BNZ Weekly Overview

7 June 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	7.75	7.50	7.25	6.2
90-day bank bill	8.18%	8.18	8.10	7.83	7.48	6.4
10 year govt. bond	6.54%	6.38	6.13	5.82	5.78	6.5
1 year swap	8.36%	8.33	8.21	7.94	7.48	6.6
5 year swap	8.06%	7.96	7.70	7.40	6.90	7.0
NZD/USD	0.756	0.73	0.735	0.681	0.627	.567
NZD/AUD	0.892	0.887	0.895	0.88	0.846	.859
NZD/JPY	91.6	88.8	88.3	79.6	70.9	66.1
NZD/GBP	0.379	0.369	0.369	0.353	0.337	.342
NZD/EURO	0.56	0.544	0.541	0.52	0.489	.51

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

Monthly Survey Time

It's that time of month again when we run our survey of Weekly Overview readers. If you have not already done so in the email used for sending out this weeks edition 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 if you can take a few seconds to let us know how conditions are currently in your industry specifying what that industry is. We have had extensive feedback indicating that these anecdotal pieces of evidence are quite valuable in getting a feeling for what is happening in the economy and particular sectors. The results will be released early next week.

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

The main things we have learned about the New Zealand economy this week are that commodity prices are still rising very strongly with dairy prices up another 11% over the past fortnight alone. We have also learnt that there are still declines underway in commercial vehicle registrations and passenger car registrations but that the all-important tractor registrations indicator has improved in seasonally adjusted terms by about 18% over the past three months.

The main event for the week however has been the Reserve Bank's tightening of monetary policy with New Zealand's cash rate now sitting at 8% compared with 5.25% in the United States and United Kingdom, 6.25% in Australia, 4% in the European Union, and 0.5% in Japan. There remains a reasonable chance that the Reserve Bank will need to raise the cash rate again although this is heavily dependent on what the economic data show over the next few months. We can see evidence of some weakness in a few economic indicators such as lending to the business and farming sectors along with declining consumer confidence and business activity, employment, and investment intentions.

But many of the other indicators still show high strength and in particular the dairy boom is going to stimulate growth in the economy over the next few years and we all know that next year's budget is going to contain a very large easing of fiscal policy. So there is a lot of water to go under the inflation bridge as yet and all we can do is keep reminding people of what we have been saying for the past three and half years. As a result of the interaction of a long list of insulating factors and a structural decline in resource availability in New Zealand inflation risks have structurally shifted to the upside. This means upside risks to both interest rates and the exchange rate and for the moment one cannot say that interest rates will not need to go up again.

One should also not be optimistic about the New Zealand dollar falling away strongly in the near future as it is going to remain very well supported by the combination of high interest rates, high commodity prices, and what we expect to still be a reasonable growth outlook for the New Zealand economy over the next few years. This week we have seen the New Zealand dollar soar on the back first of all on growing expectations that the Reserve Bank would tighten monetary policy again combined with a surge in world investor preference for the carry trade whereby people borrow in yen and invest in high yielding currencies like the Kiwi dollar. And of course today the Kiwi dollar has received an extra strong boost as a result of the tightening of monetary policy which was not fully anticipated in the market.

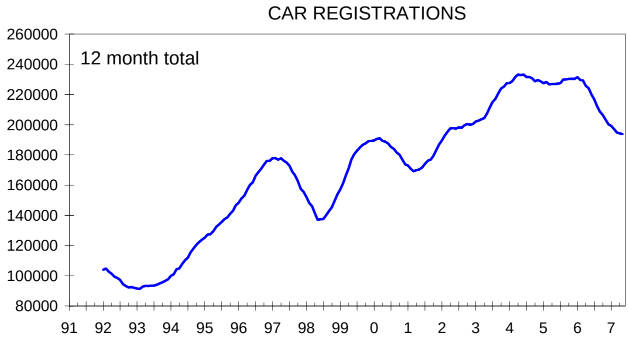
Our recommendation for conservative budgeting purposes is not to anticipate in your cash flow projections any easing of monetary policy or substantial decline in the New Zealand dollar for two years. The chances are we will see these things falling before the two years are up but in this case it's best to plan for the tight scenario.

