BNZ Weekly Overview

2 August 2006

FINANCIAL MARKETS DATA

	This week	Week ago	4 wks ago	3 months 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%	7.49	7.47	7.50	7.02	6.6
10 year govt. bond	5.84%	5.89	5.81	5.79	5.81	6.5
1 year swap	7.50%	7.53	7.44	7.35	7.00	6.7
5 year swap	6.94%	7.02	6.89	6.77	6.55	7.1
NZD/USD	0.618	0.619	0.609	0.634	0.687	.57
NZD/AUD	0.806	0.813	0.819	0.838	0.898	.86
NZD/JPY	70.6	71.9	69.7	72.1	76.8	66.0
NZD/GBP	0.329	0.334	0.33	0.348	0.388	.35
NZD/EURO	0.482	0.486	0.477	0.504	0.564	.509

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

Quiet Week

The Weekly Overview is being sent out a day early this week because of tramping requirements. Because of the same requirements we will hold off doing our monthly confidence survey until next week - assuming one makes it out of the bush in time.

This week economic data have been extremely thin on the ground in New Zealand but this Friday night we will see the monthly release of the US non-farm payrolls report. This always has potential to create movements in the greenback and medium term interest rates so will be worth having a look at on Monday morning.

Most of our attention however is on New Zealand's Household Labour Force Survey and wages data to be released next week. We expect wages growth to remain relatively high with a great number of indicators including anecdotes showing that the labour market remains tight in New Zealand. For instance the National Bank's Business Outlook survey for July showed a net 2% of businesses plan hiring extra people over the coming year. This is only just below the 10 year average of 3%. A tight labour market is one of the problems facing the Reserve Bank because there is a very high chance that with inflation at 4% people will naturally seek at least this increase in their wage negotiations.

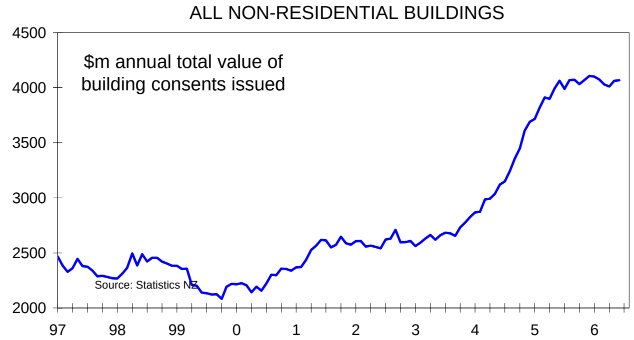
Over the week the Kiwi dollar has ended largely unchanged against the US dollar from six days ago near 61.8 cents but has crept slightly lower on the cross rates.

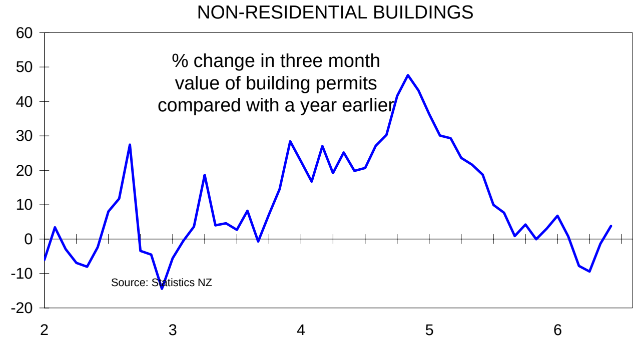
THE WEEK'S ECONOMIC DEVELOPMENTS

Friday 28

Commercial Building in Good Shape

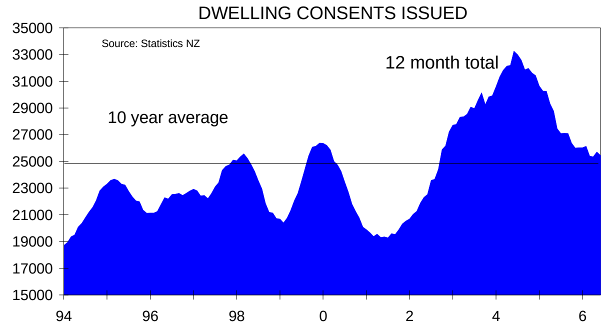
The value of non-residential consents issued in June was up by 1.2% from a year earlier at $411 million. This means that during the June quarter consent values were up by 3.8% from a year earlier and when one allows for construction costs rising this indicates a relatively small volume decline. For the entire year to June consent values were flat. The non-residential construction sector remains in remarkably good health as businesses catch up on construction they were not able to do a few years ago perhaps because of major uncertainty about costs or not been able to get the quality of builder they wanted. Many companies are probably also investing in more efficient buildings and better locations in order to lift productivity. We still expect non-residential construction volumes to ease off over the next couple of years but the extent of the cyclical easing will be extremely mild in comparison with past downturns. Notice the upturn in the quarterly rate of growth on a year ago shown in the second graph below.

