Bank of New Zealand

BNZ Weekly Overview

3 May 2007

FINANCIAL MARKETS DATA

	This week	**Week ago**	**4 wks ago**	**3 months ago**	**Yr ago**	**10 yr average**
Official Cash Rate	7.75%	7.75	7.50	7.25	7.25	6.2
90-day bank bill	8.07%	8.01	7.92	7.69	7.47	6.4
10 year govt. bond	6.08%	6.15	5.94	6.00	5.78	6.5
1 year swap	8.22%	8.22	8.07	7.89	7.35	6.6
5 year swap	7.75%	7.80	7.66	7.37	6.77	7.0
NZD/USD	0.737	0.747	0.724	0.682	0.641	.567
NZD/AUD	0.895	0.896	0.886	0.881	0.836	.859
NZD/JPY	88.6	88.7	85.2	82.5	72.6	66.1
NZD/GBP	0.37	0.373	0.366	0.347	0.348	.342
NZD/EURO	0.543	0.548	0.541	0.526	0.507	.51

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

Monthly BNZ Confidence Survey

There are many, many things happening in the economic arena at the moment with rising interest rates and a high exchange rate, plus booming commodity prices, strong business investment plans especially for construction, high labour demand, infrastructure spending and loose fiscal policy, plus acceptable tourist inflows and rising foreign student numbers. The picture seems confusing. If time permits and you have not already done so in the email used for sending the WO out on Thursday night please cut and paste the url below into your browser, click on it and let us know whether you believe the economy will get better or worse over the coming 12 months. More importantly, pen a few words letting us know how things are looking in your particular industry at the moment (specify which industry it is though!). Thanks

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

A Tipping Point? Not Yet

One theory doing the rounds at the moment is that as a result of the recent sharp rise in the exchange rate and rising interest rates a dam will burst and the positive factors which have been holding our rate of economic growth up will be swamped. The economy will then have a hard landing. Sorry, but if this was ever going to happen it would have occurred last year when the NZD ended 2005 against the AUD near 95 cents and we were above US 70 cents, the RB had raised the cash rate and warned of more to come, petrol prices were soaring, migration numbers had slipped below 6,000 and commodity prices were predicted to fall. Business confidence fell to its lowest level in 32 years while a net 35% of consumers in the monthly Colmar Brunton poll said they felt the economy would get worse – compared with the latest reading of a net 4% negative.

There are a number of key things we have been endlessly stressing since the start of 2004 leading to upside risks for inflation, interest rates and the exchange rate and implications such as the need to boost productivity, train employees, budget for higher expenses and so on. What these things come down to is a combination of a structural deficiency of resources and a list of “insulating factors”.

On the resource deficiency side our argument has been that as a result of under-investment for many years the stronger than expected period of growth from 1999 to 2004 has used up our supplies of electricity, roads, machinery, development land, buildings and people. Lately we have felt the inclination to add houses to this list.

The shortage of resources means that for any given rate of growth in the economy inflation will be higher than when these resources were plentiful. For instance if you grow 4% per annum for four years and start with an unemployment rate of 10% then wage-driven inflation will be minor. If you grow the same with unemployment starting at 7% then wage and inflation pressure will be greater.

What we have learned over the past year is that awareness of resource deficiency is so great businesses held onto their valuable employees last year even though they were saying in surveys they felt the economy was heading over the cliff. This helped generate a soft landing for growth as the traditional method by which bad business confidence causes a downward spiral in growth – rapidly rising unemployment and plummeting capital expenditure and inventories – did not occur this time around.

We doubt that with business confidence set to decline again in coming months we will see the traditional labour market response this time either. The NBNZ Business Outlook survey last week for instance showed that in spite of taking into account the high exchange rate and tightening of monetary policy a net 5.4% of businesses said they plan hiring more people.
http://www.nbnz.co.nz/economics/outlook/070426/default.htm
This is bang on the ten year average. In addition, awareness of the need to invest is so great that intentions of investing in plant and machinery jumped to a net 16.2% positive from 11.2% in March and a ten year average reading of 14.1%. This is the highest reading since March 2005.

The second big factor we have cited for three and a half years has been our list of “insulating factors”. These are things which will not boost growth as such but which provide a cushion during any slowdown. In no particular order of importance this list includes the following.

Low fixed interest rates.
Floating mortgage rates have risen 2.75% since January 2004 when the tightening cycle started but the benchmark two year fixed rate has only risen from 7.4% to about 8.8%. Having said that the rate has risen by about 0.8% in the past four months so some extra restraint will now be coming through as the 30% of fixed rates maturing in the next 12 months roll off from an average rate of 7.7%.

High job security
People feel certain about keeping their jobs so will borrow and spend more than if they fear unemployment. The NZIER's QSBO released a few weeks ago gave no reason for employees to believe they face redundancy soon. A gross 22% of respondents said lack of labour is the main reason they cannot produce more which is the highest reading since June quarter 2005 and well above the ten year average reading of 14%. A net 41% said they find skilled labour hard to find – highest since September 2005 and above the average 34%. Having said that back at the start of 2004 the debt servicing ratio was around 9.8% and will now be about 15% and one day people will have adjusted their debt and spending levels to the new job security environment – at which point the economy will be very vulnerable to a labour market shock! http://www.nzier.org.nz

Infrastructure spending
We need more roads etc. They are being built and more such spending is planned. This keeps a lot of people busy.

Business investment
Businesses cannot easily grow by hiring people nowadays and the warning we started delivering eight years ago was that even if businesses were not expanding wage costs would rise and one would need to boost labour productivity to pay them. This helps explain why business investment intentions remain strong now and have turned up, and why investment actually picked up from the June quarter of last year.

Backlog of construction
Resources are so tight in our economy there are many businesses which have not been able to undertake the construction they wanted to 1-4 years ago. If conditions ease they may get that construction done. And related to the above point, for many businesses higher productivity might best come from a new building rather than machinery or IT. Speaking of which, our monthly BNZ Confidence Survey shows very buoyant conditions in the IT sector. http://www.bnz.co.nz/About_Us/1,1184,3-29-643-2973,00.html

Acceptable growth overseas
If you are going to have a recession in New Zealand you need something close to it overseas. But it was not on the cards that foreign growth would plummet and it remains firm with the consensus pick being growth of 3.3% this year and 3.5% over 2008 from 3.6% last year and ten year average growth of 3.1% per annum. This growth helps explain the reasonable strength in tourist numbers cited by the RB in their statement last week.

Commodity prices
With reasonable growth overseas and big factors like the Aussie drought and subsidy removals in the EU plus growing Chinese protein demand we have seen a sharp jump in dairy prices. The ANZ Commodity Price Index in world price terms was at a record in March some 35% above its ten year average. It is not usual to have a hard landing in New Zealand when there is a terms of trade boom underway!

Easing fiscal policy
More and more attention is going on the role increasing government spending is playing in boosting inflation. And one should not forget the Working for Families package which has tightened labour availability by increasing the effective marginal tax rate. There is an election next year, the polls show the governing party falling behind, and ahead of the 2005 election the coffers were thrown open. The same will happen we expect in the May 2008 Budget if not earlier. This will underpin economic growth and household income expectations.

