia's exports of hard commodities and NZ exports of soft commodities will both fall.

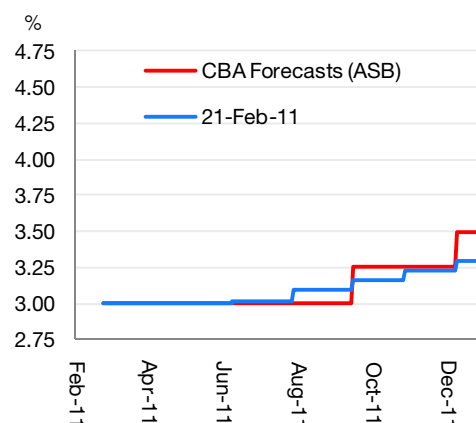
If the Australian economy is weaker than expected, then the RBA is less likely to raise rates. However, it is also likely that expectations of the RBNZ would shift downwards in such a scenario, softening the impact of the RBA-shift on the AUD-NZD spread.

Carry on the AUD and NZD swap curves

There is strong positive carry from paying AUD rates and receiving NZD

The second rationale for our original spread trade was the exceptionally high carry. While the carry on a pay AUD and receive NZD swap spread remains relatively high, it has fallen since last November. There is positive carry on receiving both NZD and AUD rates – with NZD rates having higher carry. The spread trade, of course, involves paying AUD rates. The positive carry on a received AUD position

Figure 3 – CBA forecasts of the RBNZ and expected pricing



Source: CBA, Bloomberg

Figure 4 – 1M carry on AUD swaps in bp

| Length | AUD Roll-Down | AUD Ratset-Carry | Total Carry |
|--------|---------------|------------------|-------------|
| 1Y | 2.2 | 1.6 | 3.8 |
| 2Y | 1.7 | 1.8 | 3.5 |
| 3Y | 1.4 | 1.8 | 3.1 |
| 4Y | 2.0 | 1.6 | 3.6 |
| 5Y | 1.1 | 1.6 | 2.7 |
| 6Y | 0.8 | 1.5 | 2.3 |
| 7Y | 0.8 | 1.5 | 2.3 |
| 8Y | 0.3 | 1.4 | 1.7 |
| 9Y | 0.3 | 1.3 | 1.7 |
| 10Y | 0.3 | 1.3 | 1.6 |

Source: CBA, Bloomberg

Figure 5 – 1M carry on NZD swaps in bp

| Length | NZD Roll-Down | NZD Ratset-Carry | Total Carry |
|--------|---------------|------------------|-------------|
| 1Y | 3.0 | 1.4 | 4.4 |
| 2Y | 3.8 | 2.7 | 6.5 |
| 3Y | 3.0 | 3.0 | 6.0 |
| 4Y | 2.6 | 3.0 | 5.5 |
| 5Y | 2.3 | 3.0 | 5.3 |
| 6Y | 1.8 | 2.9 | 4.7 |
| 7Y | 1.8 | 2.8 | 4.6 |
| 8Y | 1.3 | 2.7 | 4.0 |
| 9Y | 1.3 | 2.7 | 3.9 |
| 10Y | 1.3 | 2.6 | 3.9 |

Source: CBA, Bloomberg



becomes negative carry on a paid AUD position.

When we originally implemented the 10Y spread trade, the AUD swap slope was around half as steep as it now. The 2Y/10Y is 80bp now, but was around 50bp in November. The extra slope makes the AUD carry larger. Since we are paying the carry in the AUD leg of the trade, we are now paying a higher carry than we were in November. This reduces the carry of the spread trade.

In New Zealand, the total carry is generally higher than in Australia. The NZD 2Y is the highest carry point on the NZ curve. (See Figures 4 and 5.)

Total carry favours the 2Y and 3Y points

The Total carry in Figures 4 and 5 is calculated as the sum of the roll-down effect and the rateset. In an upwards-sloping curve, as time passes and a swap decays, the yield will fall. However, also, the initial rateset will be either earning/losing money as time passes. The total carry is the sum of the two effects. Please note that the values in these Figures are expressed in basis points of the original swap (adjusted for DV01).

For the AUD to NZD spread trade, the highest carry is for the 2Y spread, at 3bp per month, with the 3Y not far behind. The 10Y spread still has positive carry, but not as much as when we last implemented this trade.

