Bank of New Zealand

BNZ Weekly Overview

8 March 2006

FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 mths ago	Yr ago	10 yr average
Official Cash Rate	7.25%	7.25	7.25	7.25	6.50	6.3
90-day bank bill	7.53%	7.51	7.57	7.62	6.91	6.6
10 year govt. bond	5.75%	5.70	5.77	5.87	6.05	6.5
1 year swap	7.33%	7.33	7.39	7.57	7.13	6.7
5 year swap	6.72%	6.69	6.75	7.03	6.94	7.1
NZD/USD	0.647	0.663	0.679	0.698	0.74	.57
NZD/AUD	0.894	0.892	0.916	0.937	0.93	.86
NZD/JPY	75.6	76.8	80.4	84.4	77.3	66.0
NZD/GBP	0.374	0.378	0.389	0.403	0.384	.35
NZD/EURO	0.545	0.555	0.567	0.596	0.556	.509

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Kiwi Dollar Heads Lower

The big news in the New Zealand financial markets this week has been the strong fall in the Kiwi dollar to end this afternoon near 64.7 cents from 66.3 a week ago and 72 back in early December. This is the lowest rate since September 2004 and reflects a number of things. But first, it should be noted that nothing especially specific has happened this week to cause the Kiwi dollar to fall. There has been no exceptionally weak data and no official comment relating to the currency or the state of the economy. Instead the Kiwi dollar has been pulled lower on the back of medium term factors.

These include the fact that everyone knows the New Zealand dollar is overvalued and will eventually fall strongly. So the natural drift as it were in the currency is downward. Plus, in the past few weeks we have received information confirming that the rate of growth in the economy is continuing to slow from the 2.5% rate reached in the year to September, 2005. Specifically

- Data from Barfoot and Thompson show that their sales in Auckland in February were down by 30% from a year earlier. Their number of listings was up by 17%.
- Car registrations in the three months to February were down by 2% from a year earlier.
- Commercial vehicle registrations were down by 9% and tractor registrations were down by 20%.
- Capital goods imports were up only 3% in the January quarter from a year earlier.
- We have strong anecdotal evidence of businesses pulling back aggressively on capital expenditure in the face of tight margins and falling profitability with costs rising across the board.
- The ANZ Business outlook survey showed a net 0% business investment intentions for the coming year. This is the weakest reading since 1991, well below the reading in February last year of a net 22% positive, and below the ten year average of 14%.
- Employment intentions are a net 9% negative compared with 15% positive a year ago and ten year average of positive 6%.
- Private sector credit growth has slowed to 13.2% from 14.2% in December and a peak of 15.2% in November.

We also received data last week showing a much worse than expected trade deficit for January with exports for the year to January down by 0.6% while imports were up by 8.6%.

So the downward medium term expectation for the Kiwi dollar has been reinforced by some weakish data. But over the past week we have seen increasing debate overseas about tightening monetary policies in other countries - most notably Europe and Japan. The Europeans have just increased their cash rate by 0.25% to 2.5%, the Canadians by 0.25% to 3.75%, and it is expected that the Japanese will soon be easing their quantitatively loose monetary policy and actively start raising interest rates toward the middle of the year. While New Zealand interest rates are still going to look very attractive the simple fact that the gap between our rates and those overseas will be narrowing means some investors are starting to feel the time is right to start unwinding carry trades. These are trades where one borrows in a low interest rate country, invests in a high interest rate country and takes the foreign exchange risk. The hope is that over the time one runs this trade the exchange rate will not fall away and the intention is that if it looks like the currency is falling one will move fast and get out before other investors.

At this stage the unwinding of carry trades appears relatively limited. But because the markets know such unwinding will exert strong downward pressure on the Kiwi dollar and because the chances of such unwinding have increased recently there has been some extra selling of our currency by mainly short term speculators.

On top of this there remain concerns that although so far this month $1 billion worth of Uradashi issues have been made the volume of maturing issues over the next couple of years will swamp fresh issues and that this extra selling of New Zealand dollars in the market will place downward pressure on our currency.

The upshot is that the Kiwi dollar is drifting lower but one still cannot take a firm view on how fast the decline is going to be. In particular one cannot at this stage take a strong view on where the currency will bottom out. We suspect that tomorrow the Reserve Bank in their Monetary Policy Statement and official cash rate review will signal that scope for any easing of interest rates is exceedingly limited. In fact such scope is reduced every time the Kiwi dollar falls. And because we expect that the extent of easing in our monetary policy this cycle will be relatively limited because of capacity constraints New Zealand interest rates are still going to remain attractive to quite a number of investors overseas.

That means that while one can easily forecast that we will fall below 60 cents within the next twelve months it is difficult to generate a forecast that we will head towards 50. Of course if the economy was to surprise strongly on the downside and fall into recession this year then we would expect to see extra weakness in the New Zealand dollar. But as we have been noting for some time we do not expect a recession this year with support for the economy continuing to come from easing fiscal policy, still good job security, infrastructure spending, commodity prices easing only slightly, trading partner growth tracking above trend, and average mortgage rates only rising marginally because most people are on fixed rates.

But at least this week we have had some good news for exporters and the fall in the currency will be especially welcomed by those in the likes of fishing, forestry, and pipfruit. But the currency remains overvalued and continues to act as a drag on economic growth. And in particular the lagged effect of the high New Zealand dollar on the domestic part of our economy is only just starting to feed through into the likes of the housing market and retail spending.

So we would advise people not to get too optimistic about an upturn in the New Zealand economy in the near future on the back of this weakness in the New Zealand dollar. Things are going to get worse before they eventually get slightly better.