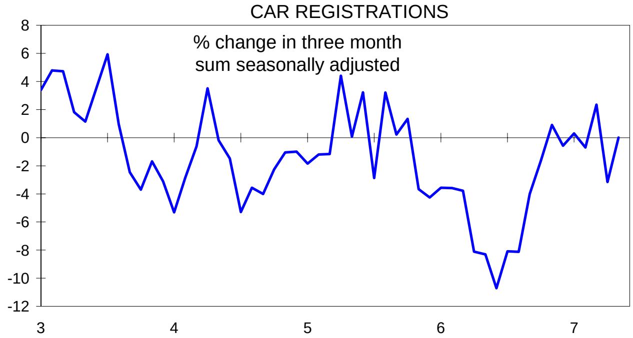
THE WEEK'S ECONOMIC DEVELOPMENTS

Tuesday 5

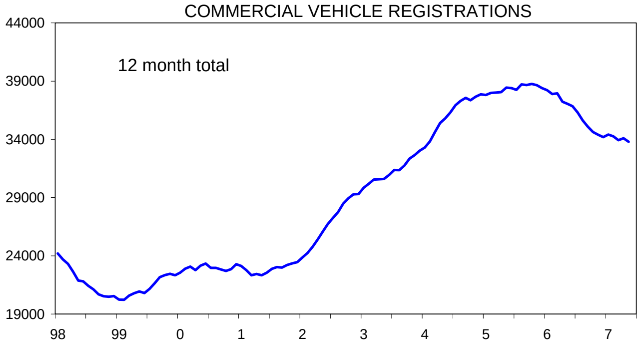
Vehicle Regos Falling – Except For Tractors!

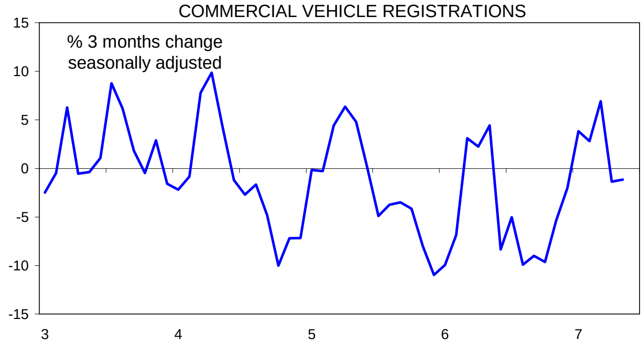
In May there were 17,356 cars registered around New Zealand. This was a 2.5% decline from a year earlier and in the three months to May registrations were down 6.3% from a year ago. In rough seasonally adjusted terms however registrations were flat in the three months to May after falling for most of the time over the past three years. There is a hint therefore that the downward trend is flattening out though this would seem a premature conclusion in light of our expectation that house price inflation is going to slow down and with strong anecdotal feedback from the motor vehicle industry of weakness in car sales and interest rates creeping higher.



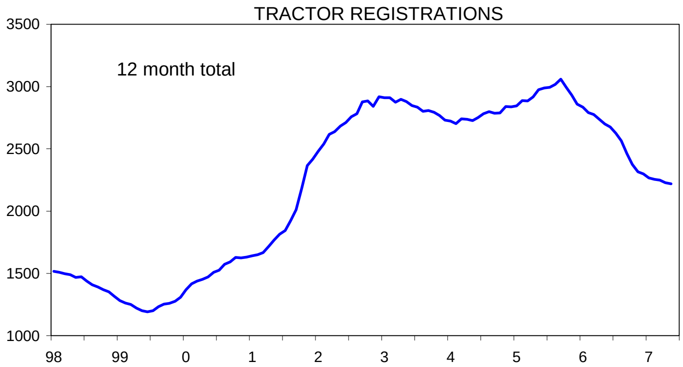


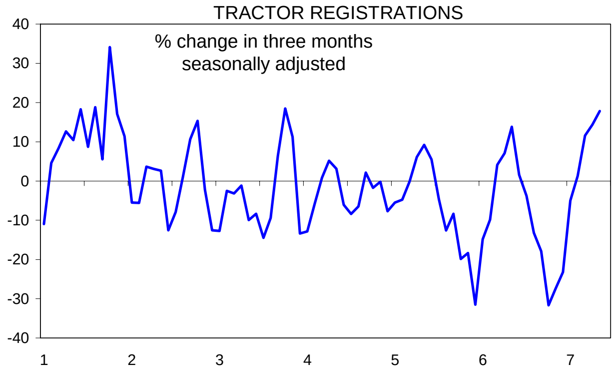
There were 2,999 commercial vehicles registered around New Zealand in May which represented a fall from a year earlier of 9.5% following a 7.2% increase in April. In the three months to May commercial vehicle registrations were down from a year earlier by 5% and in seasonally adjusted terms were down 1.1% over the previous three-month period. So there is a downward trend underway in this area of business capital expenditure - but the downward trend is relatively mild.





But we get a different picture of things when we look at the massively important indicator of tractor registrations. In May there were 191 tractors registered around New Zealand which was a small decrease from a year earlier of 4.5%. In the three months to May there was a decrease from a year earlier of 6.8%. But in seasonally adjusted terms in the three months to May tractor registrations were up a very strong 17.8% from the three months to February. So to all those who feel that the recently announced increase in milksolids payout by Fonterra will go towards paying off debt we say think again. The increased payout is clearly going to be stimulatory to the economy - or at least tractor importers and distributors.