Immigration
Everyone worries about the brain drain. But the average net migration gain for New Zealand appears to have structurally lifted. The annual gain has averaged over 10,000 in the past decade from 5,000 before that and an average loss of 18,000 from 1978-87. More people means more spending, greater housing demand and a lift in the willingness of investors to hold property even during tough times.

Housing Capacity

We mentioned this in the capacity list but the implications fall here. It is possible that just as businesses are hoarding employees because of the structural shortage of labour, so too will householders hoard property because of a perceived structural shortage of housing coupled with little belief that prices will fall. If people do not believe prices will fall then they won't decide to delay a house purchase for a couple of years when interest rates go up. Instead they hope everyone else gets depressed and sells so they can buy straight away in the same way businesses will be hoping other employers get depressed so they can then hire the employees they lay off.

Offshore buyers

Like the housing item just above we have not cited this before. But it runs along the lines of plenty of people offshore being willing to buy our companies and assets – private equity funds, traditional managed funds, pop stars and so on. In this environment asset prices have an extra underpinning not apparent in the past and their sensitivity to harder economic conditions is reduced.

So what do we have? A structurally higher level of inflation for any given level of growth AND a reduced sensitivity of borrowers to any given level of interest rates. Oh, and this week we learned that the government may subsidise house buyers next year through a shared equity scheme. More demand means higher prices.

The Reserve Bank's fight is nowhere near over. Hang on.

Select Committee Monetary Policy Investigation

Because monetary policy has been implemented in a sub-optimal manner over at least the past four years we suspect the Reserve Bank's impact on growth in the economy and our incomes has shifted from positive to negative. This arises because inflation is being allowed to settle closer to 3% than the previous 2% average. As a result this means the incentive to invest in unproductive housing is increased and the relative attractiveness of setting up a business is decreased. In addition with other economies continuing to average low inflation the cost base of New Zealand companies is increasing at a faster rate than competitors overseas. This has reduced the competitiveness of New Zealand exporters and made the current account deficit trend worse.

In addition because monetary policy was eased too much over 2003 and not tightened enough over 2004 and 2005 exchange rate volatility has been increased. The OECD share our view that it is worth investigating the role this exchange rate volatility may be playing in New Zealand's continuing poor export performance and the absence of growth in standard of living relative to other OECD economies.

Plus, because the Reserve Bank failed to sufficiently recognise the environment in which it operates its official cash rate had changed drastically they neglected to use the OCR more aggressively or ask the Finance Minister for additional instruments over 2004 and 2005. This has meant their fight against inflation is still going on and will probably still be raging over 2008. This has not only pushed the NZ dollar to a post-float high against the greenback recently but has extended the period of time during which the NZD is held at cyclically high levels in order to combat inflation. This has got to be eating very seriously into our export base.

Now the Finance and Expenditure Select Committee has been asked by the Finance Minister to have hearings into ways in which monetary policy may be better implemented. The terms of reference have yet to be decided but once this gets underway the whole exercise is going to be extremely fascinating. This is because every citizen with a barrow to push will come out of the woodwork with their particular method of controlling inflation. Plus there will be some who say the RB should stop trying to control inflation at all. These will usually be people heavily involved in the property sector who made their money when inflation was higher and access to credit a lot harder – except for them.

We can expect to see proposals such as, fix the exchange rate, control bank lending volume growth, control lending ratios, control who the money gets lent to, dumping the NZD and taking Australia's monetary policy, adopting the USD, a capital gains tax on housing, removal tax deductibility of housing investment negative cash flows, slashing depreciation allowances, cutting government spending, giving tax cuts to boost labour supply, cutting business compliance costs, rewriting the Resource Management Act, forcing councils to process building consents faster with fewer rules, force councils to relax land use restrictions, cutting immigration, restricting the power of unions if not employees generally, maybe wage and price controls by a few diehard Muldoonists, stopping banks borrowing so much money overseas, making offshore funding more expensive, decreasing the willing supply of offshore investors by increasing the tax on their interest receipts, savings incentives, shrinking the size of the public sector, targeting growth in one of the many measures of money supply growth, adjusting GST, imposing restrictions on imports, boosting tax rates, any measure that night conceivably boost business productivity growth, a fixed rate levy on home mortgages, banning fixed rate lending, different interest rates for first home buyers other owner occupiers and investors, restricting residential property investment generally, routing out sectors with low competition and imposing extra regulations if not restrictions on prices, cutting welfare payments, raising the age of eligibility for superannuation, reducing super payments etc. to force people to save more for retirement, stopping foreigners buying NZ property if not assets generally, foreign exchange controls such as restrictions on NZD purchases and minimum times funds must be invested in NZDs, getting people with better understanding of the economy to run monetary policy, getting someone more aggressive to do the job, altering the inflation target to make it either looser or tighter like it used to be, easing building standards, compulsory savings, reducing employee minimum leave allowances, cutting petrol taxes, changing the definition of inflation targeted, and so on basically through the whole gamut of economic policy suggestions over the past century.

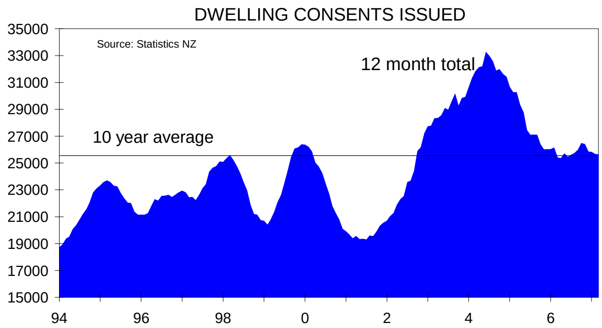
After what are likely to be hundreds of submissions by enthusiasts who feel their voice of reason on monetary policy may finally be listened to the end result will be – no change. Nada. Zilch. But it will present an interesting diversion for a while as long as one understands the enquiry is not a serious attempt to change the monetary policy framework in New Zealand. For those who wish to have some input in this area the invitation for submissions will eventually appear on the following webpage. http://www.parliament.nz/en-NZ/SC/SubmCalled/

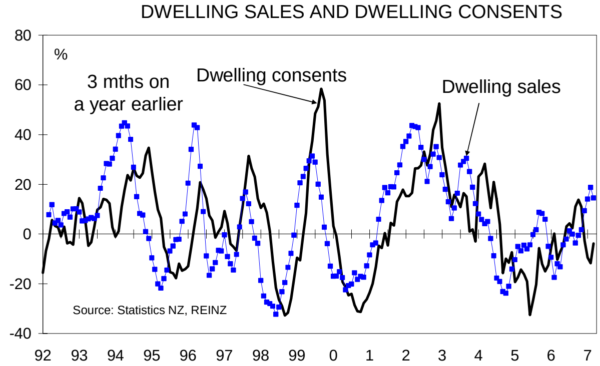
THE WEEK'S ECONOMIC DEVELOPMENTS

Monday 30

Dwelling Consent Numbers Going Nowhere For Now

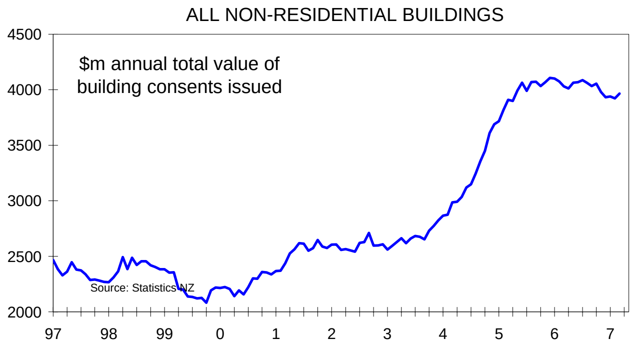
In seasonally adjusted terms the number of dwelling consents issued in March was down by 2.9% after rising 6.3% in February. Over the quarter consent numbers rose just 0.3% from the previous quarter and in unadjusted terms were down 3.3% from a year ago. There is little obvious trend in consent issuance at the moment as best evidenced by the annual number holding near the ten year average of 25,235. The annual aggregate was 25,629 in March compared with 25,406 a year earlier. Our suspicion however is that we will see some growth in consent issuance shortly (good luck to those brave souls going through the process with their local authority). There is quite a strong correlation between a change in dwelling sales and a subsequent change in consent issuance and sales in the March quarter were 14% ahead of a year ago. http://www.stats.govt.nz

