BNZ Weekly Overview

22 November 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	8.25	7.25	6.2
90-day bank bill	8.73%	8.69	8.59	9.18	7.62	6.4
10 year govt. bond	6.27%	6.53	6.37	6.23	5.67	6.5
1 year swap	8.77%	8.84	8.71	8.64	7.63	6.6
5 year swap	8.16%	8.27	8.10	7.94	7.03	7.0
NZD/USD	0.752	0.763	0.754	0.695	0.67	.567
NZD/AUD	0.862	0.85	0.842	0.867	0.87	.859
NZD/JPY	81.7	85.2	87.3	79.5	78.9	66.1
NZD/GBP	0.365	0.371	0.369	0.351	0.352	.342
NZD/EURO	0.506	0.521	0.528	0.516	0.522	.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".

A Trip To Tokyo

I'm on the road practically every week of the year between February and December giving talks to business audiences from one end of the country to the other. Only rarely does an invitation arrive to speak overseas but that was the case last week when I delivered a presentation to the Japan-New Zealand Business Council 34th annual meeting in Odaiba, Tokyo, Japan. Having never been to Japan before it was a wonderful experience with the most impressive thing being the phenomenal transport system. The train network is extremely well developed and you never have to run for a train because there are so many on the tracks travelling eerily on time.

Next week if space permits in the Weekly Overview I'll run through some of my experiences over there when not attending the conference. But for this week we'll concentrate on business and economic matters.

Just over 100 New Zealand and Japanese business people attended the conference with an almost even split. The newly appointed New Zealand Minister of Tourism Damian O'Connor was there ahead of his attendance at the biggest New Zealand cultural event ever to be held in Japan - New Zealand Paradise Week 2007. The Japanese Ambassador to New Zealand and the New Zealand Ambassador to Japan were also in attendance.

With regard to what was discussed there we offer the following main points.

On the New Zealand side the things being sought by delegates included the following.

- First and foremost a Free-Trade Agreement between New Zealand and Japan which includes the agricultural sector. It was pointed out that the primary products that are sensitive in Japan are not under threat from New Zealand as we do not produce rice or sugar and we don't export wheat, barley or pork to Japan. In addition our fruit and vegetable supplies such as Kiwifruit and squash are sent in Japan's off season. New Zealand supplies beef equivalent to only 1% of Japanese consumption in a normal year and our meat is BSE free!
- An increase in the number of Japanese tourists coming to New Zealand.
- More Japanese students travelling to New Zealand under the school exchange program and in order to do that an increase in the officially defined budget per student in Japan.
- More direct investment by Japanese companies in New Zealand.
- Awareness that in a world of increasing resource shortages including food Japan needs to give thought to whether it wants to source its future food supplies from New Zealand with our high focus on quality standards - or China.
- Japanese entry into the New Zealand telecommunications market. (Apparently they run 50mbs over copper.)
- Japanese business and government participation in the International Business Forum – arranged Japan-New Zealand Partnership Forum meeting planned for Tokyo in May 2008.
- Greater New Zealand involvement in the Japanese agricultural sector with a view that we have something to offer in terms of reducing what appears to be a growing rural-urban divide in Japan. Zespri's licensing of growers in Japan is seen as the potential tip of the iceberg for NZ assistance in development of the Japanese agricultural sector.
- Awareness that the situation regarding future electricity supplies in New Zealand in light of many recent announcements regarding increased generation is not as bad as thought. An extra 1.6 GW in capacity is expected before 2011 and $1.4 billion is being spent on line upgrades.

On the Japanese side the sort of things the delegates were interested in promoting included the following.

- Greater numbers of tourists from New Zealand.
- Much greater certainty about growth in electricity availability and security going forward.
- Reconsideration of the proposed changes in age and emission standards for used car imports.
- A massive upgrading of New Zealand's poor broadband telecommunications infrastructure.
- Encouraging Japanese tourists to buy New Zealand blackcurrants to assist sales of such products in Japan.
- More capacity on flights to and from New Zealand.
- Reductions in fuel surcharges on air flights.
- Consideration of how Japanese and New Zealand companies could benefit from Japan's rapidly growing number of retiring baby boomers.

Suffice to say that the top goal for most in attendance would be a full Free-Trade Agreement between New Zealand and Japan including agriculture and one hopes progress on such can be made in the near future. As a point of interest one might like to note that while here in New Zealand we promote ourselves as clean and green the household waste recycling program in Tokyo is years in advance of what we have in New Zealand. In addition this morning we learnt from a UN report that NZ carbon emissions increased 25% between 1990 and 2005 ranking us fifth worst increaser of the 38 countries covered. The image we promote as our strength actually risks becoming a weakness in a climate where awareness of environmental issues appears to be climbing faster overseas than here.

It's interesting to think of some of the comparisons between New Zealand and Japan. First of all we are of similar size with New Zealand being about three quarters the size of Japan in land area. But whereas we have a population of 4.1 million people Japan's population is 128 million. But our population is growing at a rate of about 1% per annum while their's is shrinking slightly.

http://www.reuters.com/article/latestCrisis/idUST277542

The Japanese government's finances are in very bad shape with ongoing deficits and a huge public debt equal to almost 150% of GDP. In New Zealand however our governments have been running fiscal surpluses for 15 years now and outstanding gross public debt is equal to only just over 20% of GDP with net debt almost zero.

Since New Zealand's upturn in 1999 growth has come largely from the rural sector and the provinces with Auckland tending to lag behind. Looking forward this pattern is likely to continue in light of infrastructure problems facing Auckland, the tight labour market and so on discussed further on in this weeks Overview, plus the boom in commodity prices and structural shift in long-term price prospects boosting the regions. In Japan the rural sector is lagging behind badly and there is strong concern about a rural/urban divide.

In New Zealand substantial economic reform was undertaken a long time ago in the 1980s and early 1990s. In Japan there is strong awareness that major reform is required but the political situation makes this very difficult.

In Japan people are being encouraged to save less money and spend more to try and diversify the source of growth in the economy away from business capital expenditure and exports towards private consumption. In New Zealand the policy focus is the opposite with encouragement being given to New Zealand households to boost their savings. (Our spend less bit is implied but not usually spoken by other than the elderly who remember the Depression.)

Japan runs a huge current account surplus in its trade with the rest of the world while we run a large deficit with no prospect of surplus for a few decades. Japan now gets half of its receipts from investments overseas. For New Zealand this proportion is about 5.5%.

We are both earthquake prone countries and while we don't have the massive hit to Japan's construction sector currently underway because of increased requirements for seismic strengthening and reporting we do have the leaky building problem. Perversely our problem appears to be boosting construction work while the effect in Japan seems to be the opposite.

They have Mount Fuji and we have Mount Taranaki with our mountain standing in for their's in the Tom Cruise movie a few years ago "The Last Samurai". Like Kiwis the Japanese people are fond of hiking and drive on the left-hand side of the road. They also have lots of hot springs people love going to while we have a massively untapped tourism resource in New Zealand and as far as we know there is only one proper Japanese-style spa set up in New Zealand in the Lewis Pass. (Well worth a visit one hears.)

We have a structurally tight labour market in New Zealand that is unlikely to change in the next few years. Our unemployment rate is 3.5% while the Japanese unemployment rate is practically the same at 3.8%. However taking into account the number of greeters at stores and hotels, the 30 people one observed helping erect a Christmas tree outside the Fuji Television headquarters, and the 12 people seen standing around looking at a hole in the road being dug by one person on a digger (circa NZ 2-3 decades ago) one would suggest they have an underemployment problem. (The people in the Tokyo fish market last Friday definitely showed no sign of underemployment however with frenetic activity and high speed jiggers transporting loads of fish around the site making walking around very hazardous. Not an activity for large groups but a wonderful experience. No whalemeat in evidence.)