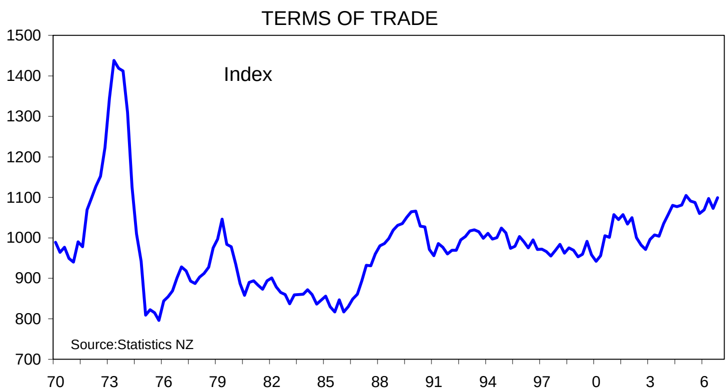


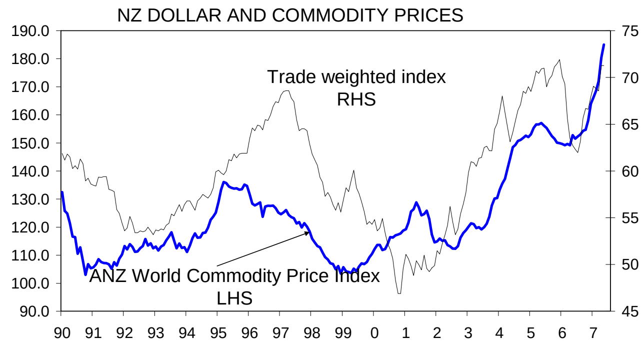


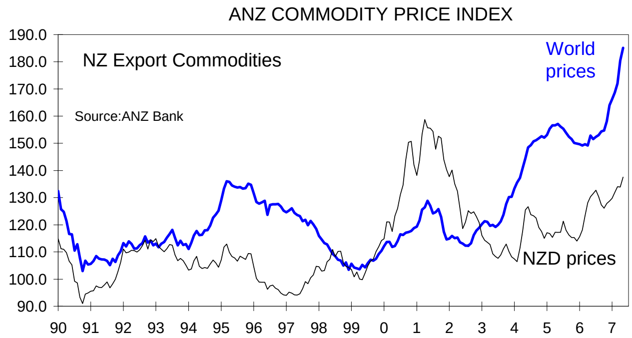
Wednesday 6

Commodity Prices Still Soaring

The ANZ Commodity Price Index in world price terms rose by 2.6% in May. This was the 11th monthly increase in a row and was led by a 5.8% lift in dairy prices, 6.9% rise in sawn timber prices, and gains of 3.2% for wool, 3.2% for Kiwifruit, 2.2% for venison (now at a five year high) and 1.2% for seafood and skins. Over the past year the world price index has gained a whopping 21.1% and now sits 44% above its ten year average. New Zealand is enjoying a fresh terms of trade boom which follows a boom in the mid-1980s which helped mask the temporary negative effects of the 1984-87 reforms, and a boom from 2001 – 2005. This is strongly supportive of growth going forward and also suggests that the NZD is going to be strong for a long time yet. Dairy prices have risen 74% over the past year.
http://www.nbnz.co.nz/economics/outlook/070531/default.htm





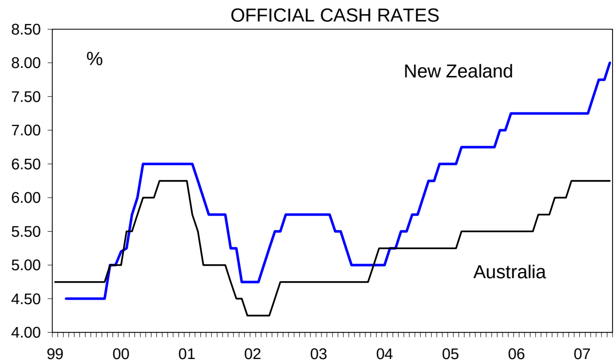


Thursday 7

Monetary Policy Tightened

As we have been expecting the Reserve Bank tightened monetary policy today by raising the official cash rate 0.25% to 8%. The cash rate started this tightening cycle at 5.0% back in January 2004. There was nothing startling in the statement from the Reserve Bank accompanying the increase. They noted upside risks to continuing strong growth in the domestic economy, shortages of capacity and in particular skilled and unskilled labour, firm business investment and employment intentions, increasing government spending, and the increase in economic activity and inflation expected from the boom in dairy commodity prices. As they did in the previous review six weeks ago there was no indication given of an expectation that they would need to raise interest rates again in the future. This may represent some sort of format change away from giving warnings about future intentions perhaps as the Reserve Bank seeks to avoid the justified criticism of their actions over 2006 when warnings from late 05 of further rate rises were not followed through on.

