Bank of New Zealand

BNZ Weekly Overview

13 September 2007

FINANCIAL MARKETS DATA

	This week	**Week ago**	**4 wks ago**	**3 months ago**	**Yr ago**	**10 yr average**
Official Cash Rate	8.25%	8.25	8.25	8.00	7.25	6.2
90-day bank bill	8.87%	8.83	8.60	8.35	7.47	6.4
10 year govt. bond	6.00%	6.10	6.42	6.85	5.87	6.5
1 year swap	8.61%	8.61	8.68	8.53	7.64	6.6
5 year swap	7.78%	7.87	8.08	8.23	7.07	7.0
NZD/USD	0.71	0.686	0.747	0.748	0.641	.567
NZD/AUD	0.845	0.835	0.884	0.892	0.854	.859
NZD/JPY	81.0	79.1	88.4	91.0	75.7	66.1
NZD/GBP	0.35	0.34	0.37	0.379	0.342	.342
NZD/EURO	0.511	0.502	0.546	0.562	0.506	.51

For addition to our emailing list for Thursday night receipt email "Subscribe WO" to tony.alexander@bnz.co.nz . To get off the list email 'Unsubscribe".

Survey Time

Many thanks to those who have responded to our monthly survey in the past. This week we are once again running our confidence survey and if you have not already done so in the email used for sending this week's Weekly Overview 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 next 12 months. More importantly if time permits pen a few thoughts on how things are looking in your particular industry at the moment. The results will be released early next week.

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

Apologies to those who have not received their Weekly Overview over the past few weeks. It's either something to do with our email system or perhaps something related to the problems experienced with Xtra. Hopefully things will work properly this week. There was no Weekly Overview last week due to tramping and many thanks to those who wished us well for the walk. In 3 1/2 days on the Heaphy Track there was not a drop of rain and only three other people (all foreigners of course).

If you are regularly monitoring what is happening with regard to the world economy and financial markets then you are likely to be somewhat confused about what is going on. Join the group. There are many things in play currently with wild fluctuations in opinions on where they are going to go and that helps explain why financial markets are so extremely volatile especially with regard to shares and currencies. Just over this past week we have seen the Kiwi dollar trade almost as low as 68 US cents and rebound above 71 US cents commensurate with fluctuations in the United States sharemarket driven by fluctuations in worries about the United States housing market, potential for interest rate cuts there, and the spread of the liquidity crisis around the globe.

With regard to the liquidity crisis it may still be many months before everyone knows where the losses from the declining United States sub-prime mortgage market will ultimately lie. For that matter is also likely to take many months to figure out what the magnitude of those losses is going to be. But at the same time it will take a few months to figure out what the impact of declining United States house prices will be on consumer sentiment along with business investment and hiring intentions. For the moment worries about these things are on the pessimistic side especially following a report showing that in August job numbers in the United States fell whereas a rise of around 100,000 had been expected.

Something confusing all of these issues somewhat is the implications of an easing United States economy for monetary policy in other countries. In most other parts of the world economic conditions remain robust and in recent months we have seen interest rates being pushed up to contain growth in inflationary pressures in the likes of Australia, China, the United Kingdom, and Europe. Our general expectation remains that interest rates are more likely to be increased in these economies than decreased in the near future especially with a lot of central banks likely to be concerned about the way global inflationary pressures, risk acceptance, and unwise lending were stoked by possibly excessive reactions to events late in 2001 and early in 2003.

Most central banks are likely to be of the opinion that if the current crisis leads to a permanent change in investor tolerance back to more normal levels then that would be positive and if there are financial institutions that collapse as a result then that is simply the way it has to be. In fact such collapses will be viewed as a positive lesson for future planning of other surviving institutions.

Here in New Zealand we probably wouldn't be all that concerned about our own growth prospects in light of the liquidity crisis overseas because of our booming export commodity prices along with the extremely sharp decline in the Kiwi dollar which is going to stimulate our export sector over the next couple of years. But we have the impact of collapsing finance companies to think about and more importantly the impact of a rapidly easing housing market. In August dwelling sales around the country were down 25% from a year earlier although prices on average in the month edged up slightly.

But then again, offsetting that we have continuing evidence of high labour demand from employers and businesses highly aware that they need to invest in order to boost productivity in an environment of continuing labour shortages. Plus we have fixed interest rates starting to edge down in anticipation of an easing in United States monetary policy. Then there is ongoing infrastructure spending to think about and with the government behind in the polls and an election due in just over a year's time any existing restraint on fiscal policy is likely to be completely thrown out the window in the coming year with positive indications for growth but negative implications for inflationary pressures and therefore scope for the Reserve Bank to cut interest rates. This week’s announcement of quick wage wins for nurses and teachers suggests the government wishes to avoid further turbulence in these electorally sensitive areas and the fiscal war chest is being willingly opened to help. Then again, maybe they are just logically responding to a very tight labour market which means if you don’t stump up the cash you’ll lose your staff.

The easing of fiscal policy is also likely to directly underpin the housing market with the government highly likely to attempt some measures to boost home affordability for low to medium income earners.

And taking all these pluses and minuses into account while allowing for the massive uncertainties currently around helps easily explain why the Reserve Bank left their cash rate unchanged at 8.25% this morning. Then again, six weeks ago they did say they didn’t anticipate raising the rate again while refraining from any hint of an easing bias. Was such a bias evident in this morning’s Monetary Policy Statement? No. the RB quite logically highlighted the uncertainties and noted the negatives of collapsing finance companies, easing housing market and deteriorating world economy being offset by the falling NZD and booming commodity prices.

They concluded

"At this point, we believe that the current level of the OCR is consistent with future inflation outcomes of 1 to 3 percent on average over the medium term. However, given greater than usual uncertainty at present, we will be watching to see how the upside and downside risks to the outlook are developing."

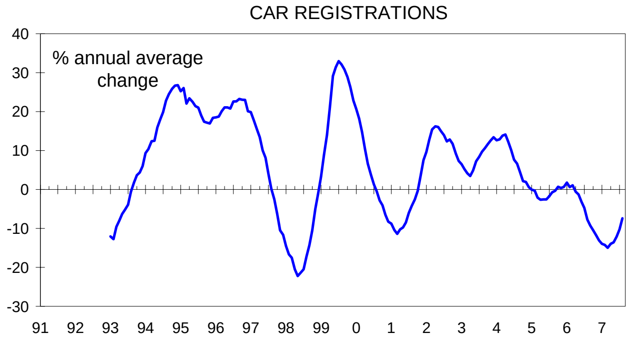
Sound reasoning and a sound policy statement. http://www.rbnz.govt.nz/monpol/statements/