Perhaps the most interesting thing is this. The general expectation is that the Japanese economy will grow close to 2% per annum over the next few years. We have a similar expectation for New Zealand of maybe 2% to 2.5%. But we expect our growth to occur in an environment where the official cash rate is going to be kept at the current level of 8.25% through perhaps all of 2008 and when cuts come through 2009 and 2010 they might not amount to much. In contrast Japan's similar growth outlook is based upon the current 0.5% cash rate continuing for a while but with slow movements first of all to 1% then maybe 1.5% a wee bit further out.

Why the difference? Partly it reflects the amazing willingness of us Kiwis to pay interest rates people overseas would not touch with a barge pole. In their regular 18 monthly review of the New Zealand economy released earlier this year the OECD recommended somebody do a serious study into why we are so thick skinned. The Reserve Bank considered hiring a psychiatrist to try and figure it out. Our inflation rate has averaged 2.1% over the past decade. In Japan in contrast there is low willingness to borrow with consumers worried about their pension incomes, house prices which have halved over the past decade or so, an ageing and shrinking population, a structural decline in job security away from lifetime employment over the past decade, and an inflation rate which over the past 10 years has averaged about -0.1% per annum with generally falling wages. Plus there are 50 million people

As noted above, next week if space permits some other observations about Japan will be included in the Weekly Overview.

Auckland Commentary

One of the themes we have been dropping into the Weekly Overview and one or two other publications since the start of the year has been potential for the Auckland economy to look like it is struggling relative to other parts of the country over the next few years. Our expectation is that over time we are going to see increasing expressions of concern about the relative economic performance of Auckland especially in light of the boom in the dairy sector. Over this past week we have seen one housing market analyst produce a fairly bad set of forecasts for the Auckland housing market in the next two years.

For your guide the sorts of things which people are likely to think about in terms of generating potential Auckland underperformance include the following.

1. The past two censuses have shown a net outflow of older people from the Auckland region. With baby boomers retiring in droves over the next few years it is likely we will see even more people retiring out of Auckland to the likes of the Bay of Plenty, Hawke's Bay, Nelson, Canterbury and so on.
2. Over the past three decades Auckland's economy has received a boost compared with the rest of the country as young people will have left smaller centres to go to Auckland in order to maximise their employment chances. These days with ongoing structural tightness in the New Zealand labour market the need to do that is minimal. Increasing numbers of young people are likely to stay out of Auckland in order to get cheaper housing, better commuting experiences, equally good if not better cafe experiences, and so on with little diminution of incomes or career prospects.
3. Maybe for somebody from the back blocks Auckland looks big. But by world standards it's a tiny city and we are finding increased frequency of the comment that if one wants to go to a big city one will move to one that has a far better infrastructure than Auckland. And with the well-known international mobility of New Zealanders perhaps this explains the relatively sharp increase in the number of Kiwis going to Australia in the past year.
4. Telecommuting is often talked about but over time this is likely to lead to a greater number of people choosing to live and work in the regions. In fact one should expect that once our country’s broadband infrastructure is greatly improved (surely!) telecommuting could take off with increasing numbers of people choosing to live in less stressful regions rather than transport-challenged Auckland. Note though that the opposite effect may occur with people finding they only need to commute to an Auckland inner city office once or twice a week if they can work from home 60% of the time.
5. Around 50% of immigrants tend to go to Auckland. With migration numbers easing off Auckland will notice the change more than other parts of the country.
6. The boom in international demand for resources including food has led to sharp increases in the prices of some food items and will likely produce increased prices for others such as beef and sheepmeat further down the line. This clearly directly benefits the incomes of farmers who tend not to be living in Auckland. In addition the capital expenditure by businesses to take advantage of improved returns on agricultural products will also tend to be focused on farms and processing facilities located not in the cities. The frontier as it were in New Zealand is in the regions - not the cities.

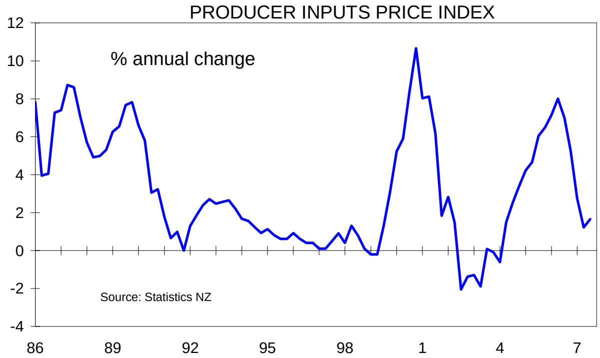
7. The high cost of living in Auckland means availability of quality staff in a tight labour market could lead to a reduction of service standards across many industries which will encourage residents to think about life outside the city.

THE WEEK'S ECONOMIC DEVELOPMENTS

Wednesday 14

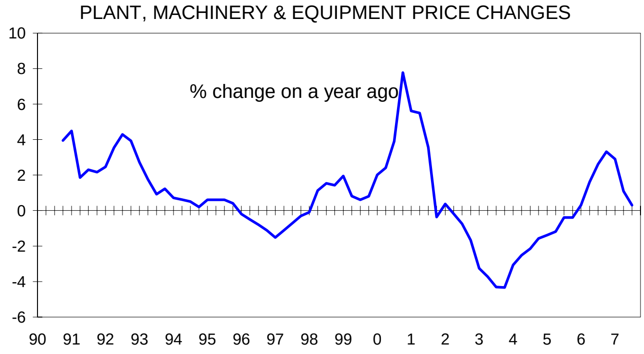
Business Costs Rising Strongly

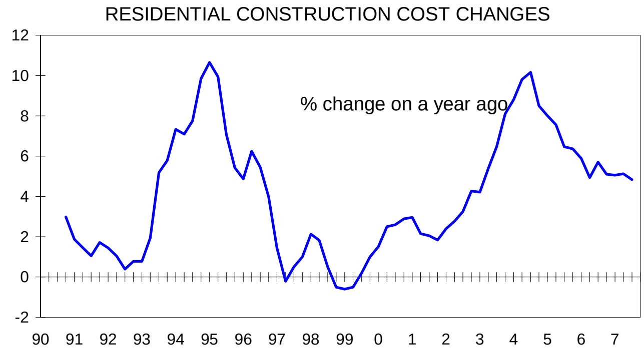
Excluding the cost of labour and depreciation, business costs on average in New Zealand rose by 2.3% during the September quarter to be 1.7% higher than a year earlier. The first question to be asked is why the low annual rate of increase in business expenses? The annual rise was suppressed by a combination of lower meat and wool prices, reduced electricity generation prices, and a pullback in fuel prices. But prices for most commodities are now on the rise again - excluding logs over the September quarter - and energy prices are heading back up. The large 2.3% rise for the September quarter is a cause of some concern. Output prices on average rose by 1.6% in the September quarter and were ahead 2.1% from a year earlier. So over the year average business margins using this exceedingly crude measure have improved slightly but the deterioration during the September quarter appears more in line with the feedback we are receiving from the business sector of declining margins.



Business Capital Equipment Costs Creeping Upward

Whereas the Producers Price Index looks at changes in all input costs facing businesses excluding depreciation and labour, the Capital Goods Price Index focuses only on the price of physical capital assets. This index rose by 0.7% during the September quarter to be 2.3% ahead of a year earlier. Nobody looks at this index for any great insight into inflationary pressures in the economy with the official inflation measure, the Consumers Price Index, already having been released a month ago. But it's worth a quick glance at changes in the costs of different capital assets. For instance over the past year the cost of building residential properties has risen 4.8% after rising 5.7% the previous year and delivering a total increase over the past five years of 38%. The cost of putting up non-residential buildings has risen by 1.7% over the past year, 6% a year earlier, and 28% over the past five years. In contrast transport equipment costs have fallen 0.6% in the past year, 0.5% a year ago, and have declined 6% over the past five years. This is a clear benefit to New Zealanders from the strong rise in the Kiwi dollar with an appreciation of the trade weighted index over the past five years of about 32%.