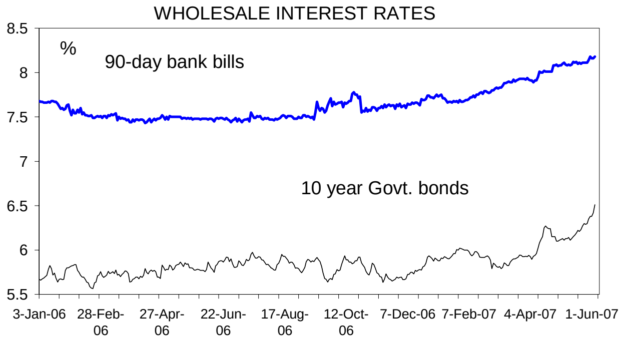
As with all tightenings of monetary policy we are now into a period where we are waiting to gauge the impact of the rate rises. This is always a "suck it and see" exercise but for now given the stimulus coming from easing fiscal policy now and obviously what is going to happen in the pre-election budget next year, still booming commodity prices, the very strong labour market, high infrastructure spending, a backlog of construction orders, and above average growth overseas the risks to inflation still appear to lie slightly on the high side and therefore one cannot rule out a further rate increase down the track. http://www.rbnz.govt.nz/

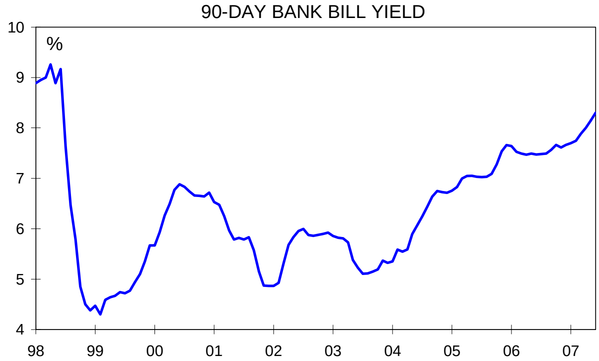


INTEREST RATES

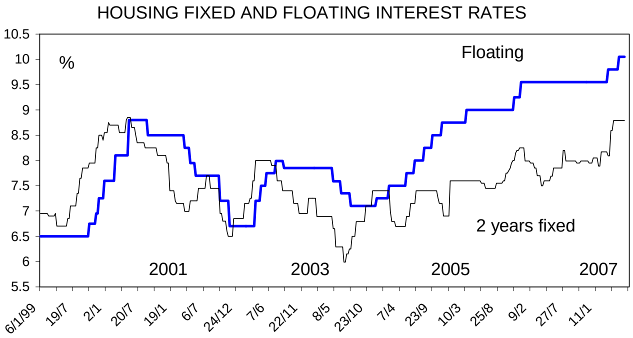
Wholesale interest rates have increased quite strongly over the past couple of weeks as the markets correctly anticipated the Reserve Bank would tighten monetary policy this morning. New Zealand's official cash rate now stands at 8% compared with 5.0% three and half years ago and it could still easily go higher. Market anticipation of the tightening came about on the basis of very strong growth stimulating factors such as the easing of fiscal policy this year and the easing that is going to come next year along with the boom in dairy commodity prices and the surge in conversions we are likely to see in the rural sector. We have also recently seen extremely positive data for March quarter economic activity in the housing market, labour market, and retail spending. Although one or two indicators have pulled back including rates of growth in lending to the farming and business sectors along with business confidence, activity expectations, and investment and employment plans, upside risks to growth and inflation persist.

This afternoon we have seen the yield on 90-day bank bills end near 8.18% compared with 8.14% last week and 8.1% two weeks ago. This is the highest yield for bank bills since they raced away to peak over 9% in the first half of 1998 as the Reserve Bank was tightening monetary policy in spite of the economy being in recession.





Of course most people do not borrow at a floating interest-rate these days so what really matters is the wholesale cost of fixed-rate lending. The two year swap rate at which we banks borrow to lend fixed for two year periods has jumped in the past few weeks to close this afternoon near 8.34% from 8.27% last week, 8.15% a fortnight ago, and just over 8% a month ago.



Where rates go from here depends very much on what the economic data show. Although the Reserve Bank has given no explicit warning that they intend tightening monetary policy further they did quite clearly say that they need to see the economy go through a slow growth period in order to get inflationary pressures under control. **"A sustained period of slower growth in domestic activity will be required to alleviate inflation pressures."** In a nutshell unless we see a sustained string of weak numbers for consumer confidence, the labour market, retail spending, credit card spending, household debt growth, house prices, dwelling sales, dwelling consent issuance, non-residential consent issuance, business activity expectations along with employment and investment intentions then the Reserve Bank will tighten again.

