

BNZ Weekly Overview

1 February 2007

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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	7.67%	7.68	7.72	7.58	7.52	6.4
10 year govt. bond	6.02%	5.95	5.95	5.75	5.82	6.5
1 year swap	7.89%	7.90	7.91	7.68	7.40	6.6
5 year swap	7.37%	7.34	7.28	7.08	6.84	7.0
NZD/USD	0.688	0.699	0.708	0.67	0.684	.57
NZD/AUD	0.887	0.876	0.889	0.866	0.906	.86
NZD/JPY	82.9	84.5	84.1	78.3	80.2	66.0
NZD/GBP	0.35	0.355	0.359	0.351	0.384	.34
NZD/EURO	0.527	0.54	0.533	0.525	0.564	.51

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

Monthly Confidence Survey Time

This week we are running our first confidence survey for the year. If time permits and you have not already done so in the email note then please cut and paste the URL below into your browser, click on it and let us know whether you feel the economy will get better or worse over the coming year. More importantly let us know what is happening in your industry at the moment – specifying what that industry is. The results of the survey will be sent out next week.

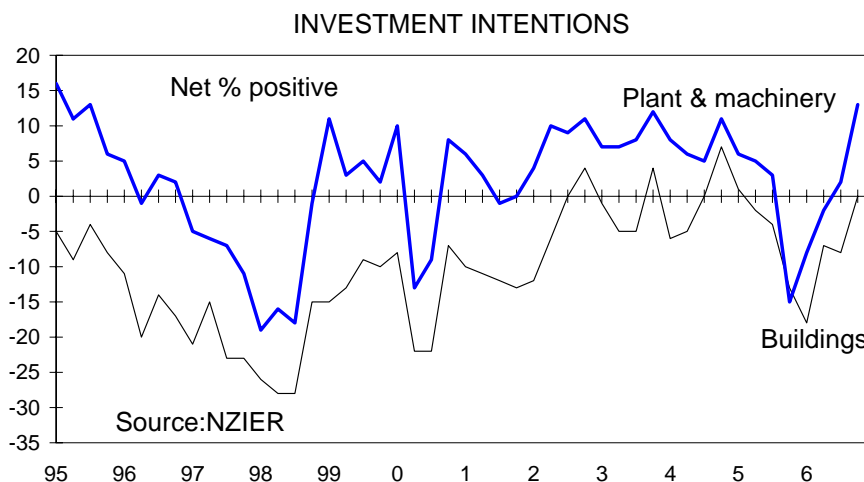
<http://www.closer.co.nz/bnzeconomist.asp>

Good News

No, this isn't about the housing market strengthening and making all of us home owners feel wealthy. Its about businesses recognising the constraints on our economy and reacting by boosting their capital expenditure. This is the most important thing happening in the economy at the moment because the only way to raise income per capita is with growth in productivity and the best way to achieve that in conjunction with higher labour skills is deepening the capital base.

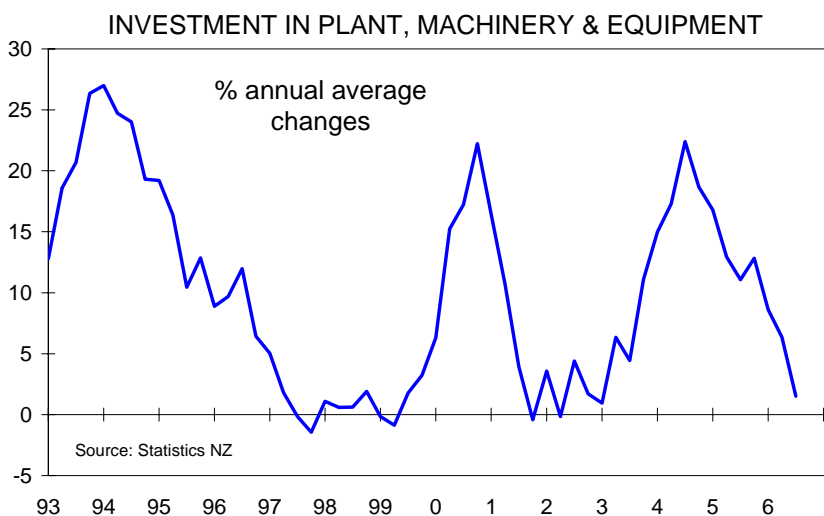
Businesses have been indicating their intention to boost investment in various surveys. The NZIER's Quarterly Survey of Business Opinion for instance showed that in the December quarter a net 13% of non-farm businesses said they intend boosting spending on plant, machinery & equipment (PME). This was well up from 2% in the September quarter, -2% in the June quarter and was above the ten year average reading of +3%. Perhaps most significantly and why we feel writing about this capital spending boom is a good idea, the 13% reading was the highest since 1995.

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A net 0% of businesses said they intend boosting spending on buildings. This is not such an outstanding result as for PME but is still very good as it correlates with the rebound in PME intentions and is well above the ten year average of -7%.