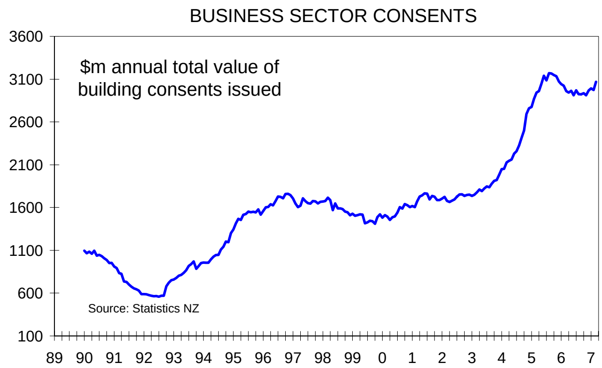




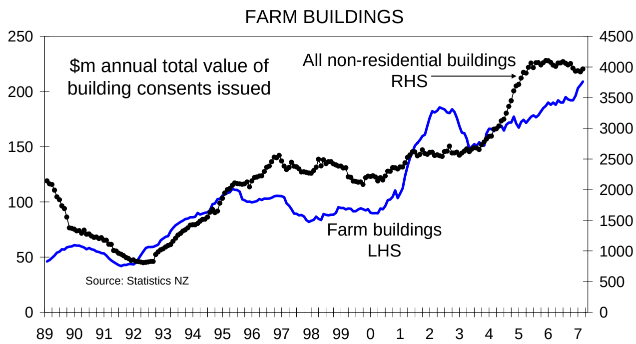
Business Construction Plans Very Strong

The value of consents issued for the construction of non-residential buildings totalled $413 million in March. This was any 11.9% increase from a year earlier which means that during the March quarter consent values were ahead by 3.7% from a year ago while for the entire year to March consent values were down by 1.6%. There is no obvious trend evident in non-residential consent issuance with increases in construction costs likely to be gobbling up the small annual nominal increase recently recorded. But the key thing that needs to be pointed out is that the level of activity remains high and certainly not consistent with a business sector which is so worried about a future of high interest rates and the high exchange rate that they are slashing expenditure on new buildings. http://www.stats.govt.nz





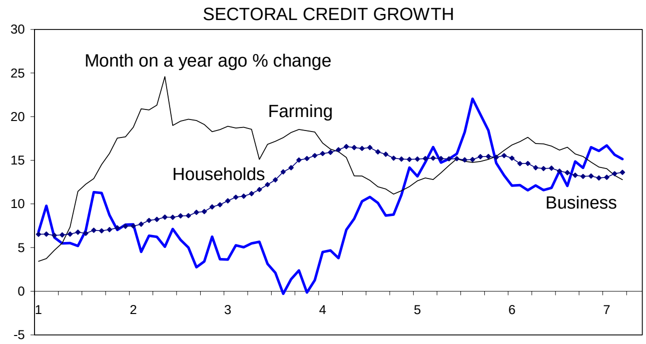
In fact if we strip out categories not obviously business related we get an increase in the value of business consents a year earlier of 39% in March and 16.3% in the March quarter from a year earlier with 3.7% growth for the entire year. Businesses are investing which is very good for productivity growth and this is one reason why we do not have a sad view on the economy going forward. Growth is going to be underpinned by business investment in a wide variety of areas. Perhaps the most interesting result in the numbers is this. In spite of the high NZD and costs rising across the board farmers are still putting up buildings. The value of consents issued for the construction of farm buildings was ahead 28% in the March quarter from a year ago and 10% for the year.

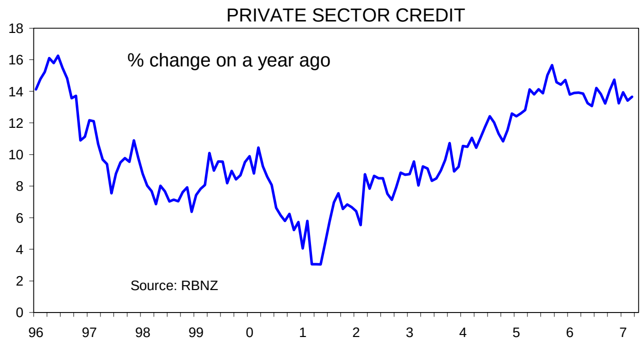


BNZ WEEKLY OVERVIEW

Lending Growth Remains High

The annual rate of growth in lending to the private sector rose in March to 13.7% from 13.4% in February and was 15.9% a year earlier. Average growth for the past ten years has been 10% per annum. The annual rate of growth in lending to the household sector accelerated in March to 13.6% from 13.5% in February compared with 14.6% a year earlier. In seasonally adjusted terms lending to households rose by a very strong 1.3% in March after rising by 1.1% in February and 1.2% in January. This is the strongest monthly rate of growth since September 2005 and there may have been some upward bias to the number as people bought houses and got a fixed interest rate ahead of expected interest-rate increases. Nevertheless the growth is still very strong and we estimate annual growth is about twice the rate which would be consistent with the Reserve Bank achieving inflation comfortably within its 1% to 3% business cycle average target. The annual rate of growth in lending to the business sector eased to 15.1% from 15.6% in February with growth in the March quarter a nominal $1.6 billion compared with approximately $1.8 billion in the same period a year earlier. The annual rate of growth in lending to the agricultural sector slowed to 12.8% from 13.3% in February and this was the slowest annual rate of growth since January 2005. http://www.rbnz.govt.nz/statistics/monfin/



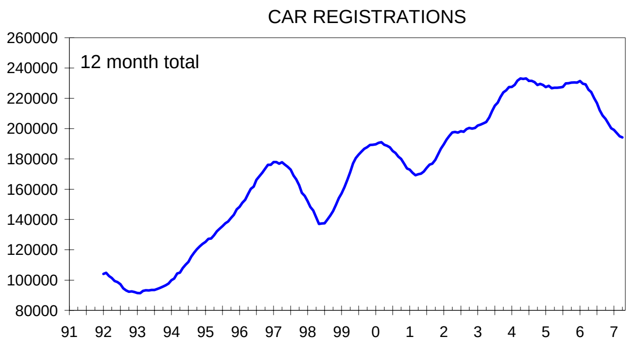


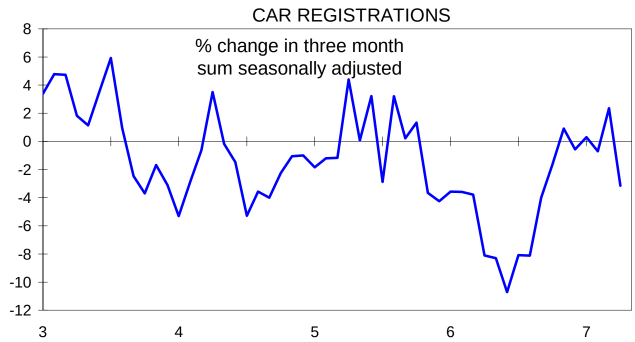
As the graph above shows all rates of lending growth remain relatively strong and certainly not consistent with the woe in the New Zealand economy one might think was occurring going by the focus of the media recently.

