Bank of New Zealand

BNZ Weekly Overview

25 January 2007

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	7.25	6.2
90-day bank bill	7.68%	7.66	7.70	7.73	7.58	6.4
10 year govt. bond	5.95%	5.92	5.85	5.93	5.67	6.5
1 year swap	7.90%	7.88	7.88	7.60	7.44	6.6
5 year swap	7.34%	7.31	7.23	7.03	6.76	7.0
NZD/USD	0.699	0.691	0.696	0.662	0.682	.57
NZD/AUD	0.896	0.879	0.887	0.875	0.91	.86
NZD/JPY	84.5	83.4	82.4	78.9	78.2	66.0
NZD/GBP	0.355	0.351	0.355	0.353	0.38	.34
NZD/EURO	0.54	0.535	0.528	0.527	0.55	.51

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Economic Prospects Look Acceptable

On an annualised basis the rate of growth in New Zealand's economy bottomed out near zero in the second half of 2005 then recovered to an official rate of 1.4% in the year to September last year. Our expectation is that growth this year is going to come in close to 2.6% with a similar result expected over 2008. Prospects for growth this year have improved recently with clear evidence that the economy was picking up reasonably well late last year. We could see this in the many indicators we examined in last week's Weekly Overview plus further data released over the past seven days. For instance with regard to the housing market we have the following.

Dwelling sales in December were almost 20% higher than a year earlier and the median dwelling sale price rose at an annualised rate of just over 20% in the December quarter. Listings are in short supply and there is growing anecdotal evidence of a shortage of rental property in Auckland. The key fundamentals which determine housing activity look firm. The net migration inflow has risen to 15,000 people in the year to November from a low point of 6,000 in the year to October 2005 though we expect only minor improvement from this level over 2007. While the Reserve Bank are almost certain to tighten monetary policy in six weeks time increases in fixed interest rates are likely to be limited especially for the longer terms with expectations of United States monetary policy easing late this year. The labour market remains very firm and the resulting high job security along with expectations of wage increases will tend to underpin housing demand.

With regard to retail spending we have seen some exceptionally strong numbers. Annualised seasonally adjusted growth in ex-auto retail spending over the three months to November was just over 10% from near 6% three months before that and 2% six months earlier. Credit card data for December were exceptionally strong and these strongly suggest that December was a good month for retail spending as well.

Looking ahead the factors which mainly determine retail spending growth look acceptable. While average interest rates will rise slightly in the first half of this year we expect house prices to continue to creep higher and maintain a diminishing positive wealth effect. The labour market will remain tight with the recently released Quarterly Survey of Business Opinion showing a strong net 14% of businesses planning to hire extra people compared with the 10 year average for the December quarter of just 4%. Wages growth is likely to remain firm, political imperatives are likely to eventually drive tax cuts from April 2008, and net migration inflows are running above average. Consumer confidence is running at firm levels with the Westpac McDermott Miller Consumer Confidence reading for the December quarter at almost 120 compared with an average level over the past seven years of 118. These factors suggest that for retailers 2007 is going to be better than we were thinking a few months ago but it won't be a boom year.

For exporters there will however be restraint because with monetary policy likely to be tightened again and the chances of the easing looking very slim over the next couple of years the New Zealand dollar is likely to remain very strong. There is good evidence that many manufacturers have adjusted to the high currency and remain profitable while in the tourism sector average growth in our trading partners this year and above average growth expected next year will tend to underpin inflows. But in the farming sector there are signs of restraint in spending, confidence is low, there may at last be widespread acceptance that land prices are not only excessive but possibly unsustainable, and we expect sustained spending restraint in the rural community through this year into 2008.

A very positive note comes from prospects for business capital spending. The capacity utilisation rate remained high in the NZIER's recent survey and there are major shortages of labour. Businesses did not engage in any large-scale rounds of lay-offs last year and the unemployment rate remains very low at 3.8%. Businesses are noting that both skilled and unskilled employees are harder to find and employment intentions are very high. In order to boost productivity we are finding businesses planning to expand their capital expenditure levels with the NZIER survey for instance showing a net 15% of businesses planning to boost spending on plant and machinery compared with the 10 year average of just 3%. This is very pleasing and hopefully will eventually lead to improved productivity growth performance for the New Zealand economy - but we will believe it when we see it.

Non-residential construction prospects also look acceptable, but as with residential construction it is more a story of construction remaining at high levels rather than rising as such.

Throwing into the mix the high probability of increased government spending - easier fiscal policy - ahead of the late 2008 election and one can conclude nothing other than that demand conditions in New Zealand economy look acceptable for the next couple of years. We don't use the word good because partly all we are trying to do here is signal that the outlook is better than it was a few months ago. But we also need to remind people that because of a shortage of capacity in the New Zealand economy we are not going to get very strong growth for a number of years. Growth in the New Zealand economy averaged 4% per annum between 1999 and 2004 but we don't see that sort of growth rate returning for quite some time. So we consider our forecast for growth this year of 2.6% and similar over 2008 to be acceptable.

The problem however is with a shortage of capacity in the economy, whether that be measured in terms of the labour force, electricity, roading capacity or machinery, inflation prospects are frankly very worrying. In the short term the annual inflation rate is expected to fall below 1.5% as a result of sharp declines in petrol prices. But this will be just temporary and we expect inflation to rise back above 3% over 2008.

What is quite worrying at the moment is that although the Reserve Bank have a similar profile in their inflation forecasts they talk in terms of inflation rising to the upper end of the 1% to 3% target band over 2008 rather than breaching the target. They continue to adopt an overoptimistic outlook for inflation which for the past three years has led to relatively poor implementation of monetary policy and resulted in a situation where the Reserve Bank are going to have to play catch up and keep both interest rates and most vitally the exchange rate high through most of this year into 2008.

This is not to say that the Reserve Bank are all by themselves in the world in having to raise interest rates. There is also upward pressure on interest rates in Europe, the United Kingdom, Australia, and Japanese interest rates are probably going to rise in the next few months as well. But the issue here is that our central bank could have done something more seriously about the inflation outlook than they have. With inflation looking like consolidating near 3% over the medium term rather than the average for the past 10 years near 2% we are going to get negative productivity impacts on the New Zealand economy along with some potentially severe socio-economic effects as well. With low bargaining ability low skilled people with poor connection on a continuing basis with the workforce will find their relative incomes are likely to decline. With higher average inflation delivering an increased incentive to purchase residential property the ability of low income people to finance their way into housing is likely to get worse over the next few years. This problem is likely to eventually become a stronger focus of government policy but for the moment if the government were to make any moves to improve the house purchasing ability of low income people they would simply drive prices higher.