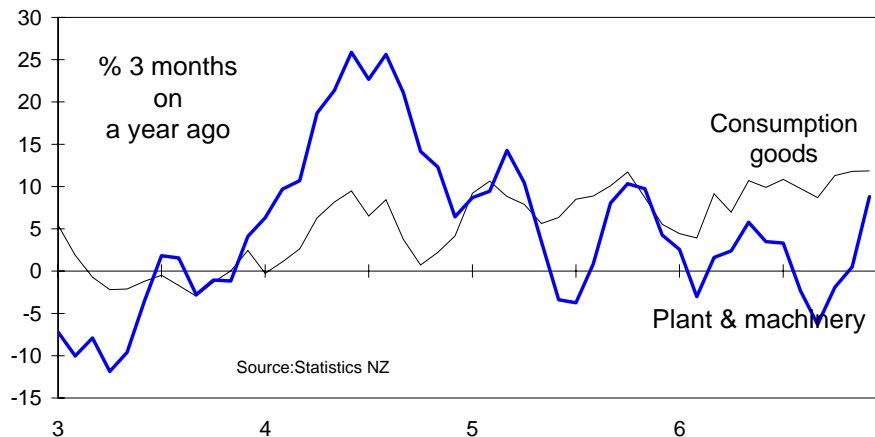
With regard to actual indicators of investment we have the following positive readings. In the September quarter the seasonally adjusted volume of spending on PME rose for the first quarter in a year gaining 2%. We anticipate this recovery continuing so the decline in the annual average measure of change in PME shown below should reverse soon.



We can get a more up to date indication of capital spending by looking at import data. Here we see that in December the value of imports of machinery and equipment was up a strong 14% from a year earlier and ahead 9% in the quarter from a year ago. Admittedly when one allows for a fall in the NZD this translates to only mild volume growth. But the recovery from weakness in earlier months is good.

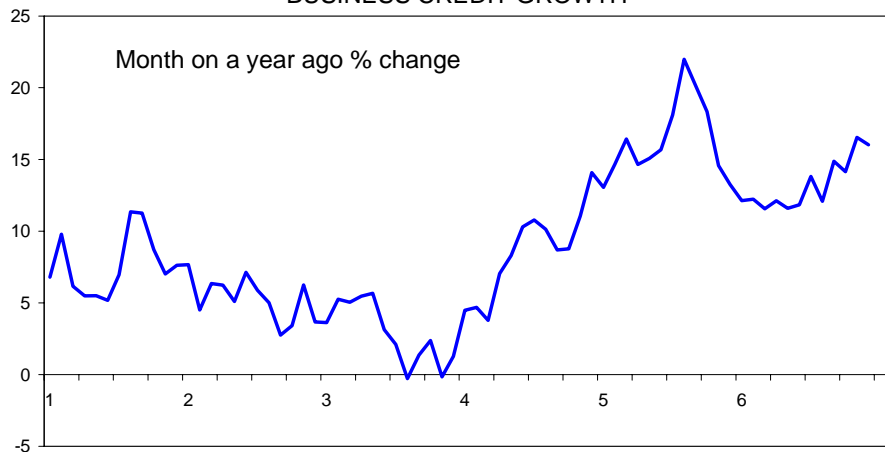
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IMPORTS BY ECONOMIC CATEGORY



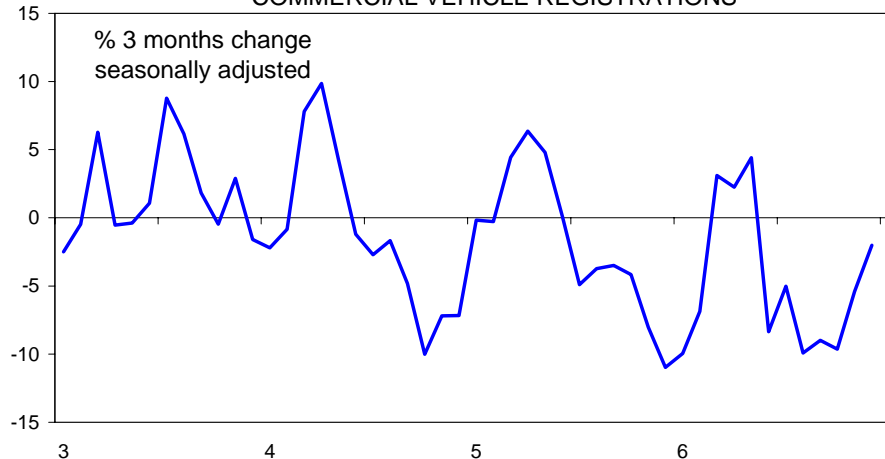
Backing up the recovery in capital spending story is a recent lift in the rate of growth in lending to the business sector. Our own experience in the market is that business credit demand is strong.

BUSINESS CREDIT GROWTH



Finally, this isn't a biggie but the latest movement does correlate with the recovery in other indicators. In the December quarter in rough seasonally adjusted terms the number of commercial vehicles registered was down by 2% from the September quarter. But this was the smallest rate of decline since the May quarter.