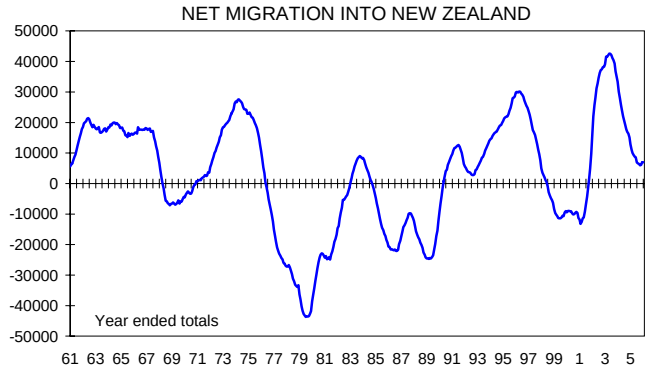
NB: Assuming the knee surgery goes okay tomorrow the Weekly Overview will revert to Thursday distribution from next week.

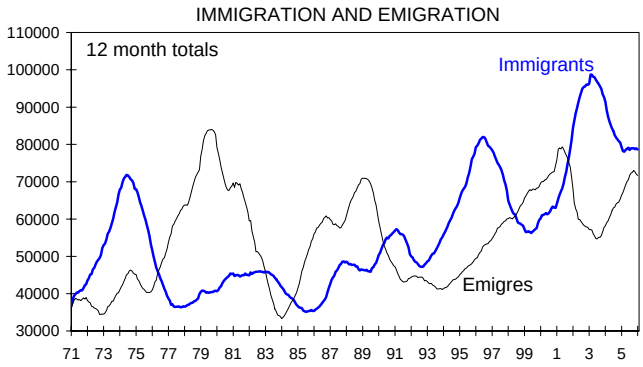
THE WEEK'S ECONOMIC DEVELOPMENTS

Thursday 2

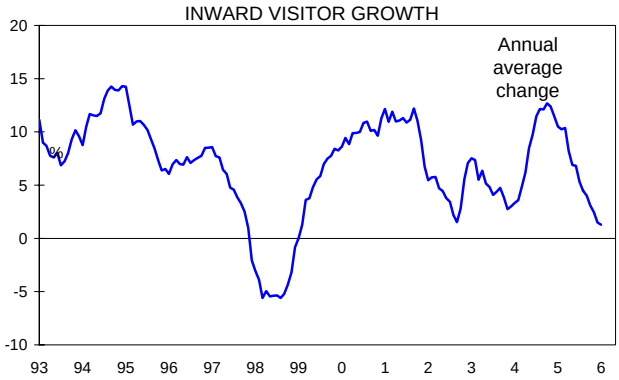
Migration flows steady

There was a net addition to New Zealand's population from permanent and long-term migration in January of 1,670 people. This was nine fewer than a year earlier and takes the annual net migration gain to 6,951 from 6,960 in December and 12,808 a year ago. Looking through the natural volatility in these numbers we can see that the net migration gain has steadied just below the 7,000 level in recent months. This arises with the number of immigrants in the three months to January down by 1.5% from a year earlier and the number of emigrants down by 6.7%. So for the moment fewer people are leaving. Our expectation is that later this year when the housing market is weaker, the currency is falling, and there is much media debate about poor long-term prospects for the New Zealand economy we will see gross outflows of people kick back up again and take the net annual migration flow close to zero.





In January the number of visitors to New Zealand was up by just 0.2% from a year earlier which means that for the year to January growth was a relatively low 1.3%. This follows growth of 10.5% the previous year and 3.3% in the year to January 2004. In the three months to January the number of visitors to New Zealand was down by 1.4% from a year ago. So it looks like the trend in visitor numbers is now negative. In contrast the number of New Zealanders traveling overseas was up 10.1% in January from a year earlier, up 4.8% in the three months to January from a year earlier, and up 7.4% for the entire year. This latter growth number is a sharp slowdown from 26% growth a year in earlier.

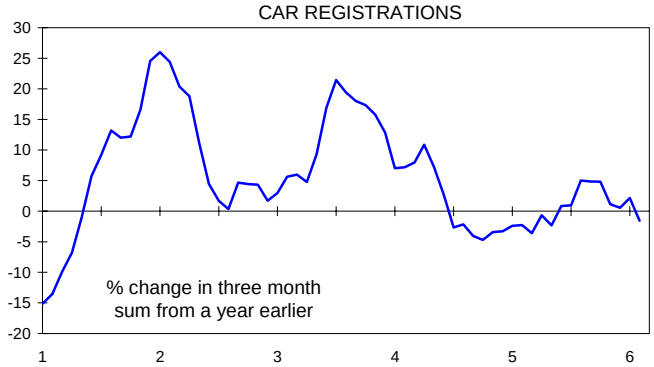


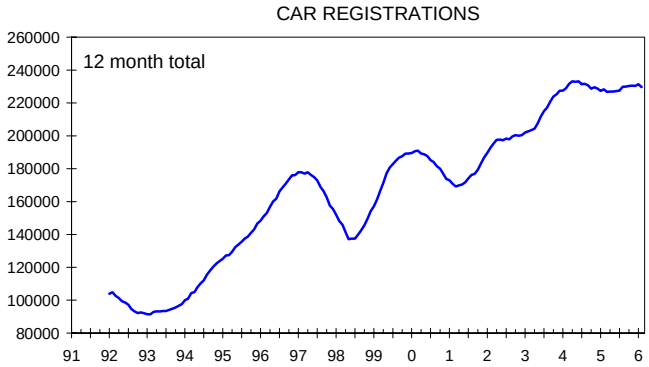
Friday 3

Vehicle spending trending downward rapidly

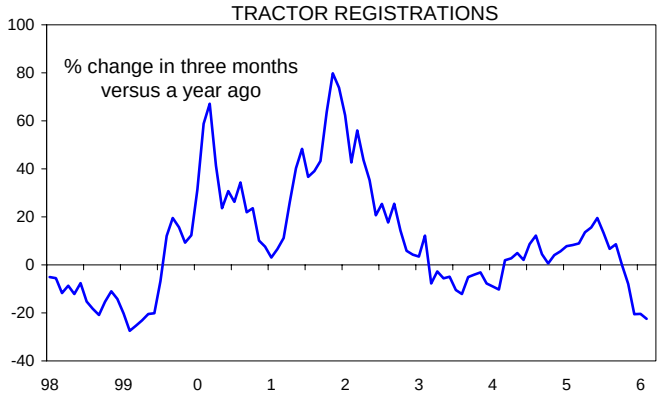
In January there were 17,052 cars registered around New Zealand. This was a 10% decrease from a year earlier, and in the three months to February registrations were down 1.5% from a year earlier. Growth for the entire year was just 0.6% following a small fall a year earlier and a rise of 13% in the year to February,

