BNZ Weekly Overview

22 February 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	7.76%	7.73	7.70	7.61	7.49	6.4
10 year govt. bond	5.94%	5.97	5.92	5.75	5.63	6.5
1 year swap	7.96%	7.98	7.90	7.63	7.34	6.6
5 year swap	7.40%	7.45	7.34	7.03	6.72	7.0
NZD/USD	0.706	0.693	0.695	0.67	0.662	.567
NZD/AUD	0.891	0.885	0.88	0.869	0.895	.859
NZD/JPY	85.4	83.8	84.3	78.8	78.6	66.1
NZD/GBP	0.361	0.354	0.352	0.353	0.38	.342
NZD/EURO	0.537	0.529	0.537	0.522	0.556	.51

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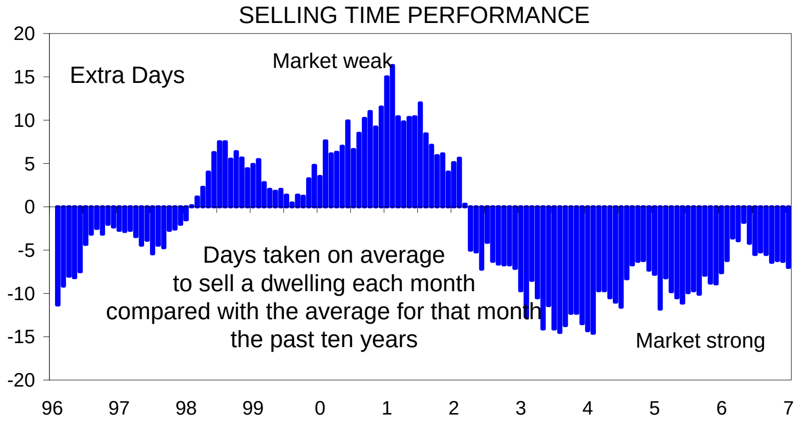
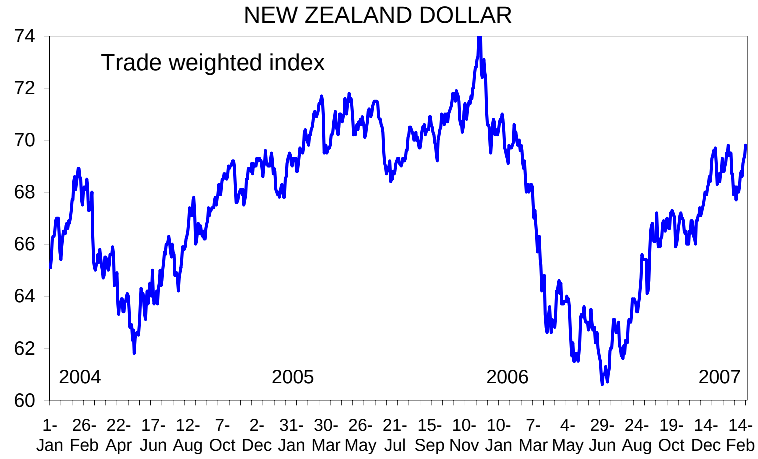
Strong Data Flow Continues

This past week there have been nothing but positive data releases on the NZ economy. We saw strong REINZ housing data last Friday with sales running 19% ahead of a year earlier, prices in the three months to January up 10% from a year earlier, and days to sell seven below the ten year average for January which is the strongest such result since January last year and much better than a 1.8 day difference in May.



Consumer confidence recorded in the One News Colmar Brunton poll was above average in February at 4% versus -10% in the last poll in October and a ten year average reading of +2%. Plus growth prospects for our top 14 export destinations have been revised up to 3.3% this year in the monthly Consensus Economics survey from 3.2% last month. All of these developments – plus the political rejection of a fixed rate levy – argue in favour of the Reserve Bank tightening monetary policy on March 8.

But on the other side of the argument we have seen the exchange rate jump strongly over the week closing this afternoon near USD 70.6 cents, over 36 pence, and near 69.8 on a trade weighted basis from 68.8 last week.