COMMERCIAL VEHICLE REGISTRATIONS



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Will the recovery in business investment continue? Such activity relies on confidence and one can never discount some shock or series of shocks coming along to scare businesses back into their shells. A big negative is the high exchange rate which is crunching some parts of the export sector. But it is also prompting many exporters to boost capital spending so they can handle the high NZD – most notably in the manufacturing sector according to anecdotal feedback.

A potential hike in interest rates would be a negative – but not a big one we feel. We have come across very few businesses over the past three years of monetary policy tightening who have expressed concern about rising debt servicing costs. Instead the focus has been on resource acquisition.

Weakness in the farming sector bears watching. Although commodity prices are high in general there has been downward movement in sheepmeat prices, debt levels are high, and the rural real estate market has quietened down significantly. Cash flows are very tight and we see evidence of spending being reined in. This suggests capital spending in the rural sector and associated businesses will weaken off this year.

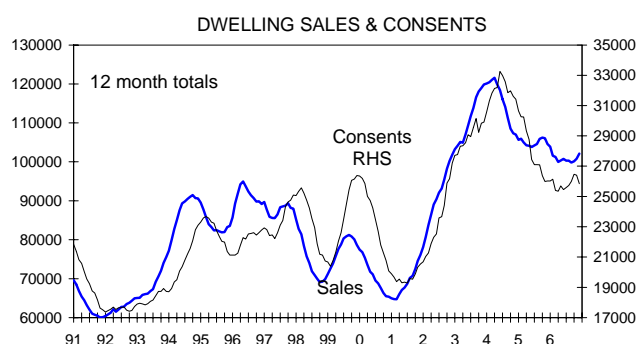
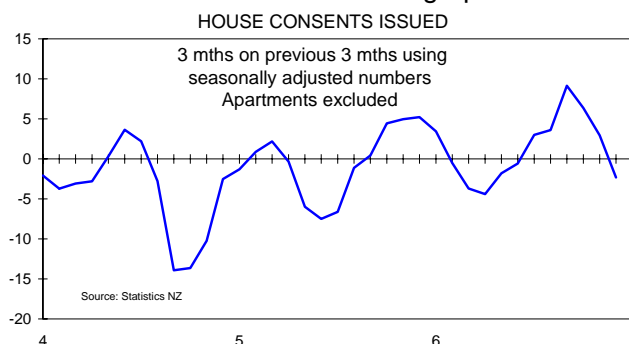
But barring some sizeable offshore shock we think prospects for business capital spending are strong. The labour market remains very tight and as we started warning eight years ago businesses are having to respond by investing more in PME and boosting productivity. This not only boosts output but helps meet increasing labour costs. Greater efforts are being made to improve the electricity supply and distribution problems around the country and this should give businesses increased confidence that if they buy a new machine the power will be there to run it – if not a skilled operator!

THE WEEK'S ECONOMIC DEVELOPMENTS

Tuesday 30

Housing Not As Weak As the Numbers Suggest

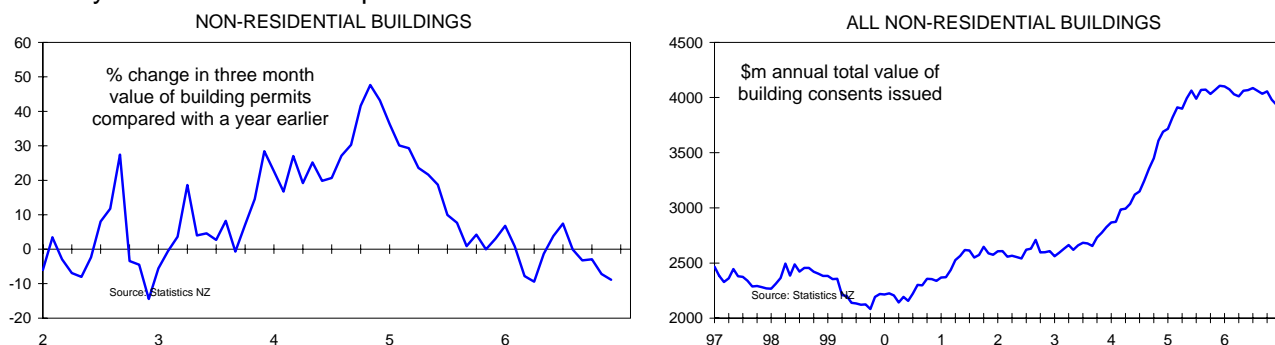
In seasonally adjusted terms the number of dwelling consents issued in December was down by 4.9% from November. This followed declines in the previous two months and means that in the December quarter dwelling consent numbers were down from the September quarter in seasonally adjusted terms by just over 11% while in unadjusted terms consent numbers were down from a year earlier by 2.2%. There is a downward trends in place for residential construction now however large fluctuations in consent issuance for apartments play a role. If we look at just houses we see that in December in seasonally adjusted terms numbers were up 2.8% but down by 2.2% over the December quarter. Things have clearly flattened out although it will be interesting to see to what extent the strength in real estate sales translates through into residential construction. There is a lagged relationship between changes in dwelling sales and changes in consent numbers as shown in the graph below.