So inflation is going to be an ongoing problem and so too is the current account deficit with exports suppressed by a continued high New Zealand dollar. But this latter problem is more in terms of an increased risk of a shock to the New Zealand economy if foreign investors become concerned about our economy and therefore become much less willing to supply the money we need to live day-to-day. In addition the ongoing strength in the housing market is likely to push house prices to more over-valued levels and increase further the vulnerability of prices one day to a severe correction. This correction will be made worse by increasing levels of household debt partly attributable to the way the Reserve Bank have allowed the housing market to barrel long at a high-speed through ineffectual use of the official cash rate.

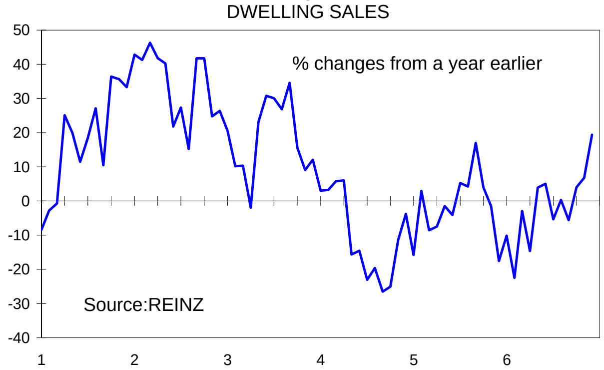
All up, apart from businesses in the rural sector we think 2007 is likely to look acceptable. But we would strongly advise businesses to adopt a very high focus on boosting productivity and cutting costs because the shortage of labour is unlikely to go away for a long time, wage and non-wage labour costs are likely to keep rising, exporters are likely to face an over-valued currency for an extended period of time, and financing costs are unlikely to fall away for quite some time.

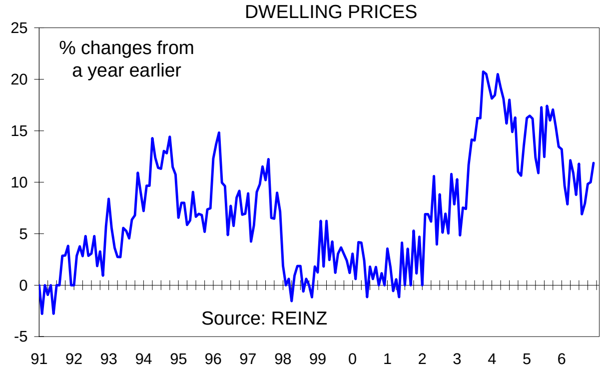
THE WEEK'S ECONOMIC DEVELOPMENTS

Friday 19

Housing Market Firm

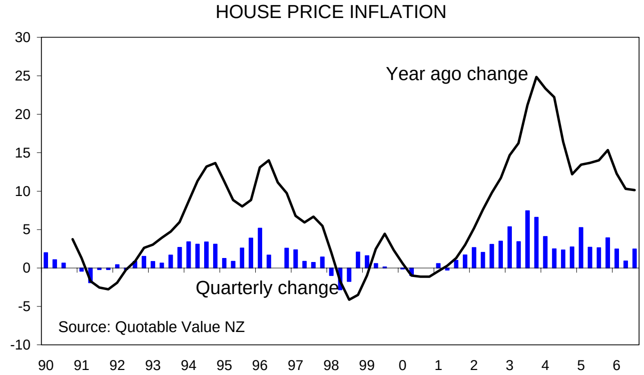
REINZ data show that dwelling sales in December were up from a year earlier by a strong 11.9%, well ahead of the 6.9% annual growth rate recorded in August. The median dwelling sale price was unchanged from November at $330,000 but annualised growth over the December quarter was very strong at 20.5%. The average number of days taken to sell a dwelling was up two from a year earlier at 29 days and 6.3 days faster than the average for December over the past 10 years. The data unequivocally show a housing market in good health with improving strength over the second half of last year. We discuss the data in more detail in our housing section below.





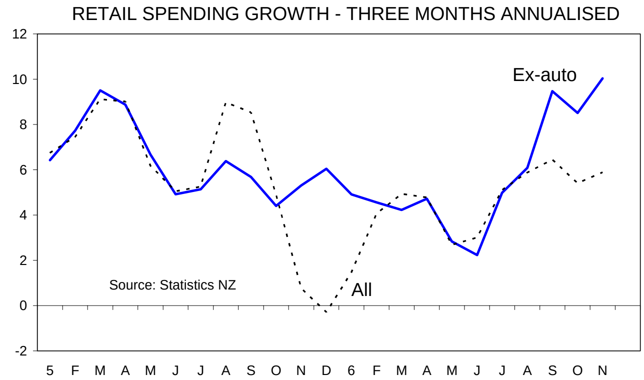
House Price Inflation Still Firm

What are now well out of date data provided by Quotable Value New Zealand show that during the September quarter average house prices around the country rose by 2.5% after rising just 0.9% in the June quarter. The annual rate of change was 10.1% compared with 10.3% in the June quarter, 14% a year earlier, and an average annual gain in the previous five years of 13.4%. The data show only a mild easing in house price inflation but then we already knew that from monthly REINZ data for which we now have December month information in hand.



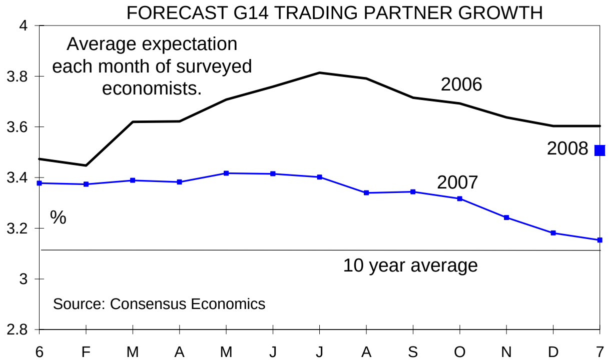
Retail Spending Growth Pauses

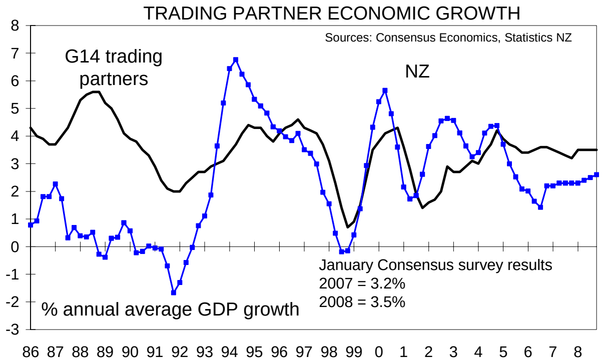
In nominal seasonally adjusted terms retail spending excluding the volatile automotive sectors fell by 0.1% in November. If we annualise the rate of change over the three months to November we get relatively strong growth near 10% compared with 6% in the three months to August and just 2.8% annualised growth in the three months to May. The data unequivocally show a resurgence in retail spending over the latter part of 2006. We don't bother looking at monthly or even smoothed changes in retail spending by storetype category because the data are simply too volatile.