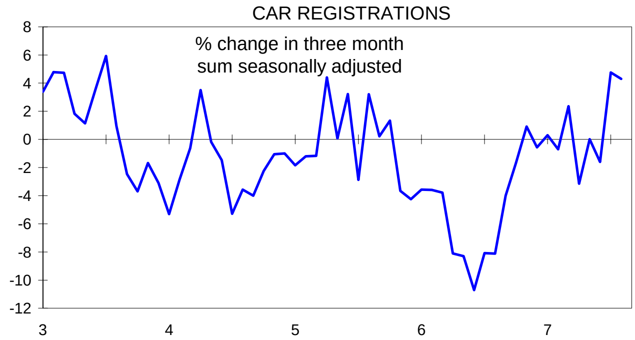
THE WEEK'S ECONOMIC DEVELOPMENTS

Tuesday 4

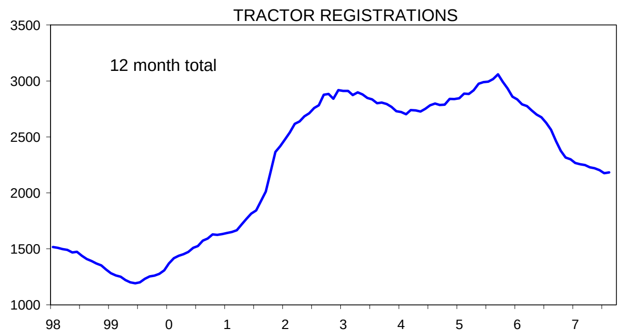
Car Registrations Rising

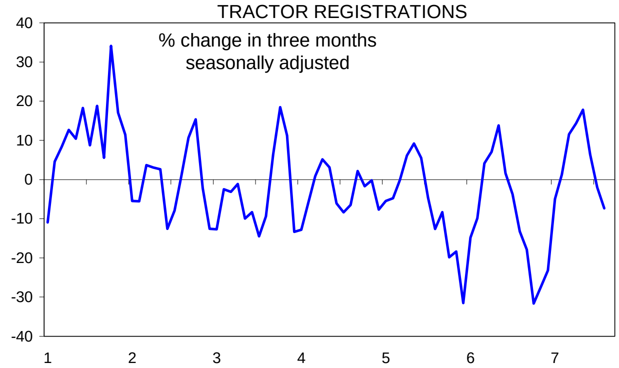
In August there were 18,119 cars registered around New Zealand. This was a relatively strong 10.9% gain from a year earlier which means that in the three months to August car registrations were up by 5.4% and in rough seasonally adjusted terms were ahead over 4% from the three months to May. These results follow a fall of 7.4% over the entire year to August indicating a fresh upturn in motor vehicle registrations is underway. This result runs strongly counter to other evidence suggesting a pullback in consumer spending and backs up our view that although the rate of growth in the domestic economy is going to slow down the extent of this easing will be cushioned by factors such as the upturn in export sector in come along with the continued firm labour market.



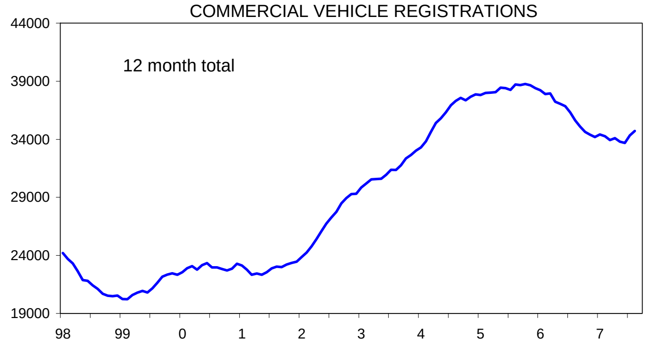


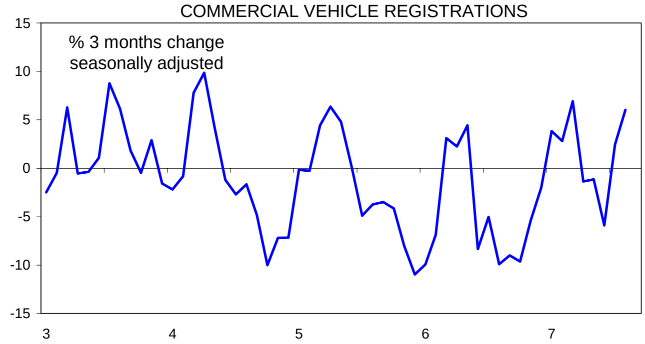
There were 217 tractors registered around New Zealand in August. This was a 3.3% increase from a year earlier and for the three months to August the change from a year ago was a decline of 6.5%. In seasonally adjusted terms tractor registrations were down over 7% from the three months to August so after a lift in spending in this area earlier in the year things are easing back again. However we think this easing off is going to be very temporary given the biggest boom in dairy incomes in decades is currently underway.





Finally, in August there were 3,248 commercial vehicles registered around New Zealand. This was a 13.4% rise from a year earlier, which followed a 22.4% gain in July and means that in the three months to August commercial vehicle registrations were up by 9.9% from a year ago. In rough seasonally adjusted terms registrations for the three months were up by 6% from the three months to May. So as with cars there is an increase in expenditure in this area and this may be an early indicator of continued strength in business capital expenditure in spite of the Reserve Bank's increase in interest rates this year and the high exchange rate of some weeks ago affecting confidence in the export sector. One can't help but think that the recent sharp decline in the Kiwi dollar will boost export sector investment although for the domestic focused parts of the economy some restraint is likely as retail spending and housing growth slow down.

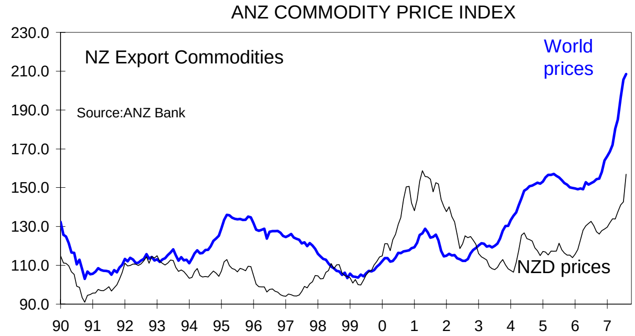


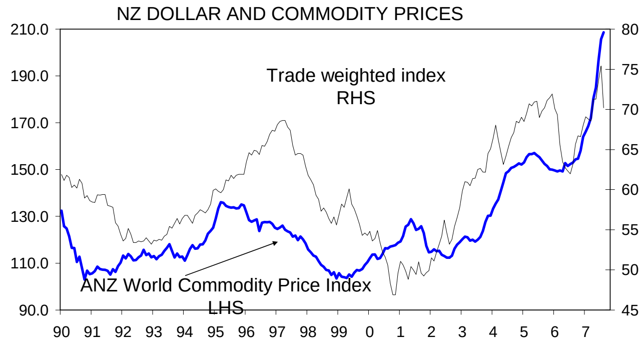


Thurs 6

Commodity Prices Climbing In Spite Of World Liquidity Crisis

The ANZ Commodity Price Index in world price terms increased for the 14th month in a row in August gaining by 1.4% to sit a huge 36.3% up from a year earlier and 60% above the average level for this index over the past decade. With the Kiwi dollar falling out of bed over the month the New Zealand dollar denominated commodity price index soared by 20% to sit 20.3% ahead of a year ago and 29% above its 10 year average. This is wonderful news for the New Zealand economy which is going to go a huge way toward offsetting the expected slowdown in world growth as a result of the current liquidity crisis. International dairy prices have increased by 120% over the past year. Note the second graph below. It shows a reasonably good correlation over periods of a couple of years between changes in the level of world commodity prices and New Zealand's trade weighted index. At the moment a relatively large gap has opened up between prices and the index which is why one needs to be careful in believing that the Kiwi dollar is going to continue falling.