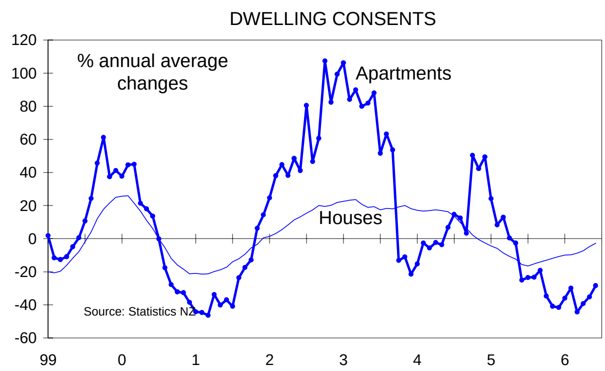




Residential Consent Numbers Easing Off

There was a seasonally adjusted decline in the number of dwelling consents issued in June of 13.7%. This means that consent numbers were down by 9.6% in the June quarter compared with the March quarter. This is a relatively sharp rate of decline. However consent numbers were up 0.8% from a year ago although at the moment month and quarter on year ago comparisons are heavily distorted by rule changes that radically altered consent number totals last year for a while. This makes the June quarter seasonally adjusted decline the appropriate area of focus. However the extent of the downward trend in residential construction is well overstated by the 9.6% fall because of a sharp decline in the traditionally volatile apartment consent numbers. If we look at houses by themselves we see that in the month of June housing consent numbers were down by just 6.8% seasonally adjusted and for the June quarter were down by only 1.2% from the March quarter. There is a downward trend in residential construction but it is relatively mild.

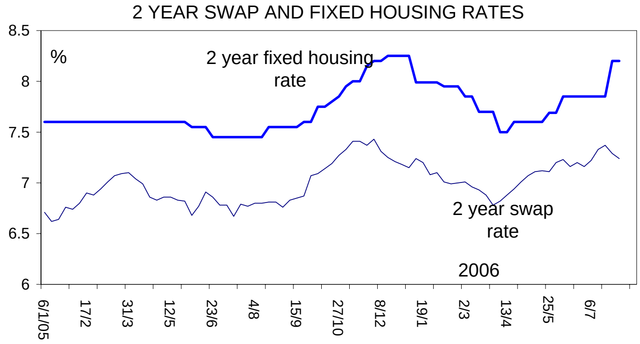


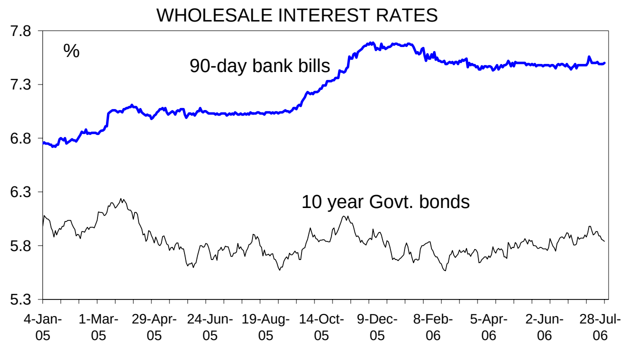


INTEREST RATES

There was downward pressure on wholesale interest rates early in the week following the release of weaker than expected gross domestic product numbers in the United States. The American economy grew at an annualised rate of just 2.5% during the June quarter whereas an increase of 3% had been expected following the 5.6% jump during the March quarter. The weaker than expected growth implies lower-than-expected inflationary pressures and has increased expectations that when the Federal Open Market Committee next meet on August 8 there will be no change in the 5.25% funds rate.

