Bank of New Zealand

BNZ Weekly Overview

20 April 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	6.75	6.3
90-day bank bill	7.49%	7.48	7.49	7.62	7.01	6.6
10 year govt. bond	5.77%	5.77	5.77	5.67	5.84	6.5
1 year swap	7.29%	7.24	7.27	7.49	7.02	6.7
5 year swap	6.62%	6.58	6.56	6.82	6.68	7.1
NZD/USD	0.634	0.623	0.635	0.681	0.72	.57
NZD/AUD	0.851	0.854	0.87	0.91	0.94	.86
NZD/JPY	74.5	73.8	74.0	78.7	77.1	66.0
NZD/GBP	0.355	0.356	0.362	0.388	0.376	.35
NZD/EURO	0.513	0.515	0.521	0.564	0.56	.509

For addition to our emailing list for Thursday night receipt email "Subscribe WO" to tony.alexander@bnz.co.nz

Its school holiday time and having taken half the children on a trip to Auckland to go to Rainbow's End, Waiheke island, the movies, plus having days off for the normal Easter break there hasn't been much time left to fill out the Weekly Overview. So things are slightly shorter than normal this week

Inflation and Growth

Our main theme over the past few months and especially the past few weeks has been that the economy is nowhere near as weak as some doom-mongers have been saying. Two weeks ago we ran through a list of indicators showing improvements in some areas of the economy and over the past week we have received further data showing the economy is not slipping into a hole in the ground. Retail spending in nominal seasonally adjusted terms grew by 1.9% in the month of February with the core measure which excludes motor vehicles rising by a relatively strong 1.4%. We have also seen a firm seasonally adjusted rise in dwelling sales in March of about 4% after an 11% decline in February. It looks like the housing market is still weakening off but the pace is very mild and we saw a record average price set for dwelling sales in March of $302,000.

A key outcome of our view on the economy is that businesses should be wary of laying off any significant number of staff because the labour market remains tight and other resources remain in generally short supply. Here we are talking about electricity for instance where some new estimates suggest that rainfall will be weak into the hydro lakes over the next three decades and of course this can only have a depressing impact upon the rate of growth in the economy over the long-term while adding to electricity price inflation.

Another key outcome of our view is that inflationary pressures in the economy still remain relatively strong and there is worse news to come on the inflation rate before things get better. This week we have seen inflation of 0.7% during the March quarter which was bang on our and the market's expectations. Annual inflation now sits at 3.4% and we expect to see this lift to 3.6% when the June quarter numbers are released in three months time.

We discuss the inflation numbers in extra detail below but the upshot is that the Reserve Bank has zero scope for easing monetary policy in the near future and one story in the financial markets over the past two weeks has been traders backing off their over-optimism regarding the timing of monetary policy easing.

This helps account for the Kiwi dollar rising about two cents against the greenback over the past two weeks and the likes of the two year swap rate rising to 6.94% from 6.78% three weeks ago. This rise in local swap rates comes in spite of some fresh news in the United States suggesting that maybe their interest rates will not rise quite as much as had been thought in recent weeks. The Federal Reserve Open Market Committee minutes which were released during the week show many members are starting to get a bit concerned about interest rates rising too far. This accounts for weakness in the United States dollar as the markets have pulled back on their expectations for the extent of further increase in US interest rates.

This is bad news for New Zealand exporters because if we are talking about the markets adjusting towards New Zealand interest rates staying higher for longer than earlier thought while United States interest rates may not go as high as previously thought the interest rate differential will not shrink as much as previously factored in. We don't think this will prevent the New Zealand dollar from weakening further over the remainder of this year but it does make us more certain that further falls in the Kiwi dollar from current levels could be slow in coming. It also makes us more confident in forecasting that we will not see the New Zealand dollar fall anywhere near the levels reached during 2000 when it hit 40 US cents. We may not fall below 50 US cents this cycle.

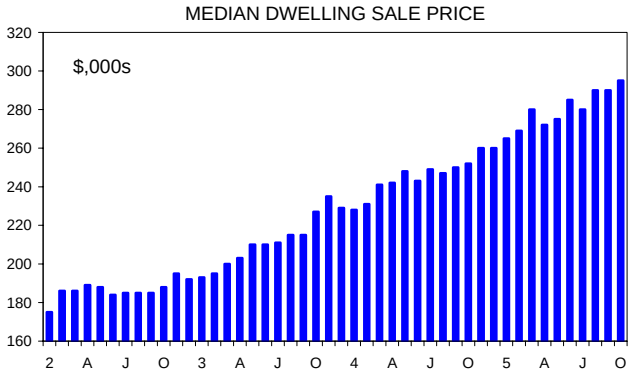
Next Thursday the Reserve Bank will undertake their regular six weekly review of the official cash rate. We expect the rate will be left at 7.25% having been raised from 5% back in January 2004. We also expect to see the Reserve Bank remind the markets that they do not anticipate easing monetary policy for any substantial period of time and that inflationary risks remain. This could place some further slight upward pressure on swap rates which may have implications for retail fixed housing interest rates.