A role reversal in NZ banking

The front end of NZ is being held down by banks being forced to “borrow long and lend short”

Part of the reason the front end of the NZ curve has such high carry is that the curve is very steep. This is mostly – but not solely - because of market expectations that the RBNZ will be raising rates over the medium term. However, our traders also report that there is a role-reversal happening in NZ banking at the moment.

In the classical banking model, banks allow “inter-temporal mediation” – a longwinded way of saying that banks borrow money for short periods and lend money for long periods. In NZ, there has been a role reversal. The very steep front end of the curve has prompted borrowers to borrow money at floating rates. At the same time, investors are investing money at fixed terms to capture the higher yields. The combination of the two means that banks are borrowing long to invest short. To hedge this risk, banks are receiving short term swap rates. The banks are artificially lowering swaps at the very front of the curve (1Y and 2Y) and exacerbating the steepness of the 1Y-3Y segment of the curve.

NZGB ASWs show the effect of swap receiving

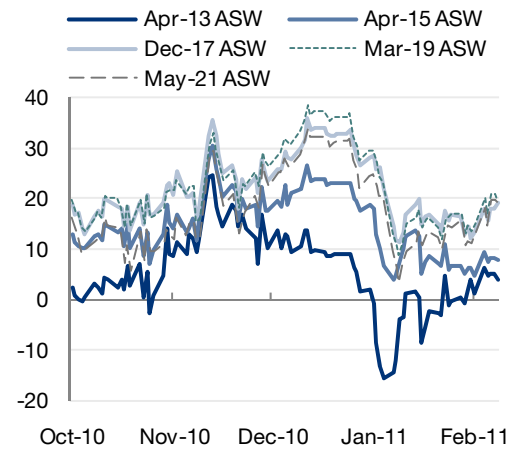
Figure 7 shows the Apr-13 NZGB ASW has been increasing substantially, even as most of

Figure 6 – 1M carry on AUD to NZD spreads

| Length | AUD | NZD | Spread |
|--------|-----|-----|--------|
| 1Y | 3.8 | 4.4 | 0.6 |
| 2Y | 3.5 | 6.5 | 3.0 |
| 3Y | 3.1 | 6.0 | 2.9 |
| 4Y | 3.6 | 5.5 | 1.9 |
| 5Y | 2.7 | 5.3 | 2.6 |
| 6Y | 2.3 | 4.7 | 2.4 |
| 7Y | 2.3 | 4.6 | 2.4 |
| 8Y | 1.7 | 4.0 | 2.3 |
| 9Y | 1.7 | 3.9 | 2.3 |
| 10Y | 1.6 | 3.9 | 2.3 |

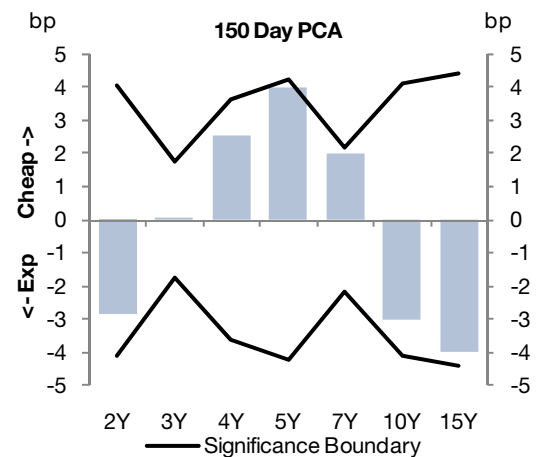
Source: CBA, Bloomberg

Figure 7 – 1M carry on AUD to NZD spreads



Source: CBA, Bloomberg

Figure 8 – PCA of NZD swap rates



Source: CBA, Bloomberg



the other bonds' ASWs track sideways. The move in the 2Y bond above swap shows that the 2Y swap has been falling.

PCA highlights that 2Y rates are too low in NZD

The dearness of the 2Y sector can also be seen in our PCA cheap/dear chart in Figure 8. The 2Y is quite dear compared to the 4Y-5Y section of the curve. However, the Figures 7 and 8 also reveal that the dearness of the 2Y is probably only worth about 5-10bp. This would increase the carry a little around the 2Y area and probably explains why the 2Y and 3Y have the highest carry. However, the underlying steepness of the curve is responsible for much of the carry too.