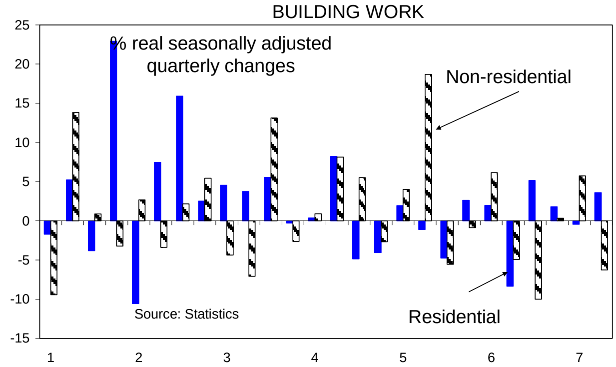


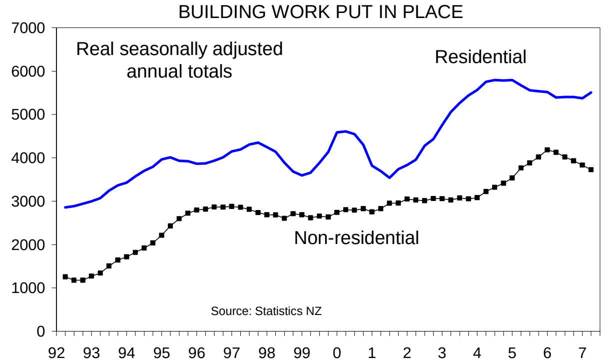


Fri 7

Construction Activity Down Slightly

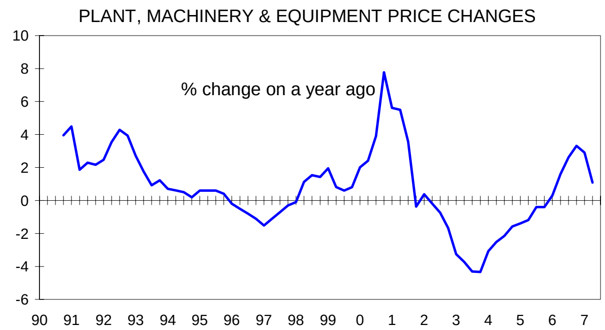
In real seasonally adjusted terms the volume of building activity undertaken during the June quarter was down 0.5% after rising by 2.1% in the March quarter. Residential construction activity rose by a relatively firm 3.6% after falling 0.4% in the March quarter while non-residential construction fell away by 6.3% after gaining 5.8% in the previous quarter. What should be reasonably clear from these numbers is that the quarterly data are relatively volatile. The same conclusion is reached by looking at the changes in the quarter compared with a year earlier where the total amount of work undertaken was up by 1.2% with residential ahead 10.4% but non-residential down by 10.5%. Perhaps what best sums it up is the second graph below showing the annual totals for residential and non-residential work. Residential activity has been reasonably flat for a couple of years while non-residential activity is pulling back having enjoyed firm progress for a number of years. Construction is traditionally one of the most volatile sectors in the economy but we perceive a backlog of both residential and non-residential construction orders which should tend to limit the decline in activity many people will be expecting over the next couple of years as a result of the rise in interest rates and perhaps slowing in world growth.

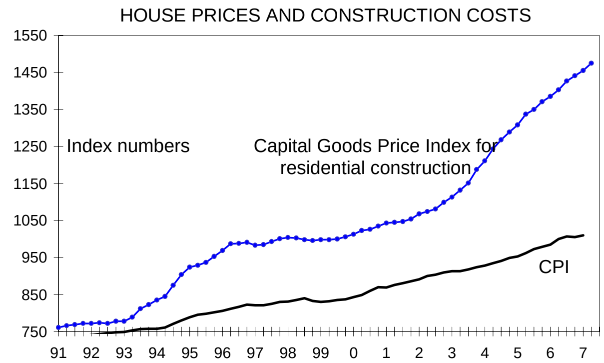




Construction Costs Still Rising Firmly

The Capital Goods Price Index measures the cost of capital items such as plant machinery and equipment, transport equipment, residential and non-residential buildings. During the June quarter the total index increased by a relatively small 0.4% following a 0.3% rise in the March quarter. Compared with a year earlier the index was up by just 2.8%. Courtesy of the rising Kiwi dollar up until just after the middle of this year the price index for transport equipment fell by 0.4% over the quarter while plant machinery and equipment costs were ahead only 1% from a year ago. But residential construction costs have increased by 1.4% in the quarter and 5.1% over the year while non-residential construction costs were ahead by 0.2% in the quarter and 3.1% for the year. Compared with five years ago the cost of residential construction has increased by 37%, non-residential construction 31%, while transport equipment and plant machinery and equipment costs have each fallen about 5% over the same period of time. In comparison the consumers price index has increased just 13.3% over the past five years while house resale prices have increased on average 87%.

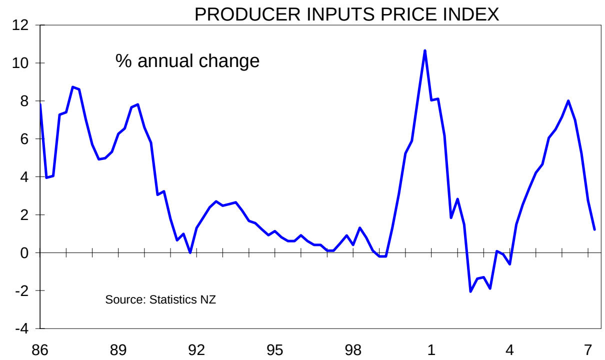


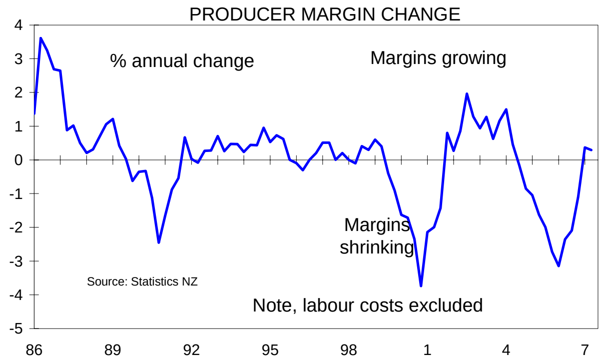


Mon 10

Business Costs Increasing

The Producers Price Index measures changes in business non-labour costs as well as changes in output prices for businesses operating in New Zealand. In the June quarter the inputs price index rose by a relatively strong 1.3% while output prices on average gained 1.2%. Input costs were 1.2% ahead of a year earlier and output prices were up 1.5% with both restrained by the sharp rise in the Kiwi dollar over the past year. It's hard to read anything much into these numbers but we report them for records sake.