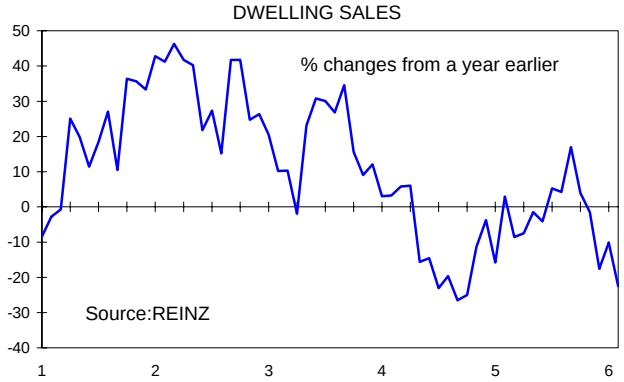
THE WEEK'S ECONOMIC DEVELOPMENTS

Tuesday 18

Housing Market Easing off Only Slowly

The REINZ reported that during March there were 10,094 dwellings sold around New Zealand. This was a 2.9% decline from a year earlier which followed a large 22.5% fall in February compared with a year earlier. In seasonally adjusted terms this represents a small gain of almost 4% for the month after an 11% fall in February. But for the March quarter as a whole sales were down in seasonally adjusted terms a rough 14% from the December quarter. The trend in turnover in the real estate industry therefore is downward but not at an accelerating rate. On average in February it took 33 days to sell a dwelling. This was five days longer than a year earlier after February sales on average took 37 days to be six days longer than February 2005. Again the data show a weakening market but not one which is weakening off at an accelerating rate. Finally, the median dwelling sale price improved in March to $302,000 from $295,000 in February. The small gain is neither here nor there given the normal volatility in the series and our interpretation is that prices have essentially been flat since October last year.

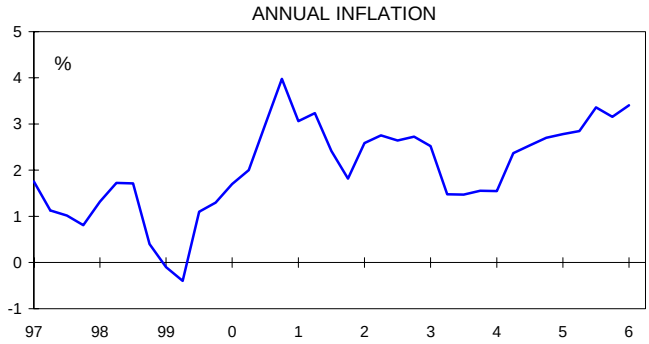


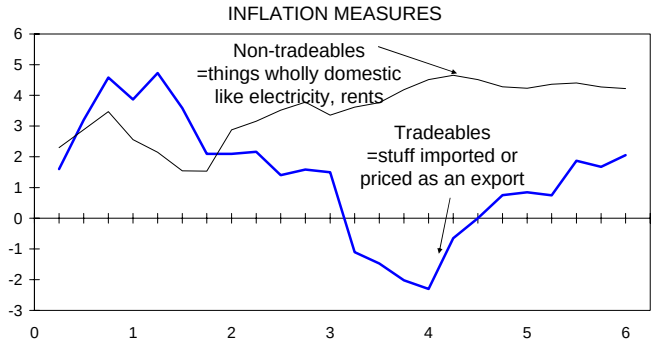


Wednesday 19

Inflation Rises To Five Year High

The consumers price index rose by an expected 0.7% during the March quarter to take the annual inflation rate up to 3.4% from 3.2% over calendar 2005. The quarterly increase was the same as during the December quarter last year but the annual increase is the highest since calendar 2000 when inflation was aggressively boosted by the New Zealand dollar falling from 71 US cents in 1997 to 40 cents in 2000. This is particularly worrying because we have inflation so high before the currency has fallen substantially and before any of the recent decrease has really had a chance to feed through. This suggests inflation is going to remain at a relatively high level for a long period of time. This lack of a falling currency feed-through so far can be seen in the fact that tradeables goods prices (things either imported or exported as well as sold domestically) actually fell by 0.1% during the March quarter to be just 2.1% up from a year earlier. In contrast non-tradeables inflation was 1% during the quarter and 4.2% for the year. This means that even allowing for the signs of slowing growth in the domestic economy we have seen over the past few months domestic inflation has yet to start trending downward.