Although this NZ role reversal is a relatively new phenomenon, we think it could continue. The underlying shape of the NZ curve is unlikely to change quickly. If the current shape is provoking behaviour that requires the banks to "borrow long and lend short" then there is no reason to assume the behaviour won't continue as long as the shape of the curve persists.

No need to receive 2Y NZD rates if we don't have to, the 3Y is fine too

The dearness of the 2Y part of the curve argues against receiving the 2Y NZD rate, despite it having the highest carry. We prefer the 3Y rate, since it is showing less influence from the bank receiving. Although we don't expect this bank receiving to snap back, there's no reason to expose ourselves to it if we don't have to. Since the 3Y spread has nearly the same carry as the 2Y, there seems little reason to take on the extra risk of the 2Y point.

Less exposed to US moves

Front end rates less exposed to US influences

The other reason to use a short end rate rather than the original 10Y is that it is less correlated to US moves. We have measured the correlations of the swap rates in three different ways. First, a (simplistic) outright correlation in levels. Second, a correlation in the natural log (LN) of the change in rates. Third, a correlation of the change in rates. The results are presented in Figure 9.

The spread between Australian and NZ swap rates is more highly correlated to US moves at the longer end of the curve (using the "Change" correlation). This makes sense, the Australian rates are generally more sensitive to the US than the NZ rates are, as a rule. Australian rates are most strongly correlated to the US at the long-end of the curve.

NZ rates tend to be the highest when rates are generally high...

The "level" measure of correlation shows a negative correlation between the AUD-NZD spread and the US rate, indicating that NZ rates move more than AUD rates do when the US moves. But this result is a correlation measure using the long-run level of rates, not the changes. We think this result shows that when rates are generally high, they tend to be highest

Figure 9 – Correlations of AUD and NZD swap rates to USD swap rates

Australia to US

| | 2Y | 3Y | 5Y | 7Y | 10Y |
|--------|------|------|------|------|------|
| Level | 0.68 | 0.70 | 0.69 | 0.71 | 0.74 |
| LN | 0.41 | 0.48 | 0.53 | 0.61 | 0.66 |
| Change | 0.46 | 0.52 | 0.56 | 0.63 | 0.67 |

New Zealand to US

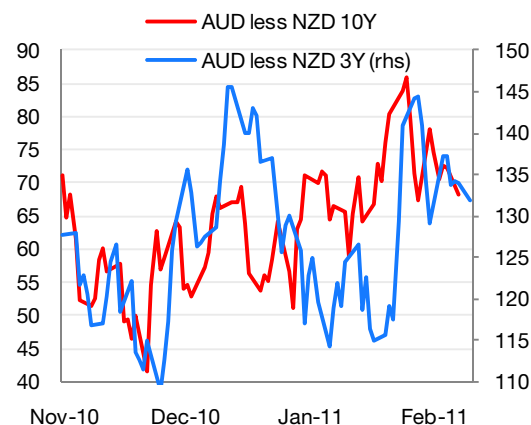
| | 2Y | 3Y | 5Y | 7Y | 10Y |
|--------|------|------|------|------|------|
| Level | 0.89 | 0.90 | 0.90 | 0.90 | 0.90 |
| LN | 0.22 | 0.24 | 0.28 | 0.31 | 0.34 |
| Change | 0.28 | 0.29 | 0.32 | 0.35 | 0.36 |

Aust-NZ spread to US

| | 2Y | 3Y | 5Y | 7Y | 10Y |
|--------|-------|-------|-------|-------|-------|
| Level | -0.87 | -0.86 | -0.83 | -0.78 | -0.68 |
| LN | n/a | n/a | n/a | n/a | n/a |
| Change | 0.24 | 0.32 | 0.34 | 0.36 | 0.37 |

Source: CBA, Bloomberg

Figure 10 – 3Y and 10Y spreads



Source: CBA, Bloomberg



in NZ. You should interpret that statement only as an indication of general tendencies, it is applicable on a long-term basis and to the level of rates. However, on a day-to-day change basis, the AUD rates are more responsive to the US. It might appear superficially contradictory to suggest that AUD rates react more each day, but NZ rates react more in total. However, we found a similar pattern when we looked at the correlation of swap rates to the level of bond rates in Australia. On any given day, the Australian swaps tend to move less than the bonds, but the swaps will move further in a large move. Please see the Strategy Weekly of 15 November 2010 for the full discussion.