This latter reading is 6.4% above the level assumed by the Reserve Bank in their December economic forecasts so counts for something in terms of extra restraint in the exporting sector. But then offsetting this we have seen Fonterra increase their payout forecast this season from $4.05 to $4.15, and the ANZ Commodity price Index in world price terms has risen 7% since the RB made their forecasts at the end of November. Plus if the high exchange rate was really a problem we might not be seeing tourist numbers in the December quarter running 5.4% ahead of a year ago. Admittedly though these numbers lag exchange rate changes – but they are mainly driven by economic growth in the source countries and things continue to look okay overseas.

All up the data and various developments continue to argue strongly in favour of the Reserve Bank tightening come March 8 and warning of further rises ahead. The surprise would be if they move 0.5% and/or say something like they will keep tightening until they make house prices fall. But these things seem too gutsy given their tentativeness and stop-start policy operation the past three years.

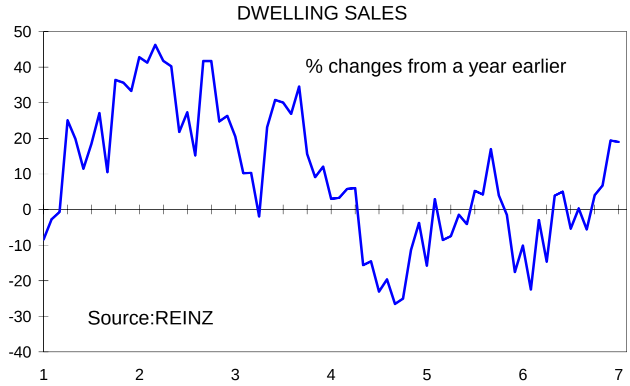
THE WEEK'S ECONOMIC DEVELOPMENTS

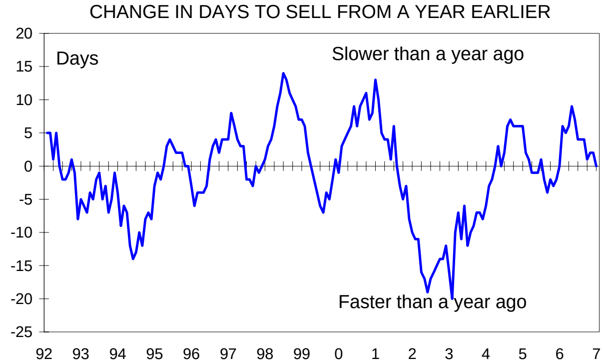
Friday 16

Housing Market Very Strong

The REINZ reported that in January there was 7,566 dwellings sold around New Zealand. This was a very strong 19% gain on a year earlier which followed a similar 19% annual rise in December and means that over the three months to January dwelling sales were up from a year earlier by a firm 14%. In contrast a year ago in the three months to January 2006 sales were 9% down from a year earlier. In spite of the strength in sales the median dwelling sale price eased slightly however to $327,000 from $330,000 in December. But this was still a 9% rise from a year earlier and looking through monthly volatility in this number we see that in the three months to January the average median dwelling sale price was up from a year earlier by a healthy 10.3%.

But the most telling statistic in the numbers comes from looking at the average number of days to sell a dwelling. This was unchanged from a year ago in January at 38 days which was seven days faster than average for the month whereas in December the 29 days taken to sell was two days longer than a year earlier and 6.3 days faster than average and back in May 2006 days to sell was running nine days ahead of a year earlier and only 1.8 days faster than average. There is clearly a shortage of listings and in fact the ratio of sales to listings in January was a record for that particular month of 24.9% using data for the Auckland region from monthly Barfoot and Thompson numbers.





The data unequivocally show a still strong housing market with a shortage of listings implying further increases in house prices. This is the exact opposite of what the Reserve Bank would have been hoping to see and virtually cements in an official cash rate rise on March 8 with near certainty of strong warnings about further rate rises. Of course whether the Reserve Bank follow through with further rate rises is not guaranteed after their failure to follow up their December 2005 increase with anything else. We think the Reserve Bank have deservedly achieved a reputation of dovishness and an attitude of benign neglect to growing inflation problems in New Zealand and the reduced effectiveness of their monetary policy instrument. This is not to say that they don't necessarily care about the negative impact we believe they are having on the economy's long run growth prospects and the export sector. It's just that they are not obliged to take these things into account. All they have to do is come up with their own definition of the length of the business cycle one needs to calculate an average rate of inflation over and try their best to avoid sudden changes in interest rates, the exchange rate, and output. Given that a sustained overvalued exchange rate is not a sudden thing then they get off scot-free.