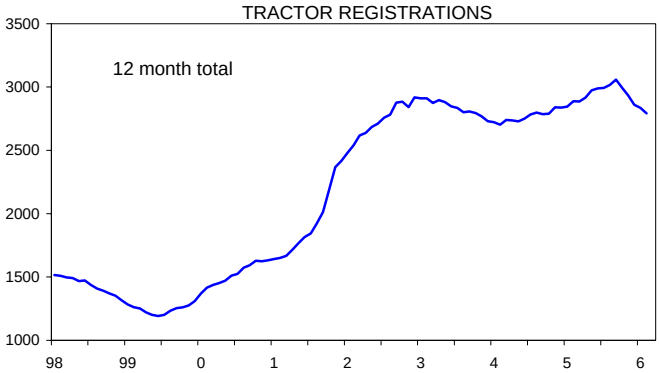
2004. The data show that after a period of relatively flat activity a decline in car registrations is now underway. This is consistent with consumers pulling back on spending in the face of rising effective average interest rates and perhaps some redundancies.



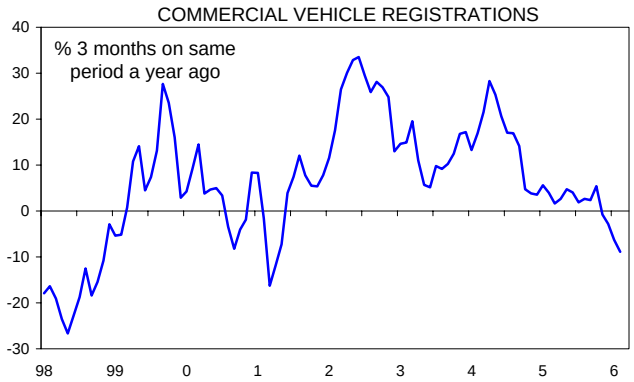


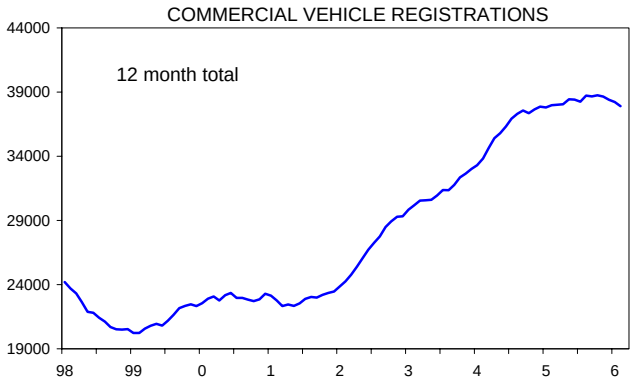
There were 150 tractors registered around the country in February. This was a 22% decline from a year earlier and in the three months to February registrations were down by 22%. This is a fairly rapid decline and means that in the year to February registrations were down by 3.3%. There is a clear and sizable decline in farm spending on tractors underway.





Finally, there were 2,749 commercial vehicles registered in February. This was an 11% decline from a year earlier taking the change in the three months to February from a year earlier to a decline of 9%. For the year to February the number of registrations was down by 0.2%. As for tractors and cars there is a downward trend in commercial vehicle registrations underway. This is consistent with businesses pulling back on capital expenditure in the face of high pessimism and declining profitability.

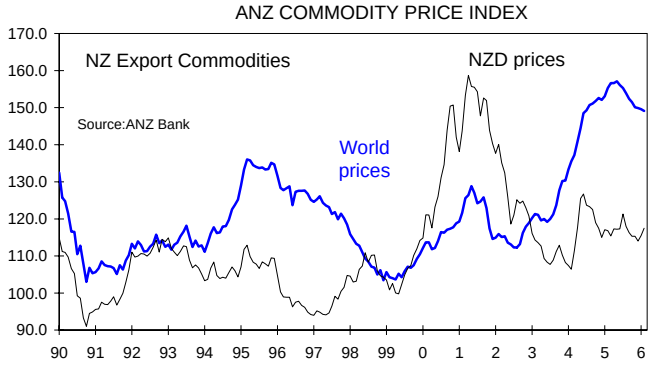




Commodity prices keep on falling

The ANZ commodity price index in world price terms fell by 0.3% in February to be 4% down from a year earlier and 5% below it's record level reached in May last year. The decline in commodity prices is relatively gradual reflecting the fact that the world economy is still in fairly good shape with growth in our trading

partners expected to come in near 3.5% this year and next from similar growth over 2005. Because of the fall in the New Zealand dollar recently in local currency terms the commodity price index rose by 1.7% in February after rising 1.3% in January. The index now sits 0.6% ahead of a year earlier and is 1% above its ten year average.