... but AUD rates more responsive to USD on a daily basis

Likewise, in NZ, the day-to-day moves are less strongly driven by the US, but when rates are generally high, the structural factors in NZ make NZ rates higher than Australia (as a general rule). These structural factors include the usual preference for short term fixed rate loans in NZ mortgages. The preponderance of short term fixed rates reduces the impact of RBNZ tightening because most borrowers have fixed rates. As a consequence, the RBNZ has, historically, needed to tighten more than the RBA in a comparable situation because the effect of each hike is smaller. This structural feature means that when rates are generally rising, they tend to rise faster in NZ.

However, as we observed earlier, NZ borrowers are using more floating rates at the moment than short-term fixed rates. The RBNZ is likely to get a strong impact from the next rate rise in this cycle because a larger than normal proportion of borrowers are currently on the floating rate. This impact will likely reduce the total number of hikes required (at least in the early part of the RBNZ cycle).

Conclusion

We recommend paying 3Y AUD rates vs 3Y NZD rates

We think the RBA will hike rates more aggressively than the RBNZ over 2011. We would like to reinstate our paid AUD rates against NZD position. The 3Y spread is closely linked to the 10Y spread (see Figure 10). However, it has better carry and is less exposed to the US moves than the 10Y spread is. For these reasons, we prefer to "reinstate" our 10Y spread trade with a 3Y spread instead. The current spread is around 132bp and the trade will have positive carry of about 2.9bp per month. We think the Australian front end will underperform the NZ front end, so being paid positive carry to hold the position is very attractive.



Key Views

| United States | | Tactical (<1 mth) | Strategic (>3 mths) |
|---|-----------------|----------------------|------------------------|
| <p>The outlook for US yields is changing. The Fed is worried about excess capacity generally, and particularly in the labour market, and concentrating on warding off deflation risks. But the recent data has been brighter and the market is embracing recovery, while still concerned about the fiscal backdrop and potential inflation impacts of QE. The market is starting to show concerns about the protests in the Middle-East, though so far the main effect has been to limit sell-offs, rather than to trigger actual rallies.</p> <p>Overall, we expect a stronger economic recovery to take hold in 2011 and for bond yields to head higher as the situation becomes clearer. But the market has run far quickly, and appears to be pricing an excessive inflation profile given the risks and capacity at hand. We look for a pull-back in the near-term as data continues to unveil a weak pricing environment. However, the strength of the activity data suggests we may not see this consolidation. The Fed is likely to be very slow to adjust its views and respond to such a recovery with tighter policy. When it does, we see room for the curve to flatten markedly.</p> <p>Higher US two-year bond yields are being met with higher two-year bond yields from the US's major trading partners (MTPs), putting mild downward pressure on the US-MTP two-year bond spread. The result is a mild weakening in the USD. As the Fed maintains their commitment to keep interest rates at historical low levels and run their QE2 easing policy until the end of June as scheduled, the USD will remain heavy. We see some upside in EUR/USD but for USD/JPY to remain range-bound close to current levels for another month.</p> | Policy rate | 0.1% | 0.1% |
| | 10yr bond | 3.40% | 3.25% |
| | 2/10 curve | 270bp | 250bp |
| | USD/JPY | 83.2 | 85 |
| | EUR/USD | 1.38 | 1.41 |
| | | | |
| Australia | | Tactical (<1 mth) | Strategic (>3 mths) |
| <p>Australia's economic health and lack of spare capacity continues to stand in stark contrast to the rest of the advanced world. RBA tightening in 2010 put substantial flattening pressure on the domestic curve and saw spreads to the US benchmark widen noticeably. But the impact of that tightening on both the retail sector and the AUD has curbed inflation pressure and contributed to a change in market trend in late 2010 (together with the US bond sell-off).</p> <p>An important dynamic in the domestic markets is tension between a comparatively weak current picture of the economy and a very strong medium term outlook. The RBA has been highlighting the medium-term outlook repeatedly in recent communications. We see the fundamental strength exerted by high commodity prices and booming investment as dominating over the year and pushing the RBA to tighten another 75bp this year to ward off inflation pressure generated by the tight labour market. However, with no "smoking gun" likely in the near term and a new flood levy on the way, timing on rate rises is harder to predict.</p> <p>There appears little reason to get bearish on the AUD given the recent testimony and guidance from the RBA. The RBA remain comfortably on a tightening bias after considering growth and the balance of risks in both the global and local economies. As we approach the end of February, major Australian exporters will commence negotiation of their quarterly iron ore and hard coking coal contract prices. While the AUD has remained in a 0.9800-1.0200 range for some time, we think the risk is that the AUD breaks to the upside.</p> | Policy rate | 4.75% | 5.00% |
| | 10yr bond | 5.60% | 5.50% |
| | 3/10 curve | 40bp | 25bp |
| | 10yr EFP | 52bp | 55bp |
| | 10yr v US | 220 | 225 |
| | AUD/USD | 1.0100 | 1.0200 |
| | | | |
| New Zealand | | Tactical (<1 mth) | Strategic (>3 mths) |
| <p>The RBNZ is on hold and our economists believe it will remain so until the third quarter. The income boost coming through from growth in Asia points to eventual extension of the cycle and further RBNZ tightening thereafter once the economy recovers some traction. However, recent data has been weak and the short term outlook is for no change in rates.</p> <p>The NZ curve has been steepening because weaker domestic outcomes have lowered front end rates while higher offshore rates have kept the long-end elevated. Markets expect the RBNZ to leave rates alone and the offshore movements are likely to continue driving the slope of the NZ curve.</p> <p>New Zealand's economy remains weak and may even be in a technical recession (we will find out for sure in a few weeks time). But the NZD/USD will remain supported courtesy of a weak USD and firm agricultural commodity prices. The AUD/NZD will continue to remain well-supported while the RBNZ interest rate outlook remains steady (at least until September) and the RBA remains on a tightening bias.</p> | Policy rate | 3.00% | 3.00% |
| | 10yr bond | 5.50% | 5.50% |
| | 2/10 swap curve | 145bp | 145bp |
| | 10yr v US | 210 | 225 |
| | 10yr v AUS | +10 | 0 |
| | NZD/USD | 0.76 | 0.77 |
| | AUD/NZD | 1.34 | 1.32 |