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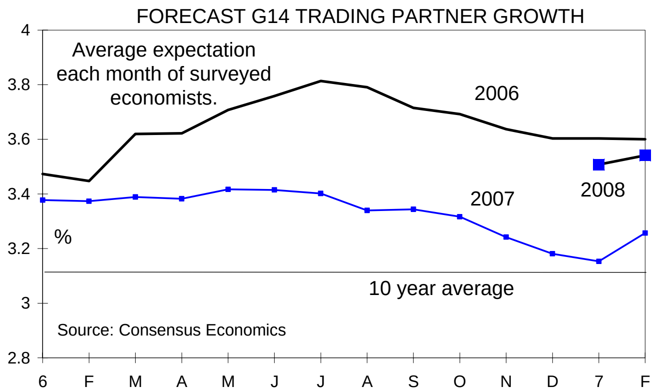
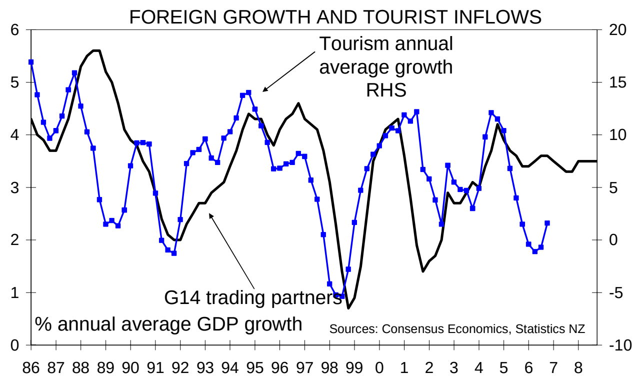
Good Growth Expected Overseas

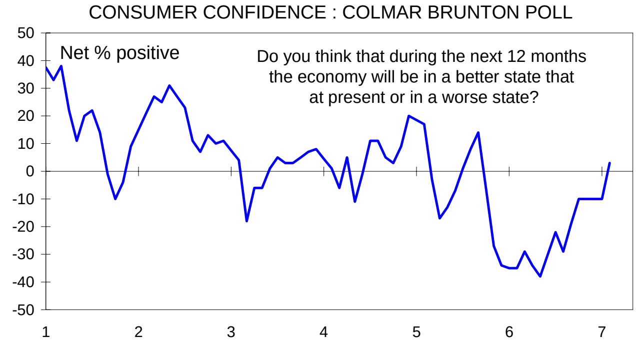
On average New Zealand's top 14 export destinations are forecast to grow by 3.3% this year and 3.5% over 2008 following growth of an estimated 3.6% during 2006. The outlook for 2007 has improved in the monthly Consensus Economics survey of economists around the world mainly because of upgrades to forecasts for growth in the United States, 2.7%, Japan 1.9%, the United Kingdom 2.6%, and the European Union 2.4%. Growth over 2008 is expected to be faster in practically all our trading partners except the United Kingdom where a slight slowdown to 2.4% is expected next year. The first graph below shows how forecasts for growth over 2006, 2007, and now 2008 alter on a monthly basis in the survey. The second graph shows the extremely strong correlation between the rate of growth in our trading partners and the rate of growth in the number of tourists coming to New Zealand. The outlook for good growth overseas shown by the solid black line measured on the left axis shows why we have a positive outlook for the tourism industry in spite of the relatively firm New Zealand dollar.