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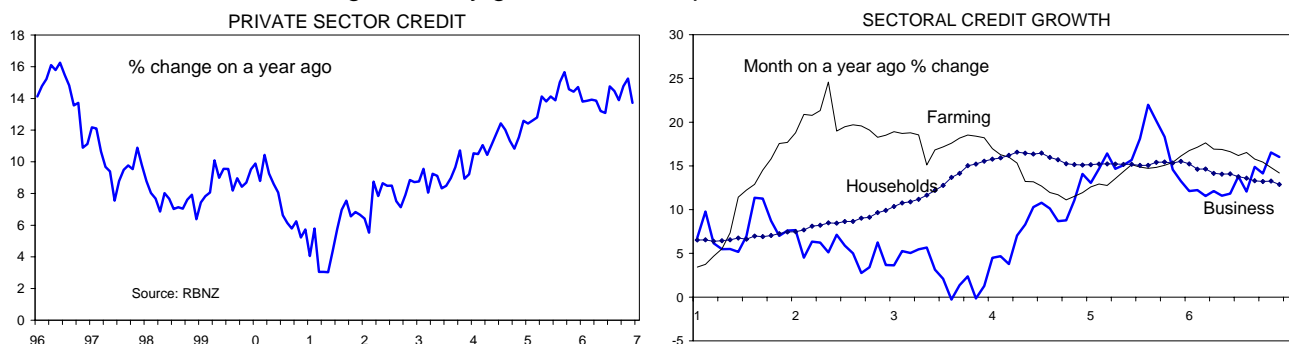
Commercial Construction Eases Off – Rebound Likely

The value of consents issued for the construction of non-residential buildings was \$333 million in December. This was a 12.4% decrease from a year earlier and means that for the December quarter consent values were down by 8.9% from a year ago while for the entire calendar year they were off by 4.2%. There is a gradual downward trend under way with regard to commercial construction but one has to be careful about concluding that this indicates weakness in the domestic economy. This is because resource shortages may be limiting consent issuance. In addition with business investment intentions indicators moving upward we are likely to see this series improve over the remainder of 2007.



Lending Growth Is Still Relatively Firm

The annual rate of growth in lending to the private sector slowed to 13.7% in December from 15.3% in November and 14.7% in December 2005. This rate of growth however is still well above the average for the past five years of 11.2% and reflects continuing acceptable growth in the economy. The annual rate of growth in lending to the business sector remained strong at 16% from 16.5% in November and 13.3% a year earlier. Lending to the business sector over the December quarter amounted to \$2.3 billion. This was \$833 million stronger than over the same period a year earlier and backs up survey measures showing businesses increasing their capital expenditure. The annual rate of growth in lending to the farming sector slowed to 14.2% from 14.8% in November and 16.1% a year earlier. Farm lending over the December quarter totalled \$631 million and this was \$285 million less than over the same period a year earlier. A relatively firm slowing in lending growth to the rural sector is therefore underway. The annual rate of growth in lending to the household sector slowed to 12.9% from 13.3% in November and 15.5% a year earlier. Total lending to the household sector over the December quarter of \$5.1 billion was \$120 million greater than the same period a year earlier. This is a relatively small increase and might lead one to conclude that a decent slowdown in lending to the household sector was underway. However in seasonally adjusted terms growth in this lending measure was 1% in December. This was unchanged from November and essentially the same as the 1.1% average monthly growth over the previous six months.



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Consumer Confidence Rises

We don't usually report on this particular poll but it has relevance given that ahead of March 8 the Reserve Bank will be looking for any indication they can find that the domestic economy and the household sector in particular is pulling back. The Roy Morgan consumer confidence index rose to 136.8 in January from 127.8 in December and 130.9 a year earlier. This is the highest reading in almost 2 years and is suggestive of continued strength in consumer spending and the housing market. So no good news for the RB here.

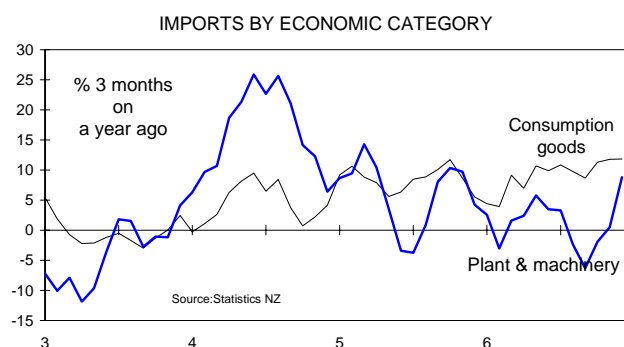
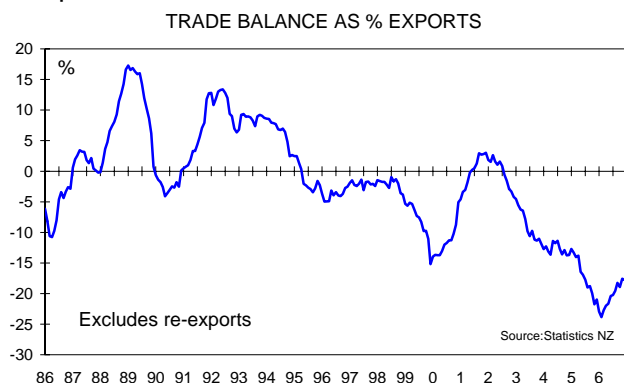
Wednesday 31

Government Accounts Running Slightly Better Than Expected

The government ran an operating surplus excluding revaluations and accounting changes (OBERAC) in the first five months of the 2005/2006 financial year of \$3.1 billion. This was \$242 million higher than forecast.