CBA Forecasts:

| Cash rate | 21-Feb | Mar-11 | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 |
|------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| US | 0.25 | 0.25 | 0.25 | 0.25 | 0.50 | 0.75 | 1.00 | 1.25 | 1.50 |
| Australia | 4.75 | 4.75 | 5.00 | 5.25 | 5.50 | 5.75 | 5.75 | 5.75 | 5.75 |
| New Zealand | 3.00 | 3.00 | 3.00 | 3.25 | 3.50 | 3.75 | 4.25 | 4.50 | 4.50 |
| United Kingdom | 0.50 | 0.50 | 0.50 | 0.75 | 1.00 | 1.25 | 1.50 | 1.75 | 2.00 |
| Eurozone | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | 1.50 | 1.75 | 2.00 |
| Japan | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 | 0.10 |
| 2-yr bond yield | 21-Feb | Mar-11 | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 |
| US | 0.75 | 0.50 | 0.80 | 1.10 | 1.40 | 1.70 | 2.00 | 2.30 | 2.50 |
| Australia | 5.08 | 5.10 | 5.40 | 5.60 | 5.70 | 5.70 | 5.70 | 5.65 | 5.60 |
| New Zealand | 3.80 | 3.80 | 4.00 | 4.20 | 4.60 | 4.90 | 5.00 | 4.80 | 4.80 |
| United Kingdom | 1.53 | 1.20 | 1.80 | 2.10 | 2.40 | 2.70 | 2.80 | 2.90 | 3.00 |
| Eurozone | 1.40 | 0.90 | 1.00 | 1.20 | 1.40 | 1.70 | 2.00 | 2.30 | 2.50 |
| Japan | 0.23 | 0.15 | 0.15 | 0.20 | 0.20 | 0.30 | 0.60 | 0.70 | 0.70 |
| 10-yr bond yield | 21-Feb | Mar-11 | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 |
| US | 3.58 | 3.00 | 3.10 | 3.30 | 3.50 | 3.70 | 3.80 | 3.90 | 4.00 |
| Australia | 5.64 | 5.50 | 5.60 | 5.70 | 5.75 | 5.80 | 5.75 | 5.70 | 5.70 |
| New Zealand | 5.62 | 5.50 | 5.70 | 5.80 | 5.90 | 5.90 | 5.90 | 5.80 | 5.80 |
| United Kingdom | 3.81 | 3.30 | 4.00 | 4.30 | 4.40 | 4.60 | 4.60 | 4.50 | 4.50 |
| Eurozone | 3.25 | 2.80 | 2.80 | 2.90 | 2.90 | 3.00 | 3.10 | 3.20 | 3.30 |
| Japan | 1.31 | 1.00 | 1.10 | 1.10 | 1.20 | 1.30 | 1.40 | 1.60 | 1.70 |
| Currencies | 21-Feb | Mar-11 | Jun-11 | Sep-11 | Dec-11 | Mar-12 | Jun-12 | Sep-12 | Dec-12 |
| AUD/USD | 1.01 | 1.02 | 0.99 | 0.94 | 0.92 | 0.90 | 0.88 | 0.85 | 0.85 |
| AUD/JPY | 84.17 | 86.70 | 85.14 | 81.78 | 80.96 | 79.20 | 77.44 | 74.80 | 74.80 |
| AUD/EUR | 0.74 | 0.73 | 0.68 | 0.66 | 0.66 | 0.66 | 0.65 | 0.64 | 0.65 |
| AUD/GBP | 0.62 | 0.63 | 0.58 | 0.56 | 0.56 | 0.56 | 0.55 | 0.54 | 0.54 |
| AUD/CAD | 1.00 | 1.03 | 1.01 | 0.97 | 0.96 | 0.95 | 0.92 | 0.92 | 0.92 |
| AUD/NZD | 1.32 | 1.34 | 1.32 | 1.31 | 1.30 | 1.29 | 1.28 | 1.25 | 1.25 |
| USD/JPY | 83.14 | 85.00 | 86.00 | 87.00 | 88.00 | 88.00 | 88.00 | 88.00 | 88.00 |
| USD/EUR | 1.37 | 1.40 | 1.45 | 1.42 | 1.40 | 1.36 | 1.35 | 1.32 | 1.30 |
| USD/GBP | 1.62 | 1.62 | 1.70 | 1.68 | 1.65 | 1.60 | 1.59 | 1.58 | 1.58 |
| USD/CAD | 0.99 | 1.01 | 1.02 | 1.03 | 1.04 | 1.05 | 1.05 | 1.08 | 1.08 |
| USD/NZD | 0.76 | 0.76 | 0.75 | 0.72 | 0.71 | 0.70 | 0.69 | 0.68 | 0.68 |