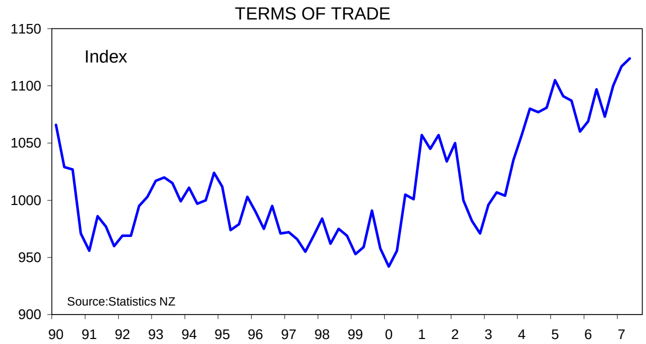




Tues 11

Terms of Trade Creep Upward Slightly

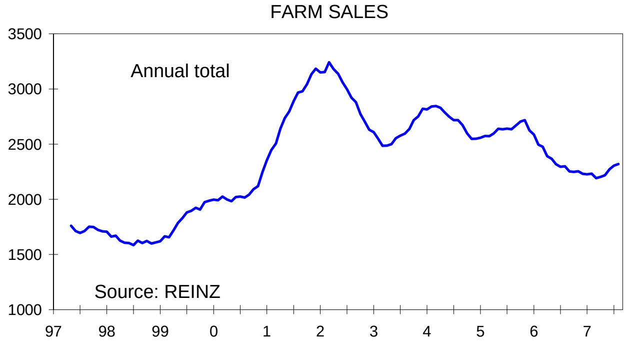
New Zealand's terms of trade improved by a relatively small 0.6% in the June quarter after rising 1.5% in the March quarter. This change resulted from a 1.1% fall in export prices being exceeded by a 1.8% fall in import prices. Both of these movements were dominated by the sharp rise in the Kiwi dollar over the quarter. Interestingly it looks like the numbers haven't really captured the recent sharp climb in dairy prices so it is likely that when the September quarter numbers come out we will see a strong jump in the terms of trade. Compared with a year earlier the June quarter index was only up 2.5% - though the actual index reading was the strongest since the June quarter of 1974. The fact that New Zealand is going through its biggest terms of trade boom in over 30 years helps explain why we don't have a particularly bad outlook for growth in our economy even taking into account the current downgrading of forecasts for foreign growth.

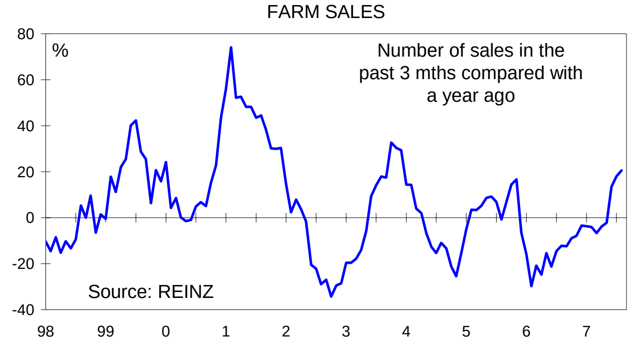


The traditional terms of trade measure focuses just on merchandise imports and exports. An additional services terms of trade measure rose by 2.2% in the quarter after gaining 3.8% in the March quarter and now sits a healthy 10.3% up from a year earlier.

Farm Real Estate Market Healthy

In August there were 189 farms sold around New Zealand. This was an increase of 8% from a year earlier which means that over the three months to August farm sales were ahead by almost 21% from a year ago. Because of changes in the mix and size of farms sold each month the following statement doesn't really mean anything. But for what it is worth, in the three months to August the average farm sale price of $1.3M was 35.7% ahead of a year ago.





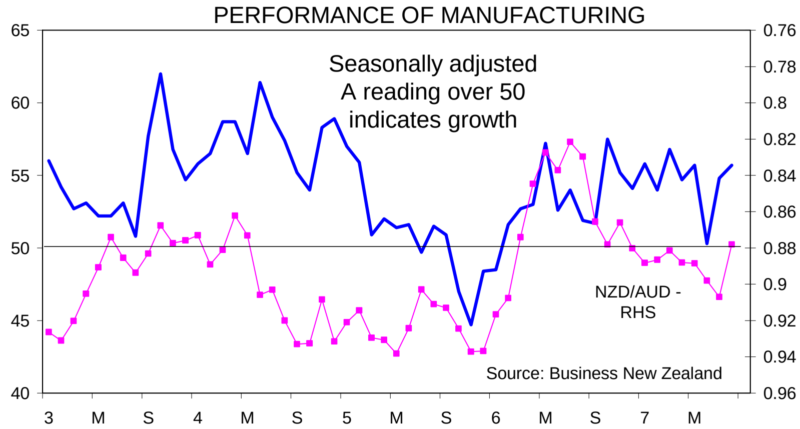
Thurs 13

Monetary Policy Left Unchanged As Expected

With so many divergent forces around at the moment it is unsurprising that the Reserve Bank left the official cash rate unchanged at the 8.25% level they took it up to six weeks ago. Back then they noted that they will probably not need to increase again. This time while balancing off negative factors such as slowing world growth, collapsing finance companies, and an easing housing market against a much lower New Zealand dollar and booming commodity prices they concluded “At this point, we believe that the current level of the OCR is consistent with future inflation outcomes of 1 to 3 percent on average over the medium term. However, given greater than usual uncertainty at present, we will be watching to see how the upside and downside risks to the outlook are developing.” If anything one can read between the lines and still see a mild tightening bias in their comments especially as they allow for no cut in the official cash rate until late 2009 with some of their numbers implying they expect another rate increase. Our own view is that a rate cut will come in September next year at the earliest with ourselves expecting growth closer to 2% in the next couple of years rather than close to 3% pencilled in by the Reserve Bank. However our view on the economy's productivity growth and therefore potential growth rate is a lot worse than the continuing optimistic assumption of the Reserve Bank.
http://www.rbnz.govt.nz/monpol/statements/

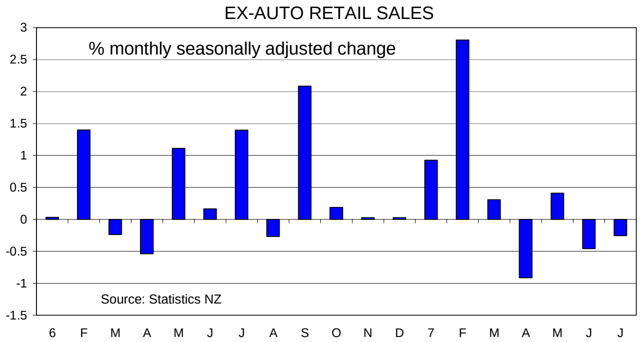
Manufacturing Conditions Improve

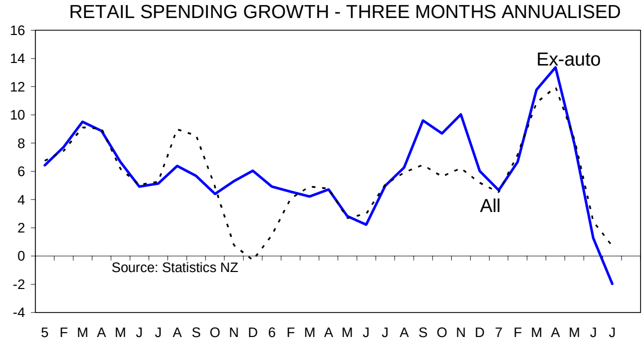
One of the key points we have been stressing in recent months has been that although the Kiwi dollar was unusually high against the American currency we were at reasonable levels against the Australian dollar near 90 cents. Now, with the liquidity crisis overseas causing a sharp decline in peripheral currencies like the Kiwi dollar, we have seen the Kiwi/Aussie exchange rate fall very strongly. Last month it averaged just under 88 cents and is just under 85 cents at the moment. The cross rate between the Australian and New Zealand currencies is highly relevant to the manufacturing sector because almost half of our manufactured exports go across the ditch. The decline in New Zealand dollar helps explain why the Business New Zealand Performance of Manufacturing Index has improved in the past two months from a no growth reading of 50.3 in June to 54.8 in July and 55.7 in August with all numbers seasonally adjusted. The September result is likely to be higher still. It is noteworthy that while there has been a lot of media attention on some manufacturers cutting down their workforce and sending production overseas you have to read beyond the headline to realise that for many of these manufacturers the key factor pushing them offshore wasn't the exchange rate but the decision by their competitors to locate their production in low-cost countries offshore. Manufacturing prospects in New Zealand appear reasonable but even with this fall in the currency we are still going to see some manufacturers shifting offshore.