In contrast the Reserve Bank of Australia increased their cash rate by 0.25% to 6% this morning in response to not just the higher-than-expected June quarter inflation numbers recently released but also some relatively strong indicators for growth in the Australian economy. Hardly anyone expects New Zealand's monetary policy will be tightened again and that is why we now have 90-day bank bills cemented back at the 7.5% level they settled at in March and swap rates have also eased off from overly bearish levels a couple of weeks ago. The two year swap rate for instance is now at 7.24% compared with a peak of 7.47% two weeks ago and 7.29% last week.

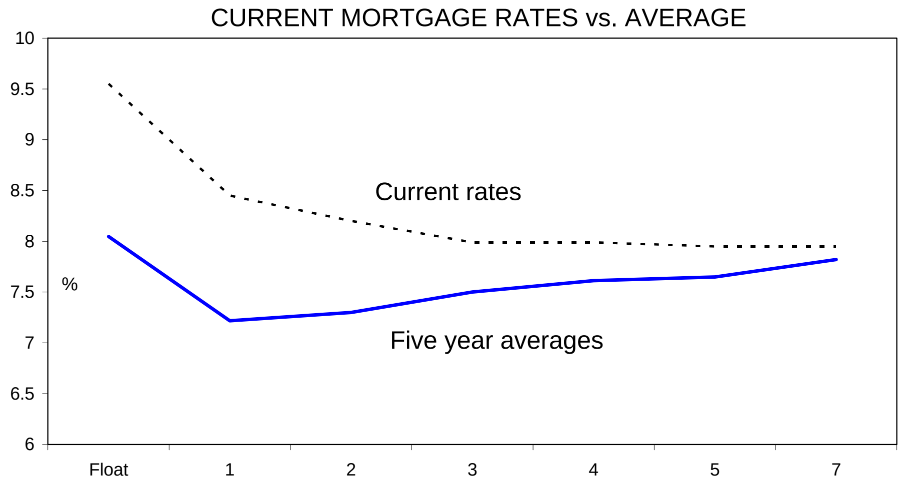




Prospects for substantial changes in NZ wholesale interest rates over the remainder of this year seem minimal.

If I Were a Borrower What Would I Do?

I would probably fix 3 years at 7.99% and would certainly not be optimistic about floating interest rates coming down all that much for a long period of time.



BNZ Fixed Lending Interest Rates					BNZ Term Deposit Rates			
	Housing	Average Past 5 yrs	Low Past	High 5 years	Days	$10-50K	$50-100K	$100-250k
Float	9.55%	8.00%	6.70%	9.55%	30	3.00	3.00	5.25
1 yr	8.45	7.16	5.95	8.45	90	6.20	6.25	6.30
2	8.20	7.28	5.99	8.25	180	6.80	6.85	6.90
3	7.99	7.49	6.30	8.30	1 yr	6.60	6.65	6.70
4	7.99	7.62	6.40	8.40	5 yr	6.10	6.15	6.20
5	7.95	7.65	6.50	8.60				
7	7.95	7.83	6.75	8.80				

Note: Conditions may apply to these rates.