Calendar – February 2011

| Monday | Tuesday | Wednesday | Thursday | Friday |
|---|--|--|---|---|
| <p>31 January</p> <p>AU Private sector credit, Dec NZ Building permits, Dec NZ Trade balance, Dec JP Industrial/vehicle production, Dec JP Housing starts/construction orders, Dec UK GfK consumer confidence survey, Jan, Index</p> | <p>1</p> <p>AU AI-Group PMI, Jan, Index, (46.3) AU NAB Bus conf/cond, Dec, Index, (6/4) AU ABS House price indexes, QIV, q%ch, (0.1) AU RBA cash rate, %, 4.75, (4.75) NZ Avg Hourly Earnings, QIV, q%ch, (1.0) NZ Labour Cost - Priv Sect, QIV, q%ch, (0.5) EU/GE/UK PMI manufacturing, Jan, Index, (56.9/60.2/58.3) UK Net consumer credit, Dec, £bn, (-0.1) US ISM manufacturing, Jan, Index, (57) US Total vehicle sales, Jan, mn, (12.53)</p> | <p>2</p> <p>AU HIA new home sales Dec, m%ch, (-0.2) EU PPI, Dec, m/y%ch, (0.3/4.5) UK PMI construction, Jan, Index, (49.1)</p> | <p>3</p> <p>AU CBA/AI-Group PSI, Jan, Index, (46.4) AU Build approv, Dec, m%ch, 2.0, (-4.2) AU Trade balance Dec, \$bn, 1.8, (1.9) NZ Emp Growth/Unemp Rate, QIV, (1.0/6.4) CH Non-Manuf PMI Jan, Index, (56.5) EU PMI services/composite, Jan, Index, (55.2/56.3) EU ECB announces int. rate, %, 1.00, (1.00) GE/UK PMI services, Jan, Index, (60/49.7) US ISM non-manufacturing, Jan, Index, (57.1) US Factory orders, Dec, m%ch, (0.7)</p> | <p>4</p> <p>AU RBA Statement on Monetary Policy UK New car registrations, Jan, y%ch, (-18.0) US Non-farm payrolls, Jan, '000, (103) US Unemployment rate, Jan, %, (9.4) US Avg hrly earnings, Jan, m/y%ch, (0.1/1.8) CA Net change in employment, Jan, '000, (22) CA Unemployment rate, Jan, %, (7.6) CA Ivey purchasing manager index, Jan, (50)</p> |
| <p>7</p> <p>AU AI-Group PCI, Jan, Index, (43.8) AU ANZ Job ads, Jan, m%ch, (2.0) AU Retail trade, Dec, m%ch, 0.5, (0.3) AU Retail sales ex inf., QIV, q%ch, -0.5 (0.7) JP Leading / Coincident index CI, Dec, , (100.6/102.4) GE Factory orders, Dec, m/y%ch, (5.2/20.6) US Consumer credit, Dec, \$bn, (1.346) CA Building permits, Dec, m%ch, (-11.2)</p> | <p>8</p> <p>JP Curr a/c total/adj., Dec, ¥bn, (926.2/1145.1) JP Trade balance - BOP basis, Dec, ¥bn, (259.7) GE Industrial production, Dec, m/y%ch, (-0.7/11.1) UK RICS house price balance, Jan, %, (-39) CA Housing starts, Jan, '000, (171.5)</p> | <p>9</p> <p>AU MI/WBC Consumer Sent, Feb, Index, (104.6) NZ Card spending, Jan, m%ch, (-0.9) JP Consumer confidence, Jan, Index, (40.2) JP