Retail Spending Easing

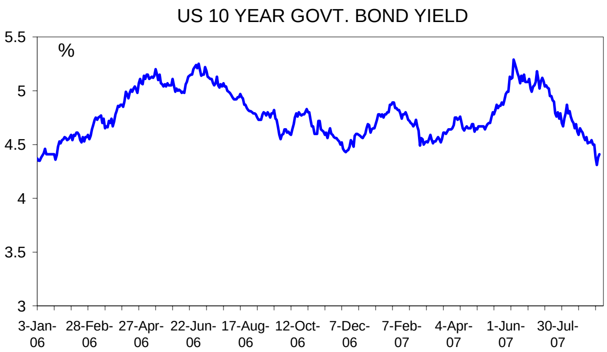
Retail spending in seasonally adjusted terms excluding the volatile automotives sectors fell slightly by 0.3% in July after falling 0.5% in June and rising 0.4% in May. There is clearly a spending response occurring to the increase in interest rates earlier this year backing up the widespread conclusion that the Reserve Bank have finally gained some domestic traction with their monetary policy tightening.

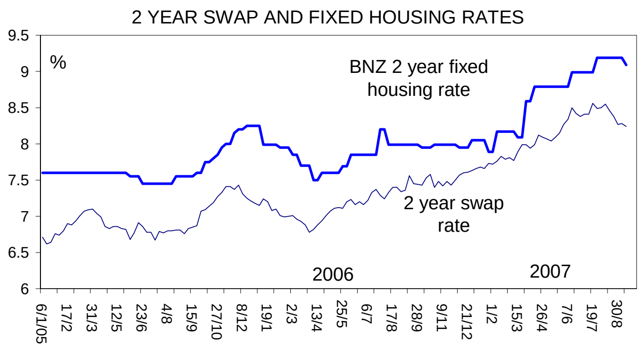




INTEREST RATES

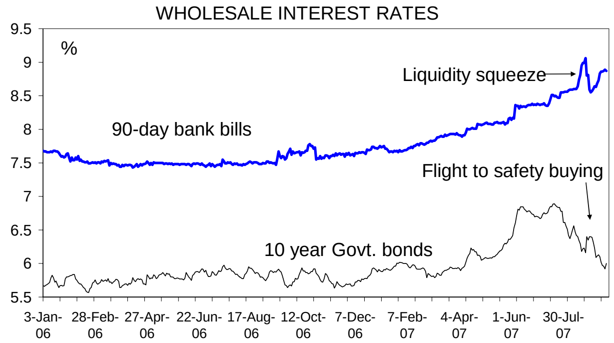
Wholesale interest rates in New Zealand relevant to fixed rate lending have decreased over the past fortnight partly in response to some weak local data on the likes of the housing market but mainly because of a jump in expectations that United States monetary policy will be eased in the near future pushing their medium-term fixed interest rates lower. One of the key interest rates we follow in the United States is the 10 year government bond yield and last night it was sitting at 4.41% compared with 4.51% a fortnight ago, 4.65% four weeks ago, and 5% two months ago.





The New Zealand two year swap rate at which we banks borrow to lend fixed for two year periods has ended today near 8.24% compared with 8.27% a fortnight ago, 8.46% four weeks ago, and 8.54% two months ago.

In contrast, with the liquidity crisis continuing overseas we have seen the initial fall in New Zealand 90-day bank bill yields following the Reserve Bank's change in discount rules partly reversed over the past week. The yield on 90-day bank bills had hit 9.2% about three weeks ago then fell down to 8.6% after the discount rules were changed. Before the liquidity crisis developed in the first half of August these yields were near 8.55%. The yield today was just under 8.9%.



Looking ahead we see short term rates holding around current levels for perhaps all the coming year with minor fluctuations up and down ahead of an expected cut in the official cash rate in September 2008 at the earliest.

If I Were a Borrower What Would I Do?

With wholesale borrowing costs falling for fixed rate terms margins for fixed-rate home lending have widened to above average levels. In the past one would have expected this to result in some fairly large cuts in home lending rates. But in the current environment that may not happen to the same degree. First of all, earlier this year the Reserve Bank made it fairly clear behind that although they respected free enterprise and all that the extremely strong competition between lenders in fixed rate products was making their job of controlling inflation much more difficult and because it implied extra upward pressure on the official cash rate was having an extra negative impact on the export sector. While the recent sharp decline in the Kiwi dollar has removed that export worry this sort of thing lingers in the back of one's mind especially in light of the current Finance and Expenditure Select Committee examination of alternative monetary policy options.

More importantly however, with a liquidity crisis sweeping the globe the greater one's rate of growth in lending the greater one's exposure to such a liquidity crisis. This probably isn't a huge factor for New Zealand financial institutions and is something more relevant for those overseas. Nevertheless one would probably want to be slightly more cautious than usual with regard to increasing lending and therefore one's liquidity requirements in this environment.

Then again, as is happening with regard to a lot of things around the world maybe in this environment we are more broadly seeing things return to previous average levels not only with regard to risk acceptance by investors but maybe margins for lending by institutions all over the planet. The following table shows margins for lending at the most commonly sought two year term roughly at the moment, over the past year, then the past two years in full, three years in full, and then the period from 2000 to the end of 2004.

Current	**Past year**	**Past 2 years**	**Past 3 years**	**2000-2004**
0.78%	0.46%	0.55%	0.57%	0.94%

My comment with regard to what I would do if I were borrowing at the moment is the same as two weeks ago. I see a small chance of some further cuts in fixed lending rates so if possible I would hold off fixing my rate for a few weeks to see where things go especially in light of traditionally strong competition between lending institutions during Spring. But I wouldn't be optimistic of a substantial cut in interest rates of say 0.3%.

Table Removed

In order to ensure compliance with the Unsolicited Electronic Messages Act 2007 and allow the distribution of the Weekly Overview to escape classification as a "commercial electronic message" the table that used to be in this section detailing BNZ home lending interest rates and term deposit rates has been removed.

Climbing Up The Mountain Versus Descending It

People often ask us to include in this section an answer to the question " If I were an investor what would I do?". We always say no and we will never address such a question in the Weekly Overview for the following reason. When talking about mortgage interest rates practically everybody is asking the same thing from the same position. They want to know whether they should fix or float and if they are going to fix - which is the case 99% of the time -what term they should choose. That's pretty much it - end of story.

But whereas most borrowers are the same each investor is unique. No two people have the same combination of risk tolerance, financial markets awareness, product understanding, sources of income and timing, range of existing investments, cash outflow timings, and so on. It is impossible to answer the question we sometimes get emailed to us along the lines of " I have just received $100,000 and want to know what I should do with it."

In a way perhaps the best analogy to describe the comparison between the borrower and the investor is as follows. All borrowers are scattered around the base of the mountain and all want to get to the top of it. They all ask what they should do to get there and the answer is very simple. " Keep walking to a place higher than where you are at the moment."