Trade Data Show Buoyant Domestic Economy

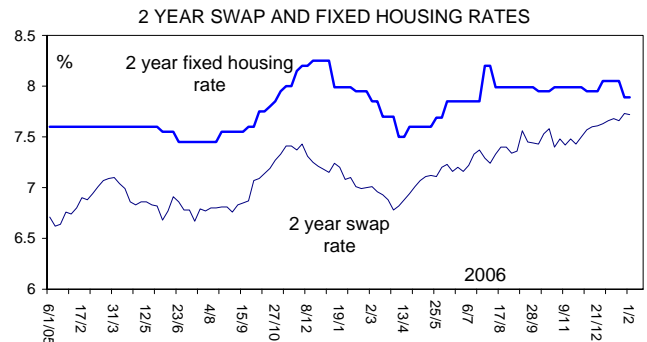
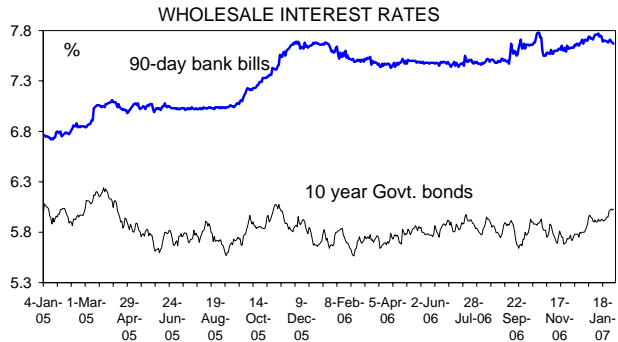
The merchandise trade account recorded a deficit in December of \$433 million. This was up from \$311 million a year earlier but about equal to market expectations. Imports were 12.4% up from a year earlier for the month and 7.1% ahead for the quarter compared with a year ago. In seasonally adjusted terms total imports were however up just 0.5% from the December quarter following growth of 2.5% in the September quarter and 0.9% in the June quarter. The 0.5% rise looks relatively weak and one might think it means the domestic economy is easing off. But the result is actually quite strong because over the quarter the exchange rate rose by 5.5% and fuel prices fell about 20%. So in real volume terms import growth was very strong in the quarter. In particular in purely nominal terms the value of imports of machinery was up 14% in December from a year earlier and 9% in the December quarter from a year ago. Businesses are clearly responding to capacity shortages by investing. This is probably the most positive thing happening in the economy at the moment and it leaves one hopeful of improved productivity growth in the New Zealand economy at some stage in the future. But at the same time over the quarter the value of consumer goods imports was up by 12% from a year earlier. This shows that we householders continue to spend up large and retailers are responding by bringing in lots of goods from overseas. For the record the annual trade deficit now stands at \$6.2 billion compared with \$6.5 billion a year ago and a peak for this cycle of \$7.3 billion in February. The first graph below shows the annual trade balance improving recently as a proportion of exports.



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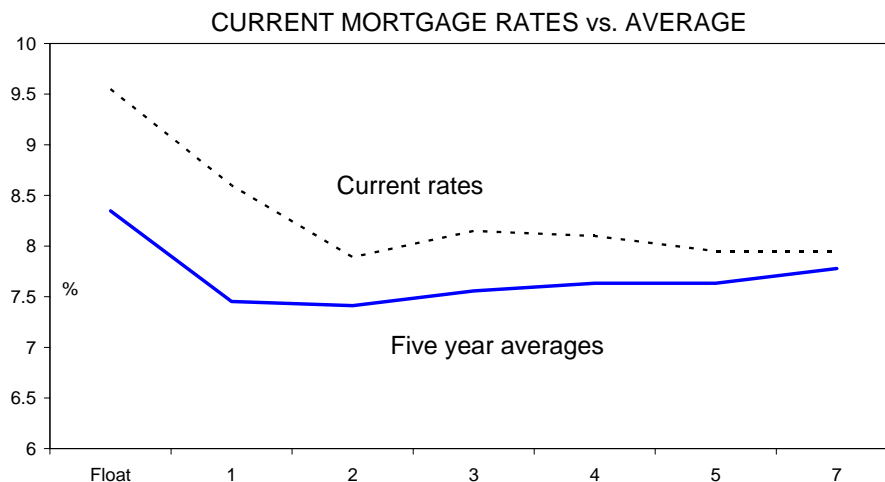
INTEREST RATES

Data releases over the past week showed the domestic economy still looking quite strong and that means there has essentially been no change from a week ago in market expectations that the Reserve Bank will be tightening monetary policy on March 8. The yield on 90-day bank bills has ended near 7.67% from 7.68% last Thursday while the two year swap rate at which we banks borrow to lend fixed for a two-year period has ended near 7.72% from 7.73%.