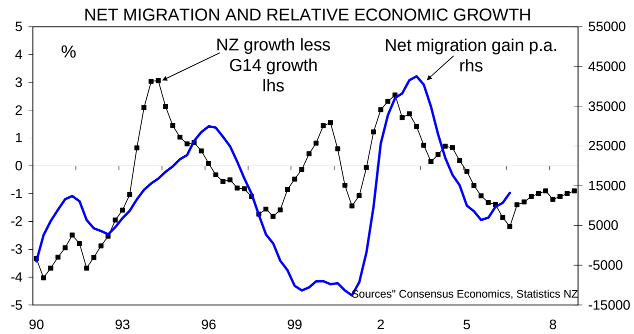
Good Overseas Growth Expected

According to the monthly Consensus Economics global survey on average New Zealand's top 14 export destinations are expected to grow by approximately 3.2% this year with growth of 2.9% in Australia, 2.4% in the United States, 1.8% in Japan, and 2.5% in the United Kingdom. Growth of 7.7% is forecast for North East Asia and 5.4% in South East Asia. Over 2008 an improvement in world growth is expected to around 3.5% with practically all our trading partners expected to achieve slightly higher growth rates. The second graph below compares New Zealand's economic performance with that in our top 14 export destinations. Looking ahead a period of sustained underperformance in the New Zealand economy is expected and if these forecasts prove correct this will be the worst cumulative relative under-performance since the early 1990s.

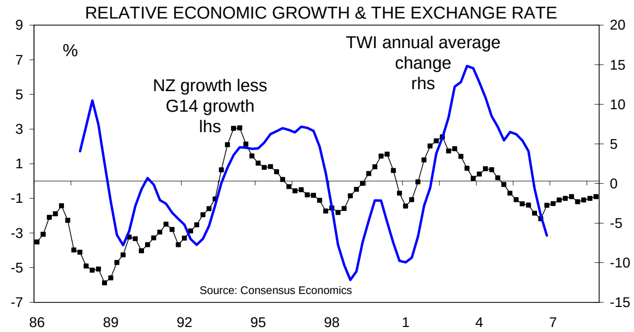




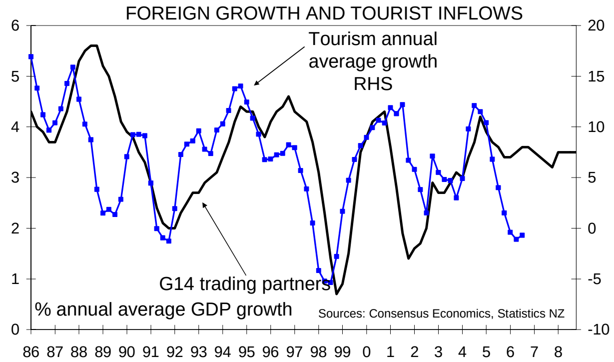
Note that although net migration inflows into New Zealand are driven by a range of factors there is some correlation between these inflows and New Zealand's economic growth relative to that of our trading partners. Our expectation of a sustained underperformance for the New Zealand economy helps explain why we are dubious about the improvement in net migration inflows since November 2005 continuing over the coming year.



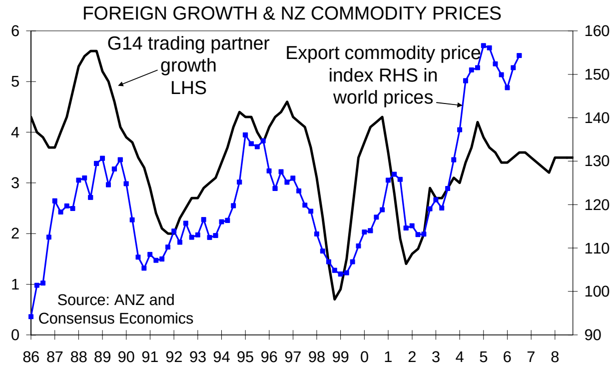
There is also some correlation between relative economic growth and movements in New Zealand's trade weighted index. This helps explain why most of us economists tend to expect the New Zealand currency to ease off over the next year or two.



There is also a really good correlation between the rate of growth in our trading partners and tourism inflows to New Zealand. The average trading partner growth expected this year and above-average performance expected next year helps explain why we have a positive outlook for the tourism industry over the next couple of years in spite of the recent recovery in the Kiwi dollar.



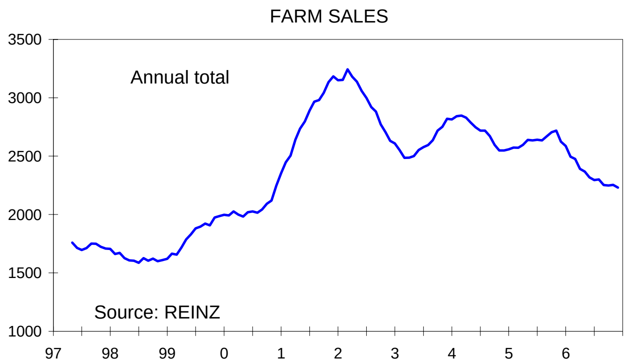
Finally, there is some correlation between growth in our trading partners and the level of our export commodity prices in world price terms. The near average performance in our trading partners expected this year and next suggests some downside risk to our export commodity prices and this also helps explain broadly why most of us expect some Kiwi dollar depreciation this year. Note that this picture is made cloudy by special conditions overseas supporting these prices such as drought in Australia.