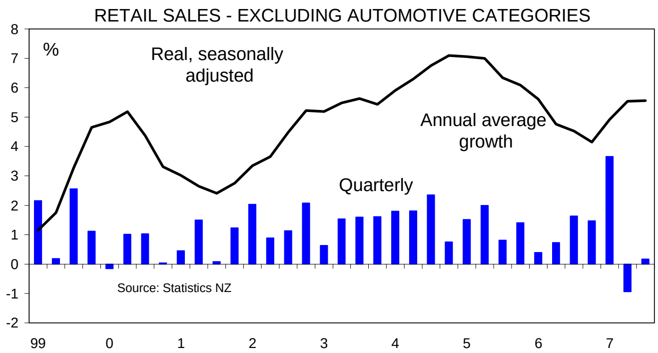


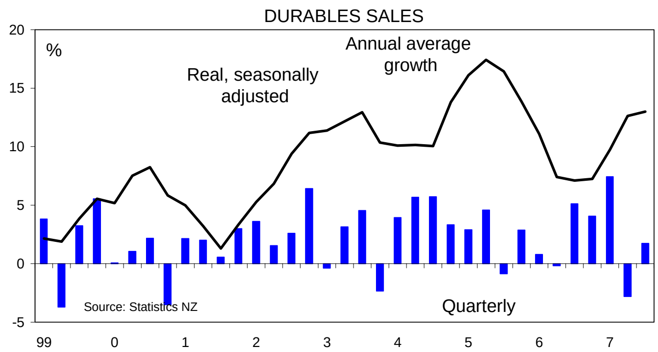
The cost of plant machinery and equipment has risen just 0.2% over the past year, was up 2.6% a year earlier, and has fallen 4% over the past five years. This is an important measure because with businesses now having to seek growth in profitability through boosting productivity the cost of plant and machinery in particular is very important. It is rising but not by all that much.

Thursday 15

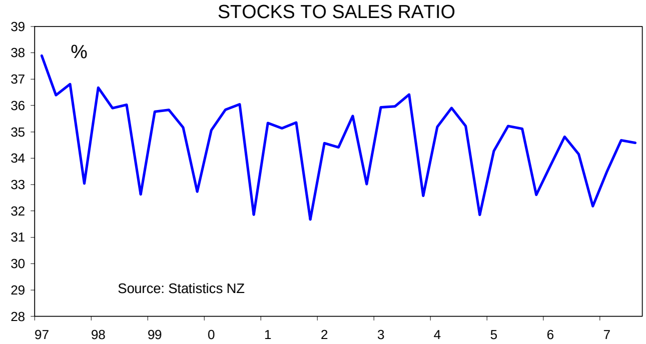
Retail Spending Still in Corrective Phase

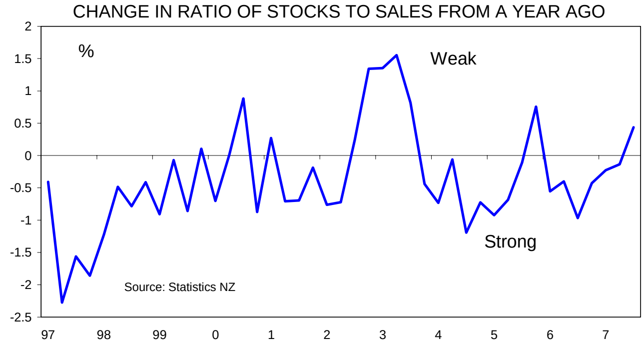
Retail spending accounts for about 38% of GDP in New Zealand so the monthly and quarterly retail numbers are important for getting a feel on where not just household spending is going but where the overall economy is moving. During the September quarter retail spending after adjusting for seasonal and price changes rose by a very low 0.2% after falling 0.7% in the June quarter. This is a fairly weak bounce back and we don't get a better picture when we take away the volatile automotives sector and focus on the core retail spending measure. This core measure also rose 0.2% in the September quarter but this followed a 0.9% fall in the June quarter. On the face of it one might think things are particularly weak - until one realises that in the March quarter core retail spending soared by 3.7% and was up about 1.5% in each of the previous two quarters. As such the weak performance over the past two quarters is probably best seen as a natural easing off in spending after a completely unsustainable boom. While we can see plenty of signs that the domestic part of the New Zealand economy is easing off we do not look at these figures and conclude domestic recession is underway. Core retail spending was still 4.4% ahead of a year earlier in volume terms while overall retail spending was ahead 5.1%.





We economists not only look at the core spending measure to try to get a feel for what is really happening with consumer spending. We also focus on what is happening with regard to spending on durable goods such as whiteware and furniture. Gathering together the storetypes which predominantly sell durable goods we see that during the September quarter in real seasonally adjusted terms durables expenditure recovered 1.7% after falling 2.8% in the June quarter. This was a relatively strong 10.5% rise from a year earlier and actually gives a better picture of the strength in retail spending than we found looking at the core number.



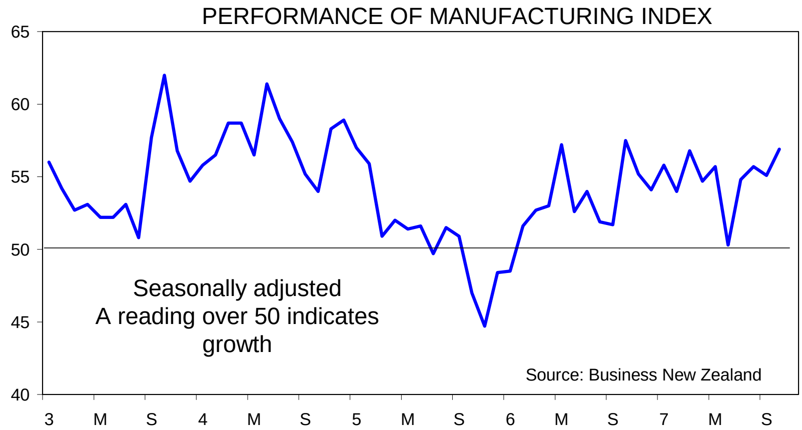


Another thing we can do is have a look at what appears to be happening with retail inventories. The value of stocks at the end of the quarter was $5.5 billion which was equal to 34.6% of retail spending in the quarter. This stocks to sales ratio was only 0.4% above the level a year earlier and does not indicate a vast accumulation of inventory ahead of Christmas.

Retail spending numbers are also calculated on a monthly basis in seasonally adjusted nominal terms. Although you often see a lot of reporting of these numbers one really shouldn't pay much attention because on a monthly basis these numbers go all over the place. But for what it's worth core retail spending improved 0.5% in September after rising 0.8% in August. This gave an annualised rate of growth over the September quarter of 2.6% which was an improvement from 1.3% over the June quarter.

Manufacturing Looking Okay

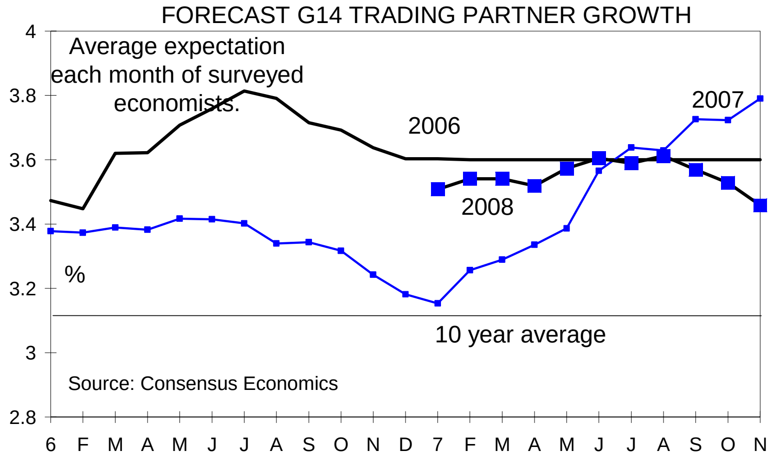
The Business New Zealand Performance of Manufacturing Index in seasonally adjusted terms for October came in at a reading of 56.9 from 55.1 in September. This is the highest reading since May 2006 and is above the average reading since the series started in the middle of 2002 of 54.5. A reading above 50 indicates growth in New Zealand's manufacturing sector. The latest number indicates good strength in manufacturing and a lot of this is likely to be due to the Kiwi dollar's recent fall against the Australian currency to sit only just above the 22 year average of 83.0 cents. Making comments about New Zealand's manufacturing sector is quite a difficult thing to do because it is spread across a wide range of industries and doesn't tend to be a sector which leads growth in the economy. For that one would look instead towards primary production. Perhaps the most sensible thing is to note that about 45% of non-primary manufactured exports go to Australia and with the Kiwi dollar not too high against the Aussie currency and the Australian economy booming prospects for manufacturing look quite good - as we have been pointing out all year.