Wednesday 2 May

Car Registrations Falling Only Slowly

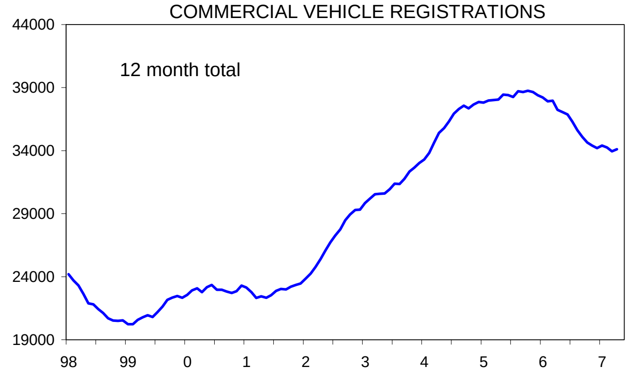
In April there were 14,192 cars registered around New Zealand. This was a decrease of 4.8% from a year ago with regos for the April quarter down 9.7% from a year ago. But three months earlier this annual rate of quarterly decline was 13.1% and three months before that 17.4%. There appears to have been a flattening out in the rate of decline of car registrations. But numbers are still falling and it would be unreasonable to expect an upturn as such as long as average effective interest rates are creeping up, consumer confidence is marginally below average, jobs growth will be constrained by lack of labour, house price growth looking like easing off later this year, and people having had a car buying binge not too long ago. Rationalisation within the motor vehicle retail industry is likely.

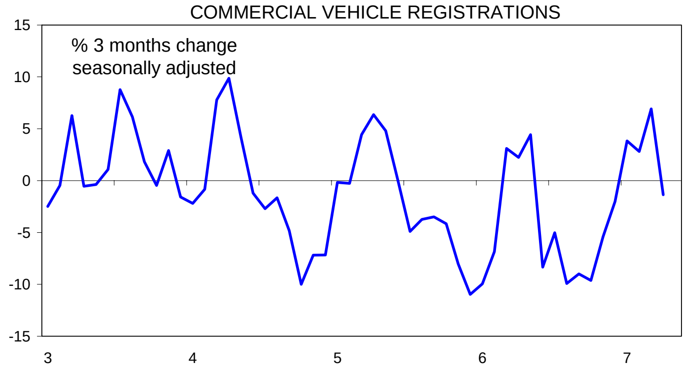




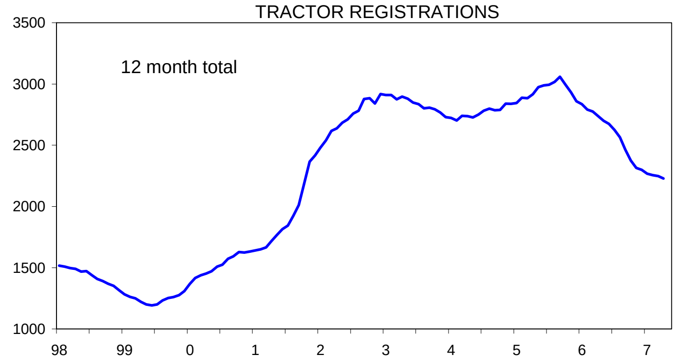
BNZ WEEKLY OVERVIEW

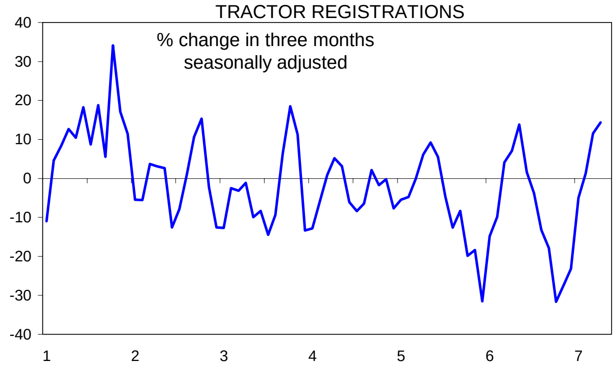
There were 2487 commercial vehicles registered around New Zealand in April. This was a 7.2% rise from a year earlier and for the three months to April there was a 3.5% decline from a year earlier while for the entire year commercial vehicle registrations were down by 8.4%. In rough seasonally adjusted terms registrations have fallen by 1.4% over the past three months. As with cars we have seen a decline in activity over the past 18 months or so but there are signs of things generally levelling out at the moment.





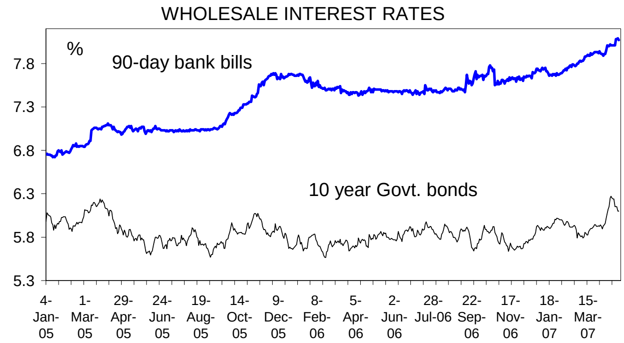
Finally, in April there were 144 tractors registered around the country. This was a relatively large 12.7% decline from a year earlier meaning that in the three months to April tractor registrations were down from a year ago by 7.9% and off by 18.6% for the entire year. But in rough seasonally adjusted terms registrations have improved by about 14% in recent months. So at a minimum there is a flattening out in what has been a fairly rapid downward trend in this measure.

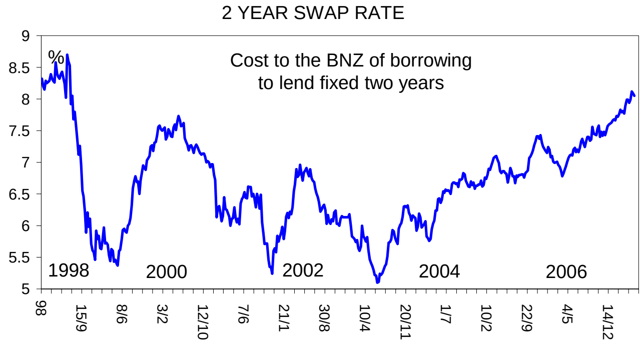




INTEREST RATES

Because the Reserve Bank withdrew their warning about the possible need to tighten monetary policy again in it's rate rise last week the markets have pulled back on their expectations of a further move. This has caused the two year swap rate at which we banks borrow to lend fixed to ease slightly to 8.07% from 8.12% a fortnight ago. 90-day bank bill yields are near 8.08% from 8.01% last week which represents barely any pricing in of a further rate rise.