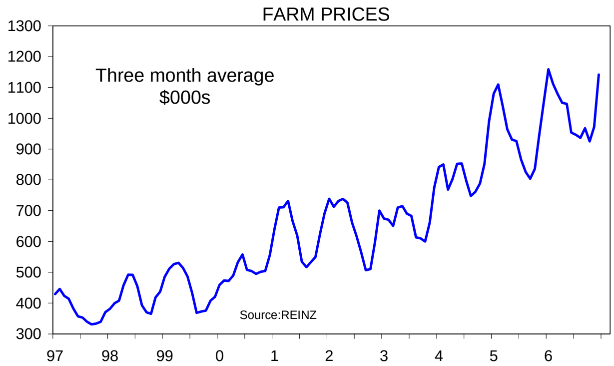


Monday 22

Farm Sales Declining

In December there were 210 farms sold around New Zealand. This was a 9.9% decline from a year earlier and means that over all of 2006 the total number of farm sales was down from a year earlier by 15.4%. There is some evidence that the rate of decline in farm sales is slowing with the number of sales in the December quarter down by just 3.4% from a year earlier and the change in sales between the September and December quarters being a very small positive in rough seasonally adjusted terms. The main period of weakness in farm sales occurred early in 2006 when there was major pessimism about prospects for the New Zealand economy. The data suggest a farming sector in consolidation phase. Reporting on the median farm sale price for the month, quarter, and even half year is not a worthwhile exercise because of massive distortions in the data introduced by changes in the size and type of farms being sold along with their location. But for the record, looking at the year as a whole the median farm sale price was up 8.3% from a year earlier at $1.035mn.

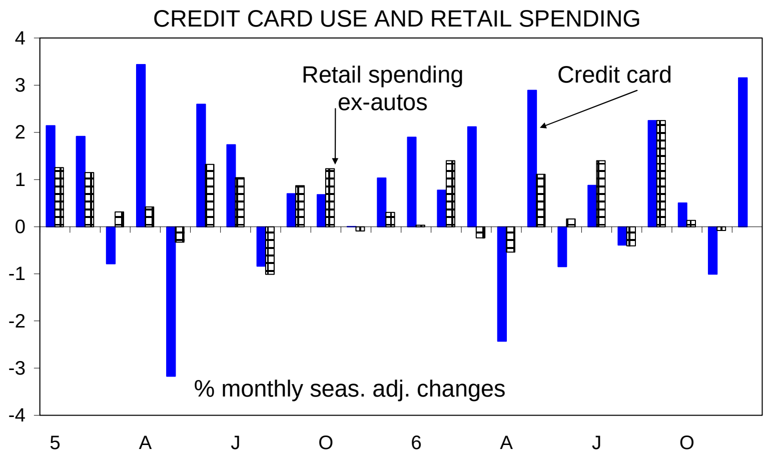




Wednesday 24

Credit Card Spending Soars in December

In seasonally adjusted terms spending on credit cards soared by 3.2% in December after declining by 1% in November. This strongly suggests that when we eventually get the December retail spending numbers a reasonably firm rise in ex-auto spending will be reported. This comes about from some analysis of the correlation between the monthly seasonally adjusted change in credit card spending and ex-auto nominal seasonally adjusted retail spending growth. The graph below shows both measures.



Sometimes the numbers seem to move together but at other times they are highly divergent. Running a regression we can explain 48% of the variability in retail spending using the credit card numbers. That is enough to allow one to take a punt in the uncertain world of economics about what retail spending may have done based upon the credit card numbers. But it is not enough to lay a dollar down on being right. However, of the 23 months shown above we see that the credit card change was in the same direction as the retail spend change 20 out of the 23 months. That means we can be quite confident that if the credit card numbers show an increase then so too will the retailing numbers.

Thursday 25

Reserve Bank Leaves Monetary Policy Unchanged - Another Mistake

As had largely been expected the Reserve Bank left their official cash rate unchanged at 7.25% this morning in spite of strong expressions of concern about the medium term inflation outlook. In particular the Reserve Bank noted in their statement the pickup in activity late last year.

"…it is increasingly apparent that domestic demand has rebounded since then, with retail trade picking up, a resurgent housing market and consumer and business confidence recovering strongly."

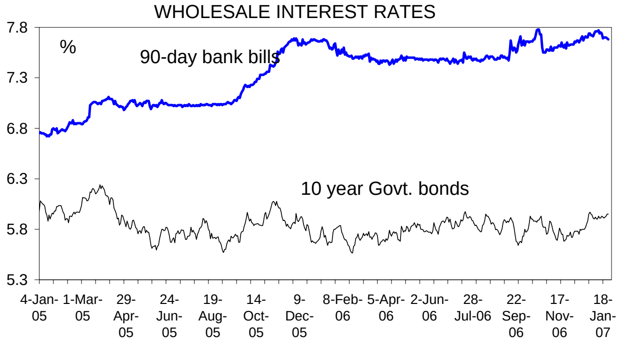
"…we remain concerned about the upside risks to medium-term inflation. In particular, our assumption that the housing market and consumer demand will resume their slowing trend over 2007 and 2008 is looking more uncertain, particularly if further fiscal expansion occurs.
"In the absence of clear indications of a moderation in housing and domestic demand, it is likely that further policy tightening will be required. The situation will be reassessed in the light of a full review of our economic forecasts at the March Monetary Policy Statement. A return to a moderating trend in housing and domestic demand will be essential if we are to see a reduction in medium-term inflation pressures."

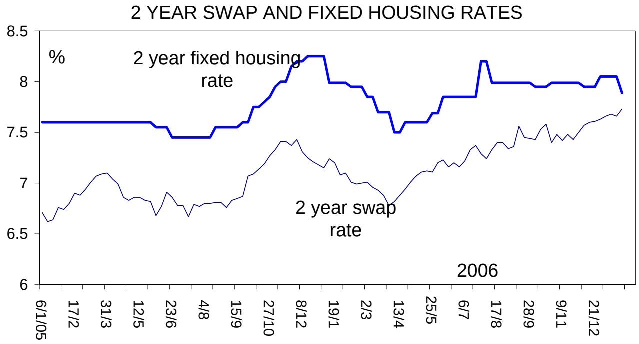
The warning about a further tightening of monetary policy is stronger than at the last review in early December when rather than saying that a further monetary policy tightening is "likely", the Reserve Bank said "…a firmer monetary policy stance could still be required…" But the disappointing thing is that over the past year while repeatedly warning that avoidance of further tightening would require easing of the domestic economy, an acceleration in growth has not prompted a tightening.

INTEREST RATES

Wholesale interest rates have changed only marginally over the past week with 90 day bank bills ending near 7.68% from 7.69% last week and the two year swap rate ending near 7.73% from 7.66%. Bill yields rallied slightly today after the Reserve Bank left their official cash rate unchanged at 7.25%. But evidence of a newly rampant housing market and a strong signal from the RB that they probably will put up interest rates further down the track caused slight weakness in wholesale fixed interest rates.