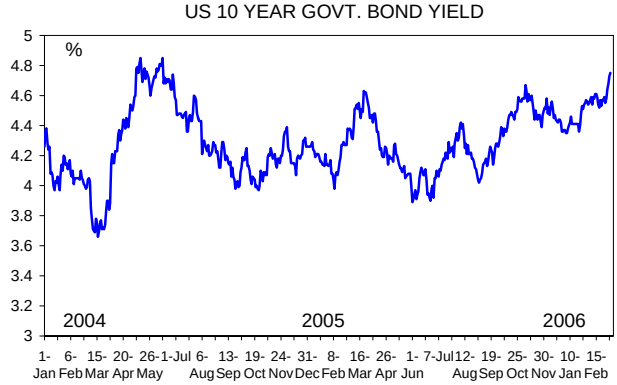
INTEREST RATES

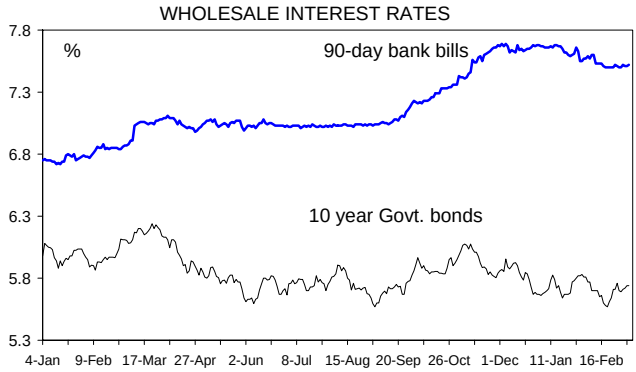
Normally, when we see something exciting happening in the foreign exchange market we also tend to see wholesale interest rates moving about a bit. In theory the sharp fall in the Kiwi dollar over the past week should cause interest rates to rise because of the extra inflationary pressure implied by a lower currency. This comes about as import prices rise and immediately boost inflation, and as export incomes improve so some extra spending has to be allowed for from the exporting sector. Maybe a few manufacturers who were thinking about shifting their production to China will choose to stay in the country as well.

But the focus in the interest rates market this week is tomorrow's Monetary Policy Statement and official cash rate review from the Reserve Bank. The weakness in the Kiwi dollar decreases the chances of any easing sign from the Reserve Bank and in fact strongly increases the chances that they will warn about extra inflation and the role of capacity constraints going forward. We expect no cut in the official cash rate tomorrow with the Reserve Bank repeating their mantra that there will be no scope for any cuts in the foreseeable future – basically out to 2008. We expect the first cut early next year.

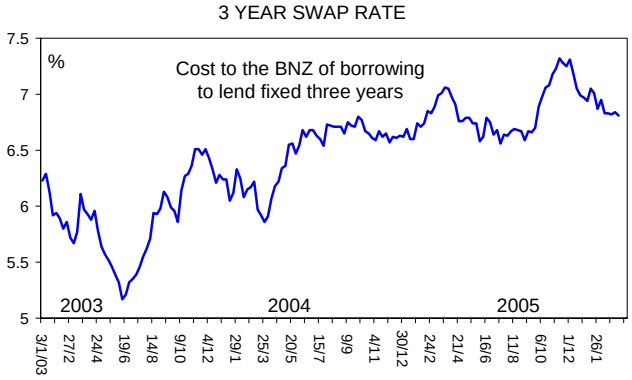
Interest rate developments have actually been more interesting overseas. As noted earlier on in the Weekly Overview expectations that the Japanese will stop their loose monetary policy have increased in recent weeks as a result of positive economic data and comments from the Bank of Japan and government officials. In Europe some of the economic data have been positive and following the 0.25% increase in their cash rate last week to 2.5% the markets assess the chances of further rate rises as being relatively strong in coming quarters.

In addition, overnight in the United States we have seen expectations of further rate rises strengthen following comments from a traditionally hawkish Federal Reserve Bank regional president and data showing stronger than expected growth in wage costs. This Friday night the monthly non-farm payrolls report will be released and this will tend to set the tone for where U.S. interest rates will be going in the near future. Because of the increasingly bearish sentiment about interest rates in the U.S. the ten year government bond yield has ended the week at almost a two year high of 4.75% from 4.55% last week and 4.37% at the start of the year.





With local markets on hold ahead of tomorrow's announcement our own ten year government bond yield has finished the week at 5.74% from 5.7% last Wednesday. The yield on 90 day bank bills has ended near 7.53% from 7.5%. Swap rates have barely moved over the week.



If I were a borrower what would I do?

I'd take into account the fact that the falling currency implies extra inflationary pressure in the New Zealand economy and be wary about expecting further substantial falls in fixed housing rates. In particular one should not ignore the increasing expectations of rate rises overseas especially in the United States where movements in their medium to long term interest rates tend to be a key driving force for movements in our own fixed rates. Personally I'd probably go for the two year rate at 7.85% at the moment. But for conservative people simply wanting to get their interest rate set so they can forget about it the five year rate at 7.55% is quite attractive.

BNZ Fixed Lending Interest Rates

	Housing	Business Advantage*	Farm First*
Float	9.55%	9.85%	9.80%
1 yr	8.40	9.20	9.05
2	7.85	9.10	8.85
3	7.85	8.95	8.80
4	7.85	8.85	8.70
5	7.55	8.80	8.65
7	7.55	-	8.55
10	-	-	8.55

* Rates shown do not include normal margins.

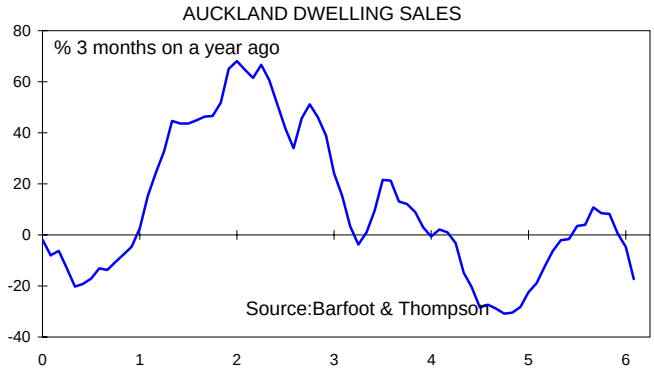
BNZ Term Deposit Rates

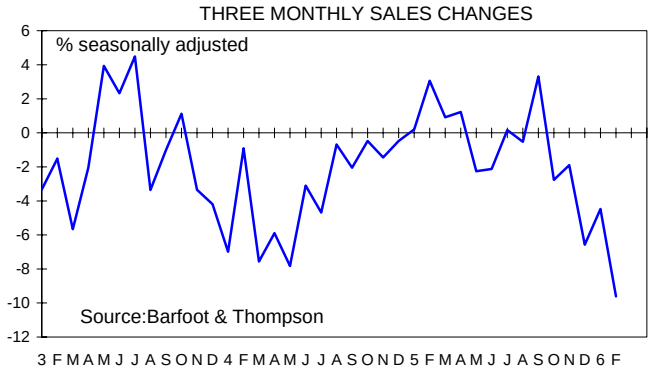
Days	$10-50K	$50-100K	$100-250k
30	3.00	3.00	5.25
90	5.90	5.95	6.00
180	6.80	6.85	6.90
1 yr	7.00	7.05	7.10
5 yr	6.40	6.45	6.50