We are in a period now when the markets are waiting for economic data to be released capturing changes after the two recent rate rises from the Reserve Bank. This is going to take some time therefore we are unlikely to see wholesale borrowing costs change by all that much in the next few weeks. Next Thursday the quarterly Household Labour Force Survey will be released showing the unemployment rate and jobs growth for the March quarter. This tends to be a lagging indicator of what is happening in the economy and is unlikely to cause any ructions in the market. It is likely to confirm that the labour market remains tight which is something we can already see by looking at the likes of the NZIER's Quarterly Survey of Business Opinion.

If I Were a Borrower What Would I Do?

This is not the part of the interest rate cycle when one wants to get a long term fixed rate in place. Instead one wants to go short so it becomes a matter then of floating or fixing one year or two. It costs a lot to float and we do not anticipate floating rates falling for a long time. Plus we don't think a plunge in fixed rates is imminent. So it is a toss up between the one and two year terms. If I was borrowing at the moment I would fix one year at 8.9%. It costs only slightly more than fixing two years, I save over 1% compared with floating (once our rate rise is confirmed), and I anticipate getting a better medium term fixed rate a year from now.

With regard to the small fall in wholesale borrowing costs – is it worth holding off in case fixed rates fall away? One suspects that with the mortgage lending market being so competitive we may see some rate discounting soon. But there is no way of predicting that. All that says to me is that I would probably not fix my rate ahead of expected drawdown within the next couple of months but would take the rate of my preferred term on the day.

BNZ Fixed Lending Interest Rates

	Housing	Average Past 5 yrs	Low Past	High 5 years
Float	9.80%	8.34%	6.70%	9.80%
1 yr	8.90	7.45	6.20	8.90
2	8.79	7.41	5.99	8.79
3	8.80	7.56	6.30	8.80
4	8.70	7.63	6.40	8.70
5	8.60	7.63	6.50	8.60
7	8.60	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	7.40	7.45	7.50
5 yr	7.40	7.45	7.50

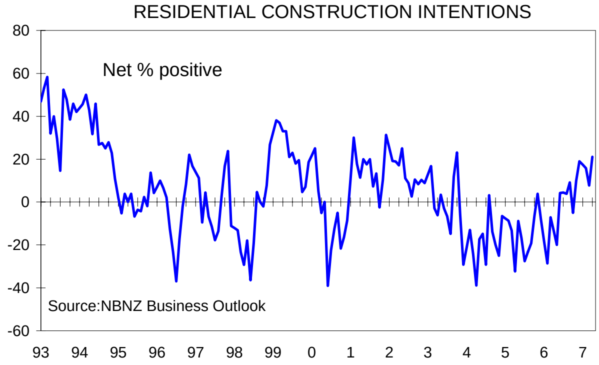
HOUSING MARKET UPDATE

No Acceleration In Dwelling Supply Apparent

There is no indication that the current shortage of housing supply is going to end in a hurry. On average over the past ten years the number of consents issued for the construction of new dwellings has averaged 25,235 per annum. A year ago the annual total was 25,406 and in the year to March this year it was 25,629. Even if we exclude apartments and look at just houses we get no indication of an acceleration in dwelling supply growth. On average over the past ten years housing-only consent numbers have totaled 21,356 per annum. The total in the year to March this year was 21,519 and a year ago it was 21,950.

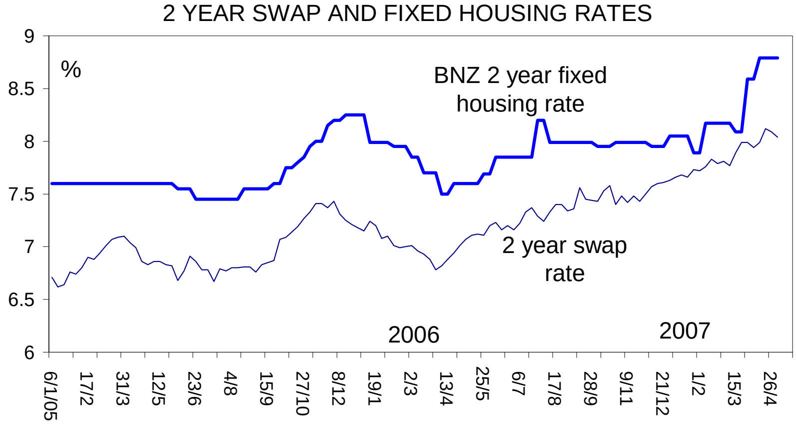
One would have expected that with house prices continuing to rise at a rate between 10% and 15% and with shortages of property around the country greater supply would be forthcoming. It is not and this is just another reason why it is unreasonable to expect that house prices will be falling or that the rate of house price inflation will get exceedingly low.

Having said that we do expect dwelling construction to lift soon. In the NBNZ Business Outlook survey for April a net 21% of construction companies were anticipating higher residential construction. This was up from 8% in March, the highest reading since October 2003 and well above the ten year average reading of 0.4%. http://www.nbnz.co.nz/economics/outlook/070426/default.htm



Interest Rate Falls Possible

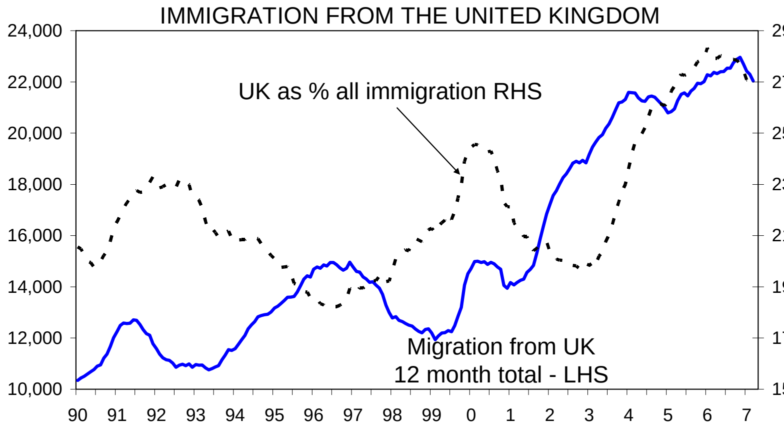
Last week the Reserve Bank raised the official cash rate as the markets had anticipated but failed to warn that further rises may be needed. This was a weaker statement then than in previous reviews and as a result we have seen the markets pricing out expectations of another rate rise. This has caused a rally in wholesale fixed borrowing costs facing us banks. For instance two weeks ago the cost to us of borrowing money to lend fixed two years was 8.12%. Now it is 8.05%. The three year swap rate has fallen from 8.02% to 7.93%, and the five year rate from 7.87% to 7.75%.



As a result of these declines lending margins have obviously increased. The home lending market is extremely competitive and one suspects that soon we could easily see fixed rates falling slightly. This does not mean that we are talking about a boost to the housing market as such because the 30% of fixed rates coming up for renewal in the coming year will be rolling off at an average rate of 7.77%. But the extent of the coming restraint may be less than earlier feared.