The Reserve Bank has said that they are likely to put the cash rate up again unless they see evidence of a pullback in the domestic economy and housing market. We seek practically no chance of such evidence appearing before the next cash rate review on March 8 and assign an 80% to 90% chance that the rate will go up then. Given the misplaced conservative attitude of the current Governor we might only see one further rate increase even though more really should be done. This means the sell off at the short end of the swaps curve is likely to be limited and over the latter part of this year with monetary policy expected to be easing in the United States we expect fixed rates to be falling.





If I Were a Borrower What Would I Do?

Fix two years at 7.89%. The rate is heavily discounted and gives good insulation against anything the Reserve Bank may have to do this year to place extra downward pressure on inflation over 2008. Nothing really leaps out at us to say with great certainty what interest rates will be doing over 2009 and 2010. We think there will be some declines from some point in 2008 for floating interest rates but see practically no chance that floating mortgage rates will get down to the current two-year fixed interest rate. That means there is no point in planning on going floating in the next few years.

BNZ Fixed Lending Interest Rates				
	Housing	**Average Past 5 yrs**	**Low Past**	**High 5 years**
Float	9.55%	8.18%	6.70%	9.55%
1 yr	8.60	7.32	6.20	8.60
2	7.89	7.34	5.99	8.25
3	8.15	7.51	6.30	8.30
4	8.10	7.61	6.40	8.40
5	7.95	7.63	6.50	8.60
7	7.95	7.78	6.75	8.80

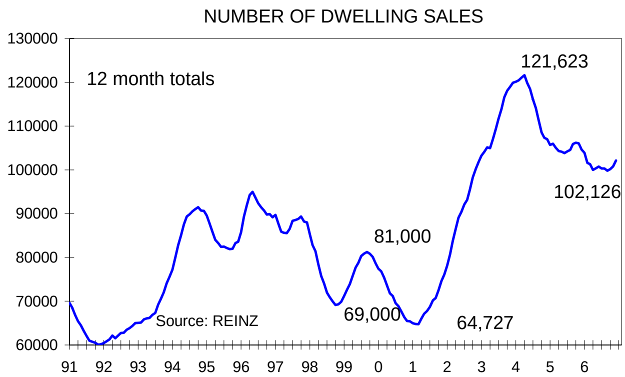
Note: Conditions may apply to these rates.

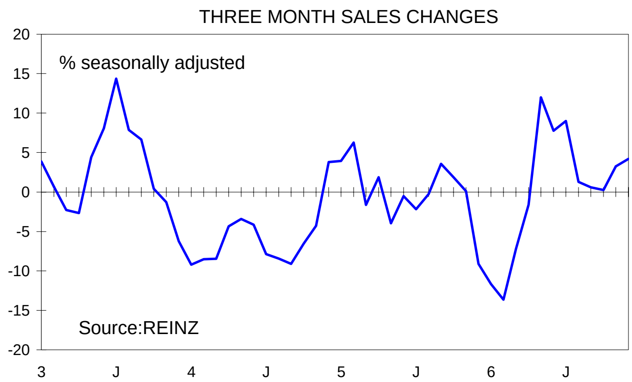
BNZ Term Deposit Rates

Days	$10-50K	$50-100K	$100-250k
30	3.00	3.00	5.25
90	6.20	6.25	6.30
180	6.90	6.95	7.00
1 yr	7.10	7.15	7.20
5 yr	6.20	6.25	6.30

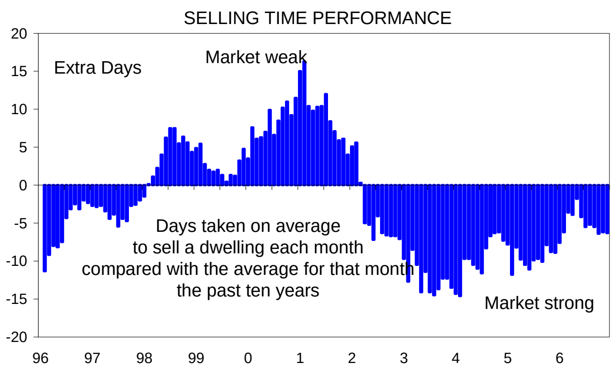
HOUSING MARKET UPDATE

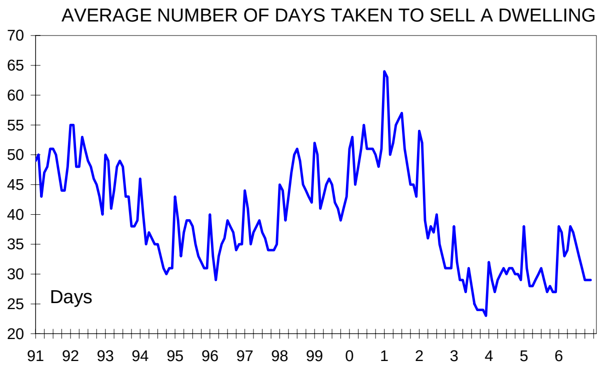
The real estate numbers for December released by the REINZ last Friday sum up the currently still good state of the New Zealand housing market very well. What they show is that sales of dwellings in December were up by a large 19.4% from a year earlier at 8,245. Sales for the month of December were actually higher in 2003 and 2004 but this result is important because it confirms an upward trend in dwelling sales. During the December quarter sales were ahead from a year earlier by 9.3% while in the September quarter they were down from a year earlier by 3.6% and in the June quarter down 2%. In the second graph below we attempt a rough seasonal adjustment of the numbers and show how things have broadly been improving in recent months.



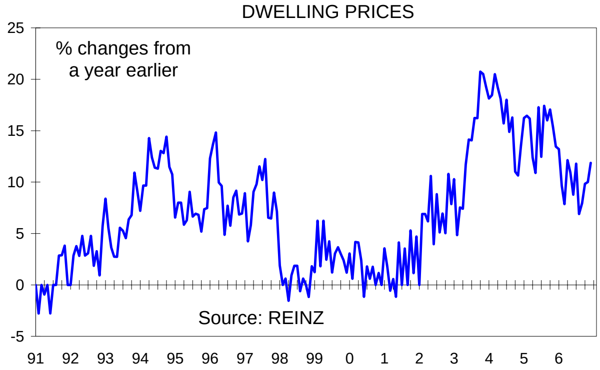


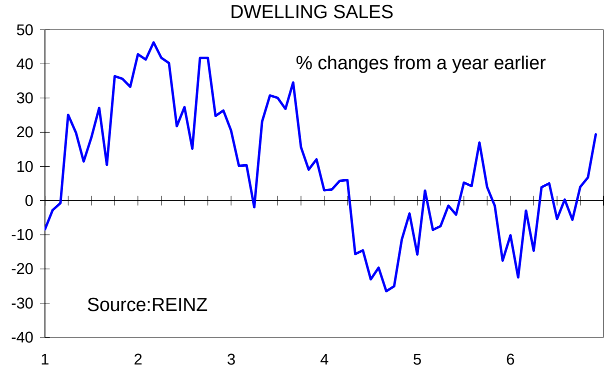
The strength of activity in the housing market is also revealed in the average number of days taken to sell a dwelling holding constant at 29 in December. This was two days longer than a year earlier and 6.3 days shorter than the average time taken in December over the past 10 years. This is the strongest below average reading since February last year when the market was still coming off amidst major misplaced worries about recession.