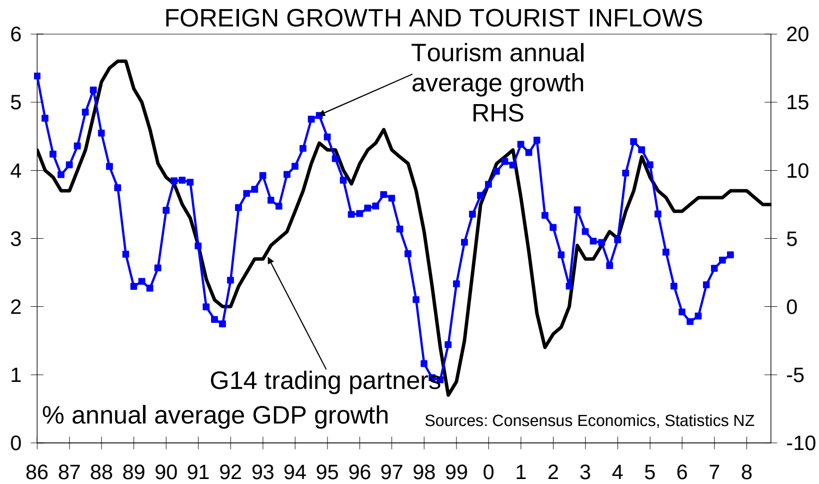
Friday 16

Foreign Growth Prospects For 2008 Creeping Down Slowly

The top 14 economies to which we send about 80% of our merchandise exports have grown on average by 3.1% per annum over the past decade. Last year they grew by 3.6% and in the monthly survey undertaken by Consensus Economics based in London it was found that growth this year is expected to be 3.8%. This was an improvement from 3.7% in the October survey and 3.6% back in July before the global financial liquidity crisis got underway. The first graph below shows the average growth expectation for each monthly survey since the start of 2006. The improvement for this year mainly reflects data for some economies for growth in earlier months coming in higher than expected. Growth in Australia is now expected to come in at 4.3% this year compared with an expectation of 3.9% back in July. United Kingdom growth prospects have been revised from 2.8% to 3%, China from 10.5% to 11.3%, Singapore 6.2% to 7.9%, and South Korea 4.5% to 4.9%. Over the same period of time cuts have been made for the likes of Japan from 2.5% to 2%, and France from 2.1% to 1.8%.



It's a different story for 2008 however with average growth for our top 14 trading partners revised down from an expectation of 3.6% in July to 3.5% this month and in the October survey. Back in July the United States economy was expected to grow over 2008 by 2.8%. That expectation now is 2.3%. Japan was expected to grow 2.2% but now growth of 1.8% is commonly forecast, for the UK the change has been from 2.2% to 1.9%, and Germany from 2.4% to 2.1%. But expectations for growth in Australia have been revised up from 3.5% to 3.7%, China from 9.9% to 10.5% and Singapore from 6% to 6.3%. Overall the results still imply an acceptable growth environment facing New Zealand exporters on average but we would suggest with continuing downside risks for growth related to a strong chance of further weakening in the United States housing market and United States economy, and further ructions with regard to the international liquidity crisis.

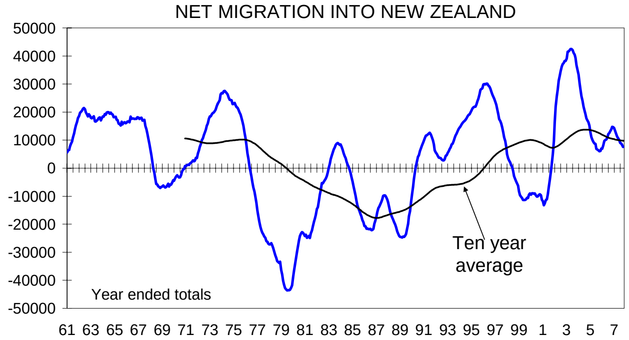


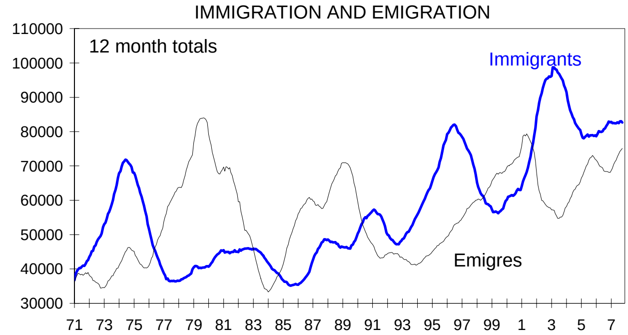
We have included the graph above because us economists love to have pretty pictures showing lines that tend to move together. There is a good correlation between changes in the rate of growth of our trading partners and changes in the rate of growth in the number of tourists coming to New Zealand. The reasonable (with downside risks) foreign growth outlook implies reasonable growth in inward tourist flows – currently ahead 3.1% in the year to October. Maybe the high NZD effect has already been seen in the dotted blue line tourist flow dip over 2005 into 2006.

Tuesday 20

Migration Tracking Below Average

There was a net gain to New Zealand's population from permanent and long-term migration flows in October of 1,561 people. This was 799 fewer than the same month a year earlier and means that the annual net gain has declined to 7,520 from 8,319 in September and 13,780 a year earlier. On average over the past 10 years the net migration gain has been just below 10,000 people per annum therefore the latest result is marginally weak. With New Zealand's population at 4.1 million people and gross inflows and outflows usually sitting around 80,000 migration movements are far more important as an influence on our population and economy than is the case in most other countries around the world. In fact relative to population migration flows are over four times as important to us as they are to Australia.





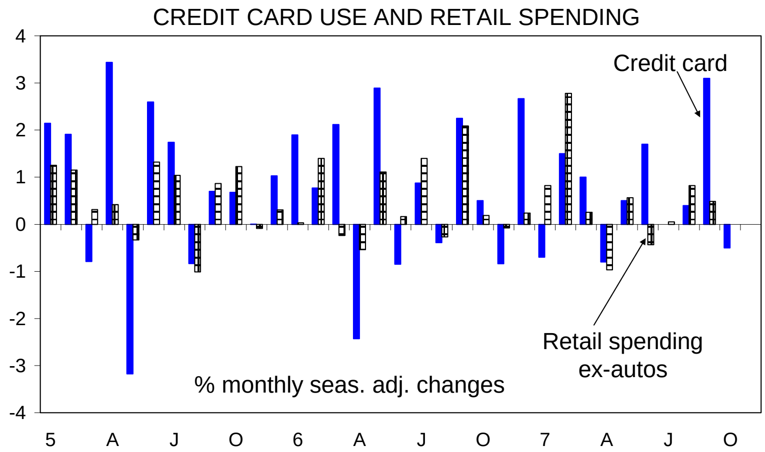
This not only means the sometimes big changes in migration flows can significantly influence housing demand and retail spending there is also a multiplier effect. This comes about because us Kiwis are well aware migration flows can change a lot and that these flows can have a significant influence on the housing market. So when we see the migration numbers getting strong we hop out and buy properties before the migrants do and when we see the numbers getting weak we get somewhat despondent and look to flog off our property assets. The below average migration numbers at the moment therefore are a contributing factor to cautious sentiment in the housing market and help explain why average nationwide prices have gone nowhere since May.