If I Were a Borrower What Would I Do?

As at the moment on a Thursday afternoon I would fix for two years at 7.89%. This should give me a rate which matures when monetary policy is easing in New Zealand with that rate being less than 0.5% above its average over the past five years and below all other fixed rates on offer. But if that special rate was not available I might be inclined to look at one of the longer-term fixed interest rates.



BNZ Fixed Lending Interest Rates

	Housing	Average Past 5 yrs	Low Past 5 years	High Past 5 years
Float	9.55%	8.34%	6.70%	9.55%
1 yr	8.60	7.45	6.20	8.60
2	7.89	7.41	5.99	8.25
3	8.15	7.56	6.30	8.30
4	8.10	7.63	6.40	8.40
5	7.95	7.63	6.50	8.60
7	7.95	7.77	6.75	8.80

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

Note: Conditions may apply to these rates.

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HOUSING MARKET UPDATE

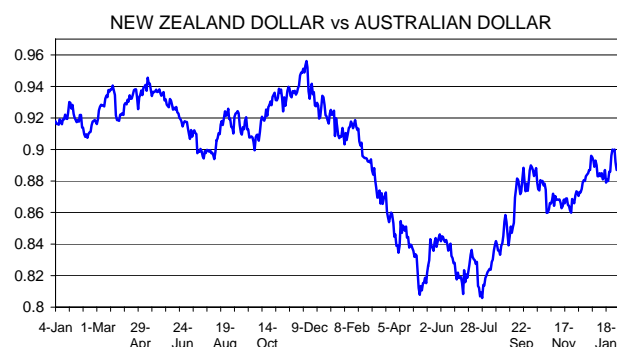
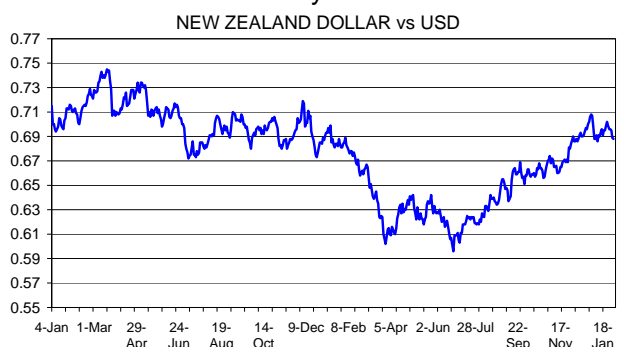
You will still read in the media are a lot of people saying that home ownership in New Zealand is falling sharply with housing affordability being so poor these days compared with in the past. Sometimes they go on to talk about a change in the Kiwi culture away from home ownership towards renting with reduced attachment to one's community if not the entire country. But this is not really the case and the actual figures on this appear to have been ignored by many commentators. As we reported in our December 7 issue the proportion of the housing stock in New Zealand occupied by the people owning it was 66.9% in March 2006. This was barely changed from 67.8% at the March 2001 census. What does this tell us?

House prices are high, Baby Boomers have been snapping up properties for retirement purposes, plus a few foreigners have been coming in and doing some buying, but other buyers have not been priced out of the market. Therefore even though affordability is poor and people are having to borrow a lot of money to get a house they are still doing so. The desire for home ownership in New Zealand still appears very strong. But the cost of pursuing the traditional Kiwi dream has skyrocketed because of the extra competition for the housing stock pushing prices up.

It's hard to know exactly how to extrapolate this information but it could vastly reduce the scope for saying that there is a boom and bust element to the current housing cycle. If the home ownership ratio had fallen sharply between 2001 and 2006 that would mean a lot of people sitting with rental accommodation which presumably they would be less attached to than one's own home. That could mean that in the event of a shock to the New Zealand economy they would be far more likely to place that property on the market to raise cash than someone who owns and lives in their house and would start sharing toothbrushes to make sure they could meet mortgage repayments.