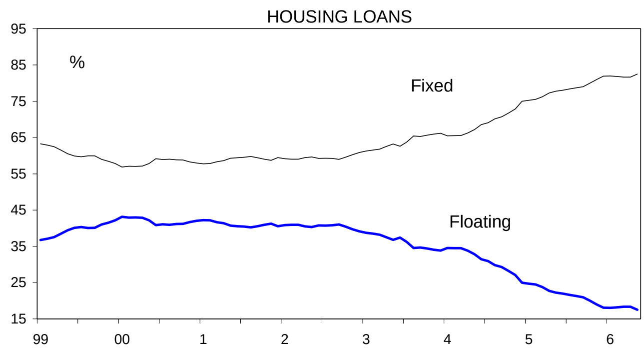
HOUSING MARKET UPDATE

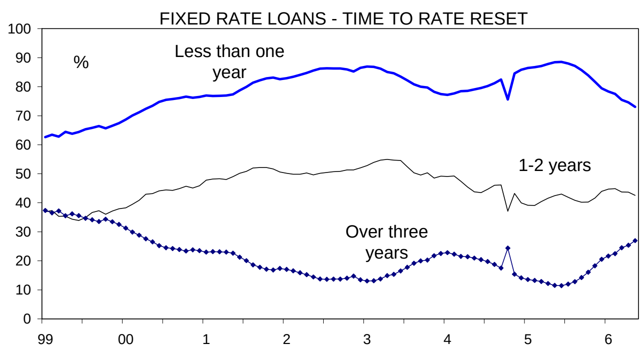
Maturing Fixed Interest Rates

Over the coming 12 months approximately $40b worth of residential mortgages held by registered banks will mature at an average fixed rate of about 7.5%. The average size of all fixed rate loans is $123,000 ($53,000 for floating) and if we assume the average size of those coming up for renewal in the coming year is the same then we can calculate the average increase in interest expense. Assuming most people roll onto something close to 8% then the half a percent increase in interest cost on a $123,000 mortgage will increase interest expense by just over $600 a year or about $51 a month. This increased expense on top of rising local authority rates, rising electricity prices, and rising petrol prices will be applying quite a squeeze to household finances over the coming year. This helps explain why we have a relatively downbeat outlook for retail spending over the coming couple of years and why we still expect the housing market to slow down.

Of course with inflation running at 4% and the labour market remaining tight we believe wage claims are likely to remain relatively high over the coming 12 months and this will clearly provide some good insulation for those who get such wage increases. But not everyone will and that is one of the main problems of running a relatively high inflation rate. You can get quite a divergence in people's remuneration experience.

According to the latest available data for May this year 82.5% of mortgages were at fixed rates (by $ value rather than number). This is the highest proportion on record and helps show why the Reserve Bank can struggle to get restraint in the housing market when it wants it. For instance if they were to increase the official cash rate at the moment it would only hit the hip pockets of 17.5% of people with mortgages.





Falling Home Ownership

This week the results of an ACNielsen survey of 10,000 people were released by a financial firm and purported to show that between the year to March 2005 and the year to March 2006 the number of people living in a home they owned fell by 173,000. One would think that with 10,000 people surveyed this result would be reliable – but it seems not to be as some basic arithmetic shows. Average household occupancy in

New Zealand is 2.7 people. So if we divide the 173,000 by 2.7 we see that over the year approximately 64,000 dwellings went from being owner occupied to rented. This seems much too high considering that the number of dwellings sold over the year to March 2006 was about 106,000 (101,277 through the REINZ and maybe another 5% private treaty.)

Concluding that nationwide there has been a 12% reduction over a one year period in the number of people living in their own house does not seem valid. Something appears askew with the survey and we look forward to the surveyors giving some insight into what bias may have crept in.

Putting this particular survey to the side for the moment however it seems reasonable to conclude based on a range of evidence that home ownership in New Zealand is falling. We won't get a proper up to date number until November this year when owner occupancy numbers from the latest census are released. But it looks like the percentage of home ownership in New Zealand now sits at a lower rate than the United States, United Kingdom, and Australia. Given that most of us think a key aspect of the Kiwi culture is home ownership this does seem to be a worrying trend especially given research indicating home ownership fosters greater commitment to the country.

In response to concerns about homeownership the government is looking at expanding its Welcome Home loans scheme. The trouble however is that all this will achieve is extra upward pressure on house prices at the lower end of the spectrum and further pricing out of the market of many people. The only way in which homeownership is going to be radically improved is if investment in residential property becomes less attractive. The logical way to do that is to introduce a difficult to avoid capital gains tax on all but the family home. But the chances of that happening seem zero as the policy is opposed both by Labour and by National. A Treasury paper (http://www.treasury.govt.nz/workingpapers/2006/wp06-07.asp) shows that if we include growth in residential property investment in the NZ household savings measure we get a rate closer to +12% rather than the oft-quoted -18% or so. (Of course were one to do the same exercise for other countries we would almost certainly still rank as the worst household savers in the OECD.) The same very good research paper suggests we spend about 10% of the increase in our housing wealth each year – which is bad news for retailers when house prices don't rise.

Given our expectation that the unemployment rate will remain relatively low in the future we see little chance of any substantial correction in the imbalance between house prices and average household incomes in New Zealand over the next few years.