HOUSING MARKET UPDATE

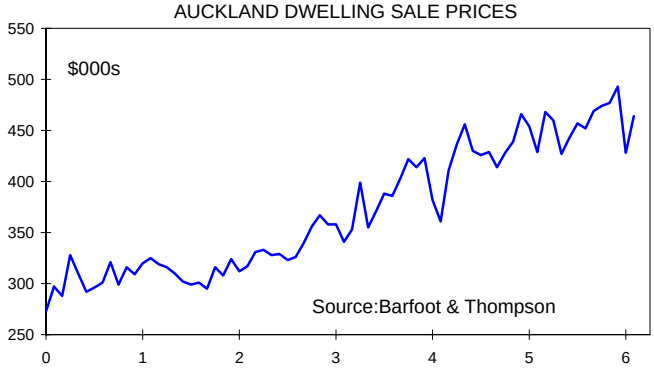
Auckland housing market data weak

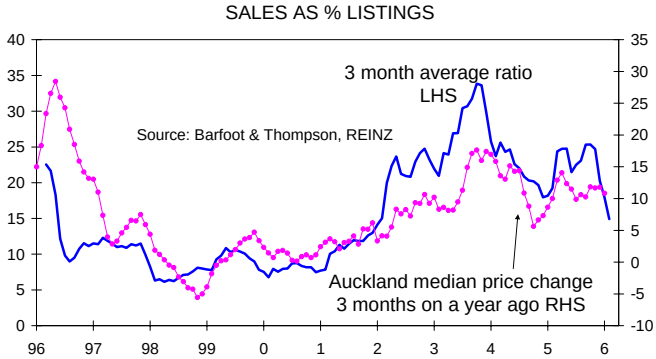
There is unequivocal weakness revealed in the Auckland housing market in monthly data released by Barfoot and Thompson this week. During February they sold 740 dwellings. This was a 30% decline from a year earlier and the weakest February performance since 2001. In the three months to February sales were down by 17% from a year earlier and in rough seasonally adjusted terms were off by 10% from the three months to November.





The median dwelling sale price improved to $464,000 from $428,000 in January but this was the second lowest such reading since August last year and up just 8.2% from a year earlier. Prices appear to have plateaued at best and there could be a downward trend underway given that the median price peaked at $493,000 in December.





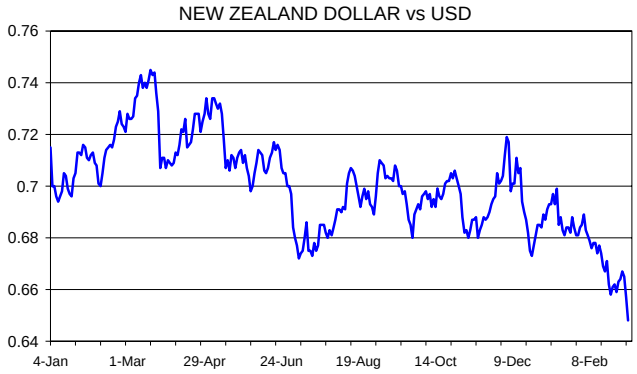
Weakness in the market is further confirmed by the total number of listings at the end of February sitting 16.8% ahead of a year earlier at 5,342. The ratio of sales to listings during February was just 13.9%. This is the lowest ratio for any month since December 2001 and suggests quite strongly that the market is becoming oversupplied with properties.

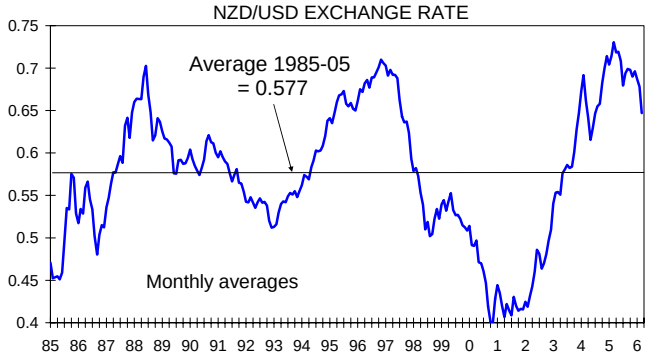
The rental market also took a slight dip in February with the number of fresh lettings down by 8.5% from a year earlier at 613, though the average weekly rent improved to $350 from $348 in January. This was however only a 2.9% increase from a year earlier.

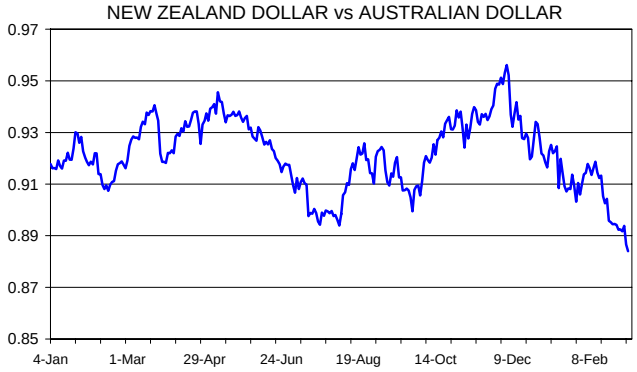
The data suggest the Auckland housing market is now easing with increasing listings, flat prices at best, and falling turnover.