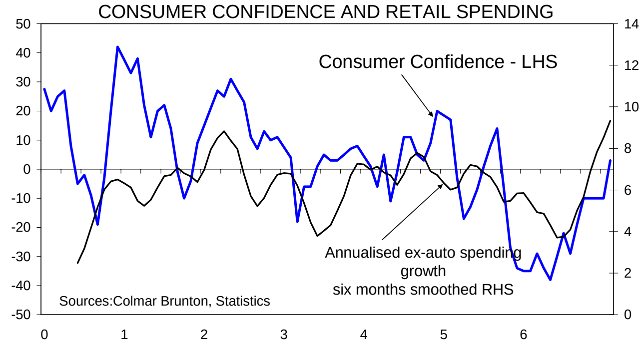




Consumer Confidence About Average

Consumer confidence measured in the One News Colmar Brunton poll improved to a net 3% optimistic about the next 12 months in February from 10% pessimistic in the last survey way back in October. This survey used to be monthly and the absence of surveys since October makes comparison of the two latest results difficult. From the Reserve Bank's point of view does the latest result truly represent an upward trend or was confidence higher a month or two or three ago and is it now easing? Because of this uncertainty we don't think too much can be read into the result. Note however that the average reading in this poll for the past ten years has been a net positive 2% so the best conclusion one can make is that things are definitely not weak with regards to consumer spending prospects. Note the correlation between the confidence index and a smoothed measure of ex-auto retail spending growth.





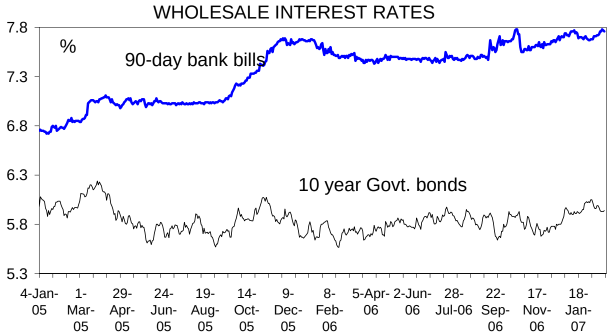
Farm Sales Falling

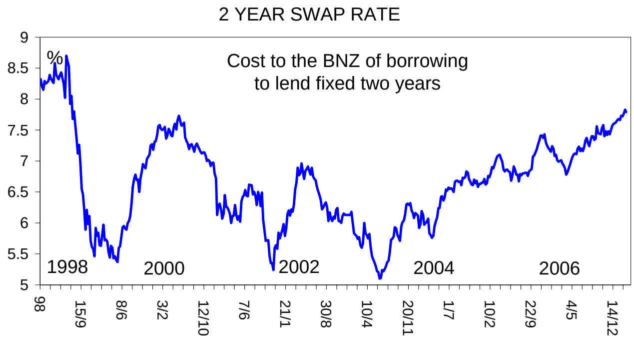
In January there were 140 farms sold around New Zealand. This was a 3.4% decrease from a year earlier and means that in the three months to January sales were down 3.7% from a year earlier while in the entire year to January they were off by 14%. There is a downward trend continuing in farm real estate activity consistent with the anecdotal evidence we are receiving from the rural sector of farmers closing their cheque books with great worries about profitability levels and cash flows in particular. Note however that neither ourselves, any of the other forecasters, or the farmers themselves feel that things are outrageously bad in the sector. It is more a case of most sheep farmers being caught out by an unexpected decline in sheepmeat prices, everybody having to adjust to continuing rises in input costs, and a realisation that perhaps yet again one of the main results of the boom years has been to successfully increase the average cost base for farming. Then there are the ongoing longer term issues of young farmers being priced out of the sector because existing farmers have used the boom to push up the price of each other's land, coupled with worries about the already high average age of farmers. On a positive note beef prices are looking good and the international dairy market remains exceptionally strong assisted by the drought in Australia slashing their production not just for this season but for future seasons to a lesser extent as well.

INTEREST RATES

In the absence of any major data releases causing any change in the already strong market expectation that the Reserve Bank will be tightening monetary policy on March 8 we have seen wholesale interest rates change by very little over the past week. Swap rates have fallen marginally assisted by a slight decline in medium to long-term interest rates in the United States and perhaps also in response to the strong rise in the Kiwi dollar over the past week. In the bad old days before the official cash rate came along in 1999 the one cent rise we have seen in the currency since last Thursday would have caused a decent fall in the 90-day bank bill yield. But that extreme short term relationship between currency movements and short term interest rates no longer exists.