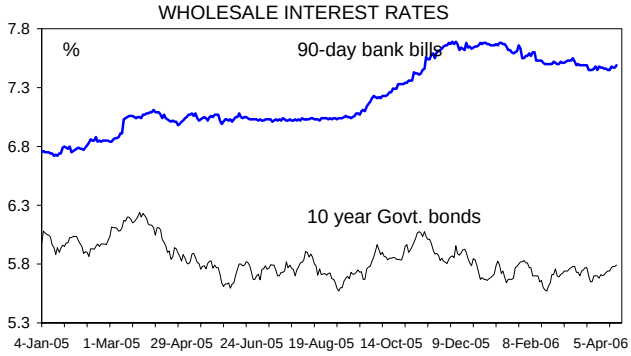


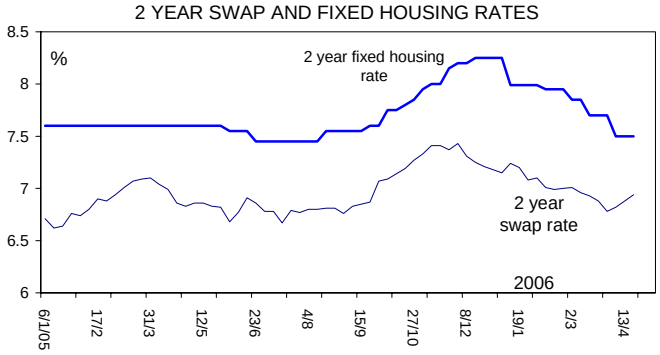
Petrol prices increased by 5.1% during the March quarter and if they had remained unchanged then the consumers price index increase for the quarter would have been 0.4% rather than 0.7%. Over the past year petrol prices have increased by 23.5% and if they had remained unchanged the annual increase in the consumers price index would have been 2.6% rather than 3.4%. But there are some other things also increasing strongly in price. Central and local government charges have increased by 5.1% over the past year indicating that the government is making a strong contribution to above average inflation in New Zealand.

The main implication of this jump in inflation to over a five-year high is that the Reserve Bank has extremely little scope to even contemplate easing monetary policy in the near future. We have yet to see the effect of a falling currency even start to feed into inflation and in a still largely capacity constrained economy there is a good chance that companies will pass on higher import costs and higher fuel prices to a greater extent than if there were many spare resources sloshing around.

INTEREST RATES

We have seen wholesale interest rates creep slightly higher this week as the markets have started pulling back from their optimistic view on the timing of the Reserve Bank's easing of monetary policy. 90-day bank bill yields have ended this afternoon near 7.49% from 7.4 rate percent last week. More importantly from a home buyers point of view the two year wholesale fixed borrowing rate has increased to 6.94% from 6.88% last Thursday and 6.78% three weeks ago.





Next Thursday morning the Reserve Bank will review the official cash rate and we expect it to be left unchanged at 7.25% but some potentially strong warnings to be given about the risk of inflation remaining at high levels. We expect the Reserve Bank to stress once more that they see minimal scope for any easing of monetary policy in the near future.

If I Were a Borrower What Would I Do?

I like the look of the two-year rate at 7.5%.

BNZ Fixed Lending Interest Rates

	Housing	Average Past 5 yrs	Low Past	High 5 years
Float	9.55%	8.00%	6.70%	9.55%
1 yr	7.99	7.16	5.95	8.45
2	7.50	7.28	5.99	8.25
3	7.50	7.49	6.30	8.30
4	7.50	7.62	6.40	8.40
5	7.45	7.65	6.50	8.60
7	7.45	7.83	6.75	8.80

Note: Conditions may apply to these rates.