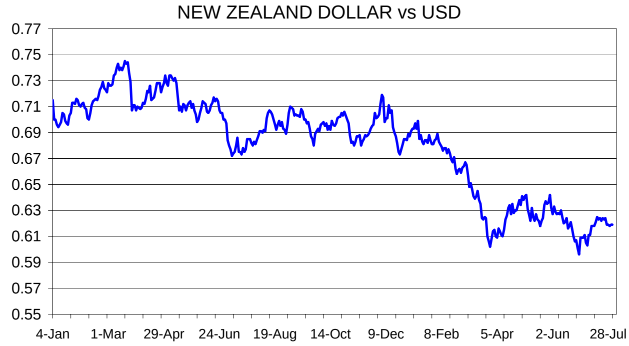
Mortgagee Sales

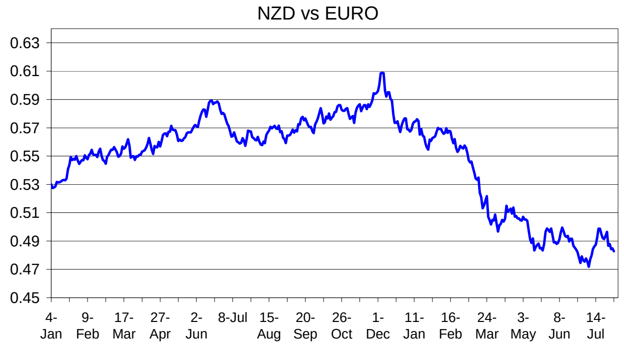
About three weeks ago a reporter from a weekend newspaper called asking about mortgagee sales. Having been in this business for a couple of decades one gets a good feel reasonably early on in a conversation with an unknown journalist whether they have a full grasp of their subject and whether they are coming from an unbiased viewpoint or have the story already written. Bias was obvious early on with this particular journalist with statements at the start along the lines of " household finances are being severely squeezed at the moment so what will happen now?". I was asked about mortgagee sales and said that we do not track data on the number of mortgagee sales but believed the number of such sales had increased going by anecdotal evidence. At no stage was the word " significant" used which is the word that appeared in the article and was attributed to me.

So far we've had about five journalists call wanting further information on mortgagee sales following on from that inaccurate article. The data will be there but we don't have it in hand. We have no evidence that there has been a significant increase in mortgagee sales in fact our own experience is that while a few more are occurring the numbers are very, very low. We don't think there will be a sharp increase in mortgagee sales this time around because of the continuing strong labour market.

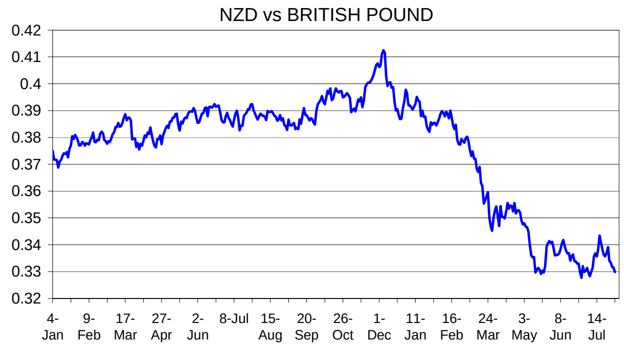
EXCHANGE RATES

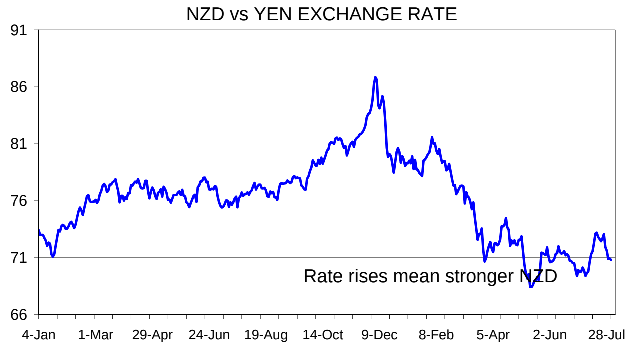
The Kiwi dollar started this week at 61.9 US cents and has ended almost unchanged. There have been no major data releases in New Zealand but next week the release of wages and jobs growth data may cause some minor currency changes. Our expectation remains that the New Zealand dollar will drift lower over the next one to two years but the extent of the decline will be limited by some probable weakness in the greenback itself along with the absence of a collapse of either New Zealand commodity prices or interest rates. Inflationary pressures in New Zealand are simply too strong and entrenched to envisage any substantial easing by the RB over the next few years.