For the record, in seasonally adjusted terms the net migration gain in October was only 260 people. This was below 660 in September and 720 in August and the weakest result since April. And as a point of interest in the year to October the number of Australians shifting to New Zealand was practically unchanged from a year earlier at 13,646. But the number of Kiwis leaving to live in Australia jumped sharply to just over 40,000 from just over 33,000 last year. The net loss across the ditch therefore has jumped to almost 27,000 from 21,000 last year.

Wednesday 21

Credit Card Spending Eases

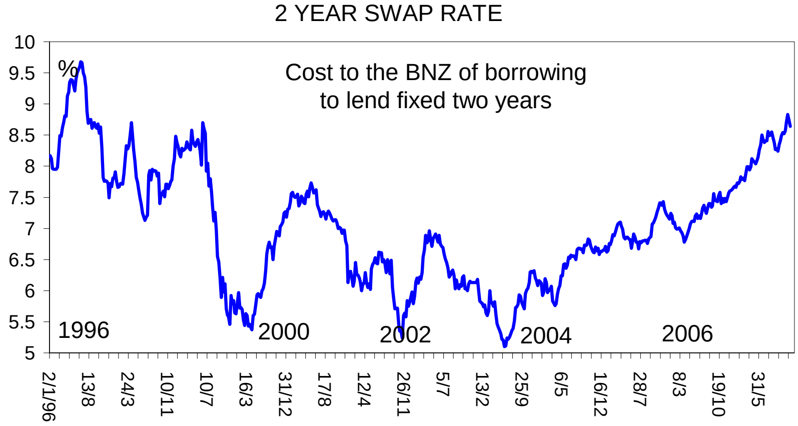
Total retail spending in New Zealand each year amounts to about $64 billion. Some $27 billion worth of that spending is undertaken using credit cards. Each month the Reserve Bank releases seasonally adjusted data on retail spending using credit cards so we can look at these numbers to try and get an early indication of what is happening with retail spending with an implication for total private consumption. In October seasonally adjusted core credit card spending rose 05% after falling 3.1% in September. There is very little correlation between the magnitude of change in credit card spending and the magnitude of change in retail spending though the direction of movement tends to be the same as shown in the graph below. Therefore it is likely retail spending in nominal seasonally adjusted terms excluding the volatile automotive sectors fell in October but one can't really take a stab at what the decline was.



INTEREST RATES

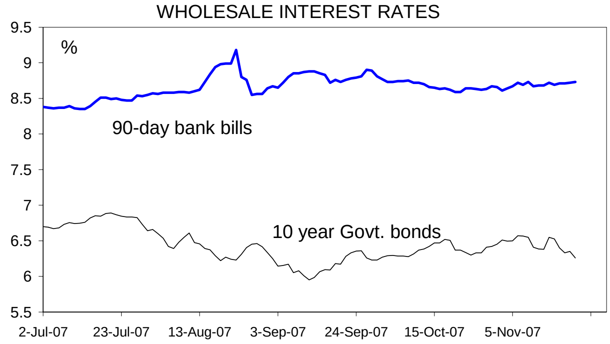
A fortnight ago fixed wholesale borrowing costs were at unusually high levels caused by a surge in concern that the Reserve Bank may be tightening monetary policy again plus a fresh liquidity crisis-related increase in international borrowing costs. But since then we have seen some poor data emerge on the United States economy with weakness in their sharemarket and that has led to a reduction in United States borrowing costs which tend to influence our fixed rates. For instance the United States 10 year government bond yield has fallen to around 4% currently from 4.3% a fortnight ago.

The two year swap rate at which we banks borrow to lend fixed for two year periods has eased to around 8.64% from 8.83% two weeks ago. That rate a fortnight ago was the highest since 1998 and even the current rate is still very high as the graph below shows.



If all that was happening was the US housing market was bucketing off we would be speaking in terms of fixed borrowing costs falling maybe 0.5% over the next few months. But the global liquidity crisis throws a spanner into the works and it says to us that while over the coming year fixed borrowing costs will decline the magnitude of that decline may initially be quite limited.

The yield on 90 day bank bill that is relevant to overdraft rates and other business short term borrowing costs has ended today near 8.73% which is barely changed from 8.69% two weeks ago. The economic data in New Zealand received recently have not radically altered the market view that the next change in monetary policy could still be a tightening in light of the pre-election easing of fiscal policy plus further rises in global commodity prices including food and oil.



If I Were a Borrower What Would I Do?

Refrain from optimism. Although the global outlook has deteriorated recently due to the worsening situation in the US and some weak data out of Japan, plus local housing data are weak, inflation remains a big problem in our shaky isles. One day we're going to be saying something different but after over three and a half years of warning about the inflation risk and being right it seems a good idea to stick with the same plot until its obviously wrong. We seem a long way from that point and it would not be wise for borrowers to feel optimistic about their debt servicing costs going down for quite some time.

But with regard to what I would do as a borrower we have finally after a very long period of time reached the point at which fixed interest rates are high enough and the risks for global and local growth slightly negative enough that moving away from our standard recommendation of fixing two years becomes optimal for many borrowers.

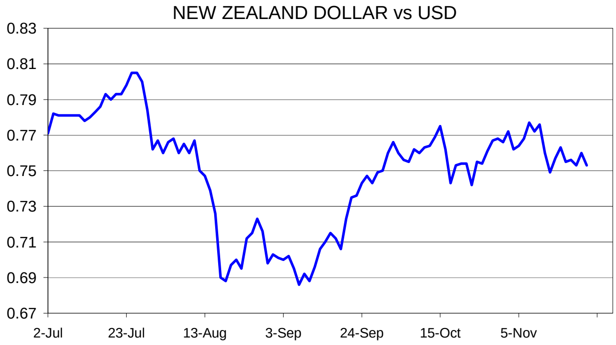
Taking the BNZ as an example our current two-year classic fixed housing rate is 9.39%. If it was a choice between fixing for this period and floating at the current variable rate of 10.55% I personally would still fix two years. But if one signs up for the alternative 9.49% variable rate contained in the Total Money package then given the high probability of easing monetary policy over 2009 it becomes a no-brainer to float.

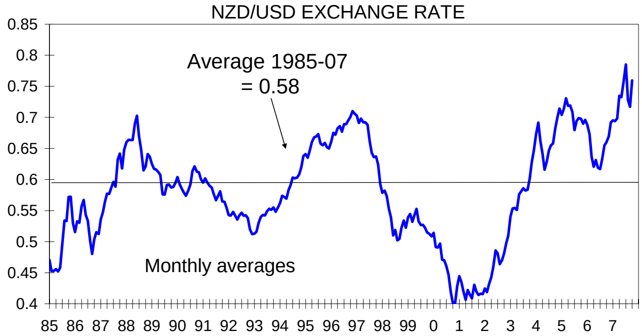
HOUSING MARKET UPDATE

We were intending to write about the October REINZ data released a fortnight ago but this week's Overview is already big enough so we are going to leave this space blank.

EXCHANGE RATES

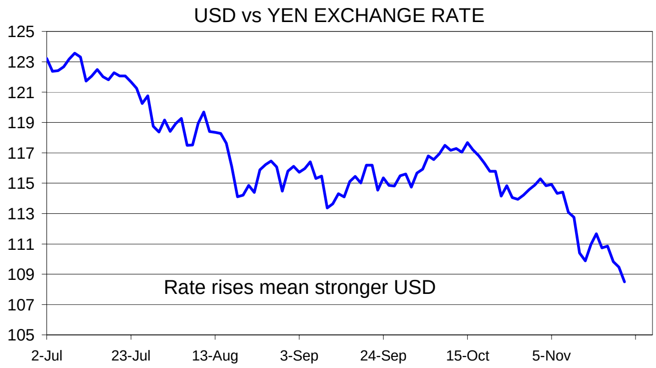
Remembering that the Kiwi dollar is viewed as a peripheral and risky currency it should come as no surprise that in light of ructions in global financial markets associated with the liquidity crisis in the past fortnight we have seen some fairly strong movements in the Kiwi dollar against both the weakening greenback and on the cross rates over the past fortnight. This afternoon we have ended against the US dollar near 75.2 cents compared with 77.2 cents a fortnight ago. Some extra downward pressure on our currency has come about in response to the slightly weaker than expected retail trade numbers for the September quarter along with the generally weak housing market data for October.