Why Tommy Comes Here

In the year to March the number of permanent and long term migrants to New Zealand from the United Kingdom was 22,034. A year earlier this was about the same at 22,367, two years ago 20,946, three years ago 21,563, and four years ago 19,648. The average for the past four years has been just over 21,500. For the previous four year period the average was near 15,700 and in the four years before that between 1995 and 1999 the average was just over 13,700. So there has been a firm upturn in migrant inflows from the UK in the past few years as shown by the solid blue line in the graph below.

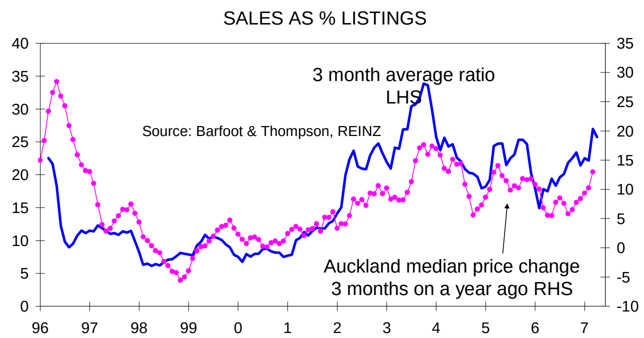


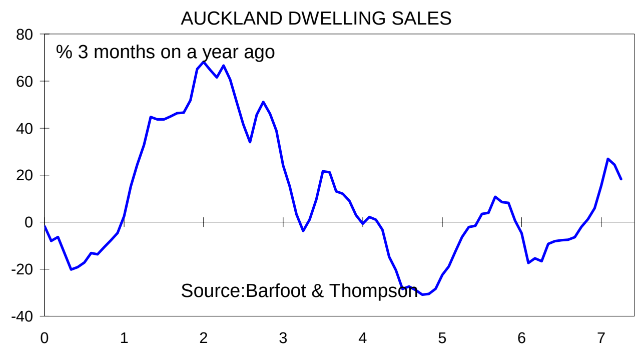
As a proportion of the total number of inward migrants the UK contribution in the year to March was 26.7% which was down slightly from 28.3% in the year to January 2006. That result was the highest such contribution since this particular series started in 1979. Why the lift in UK immigrants? It certainly won't be for the money and instead one suspects factors such as the exchange rate still offering good purchasing ability from one's savings or sale of a property back in the UK, better weather, better environment generally for bringing up a family (very subjective that one), ability to buy a piece of land and work in a city, and perhaps general discontent with how the fabric of British society seems to be changing.

A headline caught one's eye in the newsstand this week in a paper only expats probably ever buy. The 'International Express" NZ edition of 26 April – 2 May ("56 pages of news from Britain"!)had the front page heading "Immigrants Are Ruining The British Way of Life." We have no idea whether this is true or not or whether this is a new phenomenon or something that people have long felt. But the sentiment appears to be some years ahead of the thread you will find running through recent migration policy changes in Australia and New Zealand recently. These changes – most noticeable in Australia – are aimed at ensuring immigrants accept Australasian values and integrate into our societies rather than recreating their old villages etc. in this new land. Funny – isn't that exactly what the British migrants in the 1800s did? http://www.stuff.co.nz/4000944a10.html

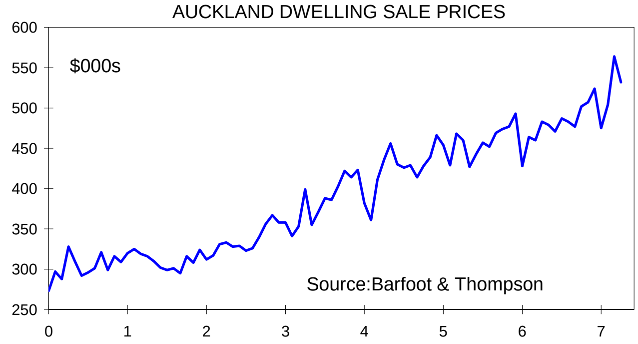
Monthly Barfoot and Thompson Data

Today Barfoot and Thompson released their monthly data on transactions in the Auckland residential real estate market. During April they sold 899 dwellings which was an 8.4% rise from a year ago meaning in the three months to April their gain in sales from a year earlier was a healthy 18.2%. The total number of listings at the end of the month was down by 20% from a year earlier and the sales to listings ratio stood for the month at 21.1%. This was the highest reading for any April since the 2002 reading of 22%. This indicates to us that property still remains in relatively short supply.





The median dwelling sale price eased over the month to $532,000 from $564,000 in March. However this indicator is hugely volatile and one needs to smooth the measure over a three-month period to get a feel for what is happening with Auckland house prices. Doing this we see that in the three months to April the average dwelling sale price was $533,000 compared with $502,000 in the three months to January. This was a 13.7% increase from a year earlier compared with a 7.7% rise for the January quarter number. Clearly prices on average are still going up.



Government Shared Equity Scheme To Underpin prices

One suspects that with all the talk about exporters struggling, the Reserve Bank raising interest rates, and some people giving up hope of ever being able to buy a house that house prices might actually fall. Fear not because the government is seriously contemplating a shared equity scheme targeted at areas of lowest home affordability. The details are of course absent with lots of consultation yet to be done and no formal announcement likely until next year. But it would run something like this. http://www.nzherald.co.nz/category/story.cfm?c_id=76&objectid=10437098

You find a house you like but can't afford the $400,000 price tag. So you pay $300,000 with the government paying the other $100,000. You pay no interest on the $100,000 taxpayer contribution and instead only have to give some capital gain away when you sell the house. This is a Godsend for vendors. Imagine you have that $400,000 house for sale and bids are coming in around $380,000. You look through the list of interested people supplied to you by the real estate agent and see one couple are first home buyers. You call them in and point out that instead of you accepting their $360,000 bid you will sell for $400,000 but they just get the remainder from the government. Fine, and so far just as we described above. But as the vendor one would point out to them that rather than getting $40,000 off the government, get the full $100,000 and use the remaining $60,000 borrowing ability confirmed by the bank to outfit the place with new furniture, get renovations done, get a new car and go for a holiday! Cool.

To find out about how shared equity works you can look at the product distributed by Adelaide Bank. You can start at their website http://www.adelaidebank.com.au/ or go straight to the company offering the product at http://www.efm.info/

Here you will find on the front page the key reason why we think shared equity is the wrong thing to be introducing at a time when the Reserve Bank is trying to stem inflation. On the front page of the website you will find the line

"Buy up to a 25% more valuable home."

The product is about giving people extra money with which to bid. The only catch as far as we can see is that if you get a 10% contribution to the purchase price under this Aussie scheme you will give up 20% of your capital gain. If a 20% contribution then you give up 40%.

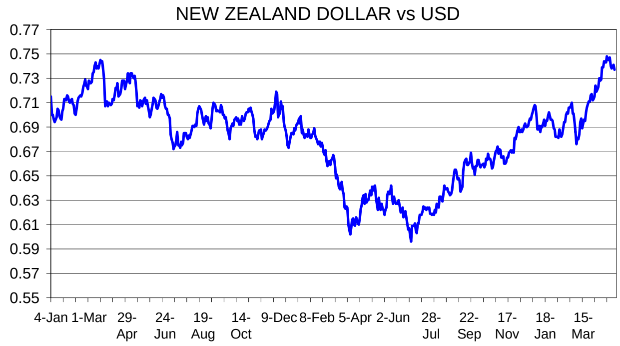
The product is available practically to anyone with a 5% deposit. One suspects that with the NZ government doing the marketing job of getting Kiwis used to the idea of shared equity we will see private financial institutions here eventually offering the product. This will add additional upward pressure to prices beyond that which will come from the government's scheme however limited it may be.