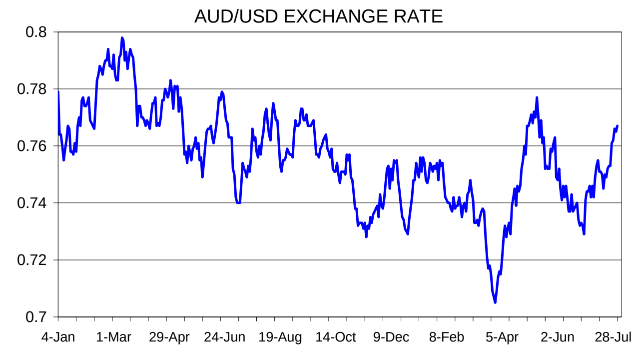


On the crosses the Kiwi dollar has edged slightly lower ending against the Australian currency near 80.8 cents from 81.3 cents a week ago, against the British pound near 33 pence from 33.3 pence, against the euro near 48.3 cents from 48.7 cents, and against the Japanese yen near 70.8 from 71.9.

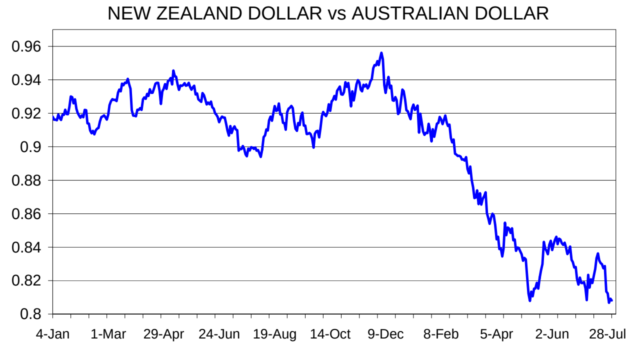


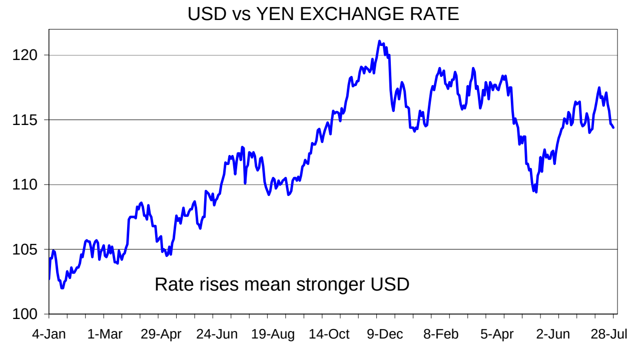


The Australian dollar has ended against the greenback near 76.8 cents compared with 76.1 cents a week ago with the markets spending the week progressively factoring in their expectation of a further tightening of Australian monetary policy.

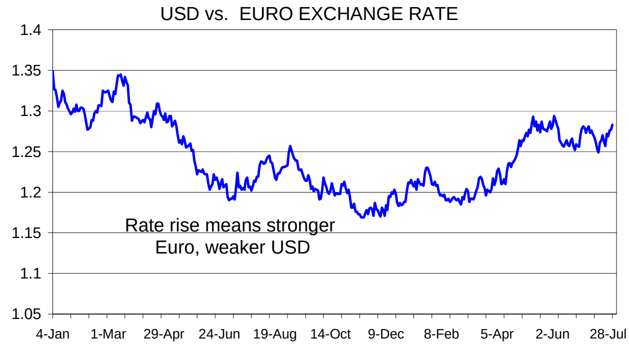


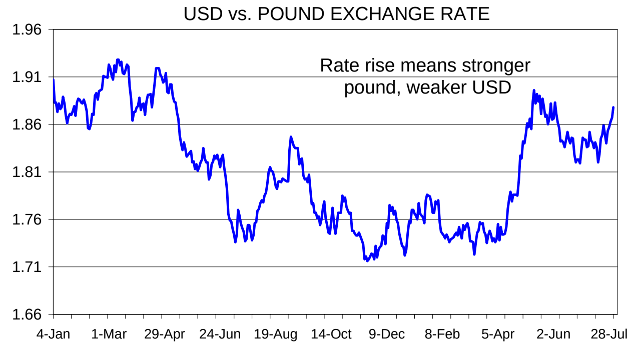
BNZ WEEKLY OVERVIEW





The US dollar eased slightly lower over the week mainly in response to the slower than expected annualised rate of growth in gross domestic product during the June quarter of 2.5%. After the United States employment report out this Friday night attention will be very strongly on the review of monetary policy to be undertaken by the Federal Open Market Committee on August 8.