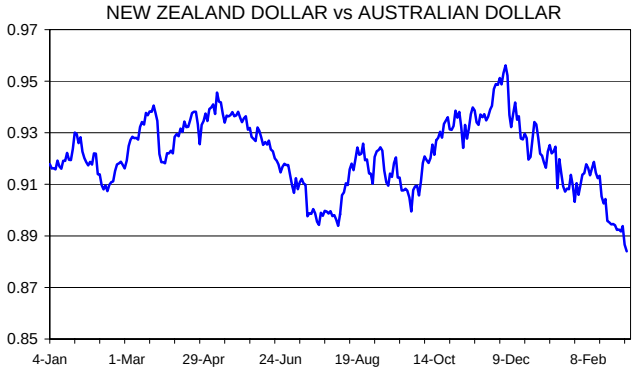
EXCHANGE RATES

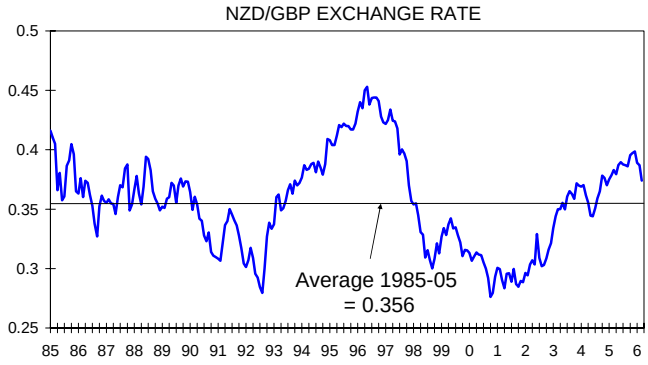
We've already written a lot about the fall in the Kiwi dollar over the past week in the first section of the Weekly Overview so won't repeat yourselves here. Suffice to say that we have fallen from 66.3 U.S. cents a week ago to about 64.7 now. We have dropped by almost a cent against the Australian dollar to 88.4¢ with the Aussie dollar itself experiencing some weakness against a U.S. dollar which has strengthened over the week. We have fallen by one yen to 75.8, one Euro down to 54.5, and half a pence down to 37.3. This week we are printing our usual foreign exchange rate graphs going back about a year plus some longer term graphs to put the recent movement in the Kiwi dollar in perspective.

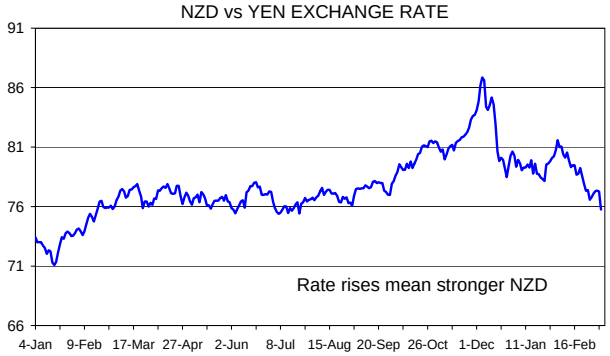


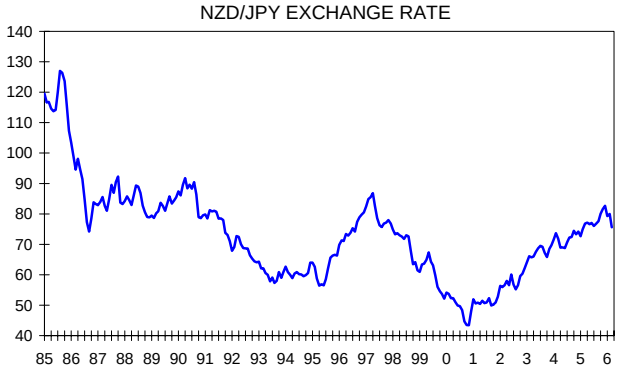


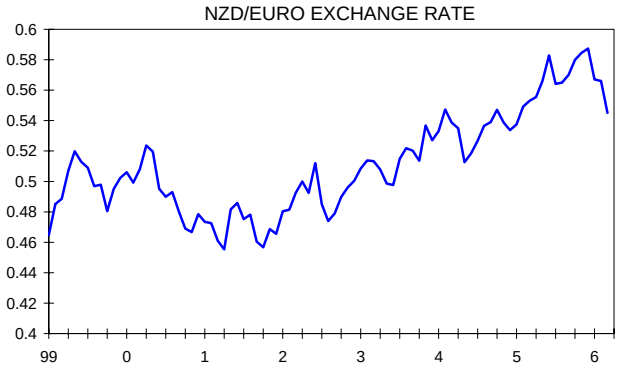












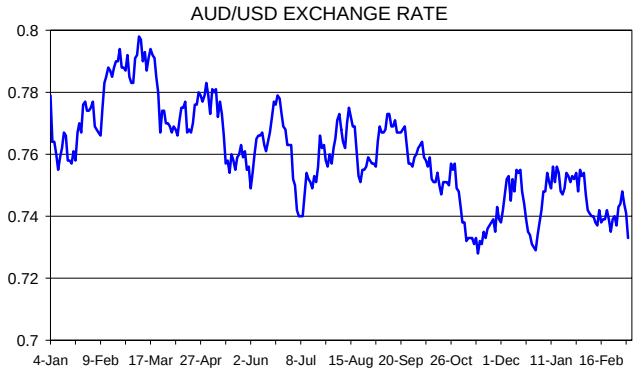
The Kiwi dollar started the week moving upward last Thursday following the European Central Bank's increase in its cash rate by 0.25% to 2.5%. The Euro firmed and this helped the Kiwi dollar to rise with short covering kicking in from punters who had been expecting the previous week's decline to continue. Further initial support for the New Zealand dollar came from news that so far this month $1 billion worth of Uradashi bond issues have been announced. But then the rot set in with traders getting increasingly concerned about the narrowing interest rate differential between New Zealand and other economies in light of the recent rise in European interest rates, a fifth straight increase in the Canadian cash rate overnight to 3.75%, upward revisions to interest rate forecasts in the United States, and expectations of loose monetary policy ending in Japan.

