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N.Z. Funds Bets on Inflation Bonds Ahead of Sales Tax Increase

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By Sarah McDonald

June 2 (Bloomberg) -- Investors should buy inflation-linked bonds sold by New Zealand's government and the state-owned power grid operator because a sales tax increase will cause consumer prices to surge, according to New Zealand Funds Management Ltd.

"A law change quirk means these inflation-linked notes offer value," **Michael Lang**, who helps manage about NZ\$1 billion (\$678 million) as chief investment officer at N.Z. Funds, said in an interview in Auckland. "Inflation is set to become a global issue in the medium term" as Europe's sovereign debt crisis threatens to slow economic growth and force governments to add stimulus measures, he said.

Transpower New Zealand Ltd.'s financing arm sold NZ\$100 million of 10-year notes last month in the nation's first corporate inflation-linked bond sale. The debt pays investors a 4.115 percent coupon plus compensation for any increases in consumer prices.

New Zealand inflation will nearly triple to 5.9 percent in the year to March 2011, partly because a tax increase announced by lawmakers on May 20 is expected to add 2 percent when it's introduced in the last quarter, according to the **Treasury**. South Korea said yesterday inflation accelerated 2.7 percent in May from a year earlier on food and oil, while Australian data showed retail sales rose in April at double the pace estimated by economists.

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New Zealand's government is "actively considering" more sales of inflation-protected bonds after investors expressed interest in the securities, **Philip Combes**, treasurer of the New Zealand Debt Management Office, said last month.

N.Z. Funds bought the government's inflation-linked notes in October, when they yielded 3.4 percent, offering a total return of 9.3 percent if the Treasury's inflation forecast is accurate, Lang said. Those returns on top AAA grade local-currency sovereign bonds would beat the yields on lower-rated domestic corporate debt, he said.

BBB rated **Contact Energy Ltd.** priced NZ\$100 million of 2017 bonds to yield 7.855 percent on April 9, according to data compiled by Bloomberg. BBB is eight rankings lower than AAA on Standard & Poor's credit quality scale.

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