The only measure in the December release which didn't show things improving as such on the face of it was the median dwelling sale price which was constant from November at $330,000. But simply to focus on this absence of an increase would be a big mistake because you need to smooth across a number of months to get a clear picture about what is happening in a small economy like New Zealand. Doing this we see that on average in the December quarter the dwelling sale price rose by 5.1% or at an annualised rate of just over 20%. This is the strongest such rate of growth since the March quarter of 2005. The December month number itself was up from a year earlier by 11.9% which was an acceleration from 10% annual growth in November and a low of 6.9% in August.





It is impossible to conclude anything other than that the New Zealand housing market was improving over the second half of last year. The question now however is to what extent that improvement was partly driven by a relief rally after weakness late in 2005 and early last year when business and consumer confidence levels were appallingly low. That is, part of the shortage of listings and upward pressure on prices and dwelling sales at the moment could be due to people catching up on purchases delayed from about a year ago. We don't know how strong this factor is but its existence is one of the reasons we think the housing market is not embarking on a fresh boom as such.

The main variables which will determine where the housing market goes over this year do however look reasonably good.

- **Labour Market**

While the latest data showed job numbers fell by 0.4% during the September quarter more up-to-date indicators suggest a resurgence in employment. Basically we are talking about the NZIER's Quarterly Survey of Business Opinion released a couple weeks ago. It showed a jump in the proportion of businesses reporting an increase in job numbers to a net 10% positive in the December quarter after three quarters of negatives. More importantly employment expectations improved to a net positive 14% from 6% in the September quarter which is well above the 10 year average reading for the December quarter of a net 4% positive.

A strong labour market is vital for the housing market because if people expect sustained employment they will be more prepared to take on extra debt. High job security will also tend to foster expectations of greater increases in wages. Basically unless something very unexpected comes along and frightens the corporate sector into mass layoffs the labour market is likely to be a firm supporter of the housing market this year.

- **Migration**

The annual net migration inflow has improved from just below 6,000 in October 2005 to almost 15,000 in November 2006. We don't think a fresh boom is underway which will take the net flow over 30,000 but it seems reasonable to expect that over the next couple of years we will achieve at worst something near the 10 year average of a 10,500 gain per annum. This won't cause the housing market to accelerate in our opinion but will prevent any unusual weakness.

- **Fiscal Policy**

The government continues to face upward surprises in its fiscal surplus much to the embarrassment of the Finance Minister who seems determined not to do something quite so capitalistic as return money into the hands of the people who earned it the first place. But if there is one thing people will have learnt from the

2005 election it is that this government has great capacity to open the treasure chest if it feels it is necessary to gather some extra votes. Given the way the polls are going the chances seen very high - like 99% - that while the Finance Minister will try and talk down the prospect of tax cuts in his budget in May this year once a new Finance Minister is (probably) appointed ahead of the 2008 budget we can expect much largess. As expectations of tax cuts build a positive attitude towards the housing market will tend to be reinforced.

- **Interest Rates**

The Reserve Bank would love fixed housing rates to jump up so that they could get some extra restraint on the housing market. But while movements in the official cash rate do have some influence on fixed borrowing costs a big influence is what is happening with the same term interest rates in the United States and to a lesser extent other countries. It looks like United States monetary policy is likely to be eased over the second half of this year, perhaps three times, and this will tend to place some downward pressure on fixed borrowing costs. It is highly likely that this downward pressure will eventuate even if the Reserve Bank of New Zealand tightens monetary policy again as we expect. What will happen is that we will get a very inverse yield curve with high short term borrowing costs but quite acceptable medium to long term borrowing costs.

The upshot is that regardless of whatever the Reserve Bank may talk about doing in the short term we don't believe people will view interest rates as being something to be scared of over 2008. Our view is that interest rates won't really be stimulating the housing market this year but they won't be restraining it either.

At this stage unless some surprisingly new and negative development comes along we expect house prices will continue to rise but expect the rate of growth will slow down toward 5% rather than the 11.9% recorded over 2006 using REINZ data. The risk is prices rise more than 5%.

Demographia International Housing Affordability Survey

During the week you may have seen headlines about the results of this survey showing that Auckland ranks as having 21st equal most expensive housing in the survey of cities based on a comparison of the average house price with average household incomes. The Auckland ratio is 6.9. Christchurch ranked 31st out of the total of 159 survey cities with a ratio of six years, while Wellington ranked 47th at 5.4 years. Australian housing was shown to be very unaffordable with Sydney ranking 7th, Perth 11th, Hobart at 20th, and Melbourne 23rd.

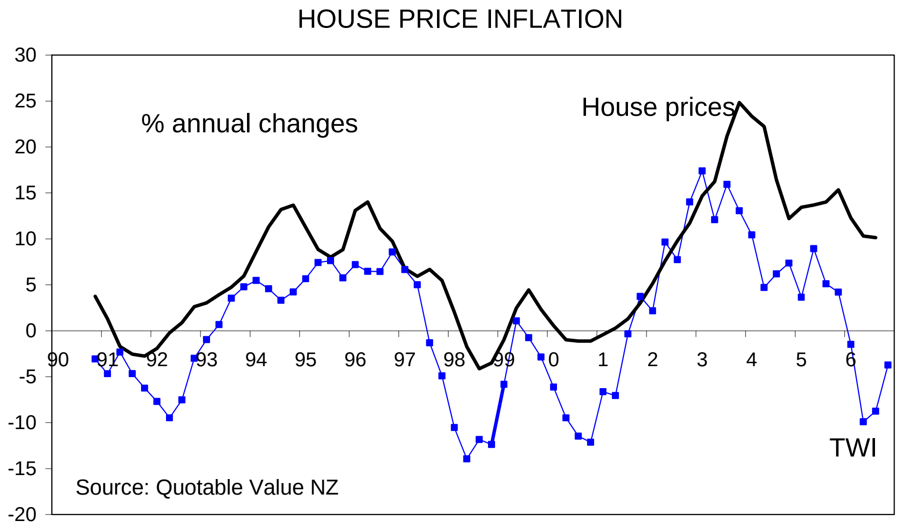
Does the survey give us any insight into where house prices are going to go? No and this is what one must always remember with these sort of affordability measures whether they apply to houses, commercial property, rural land, exchange rates or equities. They may say an asset is overpriced or in this case not very affordable. But say a survey or valuation measure says something is overpriced by 20%. It got there first of all by being overvalued 5% then 10% then 15%. If something is overvalued 20% it may only be because it is on the way to being overvalued 30%, or 40%, or 80%!