BNZ Term Deposit Rates

Days	$10-50K	$50-100K	$100-250k
30	3.00	3.00	5.25
90	6.20	6.25	6.30
180	6.80	6.85	6.90
1 yr	6.60	6.65	6.70
5 yr	6.10	6.15	6.20

HOUSING MARKET UPDATE

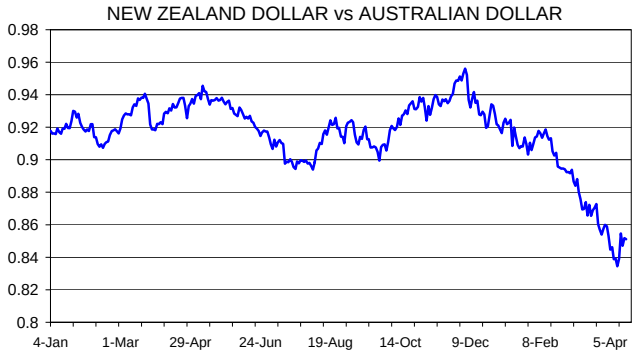
The housing market data released this week by REINZ were stronger than most in the markets were expecting with sales down just 3% from a year earlier whereas sales in February had been down almost 23%. In seasonally adjusted terms sales improved about 4% in the month after worsening about 11% in February. Our view remains that the market is easing off but that the pace of this easing is relatively gradual. There remains good support for the housing market from the likes of still high job security, the recent decline in fixed housing rates, extra income from the expanding Working for Families welfare package and net migration inflows sitting only just below their 10 year average.

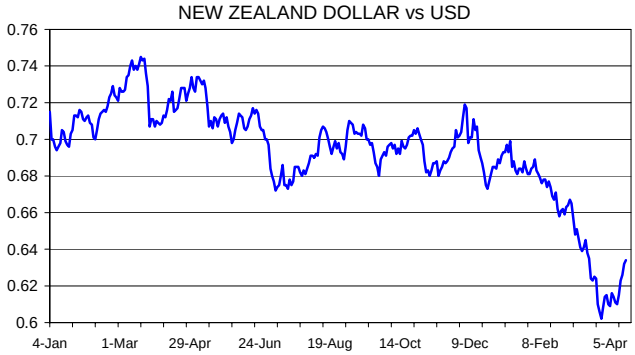
But it is hard to ignore such fundamentals as the fact that over the past five years while average house prices have risen 80% average rents have risen only 11%. Investors are relying upon capital gains and we

think these will be hard to come by to the next few years given a sustained period of slow growth in the New Zealand economy bringing below average employment growth, plus the risk that there is still an oversupply of property in the pipeline with dwelling consents running above average.

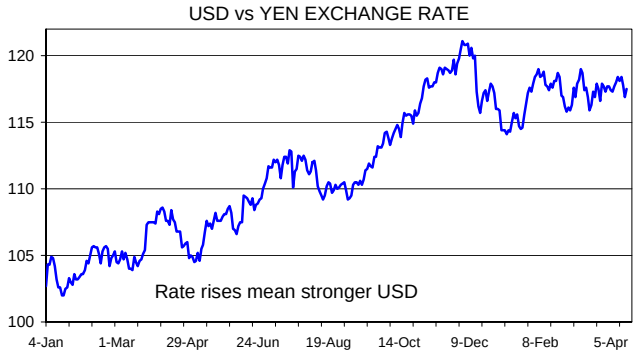
EXCHANGE RATES

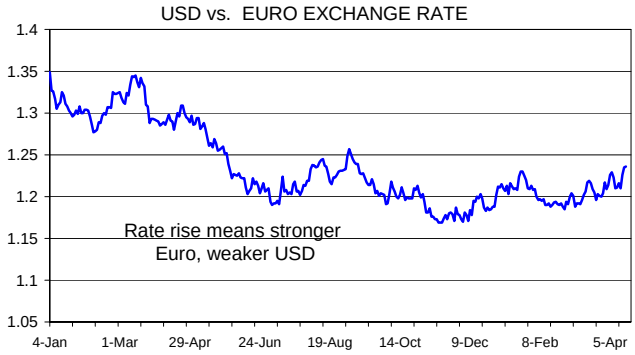
The Kiwi dollar has ended trading this afternoon against the United States dollar near 63.4 cents from 62.3 cents a week ago. We have ended largely unchanged against the pound near 35.5 pence, fallen slightly against the Australian dollar to 85.1 cents from 85.4 cents, gained against the Japanese yen to 74.5 from 73.8, and stayed largely unchanged against the euro near 51.3 cents. The fall against the Australian dollar was due to the Australian currency getting a boost on the back of gold prices rising to the highest level in 27 years and metals prices generally scaling new heights. The markets are also growing increasingly confident that Australian interest rates will be increased in the near future by the Reserve Bank of Australia. We gained against the Japanese yen as the Japanese currency suffered today following a comment from the Japanese Finance Minister that the markets may be getting a bit too aggressive in their expectations of the Bank of Japan raising interest rates in the near future.