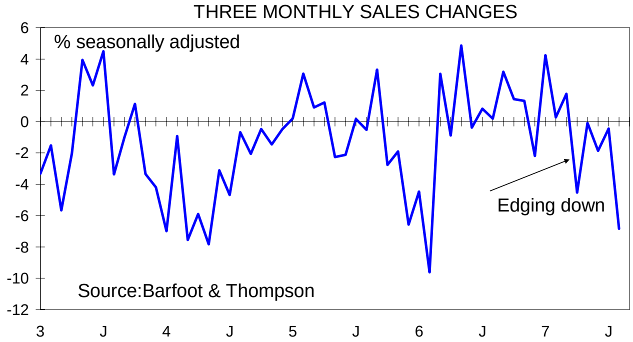
Investors however are doing things the opposite way around. They are all gathered at the top of the mountain and want to get down to the bottom but they each have their own very specific place down the bottom they want to get to. There is no rule they can all follow such as " Keep walking to a place lower than where you are at the moment". If they do that the chances that they will end up in the place they want to be are practically zero - as any experienced tramper knows.

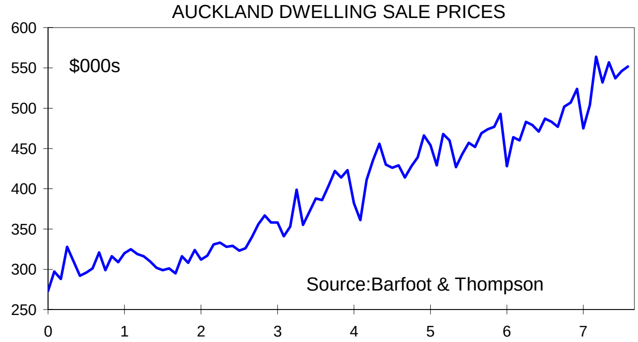
The route down for any individual investor is unique whereas the route up for any borrower is practically irrelevant.

HOUSING MARKET UPDATE

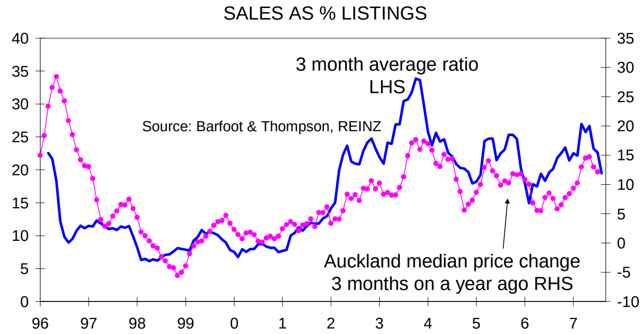
Barfoot and Thompson Auckland Data

On September 5 Barfoot and Thompson revealed that in the Auckland real estate market they sold 765 dwellings in August. This was a relatively strong 18% decline from a year earlier which followed a 2.5% rise in July from a year ago producing in rough seasonally adjusted terms a fall in dwelling sales over the past three months of about 7%. Sales activity is quite clearly easing off. There median dwelling sale price improved marginally to $552,000 in August from $546,000 in July which represented a 14.3% rise from a year earlier. So even though sales activity is declining prices are still managing to hold up which is generally our expectation for the coming year or so.



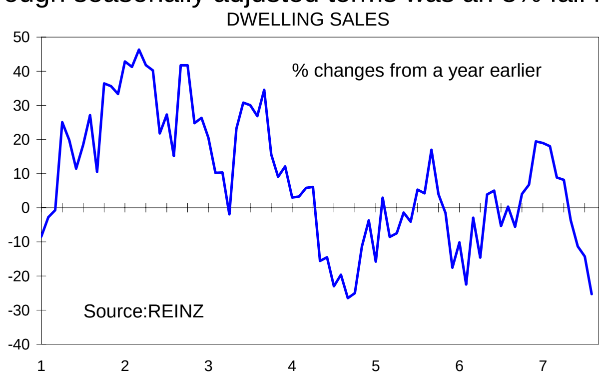


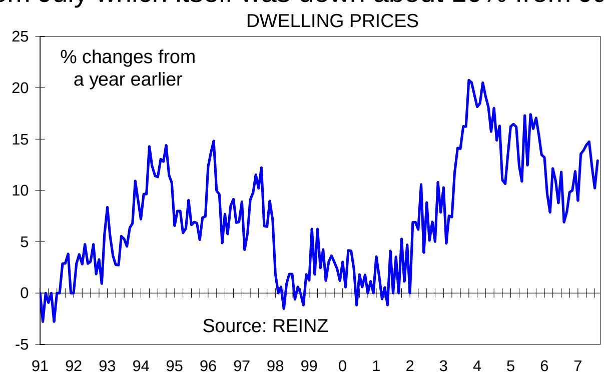
At the end of the month the total number of listings was ahead 7.4% from a year earlier and the number of fresh listings received during the month was ahead 5.7% from a year ago. The ratio of sales to listings for August stood at 16.1% compared with 21.1% a year ago and 24.9% two years ago. This was in fact the weakest August result since 13.6% recorded in 2001. There are clearly more properties on the market now and our understanding from chatting with real estate agents is that the main price adjustment is occurring on the part of vendors having to get more realistic.



REINZ Data Show Turnover Falling Strongly

Two days ago the REINZ released their numbers for nationwide residential real estate activity in August. They showed a small recovery in the median dwelling sales price to $350,000 from $345,000 in July which was an increase from a year earlier of just over 12%. But that small price recovery is really neither here nor there and the more interesting result is found when one looks at the number of sales. In August there were 6,394 dwellings sold around New Zealand. This was a fairly hefty 25.3% decline from a year earlier and in rough seasonally adjusted terms was an 8% fall from July which itself was down about 10% from June.

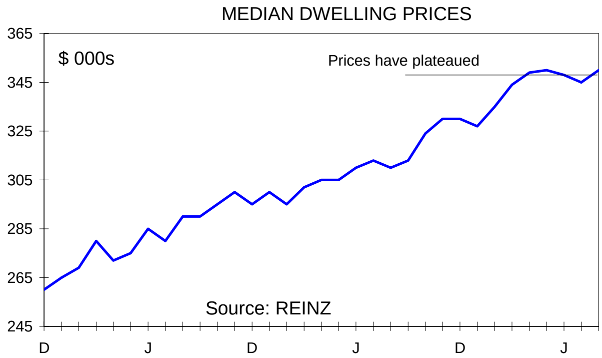


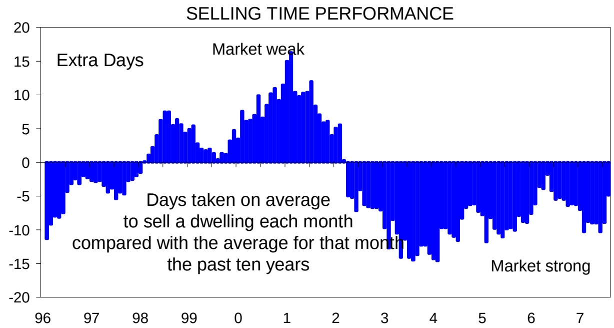


Those sort of numbers mean it is fair to say that residential real estate activity is dropping like a stone. But as noted above this decline in activity is not yet being reflected in house prices actually falling. Our view remains that house prices will hold up though the chances of rises over the next couple of years are clearly diminishing.