Machine tool orders, Jan, y%ch, (64.0) GE Trade bal, Dec, €bn, (12.9) UK Total trade balance, Dec, £bn, (-4.1)</p> | <p>10</p> <p>AU Labour force, Jan employment, '000, 25, (2.3) unemployment rate, %, 5.0, (5.0) participation rate, %, 65.9, (65.8) AU MI Consumer Inflation Expectat, Feb, %, (4.6) AU MI Unemp. Exp., Feb, Index (108.7) CH Trade balance Jan, (13.1) JP Machine orders, Dec, m/y%ch, (-3.0/11.6) EU ECB Monthly report UK Industrial production, Dec, m/y%ch, (0.4/3.3) UK BoE announces rates, %, 0.50, (0.50) US Wholesale inventories, Dec, m%ch, (-0.2)</p> | <p>11</p> <p>AU RBA Parliamentary Testimony NZ Food prices, Jan, m%ch, (-0.8) CH PPI/CPI, Jan, y%ch, (5.9/4.6) CH Industrial production, Jan, y%ch, (13.5) CA Fxd Ass Investment, Jan, y%ch, (24.5) CH Retail sales, Jan, y%ch, (19.1) GE CPI, Jan, m/y%ch, (1.0/1.7) UK PPI Input/Output/core, Jan, y%ch, (12.5/4.2/2.9) US Trade balance, Dec, \$bn, (-38.3) US Uni. Of Michigan confidence, Feb, Index CA Trade balance Dec, C\$, (-0.1)</p> |
| <p>14</p> <p>AU Housing finance, Dec, m%ch No. of own-occupiers, %, 4.0, (2.5) Value of all loans, %, 3.0, (2.9) NZ Retail sales ex inflation, QIV, q%ch, (0.7) NZ Retail sales, Dec, m%ch, (1.5) JP GDP, QIV, q%ch EU Industrial production Dec, m/y%ch, (1.2/7.4)</p> | <p>15</p> <p>AU RBA Board Minutes AU NAB Bus conf/cond, Jan, Index JP Industrial production, Dec, m/y%ch, (1.0/4.2) JP BoJ target rate, %, 0-0.10 (0-0.10%) EU GDP, QIV, y%ch, (1.9/3.9) EU/GE ZEW survey (econ. sentiment), Feb, (25.4/15.4) UK CPI, Jan, m/y%ch, (1.0/3.7); core, y%ch, (2.9) US Import price index, Jan, m/y%ch, (1.1/4.8) US Retail sales, Jan, m%ch, (0.6) US Business inventories, Dec, m%ch, (0.2)</p> | <p>16</p> <p>AU DEWR skilled vacancies, Feb, m%ch, (-4.6) AU New motor veh. sales, Jan, m/y%ch, (0.8/-3.1) UK ILO unemployment rate (3mths), Dec, %, (7.9) UK Bank of England Inflation Report US Building permits, Jan, '000, (635) US Housing starts, Jan, '000, (529) US Producer price index Jan, m/y%ch, (1.1/4.0) US Capacity utilisation, Jan, %, (76.0) US Industrial production, Jan, m%ch, (0.8) CA Leading indicators, Jan, m%ch, (0.5)</p> | <p>17</p> <p>AU RBA Ass Gov Lowe speaks in Sydney NZ Business PMI, Jan, Index, (53.1) NZ Producer prices, in/outputs, QIV, q%ch, (0.7/1.2) JP Leading / Coincident index CI, Dec, EU Current account, Dec, €bn, (-11.2) EU Construction output, Dec, m/y%ch, (-0.9/-6.8) US CPI, Jan, m/y%ch, (0.5/1.5); core, (0.1/0.8) US Leading indicators, Jan, m%ch, (1.0) US Philadelphia Fed, Feb, Index, (19.3) CA Wholesale sales, Dec, m%ch, (1.2)</p> | <p>18</p> <p>GE Producer prices, Jan, m/y%ch, (0.7/5.3) UK Retail sales, Jan, m/y%ch, (-0.8/0.0) CA CPI, Jan, m/y%ch, (0.0/2.4)</p> |