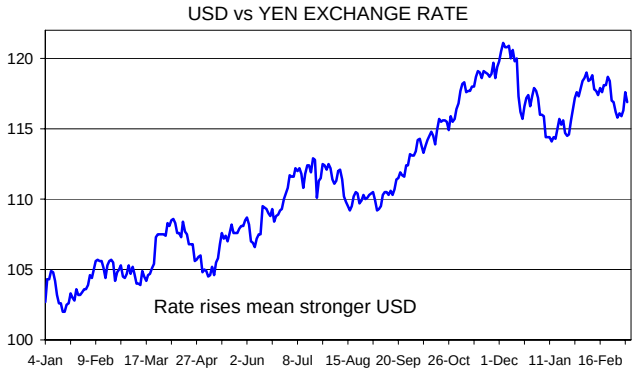
So where will it all end? While the trend in the kiwi dollar is quite clearly downward for perhaps the next couple of years we have difficulty forecasting much of a decline below 60¢ this year. The New Zealand dollar is not going to fall strongly until it looks highly likely that interest rates will be falling firmly. And we don't expect to see interest rates falling or strong falls being signaled by the Reserve Bank until a string of particularly bad data on the domestic economy appears. We have evidence that growth in consumer spending is slowing, that businesses are pulling back on their investment, and that the housing market is also easing off. But apart from our documented concern about the pullback in capital spending - which will sap productivity growth - you could not as yet say that consumer spending has taken a king hit.

This means that tomorrow when the Reserve Bank release their latest Monetary Policy Statement and review the official cash rate we don't expect them to send a signal that interest rates will be falling in the near future. We certainly expect that they will note the slow-down in New Zealand's rate of economic growth but we also expect them to note that upside risks to inflation remain with little evidence as yet that capacity pressures will ease faster than they have assumed. And for the record remember that their assumption is that even with the economy growing near 1.5% per annum over the next couple of years inflation will only just claw its way back below 3% and they will not be easing monetary policy before 2008.

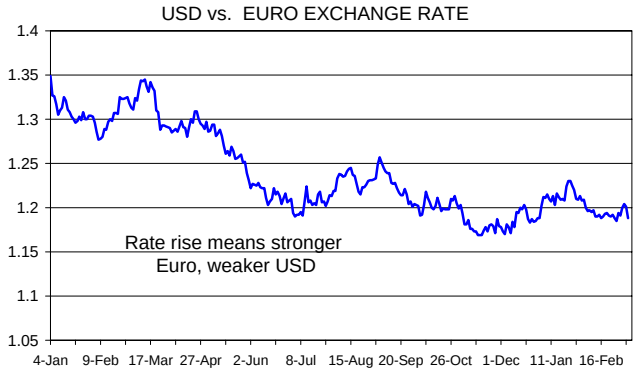
But as they say, the trend is your friend and for now the trend in the kiwi dollar is downward.

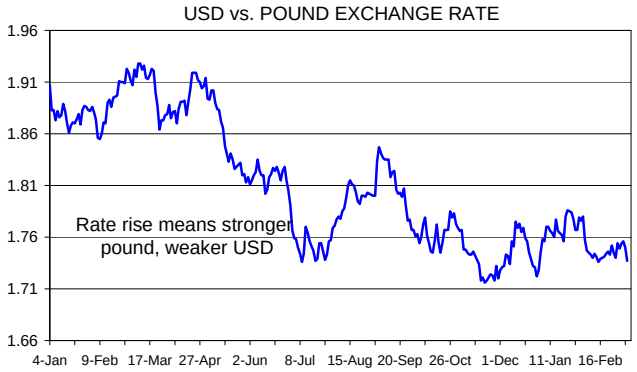
The Australian dollar received some support early in the week from retail sales figures for January being stronger than expected showing an increase of 0.8%. A rise of just 0.3% had been expected. On the day the data outweighed figures showing that new building approvals fell by 1.9% seasonally adjusted in January. The Aussie dollar has finished the week against the U.S. dollar trading near 73.4¢ from 74.3¢ a week ago.





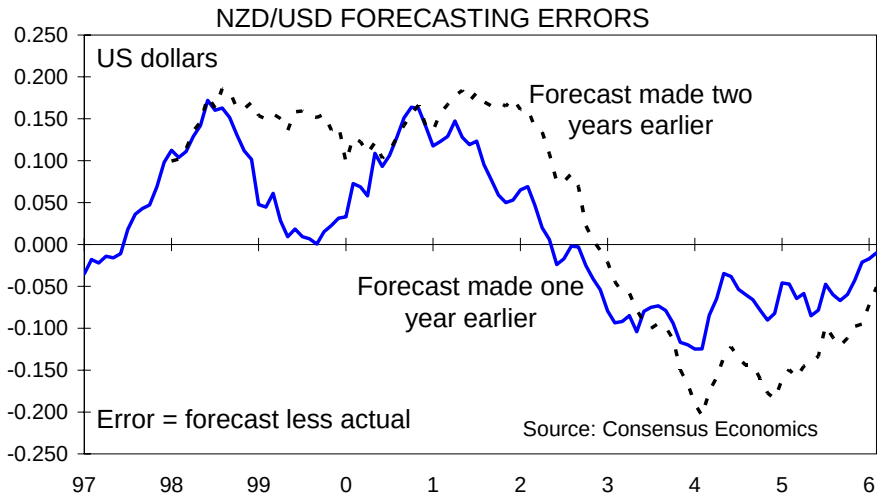
The U.S. dollar has risen over the week with the initial rise caused by some positive economic data. The Institute of Supply Management purchasing index for February was stronger than expected with a reading of 56.7 from 54.8 in January. Plus, the services index came in stronger than expected at a reading of 60.1 from 56.8 in January. Then last night some hawkish comments about the need for higher interest rates were made by Federal Reserve people. The USD has ended the week against the Japanese yen near 116.9 from 115.7 last week. Against the British pound the greenback has ended near $1.737 from $1.754 last week. Against the Euro the USD has ended near $1.188 from $1.194.