BNZ WEEKLY OVERVIEW





In two weeks time the Reserve Bank will review their official cash rate and release their Monetary Policy Statement. Until that happens we are unlikely to see much movement in wholesale borrowing costs.

If I Were a Borrower What Would I Do?

Being a conservative sort of person I would probably fix for seven years at 7.77%. However for the majority of people fixing two years at 8.17% is probably the optimal thing to do.

BNZ Fixed Lending Interest Rates

	Housing	Average Past 5 yrs	Low Past	High 5 years
Float	9.55%	8.34%	6.70%	9.55%
1 yr	8.60	7.45	6.20	8.60
2	8.17	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	7.99	7.63	6.50	8.60
7	7.77	7.77	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 only relevant piece of information this week was the monthly REINZ release which we have already covered in detail in the Economic Developments section. Suffice to say the sector still has good momentum. The main risk for the coming year or two is if the Reserve Bank seriously tighten monetary policy in the next few months. But if they continue to pussyfoot around then one can pencil in inflation consolidating at a slightly higher level and of course as any property investor knows the higher the average inflation rate the greater the tax free capital gain on housing.

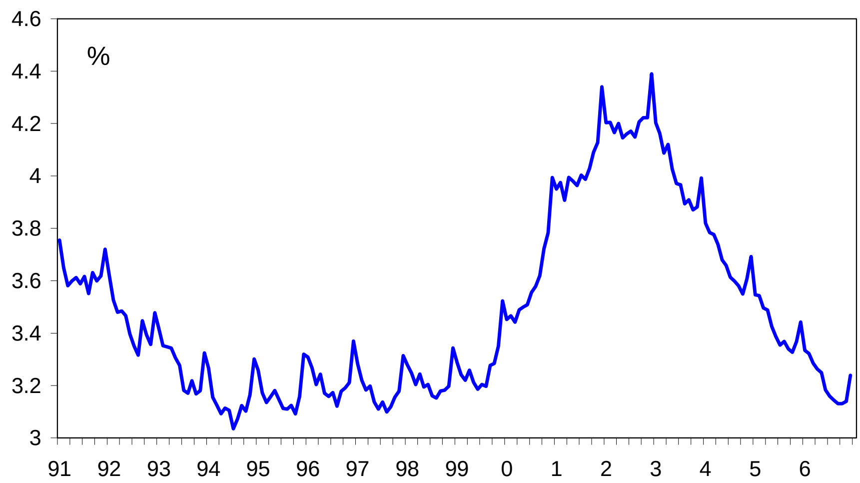
Could the government try to help the Reserve Bank out by introducing a capital gains tax, slashing depreciation rates or removing use of new LAQCs? Given growing housing affordability problems then they could do these things – but probably only as part of a more comprehensive package of measures aimed at improving affordability. These other measures could include the much talked about requirement for developers to set aside areas for affordable housing, freeing up more development land, and maybe various things to reduce construction costs – a separate building code for lower priced housing? Who knows.

But with the election now about 18 months away and an age-old theory saying that the outcome of an election is determined by things about this far out, then the chances of moves to depress a whole swathe of investors and the equity position of heavily indebted first home buyers who have already got themselves into housing does not seem highly probable.

Credit Card Debt

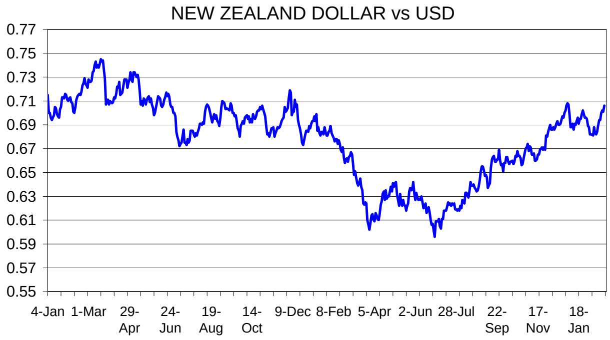
Just for your guide, every now and then the media get excited about the amount of credit card debt in New Zealand. There are undoubtedly many people who have too many cards and are having debt management problems. But it does not appear as though the country as a whole has a particularly big issue. First, credit card debt in NZ at the end of 2006 stood at $4.8b. In Australia the equivalent number was approximately $39b. If we convert the AUDs into NZDs then downgrade the amount to allow for Aussie incomes on average being about 25% more than Kiwi incomes we get a ratio of the size of the credit card debt to population of 1.8 in Australia and 1.2 in New Zealand. Credit debt per capita is less here than there.