If I Were a Borrower What Would I Do?

It's fairly clear that as a result of wholesale fixed borrowing costs increasing in recent weeks we are going to see a round of housing interest-rate increases go through the market very shortly. So if I was looking to fix my interest-rate in the very short term I would tend to get it done now or get the rate locked in for drawdown in the next few weeks. I would be looking to fix for either one year or two years but whether I would still toss a coin between the two in a few weeks time will depend upon where these rates go. If the two-year rate settles above 9% then we are into the extremely painful part of the interest-rate cycle where it is in one's best interest to take a relatively high one year rate in expectation of being able to lock in a better rate in a year's time or go floating than settling for a well above average medium-term rate at the moment.

BNZ Fixed Lending Interest Rates

Housing		Average Past 5 yrs	Low Past	High 5 years
Float	10.05%	8.34%	6.70%	10.05%
1 yr	9.00	7.45	6.20	9.00
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

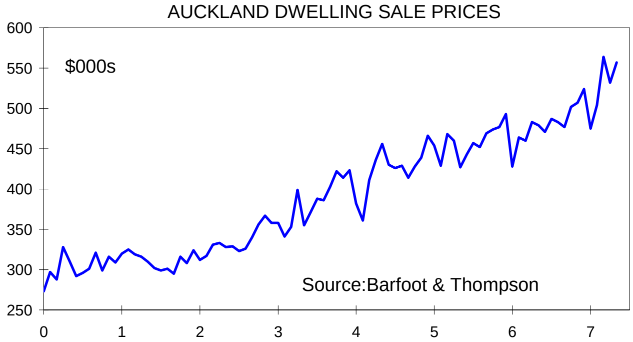
Note: Conditions may apply to these rates.

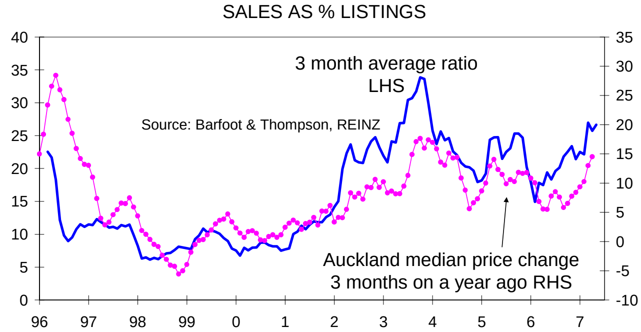
BNZ Term Deposit Rates

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

Barfoot and Thompson released some relatively strong data on the Auckland housing market this afternoon. They sold 1,109 dwellings in May which was an increase from a year earlier of a healthy 10.9% which followed an 8.9% increase in April. In the three months to May sales were 12.2% ahead of a year earlier suggesting the two interest-rate rises in March and late April have not really had all that much of an impact on the housing market as yet - hence the rise in rates this morning. The median dwelling sale price jumped relatively strongly to $557,000 in May compared with $532,000 in April which was an increase from a year earlier of 16.3% with the average price in the three months to May ahead 16.2% from a year earlier. Again bad news for the Reserve Bank.





Total property listings at the end of May stood at 4,341 which was a 14.8% decline from a year earlier and took the ratio of sales to listings to 25.5% for the month compared with 19.6% a year ago and 23.1% two years ago. The second graph above shows the good correlation between the ratio of sales to listings and the Auckland median dwelling sales price recorded in the monthly REINZ data.

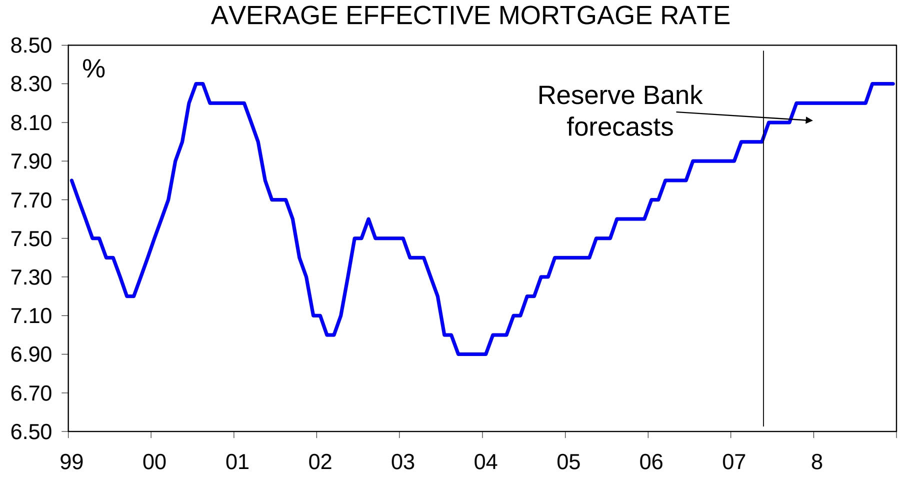
One can conclude nothing other than good things about the strength of the housing market from the Barfoot and Thompson data – which is bad news for interest rates.