Asset valuations are ultimately determined by economic fundamentals. But asset markets in the short term are driven by people's expectations not so much of what the fundamentals will do but what other players in the market will do. That is why we economists can't reasonably forecast house prices, share markets, farm land prices, commercial property prices, or exchange rates. There is no model accurate enough for telling us how investor attitudes will change. We can only focus on the fundamentals but even if we get our forecasts of these things 100% right the effect can easily be swamped by changes in how investors feel about other investors.

The common analogy here is of a beauty contest. You don't place your money on the contestant you personally find most beautiful but on who you believe the judges will find most beautiful. Your fundamentals as it were are irrelevant.

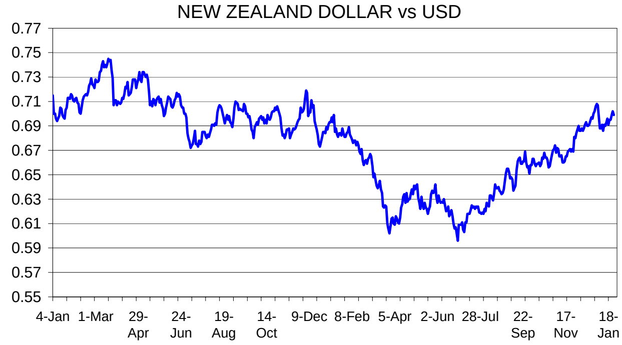
House Prices And The Exchange Rate

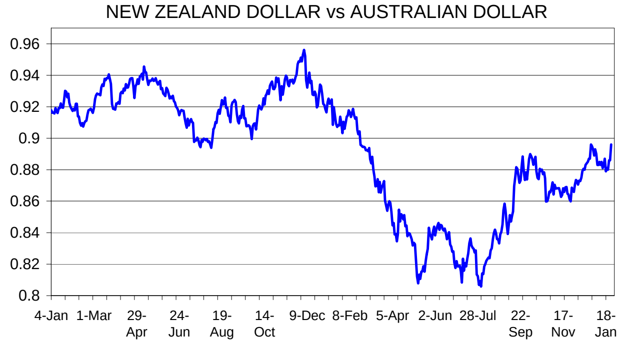
Every now and then we get a question about the relationship between movements in the New Zealand dollar and the annual rate of house price inflation in New Zealand. For those who are interested the graph below shows that relatively good correlation using it be quotable valued New Zealand data and trade weighted index. The relationship is quite close but unfortunately it doesn't look like there is a clear tendency for one variable to change well ahead of the other. Therefore for forecasting purposes the information is useful but limited. But if you have a strong view that the Kiwi dollar is going to fall out of bed you should also have a firm view that house price inflation is going to get very weak. And if you have a view that house prices are going to fall you should also have a view that the Kiwi dollar is going to fall away relatively strongly.



EXCHANGE RATES

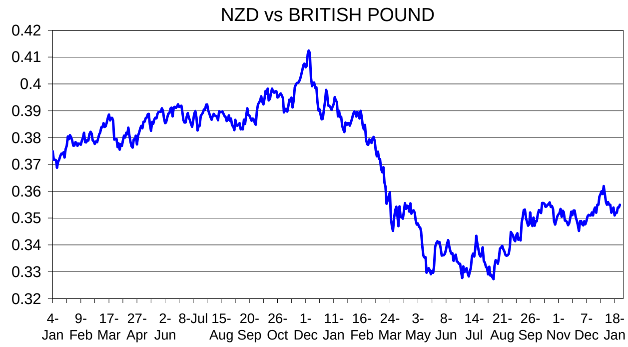
The Kiwi dollar has risen by almost one cent against the greenback over the past week to sit just below 70 cents although it traded above this level during the week. After the official cash rate announcement the Kiwi dollar rose slightly as the markets focused on the strong hint from the Reserve Bank that they will be increasing interest rates again even though they did not do so today. Our strong warning for a long time has been about upside risk to the Kiwi dollar even though our forecasts (assumptions) have been that it would decline. Looking out over the next couple of years while one can run an argument that with New Zealand's economic growth tracking below growth in our trading partners and the current account deficit remaining at high levels there will be some currency depreciation. But with the Reserve Bank having dug themselves a very big inflation hole over 2008 and 2009 the chances that they will be easing monetary policy any time soon are minimal. The risk therefore is that even our current forecast of the Kiwi dollar ending this year near 64 US cents proves too optimistic from an exporter’s point of view.