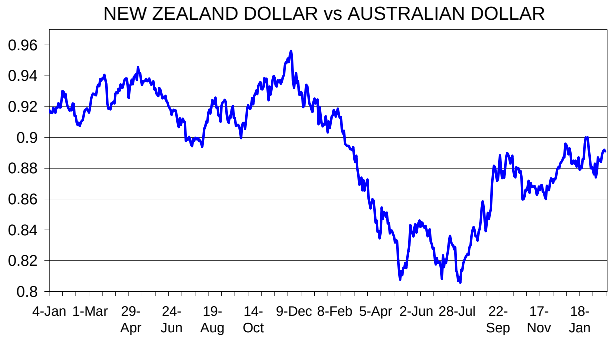
We can also compare credit card debt with total household debt. Back in the period from 2000-2003 when new card structures were appearing offering airpoints etc people sharply increased the debt outstanding on cards to 4.4% of all household debt. But there has been a strong downward trend in credit card debt since 2003. It will be interesting to see if the trend continues or we flatten out now that the old average ratio of about 3.2% has been reached.

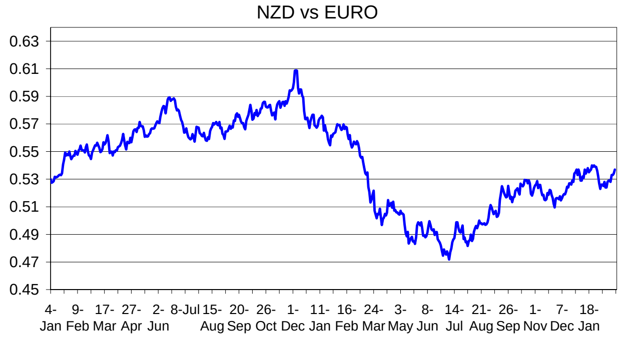


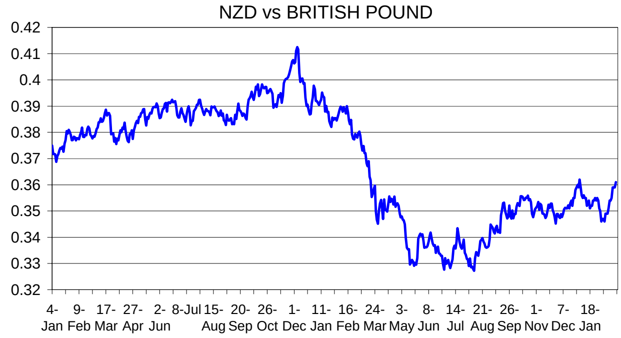
EXCHANGE RATES

The Kiwi dollar has risen firmly over the past week gaining one cent against the US currency to end this afternoon near 70.6 US cents, 89.1 Aussie cents from 88.6 a week ago, 36.1 pence from 35.4, 85.4 yen from 83.6 last week, and 53.7 cents against the euro from 52.9.