A Few Nervous Investors

We've had no change in the anecdotal feedback we have been receiving of investors backing away from the market and our expectation is that in coming weeks this anecdotal feedback is likely to strengthen.

Investors are very cash flow conscious and with fixed interest rates likely to move higher and people on average rolling off a rate near 7.8% in the coming 12 months the jump to around 9% is going to be way too painful for many to contemplate a fresh housing purchase. We think we are now starting to get into territory where interest rates are going to be biting more in the housing market than they have done at any stage over the past three and half years. This will please the Reserve Bank. But we have to remember that the housing market still remains fundamentally very well supported by high job security, strong wages growth, expectations of tax cuts in the budget next year, a belief that there is a shortage of dwellings in New Zealand now, and a queue of first home buyers just waiting for any weakness in the market to jump in and make their purchase. So we still anticipate house prices rising.

But before one gets too scared about what the impact of rising interest rates will be it pays to have a look at a series created by the Reserve Bank showing the average effective mortgage rate in the marketplace. This rate was 6.9% when the tightening cycle started in January 2004 and currently stands at just 8.1%. In other words the average mortgage rate increase over the past three and half years has been just 1.2% which is nothing like the so far 2.75% increase in average floating rates. The Reserve Bank expect this interest-rate to increase only another 0.1% over the coming year.



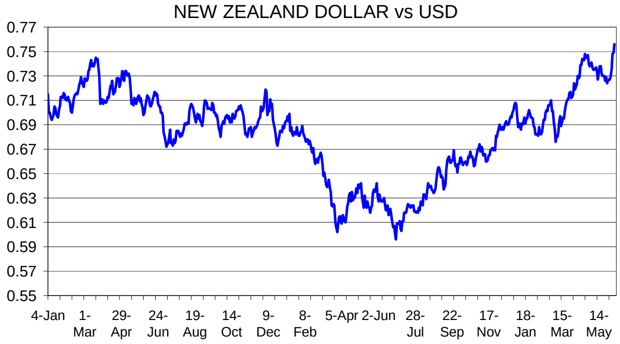
The monthly migration numbers are worth keeping an eye on given the downward trend over the past five months. This week's announcement from the government of some improvement in migration ability for rich people along with better ability for people to earn points to qualify them to live here will have some impact but probably further down the track rather than this year.

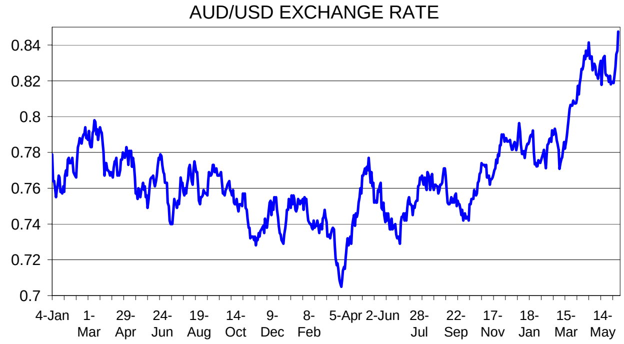
Reserve Bank Lifts Its House Price Inflation Forecasts

For your guide the Reserve Bank have increased their short term forecasts for house price inflation. Back in the March Monetary Policy Statement the Reserve Bank forecast that house prices on average would rise by 7.7% this year, 2.5% over 2008 and 0.5% over 2009. They now forecast average house prices will rise by 9.6% this year, 2.9% over 2008, but then just 0.1% over 2009.