BNZ WEEKLY OVERVIEW

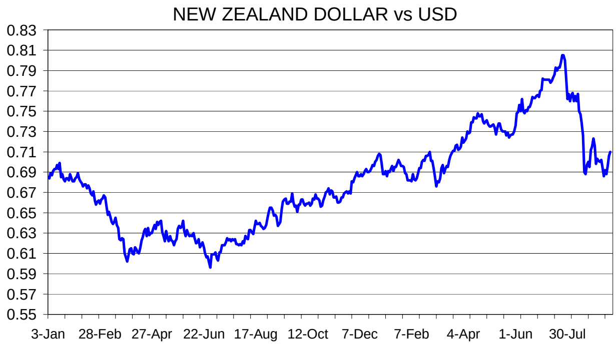
The other big piece of data contained in the monthly REINZ released is the average number of days taken to sell a dwelling. In August this was 33 which was exactly the same as in August a year ago. This result was still 4.9 days faster than the average number of days taken to sell a dwelling in the month of August over the past 10 years. However this relative improvement compared with 8.9 days in July and 10.3 days in June. In fact this was the weakest result compared with average performance since June last year and again shows activity easing off in the real estate market.

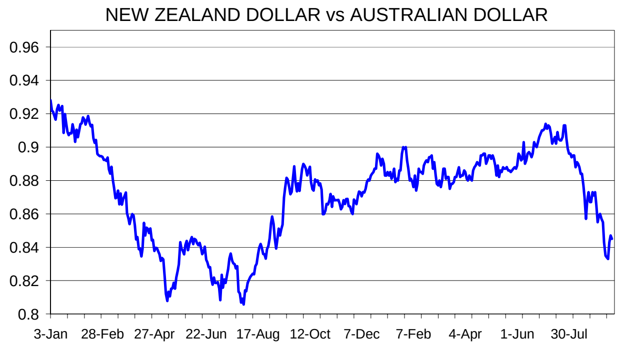




EXCHANGE RATES

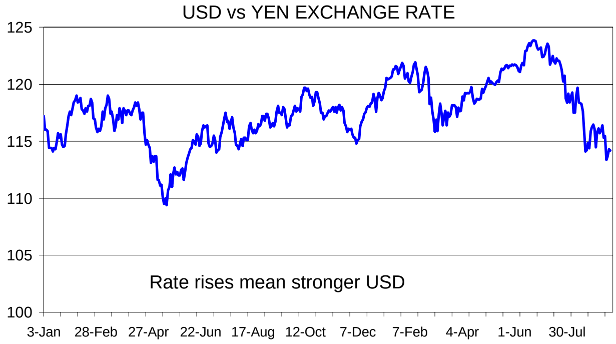
The Kiwi dollar fell to almost 68 US cents a month ago in response to a sharp lift in investor caution around the world and since then we have broadly been trading in a range from 68 cents to just over 72 cents. Two weeks ago at the time of writing the last Weekly Overview the Kiwi dollar was trading near 70.3 cents, a week ago it was 68.6 cents, and late this afternoon it was back near 71 cents. We expect high volatility in the Kiwi dollar to continue over the coming weeks and probably months and it is quite difficult to take a firm position on where we may be somewhere like six or nine months down the track. This is only partly because it is unclear how long the foreign liquidity crisis and dent in investor risk tolerance will last or how bad it will get. On top of that we have the extremely strong support for our currency from booming commodity prices, a widening interest rate differential between ourselves and United States, versus a slowdown in our domestic economy.

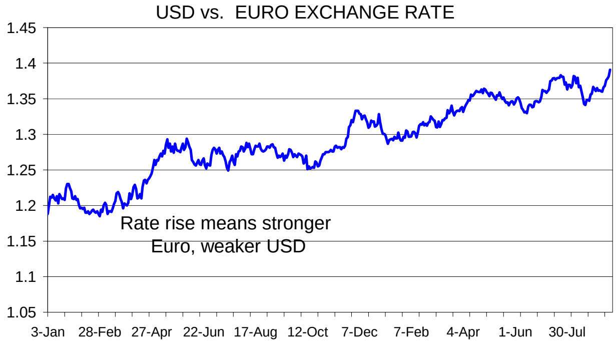




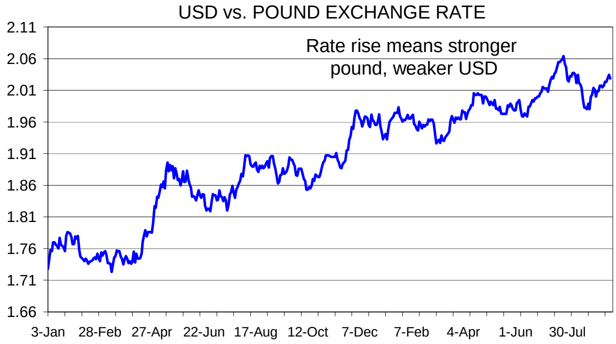
Exporters may want to take advantage of periodic declines in the Kiwi dollar back toward the 68.0 cent level.

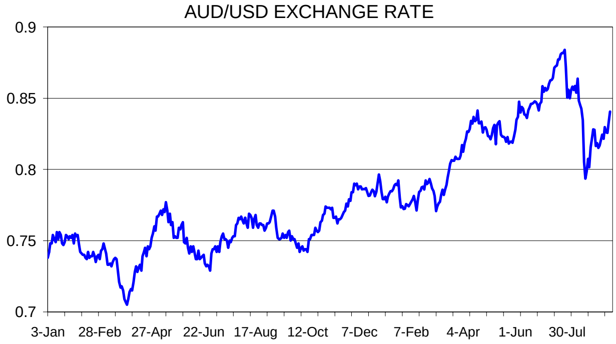
Two weeks ago against the euro the greenback was trading at $1.365. The euro is now at a record high since it was created in 1999 of just over $1.39. This decline in the greenback can also be seen against other currencies. It is currently near 114.1 Japanese yen from 115.2 a fortnight ago (in spite of selling of the yen one might have expected to follow the resignation of the Japanese Prime Minister), and $2.028 against the pound from $2.0 a fortnight ago. Most of this decline in the greenback came about after the non-farm payrolls report for August showed job numbers declining 4000 whereas a rise of just over 100,000 had been expected. The decline has increased worries that falling house prices and problems in the sub-prime mortgage market will lead to a hefty reduction in household spending and given that household spending makes up about two thirds of economic activity in a modern economy that this could push the US into recession.





We still see that has a low probability scenario but the deterioration in outlook understandably has led to some disinvestment from the United States while at the same time causing United States interest rates to fall and further depressing the currency on the basis of shrinking interest-rate differentials.





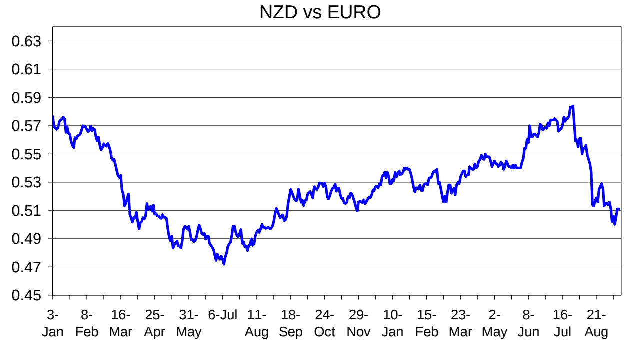
There is a very good chance the Federal Reserve will cut their funds rate next week from 5% to 5.25% though many players expect a cut to 4.75%. The difficulty for the Federal Reserve is that while on the basis of the deterioration in the economic outlook a 0.5% cut could be justified it would send a signal to errant lenders and unwise borrowers of recent years that the Fed will always do its best to bail them out. That attitude needs changing and for that reason the Fed may not be as generous in their cuts in coming quarters as many are expecting.