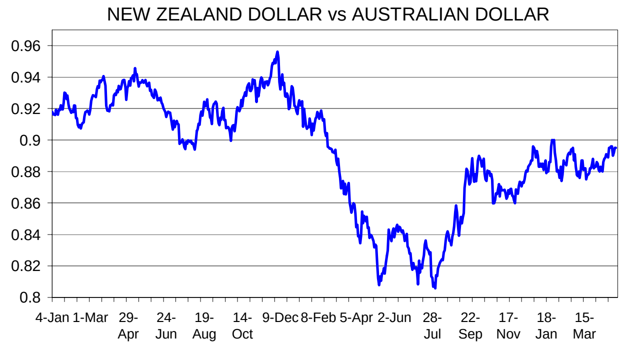
It is laudable that the government is looking at ways of helping first home buyers. But by effectively adding to the demand for houses this move will place extra upward pressure on prices. In addition it will discourage investors from selling at the moment because they know better demand is coming. This will tend to boost prices, keep inflation up, cause the Reserve Bank to raise interest rates further, limit their ability to cut rates for even longer, and cement in higher interest rates on average. So as we wrote in August last year and again this year - back issues at http://www.bnz.co.nz - and taking into account this week's news and the long list of factors we discussed in the Weekly Overview three weeks ago we feel perfectly comfortable with our title "Heck, one may as well keep buying."

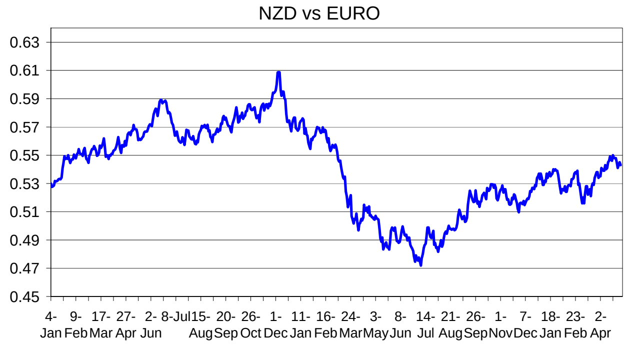
Having said that one has spoken to a journalist who has heard whispers of government moves on LAQCs and/or depreciation allowances.

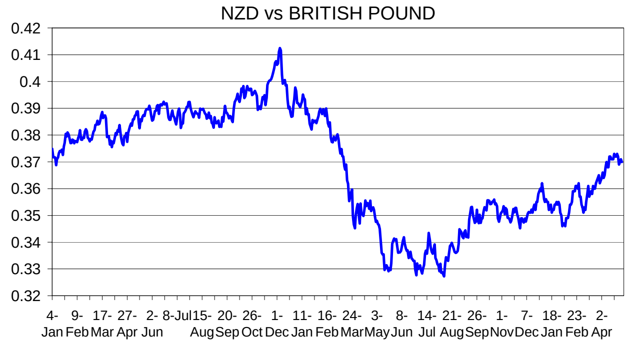
EXCHANGE RATES

The NZD has eased slightly this week on the back of some recovery of the greenback, weakness in the AUD, the general mood created by stories of exporters closing down, the absence of a further tightening warning from the Reserve Bank last week, and general profit-taking. Against the USD the NZD has ended this afternoon down one cent from a week ago at 73.7 cents. Against the AUD we are barely changed near 89.5 cents from 89.6, against the yen near 88.6 from 88.7, the euro 54.3 cents from 54.8, and against the pound 37 pence from 37.3.



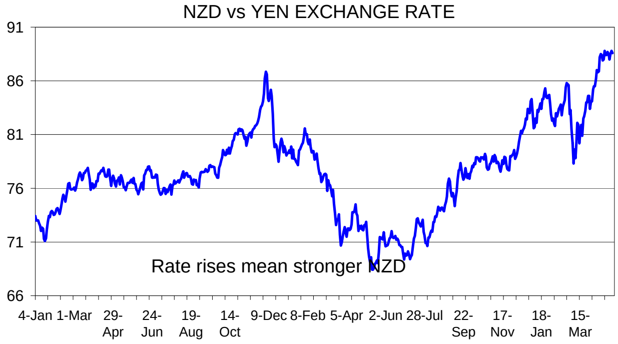


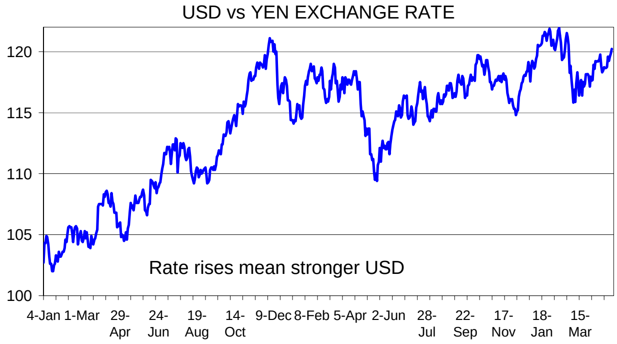




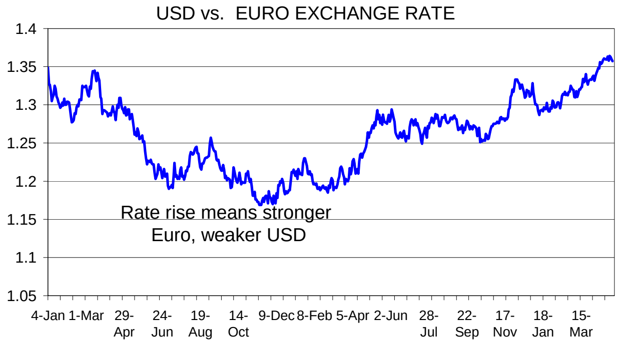
The NZD remains vulnerable to ever changing attitudes toward risk but this week with the US sharemarket hitting record levels worries about risky assets like the NZD are low. Next week we may see some movement if the March quarter Household Labour Force Survey due out on Tuesday turns out to be different from market expectations.

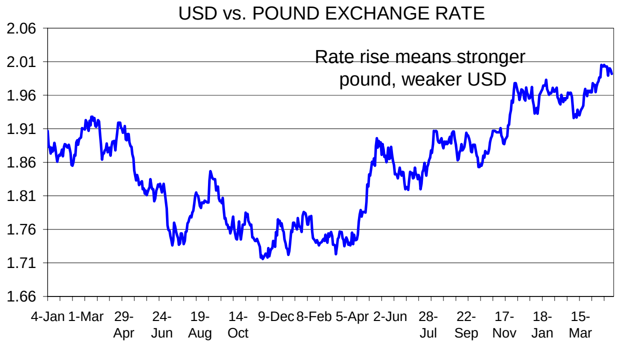
With regard to the greenback, as has been the case for many weeks, months and in some respects years since emerging from recession in late-2001, data released in the US over the past week has been as mixed as ever. The main weak number was annualised GDP growth during the March quarter which came in at just 1.3%. This was well down from 2.5% in the December quarter and an expected rise of 1.8%. But factory orders released last night were up a surprisingly strong 3.1% in March which was the largest monthly gain in a year. The ISM manufacturing index also rose to 53.1 in April which was the highest reading in 11 months and suggestive of reasonable growth in the manufacturing sector.