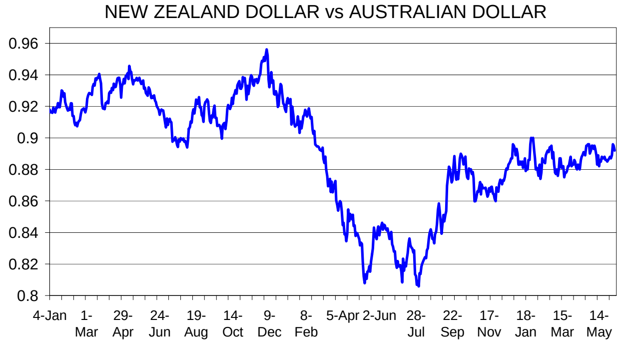
EXCHANGE RATES

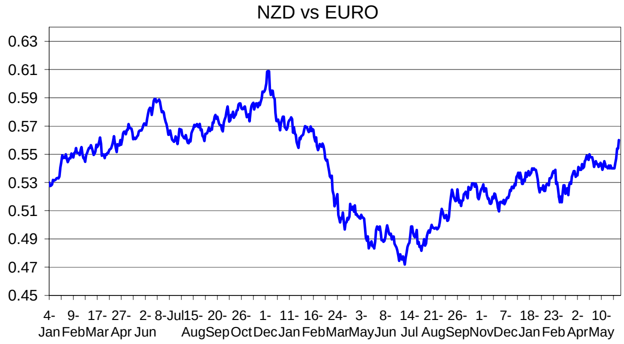
The NZD has risen to a fresh post-float high against the greenback over the past week and a 17 year high against the yen – and quite rightly so when one considers the amazing levels of the key fundamentals which determine our currency's price for short to medium term periods. The initial rise in the currency was in response to market anticipation that the Reserve Bank would raise the cash rate and when they did this morning the currency rose from just over 75 cents to end this afternoon near 75.6 cents compared with 72.7 cents a week ago. But the Kiwi dollar has also got a boost on the back of a strong jump in the Australian dollar.

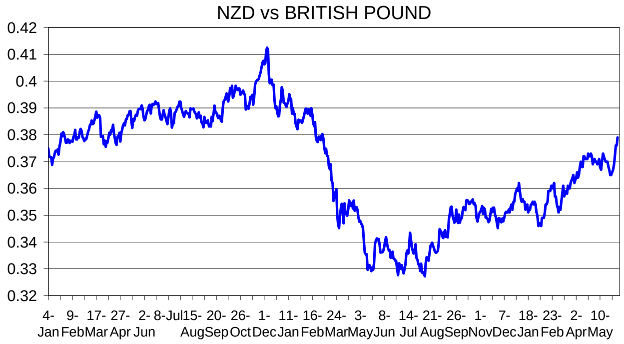




The Aussie dollar has ended this afternoon against the greenback near 84.8 cents from 81.9 cents a week ago in response to some very strong economic data. The Australian economy grew by a very strong 1.6% during the March quarter and employment data for May released this afternoon were also exceptionally firm for the umpteenth month in a row. Although we do not expect a rate rise there remains a chance that the Reserve Bank of Australia will need to increase their cash rate again later this year and scope for any easing is a long way out. In addition the Aussie dollar has risen strongly over the past couple of weeks on the back of a reduction in international investor risk aversion associated with strong growth numbers in the United States, a rising US sharemarket, and the absence of any spill over of the decline in the Chinese sharemarket into other sharemarkets.



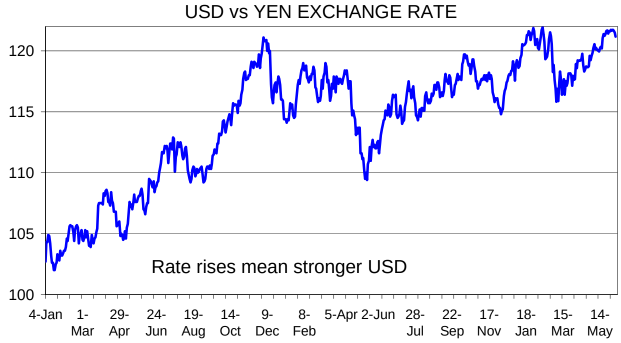


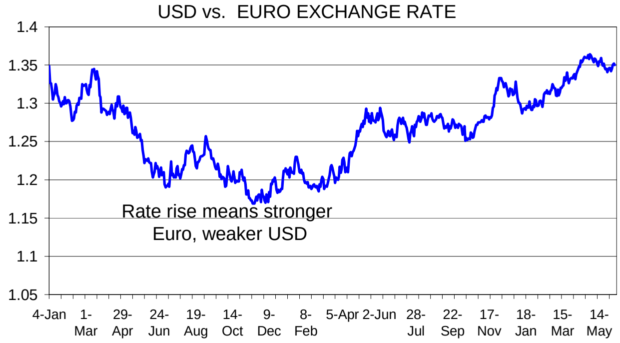


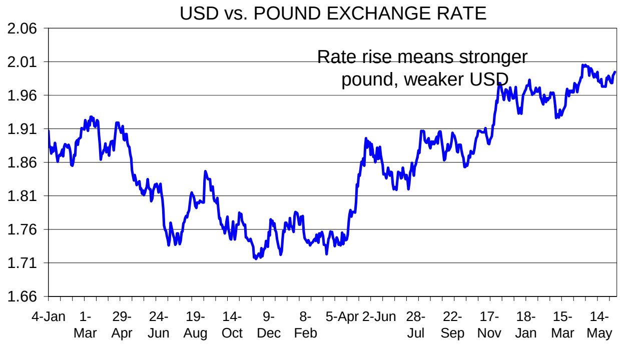
These latter factors have also assisted the Kiwi dollar upward over the week and we have ended this afternoon against the Japanese yen near a 17 year high of 91.6 from 88.5 last week. Against the British pound we have ended near 37.9 pence from 36.7 pence last week and against the euro we have ended near 56 cents from 54 cents. Against the Aussie dollar we have ended near 89.2 cents from 88.8 cents.