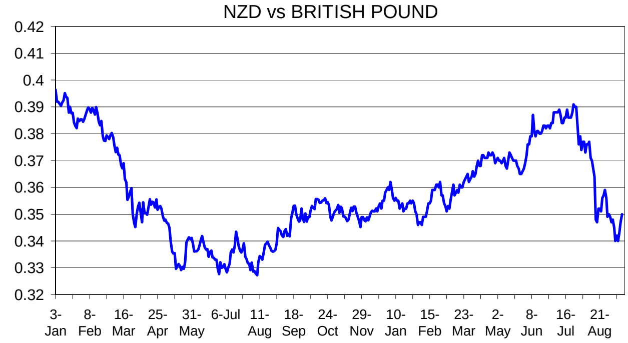
In contrast with expectations of easing monetary policy in the United States the European Central bank appear to have made some effort to continue issuing hawkish commentary about their economy and monetary policy risks there. Comments have included those along the lines of “risks to price stability are on the upside” and a tightening bias remaining in place. It's likely that the ECB will raise their cash rate from 4% to 4.25% next month.

Then again, in the United Kingdom there is more general agreement that previous upside risks to inflation and interest rates have been severely dented by the continuing liquidity crisis. In addition news of a fresh foot and mouth outbreak along with relatively strong worries about the exposure of UK financial institutions to the United States sub-prime mortgage market have tended to suppress gains in the pound against the weakening greenback.

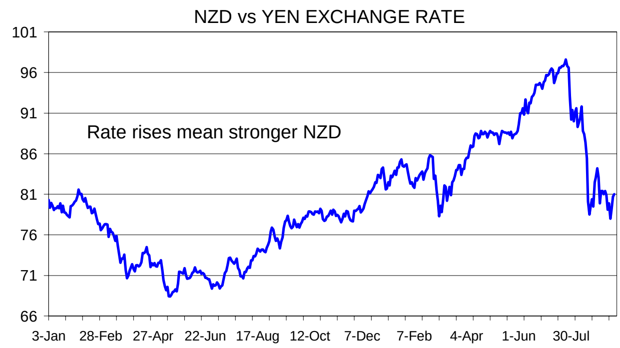
In Australia most of the economic data releases recently have surprised on the strong side. For instance the economy grew by 0.9% in the June quarter whereas a rise of 0.6% had been expected. The NAB’s monthly business conditions survey continues to find robust employment and investment plans and optimism about the future for the economy. In addition consumer confidence rebounded 4.2% in one measure in September after falling 8.1% in August following the Reserve Bank of Australia's interest rate increase. The relevant index is sitting at 115.7 which is 15% higher than the long-term average and suggestive of continuing good growth in retail spending and support for the Australian housing market.

This divergence between prospects for growth in Australia and New Zealand helps explain why we have seen the Kiwi dollar fall so strongly against the Australian currency over the past few weeks. Investors have been buying the Australian dollar while selling the Kiwi dollar. The Aussie currency has also been supported by some recent new firming in commodity prices with continuing evidence of strong growth in the Chinese economy in particular. Late this afternoon the Kiwi dollar was trading near 84.5 cents against the Aussie currency compared with 86.0 cents two weeks ago though this is an improvement from 83.5 cents last week.





With regard to the other cross rates we currently have the Kiwi dollar near 35 pence from exactly the same a fortnight ago and 34 pence last week, 81 Japanese yen compared with 79.1 last week and just over 81 a fortnight ago. Against the euro we are near 51.1 cents from 50.2 cents last week and 51.5 cents a fortnight ago.



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	1.0%	0.5	2.0	4.0	2.9
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%	3.6	3.7	......	3.6	3.7
Jobs growth	Average past 10 years = 1.9%	0.7	1.2	1.5	3.1	3.0
Current a/c deficit	Average past 10 years = 5.5% of GDP	8.5	9.0	......	9.6	7.4
Terms of Trade		0.6	1.5	2.5	0.5	1.0
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%.	-0.8	3.6	5.5	4.8	7.0
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	+8,970	11,230yr	......	12,150	6,890
Tourism - yr ago grth	10 year average growth = 5.0%. Stats NZ	3.9	4.3	3.7	-0.9	5.3
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	-8	-10	3	-29	8
Business activity exps	10 year average = 26%. NBNZ	16.7	12.4	25.7	6.1	14.2
Household debt	10 year average growth = 11.3%. RBNZ	13.7	13.8	13.1	13.8	15.0
Dwelling sales	10 year average growth = 3.5%. REINZ	-25.3	-14.3	8.9	0.3	4.2
Floating Mort. Rate	10 year average = 8.1%	10.55	10.30	9.55	9.55	9.00
3 yr fixed hsg rate	10 year average = 7.9%	9.10	9.00	8.15	7.99	7.45

ECONOMIC FORECASTS

Forecasts at Aug. 2 2007	**March Years**					**December Years**				
Due for an update!	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009
GDP - annual average % change										
Private Consumption	4.5	2.4	3.4	1.8	0.3	4.7	2.3	3.9	1.9	0.6
Government Consumption	5.1	4.2	2.9	3.5	3	4.3	4.5	3.1	3.4	3.2
Investment	4.2	-3.2	8.3	4	4.7	3.5	-2.7	7.4	4.2	4.5
GNE	4	0.7	4.8	2.8	1.9	4.1	0.7	4.6	3.1	2.1
Exports	-0.3	3.2	1	3.4	3.6	-0.6	1.9	2	2.7	3.7
Imports	4.1	-1.3	7.2	4.2	3.1	5.5	-2.5	7.4	4.3	3.2
GDP	2	1.7	2.9	2.3	1.9	2.2	1.5	3	2.3	2.1
Inflation – Consumers Price Index	3.3	2.5	2.9	3.7	3.2	3.2	2.6	3	3.3	3.4
Employment	2.6	1.7	1.4	0.9	1	1.5	1.4	2.3	1	0.9
Unemployment Rate %	3.9	3.8	3.6	4	4.4	3.6	3.7	3.6	3.9	4.3
Wages	4.6	5.5	5.1	4.5	3.6	5.1	5.5	5.2	4.7	3.8
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.64	0.7	0.71	0.63	0.6	0.7	0.69	0.73	0.65	0.59
USD/JPY	117	117	117	111	107	119	117	120	112	110
EUR/USD	1.2	1.32	1.35	1.28	1.23	1.19	1.32	1.36	1.3	1.24
NZD/AUD	0.87	0.88	0.86	0.81	0.8	0.94	0.88	0.87	0.82	0.8
NZD/GBP	0.36	0.36	0.36	0.33	0.32	0.4	0.35	0.37	0.34	0.32
NZD/EUR	0.53	0.53	0.53	0.49	0.48	0.59	0.52	0.54	0.5	0.48
NZD/YEN	74.6	81.9	83.1	69.9	63.9	82.7	81	87.6	72.8	64.9
TWI	65.6	68.6	68.7	62.2	59.8	71.9	68	70.6	63.8	59.4
Official Cash Rate	7.25	7.47	8.25	7.5	6.5	7.0	7.50	8.25	7.75	6.75
90 Day Bank Bill Rate	7.55	7.78	8.41	7.68	6.72	7.49	7.64	8.49	7.91	6.97
2 Year swap	6.99	7.76	7.91	7.01	6.55	7.24	7.48	8.3	7.21	6.58
10 Year Govt Bond	5.71	5.91	6.6	6.2	5.9	5.89	5.77	6.7	6.3	5.9

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.