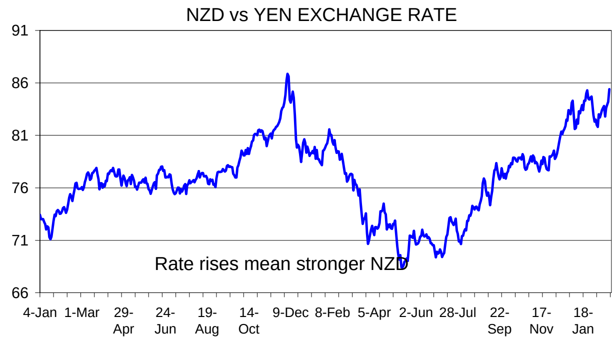


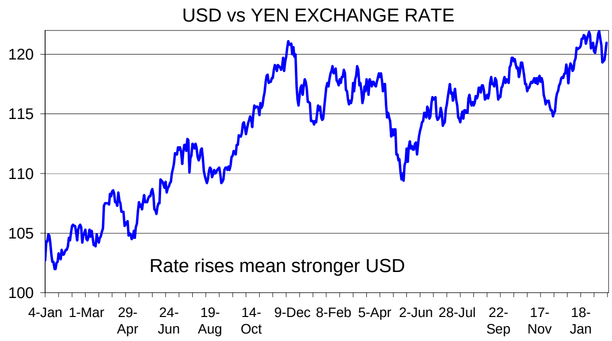




The Kiwi dollar has risen across the board in response to a surge in one of the other dollar currencies - the Canadian dollar - boosted by stronger than expected retail spending numbers, more strong data releases the New Zealand, and relatively dovish comments from the Bank of Japan Governor yesterday following the increase in their cash rate.

As had been expected by about 60% of the market the Bank of Japan raised it's cash rate by 0.25% this week – taking it to a truly whopping 0.5%. Initially the yen gained from this move but the statement from the Governor accompanying the rise was more dovish than expected and expectations of further rate rises have been pared back. The Governor said any further tightening would be done gradually and interest rates would remain low for some time. The concern of the Governor is not to scare consumers back into their burrows as weak consumer spending has been the vulnerable point of the Japanese economy for a long time. Business investment and exports have been the areas of strength in recent years.



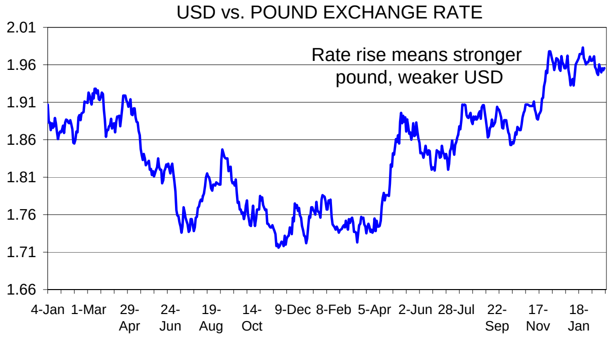


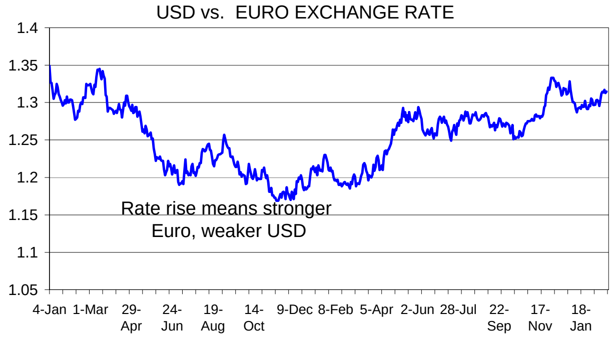
The yen had actually been boosted early in the week by December quarter GDP growing 1.2% which was greater than the market expectation of 0.9% growth. The result included a healthy 1.1% gain in private consumption so the markets had increased the probability assigned to the Bank of Japan raising its cash rate more than once in the near future. Hence the negative reaction to the dovish comments. The Japanese yen has ended the week slightly down against the greenback near 121 compared with 120.7 last Thursday.

The greenback was pushed marginally lower early in the week on the back of some slightly weakish economic data. Industrial production fell 0.5% in January whereas no change had been anticipated and capacity utilisation eased to 81.2% from 81.7%. Consumer confidence measured in the University of Michigan monthly index unexpectedly declined to a reading of 93.3 in mid-February from 96.9 at the end of January. Housing starts also plunged in January.

There was also intense interest in monthly international data showing that for the first time since mid-2005 international investors were net sellers of the USD to the tune of USD11b. This was well below the USD70b inflow which was expected.