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	1.5%	0.6	4.0	2.8	2.4
GDP growth	Average past 10 years = 3.3%	0.7	-0.1	2.2	3.7	3.6
Unemployment rate	Average past 10 years = 5.7%	3.9	3.6	......	3.8	4.2
Jobs growth	Average past 10 years = 2.1%	1.1	0.0	2.6	3.4	3.2
Current a/c deficit	Average past 10 years = 4.9% of GDP	9.3	8.9	......	7.4	4.8
Terms of Trade		1.1	-2.5	-3.0	4.5	6.1
Wages Growth	Stats NZ experimental series	1.1	1.3	5.5	4.8	4.3
Retail Sales ex-auto	Average past 9 years = 4.2%.	0.9	1.2	5.6	7.1	5.9
House Prices	Long term average rise 4.2% p.a.	2.5	3.9	12.3	13.4	23.3
Net migration gain	Av. gain past 10 years = 13,000	+10,690	10,200yr	......	8,599	22,008
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 8%. Colmar survey	-22	-38	-35	1	-1
Business activity exps	10 year average = 27%. NBNZ	15	17	-3	15	30
Household debt	10 year average growth = 11.4%. RBNZ	14.1	14.2	15.2	15.1	16.3
Dwelling sales	10 year average growth = 4.6%. REINZ	5.0	3.9	-17.6	-4.1	-14.5
Tourist numbers	10 year average growth = 6.1%. Stats NZ	-11.2	-0.3	-1.9	16.9	20.4
Floating Mort. Rate	10 year average = 8.5%	9.55	9.55	9.55	9.00	8.00
3 yr fixed hsg rate	10 year average = 8.2%	7.99	7.75	7.99	7.45	7.65

ECONOMIC FORECASTS

Forecasts at June 29 2006	**March Years**					**December Years**				
	2005	2006	2007	2008	2009	2004	2005	2006	2007	2008
GDP - annual average % change										
Private Consumption	5.8	4.1	1.6	0.6	1.1	6.5	4.7	2.1	0.7	0.8
Government Consumption	5.2	5.6	4.6	2.7	3.9	5.6	5.7	4.5	3.5	3.1
Investment	8.0	5.9	-3.1	0.8	3.7	13.5	4.5	-1.4	0.4	3.1
GNE	6.4	4.2	0.7	1.1	2.5	8.1	4.5	1.1	1.0	2.0
Exports	3.9	0.0	3.6	4.3	5.0	5.6	-0.2	1.7	4.8	4.8
Imports	13.7	4.6	-0.4	2.3	3.0	16.6	6.5	-1.1	2.4	2.7
GDP	3.7	2.2	1.6	1.6	3.1	4.3	1.9	1.9	1.8	2.7
Inflation – Consumers Price Index	2.8	3.3	3.3	3.0	2.6	2.7	3.2	3.3	3.1	2.7
Employment	3.4	2.6	0.5	0.7	1.1	4.4	1.5	1.5	0.6	1.0
Unemployment Rate %	3.8	3.9	4.3	4.5	4.4	3.7	3.6	4.1	4.4	4.4
Wages	2.9	4.6	4.6	3.5	2.6	1.9	5.1	4.4	3.7	2.8
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.64	0.57	0.55	0.58	0.71	0.70	0.58	0.55	0.58
USD/JPY	105	117	103	105	103	104	119	105	105	104
EUR/USD	1.32	1.20	1.23	1.23	1.24	1.34	1.19	1.24	1.22	1.24
NZD/AUD	0.93	0.87	078	0.79	0.81	0.93	0.94	0.79	0.79	0.80
NZD/GBP	0.38	0.36	0.32	0.31	0.33	0.37	0.40	0.33	0.31	0.33
NZD/EUR	0.55	0.53	0.46	0.45	0.47	0.53	0.59	0.47	0.45	0.46
NZD/YEN	76.8	74.6	58.7	57.8	59.5	74.2	82.7	60.9	57.8	59.7
TWI	70.7	65.6	57.2	55.8	58.3	69	71.9	58.1	55.9	57.8
Official Cash Rate	6.5	7.25	7.00	6.00	5.75	6.5	7.0	7.25	6.25	5.75
90 Day Bank Bill Rate	6.86	7.55	7.23	6.13	6.12	6.73	7.49	7.49	6.39	5.95
2 Year swap	6.82	7.0	6.35	6.08	6.20	6.61	7.24	6.52	6.10	6.17
10 Year Govt Bond	6.04	5.71	5.90	5.6	5.7	6.03	5.89	6.05	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.