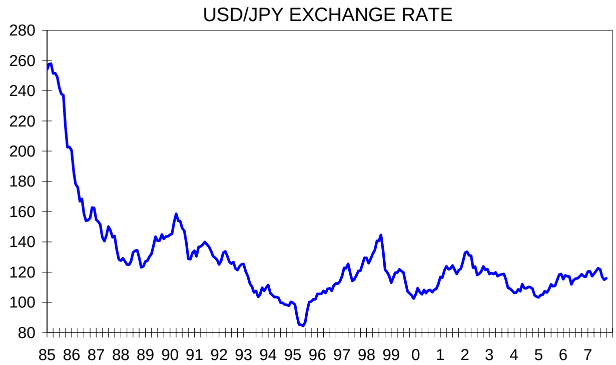




Given our expectation of continued firm commodity prices over the coming year plus high short term interest rates it would be surprising if we saw any substantial depreciation of a sustained nature in the Kiwi dollar over the coming year. But high volatility is likely to continue and exporters and importers should keep an eye out for such events in order to improve short term hedging levels.

The greenback itself has weakened against both the euro and Japanese yen over the past fortnight though has made a small gain against the British pound. In the United States over the past fortnight we have seen most economic data releases surprise on the weak side. Data related to the housing market shows construction activity and plans at their lowest levels in 16 years. Last night we learnt that the University of Michigan consumer confidence measure for November came in at a reading of 76.1 from 80.9 in October. Apart from the Hurricane Katrina period of two years ago this was the lowest reading since 1992. Industrial production in the US for October fell by 0.5% which was worse than the median forecast of a rise of 0.1%. The capacity utilisation rate also declined to 81.7% from 82.2% in September indicating weakness in the economy is spreading out of the housing market and into the manufacturing sector.



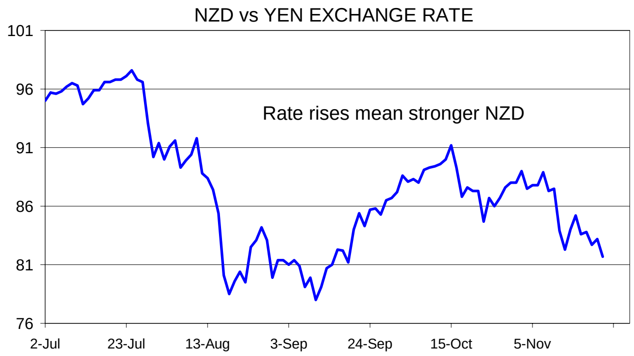


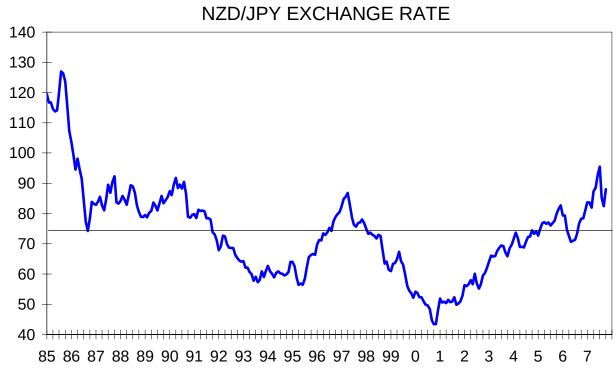
As such one of the numbers to keep an eye on ahead of the Federal Reserve's next review of monetary policy on December 11 is the Institute of Supply Management manufacturing index which will give a more forward-looking indicator of strength in the manufacturing sector. The labour market data due on December 7 will also be important because so far are there is little evidence that economic weakness is actually spreading into the labour market. If it looks like it is the expectation of even weaker consumer sentiment and spending will likely spark increased expectations of another easing from the Federal Reserve following the 0.75% worth of cuts so far.

To date the comments from various regional Federal Reserve President's have largely been along the lines that another easing in the short term may not be necessary even though the new quarterly set of economic forecasts released a few days ago showed the Fed expected growth coming in between 1.8% in 2.5% in the coming year which is weaker than the markets thought they were expecting.

As we see market expectations of the Fed. easing fluctuate and as the sharemarket moves around we can continue to expect volatility in the greenback though still around a generally weakening trend. Over the past couple of weeks this weakening trend has been accentuated by an increasing number of comments from important (some self-important) people suggesting it would be a good idea if central banks and maybe oil exporting countries diversify their reserves and investments away from the US dollar. At the recent OPEC meeting some participants strongly advocated pricing oil in a currency other than the greenback. This seems fairly unlikely given the close relationship the United States has with many large oil exporting countries and a view that those calling for such change appear motivated mainly by domestic politics.

Something interesting we came across this week is the stat that only about 20% of US growth is financed by banks versus 60%-65% in Europe. This helps explain why the US sharemarket is far more important to the US economy than perhaps any other sharemarket is to its economy elsewhere in the world.
http://www.reuters.com/article/reutersEdge/idUSL206599420071120?sp=true





The greenback has ended the week against the Japanese yen near a two-year low of 108.5 from 113.1 a fortnight ago. With the Kiwi dollar weakening against the weakening greenback that means that we have ended near 81.7 from 87.3 yen two weeks ago.

The most important piece of economic data released in Japan recently was the third quarter GDP number which showed a relatively strong annualised growth rate of 2.6% following an annualised decline in the June quarter of about 1.2%. On average growth has been 2.1% per annum over the past five years with an upturn starting in 2002. In the September quarter there was very good strength in exports plus capital expenditure but quite a bit of weakness in house construction and private consumption continues to underperform.

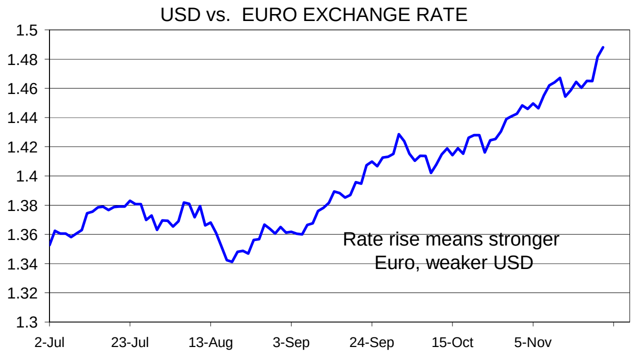
Private consumption grew 0.3% in the quarter which was well down from a healthy growth rate in late 2006 of 1.1%. Households are likely to be concerned by the loss of wealth associated with weakness in the Japanese sharemarket on the back of worries about the US economy and the sub-prime mortgage crisis. Average wages continue to fall and there is a structural change underway in the Japanese labour market with increased use of part-time and low-wage workers plus a small rise in unemployment recently. The revelation some months back that because of major data processing problems around 50 million Japanese may not have been included in the government's pension scheme is also clearly a cause for concern. One measure showed consumer confidence at a three and a half year low in October.

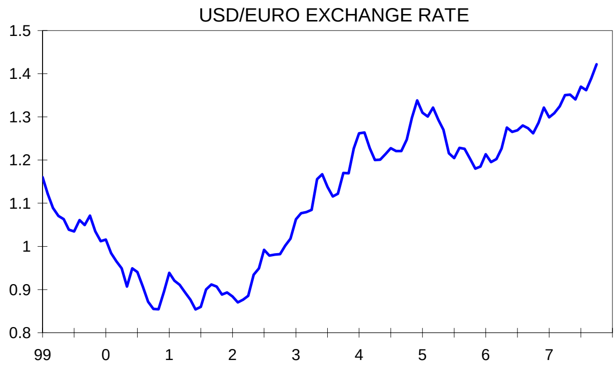
Looking ahead there is concern that not only will weak consumer sentiment restrict private consumption growth but that a recent sharp decline in business confidence will cause weakness in both employment and capital expenditure. The rise in the Japanese yen to its highest level against the greenback in over two years will also tend to depress exports slightly and to the extent the United States economy weakens this will also hit Japanese growth. But the impact of the appreciating yen is not yet evident with exports hitting a record level in October. And the comment from the Prime Minister Mr Fukuda that the yen was "…appreciating too fast …" and speculators "…need to be careful…" had little sustained impact.