But last night we saw some slightly higher-than-expected inflation numbers which jolted some of the building optimism about rate cuts later this year in the US dollar has ended this afternoon up against the British pound near $1.956 from $1.96 last week, but slightly weaker against the euro near $1.315 from $1.312 a week ago.



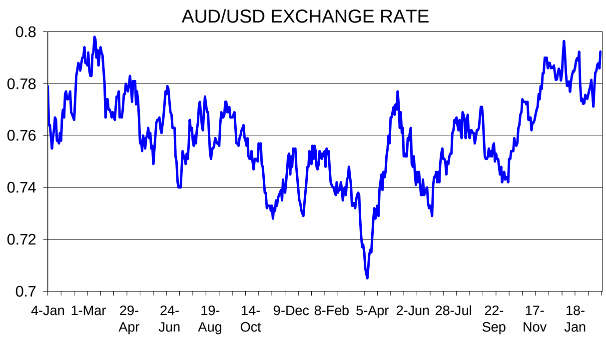


The pound was pushed lower this week by a report that retail spending fell 1.8% in January rather than rising 0.2% as had been expected. In addition an excerpt from a Bank of England report to the Treasury Select Committee suggesting "…some depreciation in the real exchange rate will probably be necessary…" scared traders.

Looking back at the Kiwi dollar now, is it possible that our currency will decline if the RB tighten monetary policy again? Yes it is, but only if they hike 0.5% and warn that their patience is at an end and they will keep raising the rate until they get a correction in house prices. Such a statement would boost expectations of new weakness in the NZ economy and make people think about pulling back on their debt-fuelled housing and retailing binge – not to mention farmland binge. Growth expectations can easily dominate interest rate differentials as we have seen in the past – most notably from late-1999 into 2000 when a cumulative 2% rise in the official cash rate by the RBNZ saw the NZD fall ten cents.

But we doubt that after three years of pussy-footing around the Reserve Bank will act with the degree of aggression needed come March 8. The chances are that while they will raise the cash rate 0.25% and warn they need to see signs of weakness in the domestic economy and housing market. They almost certainly will not say and write things in a strong enough tone to generate scary headlines in the next morning's newspapers. This is what should have been done in 2004 but did not occur – with the price of this policy implementation now being felt by exporters and first home buyers bidding against older buyers with deeper pockets and better access to credit and other assets to gear up off. The future pain will be felt by all when the economy eventually corrects back under the burden of record debt levels and falling house prices.

But it is impossible to put any timeframe on when this eventual correction will occur and that is why most of us economists don't talk in terms of an eventual economic shock but instead of a gradual slowing in the housing and household sector with muted activity over an extended period of time. And the same applies to the NZD. We know it will eventually fall away and history says the correction will be sudden. But because it is impossible to forecast when this will happen we can only put a gradual decline profile in our forecasts/assumptions for exchange rate changes.



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 = 3.0%	0.3	0.4	1.4	2.5	4.4
Unemployment rate	Average past 10 years = 5.3%	3.7	3.8	......	3.6	3.6
Jobs growth	Average past 10 years = 1.9%	-0.1	-0.5	1.4	1.6	4.4
Current a/c deficit	Average past 10 years = 5.5% 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	1.3	1.4	4.9	5.3	4.9
Retail Sales ex-auto	Average past 9 years = 3.8%.	1.5	1.4	4.2	6.0	7.1
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 = 10,400	+14,630	13,210yr	......	6,960	15,108
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	3	-10	-29	-35	17
Business activity exps	10 year average = 26%. NBNZ	24	24	17	-2	27
Household debt	10 year average growth = 11.3%. RBNZ	12.9	13.3	14.1	15.5	15.1
Dwelling sales	10 year average growth = 3.5%. REINZ	19.0	19.4	-5.4	-10.1	-15.8
Tourist numbers	10 year average growth = 5.0%. Stats NZ	3.9	7.1	-11.2	-1.9	5.3
Floating Mort. Rate	10 year average = 8.4%	9.55	9.55	9.55	9.00	8.75
3 yr fixed hsg rate	10 year average = 7.9%	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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