Debate rages about whether the Fed. will be cutting interest rates this year though the prevalent view is that a cut is likely in the December quarter. This Friday night the important monthly payrolls report will be released and as usual it has capacity to flick the USD one way or the other depending upon whether the report is perceived as weak or strong.

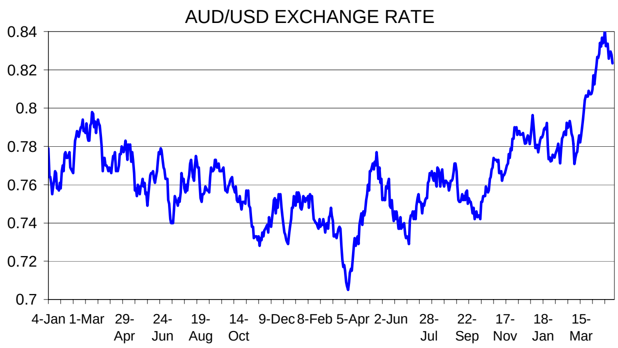




The US dollar has ended against the pound this afternoon near $1.99 from $2.0 last week, 120.2 Japanese yen from 118.7 last week, and $1.357 against the euro from $1.363 last week.

Despite the rise in the greenback it has been a strong week for the British pound on the back of a strong retail spending measure raising expectations that the Bank of England will raise its cash rate from 5.25% at its meeting next week. The Japanese yen meanwhile continues to be relatively weak with the market having little expectation of an imminent rate rise from the Bank of Japan and low expectations of any coordinated efforts to strengthen the yen following the absence of any indication of such in the Group of Seven Finance Ministers communiqué released a few weeks ago.

The AUD suffered this week as the RBA confirmed the absence of a further increase in its cash rate. This wasn't really a surprise but it was taken by the markets as an opportunity to take profits following the AUD's strong rise in recent weeks. Next Tuesday the Commonwealth Budget will be delivered and this may generate some activity. Like the Kiwi dollar the Aussie dollar has fallen about one cent against the greenback over the week to end is near 82.3 cents.



Data Sources

- Interest rates & exchange rates (both from 1985) from RBNZ at
http://www.rbnz.govt.nz/statistics/
- Housing fixed interest rates – our data from 1991 email tony.alexander@bnz.co.nz
- House mortgage data broken down many ways – RBNZ at
http://www.rbnz.govt.nz/statistics/monfin/rbssr/rbssrpartE/data.html
- House price information - REINZ at
http://www.reinz.org.nz/reinz/public/market-information/market-information_home.cfm
- The majority of economic series available in New Zealand come from Statistics NZ. This includes, inflation, employment, external accounts, retail spending, gross domestic product and so on. Their website can be torturous but one should start at
http://www.stats.govt.nz
- Government accounts, NZ Treasury at
http://www.treasury.govt.nz/financialstatements/
- Australian data go to
http://www.abs.gov.au/ and http://www.rba.gov.au/
- Parliament, select committees, publications etc.
http://www.parliament.nz/en-nz

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	0.5%	-0.2	2.5	3.4	2.7
GDP growth	Average past 10 years = 3.0%	0.8	0.3	1.5	2.2	4.5
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	9.0	9.2	......	9.0	6.6
Terms of Trade		2.4	-2.2	3.7	-1.9	4.4
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	+12,090	13,160yr	......	9,746	10,013
Tourist - yr ago grth	10 year average growth = 5.0%. Stats NZ	3.2	5.4	2.8	-0.4	10.4
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	-4	-2	-10	-34	-17
Business activity exps	10 year average = 26%. NBNZ	24.1	25.7	15	5.2	29.9
Household debt	10 year average growth = 11.3%. RBNZ	13.5	13.1	13.3	14.6	15.2
Dwelling sales	10 year average growth = 3.5%. REINZ	8.9	19.0	-5.6	-2.9	-8.6
Floating Mort. Rate	10 year average = 8.1%	9.80	9.80	9.55	9.55	9.00
3 yr fixed hsg rate	10 year average = 7.9%	8.80	8.50	7.89	7.60	7.80

ECONOMIC FORECASTS

Forecasts at May 2 2007	March Years					December Years				
	2005	2006	2007	2008	2009	2005	2006	2007	2008	2009
GDP - annual average % change										
Private Consumption	5.2	4.3	1.7	2.3	0.5	4.7	2	2.6	0.6	1.3
Government Consumption	4.6	4.7	4.1	3.3	3.9	4.1	4.2	3.5	3.8	3.2
Investment	6.7	4.1	-4.8	6.3	6.2	3.3	-3.4	3.7	6.7	5.3
GNE	5.7	3.9	0.4	4	2.7	4	0.4	3.9	2.8	2.7
Exports	4.5	-0.3	3.2	2.4	4.2	-0.6	2	2.6	3.9	4.9
Imports	12.4	4.1	-2	5	4.6	5.5	-2.5	4.4	4.7	4.6
GDP	3.9	2	1.7	2.7	2.4	2.2	1.5	2.6	2.4	2.7
Inflation – Consumers Price Index	2.8	3.3	2.5	3.2	3.2	3.2	2.6	2.9	3.2	2.7
Employment	3.4	2.6	0.8	1.7	1.5	1.6	1.4	1.9	1.4	1.5
Unemployment Rate %	3.8	3.9	3.8	3.9	4.1	3.6	3.7	3.8	4.1	4.4
Wages	2.9	4.6	5.7	5.6	3.9	5.1	5.5	5.6	4.2	2.8
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.64	0.7	0.66	0.58	0.7	0.69	0.68	0.59	0.57
USD/JPY	105	117	117	110	111	119	117	112	110	109
EUR/USD	1.32	1.2	1.32	1.35	1.26	1.19	1.32	1.35	1.28	1.23
NZD/AUD	0.93	0.87	0.88	0.85	0.76	0.94	0.88	0.85	0.77	0.76
NZD/GBP	0.38	0.36	0.36	0.34	0.31	0.4	0.35	0.35	0.31	0.31
NZD/EUR	0.55	0.53	0.53	0.49	0.46	0.59	0.52	0.5	0.46	0.47
NZD/YEN	76.8	74.6	81.9	72.6	63.8	82.7	81	76.2	64.9	62.3
TWI	70.7	65.6	68.6	64	57.4	71.9	68	65.8	58.4	57.3
Official Cash Rate	6.56	7.25	7.50	7.75	6.75	7.00	7.25	7.75	7	6
90 Day Bank Bill Rate	6.86	7.55	7.88	7.94	6.96	7.49	7.64	7.97	7.19	6.25
2 Year swap	6.82	6.99	7.84	7.22	6.6	7.24	7.48	7.53	6.71	6.45
10 Year Govt Bond	6.04	5.71	6	6	5.6	6.03	5.89	5.77	6.05	5.7

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.