The US dollar has received scant support over the week in spite of further declines in expectations that the Federal Reserve will be cutting interest rates later this year. The non-farm payrolls report showed that job numbers rose by a relatively strong 157,000 in May which was above expectations of a 130,000 gain. In addition the Institute of Supply Management purchasing managers index rose to 55 in May which was the highest level since April last year and strongly suggestive of good growth in the manufacturing sector. The non-manufacturing index also rose to 59.7 in May from 56 in April and a market expectation of 55.8. Quite

clearly the problems in the United States housing market are not feeding through into either the labour market or the important manufacturing sector and this is important for US growth going forward.
The US dollar has ended this afternoon against the pound near $1.995 from $1.98 last week, near ¥121.1 from 121.7, and $1.35 against the euro from $1.346 last week.







The euro received some mild support after the European Central Bank raised its cash rate overnight to 4% from 3.75% and in their accompanying statement made some relatively hawkish comments about the potential need for further rate rises.

We don't have a strong view on where the greenback is likely to go over the next few months but when it comes to the Kiwi dollar the risks lie firmly on the upside. The chances are strong that the Reserve Bank will need to raise interest rates again, the chances of them cutting interest rates in the next two years are diminishing all the time, commodity prices are high and continuing to rise, and the many factors on the long list of insulating factors we have been citing for over three and half years now suggest that the outlook for domestic economic growth remains relatively good. The chances are good that the Kiwi dollar will at some stage this year reach 80 US cents.

Data Sources

Interest rates & exchange rates 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 – RBNZ	http://www.rbnz.govt.nz/statistics/monfin/rbssr/rbssrpartE/data.html
House price information - REINZ	http://www.reinz.org.nz/reinz/public/market-information/market-information_home.cfm
NZ economic data, most from Statistics NZ	http://www.stats.govt.nz
Government accounts, NZ Treasury at	http://www.treasury.govt.nz/financialstatements/
Australian data	http://www.abs.gov.au/ and http://www.rba.gov.au/
European data	http://epp.eurostat.ec.europa.eu
United States data	http://www.economagic.com/
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%	3.8	3.7	......	3.9	3.8
Jobs growth	Average past 10 years = 1.9%	1.2	0.1	1.7	0.9	-0.1
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%.	3.7	1.8	4.9	5.6	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	+11,230	14,130yr	......	10,079	9,349
Tourism - yr ago grth	10 year average growth = 5.0%. Stats NZ	0.8	-1.5	2.1	0.7	8.2
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	-8	-4	-10	-38	-13
Business activity exps	10 year average = 26%. NBNZ	7.8	22.5	23.7	10.3	8.9
Household debt	10 year average growth = 11.3%. RBNZ	13.9	13.6	13.2	14.2	15.2
Dwelling sales	10 year average growth = 3.5%. REINZ	8.2	8.9	4.0	-14.6	-7.5
Floating Mort. Rate	10 year average = 8.1%	10.05	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 10 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	3.4	3.2	3.2	2.6	3.1	3.2	2.7
Employment	3.4	2.6	1.7	1.4	1.5	1.5	1.4	2.3	1.4	1.5
Unemployment Rate %	3.8	3.9	3.8	3.6	3.7	3.6	3.7	3.6	3.7	3.8
Wages	2.9	4.6	5.5	5.6	3.9	5.1	5.5	5.4	4.2	2.8
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.73	0.64	0.7	0.67	0.58	0.7	0.69	0.7	0.6	0.59
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	0.88	0.78	0.78
NZD/GBP	0.38	0.36	0.36	0.34	0.31	0.4	0.35	0.36	0.32	0.32
NZD/EUR	0.55	0.53	0.53	0.5	0.46	0.59	0.52	0.52	0.47	0.48
NZD/YEN	76.8	74.6	81.9	73.7	64.4	82.7	81	78.4	66	64.6
TWI	70.7	65.6	68.6	64.8	57.9	71.9	68	67.7	59.4	59.3
Official Cash Rate	6.56	7.25	7.59	7.75	6.75	6.99	7.44	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	5.87	6	5.6	5.89	5.77	6.05	5.7	5.9

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

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