Note that an eye is being kept on increasing efforts to slow down the Chinese economy with a warning from officials this week that interest rates might be increased further and a very tough new lending restriction introduced capping year end bank lending at its level on October 31 this year. in addition China's central bank increased the reserve ratio requirement for banks by 0.5% to 13.5% to try and slow lending growth - yet again.

http://www.economist.com/research/articlesBySubject/displaystory.cfm?subjectid=348969&story_id=10129726

With increasing talk and speculation - completely unwarranted in all probability - that the euro will increasingly displace the greenback as the International reserve currency, we have seen the euro gain strongly against the greenback over the past fortnight to reach a new record high just below $1.49 from $1.46 last week.

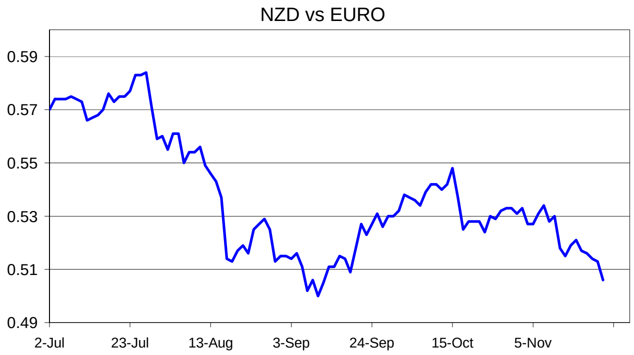


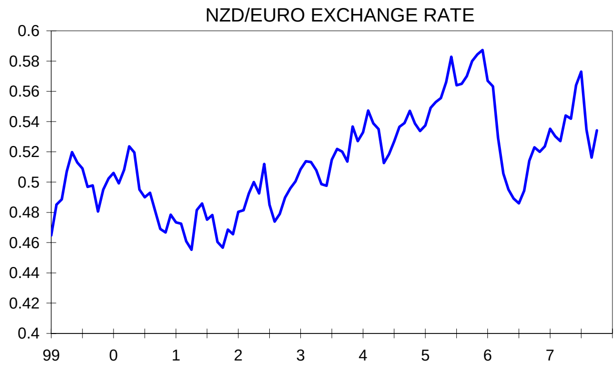


Interestingly in Europe growth has, like Japan, also been revealed at a near 2.6% annualised rate in the September quarter. This is far better than almost any quarter over the past decade and compares with growth averaging 1.7% p.a. over the past five years.
http://money.cnn.com/2007/11/15/magazines/fortune/gumbel_euro.fortune/index.htm?postversion=2007111604

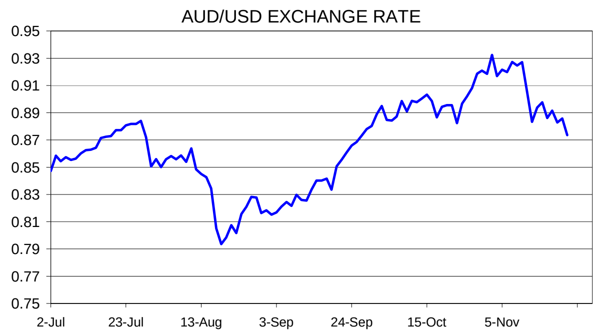
However one of the most keenly watched monthly indicators in Europe, the German ZEW survey of business sentiment fell sharply to -32.5 in November which was the lowest reading since February 1993 and well below forecasts of a -20.0 result. Because the German economy has been a key source of strength for Europe recently this has led to concerns about fourth-quarter growth in particular. Once one throws in the likely impact of the appreciating euro, tightening in lending standards to a corporate sector which many already view as highly geared, and reduced discretionary spending ability for households due to rising food and energy costs, then growth prospects risk being downgraded in coming months. One imagines the industrial unrest in France as Mr Sarkozy attempts to modernise his economy also brings downside growth risks in the short term.

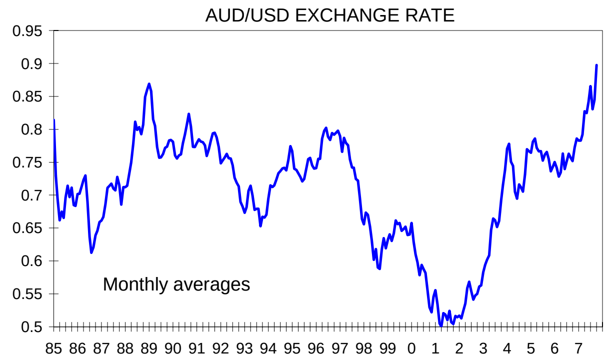
The Kiwi dollar has ended this afternoon against the euro near 50.6 cents from 52.8 cents two weeks ago. This is the lowest exchange rate since early September.



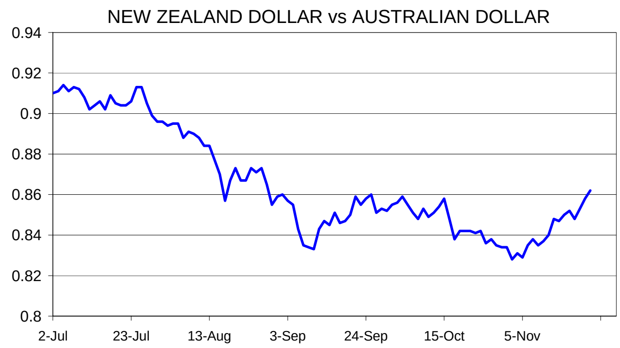


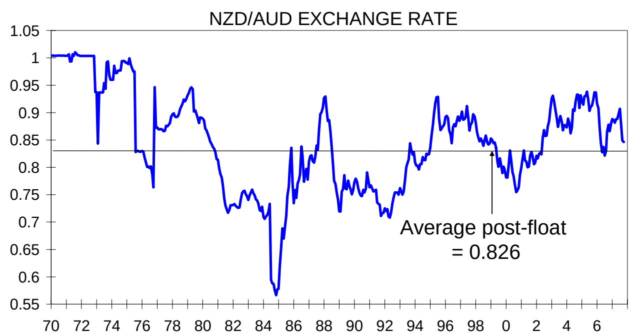
Heading into this weekend's Federal election the Aussie dollar has lost a lot of ground against the greenback over the past fortnight to end this afternoon near 87.4 cents from 92.5 cents a fortnight ago. Part of this decline is attributable to an increase in risk aversion around the world but a lot of it can be put down to a pullback in commodity prices and some caution pre-election. The fact that the Reserve Bank of Australia raised their inflation forecast for the coming year by quarter of a percent in their quarterly Statement on Monetary Policy, and the monthly NAB business survey showed a strong bounce up in business conditions initially supported the Aussie currency. But the factors noted just above plus some profit-taking following the Aussie dollar's strong rise against the Kiwi dollar saw the currency fall sharply.



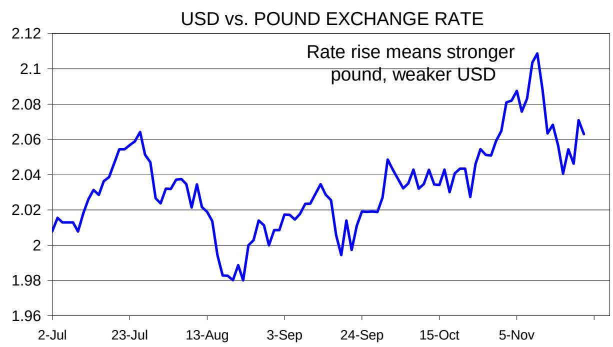


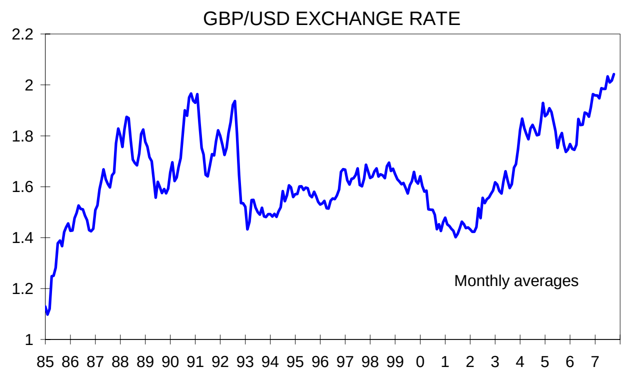
The growing dependence of the Australian economy and minerals boom on the Chinese economy means fresh Chinese efforts to slow down their growth rate may also have contributed to some AUD weakness. The Kiwi dollar has ended against the AUD near 86.2 cents from 83.5 cents two weeks ago.