Exchange Rate Forecasting

Those of you interested in the accuracy of exchange rate forecasts may like to know that something very important has just happened. One year ago the consensus view among economists surveyed by London based Consensus Economics was that in March this year the NZD/USD exchange rate would be approximately 67 cents. We are now below that level and close enough for one to say that the exchange rate view of a year ago was sort of correct. This then becomes the sixth time in the past 111 months that the average exchange rate forecast has been correct. This is shown as the solid blue line in the graph below sitting on the zero error line.



The dotted line above shows the error in two year ahead exchange rate forecasts. These forecasts have been correct on one occasion in the past 99 months – and some time in the next few months when the exchange rate gets down around 61 cents we will have a second accurate two year ahead forecast.

BNZ WEEKLY OVERVIEW

ECONOMIC DATA

All %		Latest qtr only	Previous qtr only	Latest year	Year ago	2 Yrs ago
Inflation	RBNZ target is 1% - 3% on average	0.7%	1.1	3.2	2.7	1.6
GDP growth	Average past 10 years = 3.3%	0.2	1.2	2.6	4.4	3.9
Unemployment rate	Average past 10 years = 5.7%	3.6	3.7	.....	3.6	4.6
Jobs growth	Average past 10 years = 2.1%	0.0	1.5	1.6	4.4	2.6
Current a/c deficit	Average past 10 years = 4.9% of GDP	8.5	8.0	.....	6.0	4.3
Terms of Trade		-0.5	-1.3	0.7	7.3	2.2
Wages Growth	Stats NZ experimental series	1.3	1.7	5.3	5.1	4.9
Retail Sales ex-auto	Average past 9 years = 4.2%.	0.9	1.8	5.1	7.8	5.9
House Prices	Long term average rise 4.2% p.a.	2.6	2.7	14.0	16.4	21.2
Net migration gain	Av. gain past 10 years = 13,000	+6,960	6,145yr	.....	12,808	34,906
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 8%. Colmar survey	-35	-34	8	17	1
Business activity exps	10 year average = 27%. NBNZ	-4	-2	14	31	29
Household debt	10 year average growth = 11.4%. RBNZ	15.1	15.3	15.0	15.1	15.7
Dwelling sales	10 year average growth = 4.6%. REINZ	-10	-18	5	-16	3
Tourist numbers	10 year average growth = 6.1%. Stats NZ	-1.9	-2.7	16.9	5.3	11.9
Floating Mort. Rate	10 year average = 8.5%	9.55	9.50	9.00	8.75	7.25
3 yr fixed hsg rate	10 year average = 8.2%	7.85	8.15	7.45	7.60	7.60

ECONOMIC FORECASTS

Forecasts at Jan 26 2006	**March Years**					**December Years**				
	2005	2006	2007	2008	2009	2004	2005	2006	2007	2008
GDP - annual average % change										
Private Consumption	5.8	4.5	1.6	0.5	1.1	6.5	5.1	2	0.7	0.8
Government Consumption	5.2	2.4	5.9	3.5	3.6	5.7	3.1	5.1	4.2	3.1
Investment	7.8	6.2	0.3	1.8	3.6	13.2	4.8	1.3	1.4	3.1
GNE	6.5	4.6	1.6	1.4	2.3	8.2	5	1.9	1.5	1.9
Exports	3.9	1.2	3.2	3.2	4.6	5.6	-0.1	3.3	3.1	4.1
Imports	13.7	7.7	3.4	2.5	3.2	16.6	8	4.2	2.7	2.9
GDP	3.7	2.5	1.5	1.6	2.7	4.4	2.5	1.7	1.5	2.2
Inflation – Consumers Price Index	2.8	3.4	2.9	3.2	2.1	2.7	3.2	3	3.3	2.2
Employment	3.4	2	0.5	0.5	1.1	4.4	1.8	0.6	0.4	0.9
Unemployment Rate %	3.9	3.6	3.8	3.9	3.7	3.6	3.4	3.8	4	3.9
Wages	2.9	4.6	4.2	3.4	2.6	1.9	4.8	4.5	3.5	2.8
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.67	0.57	0.59	0.6	0.71	0.7	0.58	0.58	0.6
USD/JPY	105	115	102	110	111	104	119	105	108	111
EUR/USD	1.32	1.2	1.15	1.19	1.16	1.34	1.19	1.16	1.18	1.17
NZD/AUD	0.93	0.91	0.85	0.83	0.85	0.93	0.94	0.85	0.83	0.85
NZD/GBP	0.38	0.39	0.34	0.35	0.36	0.37	0.4	0.35	0.34	0.35
NZD/EUR	0.55	0.56	0.5	0.5	0.52	0.53	0.59	0.5	0.49	0.51
NZD/YEN	76.8	77.1	58.1	64.9	66.7	74.2	82.7	60.9	62.6	66.5
TWI	70.7	68.7	59.3	60.7	62.5	69	71.9	60.2	59.8	62
Official Cash Rate	6.56	7.25	7	6	5.75	6.43	6.99	7.25	6.25	5.75
90 Day Bank Bill Rate	6.86	7.55	7.2	6.2	5.95	6.73	7.49	7.45	6.45	5.95
10 Year Govt Bond	6.04	5.85	5.9	5.7	5.7	6.03	5.89	5.95	5.75	5.7

All actual data excluding interest & exchange rates sourced from Statistics NZ.

The BNZ Weekly Overview is prepared by Tony Alexander, Chief Economist at the Bank of New Zealand. Ph 04 474-6744.