| <p>21</p> <p>AU HIA Housing Affordability Index, QIV NZ PSI, Jan, Index, (52.5) NZ Credit card spending, Jan, m/y%ch, (-1.4/2.0) GE IFO - Business climate, Feb, Index, (110.3)</p> | <p>22</p> <p>US S&P/Case-Shiller home price ind., Dec, US Richmond Fed, Feb, Index CA Retail sales, Dec, m%ch, (1.3)</p> | <p>23</p> <p>AU Prelim. construction wk done, QIV, q%ch, , (-2.1) AU WPI QIV, q/y%ch, 0.9/3.8, (1.1/3.5) JP Trade bal total/adj, Jan, ¥bn EU Industrial new orders, Dec, m/y%ch, (2.1/19.9) UK Bank of England minutes US Existing home sales, Jan, mn/m%ch, (5.28/12.3) CA Teranet House Prices, Dec, y%ch, (4.9)</p> | <p>24</p> <p>AU Capex, QIV, q/y%ch, 5.0, (6.2) AU AWE Nov, q/y%ch, 1.4/3.8 (0.4/4.5) GE GDP, QIV US Durable goods orders, Jan, m%ch, (-2.5) US New home sales, Jan, m%ch, (17.5)</p> | <p>25</p> <p>JP CPI, Jan, GE CPI, Feb, UK Total bus investment, QIV, q/y%ch, (3.1/8.9) UK GDP, QIV, q/y%ch, (-0.5/1.7) US GDP, QIV US Uni. Of Michigan confidence, Feb, Index</p> |
| <p>28</p> <p>AU Company profits, QIV, q%ch, 0.0, (-1.5) AU Private sector credit, Jan, AU Inventories, QIV, q%ch, -0.2 (-0.8) GDP contrib, %, 0.2 (-0.2) AU RP Data house prices, Jan, NZ Building permits/Trade balance, Jan NZ NBNZ Business confidence, Feb, Index JP Industrial/vehicle production, Jan EU CPI, Jan, m/y%ch, (0.6/2.2); core, y%ch, (1.1) US Personal income/spending, Jan US Pending home sales, Jan, m/y%ch, (2.0/-3.6) CA GDP, QIV, q%chsaar, (1.0)</p> | | | <p>Early March AU Balance of Payments, QIV (1 Mar) AU Govt Finance Stats, QIV (1 Mar) AU Retail trade, Jan (1 Mar) AU GDP, QIV (2 Mar) AU Trade in Goods & Services, Jan (3 Mar) AU Building approvals, Jan (3 Mar)</p> | <p>Central Bank Meetings AU RBA (1 Feb) EZ ECB (3 Feb) UK BOE (10 Feb) JP BoJ (15 Feb) CA Bank of Canada (1 Mar) NZ RBNZ (10 Mar) US FOMC (16 Mar)</p> |

Note: Figures in brackets represent previous result (if available). All information is preliminary and subject to revision. Chief Economist: Michael Blythe ph: 9118-1101 Economist: James McIntyre: 9118-1100



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