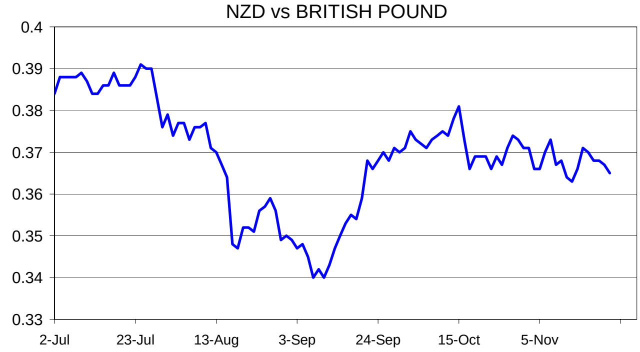
While the greenback has fallen against the Japanese yen and euro over the past fortnight that has managed to recover slightly against the British pound though still remains very weak on an historical basis. It has ended this afternoon near $2.06 from $2.10 two weeks ago. Quite clearly this gain has more to do with weakness in the pound in the past two weeks rather than strength in the greenback.

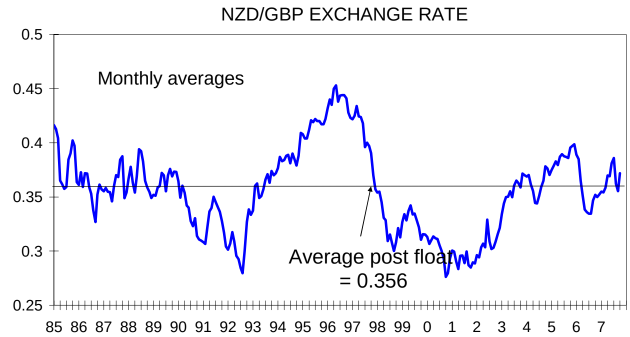




In their regular Inflation Report the Bank of England revised their growth forecasts down sharply with an expectation included in their numbers of interest-rate cuts between 0.5% and 0.75% over the next 12 months. The current cash rate in the UK is 5.75%. In addition many of the data releases have been quite disappointing with retail spending falling 0.1% in October. There are also increasing rumours that the Northern Rock bank may be in far deeper trouble than earlier thought - as if having a run on one's bank was not the ultimate indication of trouble anyway.

The markets are increasingly of the view that there may be a cut in the base rate this December rather than during the first quarter of next year and this has encouraged selling of the British pound. The Kiwi dollar has ended this afternoon against the pound near 36.5 pence which is practically unchanged from 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	0.5%	0.7	1.8	3.5	3.4
GDP growth	Average past 10 years = 3.0%	0.7	1.2	2.2	2.2	3.3
Unemployment rate	Average past 10 years = 5.3%	3.5	3.6	......	3.8	3.7
Jobs growth	Average past 10 years = 1.9%	-0.3	0.6	1.5	1.5	3.3
Current a/c deficit	Average past 10 years = 5.5% of GDP	8.2	8.5	......	9.7	8.0
Terms of Trade		0.6	1.5	2.5	0.5	1.0
Wages Growth	Stats NZ experimental series	1.6	1.2	4.9	4.9	5.1
Retail Sales ex-auto	Average past 9 years = 3.8%.	0.2	-0.9	5.6	4.5	6.3
House Prices	Long term average rise 5% p.a.	2.8	4.3	13.7	10.3	13.7
Net migration gain	Av. gain past 10 years = 10,400	+7,520	8,970yr	......	13,780	5,987
Tourism – an. av grth	10 year average growth = 5.0%. Stats NZ	3.1	3.7	3.1	-0.0	3.1
		Latest year rate	Prev mth year rate	6 mths ago	Year ago	2 yrs ago
Consumer conf.	10 year average = 2%. Colmar survey	2	-8	-4	-10	-7
Business activity exps	10 year average = 26%. NBNZ	20.3	17.2	22.5	18.0	11.6
Household debt	10 year average growth = 11.3%. RBNZ	13.3	13.6	13.5	13.3	15.3
Dwelling sales	10 year average growth = 3.5%. REINZ	-22.6	-32.0	8.2	4.0	3.9
Floating Mort. Rate	10 year average = 8.1%	10.55	10.55	10.05	9.55	9.00
3 yr fixed hsg rate	10 year average = 7.9%	9.19	8.80	8.70	7.99	7.90

ECONOMIC FORECASTS

Forecasts at Oct. 25 2007	**March Years**					**December Years**				
Best update this soon	2006	2007	2008	2009	2010	2005	2006	2007	2008	2009
GDP - annual average % change										
Private Consumption	4.4	2.4	3.5	1.4	0.5	4.8	2.1	4.2	1.5	0.8
Government Consumption	5.3	4.1	3.7	3.9	4	4.5	4.6	3.6	4	3.9
Investment	4.2	-3.1	4.4	2.2	2.9	3.1	-2.7	4.5	2.3	2.2
GNE	4	0.7	4.7	2	1.7	4.1	0.6	4.8	2.3	1.7
Exports	-0.1	3	1.5	2.5	4	-0.4	1.8	2.4	1.8	3.9
Imports	4.1	-1.4	6.6	4.1	3.1	5.4	-2.6	6.8	4.2	3.2
GDP	2.7	1.7	3.1	1.6	1.9	2.7	1.7	3.1	1.8	1.8
Inflation – Consumers Price Index	3.3	2.5	2.9	3.3	3.1	3.2	2.6	2.8	3.1	3.5
Employment	2.6	1.7	1.7	0.8	1	1.6	1.4	2.6	0.9	0.9
Unemployment Rate %	3.9	3.7	3.3	3.6	3.9	3.6	3.7	3.4	3.5	3.8
Wages	4.6	5.5	4.8	4.2	3.3	5.1	5.5	4.6	4.5	3.3
EXCHANGE RATE ASSUMPTIONS										
NZD/USD	0.64	0.7	0.76	0.67	0.59	0.7	0.69	0.76	0.69	0.61
USD/JPY	117	117	114	111	109	119	117	114	112	110
EUR/USD	1.2	1.32	1.43	1.38	1.3	1.19	1.32	1.43	1.4	1.32
NZD/AUD	0.87	0.88	0.84	0.78	0.76	0.94	0.88	0.84	0.78	0.76
NZD/GBP	0.36	0.36	0.38	0.36	0.34	0.4	0.35	0.38	0.37	0.35
NZD/EUR	0.53	0.53	0.53	0.49	0.45	0.59	0.52	0.53	0.49	0.46
NZD/YEN	74.6	81.9	86.6	74.4	64.3	82.7	81	86.6	76.9	66.8
TWI	65.6	68.6	70.8	63.7	58.2	71.9	68	70.9	65.1	59.7
Official Cash Rate	7.25	7.50	8.25	7.5	6.5	7.00	7.50	8.25	7.75	6.75
90 Day Bank Bill Rate	7.55	7.78	8.45	7.72	6.76	7.49	7.64	8.58	7.95	7.01
10 year Govt. Bond	5.71	5.91	6.4	6.2	5.9	5.89	5.77	6.5	6.25	5.9
2 Year Swap	6.99	7.76	7.95	7.05	6.59	7.24	7.48	8.35	7.25	6.62

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.