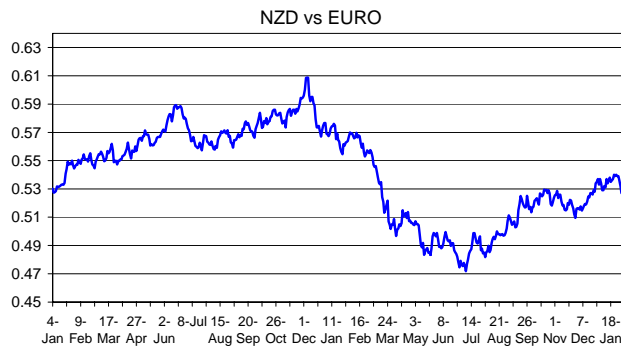
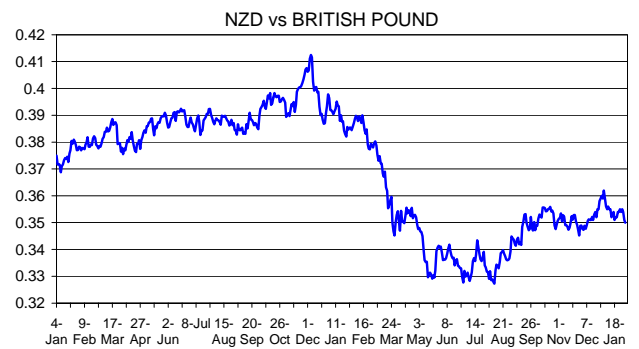
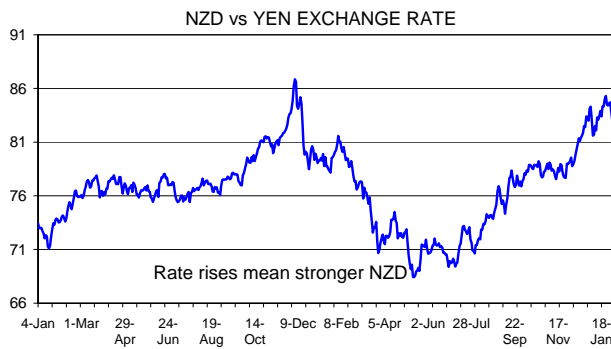
EXCHANGE RATES

The Kiwi dollar has fallen by about one cent against the greenback over the past week to end this afternoon near 68.8 US cents from 69.9 a week ago. The Kiwi dollar mainly fell away on Tuesday night amidst rumours that a major US investment bank had issued a sell recommendation. There was also perhaps some precautionary selling ahead of the Group of Seven meeting next week which some analysts feel could produce a communiqué calling for the Bank of Japan to ignore political influences and raise interest rates. There is concern in the markets that the Bank of Japan appear to have backed away from independence in their monetary policy decisions. This concern has recently driven the yen to its lowest level against the greenback in four years and has caused European officials to make various comments calling for action to be taken about the weak yen.



The Kiwi dollar has also weakened slightly on the crosses ending against the Australian currency near 88.7 cents from 89.6 cents last week, against the Japanese yen near 82.9 from 84.5, against the British pound near 35 pence from 35.5 pence last week, and against the euro near 52.7 cents from 54 cents.

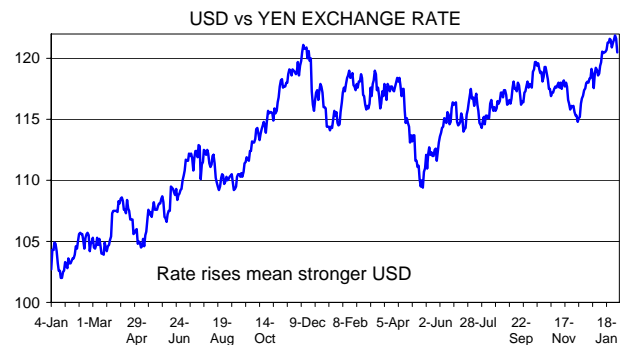
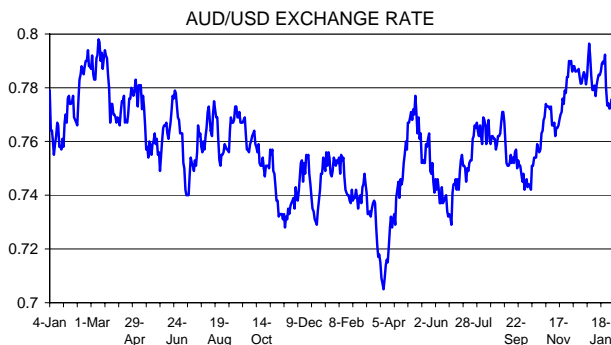
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During the week we received a couple of examples of the way in which the high New Zealand dollar is impacting on some parts of the economy. These examples follow on from information in the previous week showing high levels of pessimism in the farming sector partly attributable to the rebound in the currency. A sawmill has closed in the South Island with the owners citing a range of problems and most notably the high New Zealand dollar and their lack of faith that it is going to be declining all that much in the near future. One suspects there are probably a number of other exporters in this position who have been running unprofitably hoping that the Kiwi dollar would fall away as so many of us have been assuming and that their accounts would move back into surplus. Their hopes are being dashed so more closures are quite likely over the coming months.

The other piece of news was a slump in confidence captured in the Canterbury Manufacturers Association monthly survey. The sample base for the survey is relatively small and the results can be hugely volatile but we cite it this week because we mentioned it a couple of weeks ago. Net confidence was zero in December from positive 40% in November.

The Australian dollar has ended the week only slightly down against the greenback near 77.6 cents from 78 cents last week. The Aussie dollar has had a slight weak bias continuing on from the previous week's lower than expected CPI increase for the December quarter reducing expectations of another rate rise from the RBA. Downward pressure also came from falls in metals prices early in the week.