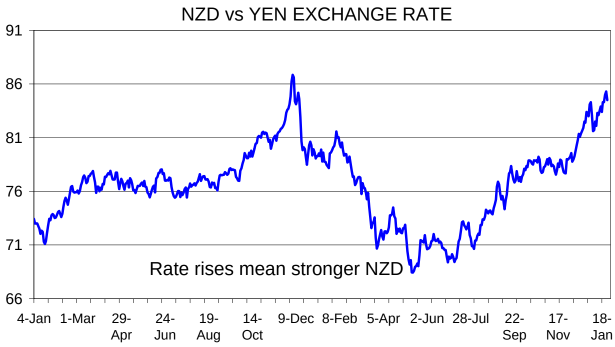


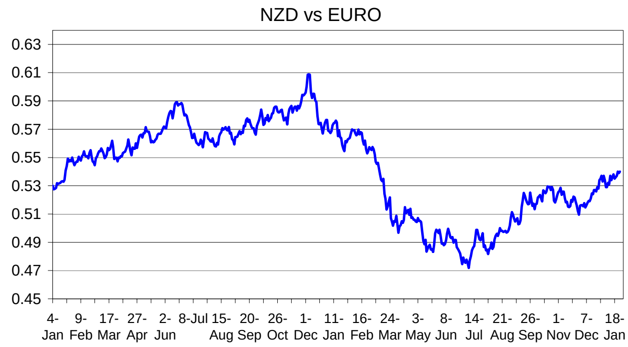


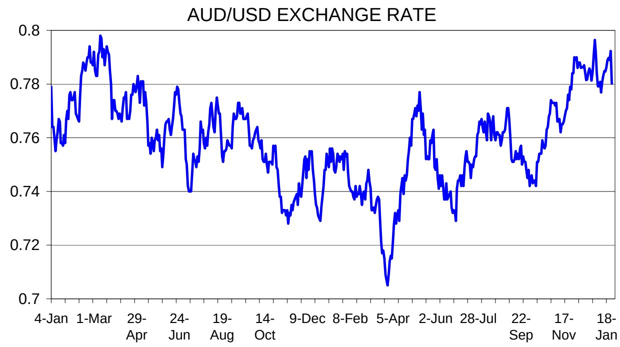
Related to the interest rate differential argument is news from Australia this week where inflation for the December quarter came in much lower than expected. This has led to a sharp reduction in expectations of any further monetary policy tightening in Australia. Contrast that with the situation here in New Zealand and it is easy to understand why over the past week the Kiwi dollar has risen to 89.6 cents against the Australian currency from 87.9 cents last week. This move will surely take some of the optimism out of the manufacturing sector which we have been seeing recently but will also apply very strong pressure to boost productivity through capital expenditure as many have been doing and continue to do.

With the Kiwi dollar having a generally firmer tone to it at the moment with upside risk over the next few weeks on expectations of tighter monetary policy and in response to what we expect to be a continuing stream of good economic data we have unsurprisingly ended higher against the British pound near 35.5 pence from 35.1 last Thursday, at 84.5 Japanese yen from 83.4 last week, and 54 cents against the euro from 53.5 last week.









As noted above the Aussie dollar was hit by a low consumer price index number during the week and has ended near 78 US cents from 78.6 cents last week.

Against the Japanese yen the greenback has ended essentially unchanged from a week ago near 120.9, unchanged also against the British pound near $1.968, and unchanged against the euro near $1.293. The greenback was supported for a while by some strong data such as the University of Michigan consumer confidence number for January coming in at 98 which was well above market expectations and the 91.7 reading for December. But the euro was boosted by high industrial orders numbers and a strong reading for

French consumer confidence. There were also positive comments from ECB officials and the markets are now thinking that there may be two more increases in the ECB's cash rate from the current 3.5%. Expectations have also risen that there will be another increase in the United Kingdom's cash rate in the near future following the surprise rise two weeks ago.

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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	-0.2%	0.7	2.6	3.2	2.7
GDP growth	Average past 10 years = 3.3%	0.3	0.4	1.4	2.5	4.4
Unemployment rate	Average past 10 years = 5.7%	3.8	3.6	......	3.7	3.8
Jobs growth	Average past 10 years = 2.1%	-0.4	0.9	1.5	3.2	2.8
Current a/c deficit	Average past 10 years = 4.9% of GDP	9.1	9.7	......	8.5	6.0
Terms of Trade		-1.9	2.1	-1.6	0.9	7.3
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%.	1.1	0.8	4.6	6.3	6.8
House Prices	Long term average rise 5% p.a.	2.5	0.9	10.1	14.0	16.4
Net migration gain	Av. gain past 10 years = 13,000	+14,780	13,780yr	......	6,145	16,334
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 8%. Colmar survey	-10	-19	-34	-7	3
Business activity exps	10 year average = 27%. NBNZ	24	24	17	-2	27
Household debt	10 year average growth = 11.4%. RBNZ	13.4	13.3	14.1	15.3	15.1
Dwelling sales	10 year average growth = 4.6%. REINZ	19.4	6.8	5.0	-18.6	-3.7
Tourist numbers	10 year average growth = 6.1%. Stats NZ	7.1	5.9	-0.3	-2.7	4.2
Floating Mort. Rate	10 year average = 8.5%	9.55	9.55	9.55	9.00	8.75
3 yr fixed hsg rate	10 year average = 8.2%	8.15	7.95	7.75	8.20	7.60

ECONOMIC FORECASTS

Forecasts at Jan 25 2007	March Years					December Years				
	2005	2006	2007	2008	2009	2004	2005	2006	2007	2008
GDP - annual average % change										
Private Consumption	5.5	4.5	1.3	1.7	0.6	6.4	4.9	1.8	1.9	0.6
Government Consumption	4.6	4.7	3.9	3.1	4	5.7	4.2	4.0	3.5	3.6
Investment	7.2	5.9	-5.1	5.1	6.2	12.6	4.5	-3.2	2.5	6.4
GNE	6.0	4.3	-0.5	3.4	2.8	7.8	4.4	-0.1	2.9	2.9
Exports	3.8	-0.1	4.9	3.1	4.6	5.4	-0.5	3.0	3.8	4.3
Imports	12.8	5	-1.7	4.6	4.6	16.4	6.2	-2.0	3.9	4.7
GDP	3.7	2.0	1.8	2.7	2.8	4.4	2.1	1.7	2.6	2.7
Inflation – Consumers Price Index	2.8	3.3	2.2	3.1	2.6	2.7	3.2	2.6	2.4	2.9
Employment	3.4	2.6	1.7	1.2	1.5	4.4	1.5	2.3	1.4	1.4
Unemployment Rate %	3.8	3.9	3.6	4.1	4.5	3.6	3.6	3.7	4.0	4.5
Wages	2.9	4.6	5.5	4.4	3.3	1.9	5.1	5.6	4.4	3.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.64	0.69	0.62	0.56	0.71	0.7	0.69	0.64	0.56
USD/JPY	105	117	116	103	105	104	119	117	105	105
EUR/USD	1.32	1.2	1.32	1.29	1.24	1.34	1.19	1.32	1.3	1.24
NZD/AUD	0.93	0.87	0.90	0.89	0.80	0.93	0.94	0.88	0.90	0.81
NZD/GBP	0.38	0.36	0.36	0.34	0.31	0.37	0.4	0.35	0.35	0.31
NZD/EUR	0.55	0.53	0.52	0.48	0.45	0.53	0.59	0.52	0.49	0.45
NZD/YEN	76.8	74.6	80.0	63.9	58.8	74.2	82.7	81.0	67.2	58.8
TWI	70.7	65.6	68.2	61.9	56.8	69	71.9	68.0	63.7	56.9
Official Cash Rate	6.56	7.25	7.50	7.0	6	6.50	7.0	7.25	7.50	6.25
90 Day Bank Bill Rate	6.86	7.55	7.95	7.18	6.20	6.73	7.49	7.64	7.54	6.35
2 Year swap	6.82	6.99	7.79	6.67	6.44	6.61	7.24	7.48	6.81	6.44
10 Year Govt Bond	6.04	5.71	6	5.85	5.7	6.03	5.89	5.77	5.9	5.65

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

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