The United States dollar has eased against most currencies over the past week on the back of worries about what record oil prices will do to the US economy, and a comment from a Chinese official early in the week that maybe the Chinese should consider moving some more of their reserves away from the greenback. This comment came ahead of a visit by the Chinese President to the United States and a meeting in Washington this weekend of the Group of Seven finance ministers.





In the near future there is a good chance we may see the Kiwi dollar remain relatively strong as the markets take profits on the strong decline in the currency over March and factor in a less aggressive timetable for the Reserve Bank's easing of monetary policy.

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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%	-0.1	0.1	2.2	4.4	3.4
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	8.9	8.5	.....	6.7	4.3
Terms of Trade		-2.3	-0.4	-1.8	4.4	6.6
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	+8,277	6,145yr	.....	11,131	30,075
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 8%. Colmar survey	-29	-35	14	-3	-6
Business activity exps	10 year average = 27%. NBNZ	5	-4	16	30	17
Household debt	10 year average growth = 11.4%. RBNZ	14.7	15.1	15.1	15.2	15.9
Dwelling sales	10 year average growth = 4.6%. REINZ	-22	-10	4	3	3
Tourist numbers	10 year average growth = 6.1%. Stats NZ	0.9	0.2	-0.9	5.1	7.1
Floating Mort. Rate	10 year average = 8.5%	9.55	9.55	9.00	9.00	7.50
3 yr fixed hsg rate	10 year average = 8.2%	7.50	7.85	7.60	7.80	6.90

ECONOMIC FORECASTS

Forecasts at Apr 6 2006	**March Years**					**December Years**				
	2005	2006	2007	2008	2009	2004	2005	2006	2007	2008
GDP - annual average % change										
Private Consumption	5.8	3.7	0.8	0.4	1.1	6.5	4.6	1.0	0.5	0.8
Government Consumption	5.2	5.2	4.3	3.2	3.6	5.7	5.3	4.4	3.6	3.1
Investment	7.8	5.6	-0.1	1.8	3.6	13.2	4.3	0.7	1.4	3.1
GNE	6.5	4.1	1.0	1.3	2.3	8.2	4.5	1.2	1.4	1.9
Exports	3.9	0.9	1.8	3.7	4.8	5.6	-0.3	1.9	3.2	4.5
Imports	13.7	5.1	1.0	2.4	3.2	16.6	6.4	0.9	2.4	2.9
GDP	3.7	2.0	1.0	1.7	2.8	4.3	2.2	1.1	1.6	2.4
Inflation – Consumers Price Index	2.8	3.4	3.3	3.3	2.1	2.7	3.2	3.3	3.5	2.2
Employment	3.4	1.7	0.5	0.5	1.1	4.4	1.6	0.6	0.4	0.9
Unemployment Rate %	3.9	3.7	4.1	4.2	4.1	3.6	3.6	3.9	4.3	4.3
Wages	2.9	5.0	4.6	3.5	2.6	1.9	5.1	4.9	3.7	2.8
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.64	0.54	0.59	0.62	0.71	0.70	0.55	0.57	0.61
USD/JPY	105	117	108	106	107	104	119	108	105	108
EUR/USD	1.32	1.20	1.21	1.24	1.23	1.34	1.19	1.21	1.23	1.24
NZD/AUD	0.93	0.88	0.79	0.82	0.84	0.93	0.94	0.81	0.80	0.83
NZD/GBP	0.38	0.36	0.31	0.34	0.36	0.37	0.40	0.32	0.33	0.35
NZD/EUR	0.55	0.53	0.45	0.48	0.50	0.53	0.59	0.46	0.46	0.50
NZD/YEN	76.8	74.6	58.3	62.5	66.3	74.2	82.7	59.4	59.9	66.1
TWI	70.7	65.6	55.6	59.5	62.4	69	71.9	56.7	57.6	61.8
Official Cash Rate	6.5	7.25	6.75	5.75	5.75	6.5	7.0	7.00	6.0	5.75
90 Day Bank Bill Rate	6.86	7.55	6.98	5.88	6.12	6.73	7.49	7.24	6.14	5.95
2 Year swap	6.82	7.0	6.20	6.06	6.20	6.61	7.24	6.35	6.04	6.17
10 Year Govt Bond	6.04	5.71	5.95	5.6	5.7	6.03	5.89	5.95	5.65	5.65

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.