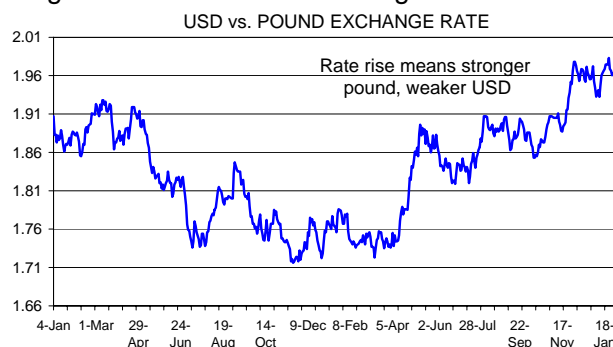
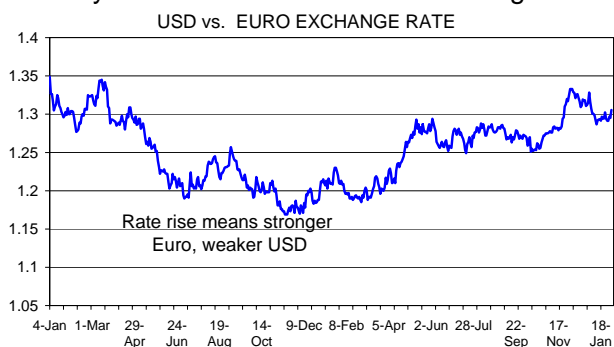


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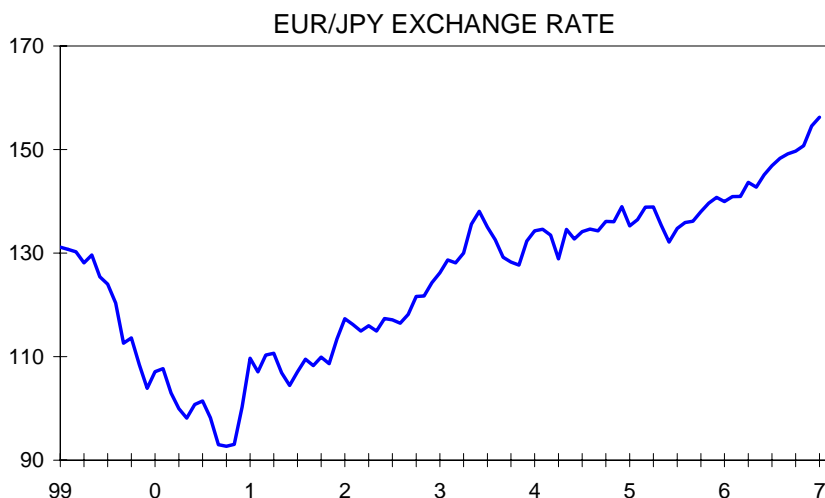
The US dollar started the week on a strong note lifted by stronger than expected data for durable goods orders in December and new home sales in December which were up by a high 4.8%. This latter news has added to a feeling that the worst of the slowdown in housing market could be over and that if this is the case then scope for the Federal Reserve to cut interest rates this year may be limited. This clearly has important implications for where the greenback may go over 2007 as well as fixed borrowing costs in New Zealand which are heavily influenced by movements in US interest rates.

But last night even though the December quarter GDP number came out stronger than expected at an annualised rate of 3.5% from 2% in the September quarter there was some selling of the greenback after the Chicago purchasing managers index came in weaker than expected. Construction spending was also down a greater than expected 0.4% in December. In addition the US Treasury Secretary said he was watching the value of the Japanese yen "...very, very carefully" and that he had "talked to their finance minister [Japan's] and will talk to him again next week" at the G7 meeting. Against the Japanese yen the US dollar has finished near a still strong 120.5 from 120.9 last week.

In their six weekly review of monetary policy the Federal Open Market Committee made some upbeat comments on the economy including "recent economic indicators have suggested somewhat firmer economic growth, and some tentative signs of stabilization have appeared in the housing market. Overall, the economy seems likely to expand at a moderate pace over the coming quarters" but they made less worrying comments about inflation and this caused a small increase in expectations that there will be a rate cut this year from 40% to about 80% and generated mild greenback weakness overnight.



Against the euro the US dollar has finished this afternoon near \$1.306 from \$1.294 last week while against British pound the greenback has ended near unchanged at \$1.967. To explain the concern of the Europeans about weakness in the Japanese yen at a time when the euro is strong consider the graph below showing the euro/yen exchange rate since 1999.



The next really major event for the Kiwi dollar is quite clearly the review of the official cash rate on March 8. But before then close attention will be paid to any indicators of the domestic economy and of course the

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housing market. Internationally the focus is now on the G-7 meeting next week and whether foreign exchange rates will be mentioned in the communiqué.

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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%. NBZ	24	24	17	-2	27
Household debt	10 year average growth = 11.4%. RBNZ	12.9	13.3	14.1	15.5	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.

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